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Tax Implementation: Commentary

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Reforming the Tax System for the 21st Century: 'The Mirrlees Review'

COMMENTARY

Chapter: Tax Implementation Issues in the United Kingdom

prepared by Brian Mace¹

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Tax Implementation Issues in the United Kingdom²

Introduction

This chapter is one of a number being prepared for publication as part of the Mirrlees Review. The Review is looking at a wide range of tax issues in the UK on the occasion of the 30th anniversary of the publication of the Meade Report in 1978. That Report put forward radical proposals for reform of the UK tax system. The chapter focuses primarily on the way the tax system is run and not on the structure, balance or incidence of UK taxes. Those issues are considered in other chapters of the Review. But as the authors acknowledge the structure of a tax and how it is administered are matters which are closely inter-linked. The structure of a tax may largely determine the way it is administered (or preclude certain administrative options). Conversely existing administration structures may make certain policy options difficult to implement without radical change.

The chapter is in three parts. Part I looks at the economic theory and other principles which may underpin attempts to optimise how taxes are implemented; Part II looks at specific issues of administration in the UK, concentrating on income tax, corporation tax and value added tax (VAT) and on the organisation of HMRC itself. This Part also puts forward a number of specific ideas for possible change. Part III sets out a number of conclusions and recommendations although some of these repeat ideas put forward in Part II.

The following commentary looks at each of these sections in turn, drawing attention to the key conclusions and testing some of ideas and proposals in a little more depth. It also seeks to identify some subjects and issues which the authors have not mentioned, or mentioned only indirectly which might be worth further attention. In preparing this commentary I have had the benefit of reading the commentary prepared by my fellow commentator on the chapter, Richard Highfield. I agree with much, though not all, of what he says.³

Part I: Tax systems and Implementation

This part is the longest section of the chapter. It looks in turn at:

- the theoretical analysis of tax design, drawing on previous work by the authors and the economic literature more generally and taking that work forward in a number of places;
- determinants of evasion, avoidance and administrative and compliance costs;
- enforcement systems;

and concludes with a section offering some particular implementation guidelines.

This part of the chapter provides a helpful background to the specific analysis of tax issues in the UK which follows in Parts II and III. A few points, not in any particular order of importance call for some comment.

- i. In their economic analysis it is interesting that the authors provide a theoretical case to support not imposing a tax charge on the imputed rent from owner-occupied property. The

² This commentary is based on the authors' version of the chapter dated 23 May 2007.

³ I have not duplicated my fellow commentator's analysis where I agree with what he says (for example, his very clear discussion of performance indicators) but have focused on subjects where I have particular experience or where my perspective on the chapter is different.

UK abolished the charge which it had of this kind - "Schedule A" - in 1964 but economists have often argued that in principle a charge of this kind should be included in a comprehensive income tax. The authors show that if broader considerations are taken into account the case for the charge is no longer sound. This confirms what tax administrators have usually argued on pragmatic grounds.

- ii. Although the authors acknowledge that the general theory is highly stylised I feel, like my fellow commentator, that the absence of any reference to the role of politicians in shaping tax policy and administrative structures is an important gap in the analysis. Tax administrators and others supporting Ministers in charge of tax policy will naturally aim to cover the considerations described by the authors in the advice that they give to government. But politicians often have wider considerations which they wish to bring into the analysis. Not all of these are the product of expediency or ideology. In seeking election a government may have made commitments about the sort of tax measures which it will or will not consider. For example, the government may have pledged not to raise a particular tax rate or not to impose tax on certain sorts of transactions. If, subsequently, there is a need to raise taxes it may therefore be that the optimal measure to do so in economic theory is closed off. In these circumstances it is not unprincipled for the government to look for alternative, if theoretically sub-optimal, means to raise the revenue it needs. It is important to recognise that administrators do not have final control over the decisions which are taken about tax structures.⁴
- iii. The authors comment on the importance of IT in the administration of the tax system. In the UK the tax administration was relatively late, by international standards, in making full use of IT in a number of areas and has subsequently continued to lag behind. There are political and historical reasons for this. Plans to computerise the largest⁵ administrative system, PAYE, on the basis of nine large centralised processing centres, which had begun in the late 1960s were abandoned in 1971 when the then government decided that it wanted to look at more radical options for a system of tax credits or negative income tax. When those proposals were in turn put on one side following the change of government in 1974 work began on proposals to computerise PAYE using desk-top terminals in local offices. As a result of this rather disrupted development process it was not until the early 1980s that PAYE was fully computerised, though that particular project was completed on time and on budget.
- iv. Although IT is now fundamental to the operation of the tax system the authors note that there are cautions to be aware of. The chapter mentions two but there are arguably others. For example, although computer systems can be very efficient at handling large numbers of straightforward, similar transactions, they may be less effective where non-standard action is required. There are two aspects to this. First, it may be more difficult, perhaps impossible, for the non-standard action to be handled by the computer even with manual intervention by an operator. This is particularly true for very large administrative computer systems. Adjustments or tweaks which in a manual system can be readily applied to give a more satisfactory outcome in a particular case may not be practicable. Second, there is a mirror to the point made by the authors that IT may lead to taxpayers being less well-informed about the tax system and how it works. This may also apply to the staff in local tax offices who, because the computer does the work and calculation, may have less understanding of what the administrative structure is trying to achieve in principle and therefore be less able to devise ways of dealing with individual problems.

