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# Tax Implementation: Commentary

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Reforming the Tax System for the 21st Century,  
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# **Reforming the Tax System for the 21<sup>st</sup> Century: The Mirrlees Review'**

## **DRAFT COMMENTARY**

### **Draft Chapter: Tax Implementation Issues in the United Kingdom**

**prepared by Richard Highfield<sup>1</sup>**

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# Tax Implementation Issues in the United Kingdom<sup>2</sup>

## Introduction

At the present time, the UK tax system is undergoing an unprecedented level of administrative reform aimed at achieving substantial improvements in overall efficiency and effectiveness. While it is by no means unusual for revenue bodies to be subject to major reform activity, a distinguishing feature of the UK situation is the existence of a comprehensive range of mandated outcome-oriented targets – all time-bound and expressed in quantified terms– for improvements to taxpayers’ compliance, service delivery, and overall efficiency, and reduced administrative burdens on business. It is difficult to identify another revenue body in an advanced economy with a more daunting array of challenges!

Given these imperatives, the subject of this paper and its timing assume a high degree of topicality and provide an ideal opportunity to explore the directions and rationale for the reform of tax implementation in the UK in a way that may inform a wide variety of interested observers.

## Structure of the draft chapter

The draft chapter is structured in three parts. In Part 1, the authors provide a description of the principles of optimal tax system design and implementation aspects. Part II discusses substantive issues in a UK context, with a focus on the main taxes (ie. income tax and national insurance contributions (NICs), corporation tax, and VAT) and concludes with a short segment on HMRC’s administration. Part III provides a set of speculations, conclusions and recommendations.

## I. Tax system and implementation

This part constitutes a major portion of the chapter and provides a good foundation for the main subject of the chapter. There are a few comments to be made.

At the end of Part I the authors suggest a number of general rules regarding tax system implementation that should be considered in an evaluation of the UK system. For ease of reference these are: 1) both the marginal administrative and compliance costs of policy changes should be considered in addition to the distortive and risk exacerbating costs; 2) maximise reliance on transactions between arms length parties where information from one side can be easily checked against information from the other (side); 3) maximise reliance on financially sophisticated entities (ie. large firms); 4) minimise the number of entities dealt with; and 5) minimise reliance on non-market valuations.

From this commentator’s perspective, these rules all sound quite reasonable. However, one can readily identify other important “rules” or “guiding principles” of an implementation nature. For example; 1) optimise the use of withholding taxes at source; 2) require the payment of tax as close as possible to the timing of the taxing event, while allowing for compliance cost considerations; and 3) arrange tax administration operations organisationally in a way that helps to minimise both administrative and compliance costs. As explained later in this commentary, this commentator is of the view that the UK does 1) well, lags well behind international best practice on 2); and has recently taken important steps to address 3).

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<sup>2</sup> The opinions and thoughts contained in this commentary are based on the authors’ version of the draft paper dated 23 May 2007.

A theme permeating through much of the chapter (and covered by the authors' first rule) is that policy developers and tax administrators should possess and use precise information on the marginal administrative and compliance costs of the various taxes administered to inform and guide policy decision-making. This would be great if it was readily achievable in practice but based on this commentator's experience it is invariably not the case, for the following reasons:

- Increasingly, revenue bodies are being organised on a 'functional' and/or 'taxpayer segment' basis, thus making it quite a complex exercise for them to accurately attribute aggregate administrative costs to each of the taxes administered. A further complicating factor is the rapidity of developments in the use of technology, which can quickly change the cost structure and aggregate costs – both administrative and compliance costs – of an individual tax. Very few revenue bodies attempt such cost attribution exercises across the range of taxes they administer and even fewer have reliable data that they are prepared to publish. The UK's HMRC is one of the few revenue bodies that quantifies administrative cost data for each of its taxes and publishes the results.
- Concerning compliance costs, here also there is a dearth of comprehensive and reliable information and to this day there remains some contention, particularly in academic circles, as to what in fact constitutes a 'tax compliance cost'. In their chapter, the authors note that HMRC's recent measurement work in this area focuses on the administrative burden resulting from tax regulations, a subset of what they consider constitute overall tax compliance costs, and question the reliability of the methodology used to quantify administrative burdens (ie. the Standard Cost Methodology (SCM)). In other words, their own observations highlight some of the problems involved in a practical sense.

