Vision and process in tax policy making: key ingredients for investment

Policy briefing #1

"An effective tax policy making process breeds greater confidence in the tax system"

In its first 100 days in office, the CBI called on the new Government to commit to a Comprehensive Business Tax Roadmap to articulate the way ahead on business tax. The Government's pledge in the Summer Budget to set out such a Roadmap in April 2016 was welcome. This paper – the first in a series in advance of the Government's Roadmap – highlights the importance of vision and process as the keys to effective tax policy making.

This paper is not about the tax rate or tax reliefs on offer to business, it is about how policies are initiated and delivered. An effective tax policy making process breeds greater confidence in the tax system and is another factor in determining whether the UK is regarded as a good place to do business.

The importance of tax policy making should not be underestimated. In KPMG's Annual Tax Competitiveness Survey 2014[1] 94% of respondents believed that stability was a factor in determining the attractiveness of the tax regime. The previous Government's commitment to a new approach to tax policy making[2] in 2010 set the right framework for developing tax policy. The beginning of a new Parliament is a good time to recommit to this approach to bring about a renewed discipline to the tax policy making process.

Businesses place great value on a clear vision and process in tax policy, and any hint of uncertainty undermines the competitiveness of the overall regime. Businesses price the uncertainty into the potential return on investment, inevitably affecting whether investments take place in the UK or not, so encouraging long term investment in the UK is rooted in the policy making process.

Vision

Setting the direction on what the Government wants to achieve is an important policy lever in itself. Certainty encourages businesses to make investment plans, as well as being a consideration for new inward investors. Setting out the strategy and sticking to it can often be more powerful than an unexpected tax giveaway. It gives businesses the confidence that the tax rules won't suddenly change, and with that the certainty to make long-term investments. In keeping with the previous Government's 2010 focus on predictability, stability and simplicity, we set out below ways in which the Government can build on these intentions.

Predictable

A predictable tax system is one where major changes are signposted in advance alongside meaningful consultation. The 2010 Corporate Tax Roadmap was an innovative way of clearly setting the agenda on corporate tax policy. The Roadmap delivered on its promises – with the Government seeing through its planned reduction in Corporation Tax, the foreign branch exemption, Controlled Foreign Company (CFC) reform, and the Patent Box – cementing the UK as a key place from which to invest and do business.

Globally, it has been seen as a powerful tool, not just in the policies it delivered but in showcasing that the UK is open for business and by allowing businesses to plan ahead. Building on its success is the welcome commitment from the Government to set out a broader Business Tax Roadmap in April 2016. We urge the Government to ensure the Roadmap is sufficiently comprehensive, covering the full range of taxes affecting businesses and recognising the value businesses attach to predictability. It should set the course and the ambitions for what the Government wants to achieve through the Parliament whilst being open about parts of the tax system that are not being considered for change. The Government would also need to commit to it and only deviate from it in exceptional circumstances for it to remain meaningful. Going forward a roadmap presented at the beginning of each new Parliament would be valuable in setting the agenda.

Stable

Stability in the tax system means minimising unexpected shocks, or unnecessary changes to the tax system. As the Government stated in its 2010 approach, fewer and better policies would help restore the UK's reputation for stability. When confidence and trust in the tax system is lost, not only does it damage business investment, but it can pose a burden on the Government too.

After the surprise 2011 North Sea oil tax hike, the industry indicated that this was likely to have the effect of limiting future investment in the region, and even some years on, some cautiousness to invest remains. The series of changes to the bank levy along with the 35% increase in 2015 has also left some banks hesitant about the UK. Unexpected changes are not quickly forgotten given that investment decisions require certainty over long periods of time, not from one fiscal event to another.

> *"Certainty encourages business to make investment plans..."*

An appropriate balance needs to be struck between the Government having the desired flexibility in policy making and businesses' need for stability. There may be occasions when the Government needs to depart from a roadmap, to counter avoidance or react to major economic shocks, but these should be rare, properly identified, and easy to justify. When there has been a series of reforms, the Government should hold back and let the policies bed in before more changes are made. For example, once the OECD Base Erosion Profit Shifting (BEPS) actions are implemented in the UK, a period of stability should be allowed to follow.

