

# **TAX**

# **SIMPLIFICATION**

An African Perspective

Chris Evans  
Riël Franzsen  
Elizabeth (Lilla) Stack

Pretoria University Law Press  

---

PULP

---

2019

*Tax simplification: An African perspective*

**Published by:**

**Pretoria University Law Press (PULP)**

The Pretoria University Law Press (PULP) is a publisher at the Faculty of Law, University of Pretoria, South Africa. PULP endeavours to publish and make available innovative, high-quality scholarly texts on law in Africa. PULP also publishes a series of collections of legal documents related to public law in Africa, as well as text books from African countries other than South Africa. This book was peer reviewed prior to publication.

For more information on PULP, see [www.pulp.up.ac.za](http://www.pulp.up.ac.za)

**Printed and bound by:**

Pinetown Printers, 16 Ivy Road, Pinetown  
Tel: +27 31 701 8019

**To order, contact:**

PULP  
Faculty of Law  
University of Pretoria  
South Africa  
0002  
Tel: +27 12 420 4948  
Fax: +27 86 610 6668  
[pulp@up.ac.za](mailto:pulp@up.ac.za)  
[www.pulp.up.ac.za](http://www.pulp.up.ac.za)

**Cover:**

Marguerite Hartzenberg, Active Space Designs

ISBN: 978-1-920538-96-5

© 2019

# TABLE OF CONTENTS

	<b>Preface</b>	v
	<b>Foreword – Tax Simplification in the United Kingdom: Some Personal Reflections</b>	vii
	<i>John Whiting</i>	
	<b>Contributors</b>	xxi
<b>1</b>	<b>Introduction</b>	1
	<i>Elizabeth (Lilla) Stack, Chris Evans and Riël Franzsen</i>	
<b>2</b>	<b>Tax Complexity and Tax Simplification: A Critical Review of Concepts and Issues</b>	8
	<i>Binh Tran-Nam, Annet Wanyana Oguttu and Kyle Mandy</i>	
<b>3</b>	<b>The Taxpayers’ Right to Tax Simplicity in South Africa and the United States</b>	39
	<i>Carika Fritz and Nina E Olson</i>	
<b>4</b>	<b>The Role of the Office of Tax Simplification in the United Kingdom and Lessons for Other Countries</b>	61
	<i>Yige Zu and Lynne Oats</i>	
<b>5</b>	<b>An Analysis of the Tax Simplification Initiatives for Pension Provision in the United Kingdom and South Africa</b>	76
	<i>Bernadene de Clercq, Andy Lymer and Chris Axelson</i>	
<b>6</b>	<b>Simplification Lessons from New Zealand</b>	123
	<i>Adrian Sawyer, Marina Bornman and Greg Smith</i>	
<b>7</b>	<b>Legal Uncertainty in the South African VAT</b>	160
	<i>Marius van Oordt and Richard Kreyer</i>	
<b>8</b>	<b>Simplifying Recurrent Property Taxes in Africa</b>	178
	<i>Riël Franzsen, Abdallah Ali-Nakyea and Adams Tommy</i>	
<b>9</b>	<b>Statutory and Effective Complexity for Individual Taxpayers in South Africa</b>	204
	<i>Sharon Smulders, Karen Stark and Deborah Tickle</i>	
<b>10</b>	<b>Small and Micro Businesses: Case Studies on the Complexity of ‘Simplified’ Schemes</b>	237
	<i>Heinrich Dixon, Judith Freedman and Wollela Abehodie Yesegat</i>	

<b>11</b>	<b>Tax Complexity for Multinational Corporations in South Africa – Evidence from a Global Survey</b>	<b>267</b>
	<i>Thomas Hoppe, Reyhaneh Safaei, Amanda Singleton and Caren Sureth-Sloane</i>	
<b>12</b>	<b>International Tax Simplification in South Africa through Managing Substantive Complexity and Improving Drafting Efficiency</b>	<b>294</b>
	<i>Jinyan Li and Teresa Pidduck</i>	
	<b>Bibliography</b>	<b>316</b>
	<b>Index</b>	<b>343</b>

# PREFACE

The chapters in this book all derive from a two-day symposium – *Tax Simplification: An African Perspective* – held in Sandton, Johannesburg, South Africa on 9-11 October 2018. The symposium was convened by tax academics from the University of Pretoria, the University of South Africa (UNISA), the University of Johannesburg and the University of New South Wales (UNSW Sydney), together with tax colleagues from the South African Institute of Chartered Accountants (SAICA), which was also the principal funding body for the symposium. Roughly 50 national and international participants, drawn from academia and all aspects of the tax profession, attended the symposium, which involved presentation and discussion of 16 papers together with more extensive panel discussion sessions. The papers were subsequently revised by their presenters, re-submitted as possible chapters for this book and subjected to a rigorous double-blind peer review process involving a panel of distinguished national and international referees, resulting in the 12 chapters in the book.

The purpose of the symposium was to consider all aspects of tax simplification – and its antonym, tax complexity – in an African (and primarily South African) context. Four key themes were explored in the papers: key principles, concepts, expectations and elements of simplicity and simplification in the tax context; the consequences of tax complexity; a comparative analysis of African and other country experiences with tax simplification; and an analysis of what might be done to address tax system complexity. Those themes are now also reflected in the chapters in this book.

The symposium would not have happened without the support of a number of persons and institutions. Particular thanks are due to colleagues (administrative and academic) in the African Tax Institute and in the Department of Taxation at the University of Pretoria; to academic colleagues from UNISA, the University of Johannesburg and UNSW Sydney; to PWC South Africa for their sponsorship of the symposium dinner; and to the many speakers and other participants who contributed so vibrantly to the debate and discussions at the symposium. Above all, thanks are due to Pieter Faber and his colleagues at SAICA who made the event possible with financial, logistical, administrative and intellectual support.

I would also like to acknowledge all those who have made this book possible: the chapter authors who have so diligently revised their chapters in the light of participant discussion at the symposium and subsequently the comments received from the referees and others; those referees for their painstaking and insightful reviews of the potential chapters of the book; my co-editors, Professors Lilla Stack and Riël Franzsen, for their tireless editorial and reviewing work; Lizette Hermann and her team at Pretoria University Law Press (PULP) for making the publishing process so straightforward and (relatively) painless; and above all Dr Peter Mellor from Monash University who spent countless hours as publication editor and ‘scrutineer extraordinary’, pulling all the chapters into shape and

ensuring they are fully compliant with the PULP style guide, and also imposing consistency, coherence and grammatical sense where (often) required. Needless to say, any faults that remain in the book do not lie with him.

The need has become pressing to simplify all aspects of taxation and this imperative is recognised by taxation authorities throughout the Western world. This book makes a unique contribution by opening the discussion and debate on various aspects of tax simplification.

**Chris Evans**

UNSW Sydney and University of Pretoria

November 2019

# FOREWORD

## Tax Simplification in the United Kingdom: Some Personal Reflections

John Whiting\*

Some personal reflections on tax simplification in the United Kingdom (UK), based primarily on the author's six and a half years as the first Tax Director of the UK's Office of Tax Simplification.

This foreword will draw on my time and experiences with the Office of Tax Simplification (OTS). It will not be a discussion of what the OTS has or has not done; instead this will be a discussion of some of the lessons I and potentially the OTS more widely learned from efforts to simplify the UK's tax system – lessons that caused the OTS to adapt its way of working; lessons as to what could or could not be done; lessons perhaps for HM Treasury, Her Majesty's Revenue & Customs (HMRC) and indeed government as a whole on why this is worth pursuing.<sup>1</sup>

My background is as a long-time tax practitioner, with 25 years as a partner at PricewaterhouseCoopers. During that time, I was always involved in the Chartered Institute of Taxation (CIOT) and was fortunate enough to be its President in 2001. One of my themes for my Presidency was the need to simplify the tax system and it is an issue that I have always championed. The Coalition government formed in 2010 had tax simplification as a point within its coalition agreement and I had a call from the newly-appointed Minister<sup>2</sup> to say – in effect – that I had been 'droning on' about tax simplification for ages, so why did I not do something about it? He and the then Chancellor of the Exchequer<sup>3</sup> asked me to set up a new body – the Office of Tax Simplification.

I hope I will be able to set the scene for the chapters that follow in this volume by trying to answer questions that may spring to anyone's mind when thinking about tax simplification:

- Why simplify?
- How (not) to do it?
- What are we tackling?
- Who best to do it?
- When to do it?

\* This foreword has been developed from the Keynote speech given by the author on 10 October 2018 at the *Tax Simplification: An African Perspective* conference, Johannesburg.

1 I accept that some may see a degree of contradiction in taking lessons in simplification from a country that starts its tax year on 6 April ... and yes, the OTS has recommended that that be changed, so far without success.

2 David Gauke MP, then Exchequer Secretary to the Treasury, now the Rt Hon David Gauke MP, until July 2019 Secretary of State for Justice and Lord Chancellor.

3 Rt Hon George Osborne MP.

- What are the barriers to simplification?
- Is it worth it?

## The Office of Tax Simplification: an outline

The OTS was set up in effect informally, not on a statutory basis. It was grounded in the coalition agreement between the Conservative and Liberal Democrat parties. It was to be independent but sponsored by HM Treasury and indeed housed in the Treasury building.<sup>4</sup> If that sounds a little non-independent, there was definite Ministerial support and access to the Minister. But from the outset it was clear that the OTS had to demonstrate its independence.

Unsurprisingly the OTS was a small operation, with under six full-time equivalent staff. I was initially one day per week (but it was a long day ...). Importantly, from the outset it was to have a mix of civil servants and practitioners and that proved a vital decision.

What was the OTS to do? Essentially, study areas of the tax system and report, each project taking up to one year. The areas had to be agreed in advance with Ministers which, in reality, also meant that HM Treasury and HMRC were happy with the projects as they would be advising Ministers.<sup>5</sup> It was expected that the OTS would come up with a range of recommendations, both short and long term, but avoid policy issues and formulate the recommendations on a revenue-neutral basis.

## Why simplify?

Simplification is not a new issue, as King Edward VI commented in 1550:

I wish that the superfluous and tedious statutes were brought into one sum together, and made more plain and short.<sup>6</sup>

Edward died young ... hopefully not as a result of his championing of simplification.

