Office of
Tax Simplification

Office of Tax Simplification
Room G 41
1 Horse Guards Road
London SW1A 2HQ

OTS Focus paper: layered legislation
A discussion document on improving tax legislation

Introduction

This paper was originally written in 2013 as part of the OTS's continuing work on complexity. That work included developing the OTS Complexity index, which included among the ten factors measuring complexity an assessment of the readability of legislation, its length and the HMRC guidance on the subject. In turn, that prompted us to consider whether the legislation could be 'done differently' and in some meetings we mooted the idea of tiering or layering the legislation. This short paper describes the idea of layered legislation and was intended to prompt debate.

The recent IFS/CIOT/Institute for Government paper on 'Better Budgets'[1] noted the idea of layered legislation and suggested it may be worth experimenting with. Accordingly, we have revised our original paper and are reissuing it – as before, to prompt debate.

The OTS work on complexity has identified a range of factors that contribute to the complexity of tax law, with the actual legislation inevitably being a significant factor. It seems to be widely accepted as a given that tax legislation is always going to be complex. But does it have to be complex[2] – or to put it another way, are there ways of improving it and making its effect less complex[3]?

The UK's Tax Law Rewrite project tried to improve legislation and make it less complex by modernising the language and writing the rules more clearly. That did have an impact and some benefit – but often at the cost of length. Good prior consultation, with the new law being developed over a proper period with input from relevant stakeholders contributes a good deal to rules that are better framed and more logical, or at a minimum has had the uncertainties probed and clarified. This happens much more frequently where the Tax Policy Making framework developed under the previous government is followed.

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

[2] There is an argument that legislation can reasonably be complex where it deals with complex issues; those who deal in complex areas must accept that they will meet complex rules and that they may have to devote resources to dealing with the rules. It may well be that such taxpayers will be in a position to hire expert advice but that will still consume resources and it should not be an excuse for over-complex legislation.

[3] It may be that complex legislation can be fairer, e.g. if it removes unintended side effects. However, that in turn raises the question of whether the target of the fairness measure can actually access it: complex legislation that is so complex that it is obscure is not going to be fair. Overall, there is a trade off between complexity, fairness and certainty.

However, we are still left with lengthy legislation that many users – or potential users – simply find too difficult to get to grips with. This paper suggests that a different approach, 'layered legislation', could be worth exploring or experimenting with.[4]

Using legislation

The idea of layering legislation stems from research work that has gone into finding out who looks at tax legislation, and for what purpose. We probably have three broad categories of user:

1. The generalist (or lay) person – in tax terms, the taxpayer who just wants to understand what they have to do or whether something applies to them.
2. The 'educated user' – this is not educated in the sense of 'A' levels but rather someone who is often an expert in a field, or at least well experienced there, but is not a tax expert. Examples would be a general accountant, a surveyor wanting to know about capital allowances or the businessman who knows all about their business.
3. The tax expert – the lawyer (though not all lawyers will be in this category) or deep tax expert in the relevant area

The three categories of user want different things from the legislation:

1. The lay person (the man or woman on the Clapham omnibus or MOWOTCO) above all wants a simple answer – to know what the issue is all about and to grasp whether it's relevant. Ideally they want an indicator where they might need some help if relevant.
2. The educated user is usually willing to look at legislation and knows that it may take a little effort to understand. They know it's important to make sure they do get the right answer – they know tax law can be tricky so they also appreciate they may need to get some expert help on tricky issues.
3. The expert knows they have to get through and understand all the detail; they have a ready supply of wet towels and know how to use them.[5]

The three types of users probably have different targets:

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[4] One feature of the UK system of tax legislation is that it seeks to define precisely what the law is and how it shall be applied. That typically creates complex and lengthy legislation that tries to legislate for every relevant possibility. (The need for precise rules can be found in many cases, ranging from the 1869 case of Partington v AG and Lord Cairns' comments through to the well-known Duke of Westminster case – for instance Lord Tomlin at 19TC520. Although the approach to interpreting the law has moved on greatly in recent years, these principles of writing the law precisely are still hugely influential.) As is well known, other jurisdictions (for example some European countries that base their law on a civil code) use a 'principles based' approach to their tax law. That is usually much shorter but is inevitably less precise. In some of our reports, the OTS has noted this style as something that would be worth testing but we do not pursue the idea further here.