4 And as my fellow commentator notes policy-makers may not have the necessary factual information about marginal costs and other matters to enable them to carry out the analysis which theory would require.

5 Largest both in terms of the number of persons liable to the tax and in total revenue raised.

- v. Another factor to bear in mind in the design of administrative systems for taxation is that longstanding taxes like income tax are not superimposed on the economic structure of a country. They are the products of a wide range of cultural, historical, economic, social, political and other factors. The way the tax system works is often deeply embedded both in economic structure of the country and in the national psyche.⁶ Moving to a new system may require not just a change to administrative procedures and computers, it may also depend on changing culture and attitudes too. This may in turn require lengthy programmes of education or re-education before a radically new design can be fully accommodated and assimilated. And those transitional costs need to be factored into the balance of whether the benefits of the change are actually worthwhile. This is partly why international comparisons in taxation need to be treated with very considerable caution. Just because an approach works well in one country and may be technically feasible in another does not necessarily mean that it can in practice be easily translated from one to the other. The approach may be the result of particular cultural or social features in the first country which simply do not apply in the other.
- vi. In section 3.2 the authors comment on the factors that lead people to pay their taxes rather than evade them. I agree with their view that the data here are not sufficient to overturn the theoretical deterrence-based model on evasion which they support. But it is important not to underestimate the role which cultural factors play in affecting compliance. On the whole, and by contrast with some other European countries, UK citizens have been acknowledged to be generally compliant in meeting their tax obligations. This goes hand in hand with a culture in which most people pay their credit card and other bills on time even where the sanctions for not doing so are weak. I suggest this is one, though not the only, reason why the UK does not have relatively strong enforcement powers (page 47 of the chapter, footnote 80).

Parts II and III

It is appropriate to look at these two sections of the chapter together since some of the conclusions and speculations in Part III build on the analysis in Part II. And some of the issues which are mentioned in Part II return again in Part III.

General

Throughout Parts II and III the authors mention a number of tax issues but focus in particular on income tax and the operation of PAYE and national insurance. This is undoubtedly an important area given the high proportion of total revenue raised by income tax and national insurance contributions (NICs). However, the issues here are in my experience well trodden ground. That is not to say there are no problems with taxes and charges on individual income but, for reasons which I shall fill out later, I am not sure that this is where the critical pressure points lie in the UK tax system. The authors might have looked at a rather wider range of issues which are current in the UK tax system. Issues on which there might have been some comment, or fuller comment, might be:

- whether, as my fellow commentator has remarked, there are ways in which the current serious leakage of VAT through “carousel fraud” might be addressed (though admittedly this may not be an issue which the UK can easily tackle on its own because of the EU rules which govern VAT);

- whether the present administrative structure for tax credits - of which there has been a lot of criticism - could be improved;
- whether the structure of the more recent “environmental” taxes (landfill tax, air passenger duty etc.) is appropriate, especially since charges like these seem likely to be a growth area for future taxation;
- the implications of European Court decisions for the structure of corporation tax;
- whether the totality of the tasks which HMRC is currently undertaking is manageable, and organisationally sensible.