There is also the political dimension to tax policy decision-making that is not acknowledged by the authors. At the end of the day, tax policy changes are decided by Government and influenced to a fair degree by its programs and political ideology. Regrettably, such decisions are sometimes made that give little or no regard to, or even fly in the face of, administrative or compliance cost considerations, of the kind rightly emphasised by the authors. This factor, coupled with use of tax systems for a plethora of objectives unrelated to their primary revenue raising role, in part explain why tax systems in advanced economies have become so complex (read 'costly to administer'). While it is true that some advanced economies have introduced procedures requiring mandatory cost/benefit analyses to accompany new legislation these very often must rely on, for the reasons indicated, "guesstimates" and broad judgments. A further weakness, as noted by the authors, is that these analyses typically exclude the impacts of legislation on individuals who in many countries bear a fair proportion of the compliance burden.

## **II. Implementation issues in the UK tax system**

Taking a broad sweep tax system implementation in the UK in 2007 and comparing it with the position, say, in the mid-1990's, one can identify many positive developments. For example:

- The outmoded separate organisation and administration of direct and indirect taxes has been dispensed with; in its place, a new revenue body has been established to deliver the many benefits that integrated processes and approaches to tax administration can bring.
- Administration of NICs has been integrated with tax system administration to achieve increased efficiencies, a practice increasingly being adopted by many other countries.

- In line with international best practice, a separate Large Business Office has been established to deliver a range of tailored services for the largest UK taxpayers who are responsible for collecting the vast bulk of tax revenue.
- There is a strong administrative focus on improving compliance with tax laws (and, as a result, government revenues) using modern risk management techniques. Estimates of the size and composition of the tax gap have been made for the major taxes using a variety of approaches (although not all of this has been published), targets have been set for compliance improvement, and a range of strategies implemented to address key areas of risk. In line with the trend and impacts of globalisation, the international dimension of taxpayers' affairs is, from all accounts, receiving special attention.
- Administrative costs have been reduced substantially – in 'cost of collection' terms, from around £1.70 (1995/96) to £1.10 per £100 collected (2005/06)<sup>3</sup> – and appear to be on a further downwards trend with further efficiencies projected up to 2011.
- Compliance costs – in the current EU jargon, 'administrative burdens' – are acknowledged as a key concern by both Government and the HMRC and are receiving special attention. Measurement exercises have recently been conducted to better understand the size and nature of the administrative burden of the major taxes, targets have been set for burden reduction, and a suite of measures has been identified to address burden concerns.<sup>4</sup>
- Progress has been made, particularly over the last 2-3 years, in the take-up of modern electronic services by taxpayers and their agents.
- A comprehensive review is well advanced to modernise HMRC's enforcement powers, deterrents and safeguards and relevant legislation is currently being considered.

The conclusion that one draws from these observations is that tax system implementation in the UK is receiving considerable attention. However, these positive developments should not hide the fact that, as highlighted by the authors in their chapter, some critically important issues remain to be addressed. These issues (and a few others) and the ideas raised by the authors are discussed in the following section, first on a tax by tax basis followed by further comments concerning HMRC's administration of the tax system.

### **Personal income tax and NICs**

This section of the draft chapter describes the operation of the PAYE and NICs systems and the self-assessment regime applicable to those required to file annual tax returns, and the role of tax advisors. It concludes with views on policy options to address perceived weaknesses in the PAYE and interest withholding arrangements.

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<sup>3</sup> This improved ratio results, in part, from the inclusion of new revenue lines (ie. NICs and VAT) in the 'cost of collection' computation, as revenue collection operations have been further integrated. Notably, 'cost of collection' ratios for income tax and NICs show improvements of over 20% since year 2000.

<sup>4</sup> See *'Progress towards a new relationship: how HMRC is working to make life easier for business'*, published alongside Budget 2006.

As noted by the authors, substantial reliance is placed on the personal income tax and NICs for Government revenue purposes.<sup>5</sup> In 2005-06, revenue from these taxes represented just on 50% of the total receipts collected by the HMRC (or around 45% of all Government tax revenue). Central to the efficient and effective collection of both PIT and NICs are the separate withholding arrangements administered by employers and financial institutions in respect of employment and interest income respectively. Applying the authors' data, these withholding mechanisms were responsible for almost 88% of all personal income tax and NICs collected in 2005-06.<sup>6</sup> This high degree of reliance on withholding no doubt contributes to achieving high levels of compliance and is to be applauded. On the other hand, such a heavy reliance on the private sector as 'tax collectors' heightens the need for withholding arrangements that impose the minimum of costs and disruption on business, while at the same time protecting the Revenue.

