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Taxation in the UK: Commentary

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1. Introduction

The tax system in any one country is, as Sandford (2000, p. 3) reminds us, the product of an eclectic and sometimes even fortuitous amalgam of factors. “Historical circumstance, constitutions and legislative procedures, customs and cultures, lethargy and the costs of change, the effects of pressure groups, the influence of other countries and international groupings and agencies”, and even “the whim of a finance minister”, all play their part in shaping a country’s tax system as much as the identification and application of any supposedly sound economic policy drivers. The UK’s tax system is no exception.

In the light of this observation, commenting on an entire tax system will always be a daunting task, and even more so when it is accompanied by the existence of temporal and geographical filters. My direct and local exposure to the UK tax system was in the 1970s and 1980s, initially as one of Her Majesty’s Inspectors of Taxes, later as a tax adviser in Central London, and finally as a tax academic. I am conscious that the practice of tax – if not always the theory – may be very different in the UK now compared to then. I am equally conscious that the tyranny of distance since migrating to Australia can also act as a barrier to full or proper understanding of the intricacies of the operation of the UK tax system in later years.

But I am heartened by the view that distances in time and space can also provide a useful counterbalance to the problems of being too close to the detail of a tax system – they can provide the observer with the capacity to see the wood from the trees. And also – fortunately – the chapter on taxation in the UK by Adam, Browne and Heady provides a more than useful contextual starting point for this commentary on the UK tax system.

Tax systems are rarely static. It is therefore not entirely surprising that taxation in the UK has moved on in the 30 years since Meade. Adam et al highlight major changes, identifying a number of the key themes, from historical, international and theoretical perspectives, that are evident in the current UK tax system. They provide a detailed analysis of many of the significant developments in the UK tax system since Meade, including essential material on the tax burden, the tax base and mix, and the tax rates and structure before going on to consider some important economic features of the UK tax system as a whole: its effects on income distribution and on incentives to work, save and invest.

There are two features, however, that do not receive as much attention in the Adam et al chapter as other aspects, but which may be more readily apparent to the external observer of the UK tax system. Both merit additional comment. The first is something of a paradox: despite the many changes that have occurred since Meade, it is somewhat surprising that so much remains the same in the UK tax system 30 years on. The second feature is the manner in which the UK tax system has become yet more complex over time in spite of many attempts at simplification. This second observation relates not just to developments in tax law design but also to the manner in which the tax system is operationalised and administered in the UK.

Each of these features is considered in more detail in the following sections.

2. The more things change the more they stay the same

Reviewing the changes that have occurred in the UK tax system since Meade, there is certainly a sense in which there has been an abundance of activity. There have, for example, been myriad changes to the tax rates and structures of the major taxes.

The rate of VAT has more than doubled over the period, and there have been virtually annual changes to the tax rates and tax brackets relating to the personal income tax. As a result the personal tax schedule is broader and flatter now than it was in the late 1970s, and many of the allowances and concessions (for example, married couples allowances, life assurance relief, mortgage interest relief) have been allowed to wither on the vine and thus have been ultimately consigned to the scrap heap of history. In the meantime a variety of concessions to encourage savings and investments (such as PEPs, TESSAs and ISAs) have been introduced. The tax unit has shifted from the family to the individual, with the introduction of independent taxation, despite the tensions this causes alongside a tax-transfer system that operates at the level of the family. The National Insurance Contribution, still a separate head of tax despite the lack of any semblance of hypothecation, has, over the period, been more closely aligned with the personal income tax structure, removing some¹ of the anomalies and arbitrage opportunities that hitherto existed.

There have also been significant changes to both the rate and the structure of the Corporation Tax, and the Capital Gains Tax (CGT) has undergone major changes in the period as a result of re-basing in 1982, rate changes and the introduction and then removal of, initially, indexation and, more latterly, taper relief. Capital Transfer Tax has been replaced by Inheritance Tax, and local taxation today, with its focus on the Council Tax, is barely recognisable from the domestic rates system that Thatcher so fatally and unsuccessfully sought to replace with the poll tax.