In putting forward ideas the authors have in a few places set out views which appear to point in different directions. For example, they record (Section 6.1.4, page 37) their perception - which I share - of the difficulties of assimilating tax credits into employers' deductions from pay. But, later (Part III page 79) they suggest consideration should be given to integrating tax credits into PAYE. Similarly, (Section 6.1.3, page 35) they question why pensioners should have to cope with the complexity of having to fill in a return. But (Part III, page 77) they also ask why everyone shouldn't have to complete a return each year. There are undoubtedly real dilemmas here and no easy answers to the questions posed, but I was occasionally left in a little uncertainty as to the authors' aims.

PAYE

The authors look at a number of aspects of the present PAYE system for deducting tax from employees' pay.

-Accuracy

In section 6.1.3 the authors refer to reports about accuracy in the operation of PAYE. This is undoubtedly a concern and it is right to stress the importance of finding ways to reduce these inaccuracies. In the light of current constraints on HMRC resources I feel this is likely to mean that individuals will have to take more responsibility for ensuring the correctness of their own tax bills. Nevertheless it is important to keep this issue in perspective. The authors refer to an HMRC internal report which estimated that around £575 million per annum of tax due had not been pursued by the department and that taxpayers were not being advised of around £295 million per annum of tax potentially repayable. However, the total yield from PAYE in 2005-6 was £113,897 million⁷ so the variances identified by HMRC were of the order of $\pm\frac{1}{2}$ per cent.

-Changes in working patterns and demographics

Employees

In recent years the number of individuals whose circumstances are less easily accommodated within PAYE has undoubtedly increased. Typically problems arise where the individual has a number of jobs either simultaneously or sequentially during a tax year. But in practice the number of such cases remains a relatively small proportion of the total number of employees. For example figures from the labour force statistics show that in 2000 over 80% of employees had been in their current job for over a year and almost 70% for two years. And while the number of employees with

7 Table 1, page 81 of the chapter.

multiple employments has increased substantially since the mid 1980s the number of employees who held more than one job in 2000 was still only 4% of the employed workforce. These figures are now slightly out of date but I do not believe that they will have changed significantly.

I feel the authors underestimate the effectiveness of PAYE in suggesting that it remains an ideal system only for those employees who have a single, full time job, paid solely in cash rather than benefits and who change jobs only rarely. PAYE can and does work very successfully, and with little manual intervention, for an employee who has a single job throughout the tax year or who changes job not too close to the end of the tax year⁸. That still describes the vast majority of the working population in the UK.

Pensioners

As the authors note, another group for whom PAYE works less well consists of pensioners who have several pensions from a number of past employments. This is a relatively recent (but growing) phenomenon as those who took advantage of the extension of pension options in the 1970s and 1980s start to reach retirement age .

In principle PAYE should work well for pensioners.⁹ Their pensions come from the same payers each year and apart from any annual up-rating the sums paid do not fluctuate between pay-periods. But difficulties occur where the pensioner has more than one pension because manual intervention is necessary to co-ordinate the correct deductions, month by month, from each payment. Getting that right requires personal attention from the pensioner's tax office which is very resource intensive. In practice it may be necessary for pensioners to be proactive themselves in ensuring that the right deductions are made from their income or in completing a tax return at the end of the tax year to ensure that they pay the right amount of tax.

The authors rightly point to the irony in having a system which, having got a person's tax affairs right without tax returns for the whole of their working life requires the person to start filing a return once they have retired. But there is no easy answer to that problem and unfortunately I believe it is unlikely that resources will be available either in HMRC or elsewhere in government to undertake the complex co-ordination work which would be necessary to get the right results within PAYE. However, one solution which might be worth examining is whether, if an individual has pensions from several sources, one of the pension payers could act in the lead as a sort of clearing house for all the others. If all the pensions due to an individual were channelled to the person through the lead payer that provider could aggregate all the amounts and apply PAYE to the total sum before then paying the correct net amount to the pensioner. Such a system would obviously require the agreement of both the pensioner and pension providers and would undoubtedly mean more work for the pension payer co-ordinating the payments. But the other pension payers could have less work to do and would simply have to pay pension without tax deductions to the lead provider. There might, therefore, not be much increase in the total compliance costs of pension payers overall.

