

DISCUSSION PAPER

Is there a way out of the tax labyrinth?

March 2009

Francis Chittenden

Hilary Foster



ACKNOWLEDGEMENTS

This report could not have been completed without the valuable support and advice of Professor Judith Freedman, University of Oxford; Mike Truman, Editor of *Taxation* magazine; David Gauke MP; Andy Love MP; Richard Aitken-Davies, President, ACCA; Chas Roy-Chowdhury, Head of Taxation, ACCA; Mukesh Gunamal, Chairman of ACCA Tax Committee; Steve Priddy, Director of Technical and Policy, ACCA; Ian Welch, Head of Policy, ACCA; and ACCA's Research Unit – Caroline Oades and Katherine Ng.

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Executive summary

Complexity in tax systems is not a new issue, nor is it confined to the UK, although there are elements particular to the UK political system that have prevented change.

The causes of complexity are summarised as follows:

1. Existing legislation
 - a. Drafting and language
 - b. Structure
 - c. Volume (including anti-avoidance measures).
2. New legislation
 - a. Frequency of change
 - b. Lack of effective pre-legislative scrutiny (issues within this are lack of time due to the annual Finance Bill, lack of resources available to MPs, and lack of specialist knowledge).

It is important to tackle these because:

'...the fact is that all compliance costs fall ultimately on the consumer and are a burden on an economy.' (Broke 1999: 3).

And also:

'The lack of effective parliamentary scrutiny could be a problem for many reasons. Firstly, it may be a problem in its own right, since the House of Commons has a constitutional responsibility to provide effective scrutiny of tax measures, which it is clearly failing to do at present. Secondly, effective scrutiny may prevent policy-makers from making policy mistakes, and improve the tax system.' (Alt et al. 2008: 7).

We also agree with a number of writers that the Tax Law Rewrite Project (TLRP) has a clear continuing role in simplifying the drafting and language of the existing legislation, and that Government support for the Project is essential. However, there is still a large task ahead.

Several writers have wrestled with how to simplify the UK tax system, and there are a number of recommendations in the existing research, including the following:

A TAX REFORM COMMITTEE (BROKE 1999)

Much as proposed by Tim Smith in 1995¹, such a committee would be charged with making recommendations for reform and simplification. It would have to be given greater powers than the Law Commission to get Ministers to implement its reports, and it would have to operate so far as possible on the basis of fiscal neutrality. The committee should be appointed by, but independent of, the Government, and should be composed of a mix of MPs, practitioners, the Revenue authorities, businessmen and so on, perhaps along the lines of the composition of the Institute for Fiscal Studies (IFS) Tax Law Review Committee. It would be given a modest amount of funding, it would be told to report regularly on subjects of its choice, and it should consult with, and be assisted by, the Revenue Authorities. Broke does not make recommendations about how politicians would then implement its findings, save only that they would have to do so. It would be for Parliament to find a way of doing it that worked.

A TAX STRUCTURE REVIEW PROGRAMME (TSRP) (HOWE 2000)

Based on the TLRP model (Howe considers that there is an important role for both), he believes that the ultimate objective of the TSRP should be the evolution of a strategy for tax simplification (covering both direct and indirect taxes) that becomes incorporated into the process of generating tax policy itself.

A TAX POLICY COMMITTEE (ROY-CHOWDHURY 2000)

Roy-Chowdhury suggested a Tax Policy Committee (TPC), (the equivalent of the Bank of England Monetary Policy Committee (MPC)) to monitor and propose tax legislation where considered necessary, and to help take politics out of tax.

SLOWING DOWN THE MACHINE (TRUMAN 2007)

Truman suggested that we need the ongoing commitment of politicians and the Government for a process to achieve a radically different system based on the model of the Administrative Burdens Reduction Exercise, with targets for reduction of legislation by a set percentage within a specified period.

AN OFFICE OF TAX SIMPLIFICATION (HOWE 2008)

The overall aim is to set in place a process that will lead to simplification of the tax system and a reduction in the size of the tax legislation. The Office of Tax Simplification (OTS) would examine the existing tax code and make proposals for simplification. The OTS would be established by Parliament, it would be overseen by a Steering Committee appointed by the Chancellor of the Exchequer and it would report to a new body, the Joint Parliamentary Select Committee on Taxation. Membership of the OTS would include staff from Her Majesty's Revenue and Customs (HMRC) and academia, together with individuals from the tax profession, to provide expertise and a fresh perspective.

¹ For details see following section 'Drafting and Language'.

Whatever the mechanics of achieving change, the two issues to be overcome are:

- The volume and complexity of the existing legislation, which is becoming more obvious following the efforts of the TLRP.
- The enactment of new legislation: the points summarised above are interlinked, as it is the time pressure on the system due to the annual Finance Bill which results in lack of effective scrutiny, which in turn results in loopholes and more legislation to plug the gaps in a continuing cycle and consequent mushrooming of legislation.

We believe that each of these tasks is important in itself and more than a single body could hope to achieve. There are however, two overarching points which we consider fundamental to achieving the required level of change:

- The process must have full Parliamentary support, with the requirement of a long-term view.
- The circus of the annual Finance Act should cease. There have been a number of calls over the years for a different process, eg that the Government should be required to submit a statement of its tax and fiscal policy for a three to five-year period, with rates to be set by normal Budget resolutions, and tax Bills every two or three years. Whatever process is decided upon, we consider that a mechanism should be found to halt the annual increase in complexity.

Once these changes have been achieved (no small step!) we suggest a way forward might be for two bodies in addition to the TLRP:

The first to be tasked with simplification of the existing legislation. Some pointers would be expected to come from the TLRP, but this new body would set its own agenda, perhaps with targets for reduction of legislation on a similar basis to the Administrative Burdens Reduction Exercise (see Truman 2007).

The second body would be responsible for pre-legislative scrutiny. This would open the way for a much more considered approach to tax law. The benefits of this would be: the opportunity for wider consultation before measures are introduced; the evaluation of proposals by a number of experts would reduce errors and loopholes, which would in turn minimise the need for spiralling anti-avoidance legislation and consequently would also contribute to a reduction in the volume of legislation.

We believe that membership of both bodies would benefit from consisting of a mix of MPs, practitioners, representatives of HMRC and Her Majesty's Treasury (HMT), academics, businessmen and members of the House of Lords. A further discussion could address the formation of an appropriate vehicle, eg Parliamentary Select Committee; Joint Committee of the two Houses or other organisational arrangement.