[5] The general tax adviser being asked about a specialist area might fall into category 2 and might normally stop at level 2 – but given their profession, they would be expected to know they have to go to level 3, either by themselves or by getting get expert advice.

1. The lay person – wants to get their tax return or claim completed and submitted and/or wants to know whether they are taxable on, or can claim a deduction for, something. They should appreciate that they may need to seek advice/assistance if they feel unsure.
2. The educated user – knows that they have responsibilities and wants to get it right. Prepared to put some effort in (or realises that they have to). They may be planning business actions and wants to make sure they have checked the consequences of the actions.
3. The expert – is researching for a reason: like all other users, they want to get it right but probably what has caused them to do this work is that a problem/issue has been identified and they need to delve deeply into it. They may be commissioned by the type 2 user who knows that they are contemplating a major action and they need to get it absolutely right.

It is an interesting question whether each of these types of user has to get their tax affairs 100% right. In principle the answer has to be 'yes' but is that practical for the lay user? However, whatever the answer to that question, at the moment these three categories of user are faced with the same legislation. We have a 'one size fits all' approach[6].

Layered legislation

The lay (category 1) person is most unlikely to use the actual legislation, even after it has been rewritten into plain(er) English. They would normally use guidance, including the notes or forms that HMRC make available. But if the legislation was written in an accessible form, would they be more likely to use it? Or, to put it another way, would there be a need for guidance for such users if the basic legislation was simple…why wouldn't the basic legislation and the guidance be the same?

So why not write the legislation to suit the three types of user? In other words, set out the legislation in stages:

1. A preamble, which states what it is all about and gives the main principles, never more than a page in length and written in 'everyday' English
2. The main body of the rules to give the way it works
3. The full, further details as needed (potentially including secondary legislation)

The key split is between 1 and 2; in many cases – where the rules are short – there may be no need to split 2 and 3.

The 'trick' in this approach is that each part stands alone as a valid statement of the law. This is governed by two key principles:

- Firstly, the principle is that if a user simply reads part 1 and follows what it says, they have done all they need and so have fulfilled their obligations, qualify for the relief or whatever.
- However, that first principle is subject to the second principle, which is that it must be reasonable for the user to stop at the level if they did.

That means:

[6] It would be possible to draw a matrix with people of low or high understanding, and with low or high tax at stake. The people of most concern would be those with high tax at stake and low understanding – but those people should be probably be using an agent, or pointed towards one.

- The MOWOTCO with no adviser can use stage 1 only....
- ...but the professional person should realise that they need to go to stage 2, even if they are not a tax professional, if it is a matter of significance;
- The small business owner who is doing their own tax should be able to get by with stage 1...
- ...but not if we are talking about a major investment, or if the business uses the services of a tax adviser as they will go to at least stage 2;
- The big business would have to go to stage 2 either themselves or through their adviser....
- ...but should not need stage 3 detail except in cases of dispute or where it is clear the facts make the conclusion form a reading of stage 2 unclear.

All of the above would be facilitated by the legislation at stage 1 or stage 2 making it clear that there is an issue or term within the rules that may be developed or defined further. For example:

- Stage 1 would use a term (e.g. person) in everyday use and expect it to be understood and used normally;
- Stage 2 would define the term is necessary (e.g. person here includes company but not a partnership);
- Stage 3 could then deal with and detailed points such as when changes or revised definitions apply.
- Stage 2 would include the main rules on when a claim has to be made;
- Stage 3 would set out the details of what happens on a late claim.

What does this look like – and where does HMRC guidance fit in?

The annex to this paper contains two examples which are intended very much as illustrative and intended to promote debate.

If it were appropriate to represent the new approach pictorially, the layered approach could be represented as a pyramid, with three levels:

- Preamble – the tip
- Main rules – the middle section
- The further details/schedules – the base

How does this contrast with the current system? In some ways we already have a staged or layered approach but the effect is rather different – the analogy may be with the layers of the onion that have to be peeled away or the nut where much effort has to go into cracking the shell to reach the kernel. Only when the kernel is reached does the overall message become clear (or not!). In addition, the various relevant bits and pieces are often not all in one place (particularly secondary legislation).

HMRC guidance

Layering the legislation would raise questions over the place of HMRC guidance. Although treated as law by many – or at least the last word – it isn't the law of course. But it is often very helpful to users in getting to an answer:

- either as an initial guide to what it is all about;

- or helping them understand the detail;
- or setting out how something really operates in practice.