-Flexibility

The authors are concerned that PAYE imposes some inflexibility on the tax system and may prevent certain policies being introduced. As an example they mention that when the present system of personal tax credits was introduced they could not be accommodated within PAYE. However, this seems a rather harsh analysis: after all even a Rolls Royce car cannot fly you to New York! Had the

8 If the change of job happens too close to the end of the tax year the P45 process may not catch up with the employee in their new job before the end of the tax year and cumulation may therefore break down.

9 And in practice more than half of those aged 65 or over are in any case not liable to income tax.

UK had a system of universal self-assessment in place at the time tax credits were introduced, the task of getting substantial numbers of credit recipients to complete returns of income as is now required would have been much simpler if not obviated altogether. But, just like PAYE, universal self-assessment could not have delivered what the Government at the time wanted, that is tax credits paid with wages and responding “in real time” to fluctuations in the employees wages or salary. That would require a much more sophisticated system along the lines of the tax credits or negative income tax envisaged by the then government in 1972. The authors point to the difficulties of asking employers to operate such a system. Indeed it must be very doubtful whether any such system could ever be made to work in a structure where the tax credits due may depend not only on changes in the individual’s own income but on changes in the income of their partner too.

Apart from the example of tax credits, the authors do not indicate which policy options they think might have been precluded because of constraints imposed by PAYE so it is not easy to know what weight to attach to this factor. I do not recall many, if any, occasions over the past 30 years when Ministers have said they would have introduced a particular, attractive policy if only the structure of PAYE had not made it impractical.

It is worth thinking about this issue in a little more detail.

One kind of policy which under PAYE could be introduced only at considerable administrative cost or by bringing a large number of individuals into self-assessment is a tax relief for a kind of personal expenditure incurred by a significant proportion of the taxpaying population.¹⁰ Child care costs might be an example. But from a tax policy perspective that restriction might well be perceived as an advantage, rather than a disadvantage if the aim generally is to have simpler taxes with broader bases and lower rates. By contrast the tax structure in the US is complicated by an wide range of specific deductions for various sorts of expenditure which can be accommodated in the system with little administrative cost because all taxpayers are obliged to file a return. That is unattractive on wider policy grounds and I think the UK system is better in this respect.

I would not, of course, suggest, that there is no case for more flexibility in the tax system. One policy which undoubtedly would be precluded by the structure of PAYE is a local income tax under which substantial numbers of local authorities were permitted to set their own, separate local income tax rates. The law already envisages that there might be a different basic rate of income tax for individuals living in Scotland if the Scottish Executive decide to introduce such a measure.¹¹ Even that would be likely to impose significant new burdens on some employers with additional risks of error. But a tax system in which there were, say, 10 different rates of local income tax would involve impossible burdens for employers and the risk of very large numbers of errors. Any future government that wished to introduce a local income tax would therefore have to find some alternative mechanism to PAYE (probably some form of end-of-year assessment) to collect it. But there is a “chicken and egg” issue to be addressed here: until the tax system is more flexible some policies may be difficult to implement, but until those policies are identified as required options by government there is less incentive to change the administrative structure.

-Compliance costs

The authors examine whether PAYE has kept the tax system simpler over time and do not reach any firm conclusions. I do not myself believe that the existence of PAYE has made the tax code itself more complicated. Over the last 30-40 years many substantial changes have been made (for

10 In the past this problem has been partially overcome by giving the tax relief at source, allowing the individual to deduct the relief from the payment before making it. Tax relief for charitable donations by basic rate taxpayers continues to be given in this way.

11 Section 73 Scotland Act 1998.

example, abolition of mortgage interest relief, abolition of child and other tax allowances, reduction in the number of income rates) which have simplified both the income tax and the basic operation of PAYE for both employers and employees. The taxation of employment income is certainly more complex than it was. But, in my view, that is primarily in response to the increasing sophistication in forms of remuneration for some employees, to which the tax code has had to respond. However, I agree with the authors that overall the employer's task in running payroll has become much more complicated since PAYE was first introduced. Because of the success of employers in operating PAYE governments have, perhaps understandably, been encouraged to require them to take on more and more tasks: deduction of earnings related NICs, payment of statutory sick pay, maternity pay and paternity pay, recovery of student loans. Moreover these tasks go alongside the wider burdens which employers have had to shoulder such as health and safety requirements for their employees. In total these requirements are now undoubtedly too heavy and, as the authors argue, ought to be reduced.