We envisage that all three bodies would work in parallel, sharing information as relevant. It may be appropriate to have an umbrella organisation to which all three would report: perhaps a Tax Policy Committee (TPC, an independent body based on the model of the MPC) or an Office for Tax Policy.

A number of writers have identified the cost of complexity as a burden on the UK economy, and yet real progress is difficult to achieve, given the perceived strong linkage between tax policy and electoral success. We suggest a deeper understanding of this area is required in order to understand more fully the opportunities for cultural change.

From our discussions with Parliamentarians, we consider that there may be scope for awareness-raising among MPs of the problems of complexity within the tax system and perhaps even for the provision of

some basic HMRC statistics regarding the number of taxpayers within each category and the associated tax take. Neither of the two representatives interviewed believed that tax policy could or should be taken out of the political debate and the idea of a TPC was viewed as either unworkable or undesirable for this reason.

Whatever the names and vehicles to be adopted, we believe that the issues identified should be addressed as a matter of urgency in order to benefit the UK economy as a whole.

Introduction

Our starting point for this research on behalf of ACCA was to identify how a Tax Policy Committee (TPC) based on the idea of the Monetary Policy Committee (MPC) might work. There are two strands to the research: the first being desk research to identify whether a TPC exists anywhere else, and how other countries handle changes to their tax systems. Within this stage we also examined the operation of the MPC and discussions of how its process has evolved, although this aspect is not reproduced in this publication. Secondly, we conducted telephone interviews with ACCA representatives, academics and a Parliamentary representative from each of the Labour party and the Conservative party. Overall we have sought to identify those issues that ACCA would need to bear in mind when taking this idea forward.

In our desk research we have reviewed relevant think tanks and the existing research. The problem of complexity in tax is not a new issue, nor is it confined to the UK. We find that a number of countries have begun to simplify their tax systems, and while much is written about what they have done in terms of structural changes to the systems and the taxes themselves, it is less clear how it has been achieved from an institutional point of view, and how successful it may or may not have been. Existing research suggests that there are particular reasons as to why it is proving so difficult to achieve this kind of change in the UK, eg the first-past-the-post electoral system, and the apparent lack of political will to initiate such a programme. We thought it fundamental to examine the issues in order to identify the problems to be solved by a TPC or other body (bodies) before specifying the details of such a committee. As the discussion unfolds, we report a number of views suggesting that the task of improving the tax system is of such proportions that more than one committee may be necessary.

In order to make this document more accessible, we have chosen to reproduce here an overview of the causes of complexity and the solutions suggested by previous authors. The conclusions section therefore points the reader towards the decision to be made, ie the clarification of the role that a TPC (as understood by ACCA) would play. Within this we have illustrated points with reference to the telephone interviews with academics and Parliamentarians, but we do not include detailed transcripts of these.

Summary of issues

The root of the problem is complexity², specifically **the complexity of legislative provisions combined with the frequency of legislative change**. Complexity is not a new problem (references were made to complexity in Gladstone's time³), but the general view is that it has escalated over the last three decades and especially since 1997⁴. And now, despite frequent promises of simplification by successive chancellors, *'It is generally reckoned that the UK has the longest tax code in the world, having recently overtaken India.'*(Truman 2008).

The causes of complexity identified in the literature are summarised as follows:

1. Existing legislation
 - a. Drafting and language
 - b. Structure
 - c. Volume (including anti-avoidance measures).
2. New legislation
 - a. Frequency of change.
 - b. Lack of effective pre-legislative scrutiny (issues within this are lack of time due to the annual Finance Bill, lack of resources available to MPs, and lack of specialist knowledge).

We agree with Truman (2007) that the TLRP has a clear **continuing** role in simplifying the drafting and language of existing legislation. There are two further important tasks necessary to achieve a reduction in volume and complexity:

1. A review of the existing legislation from a structural perspective; this would of necessity address policy questions.
2. Effective scrutiny of new proposals; suggestions are that the requirement for an annual Finance Bill should be removed, and that changes should be debated as with any other legislation, and specialist expertise should be made available.

The problem of lack of pre-legislative scrutiny is summarised by Budd (2003: 5):

2 For a full discussion of the cost of complexity see Boys Smith et al. 2008.

3 In response to a demand in the House of Commons that tax law should be made intelligible to persons who had not received a legal education, Gladstone remarked in 1853 that the nature of property in the UK made it almost impossible to deal with income tax in a simple manner. Referring in 1981 to Gladstone's comments, the then Presiding Special Commissioner, Hubert Monroe QC, suggested that it would be some advance if tax law were intelligible to those who had received a legal education. (Budd 2003: 14).

4 'Mr. Brown's penchant for fine-tuning taxes has doubled the size of the tax code to 8,300 pages ... the second-longest in the world's 20 top economies, after India....' *Wall Street Journal*, 3/21/07, p. 113, citing a report by the World Bank and PriceWaterhouseCoopers.

*The truth of the matter is that the House of Commons has neither the time nor the expertise nor, apparently, the inclination to undertake any systematic or effective examination of whatever tax rules the government of the day places before it for its approval. The irony of the Commons' failure is that, because current constitutional arrangements allow the House of Lords no participatory role in the scrutiny of tax legislation, taxation legislation receives **less** Parliamentary scrutiny than other legislation. The criticism of Parliament implicit in this statement is not new. Parliament has rarely attracted praise for its role in enacting tax legislation. The longevity of this problem, however, is no reason for the continuing failure to address it'.*

Some suggest (Howe 2000, Truman 2007) that the House of Lords would have a valuable role to play in the scrutiny of fiscal legislation both from the experience it has to offer:

'.....given that membership of that House includes... half a dozen former Chancellors and no less than nine former Chief Secretaries – as well as professors of economics, accountants and men of business galore'. (Howe 2000: 17).

and also as an extra step in slowing down the process of creating tax law (Truman 2007).

Complexity in the UK tax system and its importance

Adam Broke⁵ set out his view in the Institute of Chartered Accountants in England and Wales (ICAEW) 1999 Hardman lecture that the tax system is simple for a majority of individuals (who are dealt with through the Pay-As-You-Earn (PAYE) system and therefore are not required to fill in a tax return), however for a minority⁶ of tax payers (businesses, higher-rate taxpayers and those with capital gains), the tax system and tax legislation is highly complex and has resulted in increased compliance costs, either in terms of the taxpayer's own time or fees for tax advice. This is important because:

'...the fact is that all compliance costs fall ultimately on the consumer and are a burden on an economy'. (Broke, 1999: 3).