Another, slightly later, impetus to simplify comes from Adam Smith (emphasis added):

4 HM Treasury is housed in one section of the building known as 'GOGGS' – built as 'Government Offices Great George Street' in Westminster, London, close to the Houses of Parliament. HMRC occupies much of the rest of the building. So, the OTS's location in the building facilitated working with HM Treasury and HMRC and was undoubtedly practical – the OTS was never going to be large enough to warrant its own premises.

5 Examples of OTS projects include tax reliefs; small business; share schemes; pensioners; and penalties. All reports can be found on the OTS website: <https://www.gov.uk/government/organisations/office-of-tax-simplification>.

6 As quoted in, for example, Report by the Committee appointed by the Lord President of the Council (Rt Hon Sir (later Lord) David Renton, chair) (Renton Committee) *The preparation of legislation* Cmnd 6033 (London, May 1975) para 2.8.

Little else is required to carry a State to the highest degree of opulence from the lowest degree of barbarism but peace, *easy taxes* and a tolerable administration of justice.<sup>7</sup>

But why should we try to simplify the tax system? That may seem a non-question: to most people it will be an obvious aim. But it is worth setting out some reasons to help guide how the job is tackled. I would suggest key reasons are aiming to ensure that:

- The system is easier to deal with and so allow all parties to meet obligations;
- The system is easier to understand (not quite the same thing as the first point);
- Less time and effort is wasted doing so;
- Fewer errors are made.

These are of course for all involved – taxpayers, agents and HMRC. Including the tax authority is important: simplification has to work for them. With the pressures HMRC is under there is an obvious attraction in a simpler-to-run system.

I would add that a simpler system:

- Increases confidence among taxpayers (that they will be compliant);
- Increases trust in the system (understanding increases trust).

These have a corollary: the more complex a system gets, the more time that is wasted, more errors made, and less trust people have in the system. It is worth debating whether the average taxpayer really has confidence that they are paying the right amount of tax.

There is clear resonance here with Adam Smith's four key principles of (to summarise): Certainty/Convenience/Efficiency/Equity.<sup>8</sup> He did not actually say 'simple', but I think it is implicit in his principles.

All these reasons helped a Tax Commission set up by the Conservative party (then in opposition) in 2008 to conclude that 'something has to be done' – and that something was an OTS.<sup>9</sup> A key issue was growing concern about the administrative burdens tax put on businesses, especially small businesses. The report also drew attention to the UK having the longest tax code in the world<sup>10</sup> – that remains a potent image, but length

7 Lecture in 1755, quoted in Dugald Stewart, *Account of the life and writings of Adam Smith LLD* (1794), Section IV, 25.

8 Adam Smith *An inquiry into the nature and causes of the wealth of nations* (1776), Book V, Ch II, Pt II, 825, paras 3-5.

9 UK Government *Making taxes simpler: The final report of a Working Party chaired by Lord Howe of Aberavon* (July 2008) (Howe report), available at: [https://conservativehome.blogs.com/torydiary/files/making\\_taxes\\_simpler.pdf](https://conservativehome.blogs.com/torydiary/files/making_taxes_simpler.pdf).

10 'UK has longest tax code in the world' – release by LexisNexis, reported by Jonathan Russell, 'UK has longest tax code handbook in the world' *Daily Telegraph* (6 September 2009), <https://www.telegraph.co.uk/finance/newsbysector/banksandfinance/6146911/UK-has-longest-tax-code-handbook-in-the-world.html> (accessed 16 April 2019).

of legislation is only one of the factors around complexity, not the be all and end all of it.<sup>11</sup>

It is worth saying at this point that Lord Geoffrey Howe, who chaired the Commission, coined what is perhaps the best description of the tax simplification job – ‘it’s like painting Brighton pier ... whilst someone else is extending the pier to France’.

## A simple approach

It would of course be very easy to simplify the tax system if one had complete *carte blanche*. Scrap income tax ... or simply leave tax bills to the discretion of the tax authority. These do address those simplification drivers set out above. However, they have some obvious drawbacks and are potentially well away from Adam Smith’s principles. In short, simplification still has to be fair and workable.

## What are we tackling: what is complexity?

It is therefore necessary to dig deeper and define better what we are tackling. Instead of just looking at simplification, we need to look at complexity – what is that? Yes, it is the opposite of simplicity, but defining it will help the approach to be taken in simplifying.

It is apposite to draw on the OTS’s complexity index at this point. The index is something the OTS developed to help compare areas of the tax code and so guide its work to areas that offered the best ‘payback’. The index was developed over a period and went through some iterations, arriving at ten factors:

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 and avoidance.

There are reasons why the OTS settled on these (and not other factors), not least to get a balanced picture. The main point is that the index tries to

11 Indeed, there is an argument that a longer tax code could be simpler – if the length means that the provisions are spelt out more carefully and clearly.

assess complexity in terms of its impact – so where would the OTS get most ‘bangs for its simplifying buck’.<sup>12</sup>

But if those were ten factors, the OTS also wanted to try to assess the greatest causes of complexity. In one of the OTS’s early projects, talking to businesses produced a resounding vote for the main cause being *change*.<sup>13</sup> In other words, the more the tax system changes, the more complex it gets. Why? Well, people just lose track of things; they do not have time to assimilate the rules. Over the years I tested this on many audiences and always found it readily endorsed as a key factor.

But two other things came through over the years as also very significant causes of complexity. First, *fairness*: that may seem odd – surely making the system fairer will make it easier to deal with? Well, yes, it can do if it means, for example, leaving the low-paid out of the income tax system. But trying to introduce ‘tweaks’ to make a tax fairer can add complexity: exemptions and reliefs need to be carefully defined to make sure they are targeted – and that will add complexity.

A second, and less obvious, factor is *choice*. This can often follow from attempts to make the system fairer. Taxpayers are given the ability to elect for something – a relief, exemption or alternative treatment. Politicians like choice – it often seems like empowerment. The problem is that the taxpayer must be informed to make a choice. Without the necessary knowledge the relief or whatever will not be taken up.<sup>14</sup>

I have regularly argued that it is simpler if the taxpayer is told what to do or what is best. The OTS regularly recommended a ‘default basis’ – that a particular treatment should apply, subject to the taxpayer opting away from it if they concluded a different (potentially more involved) route would be beneficial.<sup>15</sup>

So, one principle that needs to be borne in mind by anyone trying to develop a simpler system is, I would argue: ‘choice brings complexity’.

12 The full index and methodology can be found at Office of Tax Simplification ‘Complexity index’ (June 2015), <https://www.gov.uk/government/publications/office-of-tax-simplification-complexity-index>.

13 See Office of Tax Simplification ‘Small business tax review’ (28 February 2012), <https://www.gov.uk/government/publications/small-business-tax-review>.

14 The taxpayer with an agent will of course find that the well-qualified agent will ensure that all appropriate claims, reliefs and exemptions are taken but it is clear from comments from HMRC that areas where taxpayers do not claim reliefs, often through ignorance, prove fertile ground for so-called ‘high volume repayment agents’ – see, for example, HMRC, Compliance manual (last updated 4 September 2018), <https://www.gov.uk/hmrc-internal-manuals/compliance-handbook/ch820000>.

15 Examples would be recommendations for flat rate expenses: Office of Tax Simplification ‘Review of employee benefits and expenses: Second report’ (29 January 2014), <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report>, and the cash basis for the smallest businesses: Office of Tax Simplification ‘Small business tax review’ (28 February 2012), <https://www.gov.uk/government/publications/small-business-tax-review>.

## How to do simplification: first principles

How, then, to progress matters? The obvious route is what might be termed *technical simplification*: changing – or deleting – rules. I think the Howe report vision was for the OTS to concentrate on technical simplification: simpler rules, fewer pages of legislation.

But there is a second approach: *administrative simplification*. By this I mean making the system easier to deal with, through better forms and procedures, and generally streamlined systems.

It is always interesting to ask an audience which they see as more important. The usual view, with which I concur, is that both are important and need to be taken forward – but administrative simplification is perhaps more important. It is possible to make a complex system easy to deal with if the interface is easy – so good administration can mask complexity, at least to some extent.<sup>16</sup> More subtly, the tax authority can normally effect administrative simplification without having to wait for legislative change.

Another important principle has to be that simplification must work for all parties – taxpayers, agents and HMRC. It would be possible to simplify something from an HMRC viewpoint, but the result would be more complexity for taxpayers (or vice versa). That would not really be simplification. Simplifying something for one party would be valid if there is no additional burden on others, but it will be much more powerful if it helps all.

I was often asked what I saw as the goal of the OTS – how would the OTS know if it had really succeeded? My best suggestion: taxpayers should understand what is required and how to comply. Maybe that should be the aim of the tax system generally? It may be worth noting that the tax system does not have an aim/objective – wouldn't it be helpful if it did have some principles that would guide its development?<sup>17</sup>

## Working methods to achieve simplification

So far, I have tried to set out what is to be tackled: what might be termed the strategic approach. Moving to the tactical – how should the work of simplification be carried out? These are core principles that were confirmed or developed through a mix of design and experience as described in each case:

- *Use the right people*: the mix of staff, public and private, really helped the work identify with all sides and was crucial. The OTS built trust because it could speak all languages! It would not have worked to have just private sector people – there would not be an entrée to HMRC/HM Treasury in

16 Anyone who doubts this is invited to consider their mobile phone ... Does the user actually understand how it works inside the casing? But despite this can they use it?