National Insurance Contributions (NICs)

I believe it is reasonable to argue that, on its own, and with the use of IT, PAYE for most employers, including small employes, is only a little more complicated than a non-cumulative system of tax withholding from employees' pay. But NICs add an additional level of complexity with a choice from several different rates and structures to apply depending on the employee's circumstances. Once the employee's situation has been established most of these otherwise variable factors remain constant from pay-period to pay-period. But the fact that NICs are calculated non-cumulatively and on a pay-period basis (rather than cumulatively and annually as for income tax under PAYE) means that employers have to apply two different charges to, broadly, the same earnings. This undoubtedly imposes an additional compliance burden especially for small employers. Finding a means to lighten that burden, by aligning or assimilating income tax and NICS has been at the top of wish list for business and employers for some time and the authors of the chapter also suggest action to unify income tax and NICs. Unfortunately, I do not believe that such an approach is going to be fruitful, for two main reasons.

First, significant alignment between income tax and NICs can be achieved only at the price of correspondingly significant changes in the incidence of one or both of these charges, probably mainly NICs. But that means substantial numbers not only of gainers but also losers amongst employees, many of whom could be on low or relatively low incomes. These changes would not be for any reason of improved fairness towards the individuals affected but to produce a reduction in employer compliance costs. However worthy that objective it is hard to see a government finding those consequences easy to accept.

Secondly, NICs are not just a single charge on the employee's wages or salary. There are also (secondary) employer NICs, calculated broadly but not entirely on the same base as the employee charge, but remitted and paid¹² by the employer rather than deducted from the employee's pay. Any initiative to achieve a reduction in employer compliance costs through aligning tax and NICs really has to address both of the NICs charges. Even if the employee NICs charge could be fully aligned with income tax there might be little reduction in employers' compliance costs if the employer NICs charge was left in place. But replacing employer NICs with a new charge in a way that does not have largely capricious distributional effects is very hard to achieve.

These remarks may no doubt be criticised by some as defeatist. But it would be wrong to believe that "fundamental studies" of the options in this area have not been undertaken within government over the years.

12 In economic terms the cost of employer NICs is, of course, ultimately borne at least in part by employees since the charge reduces the total remuneration which an employer can afford.

-Recent studies

Since the chapter was written the Treasury have published a study¹³ which looks at the option of charging employee NICs on an annual basis and collecting them cumulatively. The study concludes that on balance the benefits of administrative alignment do not outweigh the costs.

The study could no doubt be challenged in a number of respects. For example, the work assumes that the structure of PAYE codes remains broadly as it is now but I think there might be scope for rather more compliance cost savings for employers if the structure of PAYE codes were changed in some respects (by making them offsets against the amounts of income tax and NICs payable rather than against income subject to tax and NICs before those charges are calculated.)¹⁴ And the study does not look at the more radical option of merging income tax and NICs. But I do not think either of these changes would affect the overall conclusion that the study reaches against the change. Indeed the study indicates that the consequences of radical change to employer as well as employee NICs would have further, difficult distributional and compliance consequences.

In my view the only way to achieve radical simplification for employers in the task of operating PAYE and NICs would be gradually to phase out both employer and employee NICs over time (probably a decade or more) by systematically shifting the burden on to income tax, corporation tax and possibly other new taxes. By that means the very difficult distributional consequences of the change could be managed in such a way that individuals and employers could adjust to them slowly. Such a plan would naturally face its own obstacles since among other things it would require some replacement for the existing contributory principle (though I do not think that issue is insuperable). Amongst other things it would also require some means of dealing with the present arrangement under which employees in company or other pension schemes pay a lower “contracted out” rate of NICs. Crucially it would need a sustained commitment to the change by government over probably three general elections.

Issues for small employers

Looking narrowly at PAYE and NICs, most concern about compliance costs is focused on small employers without computer support. The Treasury study just mentioned estimates that about 20% of employers currently rely on manual payroll though HMRC expect this number to fall significantly over the next 3-4 years.