Broke believes that the fundamental purpose of taxation is to meet State expenditure, and suggests that *'... perhaps the practical answer is that we want a tax system which is not far from that which we have now. But one which changes less often, and which keeps in mind the principle that the tax system is there to raise taxes, and not to change the way we live'.*

Although Truman (2007) believes this is not necessarily correct with respect to indirect taxes, he believes that *'direct taxes should have only one aim, to tax each pound received as consistently as possible'.*

In summary, Broke believes that it is unlikely we can make any real progress on reform without some measure of institutional change. He suggests that we need a body like the MPC, with equal authority and equal independence for fiscal legislation – not to determine tax rates, but for a clean-up job. (Broke, 1999: 7).

⁵ Adam Broke is Chairman, Special Committee of Tax Law Consultative Bodies and member of the consultative and steering committees, Tax Law Rewrite Project. A tax specialist and a former president of the Chartered Institute of Taxation, he is a member of the Editorial Board of *Simon's Direct Tax Service*. He also advises in connection with landed estates and heritage assets in his role at Mercer & Hole.

⁶ However, this is likely to increase with the current changes in patterns of employment.

Drafting and language

Truman (2007) recognises the huge improvements made by the TLRP in terms of the language used, the ordering and layout of sections, and the logical framework in which they are presented, but notes that this merely serves to illustrate how much more needs to be done.

'The problem is that, now we can see clearly what the machinery is doing, the realisation dawns with awful clarity, that much of WHAT it is doing is ridiculously complicated.'

With regard to achieving **simplification**, Truman's view is that the TLRP is a start, but he is clear that it is the precursor to a much larger-scale, genuine simplification of the system.

Howe (2000) believes that the TLRP points the way to a wider future *'for it can serve, both as a model and as an encouragement for those who seek a more far-reaching and sustainable improvement in quality, and reduction in quantity, of tax legislation. I cannot repeat too often that lower quantity is at least as important as higher quality'*.

Both Howe (2000) and Truman (2007) express the view that:

*'.....far from seeking a "big bang" solution, we need instead to identify, define and establish not an event but a **process**. We must, in other words, establish a comprehensive mechanism, through which the problems can be addressed and managed tenaciously over a period of years – not unlike the Tax Law Rewrite project itself'*.

Howe suggests that institutional change is required to ensure progress in this area:

'...the need to establish and institutionalise a process, whose continuing insistence on simplicity is as irremovable, as constantly present, as the voice of the tax-raising departments – and as the politically restless, impatient, input of successive Chancellors'. (Howe 2000: 9).

Howe maintains that this can only succeed with input from tax practitioners as well as the Government and academics.

In our discussion with Mike Truman, he expressed the view that an institutional system (the use of commissions, etc) may not work, simply because it takes too long. He suggested that the first step is to stop adding to the complexity, and then use committees to simplify.

Broke's suggestion is for the creation of a **tax reform committee (TRC)** – much as proposed by Tim Smith in 1995⁷ – charged with making recommendations for reform and simplification. It would have to be given greater powers than the Law Commission to get Ministers to implement its reports, and it would have to operate so far as possible on the basis of fiscal neutrality. The committee should be appointed by, but independent of, the Government, and should be composed of a mix of MPs, practitioners, the Revenue Authorities, businessmen and so on, perhaps along the lines of the composition of the IFS Tax Law Review

7 In 1995 Tim Smith, a backbench member of the Finance Bill Committee, promoted an amendment to the Bill that was enacted as section 160 of the Finance Act 1995. It required the Inland Revenue to prepare a report on tax simplification containing, among other things, a discussion of possible solutions, including a Royal Commission on taxation and a tax law commission. (Broke, 1999:6) S 160 FA 1995 is available at <http://archive.treasury.gov.uk/pub/text/budget95/rev33.txt> last accessed 10 March 2009.

Committee. It would be given a modest amount of funding, it would be told to report regularly on subjects of its choice, and it should consult with, and be assisted by, the Revenue Authorities. Broke does not make recommendations about how politicians would then implement its findings, save only that they would have to do so. It would be for Parliament to find a way of doing it that worked.

Howe's suggestion is similar, a **Tax Structure Review Programme** (TSRP) based on the TLRP model (he believes there is an important role for both):

'It [the TLRP] is a purpose-built process, established with all-party support and committed to the completion of a clearly defined task. Its basic work is carried out not by a freestanding Commission, detached from current tax policy developments, but by a dedicated team serviced by the Inland Revenue – and thus usefully plugged into the system. That team includes a changing cast of professionals from outside the Revenue, who are acknowledged to make a valuable input. There is a comprehensive process of consultation, drawn together through a widely representative Consultative Committee. The whole is overseen by the Steering Committee, which I chair and which includes senior figures from the judiciary, the tax professions, the business community and the House of Commons. I believe that this structure serves to give the whole process an important degree of independent authority. And finally there is in place, ready to consider the Bills to be produced by the Project, a streamlined and tailor-made parliamentary procedure – shortly to be triggered, we hope by the introduction of our draft Capital Allowances Bill.' (Howe 2000: 13).

The Chancellor of the Exchequer might also be invited to attend occasional meetings.

Howe believes that the ultimate objective of the TSRP should be the evolution of a strategy for tax simplification (covering both direct and indirect taxes) that becomes incorporated into the process of generating tax policy itself:

'It needs a degree of independence from government and parliament alike. It must not be so detached from either that its work and input can be ignored. So it needs to be part of the ongoing process of government, but with some authority of its own. It must, of course, be able, in the words of the high-powered Norton Commission (which supports the concept), "to put forward proposals for tax law reform and simplification". But it must be able to do more than just propose. It must have, in Adam Broke's most recent prescription, some guaranteed "ability to get Ministers to promote the changes it recommends.'

Volume and frequency of change

Truman (2007) expresses the view, which he believes is widely held, that *'anti-avoidance is the main driver of legislative volume.'* He suggests that blocking schemes individually is likely to be ineffective because this merely creates further loopholes and continues the spiral of increasing legislation. He offers a number of alternatives to suppress tax avoidance: enactment of the *Furniss v Dawson Principle*⁸; Purposive Drafting (the inclusion of an overall purpose clause at the start of a charging section); and Targeted Anti-Avoidance Principles applying to those areas of legislation most prone to avoidance (rather than broad anti-avoidance provisions, which are generally considered to increase uncertainty)⁹.