### ***PAYE***

The UK system of PAYE has long been lauded world-wide for its ability to free the majority of employee taxpayers from the obligation to file an end-year tax return, as is the case in some other advanced economies. This is largely achieved through the operation of the cumulative withholding feature of the PAYE arrangements that requires employers to calculate and withhold taxes for each employee on a progressive (ie. cumulative) basis throughout the year, taking account of all their employment income. In conjunction with a system of withholding tax at the basic rate from interest payments these arrangements enable around two thirds of all personal taxpayers to be freed from the obligation to file an end-year tax return.

The UK approach to personal tax administration (ie. complex PAYE withholding arrangements but return-free for most employees) stands in contrast to the practice seen in other Anglo-Saxon economies (eg. Australia, Canada and United States) and in some European countries. There, simpler PAYE withholding arrangements (generally involving a non-cumulative form of withholding) are used, but all employees are generally required to file an end-year tax return. Tax returns enable the revenue body to view information relevant to determining a taxpayer's full-year tax liability and to calculate whether any taxes are due after all types of advance payments. As employees typically represent a large proportion of the personal taxpayer population, this universal requirement to file an end-year tax return results in a significant compliance burden. Not surprisingly, proponents of tax reform in many of these countries regularly call for a simpler approach, ideally that involves getting rid of tax returns for most employees.

At first glance, the return-free feature of the UK system appears highly attractive given that it avoids the compliance costs associated with end-year tax returns and the administrative costs of processing them. However, as highlighted by the authors, the PAYE arrangements are becoming increasingly more difficult (read 'costly') to properly administer for both employers and HMRC and lack the flexibility needed to effectively accommodate some Government policy demands. In support of their concerns, the authors note the following points:

- *Inaccuracy*: Reports from the National Audit Office (NAO) note that about 30% of cases require an end-of-year adjustment due to errors in coding and the way PAYE is operated. Moreover, the HMRC itself reported that in 2005 some 3.8 million taxpayers paid too

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<sup>5</sup> The OECD considers NICs as akin to personal income tax and, for comparative purposes, as a 'tax'.

<sup>6</sup> Using Table 1 of the authors' paper, employers withheld £113.9 billion PAYE and an estimated £76 billion NICs, representing 83.8% of all income taxes (and NICs)—around £226 billion; financial institutions withheld £8.4 billion tax in respect of payments of interest, representing another 3.7%.

much or too little tax, involving some £575 million in underpayments and £295 million in overpayments. Difficulties in the correct treatment of pensioners from a PAYE perspective are also reported.

- *Lack of flexibility:* There is an inability to easily accommodate new entitlements for taxpayers or new Government policy measures, as evidenced by experience with the system of tax credits introduced in 1999. The authors note that initial attempts to pay tax credits via employers failed and new arrangements entailing the direct crediting of tax credits by HMRC to taxpayers bank accounts were introduced in 2006. Somewhat perversely, these new procedures require claimants to file something akin to a tax return to support their claim.

A further difficulty raised concerns the operation of the flat rate withholding system on interest income, which for some taxpayers results in too much tax being withheld (and the need for repayment arrangements), while for others (ie. above basic rate taxpayers) too little is withheld.

Against this background, the authors' express doubts (shared by this commentator) as to whether the existing arrangements, taken in their entirety, represent a more effective and efficient means of administering the personal tax for employees than arrangements of the kind seen in other countries. An additional consideration is that there have been developments in a number of countries entailing the use of pre-filled tax returns that offer a highly effective way to minimise the compliance costs associated with preparing end-year tax returns (see later comments).

#### *Policy options for withholding*

To address the issues identified, the authors canvass a set of policy changes to the PAYE and interest withholding arrangements. On the surface, their ideas have both pros and cons and each would need careful appraisal. One reservation, in this commentator's view, is that adoption of a number of the suggestions (eg. monthly reporting by employers) would increase the compliance burden on business at a time when priority is being given to burden reduction. However, the authors have a bolder and more interesting suggestion in mind for the longer term to address the issues raised that is discussed in the next part of this commentary.