And yet, despite these obvious changes to rates and structures, it is surprising how similar aspects of the contemporary taxation system in the UK are to the model that prevailed in the late 1970s. Whilst plentiful changes have taken place affecting tax rates and structure, the tax burden and the broad tax mix and tax base have remained essentially unaltered over the period. Less surprising, perhaps, is how “comfortably” the UK system fits within the broad family of taxation systems in the developed world in the context of tax burden and tax mix.

¹ But not all – witness the debate surrounding the introduction of intermediaries legislation (IR35: working through an intermediary such as a service company) in the early 2000s, designed to eliminate the avoidance of income tax and National Insurance Contributions; and the general on-going tension between employment and self employment status in the UK context.

As a percentage of GDP, total government revenues in the UK have fluctuated from just over 40% in 1979, down to about 36% in the early 1990s and back to just over 40% today.² Tax receipts were by far the largest portion of those government revenues.

The UK tax burden in 2005 was very close to the OECD unweighted average of tax receipts to GDP, as shown in Table 1.

Table 1 Ratio of tax receipts to GDP for selected comparable countries (2005)

Country	Percent of GDP
Sweden	50.7
France	44.1
Italy	41.0
Netherlands	39.1
New Zealand	37.8
United Kingdom	36.5
<i>OECD average (unweighted)</i>	<i>36.2</i>
Germany	34.8
Canada	33.4
Australia	30.9
Ireland	30.6
Japan	27.4
United States	27.3

Source: OECD Revenue Statistics 17 October 2007 cited in Smith (2007, p. 5)

Thus the tax burden in the UK in 2005 is not dissimilar to that of 1979, and is very close to the average of OECD countries. In similar vein, the contemporary UK tax mix, in terms of composition of revenues, is not significantly different from that which prevailed in the late 1970s.³ Nor is it significantly different in recent years

² See Figure 1 “The tax burden, % of GDP” in Adam, Browne and Heady: “Taxation in the UK”.

³ See Figure 3 “The composition of revenues” in Adam, Browne and Heady: “Taxation in the UK”.

from the OECD average.⁴ Overall there remains a continued reliance on the personal income tax as the principal source of revenues (roughly 28%), supplemented to a significant degree by National Insurance Contributions (roughly 17%). The take from the UK VAT has increased significantly in the period 1978-79 to 2008-09, but that increase has been matched by a corresponding fall in the revenue from other indirect taxes (primarily excise duties), with the result that the revenue collected from all indirect taxes in the UK is similar now to the time of the Meade Report, and also similar to the current OECD unweighted average.

This analysis inevitably suggests that, despite the regular and frequent re-arranging (and occasional replacement) of the furniture of the UK tax system, the fundamental architecture of the building is still in place. Re-building and renovations (in the sense of significant tax reform) may have taken place in other comparable jurisdictions⁵, but that has not been the case in the UK in the period since Meade.

3. “Complication”

The second 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. This “complication” is certainly not unique to the UK – most developed economies continue to struggle in this regard. The Australian “Simplified Tax System” for small businesses which operated from 2001 to 2007 (Woellner et al, 2008, p. 831), stands out as an obvious example of a system that was anything but “simplified”.

Surrey and Brannon have noted that “simplification is the most widely quoted but least widely observed of the goals of tax policy” (1968, p. 915). It has been used (and abused) as a primary justification for tax reform over the last century, and typically it is seen as “a good thing” – “to say that one is in favour of tax simplification is

⁴ See Figure 4 “The composition of revenues 2003” in Adam, Browne and Heady: “Taxation in the UK”.

⁵ For example, in Australia significant and fundamental reform took place in 1985 and again in the late 1990s.

tantamount to stating that one is in favour of good as opposed to evil” (Cohen, Stikeman and Brown, 1975, p. 7). McCaffery (1990, p. 1267) has noted that “people have long sought, or said they have sought, simpler tax laws”. And yet there would be general agreement that modern tax laws are anything but simple.