17 Scotland follows the Adam Smith principles in developing their tax system – see Revenue Scotland 'Scottish approach to tax', <https://www.revenue.scot/about-us/scottish-approach-tax>. Yes, I know they are only small but if they can do it.

the same way; and solely public sector staff would not get businesses/agents to open up and engage fully. The OTS used people who knew what they were talking about, for example partnerships experts to lead the partnerships project. But people must want to work for the OTS – thankfully they do, as OTS does not pay much!<sup>18</sup>

- *Wide evidence gathering*: this was making a virtue out of necessity in many ways. The OTS did not have enough people to do all the work and so had to get out and about and gather ideas, evidence and input generally. From the start, the OTS was keen to show it was not a think tank but a group of practical people. It became a point of principle to get around a genuinely representative sample of businesses (certainly not just agents) and areas of the country. The OTS talked to the ‘usual suspects’ – the main professional and trade bodies – but also made very sure to talk to a lot of unusual ones as well.
- *Practical, evidence based*: the OTS wanted to develop recommendations that were going to work in practice and rest on evidence that they will indeed do so. Input was accepted from anyone and everyone – my boast was that nobody could say ‘the OTS wouldn’t talk to me’. Indeed, some people who did say that were bemused to find themselves contacted, invited to host a meeting or even invited onto a consultative committee.
- *Work for all*: this needs reiterating. It is not necessarily that all will benefit from everything that is recommended but there is a need to have thought of all. It will be difficult to bring in something that will help one area but damage others, unless there are balancing changes. Importantly, things should work for HMRC as well as taxpayers. Ideally changes would not just affect one business sector though I do not see that as a definitive rule.
- *Costings*: there two aspects – first, any recommendation must be ‘worth it’ – so needs to be worth effecting, given that change is the greatest cause of complexity. Secondly and perhaps more obviously are the revenue implications. Here, an early lesson was that trying to get a revenue neutral package was too restricting. Instead we had to have regard to revenue implications, on all sides. Not full, precise costings – that would be premature – but enough to show that the ideas made sense.

## Improving the OTS

Any new organisation will make mistakes or find it can improve and the OTS is no exception. These are some of the lessons learned, often stemming from that overriding need to build practical ideas that will work:

- The whole basis of the OTS was important and a major change was to get the Office put on a formal, statutory basis. That was not easy but was key to stressing its independence and obtaining a greater element of authority for the work.
- The statutory basis also gave the OTS power to choose its own projects – it was not restricted to things agreed in advance with Ministers. That is not a power to use unthinkingly: trying to do something that HMRC, HM

18 When it was set up, there was a belief from government that the private sector would readily second people into it at no cost. The OTS was fortunate in gaining secondees from a number of firms but predictably they were only ever a proportion of the staff required and the OTS quickly learned that it had to recruit – and pay – its own staff. Most were recruited for particular projects, almost all on a part-time basis.

Treasury and Ministers had no interest in would probably not get far when it came to implementation. But it allows some more ‘think pieces’.

- Note also that the OTS now has to produce an Annual Report, allowing some reflection on what it has done and how its ideas have been progressed.
- Short- and long-term ideas: the OTS always tried to do both; some ‘quick wins’ that would deliver value quickly (and so show progress, not least to our stakeholders and contributors), but also some structural ideas that could deliver bigger wins. Just doing one or the other would not work.
- Put forward answers where appropriate: if there is a definite way forward, make clear recommendations. But if something requires more exploration, say so, ideally with the direction further work and potential reform should take.
- Policy changes: to start with, the OTS was told it could not ‘do policy’. But that is an impractical restriction. Simplification needs to be able to challenge and potentially change the significant parts of the system, not just accept things as they are and do minor tweaks to procedures. Clearly policy decisions are for Ministers, but to make progress there must be a challenge to how it all works.
- Expose the issues: this is a development and something that has increased in importance. In many ways it is how to achieve big change: accept that there is a preliminary stage of exposing the issues and promoting debate. Subtly, it has been realised that it can be very useful if the OTS looks at something that is controversial and floats some ideas. That avoids it appearing as if the government is committed to changing the rules or changing them in a particular direction.<sup>19</sup>

## Who does the simplification work?

This may seem a non-question: surely the answer is going to be the OTS or an equivalent organisation? That is indeed my view – but the OTS is the focal point, not the only point. There are some further important principles here that emerged:

- An OTS cannot change the law, or practice: certainly, in the UK, changing the tax system must be a parliamentary matter. It is not something that is going to be devolved to an independent group.
- For all the work an OTS does, it cannot do everything or bottom out all the nuances. It needs to do enough to show that the proposed change is sensible and workable, but government will inevitably want to test any significant change further to ensure that all views have been considered.<sup>20</sup>

19 A recent example: the UK has a very high registration threshold for VAT – over GBP 85,000 before a business has to come into the VAT net. The OTS looked at it, showed how it distorts business and affects competition, and thus showed why a different level might be sensible. That has prompted a good deal of constructive debate and the registration threshold has in the meantime been frozen. See Office of Tax Simplification ‘OTS report on routes to simplification for VAT is published’ (7 November 2017), <https://www.gov.uk/government/publications/ots-report-on-routes-to-simplification-for-vat-is-published>.

20 A corollary is that it would be wrong for the OTS to try and bottom out comprehensively most potential changes, simply because it would be a waste of effort if Ministers decide not to pursue the matter. The trick is to make a persuasive case for change and its direction.

- One regular issue is the cost/revenue question: how much was a change going to cost? The OTS did not have the economic capability to develop fully detailed costings so this was always an area for indicative work with details to follow once the direction of reform was agreed.

Points such as these mean all the following parties need to be involved in simplification work:

- HMRC – the tax authority must support and be involved: they know most about how things operate and often why things are as they are.
- HM Treasury – the Treasury guard policy and are the main advisers to Ministers. So, they can effectively block something by advising against it if not properly involved.
- Taxpayers, agents and business/trade bodies – if the evidence gathering has been done properly, they should see that the proposals are sensible and will be supportive. But it is inevitable that not everything that each such stakeholder group wants can be recommended. There can be reasons why not to – or simply that there must be a balance. The key is to make sure it is clear that views have all been considered and explanations given for why a particular route has or has not been chosen.
- Politicians – yes, they need to be involved! After all, the Minister will have to take the changes through Parliament. For my time at the OTS there was very good engagement and support from our sponsoring Minister. But I had envisaged that the Treasury Committee, a group of Members of Parliament who scrutinise the Treasury and HMRC on behalf of Parliament, would take an active interest in our work. Ideally, they would have a look at our reports and say (in effect) ‘These look good ideas – why aren’t you Minister/HMRC taking them forward?’ but we did not get that.<sup>21</sup>

It does not mean that everyone has to agree with everything: the OTS has to be ready to put forward proposals that it believes the case has been made for, even if some of the above will disagree or oppose.

## **When to simplify: stock and flow**

The OTS was set up to look at the ‘stock’, i.e., what is on the statute book. That immediately raised issues about whether the OTS would consequently just be ‘fiddling around’ with a few bits and pieces whilst a great flood of new things was coming – the flow.<sup>22</sup>

There were regular calls for the OTS to look at the UK’s annual Finance Bill and report on its simplification attributes. Although this seems a desirable idea, it is impractical, not least because of timing, and the resources needed. And would the OTS really be allowed to block it?

A better way forward on the flow – new measures – is input to their development and so influence over what is coming. Simplification needs to be built into policy development. HMRC and HM Treasury will say that

21 The only time the OTS was on their agenda was to confirm the Tax Director and the Chair appointments.

22 Another analogy for the OTS was that it was pushing water uphill against a waterfall!

it is already but, in my view, not consistently. I have argued that it needs to be evidenced – that simplification needs to be on the ‘TIIN’ (the Tax Information and Impact Note) that is supposed to accompany all new measures. There is a risk that that becomes a ‘tick box’ exercise, but it would at least evidence that simplification has been considered.

Early involvement is facilitated by the power that the second, statutory, incarnation of the OTS has to look at what it wants to, within its simplification objective. Thus, the OTS can contribute to consultations. The OTS is also more regularly involved in developing policy where it relates to its recommendations – something that should be axiomatic to ensure its recommendations are fully understood and appreciated.

## Avoiding complexity

There were inevitable calls for the OTS to opine on how to avoid complexity. This resulted in a paper,<sup>23</sup> codifying some of what had been learned into four key principles:

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.

This probably does not sound like rocket science or a revolutionary set of findings but it is powerful if followed, especially the last point. That is something regularly encountered – out of date legislation, limits or thresholds getting in the way of transactions or imposing burdens not intended when the measure was developed. Some might reflect that the whole system of corporation tax as widely practised in many countries is a classic example!

## Barriers to simplification

Hopefully most of the readership of this volume will be convinced of the need for, and value of, simplification. But some things will get in the way:

- Exchequer cost – if a simplification measure is really going to cost a lot of money, it is probably a non-starter. More subtly, if there are winners and losers within an overall minimal cost, then losers may have to be compensated ... which means there is a cost after all.
- Risk – in the early days some in HMRC were concerned that simplification would just create loopholes ... that simplification would mean more avoidance. The solution was to show with recommendations that such

23 Office of Tax Simplification ‘OTS complexity project’ (February 2017), available at: [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/603478/Principles\\_of\\_avoiding\\_complexity\\_updated\\_Feb17.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/603478/Principles_of_avoiding_complexity_updated_Feb17.pdf).

risks had been considered and point a way to how to manage any exposure.<sup>24</sup>

- Getting the change through – there can be a lot of opposition to what seems like a sensible proposal! This can range from simple inertia (why change... ‘it’s been OK for X years’) through to vested interests: abolishing a relief as it is not working properly and is too complex, intending that money is spent elsewhere, will inevitably be opposed by those who do manage to claim it.<sup>25</sup>
- Political – how will the change play politically? There is a subtlety that it is best, if possible, to make it easy for Ministers to say ‘yes’. So, at times do not be too binary: show how benefits will accrue from more work in a certain direction to allow momentum for change to develop.

## Simplification in action: some examples

### *Small business cash basis*

In theory all businesses have to prepare full accruals-based accounts. In practice, most small unincorporated businesses do not; they just account on a cash basis and this has largely been condoned. But the rule was there, until the OTS challenged it with a proposal to allow the cash basis. This garnered a lot of support in removing burdens, though some opposition from accountants who argued that cash accounting removes crucial information from business owners. The counter to that was that the OTS proposal was not compulsory – it would be by choice but, as a result of the principle of choice causing complexity, the OTS also argued that the cash basis would be the default basis, and if businesses wanted to elect away from that – probably because they were growing – that would be fine.

Cash accounting was duly enacted and is now in use by millions of the smallest businesses.<sup>26</sup>

24 An example would be the proposal for an exemption for trivial benefits given by employers to staff: see Office of Tax Simplification *Review of employee benefits and expenses: Second report* (January 2014) ch 5, available at: <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report>.