He also argues that one of the contributory factors to complexity is the UK legislative process with regard to direct taxes. Currently there is a need for an annual Finance Bill¹⁰, which must be passed by Parliament before the summer recess in order to guarantee the continued collection of taxes, therefore there is little time for effective scrutiny. This annual process creates an expectation that changes will be made every year, when perhaps a cultural move away from this idea is called for. Truman recommends a slowing down of the legislative machinery by including more checks and balances; dispensing with the annual Finance Bill; and allowing the setting of tax rates by normal Budget resolutions. He suggests that tax Bills will then be required once every two or three years and that these should have to compete for Parliamentary time and be subject to amendment by both Houses of Parliament like any other Bill. Importantly, they should be heard by some kind of committee which is able to call on independent expert evidence.

There are many calls, besides Truman, to amend the law so that income tax is no longer an annual tax. This would remove at a stroke the excuse for annual Finance Acts and would encourage Governments to free up legislative time by having biennial or even triennial Finance Acts.

Howe (2000: 10) speaks of his experience on the TLRP in the face of annual Finance Acts which are longer than results from the TLRP *'It is like trying to repaint Brighton Pier at a time when its owners are trying to extend it to the French coast'*.

8 The limits of the principle were summarised by Lord Brightman in *Furness v Dawson* [1984] A.C. 474. In his leading speech Lord Brightman said (at p. 527D-E):

'...First, there must be a pre-ordained series of transactions, or, if one likes, one single composite transaction. This composite transaction may or may not include the achievement of a legitimate commercial (ie business) end.... Secondly, there must be steps inserted which have no commercial (business) purpose apart from the avoidance of a liability to tax – not "no business effect." If those two ingredients exist, the inserted steps are to be disregarded for fiscal purposes. The court must then look at the end result. Precisely how the end result will be taxed will depend on the terms of the taxing statute sought to be applied.'

9 Truman (2007) also discusses General Anti-Avoidance Rules (GAAR) and the General Anti-Avoidance Principle (GANTIP) as suggested by Freedman.

10 A relic from the early history of UK taxation, whereby Income Tax was introduced as a temporary tax in order to finance wars on a number of occasions and which Gladstone intended to phase out by 1860. 'Income tax is still a "temporary" tax – it expires each year on 5 April and Parliament has to reapply it by an annual Finance Act. For up to four months until the Finance Act becomes law, the *Provisional Collection of Taxes Act 1913* ensures that taxes can still be demanded.' <http://www.hmrc.gov.uk/history/taxhis2.htm> accessed 18th November 2008.

One reason for the frequency of change is the recurring cycle of *'inspirational input from Chancellors who retain the misguided (and conceited) belief that tax changes can dramatically transform human behaviour.'* (Howe 2000: 12). Generally followed by frantic attempts to plug the loopholes thereby created.

Howe (2000), Broke (1999) and Truman (2007) all believe we should try to change expectations from the system. *'Politicians and the public still believe that fiscal change can achieve social purposes. That tax-breaks work. That accelerated depreciation encouraged investment.'* (Broke 1999: 8).

Broke suggests that economists should evaluate some of the bright tax ideas of the 1960s and 1970s – sufficiently far ago to be capable of review and measurement and to be politically neutral – and report on whether or not the purposes were achieved to any measurable extent. If, as he believes, they were not, he would try to get the politicians to understand their failures, and not to try it again.¹¹

Howe agrees with Broke's recommendation that we should write in stone the Government's continued support for the Rewrite. Broke fears that in times of recession it may fall by the wayside as the Government will start to look for ways of saving money. He is concerned to maintain the impetus so far developed. And although it is not the job of the Rewrite teams to suggest ideas for change, they should make available to the Tax Reform Committee (or TSRP) the fruits of their researches.

¹¹ See Howe (2000: 12) *'I must confess, and emphasise, that much of the complexity of which we complain has arisen from that fundamental misconception. I plead personally guilty, by way of example, to what has been described as "the best example of a behemoth that has never achieved its purpose": The Business Expansion Scheme, introduced in my 1982 Budget. I was warned at the time by the Inland Revenue that it could turn into a huge avoidance loophole. And so indeed it did. But I was at the same time urged in the opposite direction by a working party, which I had established specifically to design a more "enterprise-friendly" tax structure. So I consciously decided to accept the fiscal risk for the sake of the hoped-for structural reward. And I was wrong. I shall never forget the lesson.'*

OFFICE OF TAX SIMPLIFICATION

Lord Howe continues his quest for tax simplification¹² in the report from his latest working party, which recommends an Office of Tax Simplification (Howe 2008). Briefly, the proposals are as follows¹³:

The overall aim is to set in place a process that will lead to simplification of the tax system and a reduction in the size of the tax legislation.

At the heart of its recommendations the Working Party proposed the establishment of an **Office of Tax Simplification (OTS)**. The OTS would examine the existing tax code and make proposals for simplification. The OTS would be established by Parliament, it would be overseen by a Steering Committee appointed by the Chancellor of the Exchequer and it would report to a new body, the Joint Parliamentary Select Committee on Taxation, which is described below. Membership of the OTS would include staff from HMRC and academia, together with individuals from the tax profession, to provide expertise and a fresh perspective.

It is anticipated that over time the OTS would become an authoritative and independent voice on tax law and create a powerful institutional pressure for simplification of the tax system.

The second body would be a **Joint Parliamentary Select Committee on Taxation (JPST)** whose members would be drawn from both Houses of Parliament, the Lords and the Commons, and would have oversight of tax legislation. It would have no powers to initiate tax changes, nor would it be able to influence the rates and incidence of taxation. It would be able to take written and oral evidence from external experts.

The third and final proposal is to establish a convention under which any changes to tax law with technical content should be proposed no later than the Pre-Budget Report in the autumn before the following spring's Budget and Finance Bill in which the proposals are to be included. This is to avoid the problems that have been particularly acute this year, whereby tax changes have been put forward with little or no consultation and last-minute legislation rushed through Parliament without sufficient scrutiny.

¹² Lord Howe acknowledges his life-long interest in tax simplification which he had spoken about even before he became Chancellor of the Exchequer in 1979 in the administration of Margaret Thatcher. His 1977 address to the Addington Society, (a group of the top tax professionals in the country which meets several times a year to consider the burning tax issues of the day) is among the best-known modern criticism of Parliament's role in the process of creating tax law. (Howe 1977).