A number of factors have been at work to cause the complexity. In the Australian context, Krever (2000, p. 86) identifies “judicial misapplication [primarily of doctrines from the UK which have little or no relevance to Australia], aggressive manipulation by advisers, poor drafting by wordsmiths and narrow advice by Treasury officials” as factors contributing to complexity in the income tax law, but notes that “in almost all cases these factors are symptomatic of or derivative from more fundamental causes of complexity”.

The more fundamental causes of complexity that Krever identifies (p. 86) are the increasing use of the tax system by modern governments to achieve social and political goals (“abuse of tax law as a spending vehicle”), and the “many legal distinctions used throughout the law to differentiate taxpayers, transactions, investments and entities that are similar in economic effect but different in legal form, and, on the basis of the legal distinction, are subject to significantly different tax burdens”. A third factor, not mentioned by Krever, is the greater complexity of commercial and other transactions in the modern world.

McCaffery (1990) identifies three types, or layers, of complexity: “technical”; “structural”; and “compliance”. All are evident in the context of the UK tax system. Technical complexity relates to the level of understanding or comprehensibility of a particular legislative provision in isolation. Structural complexity (sometimes referred to as transactional complexity), relates to the way in which laws are interpreted and applied, and which can affect the certainty and manipulability of legislative provisions. And finally compliance complexity relates to the variety of record-keeping and form-completing tasks a taxpayer must perform to comply with the tax laws. The introduction of self assessment in the UK in the 1990s, together with the changes to tax schedules and rates already noted, will certainly have considerably added to the compliance complexity. As Smith (2007, p. 24) has noted:

“a broader tax base and lower rates most often involve greater transaction numbers and recording requirements than narrower bases”.

Evidence to support the contention that the UK tax system has become more complicated at all of these levels is not difficult to find. One barometer of complexity, not always entirely convincing, is provided by reference to the volume of primary legislation in a jurisdiction. In the UK context, Broke (2000, p.19) has noted that in the period from 1945 to 1964 the average number of pages in the annual Finance Act was about 74. Between 1965 and 1986 the average was 189 pages. Since then the average has been 289 pages. More recently a report compiled for the World Bank by PricewaterhouseCoopers (2007, p. 16) has suggested that in 2006 Britain had the second largest volume of tax law in the world (behind India)⁶; and that the number of pages had more than doubled over the past 10 years, from approximately 3,700 to 8,300 (p. 17).

Of course, a simple measure of the volume of primary tax legislation may not be an appropriate measure of the complexity of that legislation. Quantity should not be confused with quality or with impact. For example, the UK experience is undoubtedly distorted by the impact that its Tax Law Rewrite project has had on the volume of tax legislation in the last 10 years. Thus far the Rewrite project has considered and re-drafted a number of areas of direct taxation, including capital allowances, savings income, employment income, general income and losses, trusts and avoidance. Relatively early in the process, Lord Howe, the chairman of the Steering Committee, had noted that the project “can now be seen to be delivering a product that is indisputably an improvement on the previous chaos” (Howe, 2001, pp. 113-114). This claim appears to be substantiated by more impartial commentators, including Broke (2000, p. 24), who states that “there is no doubt that the final result [of the work of the Rewrite teams] is an immense improvement in terms of comprehension”.

A simple count of pages of primary tax legislation also misses the very significant impact that supporting regulations can have on the complexity of a tax system. The

⁶ Measured by the number of pages of primary tax legislation. The figure for Britain was 8,300 compared to 9,000 pages in India (which ranked first).

USA, for example, ranks only fifth in terms of volume in the World Bank survey (2007, p. 16), reflecting its relatively compact primary code. Once supporting regulations are taken into account, however, many commentators would argue that it has a more complex tax system than the UK.