Because of the complexity of PAYE and NICs combined there are very good reasons for encouraging all employers, however small, to make use of computerised payroll processing. Such processing can in fact be purchased quite cheaply, as the chapter notes (footnote 59, page 38). The chapter suggests that HMRC might themselves offer a payroll service for small employers but, like my fellow commentator, I think it would be preferable to subsidise small employers to use commercial payroll schemes. It would not necessarily be right for HMRC to set up in competition with commercial payroll firms and employers ought to have agents who are independent of HMRC. There have, of course, been subsidies for employers to e-file their end of year and other returns for some time which is in itself an encouragement for employers to switch to computerised payroll.

Changes to withholding

13 “Income tax and national insurance alignment: an evidence-based assessment” published by HM Treasury, 9 October 2007.

14 This further change would involve additional transitional cost for all employers and government which would have to be taken into account.

The chapter suggests three changes to withholding in order to improve the operation of PAYE: the application of PAYE to taxable state pensions and benefits; varying withholding on non-PAYE income by reference to PAYE income and introducing pay-period information reporting. As my fellow commentator notes these changes would increase the compliance burdens on business when priority is being given to reducing that burden - an initiative which the authors also support. Moreover, I feel these changes may be pointing in the wrong direction. I think it is right to recognise that PAYE withholding cannot get everyone's tax deductions precisely correct during and at the end of the tax year without disproportionate and costly intervention by employers and other intermediaries or staff in local tax offices. I shall return below to what I think is better strategy, and one with greater potential for the longer term.

Self-assessment

The authors review the introduction and progress of self-assessment since its implementation in 1996-7. I share the authors perception that while overall the introduction of self-assessment has been good some aspects of it have been less so. And as they point out there is still more that could be done.

One aspect of self-assessment which the authors mention is e-filing. This undoubtedly had its teething troubles when it was first introduced. But for individuals the system now works well and HMRC could do more to publicise its virtues. The authors suggest that there is no real incentive in the UK system to e-file, by contrast with New Zealand where a refund is remitted within 14 days in response to an e-filing. In practice, anecdotally, the UK system can already do better than this. I filed my 2006-7 tax return on line on 27 September 2007 and a refund was in my bank account on 2 October, 5 days later.

The authors note that efforts have been made to remove people with simple tax affairs from self-assessment and ask whether more could be done to eliminate the need for pensioners to have to fill in tax returns. That is worth considering, but it is also worth asking whether striving too hard to keep people out of self-assessment is actually the right approach. As I noted earlier there is a real dilemma to be addressed here in relation to how best to deal with the tax affairs of the minority of employees and other individuals with which PAYE does not deal effectively. One solution might be to identify groups of taxpayers - such as those who have a series of employments during the year - who should be positively encouraged to take greater charge of their own tax affairs, maintain records of their own and make use of self-assessment with e-filing at the end of the year to get their tax liability right.

The longer term

The authors and my fellow commentator feel that the problems which have been identified with PAYE provide a strong case for looking at a move over time to some sort of universal self-assessment system. However, I do not myself find the arguments put forward persuasive or at least not as persuasive as they do. This is partly because I think the circumstances in which PAYE does not work well are less common than is often suggested, as I have mentioned above.

The authors suggest five reasons why a system of universal self-assessment would have advantages. The change would require all employees to file a tax return each year which would mean either additional work for them or incurring the cost of paying an adviser to handle the task. For that price the chapter says that HMRC would save some work, employers' compliance costs would fall "a little", some as yet unspecified policy changes - new stealth taxes? - would be facilitated and taxpayers would understand their tax bills better. That does not sound a very easy proposal for a government to persuade people to accept. For a number of individuals, tax bills would be made

more accurate. That might be sufficient to persuade some that the change was worthwhile, but they might also ask whether there was simpler way of achieving the same result. I believe that taxpayers whose affairs are unlikely to be correctly dealt with under PAYE should be encouraged to take more responsibility for their own tax affairs. But I do not think there is very strong case for asking all employees to do this.

In putting forward the case for looking at a system of universal self-assessment the authors and my fellow commentator argue that the additional compliance costs of the large numbers of employees filing tax returns for the first time would be significantly reduced if tax returns were pre-populated by HMRC with information about the individuals income and tax deductions. This approach has clearly worked well in other countries such as Denmark, and is certainly worth further examination in the UK.¹⁵ But as the authors and my fellow commentator note there are a number of features, not yet present in the UK system, which are pre-requisites for pre-population to work well. For example, the absence of a unique taxpayer identifier in the UK is a major hurdle to be overcome.