¹³ Summarised at:

http://www.icaew.com/index.cfm/route/158905/icaew_ga/en/Technical_amp_Business_Topics/Faculties/News/Making_taxes_simpler
accessed 05 October 2008

Pre-legislative scrutiny

Alt et al. (2008) examine institutional reasons that have contributed to complexity in the UK tax system and legislation. They examine the UK tax-setting context and its impact on the resulting legislation.

'Tax policy should be credible, especially in a dynamic setting, so considering elections and information is critical.'

They identify the lack of effective pre-legislative scrutiny as a major concern:

'A degree of parliamentary accountability through greater levels of pre-legislative scrutiny of tax policy would be highly desirable. Of course, a lack of effective parliamentary accountability extends to other areas of policy, beyond taxation, and is a general political concern. However, the degree of pre-legislative parliamentary scrutiny is even weaker for tax policy, since in other areas policy proposals are regularly published in White Papers or Green Papers. Although there is pre-legislative scrutiny of draft tax proposals by tax professionals and other interested parties, Parliament is rarely involved in this process.' (Alt et al. 2008:3)

Alt et al. analyse specific features of the political system that shape tax reforms to give insight into specific institutional remedies that can improve the quality of tax policy. An important feature of their research is the series of interviews with individuals at the heart of tax policy over the previous 30 years, including former special advisors, senior civil servants and individuals on the other side of the process in the business community (in order to keep their identities hidden they are referred to as Persons A-G). We have reproduced these quotes where we believe they illustrate a particular point.

The UK electoral system is identified as a key factor in the context of tax policy setting:

'The first-past-the-post electoral system used for the House of Commons usually allows single parties to govern with significant legislative majorities. Ministers responsible for tax policy (those at the Treasury) will be selected from the ranks of the governing party's MPs by the Prime Minister. This power of patronage is a major reason why these large legislative majorities also tend to be cohesive, with Government bills almost always being passed by a subservient House of Commons. One should also note that the British tax system is exceptionally centralised by international standards: little actual discretionary power is located anywhere outside central government.'

Thus it appears that Britain has a narrow base from which policy initiatives can be made: the only body that can put forward tax policy proposals to Parliament is the Treasury¹⁴. This is a tremendous advantage to the Government and empowers ministers to propose tax measures in the annual Finance Bill following the Budget – a major event in the Parliamentary calendar. The unelected House of Lords has no power to block Finance Bills.

¹⁴ Very occasionally a tax-related provision turns up in some other Bill (eg partnership law) but it would have to be cleared with the Treasury (Person A interview).

Following the *O'Donnell Review*, which proposed the merger of the Inland Revenue and Customs and Excise to create HMRC there has been a reallocation of teams and responsibilities¹⁵. These organisational changes have thus increased the power of the Treasury over tax policy, which was already quite substantial, at the expense of HMRC. Alt et al. report a disconnect between those responsible for tax policy-making and what happens in the field, as described in the Person A interview:

'... the reallocation weakened the link between HMT and assessment of what happened in the field. Now the process has a clear divide with policy in HMT, but real-world experience is at HMRC and they don't communicate as well as if they were all in one organisation. It also affects career structures: now, if you are interested in tax policy, you go to HMT. If you start there the chance you will understand what happens in the field or on the ground is low. Policy becomes divorced from an understanding of how it is affecting behaviour in the field.'

Alt et al. describe the importance of the Treasury's role; not only does it have enormous agenda-setting powers, but the resources available to it are vast when compared with those available to most MPs. *'Treasury can draw on much policy and practical expertise, as well as analysis conducted by HM Revenue and Customs (HMRC).'*

MPs have much fewer resources at their command throughout the year. When discussing the annual Finance Bill, they must generally rely on outside organisations for advice. Parliament thus finds it difficult to provide effective scrutiny of tax measures, and measures are nearly always enacted unchanged in the annual Finance Bill that follows the Budget. As Person A put it,

*'Debate on the Finance Bill is poorer because there is no expert support available to MPs. Typically an Opposition MP will be briefed by an accounting firm and will have a question to ask during the committee stage, the minister has been briefed by officials and gives an answer, but the individual MP is unable to evaluate the response and cannot pursue a sensible discussion. So debate is utterly meaningless.'*¹⁶

Alt et al. note that criticisms of this kind could be made of Parliamentary scrutiny of other spheres of public policy, with executive dominance evident in many other areas of such policy. However, there are important differences compared to other areas of policy; the House of Lords cannot amend Finance Bills and therefore has limited powers of scrutiny. Alt et al. also note that tax measures receive far less pre-legislative scrutiny than other areas of policy because White Papers and Green Papers are not used for proposed tax measures. White Papers and Green Papers tend to receive much scrutiny in and outside Parliament (although the effectiveness of this scrutiny is not measured), but tax policy doesn't even receive this level of pre-legislative scrutiny. On the other hand, Alt et al. note that pre-legislative consultation of tax professionals has become more widespread in recent years, which they trust will help in the development of good tax policy.

¹⁵ Consequences of the *O'Donnell Review* with regard to tax policy making are also discussed by Wales (2004), (2007) and (2008: pp. 4–5).

¹⁶ Person A interview. In fact, *'It has happened that the Minister picks the wrong answer off the list, but the MP doesn't know and is satisfied with the answer.'*

'The lack of effective parliamentary scrutiny could be a problem for many reasons. Firstly, it may be a problem in its own right, since the House of Commons has a constitutional responsibility to provide effective scrutiny of tax measures, which it is clearly failing to do at present. Secondly, effective scrutiny may prevent policy-makers from making policy mistakes, and improve the tax system.'

Therefore we consider it is imperative that this be addressed. There is an urgent need to improve pre-legislative scrutiny of tax law.

Differences in the tax policy process compared with other countries

It is useful to be aware also of the different way tax policy is made in the UK compared with many other European countries, particularly those with systems of proportional representation and powerful veto players. Alt et al. give the example of Italy, where coalition governments are the norm, tax policy is made as a result of negotiations within coalitions, and third parties, such as trade unions, are often consulted much more than in the UK.

'A good recent example from Italy is the cut in income tax enacted by Silvio Berlusconi in 2004. Before this became possible, agreement was required between all members of the governing coalition, who sometimes had quite different priorities. For instance, the far-right National Alliance wanted more to be spent on the South of Italy, whilst the Christian Democrats were keen to protect the privileges of public sector workers'.

Another example they give from Germany, showing the importance of veto players, is the cuts in corporate and income taxes undertaken by Gerhard Schroeder's Government, starting in 2001.

