

The Office of Tax Simplification Complexity project

An OTS Focus paper

This paper updates aspects of the OTS's work on Complexity in the tax system. We have revisited the papers we have published on the subject since the OTS was formed. Some have been updated; some remain valid as they stand. In publishing this update in our Focus series, we aim to draw further, potentially new attention to the work we have carried out.

We will continue to carry out work in this general area of Complexity as it clearly underpins all of our work and will periodically issue further papers and updates. We would welcome comments, including ideas for further aspects we should study. Please contact us at: ots@ots.gsi.gov.uk.

Introduction

Since it was set up in 2010, the Office of Tax Simplification has been carrying out an intermittent but ongoing project looking at the reasons why tax is complex. In our first five years, we published a number of papers on the subject. It is timely to revisit these papers and update some of them.

The papers are as follows:

- **Length of legislation:** how long is the UK's tax code really? (first published April 2012)
- **Tax thresholds:** how many are there and how are they operating? (first published February 2013)
- **Layered legislation:** could legislation be written differently? (first published September 2013)
- **Definitions in tax legislation:** do they simplify or do they add to complexity? (first published October 2013 with a response document published April 2014)
- **How to avoid complexity in the tax system:** some principles (first published June 2015)

In addition we have published a number of iterations of our **Complexity Index**, the most recent version in July 2015. We also started a project on **Avoidance and Complexity**.

This paper will summarise and review each of the above each of these topics.

1. Length of legislation

The UK tax code is widely cited as being the longest in the world and that length is often equated to meaning the UK code is equivalently complex. This paper tests this linking and asks:

- What really is the effective length of the legislation?
- Does length necessarily mean complexity?

Using the 2011/12 Tolley's tax handbooks as the basis of the study, which at that time stood at 11,173 pages, analysis showed that there were (once notes, duplications and other factors were eliminated) 6,102 'real' pages of legislation. **In other words, only some 50% of the claimed length of the tax code was 'actual' tax code.** Nonetheless, the length has increased steadily (the paper looks at recent Finance Acts) and has continued to do so; however it is analysed, there is a lot of UK tax law.

Does this mean that the tax law is necessarily complex – or that longer law means more complex law? We do not think so; **we do not believe length necessarily equates to complexity.** However, it is clear that people associate length with complexity – or at least take it as a convenient proxy. So we have used **length as one of the ten factors in our Complexity Index** – but only one of ten.

We think the methodology used in the paper remains valid; we think that although the base of the study is now some years in the past, a new study of current law would reach a similar conclusion. Thus we have not updated the paper at all and simply reproduce it now.

2. Tax thresholds

Following on from our early project on tax reliefs (when we noted some reliefs had not altered in value for many years and so become less or totally ineffective), we thought it would be a useful exercise to list all these numerical values, thresholds and ceilings and see if there were any patterns or common themes, and also whether we could draw out any lessons for tax simplification. Thresholds have the potential to make a useful and significant contribution to tax simplification by excluding low-value transactions and some taxpayers from having to be considered by the tax system.

We found 639 specific monetary values in tax legislation as at October 2012. Of these 425 were thresholds and 214 relate to penalties. Unsurprisingly, some have remained at constant figures for many years (the oldest from 1842). Numerical tax thresholds and ceilings can be a great simplification. But leaving them unaltered means they are less effective or start to have different effects – and if they are penalty amounts, they become less effective.

As we noted in the original paper, it would clearly be a big job to tackle all 639 thresholds and ceilings at once, analysing whether they should be left alone, updated or abolished. At that time we went on to say that at a time when HMRC/HMT is facing exceptional resource and cost pressures, it is probably not a priority task either.

In the interim, the pressures on HMRC/HMT have only increased but the issue of outdated amounts remains. It is pleasing that some have been tackled: notable examples are the £8,500 'higher paid employees' threshold (now all but abolished) and the 15p daily luncheon voucher exemption (now abolished). Both of these followed OTS recommendations. But more amounts have come into the tax system.

We would therefore repeat our conclusion. At the time we did not make it a formal recommendation though we perhaps should: that it should be possible to draw up a priority list of

which thresholds should be looked at first, taking account of which would have the greatest simplification impact. Naturally revenue considerations will influence what can be done.