Simple

Change, even with the aim of simplicity, often creates more complexity so there is a natural tension in aiming for this. That said, there is enormous potential to simplify the tax system to ensure it minimises the burden on businesses of all sizes. The formation of the Office of Tax Simplification (OTS) during the last Parliament and the permanence of the Office has been a welcome step. We look forward to working collaboratively with the OTS and the Government to ensure reforms to the tax system minimise the burden of complying with the tax system. An appropriate weight to simplicity in the formulation of new tax policy should also be given fresh impetus. There may be merit in considering whether there is an increased role for the OTS at the start of the tax policy making process, assessing policies on a real-time basis, to alleviate what could otherwise become a perpetually complex tax system.

CONSTANT CHANGES TO PENSION TAX RELIEF

Nowhere is certainty more important than in making the long-term decisions required for saving into a pension. Not least because the cost of an ageing society ill-prepared for retirement will eventually fall back onto the tax payer. To encourage people to save for their retirement it's important to build trust in the pensions system. This is best done by maintaining a stable pensions tax system. During the 2010-2015 Parliament, at nearly every Budget the Chancellor reduced the rates of pensions tax relief for private pensions. Meanwhile, the Government is consulting on even more far-reaching changes to the system. Every time there is a change to the rates of relief, trust in the system and willingness to save into a pension is reassessed.

Process

To enable policy objectives to translate into effective legislation, it is important to get the process surrounding the development of tax policies right. More time should be built into the enactment cycle, allowing better and more meaningful consultation, as well as greater scrutiny and post-implementation reviews.

A recommitment to 2010 tax policy making principles

The last Government's new, more considered, approach to tax policy making announced at the beginning of the last Parliament demonstrated the Government's understanding of the value that taxpayers place on predictability, stability and simplicity. Where possible the Government aimed to set out policy objectives and rationale for major areas of tax reform, along with earlier consultation and the publication of draft legislation at least 3 months before the introduction of the Finance Bill. By and large, the Government has delivered these improvements. However, the unanticipated time pressure placed on the Finance Bill reading towards the end of the first fixed term parliament and the lack of consultation on some of the measures introduced in the Summer Budget 2015 should be reflected on. In addition we'd like to see a recommitment to the 2010 principles, with the good intentions offered within that document delivered in practice.

Developing policy over a longer cycle

Changes to the enactment cycle at the beginning of the last Parliament were welcome, anticipating it would deliver more time between fiscal events to properly debate and scrutinise new tax policies. The last Government said in the new approach to tax policy making that "tax policies would be developed over a longer policy cycle, with the majority of tax measures announced in Budget for inclusion in Finance Bill the following year at the earliest".

If used appropriately, the Autumn Statement can complement this process, providing an update on economic forecasts and providing advance warning on consultations. However, increasingly throughout the last Parliament the Autumn Statement has been used as a fiscal event in its own right, effectively doubling the volume of policies going through the cycle and doing little to contribute to a predictable, stable and simple tax system. In the first Budget of 2015, 340 pages of legislation were published with a further 212 pages published four months later in the Summer Budget.

The frequency of change has created a process that is overloaded, meaning there is insufficient time for proper parliamentary debate and scrutiny. And whilst the opportunity to consult on policies is welcome, the volume of consultations produced as a result of the frequency of fiscal events can be burdensome for many of the stakeholders involved.

Meaningful consultation

When done properly, consultation between stakeholders will result in tax legislation that better meets its policy objectives. It can also minimise undue burdens, to the benefit of both the taxpayer and the Exchequer. The general approach of HM Revenue & Customs (HMRC) and HM Treasury (HMT) to consultations during the last Parliament has been welcome. The second phase of the consultation on the CFC regime has been cited by many stakeholders as best practice. However further improvements can be made by ensuring consultation remains at the heart of all stages of the policy making cycle (see Appendix 1).