Alt et al. quote Ganghof (2006), who demonstrates that despite an apparent preference for the introduction of a dual-income tax system over across-the-board cuts in corporate and income tax rates, the latter was instituted instead. The dual-income tax system was primarily a non-starter in Germany because the Constitutional Court had already let it be known that differential tax treatment of income and capital would most probably be ruled unconstitutional.

Additionally Alt et al. note that Steinmo (1996) has already identified the role of committees and legislative bargaining as being crucial to understanding how US tax policy has evolved over time. In comparison with the United States, Michael Keen wrote:

*'To the outsider, the most obvious contrast is in the degree of consultation in the formation of tax policy. In the United States, major tax policy initiatives are developed, marketed, analyzed, and negotiated In the United Kingdom, they are commonly announced'*¹⁷¹⁸

However, Professor Freedman (interview) notes that you can have too much consultation. In the end the Government needs to be able to pass legislation that not all interest groups agree with.

¹⁷ 'A British Perspective on Tax Policy in the United States', in Joel Slemrod (ed.), *Tax Policy in the Real World*, Cambridge UP, pp. 505-506.

¹⁸ Professor Freedman points out that Michael Keen was writing some time ago, and there is now much more consultation in the UK.

Much of the outcry we have seen in response to recent Budgets has been as a result of far-reaching changes being 'sprung' on an unsuspecting public. Alt et al. (2008) suggest that in the UK the processes of analysis, negotiation, and marketing take place much more within the Executive Branch than in the legislature, or indeed in politicians' campaigns for election. The Executive has extensive agenda power, and Government proposals are rarely subject to significant amendment, let alone veto¹⁹.

'The centralisation of revenues, lack of information and expertise in Parliament, rarity of coalition bargaining, and absence of any powers of initiative and referendum reinforces the familiar executive dominance of British politics.'

Alt et al. 2008:3 make a number of recommendations in their proposal for greater scrutiny:

- They believe that the best vehicle for pre-legislative scrutiny is the select committee system. They leave it as an open question as to whether scrutiny of tax policy is best undertaken by the existing Treasury Select Committee or by a new select committee on taxation. But they are clear that ensuring higher levels of pre-legislative scrutiny should be a priority for the Government.
- Furthermore, they call for additional resources to be made available to MPs in order to enable them to undertake effective pre-legislative scrutiny. At present, much advice and support comes through external organisations, and this could be extended. However, another possibility is a formal in-house service akin to the Congressional Budget Office in the US, which could be explicitly charged with providing analysis of tax policy for MPs.
- Finally they make a broad recommendation that serious thought should be given to instituting a body to oversee the public finances. A group of experts with genuine knowledge of the operation of tax systems could be put in place to offer advice and to audit revenue and spending figures. This body could be accessible and accountable to Parliament as well as to the Executive, with appointments appropriately scrutinised. As well as scrutinising Government plans, the body could offer advice to all parties, particularly around election times. To provide meaningful scrutiny and advice, any such body would require access to more data than are currently provided to Parliament. As well as providing more data to this body, providing more data to the public could improve external scrutiny, eg by publishing all assumptions behind fiscal forecasts.

¹⁹ A rare example of Parliament significantly affecting the course of tax legislation is the so-called Rooker-Wise Amendment, introduced in the 1977 Finance Bill Committee by two Labour backbenchers. This ensures that an Act of Parliament is required in order to increase income tax allowances by less than the increase in the Retail Price Index (RPI), which means that the default option is that they be up-rated in line with the RPI. Note that this amendment was introduced at a time when the governing Labour Party did not have a majority. (Alt et al. 2008).

The political challenge

From our desk research we have seen that calls for simplification have increased, particularly during the period since Lord Howe's 1977 speech, but during the same period the volume and complexity of legislation have increased. Evans (2008: 5) describes this phenomenon:

'..[a] striking feature of the UK tax system over the past 30 years is the extent to which its principal stakeholders have been committed to the goal of simplification, combined with their failure to achieve any such simplification over the period. Indeed, many of the initiatives designed to simplify have only served to make that system, at its technical, operational and administrative levels, yet more complicated.'

He reassures us that this is not unique to the UK, and is in fact a problem for most developed economies.

However, in the interviews, both Professor Freedman and Mike Truman expressed concern that it is difficult in the UK to take the politics out of tax. Indeed, Riddell (2008: 16) is firmly of the view that:

'...tax decisions cannot be taken out of politics. They are the stuff of the party battle.'

Riddell (2008) gives a number of insights into the tax policy decision-making of Chancellors Howe, Lawson, Clarke and Brown, covering in total the period from 1979 to 2007, and illustrates that under the current system politicians view tax policy as fundamental to electoral success. It therefore seems unlikely that politicians will easily relinquish their grip.

Professor Freedman is concerned that currently, politicians have a tendency to focus on tax as the answer to every problem, rather than considering other measures.

We understand informally that a different process operates in Scandinavian countries and this may be worth investigating further.

Professor Freedman shared some of her own experience of working on a variety of committees, and in her view it is very difficult to divide the technical from the political. However she does consider that greater technical input would be helpful. She considers that one way forward would be to have a Parliamentary committee, with staff and the money to investigate issues thoroughly, modelled on the House of Lords Committee, which looks at the Finance Bill every year²⁰. They do an excellent job but are not very well resourced. Added to which the Committee can only start looking at the issues once the Finance Bill is published, so they hardly have any time. Professor Freedman would like to see an extension of this brief, with clerks and special advisors who have knowledge of tax, although she acknowledges that this does raise more general issues about the role of the House of Lords in relation to money bills.

²⁰ The Economic Affairs Committee

Mike Truman proposes that we need a radically different tax system, and simplification on this scale would require the ongoing commitment of politicians and the Government; thus it seems the most productive solution is likely to be a continuing process rather than a 'big bang' approach. This process would be two-pronged:

Firstly a model similar to that being used to reduce administrative burdens could be implemented, with the express aim of reducing the volume of tax legislation by a set percentage in a specified time frame. The focus would be maintained by the efforts of a small number of senior people from the accountancy and legal professions and the Government.