25 The allowance for ‘late night taxis’ is a classic example: 90% or more of the relief goes to ‘City’ finance sector people rather than, as is popularly supposed, to the nurse who has worked a late shift, but many argued that abolition would penalise too many ordinary employees. Wrong, but the argument prevented reform. Originally proposed in the Tax Reliefs review: Office of Tax Simplification ‘Tax reliefs review’ (3 March 2011), <https://www.gov.uk/government/publications/tax-reliefs-review>; see also Office of Tax Simplification *Review of employee benefits and expenses: Interim report* (August 2013) ch 8, available at: <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-interim-report>.

26 Office of Tax Simplification ‘Small business tax review’ (28 February 2012), <https://www.gov.uk/government/publications/small-business-tax-review>. Note that this was not for companies – though the OTS did propose that later.

### *Share schemes*

This is an example of a complex, technical area the OTS tackled.<sup>27</sup> There were a range of tax-advantaged share plans available, but with differing bases and rules. The OTS proposed various harmonising steps in the rules and ways of streamlining processes, most of which went through.

The OTS also looked at the rules around ‘unapproved’ share plans, though with less progress, probably due to avoidance worries.

### *Blind person’s allowance*

The UK has an extra tax allowance for the blind – which the OTS recommended abolishing.<sup>28</sup> This was not because the OTS were a tough and unfeeling lot, but the point was that the allowance was only claimed by about one-third of those eligible. The reasons were a combination of: not having enough taxable income; difficulties with the administration; or simply lack of awareness.

Instead, the OTS recommended replacing the allowance with a direct grant at the equivalent value. The blind charities were all in favour, but it did not happen. Leaving aside the extra cost to HM Treasury, there was great concern about the change being misunderstood and portrayed as a tax grab from the blind, even though no one would lose and overall they were getting more money.

### *Land and buildings transaction tax*

The land and buildings transaction tax (LBTT) is the Scottish replacement for the UK’s stamp duty land tax (a property transfer tax).<sup>29</sup> As Scotland could start with a clean sheet in terms of procedures, simplification principles could be incorporated into the design to ensure the system that was implemented worked for taxpayers and their agents as well as for the tax authority. That has resulted in 99% of tax returns being submitted electronically using a system that is easy to use and fits with how users operate.

### *Income tax and National Insurance Contributions*

Probably the most popular simplification move in the eyes of many people and businesses would be to merge income tax and National Insurance

27 Office of Tax Simplification ‘Share schemes simplification recommendations put forward’ (6 March 2012), <https://www.gov.uk/government/news/share-schemes-simplification-recommendations-put-forward>; and Office of Tax Simplification ‘Employee share schemes review’ (16 January 2013), <https://www.gov.uk/government/publications/employee-share-schemes-review>.

28 Office of Tax Simplification ‘Tax reliefs review’ (3 March 2011), <https://www.gov.uk/government/publications/tax-reliefs-review>.

29 Revenue Scotland ‘Land and buildings transaction tax’, <https://www.revenue.scot/land-buildings-transaction-tax>.

Contributions (NICs, the UK's social security system).<sup>30</sup> To those outside the system, this is obvious and would save a lot of effort for HMRC, employers and indeed individuals (who in turn would understand things much better).

The OTS did a major project and showed the benefits that would accrue from bringing the two taxes closer together – harmonising them – and also that a full merger of the two taxes was impractical.<sup>31</sup> But little has been done – partly because there would be significant numbers of winners and losers in the simplification process. With little chance of money being available to compensate losers, that meant great political difficulty in taking measures through, particularly when attention is inevitably focused on the larger issue of the UK's withdrawal from the European Union through the Brexit process.

### ***Benefits-in-kind: P11D forms***

The P11D is the HMRC form that has to be submitted by an employer when an employee is given a benefit-in-kind – broadly something other than pay. Until recently, some 4.4 million forms were completed each year, imposing significant administrative burdens on HMRC and employers, and confusing many employees. The OTS developed proposals, starting with payrolling of benefits, which would hugely reduce the numbers of P11Ds required.<sup>32</sup> Reforms in this direction have started and are already having an impact.

## **Conclusion – evaluating simplification: is it worth it?**

Is simplification worth doing? I think it is. I do not believe we can ever have a *simple* tax system – but that should not stop us striving for a *simpler* system.

Measuring the OTS's success (or otherwise) is difficult. In the early years the OTS monitored how many recommendations were taken forward and could show a reasonable 'hit rate'.<sup>33</sup> But that is crude and, especially when the OTS is developing longer term, structural reforms, success in relation to those broader reforms is less easy to measure. In many ways the key success is that simplification is on the agenda.

The OTS can be shown to be value for money. Its annual budget initially was less than GBP 500,000; it is now more than GBP 750,000 but that remains very good value – not least because of the way the OTS got so

30 In the polling of businesses on their perception of the main causes of complexity (see text at n 13 above), income tax/NICs was the second biggest cause of complexity.

31 Office of Tax Simplification 'Closer alignment of income tax and national insurance contributions' (7 March 2016), <https://www.gov.uk/government/publications/closer-alignment-of-income-tax-and-national-insurance-contributions>.

32 Office of Tax Simplification 'Review of employee benefits and expenses: Second report' (29 January 2014), <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report>.

33 See, eg, Office of Tax Simplification 'OTS list of recommendations' (27 March 2015), <https://www.gov.uk/government/publications/ots-list-of-recommendations>.

much free or cheap input to its work from stakeholders. Two measures alone (cash accounting and the programme to eliminate millions of the P11D forms referred to in the previous section above) will save far more in administration costs than the OTS has cost and would not have happened without the OTS.

A final thought: there is always a lot of emphasis on the need for the tax system to be fair. But I would argue that a system that is too complex for most people to navigate cannot be fair. Simplicity and fairness in many ways pull against each other – but actually simplification should be seen as part of the effort to make a fairer system.

# CONTRIBUTORS

**Abdallah Ali-Nakyea** is the managing partner of Ali-Nakyea & Associates, a firm of Tax Attorneys, Solicitors and Consultants in Accra, Ghana and part-time lecturer in tax law (LLB Programme) and fiscal dimensions of oil and gas (LLM Programme) at the School of Law, University of Ghana, Legon. He has more than 25 years working experience in taxation, 10 years of which includes legal practice. He holds MPhil (Economics), BA (Hons) (Economics) with Philosophy, and LLB from the University of Ghana, Legon. He is a PhD Tax Policy student at the African Tax Institute, University of Pretoria, South Africa.

**Christopher Axelson** is the chief director of the Economic Tax Analysis unit at the National Treasury of the Republic of South Africa. He previously worked at HM Revenue and Customs where he focused on taxes related to retirement savings. Chris has a Masters of Commerce in Economic Science from the University of the Witwatersrand and is a CFA charterholder.

**Marina Bornman** is associate professor in the Department of Accountancy at the University of Johannesburg. Her PhD in Taxation was attained at the University of Johannesburg and is on the topic of voluntary tax compliance. Apart from lecturing research methodology to Masters' students she is a regular supervisor for Masters and PhD students in Taxation. She is a registered tax practitioner with the South African Revenue Service.

**Bernadene de Clercq** is an associate professor in the Department of Taxation at the University of South Africa (UNISA). She is involved in the masters and doctoral portfolio of the department. She is also a member of the OECD/INFE Financial Education Research Committee and a research fellow in the Centre for Household Assets and Savings Management. She holds a DCompt from UNISA, is a Chartered Accountant and a Certified Financial Planner®.

**Heinrich Dixon** is a senior lecturer of cost and management accounting at the Tshwane University of Technology. He is a member of the South African Institute of Professional Accountants and admitted as an advocate in the High Court of South Africa and consults widely.

**Chris Evans** is a part time professor of taxation at UNSW Sydney and also a part time extraordinary professor at the University of Pretoria. He is also an international fellow at the Centre for Business Taxation at the University of Oxford and at the Tax Administration Research Centre at the University of Exeter. He is a former editor of *Australian Tax Review* and has published extensively in the areas of tax administration (and particularly tax compliance, tax compliance costs and tax simplification) as well as in comparative taxation and in the taxation of capital and wealth.

**Riël Franzsen** is professor and the director of the African Tax Institute at the University of Pretoria where he also occupies the South African Research Chair in Tax Policy and Governance. He has acted as external expert for the International Monetary Fund, United Nations and World Bank. He specialises in local government own-source revenue and property-related taxation, focusing on property tax policy issues and administrative challenges. He has published extensively on land and property taxes.

**Judith Freedman** is Pinsent Masons Professor of Tax Law and Policy at Oxford University and an adjunct professor in the School of Taxation and Business Law, UNSW. She was a co-founder of the Oxford University Tax Centre and of the Oxford University Tax MSc. She is joint editor of the *British Tax Review* and has written extensively on tax matters, including small businesses, tax simplification and tax avoidance. She has served on UK government committees on those topics and is on the IFS Tax Law Review Committee. Judith is a Fellow of the British Academy and was awarded a CBE for tax research.

**Carika Fritz** is a senior lecturer in the Department of Mercantile Law at the University of Pretoria, South Africa and holds the degrees LLB, LLM and LLD from that university. She is admitted as an attorney of the High Court of South Africa and notary public and is a member of the scientific committee of the African Tax Administration Forum (ATAF).

**Thomas Hoppe** is a research assistant at the Faculty of Business Administration and Economics, specialising in business taxation, at Paderborn University, where he is also pursuing a doctoral degree in business taxation. His research is focused on tax complexity and its effect on MNCs.

**Richard Krever** is a professor in the University of Western Australia Law School and an international fellow at the Centre for Business Taxation at the University of Oxford. He has previously held tax law drafting, design, and interpretation roles with the IMF, World Bank, Australian Treasury, and Australian Taxation Office, and provided tax law design and drafting assistance on behalf of international organisations in many Asian, African, Caribbean, South American, Pacific, and eastern European nations. Richard was made a Member of the Order of Australia in recognition of his contributions to tax academia in Australia.

**Jinyan Li** is a professor and co-director of the LLM Tax Program at Osgoode Hall Law School of York University and guest lecturer at the University of Sydney Law School. She was a member of the Expert Panel on Reviewing Tax Expenditures (Canada) and is currently a member of the Advisory Board of BRITACOM (Belt & Road Initiative Tax Administration Cooperation Mechanism) and co-editor of Current Tax Readings of the *Canadian Tax Journal*.