But even if volume is not necessarily the sole criterion of complexity, it is certainly a reasonable indicator of that complexity. Another indicator of the degree of complexity in a tax system is the extent to which its taxpayers use intermediaries – tax agents – in their fiscal dealings with the revenue authority. Studies by Sandford et al in the 1980s suggest that 10.5% of the personal income taxpaying population (employees and self employed) used paid tax agents in 1983-84 (Sandford et al, 1989, p. 68). Twenty years later the proportion of personal taxpayers required to submit tax returns who used paid tax agents had increased five-fold and was 53% (OECD, 2005, p. 59). Although the comparable figures for corporate taxpayers are not available, in 2004 85% of corporate tax returns were prepared with the assistance of tax professionals (OECD, 2005, p.59). This figure is almost certainly higher than it was 20 years earlier.

Perhaps one of the more reliable or convincing indicators of the complexity of a tax system is the level of its operating costs: compliance costs for taxpayers in dealing with their tax affairs and administrative costs for revenue authorities.⁷ The evidence suggests (Evans, 2008) that such costs have been increasing over time in most countries, and recent UK-specific studies (Green, 1994; Collard et al, 1998; Hasseldine and Hansford, 2002; Evans 2003) tend to confirm that this is certainly the case in the UK. For example, in 2002 93% of UK tax practitioners who responded to a survey about the compliance costs of the CGT agreed or strongly agreed with the statement that “the CGT legislation is more complex now than it was five years ago” (Evans, 2003, p. 158). Practitioners identified the complexity of the legislation, and the frequency with which that legislation changed, as the two principal drivers of the high compliance costs in the CGT field (p. 163).

⁷ Slemrod (1984) has argued that the total cost of collection is a useful, though flawed, index of the complexity of a tax system. It is flawed, he argues, because it does not distinguish purely compliance costs from planning costs, or between costs of administration and costs of enforcement.

Frequent change in legislation, or the introduction of new legislation, can significantly impact upon the compliance burden, and it does not matter whether that change is as a result of the introduction of a relieving provision or the introduction of an integrity measure designed to protect the revenue base. Change has the capacity to interfere with the smooth operation of the tax administrative machinery that facilitates the interactions that necessarily occur between taxpayer and revenue authority, and which takes time to settle down to cope with change.

Moreover, if tax change is needed, it is imperative that as much consultation with affected parties as is possible and practical should be undertaken. Taxpayers, representatives from tax professional bodies, and tax practitioners as well as tax administrators all have a very real knowledge of the temporary and recurrent compliance and administrative costs that are likely to occur as a result of change, and can help to ensure that tax change is introduced in a manner that minimizes the expected burden.

Attempts at measuring the administrative burden⁸ in the UK by way of a “total tax contribution” framework⁹ are at an early stage of development, but they also tend to confirm that the administrative burden in the UK is high relative to many other countries and also higher than would have been the case in earlier times (World Bank/PricewaterhouseCoopers, 2007).

In short, therefore, the fundamental architecture of the UK tax system may not have needed significant capital works in the past 30 years, but ever higher maintenance

⁸ Administrative burden is a somewhat different concept from operating costs. It is defined by the UK National Audit Office (in OECD, 2008, p. 3) as “the cost to business of carrying out administrative activities that they would not carry out in the absence of regulation, but that they have to undertake in order to comply with it”. It is therefore closer to, but not synonymous with, compliance costs.

⁹ The total tax contribution that a corporation makes comprises information from five areas collated to establish a complete appreciation of a company’s overall economic contribution. These five areas are: the business taxes borne; the business taxes collected; tax compliance costs; other payments to and from government; and indirect economic impacts. The framework has been developed by PricewaterhouseCoopers, who sought to identify a methodology which would enable companies in different tax jurisdictions to collect and report total tax information in a consistent manner (World Bank/PricewaterhouseCoopers, 2007, p. 31).

costs have been involved in managing the complexity¹⁰ of that system that has steadily increased in that period.

4. Conclusions and future challenges

At the outset of this commentary, reference was made to the wide range of factors that help to shape a tax system. Overall, the forces that have been at work in shaping the UK tax system have produced one that is robust and which has stood the test of time. Change has taken place, but that change has been incremental and has not been as dramatic as might at first be supposed. The system has had to adapt (and has generally adapted well) to new circumstances and realities, including the challenges of globalisation and the shift to a much more open economy than was the case 30 years ago. The system is certainly far more complex now, and that complexity exacts a high price in terms of compliance and the burdens it imposes.