Secondly, once simplification has been achieved it is imperative to prevent Parliament from re-complicating the tax code. Truman (2007) argues that one of the contributory factors is the UK legislative process with regard to direct taxes. Currently, for historical reasons as discussed in an earlier section, there is a need for an annual Finance Bill. This annual process creates an expectation that changes will be made every year, and encourages chancellors to 'pull rabbits out of hats' when perhaps a cultural move away from this idea is called for. Truman recommends a slowing down of the legislative machinery by including more checks and balances; dispensing with the annual Finance Bill; and allowing the setting of tax rates by normal Budget resolutions. He suggests that tax Bills would then be required once every two or three years and that these should have to compete for Parliamentary time like any other Bill. Importantly, they should be heard by some kind of committee which is able to call on independent expert evidence.

From our interviews with Parliamentarians we note several areas of agreement. Both interviewees consider that it is impossible to take tax policy out of politics. They believe that tax is an inherently political issue and therefore a body similar to the MPC would be inappropriate. Both think that there is a need for more effective pre-legislative scrutiny. One representative is of the view that Lord Howe's paper re the OTS would be a way forward, however the other representative thinks it would be difficult to ensure an effective review within a realistic time scale.

Both representatives believe that it would be unworkable to require a Government to set out its tax policy in detail at the start of the term of office. Essentially their argument is that Governments need to be able to respond to changing circumstances (eg the recent financial difficulties, or tackling avoidance schemes). They are also in agreement that there may be a role for ACCA in providing independent evidence and information to support MPs with pre-legislative scrutiny.

Their views differ with regard to complexity. One representative sees complexity as a major problem, making it increasingly difficult to do business in the UK – for large corporations, small businesses and private individuals. The other representative, however, is of the opinion that for the majority of taxpayers who are dealt with under PAYE there is a small amount of legislation. He acknowledges that there is also a large volume of complexity but in his view this only applies to the top 5% of wealthy individuals, who are able to afford tax advice to minimise their liability. He is emphatic that the activities of these individuals should be countered and that they be made to pay their fair share of tax. In response to the issue of complexity for the increasing numbers of self-employed, there was a suggestion that the majority of these are claiming to be self-employed in order to avoid tax, whereas they are (in his view) clearly employed by companies.

They also differ with regard to the chances of cross-party agreement. One representative believes that cross-party agreement would be difficult to achieve because of the fundamental differences in views of tax policy among the major political parties. The other representative considers there is scope for cooperation between the parties and he believes there is general agreement across the political spectrum that there is currently too much complexity.

As a result of these discussions, and bearing in mind the diverse experience of parliamentarians, we consider that there may be scope for awareness-raising among MPs of the problems of complexity within the tax system and perhaps even by the provision of some basic HMRC statistics regarding the number of taxpayers within each category and the associated tax take. Neither representative believed that tax could or should be taken out of the political debate and the idea of a TPC was viewed as either unworkable or undesirable for this reason.

An international perspective

Arguing in favour of simplification of tax law, PricewaterhouseCoopers (PwC) (2007: 21) state:

'The boldest reform is to simplify tax law so that every business faces the same tax burden – with no exemptions, tax holidays or special treatment for large or foreign businesses. Many tax laws start that way. But when hard times come and governments need revenue, tax rates are often raised. This is unpopular, and large or well-connected businesses usually obtain special treatment. Soon the tax law becomes riddled with exceptions, generally at the expense of small businesses, which have the least ability to lobby. Often they are pushed into the informal sector'.

PwC are keen to promote the message that there are benefits to business and to the Government from tax reform. Evidence from the survey shows that tax reform creates more vibrant businesses and a smaller tax burden encourages firms to invest. Furthermore, streamlining taxes increases the positive effect, leading to increased productivity²¹. From the Government point of view, a complicated tax system costs a lot of money to run; therefore streamlining administration will release funds that could be better spent on education, health care and infrastructure.

'Tax reforms inspire political debate and can be hotly contested. But both businesses and government benefit when taxes are simple and fair and set incentives for growth.' (PwC 2007: 15).

²¹ A study in India estimates that tax reform can increase productivity by up to 60% (PwC 2007: 14).

Ideas for handling change in tax systems

NEW ZEALAND

Broke (1999) notes a development in New Zealand – which with Australia has led the process of rewriting tax law – which has set up the Generic Tax Policy Project (GTPP) in 1993. The Project requires the Government to propose a three-year plan for an economic and fiscal programme, which is first debated as a policy. It is then passed to the Inland Revenue and the legal draftsmen to put into legislative form and is only then enacted. Once set, the programme must be kept without further legislative amendment, subject only to emergency changes, such as anti-avoidance legislation.

The main objectives of the GTPP are to:

- encourage earlier, explicit consideration of key policy elements and trade-offs by ministers
 - provide opportunities for substantial external input into the policy formulation process, to increase transparency and to provide for greater contestability and quality of advice at both the conceptual and detailed design stages
 - clarify the responsibilities and accountabilities of participants in the process
- and
- ensure that the performance of tax policy initiatives, as well as the process of reform, are reviewed regularly.

Formal consultation (undertaken at different levels depending on the measure) can involve the release of 'issues papers', discussion documents and draft legislation. In addition, the Inland Revenue Department consults regularly with stakeholders on an informal basis (including before options are put to the Government for consideration and released publicly).

The process of policy and legislative development in New Zealand is characterised by a relatively high degree of transparency. However, it is generally accepted that proposals subject to the GTPP will take up to two years to develop and implement. Furthermore, it is not applied to a number of measures (particularly tax avoidance measures) and there is concern that too many documents are released for public comment.

Broke welcomes this as '*a brave attempt to roll back the mindset of annual change*'. In 1999 he was concerned that the GTPP might be the first casualty in times of recession, however it still appears to be in existence.²²

²² <http://www.ird.govt.nz/aboutir/reports/briefing/briefing-2005/bim-part2/bim-part2.html> accessed 17 December 2008.

AUSTRALIA

In 2007 the Australian Government examined the GTPP to see what lessons it could learn. However, it has its own complexities resulting from the apparent lapsing of its Tax Law Improvement Project. That Project arose out of a recommendation in 1993 by the Joint Committee of Public Accounts that a task force be established to restructure, renumber and rewrite the *Income Tax Assessment Act 1936*. The first package of draft legislation developed by the Project was introduced in 1995 (the *Income Tax Assessment Act 1997*). Tax Acts introduced since 1997, have, wherever possible, been drafted in the style developed by the Project.

As the Project was designed to rewrite the tax law over a considerable time, the Australian tax system concurrently has two operating income tax assessment Acts.

A useful point about volume of legislation is made:

'However elegantly written, well laid out or helpfully structured, the sheer volume of information in tax laws can be a barrier to their usefulness. While it is true that few taxpayers ever need to deal with more than a few provisions of the law, nevertheless those parts are scattered throughout the Acts, amongst more obscure and sometimes inoperative material.'