#### *Long term reform options*

To address the many "rough edges" and limitations of the current withholding mechanisms, and to simplify their administration, the authors advocate the idea of adopting a system of universal self-assessment, ideally supported by a system of pre-filled tax returns. The rationale for this idea is as follows:

- 1) A move to universal self-assessment would provide a simpler, less costly and more accurate means of establishing each taxpayers' proper end of year tax liability and its reconciliation with taxes withheld at source, as well as providing information to validate taxpayers' entitlements to tax credits; and
- 2) To avoid the significant additional compliance costs that a system of universal self-assessment arrangements would otherwise impose, the introduction of a system of pre-filled tax returns, along the lines seen in a growing number of other countries, is suggested as an accompanying feature.

At first glance, the authors' suggestions may appear a little unrealistic, given the magnitude of the changes their adoption would entail and perhaps a general lack of awareness of the concept of pre-filled tax returns. However, this commentator believes that the suggestion has considerable

merit and a strong underlying rationale, as explained in the comments that follow, and warrants detailed study.

Around 15 of 30 OECD countries generally require all personal taxpayers to file an end-year tax return. In most of these countries, this obligation results in a significant compliance burden for employee taxpayers, given the relatively large number involved and the tendency for complex tax systems. In the late 1980's, taking advantage of newly-emerging technology and a strong desire to ease the compliance burden of personal taxpayers, Danish tax authorities piloted the first version of what is now known as a 'pre-filled tax return'. The system has undergone ongoing refinement since the initial version.

As the name implies, a pre-filled tax return is one prepared in the first instance by the revenue body for the taxpayer. Under these arrangements, information reports (eg. covering wages, fringe benefits, interest, dividends, pensions, sales of assets, taxes withheld and certain deduction items such as child care, mortgage interest, and pension contributions) that must be reported on electronic media and contain a unique taxpayer identifier are captured and validated by the revenue body. This large information processing activity enables the revenue body to generate a (pre-filled) tax return that sets out amounts and sources of known income and deductions etc, and provides a preliminary calculation of tax liability/ refunds etc. These returns are sent to taxpayers for vetting around 5-10 weeks after the end of the relevant fiscal year, either via the Internet and/or on paper, with taxpayers being normally required to indicate either that the return is complete or to provide further information. In a few countries, taxpayers need not respond if the return is correct. Once taxpayers' responses have been processed by the revenue body, formal notices and refunds, where applicable, are sent to taxpayers.

Compiling and presenting information in the form of a pre-filled tax return removes the need for many taxpayers to undertake the task manually, thus significantly reducing the burden that they would otherwise face to comply with the law. In countries where these systems are well established and based on a comprehensiveness array of third party reports, substantial benefits are being derived. For example, the Danish revenue body reported that for fiscal year 2006 around 70% of all personal taxpayers received a pre-filled return that was complete in all respects.

Today, the use of pre-filled returns is well entrenched and operating very effectively in all Nordic region countries. In recent years, similar (but not as sophisticated) pre-filled return systems have been adopted by revenue bodies in Chile, Portugal, Spain and France. The Australian revenue body incorporated a concept of pre-filling into their electronic return filing system from July 2007 and the Dutch revenue body plans to introduce pre-filled personal tax returns in 2008.

Given the experience in the countries mentioned and in light of what appears to be an emerging trend in personal tax administration, it is quite conceivable to this commentator that adoption of the authors' suggestions is both realistic and, potentially, the most effective overall solution to address the problems being experienced. However, this solution is one for the longer term. Implementing a system of universal self-assessment incorporating a system of pre-filled tax returns is a substantial undertaking that would take many years to implement fully. In addition to the planning needed a system of pre-filled tax returns requires three prerequisite features to be in place: 1) an extensive system of third party reporting to the revenue body; 2) the use of a unique high integrity taxpayer identifier by third parties so that reports can be readily and accurately matched with tax records; and 3) optimal use of technology by all parties involved.

## **NICs**

The authors also draw attention to the fact that substantial reform of the NICs has eroded the link between NICs paid and social security benefits received to the point where it appears worth considering whether the case for separate NICs any longer exists. NICs are, after all, analogous to the personal income so it might well be asked- is there a need for two personal income taxes? A related concern is that despite their convergence over time, in practice a number of differences exist between PAYE and NICs that unnecessarily complicate compliance (read ‘add costs’) for employers who collect the vast majority of NICs. For example, as noted by the authors the definition of pay differs for PAYE and NICs purposes, while PAYE operates on a cumulative basis, but a different approach applies for NICs. They indicate that because of these sorts of complications businesses are regularly calling for reform as a matter of high priority.

