



HOUSE OF LORDS

Select Committee on Economic Affairs

4th Report of Session 2010–12

The Finance Bill 2011

Ordered to be printed 14 June 2011 and published 17 June 2011

Published by the Authority of the House of Lords

London : The Stationery Office Limited
£price

HL Paper 158

Select Committee on Economic Affairs

The Economic Affairs Committee is appointed by the House of Lords in each session with orders of reference “to consider economic affairs”.

Current Membership

Lord Best
Lord Currie of Marylebone
Lord Forsyth of Drumlean
Lord Hollick
Baroness Kingsmill
Lord Lawson of Blaby
Lord Levene of Portsoken

Lord Lipsey
Lord MacGregor of Pulham Market (Chairman)
Lord Moonie
Lord Shipley
Lord Smith of Clifton
Lord Tugendhat

The Members of the Sub-Committee which carried out this inquiry (The Finance Bill Sub-Committee) are:

Lord Bilimoria
Lord Griffiths of Fforestfach
Lord Hollick
Baroness Kramer
Lord McFall of Alcluith
Lord MacGregor of Pulham Market (Chairman)

Lord Maples
Lord Moonie
Baroness Noakes
Lord Shipley
Lord Wakeham

Declaration of Interests

A full list of Members’ interests can be found in the Register of Lords’ Interests:

<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-lords-interests/>

Publications

All publications of the Committee are available on the internet at:

<http://www.parliament.uk/hleconomicaffairs>

Parliament Live

Live coverage of debates and public sessions of the Committee’s meetings are available at

www.parliamentlive.tv

General Information

General Information about the House of Lords and its Committees, including guidance to witnesses, details of current inquiries and forthcoming meetings is on the internet at:

<http://www.parliament.uk/business/lords>

Committee Staff

The current staff of the Committee are Bill Sinton (Clerk), Stephen Seawright (Policy Analyst) and Karen Sumner (Committee Assistant).

Contact Details

All correspondence should be addressed to the Clerk of the Finance Bill Sub-Committee, Committee Office, House of Lords, London, SW1A 0PW.

The telephone number for general enquiries is 020 7219 5358/6968

The Sub-Committee’s email address is: financebill@parliament.uk

CONTENTS

	<i>Paragraph</i>	<i>Page</i>
Abstract		5
Chapter 1: Introduction	1	7
Chapter 2: The New Approach to Tax Policy Making	9	9
Context	10	9
The Tax Policy Making Consultation	12	9
The Treasury Committee's Principles of Tax Policy	20	10
The Tax Consultation Framework	21	11
The New Approach in Principle	23	11
Finance Bill 2011	32	13
Disguised Remuneration	37	13
Flexibility and Changes to Oil and Gas Taxation	45	15
The 2011 Finance Bill as a Whole	52	16
Delivering the New Approach	57	17
Embedding the New Approach to Tax Policy Making	58	17
Delivery: Tax and Policy Skills and Responsibilities	63	18
Delivery: Administering Tax Changes	77	20
Delivery: Widening Consultation with Smaller Businesses and Individuals	83	22
Delivery: Consulting on Tax Information and Impact Notes	91	23
Extending the Scope of the New Approach	96	24
Post-implementation Review	96	24
Outlining the Government's Tax Strategy	103	25
Enhancing Parliamentary Scrutiny of Tax Legislation	109	26
Chapter 3: Anti-Avoidance with Special Reference to Disguised Remuneration	124	30
Context	124	30
The Government's Anti-Avoidance Strategy	126	30
Finance Bill Measures	132	31
Anti-Avoidance: The Government's Strategy	136	32
Tackling Avoidance Early	141	33
General	141	33
Disguised Remuneration: The Cost of Not Tackling it Early	144	33
Tackling Avoidance Effectively	156	35
General	156	35
The Effectiveness of the Disguised Remuneration Legislation	160	36
The Primarolo Statement	177	39
Principles-Based Drafting	184	40
A General Anti-Avoidance Rule (GAAR)	191	41
Evasion	195	42
Chapter 4: Corporate Tax Reform	199	43
Context	199	43
CT Road Map and the Move Towards Territoriality	203	44