We have made some small amendments and updates to the original paper and reissue it. There are no formal recommendations in the paper as we readily acknowledge the potential cost (in time and cash terms) involved in general updating. However, **we think there is merit in developing a priority list – of those thresholds and limits where uprating would most contribute to simplification.**

3. Layered legislation

We regularly hear that UK tax legislation is too complex. Some complexity is accepted: taxpayers live and operate in a complex world. But could the tax law be written in a different way that would lead to simpler, more accessible rules?

The OTS has noted the way some countries use principles-based legislation and suggested in some of our reports that such an approach would be worth testing here. But another way of writing the legislation would be to frame it according to the user's needs. The general taxpayer would be able to use just a summary briefing; businesses and general professionals would use a fuller system; experts would have further detail to assimilate. This is the concept of 'layered' or 'tiered' legislation.

This paper outlines out how layered legislation might operate and discusses some of its features, advantages – and potential issues. The concept was noted in the recent paper from the IFS, CIOT and Institute for Government on 'Better Budgets'¹ and this has prompted us to revise and update the earlier paper.

We think that this approach is worth experimenting with; we would welcome comments on the idea.

4. Definitions in tax legislation

This project looked at definitions in tax legislation, identified common themes and considered some suggestions and guidelines for a 'good' definition.

Our overall conclusion was that there is scope for policy makers and draftsmen to focus more on definitions, especially to ensure that definitions are consistent where possible, are not overused nor the same label used for different definitions. We appreciate that both draftsmen and policy makers operate under time pressure, but that should not be an excuse for a proliferation of definitions that may make things more difficult for the user. We are also well aware that a definition has to meet a policy objective, which may differ from similar usages of the term – though from a simplification point of view that should lead to a challenge as to why there has to be a difference.

One obvious suggestion which would assist would be the creation of a database of all definitions in tax legislation. That would be a readily accessible reference point, not only for policy makers and

¹ <https://www.instituteforgovernment.org.uk/publications/better-budgets-making-tax-policy-better>

draftsmen, but also for users of legislation. We do not underestimate the difficulty of creating such a reference tool – and that very difficulty shows how the tax system has become less manageable.

It is tempting to make the creation of a definitions register or database a formal recommendation as it is clear that since we first published this paper the position has only got worse. But given the pressure on resources in HMRC, OPC and indeed Parliament, we cannot say this should be a priority. Instead, we reiterate that **we hope that the principles we outline for simpler definitions will be helpful to HMRC and HMT policy makers and to drafters of tax legislation.**

Accordingly we reissue the paper, now incorporating the feedback received from stakeholders in response to the first edition of the paper.

5. How to avoid complexity in the tax system

This paper, published in June 2015, summarised the lessons we had learnt about tax complexity so far. **It sets out four principles for avoiding complexity**, each with some subsidiary lessons:

1. Ensure the proposed tax measure meets the policy aims
2. Focus the measure carefully
3. Design the measure to meet the aim
4. Maintain the measure properly

Our work over the last 18 months has validated the principles in the paper. The recent paper from the IFS, CIOT and Institute for Government on ‘Better Budgets’² draws out principles that echo the points we make in our paper. We therefore simply reissue the paper with some minor revisions: it remains valid and, in our view, something that should be used as guidance by policymakers.

6. OTS Complexity Index

Our complexity project has a number of strands but the main component has been the development of a complexity index. We published a number of iterations of the index between 2012 and 2015, each refined to reflect comments from interested parties and our own further researches. Subsequent to the 2015 version we received further helpful comments and met with some groups and we have incorporated this further input into the generally updated and extended paper that we now publish. This is supplemented with the ‘scoresheet’ of 110+ parts of the tax system.

The aim of the index has always been to give a relative measure of complexity of areas of the tax system, with a view to helping the OTS prioritise future projects. We were not looking for absolute precision but instead for reasonably based assessment of which areas of the code are more complex than others. The index is best used as a diagnostic tool rather than as a rigorous academic analysis of complexity. It is valuable in identifying what areas of tax are most complex and why, but the measuring factors it uses are indicators (i.e. symptoms) of complexity rather than the direct causes. It is important to remember that it is a relative, not an absolute, measure of complexity.