**Andy Lymer** is professor of accounting and taxation at the University of Birmingham and honorary professor of taxation in the College of Accounting Sciences, University of South Africa. He has held visiting positions in Australia (University of New South Wales, University of Sydney, University of Melbourne and Curtin University) and in the US as the Rawls Visiting Professor of Taxation at Texas Tech University. He directs the Centre for Household Assets and Savings Management (CHASM) that explores all aspects of tax and personal finance.

**Kyle Mandy** is a partner and the tax technical and policy leader for PwC South Africa. He is actively involved in tax policy and design in South Africa and works closely with both government and the South African Revenue Service in this regard. He also has more than 20 years of experience in advising a broad range of taxpayers in relation to their tax affairs.

**Lynne Oats** is professor of taxation and accounting, University of Exeter Business School, where she teaches UK and international tax and is also deputy director of the Tax Administration Research Centre. In addition to publishing numerous journal articles and book chapters, Lynne is managing editor of the *Journal of Tax Administration*, assistant editor (Accounting) of the *British Tax Review*, and has published widely in the accounting and taxation fields. She is co-author of *Taxation Policy and Practice*, *Principles of International Taxation*, *Accounting Principles for Tax Purposes* and editor of *Taxation: A Fieldwork Research Handbook*.

**Annet Wanyana Oguttu** is a professor in the Department of Taxation and the African Tax Institute in the Faculty of Economic and Management Sciences - University of Pretoria. She is a visiting professor lecturing international tax at the University of Johannesburg. She is a rated researcher of the National Research Foundation. Her field of expertise is international tax law. She has authored the seminal book *International Tax Law: Offshore Tax Avoidance in South Africa* (Juta, 2015); co-authored *Tax Law: An Introduction* (Juta, 2013) and has contributed chapters in a number of tax textbooks. She has published many articles on international tax law topics in accredited journals and has presented papers at many national and international conferences.

**Nina E Olson** is the executive director of the Center for Taxpayer Rights, a nonprofit that advances taxpayer rights in the US and internationally and convenes the International Conference on Taxpayer Rights. From 2001 to 2019, she was the National Taxpayer Advocate of the United States.

**Teresa Pidduck** is a senior lecturer in the Department of Taxation at the University of Pretoria, South Africa and a chartered accountant (SAICA). She is a guest lecturer at the University of Johannesburg, North-West University and the African Tax Institute. Her PhD from Rhodes University focuses on the general anti-avoidance rules and she consults widely.

**Reyhaneh Safaei** is a research assistant at the Faculty of Business Administration and Economics, specialising in business taxation, at Paderborn University. She is also a doctoral candidate in business taxation at Paderborn University. Her research interests include the transfer pricing issues associated with multinational corporations.

**Adrian Sawyer** is professor of taxation at the University of Canterbury and an international fellow of the Tax Administration Research Centre (TARC) at the University of Exeter. His SJD is from the University of Virginia and he has served on the most recent New Zealand Performance-Based Research Fund (PBRF) research assessment exercise. He is the chair of the editors of the *New Zealand Journal of Taxation Law and Policy*, and on the editorial board of numerous journals. He is a life member of the Australasian Tax Teachers Association (ATTA), and recipient of the ATTA Hill Medal and the inaugural Cedric Sandford Medal.

**Amanda Singleton** CA(SA) is a professor and head of taxation and estate planning in the Department of Accounting Sciences at Nelson Mandela University. She is the co-author of *A Students Guide to Advanced Tax* and is a current PhD student at UNISA.

**Greg Smith** is a senior manager at PricewaterhouseCoopers in Johannesburg, South Africa, and consults to South African and international clients across a wide range of industries on a broad spectrum of tax issues. In addition, he comments regularly to National Treasury, SARS and the South African National Parliament on developments in South African tax legislation and policy. Between 2008 and 2012, he was part of the Legal Drafting Unit at the South African National Treasury, and was the lead drafter for Income Tax within the unit between 2009 and 2012.

**Sharon Smulders** CA(SA) is project director: tax at the SA Institute of Chartered Accountants where she is responsible for liaising with the South African Revenue Service, National Treasury and Parliament on tax technical and policy matters. Before this she was an associate professor at the University of South Africa and the University of Pretoria. She holds a doctorate in taxation that was mentioned in the Davis Tax Committee's Report on small business taxation in South Africa. Prior to joining academia, she was a manager in the taxation department of Deloitte where she assisted various clients with their tax affairs.

**Elizabeth (Lilla) Stack** holds a doctorate qualification from the University of South Africa (UNISA). She is a professor of taxation at Rhodes University (South Africa) and an emeritus professor of the University of South Africa. She has taught taxation at all academic levels and now concentrates on the supervision of master's and doctoral candidates. She has also published textbooks on tax and contributed to textbooks on management accounting and research methodology.

**Karen Stark** CA(SA) is a senior lecturer at the University of Pretoria. She is currently pursuing her PhD in taxation exploring the tax compliance costs of individual taxpayers in South Africa.

**Caren Sureth Sloane** is professor for business administration, specialising in business taxation, and dean of the Faculty of Business Administration and Economics at Paderborn University. Since 2010, she has been guest professor at

the Vienna University of Economics and Business in the Doctoral Program in International Business Taxation (DIBT). She is spokesperson of the trans-regional Collaborative Research Center 'TRR 266 Accounting for Transparency' funded by the German Research Foundation (DFG): with 23 coordinated projects and more than 80 researchers examining how accounting and taxation affect firm and regulatory transparency and how transparency and related regulations affect economy and society at large (<https://accounting-for-transparency.de>).

**Deborah Tickle CA(SA)** (chartered accountant) is an adjunct associate professor at the University of Cape Town where she lectures the tax Masters course. As managing partner of the tax department at KPMG (Cape Town), she led the team for ten of the 31 years she spent consulting to large, listed and global clients of the firm. She served on the Davis Tax Committee that was formed by the South African Minister of Finance for the purpose of establishing whether South African tax policy aligns and supports overall government policy. She also served as deputy chair of the national tax committee of the SA Institute of Chartered Accountants.

**Adams Tommy** is an economics and social policy researcher and practitioner with 18 years' experience in revenue mobilisation, public financial management and local governance with a focus on decentralisation, intergovernmental fiscal relations and local economic development. He holds a BSc (Hons) in economics from the University of Sierra Leone, an MSc in economics from Njala University, Sierra Leone and a Joint European master's degree in comparative local development from the University of Trento, Italy. He is a PhD Tax Policy student at the African Tax Institute, University of Pretoria, South Africa.

**Binh Tran-Nam** is a professor in the School of Taxation and Business Law (Atax), UNSW Sydney; an adjunct professor at School of Business and Management, RMIT University Vietnam; an international fellow at the Tax Administration Research Centre at the University of Exeter, and an editor of the *eJournal of Tax Research*. He has researched and published extensively in tax policy and administration, particularly tax compliance costs and tax simplification.

**Marius van Oordt** is a senior lecturer at the African Tax Institute, University of Pretoria. His current research is on value-added taxation (VAT) in developing countries and heterodox tax theory. His educational background is in accounting, tax law, and public finance and he holds a PhD in Tax Policy from the University of Pretoria. He is also a member of the United Nations sub-committee on extractive industries taxation in developing countries.

**John Whiting** was the tax director of the UK's Office of Tax Simplification (OTS) from its establishment in 2010 until 2017; he was a non-executive director of HMRC from 2013 to 2019. Current roles include being a board member of Revenue Scotland. He was a tax partner with PricewaterhouseCoopers for 25 years and then from 2009 until 2013 the first Tax Policy Director of the Chartered Institute of Taxation. He has also served on the first-tier Tax Tribunal. John was awarded the OBE in 2008 for services to the tax profession and the CBE in 2016 for his OTS work.

**Wollela Abehodie Yesegat** is assistant professor of taxation at the College of Business and Economics of the Addis Ababa University, Ethiopia.

**Yige Zu** is an assistant professor in commercial and corporate law in Durham Law School, Durham University.

# CHAPTER 4

## THE ROLE OF THE OFFICE OF TAX SIMPLIFICATION IN THE UNITED KINGDOM AND LESSONS FOR OTHER COUNTRIES

*Yige Zu and Lynne Oats\**

---

### **Abstract**

While simplicity is a desirable feature of a good tax system, simplification is more a slogan than a part of an actual policy agenda in many countries. Striking out on a different path, the United Kingdom (UK) has adopted an innovative approach to tax simplification with its creation of an independent advisory body, the Office of Tax Simplification (OTS), in 2010. This chapter reviews the UK experience with the OTS and considers whether there is a place for an organisation equivalent to the OTS in other countries. Following a discussion of the independent status and the advisory role of the Office, the chapter concludes that the OTS has shown its value in achieving simplification of the administrative and compliance aspects of the tax system but it has had a limited role in bringing about more fundamental changes. The OTS experience provides important lessons for other countries as to what might be achieved with an independent institution undertaking simplification responsibilities.

### **1 Introduction**

Tax simplification has been the mantra of tax reformers for decades, but attention has sharpened in recent times with the realisation that simplification holds the key to reducing the government's tax administration costs and taxpayers' compliance burden. Although governments talk about it and 'simplification' is cited as a rationale for every type of tax change, few have gone so far as to embrace the goal as a statutory objective. In this respect, the United Kingdom (UK) leads the world with the creation of the Office of Tax Simplification (OTS), an independent office of HM Treasury, in 2010 and its elevation to a statutory body in 2016. The OTS was established to provide independent advice on simplification of the tax system to the government of the day.

\* The authors would like to thank John Whiting, the first Tax Director of the OTS, and Paul Morton, the second Tax Director of the OTS, for comments on earlier drafts of this chapter. All views in the chapter are those of the authors only.