The Main Elements of the CT Reform Package	210	45
The Balance Between the Elements of the Package	210	45
Reform of the CFC Rules	218	46
Reform of IP/Introduction of Patent Box	225	48
Foreign Branch Taxation	229	48
Overall	231	49
Implications for Growth and Tax Competitiveness	232	49
Chapter 5: Conclusions and Recommendations	243	52
Appendix 1: The Finance Bill Sub-Committee		57
Appendix 2: List of Witnesses		59

NOTE:

Evidence is published online at <http://www.parliament.uk/hlfinancebill> and available for inspection at the Parliamentary Archives (020 7219 5314)

References in footnotes to the Report are as follows:

- Q refers to a question in oral evidence;
- FBSC 1 refers to written evidence as listed in Appendix 2.

Abstract

The Finance Bill Sub-Committee (FBSC) of the Economic Affairs Committee has met each year since 2003 (except in 2010, because of the General Election) to examine selected aspects of the year's Finance Bill.

New approach to tax policy making

Recent months have seen the introduction of a new approach to tax policy making by the Coalition Government, with the aim of bringing about a clearer, more stable and predictable tax system with better tax legislation and more effective scrutiny of tax changes. In line with its new approach, the Government conducted various policy consultations starting in summer 2010 and published draft Finance Bill clauses in December. As a result, when it was published in March 2011, much of the content of the Finance Bill reflected earlier and fuller consultation than in the past.

The representative bodies and tax specialists which gave evidence to us welcomed in principle the new approach to tax policy making which, if implemented consistently, seemed to promise better outcomes.

A main theme of this year's report is how far, in its first year, the Government has stuck to its own new approach, including full consultation at each stage in the process. Our witnesses thought that on the whole the Government had done so, and that the outcome would be better tax legislation. Witnesses' disappointment over some instances where the Government brought in unheralded tax changes or launched a consultation at too late stage in the policy making process was perhaps all the keener as a result; although in the latter case some recognition should be given to the fact that the new Government had only recently taken office.

Cases in point include the peremptory Budget announcement of an increased supplementary charge on oil and gas production and new provisions against tax avoidance through disguised remuneration; the latter has mushroomed to over 60 pages of new legislation. The view of our witnesses was that consultation from the time the measure was announced, in accordance with the new approach, would have led to better legislation. We share these concerns: if the Government does not abide by its own rules for tax policy making, it risks eroding the credibility of its commitment both to the new approach and to a stable and predictable tax system for the UK.

Concerns were expressed by witnesses about whether HM Treasury (HMT) and HM Revenue and Customs (HMRC) still had the skills, resources and organisational effectiveness to deliver fully the Government's new approach. In contrast, officials assured us that the partnership between the two departments was working well. There was a worrying disconnect between the respective views. We recommend that the Government should publish the findings of the internal review of the present arrangements and conduct a comprehensive audit of the tax skills and experience of HMT and HMRC staff working in the areas of developing tax changes. We also share the concerns of witnesses about the quality and training of frontline HMRC staff and recommend that HMRC should seek to understand these concerns and address them urgently.

We recommend that HMT and HMRC should extend their current initiatives aimed at consulting smaller business so as to engage more effectively with specific types of enterprise, and that they should develop and publish a comprehensive strategy for consulting non-business stakeholders on tax proposals likely to affect them. We also recommend that there should be full consultation in developing the new Tax Impact and Information Notes prior to their publication.

Witnesses saw scope for extending the new approach to tax policy-making to include publication of more strategic frameworks for given areas of taxation on the model of the reform of corporation tax. We agree, while recognising that Governments need flexibility to react to changing circumstances. We also share the view of witnesses that there should be more monitoring and post-implementation reviews of tax changes to see if they have the effect intended.

Most of our witnesses thought the new approach should be complemented by better Parliamentary scrutiny of tax legislation and that the longer, consultative tax policy making process offered scope for achieving this. It was suggested in particular that the experience and expertise of the House of Lords could be used better. One obvious means to do so would be for the Finance Bill Sub-Committee of the House's Economic Affairs Committee to begin work earlier each year, perhaps when the draft Finance Bill is published in December, rather than wait until the formal publication of the Bill as laid down in its remit. It will be for the House to consider any case for changing the remit.