Across the OECD, 28 of 30 member countries operate separate social security contribution (SSC) schemes; only two countries (ie. Australia and New Zealand) do not administer separate SSC regimes, instead choosing to pay the various benefits out of general government revenue (and thus avoiding the costs of such schemes!). While there does not appear to be any worldwide trend to rationalise personal income tax and SSC regimes, the authors’ idea appears worthy of study in a UK context given the NICs’ evolution and the potentially significant benefits that a unified approach could deliver.

Putting aside the idea of unification, further efforts to harmonise PAYE and NICs would also appear worthy of urgent consideration. Actions along these lines have recently been taken by the Dutch Government in its efforts to reduce administrative burdens on business by 25% by 2007. From all accounts, this objective will be met and measures to harmonise SSCs and PAYE have reportedly made a fair contribution to this outcome.<sup>7</sup>

## **Corporation tax**

Despite the fairly high profile of the corporation tax in the UK, it is a relatively small source of Government revenue. In 2005-06, corporation taxes represented less than 10% of government receipts (see Table 1 of the authors’ chapter). The last published figures for OECD countries show UK corporate tax receipts in 2004 at some 2.8% of GDP, somewhat below the OECD- (unweighted) average of 3.4%. Yet, despite its relatively low contribution of revenue the administration of corporation tax receives considerable attention within HMRC, in particular, its enquiry program. As noted by the authors, the revenue yield from these activities is significant and growing, an outcome in line with what is being observed in most other advanced economies.

An issue not raised by the authors concerns the extraordinarily generous return filing and tax payment obligations that are a feature of the current UK corporate tax regime (and to an extent for the income tax). Compared to the position in most OECD countries the timing of tax payments (including advance payments) for corporate taxpayers is lagged considerably, particularly for companies with profits < £1.5 million, while companies generally receive up to twelve months to file their end-year tax return. While these arrangements clearly benefit companies by reducing their compliance burden they are “quite excessive” when contrasted with the practices in other advanced economies. Deferring tax payments has a cost and may contribute to revenue losses as taxpayers “find other uses for their funds”. Abnormally long filing periods, coupled with lagged payment arrangements, are also likely to impede a revenue body’s capacity

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<sup>7</sup> See ‘Focus on Businesses, Dutch Progress Report on Reducing Administrative Burdens’, April 2006.

to detect and deal with non-compliance behaviour in a timely manner, an issue for revenue bodies seeking to improve the “currency” of their enquiry work.

### **Value added tax**

The VAT is a significant source of UK Government revenue raising almost £73 billion in 2005-06, around 16% of all government revenue (as per Table 1 of the chapter).

While originally conceived as a simple single rate tax on consumption expenditure, VAT systems generally have evolved into a relatively complex (read ‘costly’) method for raising Government revenue. The UK’s VAT, with its multiple rate structure and various exempt goods and services, fits squarely into his category, notwithstanding a range of policy measures taken by the UK Government to ease the compliance burden of smaller businesses.

As noted by the authors, the UK’s VAT is characterised by a quite generous (by EU standards) registration threshold and a number of concessions, also subject to generous thresholds, to smaller businesses that enable use of simplified approaches for determining VAT liabilities. These concessions, which include the cash basis of accounting and a flat rate scheme where VAT liabilities can be based on a set proportion of a business’ turnover, are intended to ease their administrative burden. Yet, despite these concessions, the administrative burden of the VAT, as quantified by HMRC’s own measurement research, is the highest of any tax administered.<sup>8</sup>

An additional challenge for HMRC and the Government concerns the relatively high level of revenue leakage from the VAT system resulting from all forms of non-compliance, in particular, ‘missing trader intra-community’ or ‘carousel’ fraud. The authors note that HMRCs own research of the VAT tax gap points to a high incidence of revenue leakage – some 14.5% of the theoretical tax base for 2005-06. For what was originally conceived as a self-policing tax, leakage of this magnitude constitutes serious erosion of the tax base and warrants close and sustained attention.

