



Proposal 3

The legislative and administrative process

A strategic policy framework and better analysis should be accompanied by radical reform of the legislative process. Good policy intention can end up as bad law if the legislative process is deficient.

Reforming the tax policy development process

The first step to reforming the legislative process must be to ensure that the Tax Policy Division in HM Treasury is effective.

The O'Donnell review recommended a separation of policy-making between HM Treasury and HMRC. HM Treasury now leads on tax policy development and HMRC leads on policy maintenance and delivery.¹⁴⁴ Owing to the structure of the career civil service, however, this has often led to a separation of tax expertise and policy-making. A more planned and consultative approach to tax policy-making is necessary to ensure that this division of labour delivers real benefit to business.

In addition to publishing its overall fiscal strategy and road map for reform of the corporate tax system, HM Treasury should consult on and publish a multi-year tax policy agenda. This would, in essence, be a programme of works that would form the framework for external consultation and detailed policy development.

In order to ensure that this programme is formulated and delivered effectively, the Tax Policy Division in HM Treasury must be able to call on an appropriate mix of technical and commercial skills. Recent policy initiatives, such as discussions on the taxation of foreign profits have raised two issues; first, a seeming lack of commercial understanding and appreciation of the practical application of proposals in HM Treasury,¹⁴⁵ and second, that technical proposals from HMRC reflect more of a tax administrator's concerns than a fully integrated policy view. The recommended reforms are:

- The Tax Policy Division should be staffed by a mixture of tax technicians and business people with real

experience of the commercial sector. Appropriate resource should be provided to attract and retain the right people. This could be addressed through secondments, hiring expert staff for specific projects, non-career posts for people from the private sector as is done in the US, and adequate funding to make a long-term career in tax policy or administration financially attractive to those in the commercial sector.

- Sector leaders and customer relationship managers in the Large Business Service should be consulted by Treasury policy officials to give an “on the ground” perspective of the effect and implementation of any new proposals.
- Documentation prepared by the Tax Policy Division should be publicly available and should state clearly the policy intention behind particular proposals and include an impact assessment (IA). This should inform more effective consultation.
- There should be an opportunity for early consultation with business as part of the policy-making process.
- While policy decision-making is the preserve of government, an independent body comprised of a range of stakeholders and experts should be formed to initiate and inform HM Treasury thinking.

Improving the information available to parliament and taxpayers

Often the underlying policy rationale is hard to determine when proposals are first introduced. One recent example has been the consultation on the taxation of foreign profits, where business considers the policy intention to be unclear. If the policy rationale were clear from the beginning, debate between government and other stakeholders would be much more productive because it would be clear what was really at issue. As importantly, it would make the implementing rules easier for the government to draft, and easier for taxpayers to understand because they would directly, and logically, follow from the policy rationale, rather

than, as sometimes seems to be case, being ad hoc collections of disparate ideas. Improving the information available during the consultation process by including robust IAs alongside policy consultations (as is currently the procedure for new legislation) would be a significant improvement.

IAs are tools designed to explain the rationale for a proposed policy, how it will affect business and other key stakeholders, and its estimated costs and benefits. They are vital to ensuring that policy-makers understand the full implications of any regulatory or policy intervention. Historically, IAs have not fulfilled this function, often being constructed after the proposal has been developed, and with figures that bear little or no relation to the real world in which the intended legislation or regulation is to be enacted. This hinders public understanding of the intention and costs of the proposal. This is important as it is these policy proposals that ultimately give rise to draft legislation.

Following consultation in 2006, the government revised its guidelines to make IAs simpler, more transparent and embedded at an early stage of the legislative process.¹¹⁶ Since May 2007 all regulatory proposals must be accompanied by an IA. This development is welcome but it should be extended further so that IAs are also included in the policy-development stage.

The IA for tax proposals should set out the government's analysis of how the proposal improves the competitive position of the UK and how the four key principles of simplicity, certainty, flexibility and neutrality are being met. Specific attention should be paid to simplifying and minimising the administrative burden on business. IAs for tax policy should also include an assessment of the likely behavioural responses to the proposed policy. This additional information would enable consultees and ultimately parliament to properly evaluate the government's analysis.