Other themes

As well as this year's main theme of the broad, new approach to tax policy-making, we focussed on two areas of taxation where far-reaching changes are planned.

Anti-avoidance with special reference to disguised remuneration

We recognise the need to tackle avoidance and welcome the Government's commitment to do so through the introduction of its strategic approach to anti-avoidance. But we believe that the Government should act as early as possible, particularly where the avoidance is likely to mushroom as was the case for tax avoidance through disguised remuneration. Our private sector witnesses were hugely critical of the shape and complexity of the legislation and our firm view is that had there been consultation from an earlier stage this complexity could have been addressed. There are clearly lessons to be learned here and we recommend that HMRC should carry out a review to learn these lessons and avoid similar pitfalls in the future.

Some of our witnesses were so concerned with the complexity of the legislation that they were prepared to consider whether using the Primarolo statement of 2004 might have offered a better approach, albeit without any element of retrospection. We agree that the status of the Primarolo statement should be clarified and consideration be given to a revised statement to help deter future avoidance in this general area of the tax system. We also recommend that the Government should take effective measures against tax evasion, including developing an anti-evasion strategy, where more revenue is lost than through tax avoidance.

Corporation Tax Reform

We welcome the Government's publication of its strategy for reform. We consider that the reforms should make the United Kingdom's corporate tax regime more competitive. But we recommend post-implementation reviews of the outcomes of this reform package, so that any necessary adjustments can be made if, for instance, the strategy worked to the disadvantage of small and medium-sized businesses.

The Finance Bill 2011

CHAPTER 1: INTRODUCTION

1. This is the eighth report in a series which began in 2003 when the House of Lords Select Committee on Economic Affairs first appointed a Sub-Committee to inquire into selected aspects of that year's Finance Bill. The Finance Bill Sub-Committee's inquiries address technical issues of tax administration, clarification and simplification rather than rates or incidence of tax.
2. The Sub-Committee did not meet last year owing to an unusual Finance Bill cycle. The Economic Affairs Committee aims to publish the report drawn up by its Sub-Committee in time to enable members of the House of Commons, if they so wish, to draw on its recommendations in moving amendments to the Bill at the Report Stage. The report should also inform the Second Reading debate of the Bill in the House of Lords.
3. As in previous years the Sub-Committee selected a few topics for close examination. If it chose to examine the whole Bill, its treatment of each topic could be only cursory.
4. This year the Sub-Committee chose three topics which it considered of particular importance. The first topic involved the Government's new approach to tax policy. Last June a discussion document was published setting out how a new approach might work and a response document followed in December, along with drafts of most Finance Bill clauses and schedules. The Government's Tax Consultation Framework was finalised in a document published in March 2011. The Sub-Committee chose to have an early look at this new approach and how it had worked in its first cycle involving Finance Bill 2011. Many of our recommendations also apply to the Government's new approach to tax policy making as it unfolds over the next few years.
5. The second topic concerned the Government's new approach to anti-avoidance with special reference to the draft legislation on disguised remuneration. In its tax policy making document of June 2010, the Government launched a strategic approach to tackling tax avoidance. How it would be implemented was set out fully in a Budget 2011 document *Tackling Tax Avoidance*. The disguised remuneration legislation had been included in the draft Finance Bill published in December 2010 and has been the subject of much controversy and amendment.
6. The third topic related to the corporation tax reform package set out in a document published in November 2010 with further enhancements in Budget 2011. Some of the proposals in this package are part of Finance Bill 2011, others are still subject to consultation and will be included in a later Bill.
7. As in previous years, the Sub-Committee conducted its inquiry by taking written and oral evidence drawn mainly from leading professional and business organisations and from HMT and HMRC. A list of those who have contributed to the inquiry in this way is given in Appendix 2: their evidence is published on the following link:

<http://www.parliament.uk/documents/lords-committees/economic-affairs-finance-bill/FBSC11ev.pdf>.

The Sub-Committee would like to thank all those who have contributed to its work.

8. The Sub-Committee's findings on the three topics are in Chapters 2 to 4. Its conclusions and recommendations are in Chapter 5.