In circumstances of significant administrative burden and high revenue leakage it is disappointing that the authors have not canvassed any ideas for VAT reform. Is it time, for example, to at least consider the feasibility of a major simplification of the VAT system, entailing a substantial broadening of the tax base and a single (but substantially lower) standard rate? For example, a VAT system with a tax base modelled along the lines of New Zealand’s GST and a basic rate of, say, 12.5%, would raise substantially more revenue than the existing VAT system, some of which could be used to compensate those adversely impacted by a such a VAT. More importantly, however, a VAT designed along these lines would be much easier to administer (read ‘less relatively costly for business and HMRC to operate’) and provide considerably less incentive for non-compliant behaviour (read ‘easier for HMRC to administer’). While this idea would undoubtedly face strong political opposition, one can argue that the existing situation requires a radical response. Further tinkering is unlikely to get the job done!

### **HMRC: Tax administration**

This section of the chapter raises a number of issues and expresses and number of viewpoints on HMRC’s administration of the tax system. A few comments are called for.

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<sup>8</sup> HMRC’s administrative burden measurement studies conducted in 2005-06 revealed that the VAT was by far the most costly tax for business to administer- some £1,020 million. The figures for other major taxes were £ 608 million (corporations tax), £759 million (employer taxes- PAYE and NICs) and £ 857 million business taxes.

### *The organisation of tax administration*

The authors note the recent merger of the two predecessor revenue bodies into a single revenue and customs agency (HMRC) and the efficiency-related rationale for this reform. There are two aspects worthy of comment.

The merger of the two tax bodies was indeed long overdue and there was a strong case on efficiency grounds for the amalgamation, as acknowledged by the authors. An additional benefit from the merger, as highlighted by the O'Donnell Review that led to the Government's decision, is that it will allow for substantial re-engineering of the way many tax administration are conducted, potentially enabling substantial improvements in overall organisational effectiveness and taxpayers' satisfaction with the standard of administration.

A second issue concerns the inclusion of the customs portfolio within HMRC's responsibilities. The administration of customs laws raises many issues unrelated to mainstream tax collection and in these times of heightened risks from terrorism, illegal immigration and drug trafficking one can well argue that there is a strong case, in a country with 60 million citizens, for a separate dedicated agency for customs administration. One can equally argue that administration of the tax laws (and the other roles that HMRC has assumed), with an organisation of around 60-70,000 staff, is more than enough for a single government agency. While a few other OECD countries administer both tax and customs from within a single organisation, the vast majority of countries do not and there is certainly no trend in this direction.

### *Performance indicators*

The authors note the setting of compliance improvement targets for VAT- expressed in terms of achieving a reduction in the estimated tax gap, so as to achieve a gap figure of 11%- and direct taxes and NICs- expressed in terms of additional revenue (some £3.5 billion). On this matter, they question what appears to them as a lack of transparency concerning the reasoning behind these objectives and pose the question whether compliance cost-reducing initiatives reflect the same trade-offs as the enforcement-increasing policies. They also question whether performance indicators and targets based solely on additional yield might prompt areas of the HMRC to concentrate on inquiries of taxpayers' affairs with firmer prospects of immediate payback at the expense of preventative work which might lead to more significant yield in the longer term.

These viewpoints justify a range of comments, in part drawing on this commentator's working experience with HMRC officials:

- There is a strong case to argue that one of the major goals of a revenue body is to achieve improved overall compliance with tax laws, noting that increased revenues flow from improved compliance in an overall sense. Objectives expressed in terms of increased compliance (even if in revenue terms) are a logical consequence of this primary goal and specific targets would seem to be appropriate as a means of gauging overall progress.
- The targets set are, in many respects, aspirational in nature and form part of a broader set of objectives used by HMRC to gauge progress in achieving improved performance.
- Progress towards the targets is to be made in each of years up to the target year, and is the expected outcome from the full range of HMRC's service, education and enforcement activities across all segments of taxpayers, not just from inquiries/audits, as implied by the authors. HMRC does not break down the overall targets and attribute them to

individual functional areas within its operations and, in this sense, it appears unlikely that the targets per se would lead to the sort of behaviour suggested by the authors.

- HMRC has been extremely transparent in its work on VAT gap measurement, considerably more so than revenue bodies in other advanced economies, and it provides a report of its ongoing work each December with the Government's pre-Budget papers. If one looks at HMRC's most recent report the improvement in compliance required to achieve a VAT gap target of 11% is around £3.0 billion, which is more or less in line with the target for improved compliance of direct taxes and NICs (ie. £3.5 billion). In this sense there appears to be some consistency from HMRC in the respective targets, although clearly each area of risk will be subject to its own set of strategies
- HMRC is largely a "trailblazer" among national revenue bodies with mandated targets of this nature; perhaps some time should be allowed to see if the approach has any validity as a performance enhancing tool for revenue bodies before judgments are made.
- The authors are most probably correct in questioning whether the same trade-offs have been made concerning compliance cost-reducing initiatives. In fact, it is more than likely that the targets were set quite independently, by different officials and at different points in time of the process for setting compliance improvement targets.