Guidance is in many cases extensive – it is one of the factors that the OTS uses in assessing the complexity of an area of the tax system. Although much valued, its use can be controversial: it should not be a substitute for clear law and should not mean that the taxpayer is 'taxed by law and untaxed by concession'[7], or that unworkable law is made to work by guidance.

If layered legislation works, it should obviate the need for guidance that fills the first role: the stage 1 legislation should suffice. Understanding the detail might be part of stage 3; examples on how it really operates will always be useful and perhaps would remain as guidance.

If guidance continued under a system of layered legislation, there would need to be a principle developed on when users should access it. Should they first trawl through all the legislation before going to the guidance? Or can they bypass legislation and go straight to guidance? Currently, both scenarios happen...is that satisfactory? Would it be better if those simply seeking basic guidance found it straightaway and had confidence that they had got to a fair answer…which takes us back to stage 1 layered legislation?

Operating the layered law

It is worth reiterating the two principles set out earlier:

- If a user simply reads part 1 and follows what it says, they have done all they need and so have fulfilled their obligations, qualify for the relief or whatever; subject to
- That it must be reasonable for the user to stop at the level if they did.

It's easy to say that the layers should mesh together smoothly and that there should be no clashes between the various levels. In particular, that it should be possible summarise rules in a way that does not mean that the summary is inadequate or invalid[8]. The summary would need to flag up key terms so that anyone trying to claim the relief (or whatever) is put on warning if they do not have a simple situation.

Any tensions (or clashes) are most likely in terms of the 1-page preamble. In the great majority of cases it will have some generalities that then get developed in detail in stage 2 (and 3 where needed). Someone just going by that one page summary may (for example) claim (or miss) a relief that the full rules preclude (or allow). How is that to be managed in practice?

Consider some scenarios:

- The claim is invalid; do HMRC challenge?

[7] See the judgement of Walton J in Vestey v CIR (1980 STC 10) '…one should be taxed by law, and not be untaxed by concession', a dictum regularly used by bodies such as the CIOT.

[8] It seems likely that almost by definition the summary will not be able to cover special cases, so it will be invalid for a proportion of people. The question is whether we are worried about that and whether sufficient flags can be put into the summary to help users realise when they need to go into more depth.

- ....yes, if they see it is invalid, but they have regard to what it is and why it is invalid.[9]
- The claim is missed; do HMRC have a duty to point out?
- ....yes, if they see it is obviously missed but as it is up to the taxpayer to claim based on stage 1 legislation, HMRC would not be expected to examine a return to check for appropriate claims.
- Does the taxpayer have any exposure to penalties for errors?
- ...not if they looked at what they should have done and complied.
- Can HMRC use fine print to overturn a claim by the taxpayer who just looked at the preamble?
- ...not if that was all the taxpayer should have looked at under the second principle.
- What if the taxpayer is alerted later to a claim they could have made?
- ....then, as now, they have an ability to make the claim within set time limits.

The crux is clearly what the taxpayer should look at. As outlined above, it would be acceptable for a MOWOTCO just to look at the preamble/stage 1, but for a large/significant item they should look further, including taking advice. And they have no exposure to penalties provided that was a reasonable course of action. Meanwhile, another MOWOTCO may miss something that they might have claimed had they had ploughed through the legislation in detail...but is that any different to now? This style of legislation does not in any way preclude a taxpayer – MOWOTCO or business – taking advice from a specialist tax adviser (who by definition would have to probe the legislation into stages 2 and 3).

It is clearly possible that adopting this style of legislation might lead to more arguments about what is 'reasonable', but there is already plenty of case law on reasonable/reasonable excuse[10]. There could also be an issue about preventing abuse – though that is hardly a new issue.

Conclusion

This paper has briefly set out a possible way that tax legislation could develop in a way that would mean it was simpler for users. It has drawn on the experiences of the OTS in gathering evidence for our projects. As is the style of our Focus papers, we make no formal recommendation beyond arguing that that this is a route that is worth further discussion. We hope it attracts further comments and would welcome observations to ots@ots.gsi.gov.uk.