Formal consultative process

One of the most welcome advances in the tax-policy process in the UK in recent years has been the willingness of HM Treasury and HMRC to engage in consultation with business. However, consultation is still very patchy and notably was lacking when radical reform of the capital gains tax regime was announced in the 2007 Pre-Budget Report. There is merit in formalising the consultation process to bring consistency of approach to all significant tax proposals.

Effective consultation should be founded on the following principles:

- Consultation, both formal and informal, as early as possible and throughout the tax-policy process. Business should be consulted on the government's strategic road map for the corporate tax system, detailed policy development, implementation proposals, and the review of legislation once it has had time to bed-in. Consultations should last for a minimum of 12 weeks.
- Clear guidelines and objectives. Improving the competitiveness of the UK and simplifying the corporate tax system should be clear goals of all policy proposals under consultation.
- An environment of openness and trust. This is difficult to prescribe but consultation will be better if all parties approach consultation in an open manner. Government could assist the process by sharing information used to formulate tax policy (for example, costings) and by consulting on a genuine range of options rather than on decisions that have, in effect, already been made. Business also has an important role to play in fostering an open environment by being honest about the likely behavioural responses to tax measures.
- Wide representation. There needs to be better representation from sectors that are traditionally under-represented in consultation, such as SMEs. However, the large number of special interest groups

representing stakeholders in the UK means a balance will need to be found between wide representation and achieving a framework for consultation that is effective and efficient.

- Cross-fertilisation between the public and private sector. Both government and external bodies should bring appropriate skills and expertise to the consultation process. Business has an important role in providing opportunities for HM Treasury and HMRC staff to gain appropriate commercial experience.

This report is not prescriptive in defining how consultation should be undertaken in the UK and many of these points, and some additional ones, were considered in the recent Cabinet Office paper entitled *Effective Consultation*.¹¹⁷ The key principles set out above are however important and should be built into an appropriate framework for consultation. Other jurisdictions have adopted different frameworks (for example the generic tax policy process in New Zealand) and government may be able to learn from this experience.

Whilst consultation is of fundamental importance, it needs to be undertaken in conjunction with radical reform of the parliamentary process. Consultation is not a substitute for proper parliamentary scrutiny. Even where particular measures are extensively consulted on, these should not be presented to parliament as a *fait accompli*, however wide the consensus is within the business community.

New approach to drafting legislation

All new legislation should include a statement of intention and purpose. This should explain clearly and succinctly what it is intended to achieve. Combined with a proper legislative history, this would enable taxpayers, tax administrators and the courts to clearly assess whether a transaction is contrary to the intention of parliament. The intention would be to provide taxpayers with more certainty.

This is an approach considered by the government in the recent consultation document, *A principles-*

based approach to financial products avoidance.¹¹⁸ If a purposive approach to drafting legislation is adopted, it should be subject to critical evaluation to determine whether it achieves its goal of delivering greater certainty.

Reform the parliamentary process for tax law

Better tax policy-making, consultation and drafting, should be accompanied by a different approach to introducing the government's legislative proposals to parliament. The adoption of a three-year rolling tax policy agenda would mean dispensing with much of the annual finance bill, in favour of less frequent technical tax bills. Technical tax bills would be brought before parliament as and when external consultation on their policy content had concluded.

The annual finance bill process is responsible for much of the complexity and deficient legislation within the UK corporate tax system. It encourages the government to tinker with the tax system rather than take a strategic approach. It is also subject to less parliamentary scrutiny than almost any other type of legislation. Most other legislative proposals go through a green paper and white paper stage, or are published as draft legislation before being presented to parliament. This allows the relevant select committee to elect to scrutinise the proposals. The Treasury Select Committee is given no such opportunity with the provisions in the annual finance bill.

Although an annual finance bill would still be required for many routine matters (such as setting rates) and to allow, in exceptional circumstances, for the introduction of specific anti-avoidance legislation where there is perceived to be a significant threat to public revenues, it would be a much smaller bill. Most tax law would be proposed, consulted on and introduced to parliament outside the framework of the annual finance bill.

