Office of Tax Simplification Board Meeting

6 December 2012

Present
Rt Hon Michael Jack – Chairman
John Whiting – Tax Director
Teresa Graham
Adam Broke
Mike Williams – HM Treasury
Sam Mitha – HM Revenue & Customs

Secretary
Jeremy Sherwood

Apologies
Edward Troup

In attendance
Professor David Ulph[1]
Mark Thompson (OTS)

The Chairman welcomed Sam Mitha, standing in for Edward Troup who was attending the House of Commons Public Accounts Committee. The Chairman also welcomed Professor David Ulph, and Mark Thompson of the OTS.

1. Minutes of the last meeting

The minutes of the 5 November 2012 meeting were formally agreed.

2. Action points from previous meeting

Update on next projects – The Chancellor had announced in the recent Autumn Statement that the next OTS project would look at employee benefits and expenses, including termination payments. The project would start after Budget 2013. The OTS was also exploring with HMRC and HM Treasury the possibility of taking up another project later in 2013, with three subjects on the table – employment status; partnerships; and regulatory penalties, discovery and other HMRC powers.

John Whiting explained that in discussions with HMRC it had become clear that employment status was too big a subject for the OTS and HMRC to take on alongside the review of employee benefits and expenses, so he proposed putting back a decision on taking this up to 2014 or later. While a project looking at penalties and discovery might potentially be a useful tidying up exercise, it was unlikely to bring big simplification gains to a large number of people. Also, given that the recommendations of the recent HMRC Powers Review were still being implemented, it was probably too early to start a simplification project in this area.

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[1] Professor of Economics, University of St Andrews, and Director of the Scottish Institute for Research in Economics

However, initial discussions on partnership taxation had been positive, and the OTS would carry out further scoping work on a possible project in the New Year. After a short discussion the Board agreed that the OTS should explore further the partnerships project but not do further work on the other two subjects before 2014.

Funding for evaluation of OTS - The Secretary had put in a bid to HM Treasury for funding for an external evaluation of the OTS in 2014/15.

3. Update on current projects

John Whiting led the Board through the emerging recommendations for the pensioner project and unapproved share schemes project. The Board was content with the package of recommendations and noted that publication of both reports was due in January.

4. Measuring tax complexity

Professor David Ulph gave a presentation based on a draft paper he had written on defining and measuring tax complexity, and commented on the draft OTS complexity index. He drew a distinction between design complexity – things like tax rates and allowances – and operational complexity – the interactions between the taxpayer and the tax system. Design complexity could include issues outside the UK's control, for example some impacts of other countries' tax systems on international transactions. Design complexity also depended on policy decisions such as the number of different rates and taxes in a tax system, and differences in the taxation of different goods or services. In designing a tax system, simplification was just one design factor that needed to be traded off against the basic aims of a tax system to raise money in a way that was economically efficient and fair, and not vulnerable to avoidance and evasion.

A certain element of complexity was inevitable given these different aims for a tax system. An interesting question was whether there was an optimum level of complexity (which would differ according to different Governments' aims for the tax system), and if so, whether you could define and measure the unnecessary complexity on top of this optimum level.

Operational or administrative complexity reflected how easy or costly it was for an honest taxpayer to comply with their tax obligations. Design complexity contributed to this, with more rates and categories likely to make a tax system more costly to comply with. But there were other factors to administrative complexity including:
- the fit between the terms the tax system uses to treat a particular transaction and the way a typical taxpayer understands and conducts their affairs,
- the language used in law, guidance and forms which may be hard to understand,
- inconsistencies in law and guidance, such as different definitions for the same word in different situations, and
- frequency of change.

To reduce tax complexity, you could either retain the existing tax system and simplify the processes and language to help people comply, or you could reduce the unnecessary design and administrative complexity. Simplifying the tax system could make it more efficient economically (reducing distortions), reduce non-compliance, compliance costs and legal uncertainty.

In thinking about measuring complexity, it was important to define the purpose of a complexity measure. Was it to help the OTS prioritise its work, or to highlight areas for the Government to simplify in future, or to benchmark the UK system against other countries' systems, or to track changes in complexity over time? And was the aim to measure the intrinsic complexity of the tax system or to measure the costs of complexity, or both? Measuring the costs of complexity might be an indirect way of measuring intrinsic complexity.