There are a number of current and impending challenges – environmental, economic, political, institutional, legal, social and administrative – that will compel the system to continue to adapt in the future, and will also impose further costs. These factors are worthy of some further, albeit brief, consideration.

The UK tax system currently raises, as Adam, Browne and Heady note, some seven or eight per cent of total tax revenue from what can loosely be called environmental taxes, with the bulk of that coming from various motoring taxes. There is little doubt that environmental considerations – particularly shaped by the climate change debate – will play a greater role in the UK tax system in future years. Various existing taxes can expect to be adapted to better serve environmental imperatives, and new taxes are also likely. Carbon taxes may not ultimately prevail, but the tax implications of their obvious alternative – carbon emissions trading schemes – will nonetheless ensure that environmental factors will take a more central role in shaping the tax system as it moves forward.

¹⁰ Both Surrey (1969, p. 673) and Grbich (1990, p. 266) explore the notion that the focus needs to be upon “managing complexity” rather than upon “simplification”.

An obvious economic factor that will continue to have an impact upon the shape of the UK tax system is globalisation. The legislation underpinning the UK tax system in the last 30 years has ensured that London has been able to attain, and subsequently retain, its status as one of the leading financial centres or hubs of the world. But capital is highly mobile, and so too are certain high wealth individuals. Changes to tax rules can have an immediate and potentially devastating impact upon that status, as is evident from the current implications of the change to the legislation relating to the tax status of resident but non-domiciled individuals in the UK.

Tax is politics with a dollar sign in front, and political and institutional factors will always help to shape the future direction of the UK tax system. The hysteria (and Labour government reaction in significantly raising thresholds) generated by the mass media after the Conservative Party proposals to abolish Inheritance Tax were aired in 2007 is testament to the force of simple politics in the UK tax system. Such pressures will re-emerge in this and other areas.

Future political and institutional challenges will also include the supranational pressure that will come from the European Union in the direct tax field, matching earlier encroachments on national fiscal sovereignty in indirect taxation. There will be real questions in the future, some of which are already being debated around the issue of a common consolidated corporate tax base, about how much room will be left for national tax policy formulation by member states of the European Union.

Debate about the size of the tax gap and shadow economy, together with the unabated growth of what revenue authorities often term aggressive tax planning, will ensure that legal and social responses relating to tax evasion and tax avoidance will continue to be powerful forces in shaping the tax system of the future, in the UK as well as elsewhere. These responses against what Tanzi (2000) and Braithwaite (2005) have respectively called “fiscal” and “moral” termites will continue to include a host of compliance activities as well as the development of specific anti-avoidance rules and further disclosure regimes.

There is now recognition that tax simplification is not always possible, and that managing complexity is all that can be hoped for. This places a strong onus on

getting the administration of the tax system right – if tax is inevitably complex at the technical and structural levels, at least ensure that the compliance complexity is as well managed and administered as possible. It also entails appropriate consultation, and getting it right first time whenever possible, in order to avoid the problems associated with frequent tax change. Failure to consult, as the UK's 2006 proposals on the bringing forward of dates for filing of annual returns has shown, can be disastrous. In that case some seemingly sensible recommendations by Lord Carter, made without any meaningful input from affected parties, had to be withdrawn when it became obvious that they were not capable of sensible implementation and would not be happily accepted by tax practitioners because of the compliance cost implications. Earlier and more appropriate consultation would have averted an otherwise embarrassing situation.

The OECD (2008, pp. 5-6) has already identified a number of key policy and administrative strategies that are taking place which can help to contain the administrative burden that the tax system imposes. These include re-engineering government processes for the collection of data and revenue; implementing citizen and business centric approaches to tax administration; leveraging advances in technology; and redesigning compliance interventions. Administrative initiatives such as these will inevitably help to shape the future UK tax system.

It will certainly be interesting to see just what impact these administrative factors, along with the various other factors mentioned above, will have on the shape of the UK tax system in the next 30 years.

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