

The Budget and finance – can't we do better?

by Francesca Lagerberg ACA, Barrister

The author argues the need for a radical re-think in the way tax legislation is processed.

At the beginning of March 2001, the Chancellor of the Exchequer stood up to give his annual party piece in the form of the Budget. Whilst recycling much of the material from the Pre-Budget Report, his talk of around 45 minutes was backed up with a vast array of press releases and Budget Notes alerting the reader to numerous tax changes that have now formed the Finance Bill 2001.

Prior to the Budget, the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) had suggested Gordon Brown should 'scrap the Budget'. This was not a naive hope pinned on wishful thinking but a considered alternative to a process of making tax law that is simply not working very well.

The difficulty with the annual finance methodology is that it encourages change for change's sake. No politician, offered his moment of glory, is likely to stand up and say 'I've decided to make no changes this year'. The spectacle of the Budget, and the hunger of the press, means that it becomes far more appealing to use the opportunity to announce a raft of changes that appear to show the Chancellor is 'doing something'. However, no other Government department is expected to cram its main measures into one annual set piece.

What has tended to happen over recent years – and this is not a reflection on any one political party – is that tax measures are either squirreled away until the Budget (as opposed to being dealt with on a timely basis). Or, worse still, there is a casting around for measures that can satisfy the requirement of making the Budget 'look good' and show the Chancellor in a positive light. Again, this does not necessarily equate with good tax law.

Benjamin Franklin famously said: 'Nothing in life is certain except death and taxes' but at least death doesn't get worse every year.

The Budget process is then followed by a hefty Finance Bill. It was over 600 pages in length in 2000 and this year's, despite the possibility of a looming election, still

manages to nearly be 300 pages long with 108 clauses and 32 Schedules. Pushed through under impossibly tight timeframes, the Bill receives little Parliamentary review. For example, the serious debate on last year's Finance Bill can be measured in mere hours rather than days.

Many of the Members of Parliament who participate in the Finance Bill Standing Committee, which is intended to consider the Bill in detail, are career politicians. Not surprisingly they have limited financial and tax experience and they struggle to cope with the intricacies of complex proposed legislation that test even those who work day-in and day-out in that particular specialist field of tax. Consequently, most Finance Bill measures become law without adequate Parliamentary scrutiny and this is reflected in poor legislation that often has to be corrected in the following years.

A sadly not unusual example of such a case were the rules affecting double taxation relief (DTR), brought in with the *Finance Act 2000*. The Government issued a consultation document around the time of the Budget in 1999. The deadline for comments was 30 September 1999. Nothing more was heard until Budget day 2000, when the Government announced the end of offshore pooling, a practice involving the use of an overseas intermediate holding company to receive dividends from a third country in order to maximise use of foreign tax credits. Twenty pages of highly complicated draft legislation were issued and a three-week deadline for responses was set. The legislation was riddled with problems and the proposed starting date was unachievable. It took an outcry from the business community, followed by extensive consultation, to achieve a workable solution.

The *Finance Bill 2001* will contain some relaxation of the original measures to help alleviate some of the issues surrounding this area – but the point remains that the situation should not have arisen in the first place. It is also clear that the Finance Bill 2001 changes are still highly complex and are seeking to put right issues that should have been properly addressed from the outset.

For another example, take the rules relating to the tax treatment of those who provide personal services via an intermediary. These rules were announced in the Budget 1999 by way of a press release now infamously known simply as 'IR35'. The rules in their original format were, in my view, unworkable. The Revenue never issued a proper consultation document but did listen to some representations on the detail. However, the over-arching policy was never open to discussion. The *Finance Act 2000* rules are riddled with a number of very practical problems that will become more apparent this year as people struggle with the calculations for the first time.

THE ALTERNATIVES

So what are the alternatives? Is there a better way of getting tax law? The answer is 'yes', if the political will is there.

Firstly, we need to take a step away from the cycle of change. For historical reasons, certain tax measures have to be renewed annually. For example, as a result of the Napoleonic Wars, income tax was introduced as a temporary measure. Despite such anachronisms, it would not be so problematic if there remained some form of annual Bill to deal with tax rates and allowances. What is more of a necessity is to take the detailed tax provisions out of the package and just make such detailed changes as and when necessary.

By making ad hoc bills, these could be given the consideration they deserve. There have already been major improvements in the level and quality of consultations taking place prior to tax proposals being introduced. This can only be welcomed. However, there is still the situation when the consultation comes too late – as the policy has been decided before the talking with non-governmental departments starts. There needs to be a genuine debate of proposed new tax measures, coupled with sufficient time for those affected to be able to point out any practical problems or technical flaws which could be resolved before legislation is enacted.