As there were multiple components that contributed to both design and operational complexity, you had to decide which ones to measure and how to combine them by assigning relative weights to different components. Also, some of the individual components were difficult to measure. One approach might be to use indirect proxies for complexity that could be more easily measured, such as length of legislation. Another might be to use "crowdsourcing", using a carefully designed questionnaire to seek the views of informed users of the tax system, asking them to assess its complexity on a scale.

The draft OTS complexity index split the tax system into discrete subject areas and assigned complexity values from 1-5 to seven factors across both design complexity and operational complexity and combined them into a single figure by assigning weights to each factor. The aim was to arrive at the values for each complexity factor by asking experienced users of the tax system.

The Board discussed the draft complexity index in the light of Professor Ulph's presentation and made the following points:
-   Initially the OTS had intended to try and understand what was meant by tax complexity, to come up with ways to reduce tax complexity in future and to devise a complexity ranking, or index, for different parts of the tax system to help decide what subjects to tackle next. But this complexity index could also be developed into a tool to help the Government measure and minimise tax complexity in future. The complexity index was an attempt to quantify the instinctive feeling that some parts of the tax system were more complex than others.
-   When the OTS started, there was an expectation that it would be concentrating on reducing legislative complexity, reducing the number of pages of tax legislation. But in gathering evidence for the first reviews, it very quickly became clear that administrative complexity was as important, if not more so, from the point of view of taxpayers.
-   For most people in the UK, compared to some other jurisdictions the tax system was very simple and cheap to comply with: the majority of taxpayers were not required to submit tax returns annually, and for those in relatively stable employment or earnings (again, the majority) the PAYE system automatically gave the right answer, with most employees needing very little interaction with HMRC. The online self-assessment system was also increasingly seen as simple to operate and comply with. Both systems presented the user with a relatively simple interface which hid a relatively complex underlying tax system.
-   However, the PAYE system in particular relied on people's trust in HMRC getting it right, especially when issuing tax codes. Many people did not understand how tax codes worked, so were unable to check they were correct.
-   It was important to consider the resources and ability of the users of a piece of tax legislation and target it accordingly. For example, the controlled foreign company rules were complex but aimed at sophisticated multinational companies who could

afford the best professional advice. The relatively high thresholds for liability in some of the regimes meant they were not a burden on less sophisticated taxpayers

- On the complexity index, a paper setting out the methodology behind it had been published on the OTS website, and comments invited by interested parties. Any feedback would be used to refine the model, and the OTS expected to publish another version in a few months' time.
- More work was needed to choose the best combination of complexity factors and to explore the interactions between them, aiming to minimise "double counting".
- A clearer distinction needed to be drawn between design complexity factors, operational complexity factors, and the costs of complexity.
- There were pros and cons of combining the different factors into one measure. On the one hand, a single figure was simple and clear to understand for the general public, but by combining the underlying factors you had to make difficult judgments about their relative weights and lost information about the individual factors. It would be better to rely on these individual measures for discussions with policy makers and decisions about prioritisation of future simplifications.
- Asking people for their views on the relative complexity of different parts of the tax system was one way to arrive at an appropriate weighting for the different complexity factors, but it was important they only judged areas they were personally familiar with.
- It was important to ask the actual users of the tax system how they felt about complexity, not just the experts. A typical taxpayer or small business should be able to get it right without needing expert help.
- The tax system needed to be designed from the bottom up with the small, unsophisticated taxpayer in mind, and bits added for more sophisticated transactions and taxpayers. The current system tended to operate the other way round, with complex legislation designed with sophisticated multinational businesses in mind, but which also caught small businesses.

The Chairman thanked David Ulph for his paper, and it was agreed that the OTS would publish an updated version of it on the OTS website early in 2013.

5. AOB

- Autumn Statement announcements – The Chancellor's Autumn Statement contained a section on tax simplification which gave an update on the Government's responses to the OTS small business and approved share schemes projects. The draft legislation to be included in Finance Bill 2013 would be published on 11 December; it would include draft legislation on some key OTS proposals, including a cash basis for the smallest businesses.

- Resources and staffing – The OTS would shortly be advertising for a postgraduate law student to assist in a project on tax definitions, and would also advertise for tax experts to help on the review of employee benefits and expenses.

- An OTS blog had been launched, and would be updated every two weeks or so with news on tax simplification.

- The Board asked the OTS secretariat to circulate a list of agreed meetings for 2013.

Jeremy Sherwood
OTS Secretariat