Over its short history, the OTS has surveyed some of the thorniest areas of the UK tax system, including tax reliefs, small business taxation and employee benefits and expenses. Many consider its work to have been a significant success, but there are critics who question the value of OTS recommendations. This alternative view sees the creation of OTS as a reactive move by the government made without careful planning, in response to the increasing complexity in the UK tax system.<sup>1</sup>

The unique nature of the OTS has attracted international attention and prompted questions as to whether any aspects of the initiative may have application elsewhere. Clearly the actual work program of the OTS cannot be directly transferred to another jurisdiction. However, the possible role of a statutory body providing independent advice on simplification to the government of the day may be an option that countries seeking solutions to complex tax laws should consider. The review of the work and impact of the OTS set out in this chapter may be a helpful catalyst for devising simplification programs in other jurisdictions. The chapter starts with a brief history of the OTS, followed by an introduction to the challenge of simplification, an issue fundamental to the understanding and evaluation of the role of the OTS. The chapter then assesses the independent status of the OTS and its advisory role in terms of achieving substantive simplification of the law and simplification of administrative processes. Finally, it concludes with lessons for other countries.

## 2 A brief history of the Office of Tax Simplification

The idea of the OTS was mooted in a 2008 report<sup>2</sup> from a Conservative Party Working Party led by Lord Howe, established by the then Shadow Chancellor of the Exchequer, George Osborne MP. The OTS was subsequently set up by the coalition government in 2010 as a response to the complexity of the UK tax system. One important implication of being an independent office of HM Treasury is that the OTS was initially established on a temporary basis, having the same lifetime as the then Parliament.

The tasks of the OTS are to identify and advise the government on the areas of complexity in the UK tax system that have the potential to be simplified and to conduct inquiries into complex areas of the tax system, collect evidence and advise the government on options for reform.<sup>3</sup> The initial and interim framework documents, which are non-statutory, clearly set out the remit of the OTS, including reviewing the existing tax law, the

- 1 J Freedman 'Creating new UK institutions for tax governance and policy making: Progress or confusion?' [2013] 4 *British Tax Review* 373.
- 2 Working Party chaired by Lord Howe of Aberavon *Making taxes simpler: The final report of a Working Party chaired by Lord Howe of Aberavon* (July 2008).
- 3 HM Treasury, HM Revenue & Customs and Office of Tax Simplification 'Office of Tax Simplification Framework Document' [2010] (Framework Document).

underlying policy and administrative aspects of the tax system.<sup>4</sup> At the time of establishment, the OTS could only carry out simplification reviews of matters agreed with the Chancellor. As an advisory body, the OTS can only make recommendations. Whether or not the recommendations are taken forward and the policy decisions are made remains a matter for Ministers.

Initially the OTS was established as an experiment with a small size and budget. It was understaffed for the work it was assigned. The Office has a board that is comprised of a Chair and a Tax Director, as well as one senior official from each of HM Treasury and HM Revenue & Customs (HMRC). The initial Chair was the Rt Hon Michael Jack, a former MP and Treasury Minister, and the initial Tax Director was John Whiting, a former PricewaterhouseCoopers partner and past president of the Chartered Institute of Taxation. The board was supported by a mix of full-time secondees from HM Treasury and HMRC in addition to individuals from the private sector working two to three days per week. In the first five years, the OTS had an equivalent of four to six full-time staff.

The OTS is funded jointly by HM Treasury and HMRC. It had a small operating annual budget of GBP 500,000 in its first five years. Both the Chair and Tax Director were initially unpaid. The government expected much of the OTS work to be done with free secondments from the tax profession.<sup>5</sup> It was estimated that the OTS enjoyed free private sector support worth GBP 500,000 over the course of its first five years.<sup>6</sup>

The role of the OTS was viewed positively by politicians and many commentators, in particular in light of the limited resources available to the body. During the first five years the OTS completed ten major projects, published 32 reports and papers and made 401 formal recommendations.<sup>7</sup> Its work covered a wide variety of topics and degrees of specificity, some very narrowly targeted (for example, share schemes, and employee benefits and expenses) and some broader (for example, small business taxation and HMRC guidance). Some were short term (for example, thresholds) and some long term (for example, a complexity index). A frequently cited measurement of the impact of the OTS is the volume of its recommendations that have been taken forward by the government, which scores over 50%.

4 Framework Document (n 3 above), and Office of Tax Simplification, 'Office of Tax Simplification Interim Framework Document' [2015].

5 J Sherwood *et al* 'The Office of Tax Simplification: The way forward?' [2017] 2 *British Tax Review* 249.

6 Sherwood *et al* (n 5 above).

7 The OTS recommendations in the first five years were summarised in Office of Tax Simplification 'OTS simplification recommendations: summary at March 2015', 26 March 2015.

Its performance in the first five years had convinced many that it should be granted a more sustainable status to allow it to play a greater role in simplifying the UK tax system<sup>8</sup> and in 2015, the Chancellor of the Exchequer announced that the Office would be made a statutory body with the shift effected in the Finance Act 2016. Since then the OTS has a larger size and budget and a wider remit. Its budget for the financial year April 2017 to March 2018 was GBP 870,000. It now has an equivalent of eight to ten full time staff. Importantly, under its statutory power, the OTS can now look into areas of complexity on its own initiative.

### 3 The challenge of tax simplification

Tax complexity is recognised as a feature common to many modern tax systems around the globe.<sup>9</sup> Simplification of the law or administration to address this complexity must be based on a clear understanding of what causes tax systems to be complex and how the simplification objective weighs up against the primary objectives of a good tax system. Three factors might give rise to tax complexity – the language of the law itself is difficult to understand and hence apply, the administrative procedures that must be followed to comply with the law are complicated and, most significantly, the policy of the law creates complex distinctions between commercially similar transactions or establishes borderlines difficult to apply in practice.

One reason policy matters lead to complexity is the increasing use of the tax system by policy-makers to achieve social and political goals.<sup>10</sup> A commonly cited example is the use of tax relief for redistributive purposes that not only creates boundary problems but also often requires further anti-avoidance rules to prevent abuse of concessions.<sup>11</sup> At the same time, any proposal to simplify the law or administrative policy must be balanced against other objectives, for example, efficiency and equity, in a good tax system. As Freedman noted, ‘simplification cannot be the only, or even the main, driver of tax reform’.<sup>12</sup>

The volume of legislation provides an arguably less reliable measure of complexity, with many arguing that a clearer drafting technique that uses plain English may increase the length of legislation but make the legislation more easily readable by lay persons who did not receive legal or

8 T Bowler ‘The Office of Tax Simplification: Looking back and looking forward’ Institute for Fiscal Studies Tax Law Review Committee Discussion Paper No 11, December 2014.

9 Sherwood *et al* (n 5 above) 262; J Freedman ‘Managing tax complexity: The institutional framework for tax policy-making and oversight’ in C Evans *et al* (eds) *Tax simplification* (2015) 253.

10 A Broke ‘Simplification of tax or I wouldn’t start from here’ [2000] 1 *British Tax Review* 18.

11 Broke (n 10 above) 22.

12 Freedman ‘Managing tax complexity’ (n 9 above) 255.

tax education.<sup>13</sup> Simplification of legislation may benefit taxpayers in a less direct manner than it was thought, however. Legislation is most often used by experts and advisers, rather than individual end users. The volume of rulings and litigation is clear evidence that the law as it stands is not clear. Simplification that removes uncertainty and ambiguity will ultimately benefit the end user who would no longer have to pay for advice at each step currently needed to clarify the meaning. The final products of the Tax Law Rewrite Project (TLRP) in the UK that was set up in 1996 with an aim of making the UK's direct tax legislation clearer and easier to use were considered 'an improvement on the previous chaos',<sup>14</sup> although the length of legislation was significantly increased as a result of rewriting.

Simplification of the language of tax law and operational aspects of the tax system will not address underlying policy complexity. It is nevertheless accepted that complexity in terms of policy is inevitable because the world in which the tax system operates is complex and there are political and other objectives that prevail over the simplification objective.<sup>15</sup> This is, however, not to say that simplification should not be pursued. Rather, where changes of underlying policy cannot be made, the tax law and administrative and compliance procedures should be simplified as much as possible to reduce the burden for tax authority and taxpayers.<sup>16</sup>

## 4 The independent status

If complexity is a problem that calls for simplification, who should be assigned primary responsibility for a simplification agenda? The growing complexity of tax law led to the view that there would be value in bringing input from an independent body into the tax law reform process. The alternative would have been to require the Treasury and HMRC to evaluate simplification options for all proposed legislation in light of the higher-level policy drivers that led to the foreshadowed changes to the law in the first place.

The independence of an advisory body has two limbs. First, the Office should be independent from the government so that the proposals and recommendations are not formed under political pressure and do not reflect the political interest of the government of the day. Second, the Office should be sufficiently independent from the business community to avoid becoming a lobby group by another name. An independent office clearly has a potential advantage in achieving the simplification objective in a more transparent and unbiased manner. The extent to which it

13 See for example, C Turnbull-Hall & R Thomas 'Length of tax legislation as a measure of complexity' Office of Tax Simplification research paper, April 2012.

14 Lord Howe of Aberavon 'Simplicity and stability: The politics of tax policy' [2001] 2 *British Tax Review* 113 114.

15 Freedman 'Managing tax complexity' (n 9 above) 254; Bowler (n 8 above).

16 Freedman 'Managing tax complexity' (n 9 above) 254.

accomplishes these lofty goals may, however, depend on whether its structure impinges on its genuine independence.

Although the OTS was established as a discrete entity within the Treasury as a result of the agreement establishing a coalition government, its 'independence' was questioned particularly in, but not limited to, its first five years of existence, prior to its eventual shift to become a statutory body.<sup>17</sup> It was (and remains) physically located in the Treasury building, was reliant on funding from the Treasury budget, and had a life no longer than the lifetime of the then government. The OTS has at all times worked closely with HMRC and HM Treasury while remaining independent from both organisations. The input from HMRC and HM Treasury is especially useful in testing ideas and developing practical and feasible recommendations. Until it acquired greater independence as a statutory body, the OTS was subject to the normal Treasury chain of command and, as noted, could only take on projects for study that were agreed with the Chancellor. It is accountable to the Chancellor and is bound by the Finance Bill and Budget processes.<sup>18</sup> The OTS' limited tenure initially prompted it to seek 'quick wins' that could yield immediate simplification benefits and in the process build the case for its continuation.<sup>19</sup>

Evaluations of the success of the OTS in its first five years were made in the context of the limited resources available to it, especially its small size and operating budget.<sup>20</sup> The consensus was that the OTS had achieved more than what was expected given its lack of resources, with success attributed by some to the Office's personnel, its highly respected and experienced chair and tax director, and most notably their success in attracting free support from the private sector by way of secondment.<sup>21</sup> Private sector secondees can bring much-needed tax expertise and practical experience to the Office.