The advantage of a good consultation process is that it enables tax measures to be scrutinised both by taxpayers and tax advisers. This knowledge can then be fed into the parliamentary debates. Another major facet of change, which is required, is the need to move away from constant tinkering with the tax system. It has been argued that the tax profession has been partly to blame for this as much of the minor tax changes relate to anti-avoidance legislation to counter perceived 'misuses' of the current tax system.

However, is all of this legislation really necessary? Last year's *Finance Act* contained 16 pages of complex capital gains tax anti-avoidance legislation. On analysis it appears that such measures were expected to bring in no extra tax yield at all in 2000-01 and a mere 0.03 percent of government revenue yield in future years. Therefore, what

is needed above all is a re-think about the way in which we produce tax law. A better system would revolve around less change, more consideration and an all-out effort to make any change worthwhile and practical so that when we get new tax law we get good law, not a muddle.

THE HOUSE OF LORDS

What about making use of the Second Chamber to help with a review of financial matters? At the moment there are legislative reasons why this does not occur, namely the *Parliament Act 1911*, which excludes the House of Lords from any role in the scrutiny of Money Bills. This is a waste as there is a reservoir of experience and knowledge within the Lords that would be very well suited to providing a review of financial proposals.

Lord Saatchi has put forward a Private Member's Bill to try to achieve just this aim. It received its Second Reading in the House of Lords on 21 March 2001 but is unlikely to receive the necessary Government support to enable it to make its way on to the Statute books.

WHAT ELSE CAN BE DONE?

The Tax Faculty began a campaign in 1998 called 'Towards a better tax system'. It started by considering what were the main problems with the current tax system. There were plenty to choose from! However, many issues fell into four main categories:

Complexity

The tax system is now so complex it is almost impossible to see and appreciate the tax consequences of your actions. For example, the self-assessment income tax calculation guide takes over 25 pages to explain how taxpayers should calculate their liability. Some might argue that greater complexity means more work for tax advisors. However, those with simple tax affairs should be able to understand what their basic tax position is without recourse to professional help. Furthermore, a good tax advisor can nearly always bring value to a client without having to rely on densely written and convoluted legislation.

Anomalies

Every tax professional can point to one anomaly in the tax system - some strange quirk that often is not justifiable. Some are relics from another age, whilst others are of a more modern vintage. For example, can the rules relating to the tax treatment of luncheon vouchers with its 15p per working day limit be said to fit well in a modern era?

Change

Our tax system is changing at an incredible rate. Since January 2001 of this year the Inland Revenue alone has issued over 60 press releases. This means it has found over 60 new items to comment on in around four months. This

pace of change is also reflected in the size of recent *Finance Acts*. Those *Finance Acts* passed from 1966-70 had 256 sections and 78 Schedules. In the years 1996-99 (just four years as opposed to five) there were 679 sections and 114 Schedules. The *Finance Acts* also contain not only more legislation but also much lengthier provisions. The two *Finance Acts* in 1955 took up just 24 pages of legislation (using the bound brown Law Statutes Series by the Incorporated Council of Law Reporting in England and Wales). The *Finance Act* 1998 took up a hefty 560 pages and the 1996 *Act* had a whopping 618 pages. For even highly numerate taxpayers, such a pace and quantity of change is overwhelming. For the taxpayer who is not represented it is totally bewildering.

Lacking in democratic control

The speed of introduction of much new legislation often leaves little time for adequate consultation. Parliament is given little time to study and debate proposed legislation, so reducing opportunities for second thoughts and useful amendments. Too much legislation escapes parliamentary scrutiny altogether and some is effectively made by the revenue authorities themselves, against whom there are not always suitable methods of appeal. The end result is a tax system being run for the convenience of Whitehall rather than the taxpayer. This is accentuated by the growth in secondary legislation i.e. statutory instruments, which receive even less scrutiny than primary legislation.

WHAT IS THE SOLUTION?

But what can be done? The Tax Faculty of the Institute of Chartered Accountants in England and Wales asked itself the same question. The result was our discussion paper entitled *Towards a better tax system*. We want to start the debate on where our tax system should be headed and what should be the guiding principles.

We think it is time to take a step back and look at the system as a whole rather as if to look for the wood beyond the trees.

A TEN – POINT ACTION PLAN

We have developed a 10-point action plan – our 10 tenets for a better tax system.

These are as follows:

Tenet One – Statutory

Tax legislation should be enacted by statute, not by regulation nor effectively brought in by means of Revenue or Customs leaflets. It should be subject to proper democratic scrutiny by Parliament. It follows that at no stage should an oppressive or penal tax be introduced by secondary legislation. A prime example of such a tax occurring can be found in the personal portfolio bond regulations. These introduced an annual charge of 15 per

cent on the notional value of the bond, which was totally unrelated to the underlying income and gains, and is far above the return actually achieved by most investors.