Developing a meaningful consultation process that is not overwhelming and is as inclusive as possible is worthy of further consideration. While the CBI is able to participate in consultations we are aware that the current process can exclude some who do not have sufficient resources. Introducing mechanisms to increase the flexibility of consultation formats would be beneficial, with some consultations operating on a more informal basis. Mirroring the OECD BEPS consultations for large scale reforms (where their webinars reached over 10,000 people) would ensure a wider group of stakeholders are represented. Accessing SMEs raises different challenges, but better use of the Government's own data may help to identify the right and broadest population to engage.

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Consultation on anti-avoidance measures is more difficult. However, in an era with a more strategic approach to tax avoidance with the General Anti-Abuse Rule (GAAR), the Government should trust these mechanisms and be able to consult on new measures. Big ticket changes such as the Diverted Profits Tax (DPT) deserved proper consultation to ensure the legislation met its policy intentions. In its absence businesses will be left to interpret widely drawn legislation and rely heavily on guidance, with the accompanying uncertainty denting perceptions that the UK is a good place in which to do business.

Moving from policy articulation to legislative language

It is a difficult task, to move from policy objectives to well drafted legislation. Taking the new CFC regime as an example, despite extensive consultation the first draft of the CFC legislation placed a heavy compliance burden on business. Fortunately this was alleviated in subsequent drafts as a result of more consultation. Greater use of groups such as the Business Tax Forum's legislative subgroup to test draft legislative language matches policy objectives in the clearest and simplest way could be good way forward.

Greater scrutiny

Legislative clarity enables taxpayers and the tax authority to understand the policy objectives and intentions of parliament. Not only that, it should reduce compliance costs for HMRC and taxpayers alike by enabling quicker understanding and therefore fewer disputes. More resources may need to be devoted to HMRC in instructing Parliamentary Counsel and within the Counsel itself to ensure that the legislation is clearly articulated within the timescales afforded. Publishing the initial instructions given to Counsel would bring added transparency and a natural discipline to create well drafted legislation.

While it may not be appropriate to publish all correspondence, the initial Parliamentary Counsel instructions would prove a valuable resource for stakeholders, and may make the explanatory notes accompanying legislation redundant.

The instructions could provide additional value for the formal review process of the Finance Bill Committee stages, although further support should be considered to ensure MPs can provide adequate scrutiny of technical legislation. For major legislative changes an enhanced version of the summary of consultation responses document could also be published. This document would set out the Government's conclusion along with more details on how the policy objectives have been formed. If the policy objectives are clearly articulated this will bring about improved legislation and prove a useful resource for parliamentary debate.

Post-implementation review

Measuring the impact of a policy against its objectives is an important and obvious next step. The learnings from whether policy objectives have been met or not are vital in ensuring the tax system becomes fit for purpose. The Tax Professionals Forum have provided a welcome layer of scrutiny to the policy process which we would like to see continued on a more regular basis during this Parliament. However a more formal post-implementation review could also be undertaken by HMRC, HMT, NAO or a parliamentary group like the Treasury Select Committee on big ticket policy measures. Setting aside this time, after say 3 years, to formally review how well a policy has met its objectives would be a useful addition to the policy making calendar. And when particular one-off policy objectives have been achieved then sunset clauses should be considered to remove parts of the legislation no longer needed.

These additions, along with a recommitment to the 2010 principles will complete the policy making process. The roadmap at the beginning of the cycle to set the direction, giving businesses the long-term certainty over the direction of policy; followed by enhanced clarity around policy objectives; a more meaningful consultation process and greater scrutiny will ensure the legislation achieves its policy aims. Finally, the post-implementation review will complement this framework, creating a tax system that encourages long-term investment in the UK and ensuring the UK is seen as a good place in which to do business.