At the same time, however, the policy assumes seconded employees in pursuit of the goals of their temporary employer will offer advice that might be against the interests of their past and, following secondment, restored clients or contrary to their future professional interests. Separately from the OTS experience, evidence considered by the Committee of Public Accounts suggested that there had been some incidence of secondees to the Treasury and HMRC deliberately failing to alert the departments of

17 See, for example, Letter of 29 June 2015 from Andrew Tyrie MP to George Osborne MP, [http://downloads2.dodsmonitoring.com/downloads/misc\\_files/TyrieLetter2906.pdf](http://downloads2.dodsmonitoring.com/downloads/misc_files/TyrieLetter2906.pdf) (accessed 30 September 2018).

18 Bowler (n 8 above) 22.

19 Sherwood *et al* (n 5 above) 255.

20 See A Sawyer 'Moving on from the tax legislation rewrite projects: A comparison of the New Zealand tax working group/generic tax policy process and the United Kingdom Office of Tax Simplification' [2013] 3 *British Tax Review* 321; J Whiting *et al* 'The Office of Tax Simplification and its complexity index' in C Evans *et al* (eds) *Tax simplification* (2015) 238.

21 Sherwood *et al* (n 5 above) 262.

loopholes in the legislation that they could exploit upon a return to private practice.<sup>22</sup> If true, the same might be assumed of secondees to the OTS. This is, at best, a difficult proposition to test and, at worst, a grave risk.<sup>23</sup>

Another factor that was said to have contributed to the success of the OTS is its consultative approach.<sup>24</sup> Recognising that wider support holds the key to the successful implementation of changes, the OTS consults with stakeholders, in particular potential losers from the changes, across the nation to understand their concerns. However, while the engagement from the business community is no doubt of great value in policy-making, there appears to be insufficient effort to collect the views of other interested parties, including the academic community. The latter, in particular, may be in a position to enhance the quality of OTS work by complementing practicability with theoretically sound options.

In general the OTS is viewed as having less independence and authority in the policy-making process than some advisory non-departmental public bodies, such as the Office for Budget Responsibility and the Law Commission.<sup>25</sup> Critics of the independent status of the OTS see the design features that reduce its independence as design flaws and call for greater resources and an expanded size and role for the OTS.<sup>26</sup> These recommendations appear to presume that simplification is an end in itself. The design features that constrain the independence of the OTS may, however, simply reflect the government's perception that simplification is a means to an end of an efficient and fair tax system that imposes the least administrative and compliance costs possible, not an ultimate objective in its own right.

## 5 The advisory role

### 5.1 The focus on administration and compliance

The OTS is strictly an advisory body with no remit to carry out substantive changes such as the tax law rewrite projects that have been conducted in a number of jurisdictions, including the UK, Australia and New Zealand. The constraints imposed on the Office raise an important policy question:

22 House of Commons Committee of Public Accounts 'Tax avoidance: the role of large accountancy firms', April 2013; J Rutter *et al* *Better budgets: Making tax policy better* (Institute for Government, January 2017).

23 J Whiting & M Gammie 'Tax policy making in the United Kingdom' (2013) 61(4) *Canadian Tax Journal* 1057.

24 Sherwood *et al* (n 5 above)

25 Bowler (n 8 above) 22-23.

26 Letter of 29 June 2015 from Andrew Tyrie MP to George Osborne MP (n 17 above); J Rutter 'Making tax policy better: The case for strengthening the Office of Tax Simplification' (1 September 2015), <https://www.instituteforgovernment.org.uk/blog/making-tax-policy-better-case-strengthening-office-tax-simplification> (accessed 14 December 2018).

what features discussed in section 3 above that give rise to complexity can be successfully addressed in a simplification program?

Simplification of the language of the law, as exemplified by the TLRP in the UK, has often been criticised on the basis that a redraft of the law without changes to the underlying policy will fail to address the prime causes of complexity in the tax system. The limitations of the TLRP prompted the establishment of the OTS, promoted as ‘a key element in any attempt to start a process of simplification and legislative reduction’.<sup>27</sup> The OTS, as it was envisaged initially, was thus expected to achieve more fundamental simplification. As noted, it was permitted to investigate and advise on both substantive and administrative aspects of the tax system.

After a few years of operation, however, the OTS now places its focus on simplification of administration and compliance, in particular simplification of user experience by the use of technology.<sup>28</sup> The shift of focus towards administrative issues may be driven primarily by the desire of the OTS to achieve ‘quick wins’, a result of design constraints discussed in section 4 above. OTS reports today often contain distinct short-term, medium-term and long-term recommendations. Proposals for short-term and medium-term changes primarily deal with administrative issues. The longer-term proposals address key policy issues with the aim of stimulating debate and encouraging thinking about new challenges to the tax system in the context of simplification.

Substantive tax policy questions are inherent in some ‘administrative’ issues and it was inevitable that the OTS would at different times review substantive aspects of complexity while focusing on various administrative and compliance matters. Many of the substantive changes proposed by the OTS have not been implemented, however. It has been suggested that the government has often failed to provide an explanation of why it did not follow OTS recommendations when it chose not to do so.<sup>29</sup>

One reason that the government of the day may not implement recommendations of the OTS is a conclusion that they may entail too great a political risk, even where the OTS has considered broader political or socio-political aspects of a proposal. An example is the recurring recommendation in the OTS reports that National Insurance Contributions (NICs) should be aligned with the income tax to achieve simplification benefits for employers and the self-employed.<sup>30</sup> The simplest option, clearly, would be folding the NICs into the corporate and individual income taxes but the simplification benefits would be

27 Working Party chaired by Lord Howe of Aberavon *Making taxes simpler* (n 2 above) 5.  
 28 Office of Tax Simplification *Annual report 2017-18: Simplifying the tax system to make it easier for the taxpayer to use* (July 2018).  
 29 Bowler (n 8 above) 2.  
 30 Office of Tax Simplification *Small business tax review: Interim report* (March 2011); Office of Tax Simplification *Employment status report* (March 2015).

accompanied by the elimination of the country's most significant hypothecated tax. While critics of hypothecated taxes argue that every government should have full discretion to spend revenue as it sees fit as per the mandate it received from the electorate, there is a widespread consensus in the UK that responsible governance entails respect for decisions of previous governments to quarantine some revenues through a hypothecated tax for pensions. The logic of this position is that these social welfare obligations transcend day-to-day political considerations and should be insulated from the whims of governments or voters, given the legitimate expectation of current and future pensioners that the pension system will continue.

Initially, the OTS made the radical recommendation of integrating the income tax and NICs, which was immediately rejected by the government. Alerted to the high level socio-political constraints, the OTS bypassed what would have been the first best option if simplification was the only consideration and moved to options that retained separate income tax and NICs.<sup>31</sup> The final proposal was for 'alignment' or 'operational integration' of the two regimes, a system that would retain the separation of the two taxes but use a common tax base and collection system. To date, these proposals have attracted limited support in Whitehall, no doubt because of direct political implications, and following a call for evidence in 2011, the only main achievement has been the shift of Class 2 NIC collections to a self-assessment regime.<sup>32</sup> As the OTS notes, the changes could be designed to be revenue neutral, but there would be both losers and winners from the changes, with the total tax burden rising for some and declining for others. The government's reluctance to embrace the proposal is presumably related to political sensitivities over the former group.

The OTS's remit was backward-looking in the first five years when it was only allowed to study the stock of current tax law and explicitly prevented from playing a role in the development of new tax measures. The examination of current law was not without merit. It filled a gap in the UK policy-making process which lacked an effective system for the review of tax law after implementation.<sup>33</sup> For example, concessions remained on the statute book without scrutiny long after they ceased to serve a useful purpose or achieve the policy aim originally intended.

However, the limitations that restricted the OTS from examining legislative proposals both before their release in the budget and after the budget night before enactment into law considerably undermined its ability to review substantive policy issues and effectively excluded it from the core policy-making process. With the establishment of a separate tax simplification office patching the cracks and filling the holes after the fact,

31 Office of Tax Simplification *Small business tax review: Interim report* (n 30 above).

32 Bowler (n 8 above) 16.

33 Whiting & Gammie (n 23 above) 1063.

the government in effect conceded that the law was not designed properly in the first place. The extent to which effective simplification can be achieved is therefore questionable, if the OTS is clearing up some complexities while the government is creating more at the same time.<sup>34</sup> For example, despite the abolition of 47 reliefs following the first report of the OTS, the total number of reliefs soon increased to a level exceeding that in effect at the time of the report.<sup>35</sup>

The restriction that prevented the OTS from reviewing new laws, found in its original 2010 framework and the 2015 interim framework, was not included in the Finance Act measures that established the OTS as a statutory body<sup>36</sup> and, accordingly, did not appear in its revised 2016 framework document<sup>37</sup> prepared by the OTS in anticipation of its new status. Since that time the government has shown a real interest in OTS involvement in ongoing policy development, a shift that recognises the benefits of accessing the Office's greater experience and access to resources.

The move that was viewed by many as positive raises the question of how the OTS should interact with HM Treasury and HMRC in tax policy development. In general, the Treasury is concerned with high-level structural aspects, whereas HMRC is concerned with administrative and operational aspects of the tax system.<sup>38</sup> With the OTS working independently on simplification, there is a risk of duplication of work between the body and the two government departments, in particular when the OTS tries to align its work with those of the Treasury and HMRC to increase the chance of making changes. The OTS could itself be a source of complexity in the case of overlapping responsibilities.<sup>39</sup>

A more worrisome possibility is that the increasing involvement of the OTS in the policy making process may lead to a retreat by the Treasury and HMRC to a single lens focus, with the Treasury focusing on the impact of tax policy on economic growth, HMRC focusing on administration and revenue raising and the OTS focusing on simplification. None of these functions can operate in its own silo as each draws on aspects of the others.

34 Institute of Chartered Accountants in England and Wales 'Budget 8 July 2015 – ICAEW Suggestions', 2015, <https://www.icaew.com/~/media/corporate/files/technical/tax/tax%20faculty/taxreps/2015/taxrep%2031-15%20icaew%20comments%20in%20advance%20of%208%20july%20budget.ashx> (accessed 30 September 2018).