Better parliamentary scrutiny

Scrutiny of UK tax law is poor by international standards. The IMF index of budgetary powers of national

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legislatures indicates that the UK has some of the weakest parliamentary powers when it comes to budget scrutiny, scoring just one out of a possible ten.¹¹⁹

There is little or no discretionary power outside central government, and in a system where large majorities are common, scrutiny by parliament is often weak. Indeed tax is the only area of legislation where there is no opportunity for either parliamentary or external pre-legislative scrutiny. Given this, and because the House of Lords is constitutionally unable to amend tax legislation, there is less effective scrutiny of tax law in the UK than any other type of legislation. This is especially pertinent because most parliamentary scrutiny currently occurs in the House of Lords where the members have the expertise and the time to examine legislation carefully.

Indeed it would not be unreasonable to say that, as a result of technical complexity, length, lack of time, tight government control and a lack of technical expertise, there is no genuine scrutiny of the finance bill under the present system.

Improving parliamentary scrutiny of tax legislation must involve the following:

- Specifying objectives for the scrutiny of tax law

Parliament should scrutinise all aspects of new law with particular attention being paid to whether proposals improve the UK's international competitiveness and are consistent with the key principles of simplicity, stability, flexibility and neutrality. This should act as a formal counterbalance to the tendency for growing complexity and the recent deterioration in the competitive position of the UK tax system.

Parliament's focus on tax simplification is particularly important given that government consultation is unlikely to be successful on its own in combating complexity. There has been extensive consultation in some areas in recent years and, whilst this has had

positive benefits, there is little evidence that it has advanced the cause of simplification.

- Increasing the time available for scrutiny

Reforming the annual finance bill process should increase the time available for parliamentary scrutiny. In addition, pre-legislative scrutiny should also be introduced for key bills to ensure that legislation is considered in draft form prior to being formally introduced.

If the annual finance bill was retained as the vehicle for new tax law, publishing draft legislation at the time of the Pre-Budget Report would at least provide parliament with a significantly extended time-frame to consider legislative proposals.

- Introducing more expertise and independence into the process

This is of fundamental importance. The current standing committee debate on the finance bill is unnecessarily partisan. It fails to focus on improving the quality of legislation before it – rather its focus is on passing the bill as quickly and with as few amendments as possible. A government majority on the committee typically ensures that this is the case and opposition amendments, whatever their merits, are generally defeated.

To achieve this four specific reforms are required:

- A) A parliamentary joint committee on taxation should be instituted. Its role should be to scrutinise proposals for new law and draft legislation prior to being introduced to parliament and during passage. Its terms of reference should include the specific objectives for scrutiny set out above. The joint committee would need to have its own permanent staff to support its work. Such a body could also independently review government estimates of the budgetary impact of proposed legislation, as recommended in this report.

- B) Separate to this new committee, there should be greater involvement of the House of Lords in the scrutiny of legislation before parliament. Much of the parliamentary expertise on taxation sits in the House of Lords and this should be used to the fullest extent to ensure that parliamentary scrutiny is the best it can be. Although the Lords are not precluded from commenting on new tax law, they have no powers of amendment.
- C) The use of independent expertise should be available to all members of parliament. They are not technicians and should therefore have available to them independent analysis of proposed tax law. One example is the US system where the Congressional Budget Office provides independent support on fiscal matters to both the Senate and Congress.
- D) To improve the information available to members of parliament, the House of Commons should adopt the normal public bill committee procedures for tax bills and take direct expert evidence.

These proposals are together designed to keep parliament at the centre of the scrutiny of tax law in the UK, whilst ensuring it has the tools to perform its role effectively.

The task force has considered whether an independent tax policy committee (similar to the Monetary Policy Committee) is warranted to drive the policy agenda in the arena of corporate taxation. However, as long as the Tax Policy Division in HM Treasury is effective, and parliament is able to fulfil its role in scrutinising new tax law (including pre-legislative scrutiny and the ability to seek independent expertise), there is little additional merit in removing control of corporate tax policy from parliament. Clearly this would go against parliamentary sovereignty, which the task force fully supports.

Independent review of tax law

The recommendations above are aimed at ensuring that policy-making and the parliamentary process are effective. However, even with significant improvements in these areas, mistakes will be made and new law

will in time become obsolete or ineffective. Therefore it is important that there is an independent process for reviewing the effectiveness of tax law and making proposals for change. This is particularly important given that the existing corporate tax system is now ripe for radical reform.