Recommendations

1. Renewed commitment to the Government's 2010 tax policy making principles.

2. Publish a Comprehensive Business Tax Roadmap at the beginning of every parliament.

3. Resist unnecessary or frequent changes that destabilise the tax system.

4. Ensure appropriate weighting to simplicity is given in formulation of tax policy and consider increased role of the Office of Tax Simplification to challenge new legislation on a real time basis.

5. Allow sufficient time in the enactment cycle to develop, consult and scrutinise tax policy.

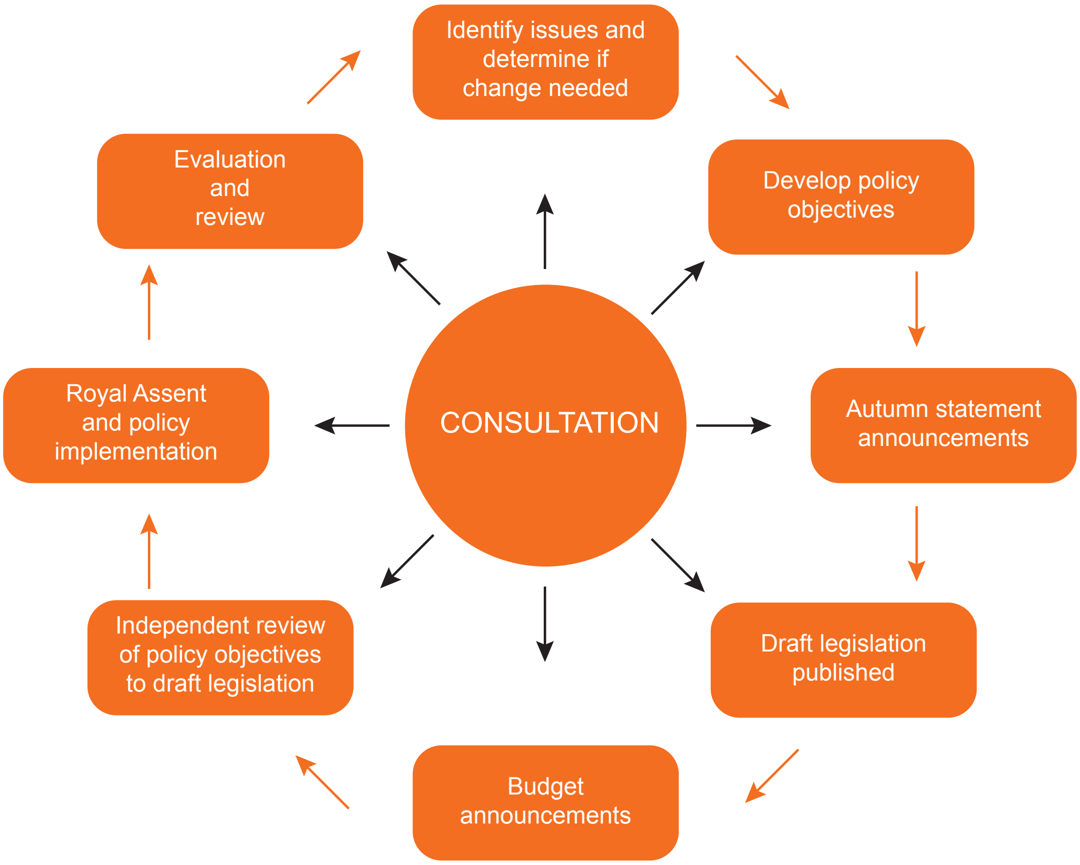
6. Examine the consultation process to explore ways to create a more flexible, inclusive and meaningful engagement.

7. Publish an enhanced consultation response document to increase clarity on government's conclusions from consultations.

8. Increase resources directed to legislative drafting in HMRC and the Office of Parliamentary Counsel, and publish Counsel instructions.

9. Introduce a formal post-implementation review of tax policy measures and consider use of sunset clauses.

Appendix 1 – Tax Policy Making Cycle



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