² *ibid*

Thus we see it as being used in two ways:

- As noted, to prioritise and target efforts to simplify the tax system (i.e. to assess the existing system); but also
- To give policy makers a tool to track the relative complexity of their policy changes (i.e. to monitor changes to the system).

It will be appreciated that the first of these is essentially retrospective: taking stock of the state of play of an area. The second is also retrospective – but we think that the index also has the potential to be used prospectively, to assess the complexity of a proposed measure. This reflects our long-held belief that consideration of complexity/simplification should be built into the development of new policy measures. Perhaps the key is that such consideration should be evidenced – that as we have suggested ‘simplification should be on the TIIN’.

The index produces two figures, based on ten factors which are aggregated and averaged to produce ratings:³

- **The underlying complexity:** a measurement of the structural complexity of a tax measure, based on the policy, legislative and administrative complexity, incorporating six factors
- **The impact of complexity:** a measure of the costs of complexity in the tax system, to both the taxpayer and HMRC, incorporating four factors

The ten factors are a mix of objective and subjective; for the subjective measures we set parameters and guidance to control the ‘scoring’. The factors are:

1. Number of exemptions plus the number of reliefs
2. The number of Finance Acts with changes (since 2000)
3. The Gunning-fog readability index
4. Number of pages of legislation
5. Complexity of HMRC guidance
6. Complexity of information requirement to make a return
7. Number of taxpayers affected
8. Aggregated compliance burden for a taxpayer and HMRC
9. Average ability of taxpayers
10. Revenue at risk due to error, failure to take reasonable care (FTRC) and avoidance

The rationale for choosing these factors (which have evolved as we have developed the index) is discussed in the full paper on the index. We think we have a good balance of the factors that make something complex or simple. The paper also discusses how the factors might be adjusted so that a prospective measure could be assessed.

³ The full paper includes in an annex an illustration, using the index to assess Air Passenger Duty, Inheritance Tax and Landfill tax. The results are:

- Underlying complexity: APD 3.1, IHT 8.1, LfT 3
- Impact of complexity: APD 1.9, IHT 6.9, LfT 1.3

Arguably this is not a fair comparison, in that IHT is a tax with a much greater impact than APD or LfT, but it shows that if the OTS were trying to decide which we should concentrate on, IHT would be the winner.

It has been suggested that the index could be aggregated into a single measure of the complexity of the UK's tax system. This has obvious potential attractions: a rolling measure of complexity would allow an assessment of the impact of each Finance Act. But we have to caution against any assumption that such extension of our work would be easy. We also have to reiterate the aims of the index: primarily to inform the OTS's future work. But extending the index in these directions would undoubtedly be interesting!

7. Avoidance and Complexity

We started some work on avoidance in 2014. This was not aiming to develop a solution to the 'avoidance problem' but rather carrying out a review of current anti-avoidance legislation with a view to identifying any correlation or possible causation between anti-avoidance legislation and complexity. The work focussed on corporation tax, to make the project manageable; the aims included:

- Review where the anti-avoidance legislation is concentrated;
- Analyse whether any specific anti-avoidance legislation can be removed, either because it is no longer relevant, or because it has been made obsolete by changes in the legislation;
- Compile and test hypotheses surrounding any potential links between anti-avoidance legislation and complexity
- Aim to test the popular assumption that complexity in a particular area of tax will inevitably generate avoidance, which in turn generates more complexity ('the leapfrog theory');

We did some initial work, including listing relevant anti-avoidance legislation, but were not able to progress the work properly due to lack of resources and pressures of other work.

Many stakeholders have suggested this is an area the OTS should pursue, often citing the advent of the GAAR as giving the opportunity to review and repeal many specific anti-avoidance provisions. We can see the potential for this simplifying the tax legislation but HMRC would naturally be cautious with any repeals. We would welcome views on the potential for this area as a potential OTS future project.

In conclusion

As we note at the start of this paper, the OTS work in the general area of complexity is ongoing and will continue. We want to look at specific issues but also develop and promulgate tools and techniques that encourage 'good practice'. Please do contribute ideas and comments to this work, which is surely in the interests of all stakeholders in the tax system!

The Office of Tax Simplification

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