In practice I feel neither PAYE or universal self assessment provide an ideal way to collect income tax with low administrative costs, low compliance costs for **both** employers and employees, flexibility to accommodate a wide range of different tax policies and securing the flow of tax revenue to government. Each system has its advantages and disadvantages and I am not convinced there is an objective basis for preferring one system over the other. However, once one particular system has been adopted by a country and has become embedded in its culture, it is very difficult to change to another.

Against this background I do not believe that a study of universal self-assessment is likely to prove productive at the present time. That is not to say that the existing system does not require change and development. My preferred strategy, as I have already indicated, would be to abandon the task of trying to make PAYE work for individuals for whom the work involves disproportionate costs either for employers or HMRC **but** to ensure the PAYE system is properly maintained for the majority of employees for whom it works satisfactorily. And there are a number of further initiatives such as an examination of whether returns can be pre-populated which are worth pursuing. A combination of these strategies would provide sufficient work for HMRC to handle in the short to medium term and would not close off options for wider change in the future.

HMRC

Good tax administration requires adequate resources and funding. Running the tax system is never going to have the same priority within government as major spending programmes such as education, health or defence. But it is important that tax administration is not starved of the relatively modest sums which it needs to maintain and renew itself. Efficient administrative systems and willing compliance are not easy to recover, once lost, and without them the funding for public spending generally may be put at risk.

HMRC is currently undergoing a large amount of change and is also trying to achieve a substantial reduction in the numbers of staff in the department - by about 12,500 at present with a further similar reduction to come over the next five years. The authors note that this has led to concerns about staff morale. Managing change and down-sizing simultaneously is a very difficult combination of measures to handle. Some concern has been expressed in the media that the senior management of HMRC have recently been too focused on managing change and not sufficiently on the basic business of running the tax system.

15 However, a policy which is successful in a country of 5½ million people will not necessarily work so well in a country with more than 10 times the population.

The authors approve the merger of the Inland Revenue and Customs and Excise to form HMRC which took place in 2005. The merger was recommended in a report by the then Permanent Secretary to the Treasury, Gus O'Donnell¹⁶ and there was undoubtedly a case for making this change. But as the authors recognise such mergers require amongst other things substantial amount of senior management time to carry out successfully. And while the changes may yield savings in the longer term they initially require investment to ensure that the full benefits of merger can be realised. For HMRC, it is not clear whether all the necessary investment has been put in.

As the authors note the report by Gus O'Donnell also recommended the transfer of most tax policy work from HMRC to the Treasury. The case for this change was unclear since over time the UK tax system has undoubtedly benefited from the fact that tax policy advice to Ministers came from officials with close practical understanding of the tax system and taxpayers. Some evidence may already be emerging in recent policy announcements (for example on capital gains tax and the taxation of foreign profits) that the quality of decision-making may be suffering as a result of breaking this connection.

Since the chapter was completed a further change has been proposed in the responsibilities of HMRC. On 14 November the Prime Minister announced that a new Border Agency was to be established to take on the border control work of HMRC as well as the work of the existing Border and Immigration Agency and UKvisas). However, a Commissioner of HMRC will be a member of the Board of the new Agency.

The authors rightly emphasise the need to ensure that HMRC computer systems are well maintained and regularly updated but this also requires funds for investment. I am sure HMRC officials recognise the importance of this issue but, again, it is less clear that the necessary funds are available to ensure that the work is carried through.

Until 20 November 2007 I would have agreed with the authors view that the UK tax system is not in too bad a shape. And in many respects that assessment remains valid. But the announcement by the Chancellor of the Exchequer on 20 November that HMRC had mislaid two CDs containing the personal details of 25 million child benefit claimants and their children, and the resignation of the Permanent Secretary of the department in consequence of that operational failure has brought to the surface a number of concerns about the current state of health of the department. I doubt that this loss of data is a consequence of systemic failure but it will mean that all the work of HMRC is under the spotlight for the immediate future. And it may be some time before the full consequences of the incident can be perceived.