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[9] If this is a MOWOTCO who has made a claim based on Stage 1 legislation without appreciating that one of the key terms is defined at length in Stages 2 & 3 in a way that excludes their specific, unusual situation, then the claim should be accepted. The MOWOTCO has complied with their responsibilities. However, that would be subject to HMRC showing that it was not reasonable for this particular MOWOTCO to stop at stage 1. In other words HMRC have to accept invalid claims if made in good faith: that is the point of having a simpler tier 1. It is in effect an inbuilt 'reasonable excuse' test and in many ways not much different from current practice.

[10] There is some academic research on how people make choices and if they are offered too many choices they are more likely to get confused and make bad choices.

Annex

This annex contains two examples of how a preamble or Stage 1 of legislation might be constructed. They are illustrative and not intended to set out the precise R&D or tax-free childcare rules. Readers should bear in mind the target of a 1-page, easy to follow summary.

Preamble: Research and Development tax relief

Businesses are able to claim an extra deduction from in calculating trading profits if they undertake research and development (R&D). This is known as **Research and Development tax relief.** The relief is available for each accounting period for which the business makes tax returns. The relief is only available to businesses carried on by companies, not partnerships or sole traders.

The relief is calculated as a proportion of the amount the business spends on R&D. But **R&D is defined** for these purposes, so what the business classes as R&D may not match what the claim can be made for. As a first stage, the relief is given only for R&D that is researching products and services – so simply improving something that is already on the market is unlikely to qualify. Then it must be products or services that are going to be sold – not necessarily on their own but they must be something that has sale potential.

Assuming the business is spending on that sort of R&D, the relief is available for **spending on**:

- **Costs of materials** used in the R&D
- **Salaries of researchers**
- **Overheads** for the R&D department
- Creating a new product to replace an existing one that is markedly different

It's not available on:

- Building costs
- Equipment costs (but these may well get capital allowances)
- Development spending (i.e. improving an existing product)
- Marketing costs

The key is that the relief is available for something new and it covers the costs of devising that new product and getting it to a state ready to sell.

Having worked out the costs that are eligible, the business scan claim:

- An extra 30% (so £130 for each £100 spent) against trading income if it is a large business
- An extra 125% (so £225 for each £100 spent) against trading income if it is a small or medium sized business (SME)

Here, an SME that has turnover not exceeding €100m and/or a balance sheet total not exceeding €86m and fewer than 500 employees. These figures apply not just to the SME itself but to the total of the SME and all companies that are part of the same group.

However, note that the way that R&D tax relief is given is changing. The way of giving relief changes from 1 April 2015 (though the new method can be used earlier). This new system will allow a company that doesn't have a corporation tax liability because of losses to be paid an R&D credit – so if a loss maker can now benefit from the relief.

Preamble: Tax-free childcare

This is a system under which HMRC will make payments towards the costs of childcare. These payments can be as much as a quarter of the cost of the childcare, so the system under which HMRC gives out the money does have a number of rules which have to be followed.

The 'top up payments' will be made into a **childcare account** which must be set up with the organisation that will be running the system with HMRC. That organisation is NS&I. A childcare account can only apply to one **child,** but you can have an account for each of your children.

The top up payments will be made every three months, known as an '**entitlement period'**. If you pass the various conditions for an entitlement period, and don't trip over any of the failure conditions, HMRC will make the top up payment. This will by the 14th of the month after the three month period ends, normally of an amount equal to 25% of the amount you've put into the account.

You can pay into each childcare account as and when you like, up to a maximum of £2,000 for each entitlement period.

To be eligible for the top up payments, you must:

- Be over 16, with a child under 16
- **Be in the UK**
- Have **responsibility** for a child
- The child must **normally live with you**
- You and your **partner** (if you have one) must be **in work**
- Between you, you must be working for **30 hours a week or more**

You can't get the top up if you fail any of these conditions:

- Your income, together with that of your partner, **for the year is over £50,000**
- You and you partner are **claiming universal credit**
- You or your partner are getting **childcare provided at your work**
- You or your partner are getting **support for childcare costs** from other sources.

The only payments that can be made from a childcare account are for **qualifying childcare**. That means childcare at a **registered or approved childcare provider** so that you and your partner (if you have a partner) to work.

There are rules that mean HMRC **can recover top up payments** where the account has been operated wrongly and there can be **penalties** for some wrongdoings relating to wrongly operating the accounts.

Please note that the words in bold are defined in more detail in the legislation. The aim of this preamble is to enable readers to decide whether this system is relevant to them. If you think it is, go to …. to complete an application form on line or see … for fuller details.