They have two suggestions to solve this:

1. the repeal of inoperative provisions in the income tax law
2. to collect the relevant operative provisions for individuals and small business into a separate Part. That is, it may be possible to place all of the material required by large numbers of taxpayers with simple affairs together in one spot. This could reduce the number of provisions these taxpayers and their advisors need to be aware of and understand in order to fulfil their obligations under self assessment.

UNITED STATES

In the US, the Congressional Budget Office (CBO) carries out an advisory role. The CBO's mandate is to provide the Congress with:

- Objective, nonpartisan, and timely analyses to aid in economic and budgetary decisions on the wide array of programmes covered by the Federal Budget

and

- The information and estimates required for the Congressional Budget process.

The CBO's Role in the Budget Process Under the *Congressional Budget and Impoundment Control Act 1974* the annual Congressional Budget process begins with adopting a concurrent resolution on the Budget that sets forth total levels of spending and revenues, and broad spending priorities, for several fiscal years. As a concurrent resolution, it is approved by the House and Senate but does not become law. No funds are spent or revenues raised under the Budget resolution. Instead, it serves as an enforceable blueprint for Congressional action on spending and revenue legislation.

The CBO assists the House and Senate Budget Committees, and the Congress more generally, by preparing reports and analyses. In accordance with the CBO's mandate to provide objective and impartial analysis, its reports contain no policy recommendations.

The CBO currently employs about 230 people. The agency is composed primarily of economists and public policy analysts. About 70% of its professional staff hold advanced degrees in economics or public policy.

Additionally there are two panels of advisors:

- Panel of Economic Advisors – composed of some of the CBO's previous directors and eminent economists, who serve two-year terms. The CBO's Panel of (20) advisors meets twice a year. The Panel reviews and comments on the CBO's preliminary forecasts of the economy and provides advice to further the reliability, professional quality, and transparency of the CBO's work.
- Panel of Health Advisors – Consisting of acknowledged experts in health care, the CBO's panel of (18) health advisors meets periodically to examine frontier research in health policy and to advise the agency on its analyses of health care issues. The panel thus helps to further the reliability, professional quality, and transparency of the CBO's work.

NB Professor Freedman suggested that a problem experienced in the United States is that there can be too much consultation. As noted earlier in this paper, in the end government has to be able to pass legislation that interest groups don't like.

Conclusions

We have reviewed the available information from the perspective of what a TPC (as supported by ACCA) might look like. While it is generally accepted that there will always be some element of complexity in a tax system, it seems reasonable that this should be minimised as far as practicable because of the burden of compliance costs on the economy.

We agree with a number of writers that the causes of complexity may be summarised as follows:

1. Existing legislation
 - a. Drafting and language
 - b. Structure
 - c. Volume (including anti-avoidance measures).
2. New legislation
 - a. Frequency of change
 - b. Lack of effective pre-legislative scrutiny (issues within this are lack of time due to the annual Finance Bill, lack of resources available to MPs, and lack of specialist knowledge).

We also agree with a number of writers that the TLRP has a clear continuing role in simplifying the drafting and language of the existing legislation, and that Government support for the project is essential. However, there is still a large task ahead.

Broadly, the two issues to be overcome are:

- Volume and complexity of the existing legislation, which is becoming more visible following the efforts of the TLRP.
- The enactment of new legislation: the points summarised above are interlinked, as it is the time pressure on the system due to the annual Finance Bill which results in lack of effective scrutiny, leading to loopholes and more legislation to plug the gaps in a continuing cycle and consequent mushrooming of legislation.

We believe that each of these tasks is important in itself and more than a single body could hope to achieve. There are however, two overarching points which we consider fundamental to achieving the required level of change:

1. The process must have full Parliamentary support, with the requirement of a long-term view.
2. The circus of the annual Finance Act should cease. There have been a number of calls over the years for a different process, eg that the Government should be required to submit a statement of its tax and fiscal policy for a three to five-year period, with rates to be set by normal Budget resolutions, and tax Bills every two or three years. Whatever process is decided upon, we consider that a mechanism should be found to halt the annual increase in complexity.

Once these changes have been achieved (no small step!) we suggest a way forward might be for two bodies in addition to the TLRP:

(We have chosen to describe the function of each rather than throwing another acronym into the mix)

The first body would be tasked with simplification of the existing legislation. Some pointers would be expected to come from the TLRP, but this new body would set its own agenda, perhaps with targets for reduction of legislation on a similar basis to the Administrative Burdens Reduction exercise (see Truman 2007).

The second body would be responsible for pre-legislative scrutiny. This would open the way for a much more considered approach to tax law. The benefits of this would be: the opportunity for wider consultation before measures are introduced; the evaluation of proposals by a number of experts would reduce the errors and loopholes, which would in turn reduce the need for spiralling anti-avoidance legislation and consequently would also contribute to a reduction in the volume of legislation.

We believe that membership of both bodies would benefit from consisting of a mix of MPs, tax practitioners, representatives of HMRC and HMT, academics, businessmen and members of the House of Lords. A further discussion could address the formation of an appropriate vehicle, eg Parliamentary Select Committee; Joint Committee of the two Houses or other organisational arrangement.

We envisage that all three bodies would work in parallel, sharing information as relevant. It may be appropriate to have an umbrella organisation to which all three would report : perhaps a TPC (an independent body based on the model of the Bank of England Monetary Policy Committee) or an Office for Tax Policy.

A number of writers have identified the cost of the complexity in the tax system as a burden on the UK economy, and yet real progress is difficult to achieve, given the perceived strong linkage between tax policy and electoral success. We suggest a deeper understanding of this area is required in order to understand more fully the opportunities for cultural and political change.

From our discussions with Parliamentarians, and bearing in mind the diversity of MP's experience, we consider that there may be scope for awareness-raising among MPs of the problems of complexity within the tax system and perhaps even for the provision of some basic HMRC statistics regarding the number of taxpayers within each category and the associated tax take. Neither representative believed that tax could or should be taken out of the political debate and the idea of a TPC was viewed as either unworkable or undesirable for this reason.

Whatever the names and vehicles to be adopted, we believe that the issues identified should be addressed as a matter of urgency in order to benefit the UK economy as a whole.

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29 LINCOLN'S INN FIELDS
LONDON WC2A 3EE
UNITED KINGDOM

T +44 (0)20 7059 5000
F +44 (0)20 7059 5050

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