A Tax Law Commission would be a welcome addition to the tax landscape. This would be constituted along similar lines to the Law Commission, an independent statutory body committed to work with the government to deliver the benefits of clear, simple, modern law. However, tax law is not within its remit.

Much like the Law Commission, a Tax Law Commission would exist to; ensure that tax law is competitive, modern, simple and cost effective; review existing law and make systematic recommendations for consideration by parliament; and codify tax law, eliminate anomalies, repeal obsolete and unnecessary enactments, and reduce the number of separate statutes.

It would be constituted to perform some of the very limited functions currently undertaken by the Tax Law Rewrite Project. However, its remit would go far beyond this – it would be able to consider radical reform to the corporate tax system as well as more routine “housekeeping” of tax legislation.

A Tax Law Commission would not usurp the role of parliament. It would exist simply to make independent recommendations to parliament and its activities would be undertaken in consultation with both government and external stakeholders. There should, however, be a commitment from government both to respect its independence and to take forward the Commission’s recommendations in a timely manner.

Complicating the tax policy process?

A key objective of this review is to recommend how the UK corporate tax system can be simplified. It is important

HMRC

Must play a central role in delivering a more competitive tax environment in the UK

that this is not achieved at the expense of a cumbersome legislative procedure.

These proposals constitute a menu of options each of which would improve the tax policy process and none of which are mutually exclusive. Together they should not unreasonably burden parliament, HM Treasury or HMRC. It is accepted, however, that full adoption of the proposals may increase the time taken to adopt and implement new legislation. This is no bad thing. Any institutional counterbalance to the recent explosion in the amount of new tax legislation (much of which has been poorly conceived and drafted) is to be welcomed. The focus must be on less new law but law which is better conceived, properly scrutinised and fully consistent with the goal of improving the competitiveness of the UK.

Reforming tax administration

HMRC must play a central role in delivering a more competitive tax environment in the UK. Reform in each of the areas discussed in this report must be accompanied by reform of tax administration.

The public debate in this area is encouraging. The Varney Review of the links between HMRC and large business is welcome.¹²⁰ The challenge now is to implement fully each of the recommendations in the Varney Review. This will require both time and proper funding. It is not clear however that HMRC will be able to achieve this given its existing resource and funding constraints without seeking to transfer more burdens onto business.

The current targets-based culture within HMRC means that too much focus is given to short-term revenue collection. Too often HMRC fails to adopt a strategic perspective, even if this would actually yield greater long-term revenues. HMRC has an important role in enforcement but there should also be a strong spirit of partnership with business aimed at ensuring that the tax system enhances the competitiveness of UK companies.

Consistency of approach is fundamental in delivering certainty for business. A code of conduct governing HMRC's relationship with business is necessary so that the discretion in the hands of local inspectors (which is valuable) is not exercised unfairly. This includes the consistent application of HMRC's newly published risk assessment framework.¹²¹⁻¹²² Businesses should have avenues of recourse if they feel they are being treated inconsistently by HMRC.

The system of advance rulings currently subject to consultation is welcome. However, it is important that HMRC has sufficient resources and funding to make the system work.

There should be better cross-fertilisation between HMRC and the private sector to improve the commerciality of approach from HMRC inspectors. HMRC's planned development of a five-year Tax Professionalism Programme indicates a desire to move in the right direction.¹²³ Secondments to business should be welcomed but a senior tax career in the public sector should also be a competitive proposition for those in the commercial sector. If not, HMRC will remain detached from the commercial world and will struggle to understand and meet the needs of business.

Many of the challenges facing HMRC boil down to having sufficient resources to implement wholeheartedly the recommendations in the Varney Review. This does not necessarily require significant additional funding for HMRC. A simple, transparent and competitive tax system should be simple and cost-effective to administer. Therefore, implementation of the reform agenda set out in this report should generate significant administrative savings for HMRC thereby allowing better resourcing of some of the helpful initiatives now being introduced.

The task force recognises the role that business must play in facilitating reform of the tax administration process. Fostering an open and cooperative relationship between business and HMRC is critical and business' part in delivering this cannot be ignored.