35 J Whiting 'Tax simplification: what has the OTS ever done for us?' (2015) 1263 *Tax Journal* (21 May).

36 Finance Act 2016 ss 184-189.

37 Office of Tax Simplification 'Office of Tax Simplification Framework Document', May 2016 (Revised Framework Document), [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/522874/20160512\\_ots\\_draft\\_revised\\_framework\\_document.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/522874/20160512_ots_draft_revised_framework_document.pdf) (accessed 29 September 2018).

38 Whiting and Gammie (n 23 above) 1060.

39 The point was made in a broader context in M D'Ascenzo 'Pathways for tax policy and administration: Institutions and simplicity – an Australian perspective' in C Evans *et al* (eds) *Tax simplification* (2015) 293.

The challenge is to balance the risk of duplication with the necessary integration of simplification and other policy objectives. Each of the parties needs room to specialise in one aspect while engaging with the others and incorporating into its own work the perspectives of concern to the other parties. How this is to be achieved in practice is a question yet to be resolved.

## **5.2 Balancing simplification and tax objectives**

A model tax collects revenue in an efficient and equitable manner while imposing the lowest possible compliance and administrative costs. An opportunity for simplification that does not undermine the economic neutrality and equity of a tax should, of course, be pursued. Simplification that yields a loss of neutrality or equity may be acceptable if the savings to taxpayers and tax administration greatly outweigh a marginal decrease in efficiency or equity. An issue to be resolved in the context of a body such as the OTS is whether the organisation is equipped to balance these considerations if simplification cannot be achieved with no cost to tax objectives.

The terms of reference for the OTS anticipated this broader perspective, with its initial framework document noting that although the primary focus of the Office would be on simplifying the tax system, it would be expected to consider the potential impact of options it puts forward on the government's objectives of the tax system. In practice, however, it is less clear how well the OTS recognises the efficiency and equity implications while focusing on simplification benefits. Its recent work on the consequences of the UK's high VAT registration threshold illustrates the inherent contradictions faced by those seeking to simplify the tax law.<sup>40</sup> An initial simplification measure may lead to unintended behavioural responses, prompting proposals for ameliorating measures that might in turn offer opportunities for avoidance and trigger new anti-avoidance rules. The end result may be that one type of complexity is substituted for another.

The use of a registration threshold is a feature of the VAT law intended to reduce administrative and compliance costs by excluding small businesses from the VAT system. Adoption of a threshold to protect small businesses from disproportionately high compliance costs comes at a cost, namely the phenomenon of business 'bunching' just below the registration threshold. Small businesses have two incentives to remain below the registration threshold – they avoid the compliance costs associated with being in the VAT system and, if they sell to final consumers who do not require tax invoices, they enjoy a price advantage over registered competitors. While the price of their goods and services includes a

40 Office of Tax Simplification *Value added tax: Routes to simplification* (November 2017).

component for unrecovered input tax on their acquisitions, there is no tax imposed on the mark-up of unregistered businesses.

The OTS identified three types of business behaviour that explain the bunching phenomenon. First, small businesses may deliberately hold back expansion to remain unregistered. Secondly, businesses with true turnovers above the threshold may fraudulently under-report sales. Third, businesses may split the enterprise along operational lines with each part remaining a separate person below the threshold. Appropriate risk analysis and audit processes by HMRC can address the second problem and an existing anti-avoidance rule<sup>41</sup> that combines the turnovers of associated enterprises for threshold measurement purposes addresses avoidance based on the third technique. The primary concern of the OTS is the first type of behaviour, however. The concern is the deliberate restraint by small businesses that results in reduced productivity across the economy.

The OTS explored two options for smoothing the financial and compliance impacts of crossing the threshold. The first was further increased use of the Flat Rate Scheme (FRS) now available to small businesses just above the threshold as an alternative to costly tracking of input tax credits and the second, and more radical option, was adoption of a new 'financial smoothing mechanism' that would provide newly registered small businesses that have just crossed the registration threshold with a disappearing credit which would phase out completely at an upper threshold.

The OTS report noted the view of small businesses that they value the FRS as a simplification measure. The FRS system works by substituting a presumptive input tax credit entitlement for measurement of actual input tax costs. As the FRS system is voluntary, it is likely to be used predominately by businesses that benefit financially from the presumptive input credits – that is, enterprises that can claim more credits under the FRS than their actual input tax. In an effort to more accurately align the presumed entitlement under the FRS with actual inputs, the formula applies 45 different rates for different industries. The complex classification regime leads to increased compliance and administration costs and reduced economic efficiency and revenue as businesses calculate tax both using and not using the scheme to decide whether it is financially beneficial. At the same time, borderline enterprises or those with mixed outputs falling into more than one camp take steps to shoehorn themselves into the more generous classification.

Apparent abuse uncovered by HMRC has led to the recent adoption of 'limited cost trader tests' to restrict access to unreasonably generous presumptive entitlements. The anti-abuse measures built into the FRS

41 Value Added Tax Act 1994 sch 1 para 1A (amended by Finance Act 1997 c 16 sec 31(1)).

regime provide an example of concessions that require anti-avoidance rules to safeguard the regime, an outcome that further complicates the tax system. The case for the FRS as a simplification measure that reduces compliance costs, too, is yet to be made convincingly, however. An argument that it helps to reduce bunching, the primary aim of the simplification proposals, may be even more difficult to sustain.

The ‘financial smoothing mechanism’, the second OTS proposal to reduce bunching, offers tapering credits for businesses that cross the registration threshold. The credits would allow traders to retain some of the VAT collected from customers as compensation for both the higher fiscal costs and the higher compliance costs they face as registered taxable persons. The tapering feature gradually reduces credits as a business grows until they are withdrawn entirely at some point.

A tapering credit system along the lines of that explored by the OTS poses a number of challenges for policy-makers. The tapering system needs to be sufficiently generous to encourage transition to the normal VAT system but avoid excessively high windfall gains to successful growing businesses that would make no effort to remain deliberately below the registration threshold in the absence of a subsidy. The regime needs to be designed in a manner that does not give rise to new bunching problems as enterprises resist further growth that would result in a loss of credits or engage in splitting schemes to remain entitled to a credit. One solution to this problem might be adoption of a time limit for credits provided to businesses eligible for the transitioning concession so there are no incentives for businesses capable of further expansion to cap outputs below the point at which concessions are withdrawn.

The idea of a smoothing system based on tapering retention of VAT by traders has been tried in a few countries, including Japan, Finland and the Netherlands. Their experience is far from encouraging, however.<sup>42</sup> If a low upper threshold is adopted, as is the case in Finland, the regime does not provide enough incentive for small businesses to join the VAT. If the threshold is high, as is the case in Japan, the regime would deliver windfall benefits to businesses that were within the VAT or would join the VAT even without subsidies. Significant revenue losses attributable to windfall benefits led Japan to abolish its smoothing regime eight years after implementation.

Upon receipt of the OTS report, the government opened the proposals to public consultation.<sup>43</sup> It soon recognised, however, that smoothing

42 See further Y Zu ‘VAT/GST thresholds and small businesses: Where to draw the line?’ (2018) 66(2) *Canadian Tax Journal* 309.

43 HM Treasury ‘VAT registration threshold: Call for evidence’ March 2018, <https://www.gov.uk/government/consultations/vat-registration-threshold-call-for-evidence> (accessed 30 September 2018).

mechanisms in their simple form would reduce efficiency gains and lead to a revenue loss for the Treasury.<sup>44</sup> Its response to the conundrum has been to shelve the OTS proposals for possible revisiting after the Brexit chaos subsides.

It is not clear how rigorously the OTS considered potential limitations or efficiency and revenue costs of its proposed changes. The recommendations nevertheless have value as they alert the government to the problems and provide it with the information that is helpful for making the correct policy decision in the long run. Too much information, however, is not necessarily an advantage as HMRC and HM Treasury have limited resources and are already burdened with other priorities.<sup>45</sup> The OTS recommendations would be of greater value if the Office could clearly identify compromises with other objectives for achieving simplicity with any particular change it proposes to provide sufficient information for the government to make the ultimate decision. This, however, would lead to a larger question of whether more balanced advice on policy changes could be made with an independent ‘tax simplification’ or ‘tax policy’ office as was envisaged by Freedman.<sup>46</sup>

## 6 Conclusion

The UK experience with the OTS reveals a dilemma faced by policy-makers on the path towards tax simplification. The establishment of the OTS showed the government’s commitment to a simpler tax system. At the same time, many design features of the OTS appear to compromise its ability to tackle fundamental complexity. These features reflect a paradox of tax policy: while simplification of the tax system is desirable, it cannot be pursued at the cost of retreating from intended underlying tax policy objectives.

Although the creation of the OTS has often been criticised for not being based on careful planning, the value of the Office has been clearly shown, in particular in respect of administrative simplification. Substantial policy changes are difficult to achieve, with or without an independent tax simplification office. The accomplishments of the OTS to date probably reveal its limitations, and the body should not be expected to address more fundamental problems. It nevertheless illustrates the potential of an office of this sort to influence policy development and increase the chance of building simplification into new rules. At the end of the day, political and other considerations may explain why the government might not adopt measures recommended to simplify the tax system. The importance of

44 HM Treasury ‘VAT registration threshold: Summary of responses’ October 2018.

45 Sherwood *et al* (n 5 above) 260.

46 Freedman suggested that an ‘Office of Tax Policy’ would be a much better institution. See Freedman ‘Creating new UK institutions’ (n 1 above).

generating discussion and exposing options for simplification cannot be understated, however.

The OTS experience provides important lessons as to what might and might not work for simplifying the tax system. Countries that seek to replicate the OTS should have a well thought through view about what such an office is expected to achieve before its adoption. The ultimate design of a tax simplification body, which will to a large extent determine its effectiveness, will reflect a government's perception on how simplification is weighed against political and tax objectives. If simplification is pursued as one of the core policy objectives, it is most sensible to look beyond after-the-fact simplification to make it part of the policy-making process. Importantly, the role of the body and how it is expected to interact with the Treasury and the revenue authority to develop a coherent policy need to be clearly defined from the start. There is no panacea for complexity in the tax system. The OTS model may be a useful starting point for jurisdictions seeking mechanisms for simplifying their complicated tax systems.