Tenet Two – Certain

Almost all rules should be certain in their application. It should not normally be necessary for a taxpayer to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

Tenet Three- Simple

The tax rules should aim to be simple, understandable and clear in their objectives. Taxpayers should be able to understand the rules by which they are to be taxed. The best way to achieve this is to keep tax rules clear and simple. Many tax concepts are complex but the starting point for any new rule should be to express it in as simple a manner as possible.

Tenet Four - Easy to collect and easy to calculate

It is important that tax is easy to collect. Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as is possible. Increasingly, the burden of collecting tax has moved from the revenue authorities to the taxpayer or his employer. With income tax self-assessment the individual taxpayer now firmly bears the responsibility for managing his or her own tax affairs. Another example is the additional administrative burdens and extra costs imposed on employers following the introduction of the Working Families Tax Credit and the Disabled Person's Tax Credits. Further burdens will arise in the administration of Student Loans and eventually the Scottish Variable Rate.

Tenet Five – Properly targeted

The Government has a legitimate interest in maintaining tax revenues. This means it will from time to time need to repair legislation, which has failed to capture the necessary tax revenues. However, such anti-avoidance legislation needs to be balanced against simplicity and certainty. Any anti-avoidance legislation needs to be targeted. This ensures taxpayers understand how and why it is affecting any particular transaction. For example, one of the major criticisms of a proposal to introduce a General Anti-Avoidance Rule was that it was couched in such a manner as to make it very difficult for a taxpayer to have any certainty as to whether he or she might be transgressing the rule. Any time a new relief is added to the tax system or a relaxation made, the resulting legislation often comes ring-fenced with myriad restrictions to prevent any possibility of abuse. Whilst accepting that the tax base must be protected, at times these restrictions are of the 'sledgehammer to crack a nut' variety and often seek to cause unnecessary complications.

Tenet Six- Constant

Changes to the underlying rules should be kept to a minimum. There should be a consensus on the core of the tax structure. If the Government then wants to use the tax system to encourage or discourage activity this should be done without changing the core elements of the tax law. The underlying principle should be to seek continuity in the tax law and any change should be publicly justified prior to being enacted. There are useful examples to consider in other jurisdictions. For example, in New Zealand greater focus is placed upon the design of the tax legislation and the design of the tax collection system, with a belief that any change to the tax system should be carefully managed.

Tenet Seven – Subject to proper consultation

Consultation is a vital part of tax law development. This is recognised by the present Government. In addition the Inland Revenue has issued a Code of Practice on this matter. The best legislation tends to arise after full and genuine consultation with representative bodies. Such consultation requires adequate time to complete and should follow a formal process. From time to time, measures are required which are not consulted upon because of fears of substantial revenue loss if legislation is not brought in swiftly. However, the number of situations where this is the case is small and this argument should not be used as an excuse to avoid the consultation process. The revenue authorities and the Government need to have serious and substantive reasons for not consulting and these reasons should be made publicly available.

Tenet Eight – Regularly reviewed

In order to maintain the simplicity, clarity and certainty required in the tax system it is necessary to hold a regular and public review of the tax system and to remove from the statute book rules which are no longer required. For example, it was only in 1998 that the provision relating to an employee using a horse in his duties was finally removed from the statute books, even though it became obsolete many years before.

Tenet Nine - Fair and reasonable

The revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

Tenet Ten – Competitive

Government should recognise that countries are in a competitive environment and that the UK tax rules need to take into account healthy tax competition. A good example is the developing rules for the tax treatment of E-Commerce, which need to find a balance between maintaining each country's tax base and its right to tax activities within its remit, with the need to avoid stifling the trading opportunities of electronic trade.

CODE FOR FISCAL SIMPLICITY

In our present tax system we have many Codes of Practice for determining how rules should be applied. For example, in the last year the Government has introduced a 'Code of Fiscal Stability' as a guiding principle for its economic pronouncements. The Tax Faculty suggest that what the tax system also requires is a 'Code for Fiscal Simplicity'. This would impose on ministers an obligation to review every proposed policy change to taxation.

The purpose would be to ensure that it satisfies the test that it will not make the tax law more complex, in particular for the benefit of the taxpayer who is not represented. It could also ensure that all legislation is scrutinised before it is put before Parliament to see if it is well expressed and comprehensible to those who will need to rely upon it. A Parliamentary sub-committee could monitor such a Code or an outside body set up for the purpose.

The benefits

We believe if our ten-point action plan is followed and the code for fiscal simplicity is put in place then there will be sound, fundamental principles guiding tax law in this country. This is as opposed to the present situation where tax law is often rushed through, poorly considered and poorly drafted.

We are, of course, not alone in calling for tax reform and simplification. There is a considerable ground swell of opinion from other representative bodies that enough is enough and the system is creaking at the seams. With an election close at hand it would be an ideal opportunity for a political party to make a commitment to tax reform and make a difference to anyone who has to pay tax. 

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