#### *Measuring compliance costs*

The authors note the considerable work carried out by HMRC (with KPMG's assistance) to get a better handle on the incidence and nature of the administrative burden on business resulting from the tax system, and the setting of targets aimed at achieving burden reductions. However, they express a number of concerns.

The first relates to a lack of attention to individuals/citizens in any of the measurement work and a related concern that, as a result of this omission, the opportunity might be taken to transfer some of costs of business onto individuals as part of the burden reduction program. The second issue stems from the fact that the burden measurement work undertaken using the Standard Cost Methodology (SCM) may not be statistically representative and therefore questions arise in relation to its accuracy and usefulness. A few comments are called for.

The authors are correct in their conclusion that the focus of the recent burden measurement work has been on business and not individuals. However, given that the measurement work did cover some 3.0 million unincorporated/self-employed individuals who pay income tax, it can be said that a portion of the individuals' population is covered. This does, of course, leave some 7 million other taxpayers (eg. employees and investors) who file tax returns and pay taxes and as a result incur an administrative burden.

Concerning the possibility that measures taken to address business' administrative burden may result in some cost transfer to individuals this does appear to be unfounded. In parallel with the conduct of the measurement studies the HMRC (and Treasury) undertook a detailed study of measures that might be taken to reduce administrative burdens and achieve the targets set. The results of this study were published alongside Budget 2006.<sup>9</sup> A reading of the study indicates that the measures planned to reduce business administrative burden should have no impact on citizens.

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<sup>9</sup> See 'Progress towards a new relationship: how HMRC is working to make life easier for business'

In relation to use of the SCM, the published reports do acknowledge that because of the underlying methodological approach the aggregate costs are likely to be “understated”. That said, the measurement of administrative burdens/ compliance costs, regardless of the methodologies used, is generally always associated with various assumptions and elements of guesswork that give rise to some degree of inaccuracy or doubt. The quantification of burdens/ costs resulting from tax regulations is by no means a precise science.

On the other hand, application of the SCM does have the clear advantage of providing detailed and precise information on the specific information obligations pertaining to each tax and, as a result, facilitates the identification of the most burdensome areas of regulation. Furthermore, there is currently considerable interest in, and use of, the methodology across Europe, potentially leading to some opportunities for cross-country benchmarking. In February 2007, the EU’s ECOFIN Council mandated use of a modified SCM methodology as part of an EU-wide burden reduction effort to achieve savings of 25% by 2012.

### III. Speculations, Conclusions and Recommendations

The authors make a set of concluding comments and recommendations. Their key points and this commentator’s views are briefly summarised below:

<b>Author’s conclusions / recommendations</b>	<b>Commentator’s view</b>
Attending to the modernisation of HMRC’s IT systems should be a high priority.	Strongly supported in principle. Further inquiry is likely to show that this matter is already receiving high priority within HMRC.
Greater efforts need to be made to harmonise definitions and rules for PAYE and NICs purposes.	Strongly supported, as described in the body of this commentary.
Consider the unification of personal tax and NICs	Worthy of consideration given the erosion of the contributory principle and the potential benefits flowing from a simpler system.
Adoption of universal self-assessment incorporating a system of pre-filled tax returns, and rationalising the reporting requirements for the tax credits system	Strongly supported, as described in the body of this commentary.
Renewed efforts are called for to deal with tax shelters with a cross border dimension, including assessments of the overall revenue at risk	This is a complex and difficult area for all revenue bodies. Further inquiries are likely to reveal that this area of risk is already receiving a high degree of priority within HMRC.
Assist very small employers by having a scheme whereby HMRC carry out payroll and other compliance tasks for very small employers, being paid a competitive set rate.	It may be simpler to subsidise smaller businesses for their use of payroll agents. (New Zealand IRD administers such scheme.)

In their chapter, the authors have explored a considerable range of issues and made a number of suggestions. Hopefully, their ideas and a few by this commentator will contribute to ongoing efforts to improve tax system implementation in the UK.