CHAPTER 2: THE NEW APPROACH TO TAX POLICY MAKING

9. This chapter looks at the “new approach to tax policy making” introduced progressively over recent months and assesses its impact on the Finance Bill 2011. The chapter goes on to consider how the new approach might be embedded in the practices of policymakers, delivered more effectively and its scope extended. It concludes by looking at various proposals for enhancing the Parliamentary scrutiny of tax legislation.

Context

10. In June 2010, alongside the Chancellor’s Emergency Budget, the Government published a discussion document setting out proposals for a new framework for policy making. In his foreword to the document David Gauke MP, Exchequer Secretary to the Treasury, wrote
- “I want a new approach to tax policy making; a more considered approach. Consultation on policy design and scrutiny of draft legislative proposals should be the cornerstones of this approach. The Government will always need to maintain flexibility to make changes to the tax system. But in doing so, it should be transparent about its objectives, and open to scrutiny on its proposals.”¹
11. The Introduction spelt out the Government’s intentions, saying that it “is committed to a new approach to tax policy making, designed to support its ambition for a more predictable, stable and simple tax system”. The new approach will provide “clarity ... on the future direction of the tax system, ... fewer and better developed proposals” and increasing simplicity by creating “an independent Office of Tax Simplification.”² “It is also important that the Government is held to account in the development of tax policy” by ensuring proper scrutiny, more transparency and evaluation of “the impact of significant changes after implementation.”³

The Tax Policy Making Consultation

12. Aside from a commitment to tax simplification and a more strategic approach to anti-avoidance, the core of the new approach consists of making space for consultation to take place at each stage in tax policy development, improving the consultation process and enabling more effective scrutiny of tax policy and legislation.
13. The June proposals distinguished three stages in the policy-making process: setting out policy objectives and identifying options; determining the best option and developing a detailed framework for implementing it; and drafting legislation to give effect to the policy. To create a window for consultation on draft Finance Bill legislation, the majority of tax changes would be “confirmed no later than three months before the tax year in which they come into effect or publication of the Finance Bill in which they are to be included.”⁴
14. In practice, this would mean that most major tax measures announced in one year’s Budget would not be legislated until the following year’s Finance Bill, and that the great majority of the Bill would be issued in draft three months before it

¹ *Tax policy making: a new approach*, HMT and HMRC, June 2010, page 3

² *Ibid*, paragraph 1.5

³ *Ibid*, paragraph 1.6

⁴ *Ibid*, paragraph 2.10

was published formally. The main exceptions to this timetable would be straightforward changes to tax rates, allowances and thresholds, revenue protection measures and those areas where there was a significant risk of forestalling.

15. To improve the consultation process the document proposed consulting at each stage in the policy-making cycle; setting out the policy objectives, impact analysis, and assumptions on which the policy had been developed; and outlining the strategy for stakeholder engagement, including the individuals leading a particular consultation. To enable more effective assessment of tax proposals and their consequences, Tax Impact Assessments covering a wider range of impacts than regulatory impact assessments would be published. In addition, alongside the Budget, the Government would issue a document on its policy costings, scrutinised and certified by the Office for Budget Responsibility.
16. The June document also outlined the Government's new anti-avoidance strategy, discussed in Chapter 3, and confirmed its intention to establish an independent Office of Tax Simplification (OTS). The OTS was set up on 20 July 2010 in order "to provide advice to the Chancellor on simplifying the UK tax system, with the objective of reducing compliance burdens on both businesses and individual taxpayers."⁵
17. The Government's response to the consultation⁶, published on 9 December 2010, confirmed the main elements of the new approach to tax policy making described above. Proposals concerning the consultation process were reworked and consolidated into a draft Tax Consultation Framework. The response document also responded to calls for greater Parliamentary scrutiny by announcing that the House of Commons Treasury Committee intended to take a more active role in scrutinising proposals on taxation and had launched an inquiry into the principles of tax policy.
18. The proposed Tax Impact Assessments were renamed Tax Information and Impact Notes (TIINs) and their scope was extended to "set out in a single place, for each measure, what the tax change is, why the Government has decided to make the change and what are the likely impacts of the change."⁷ The Government would engage with interested parties in developing its analysis and a "final assessment of impacts will be published once the final policy design has been confirmed"⁸, in most cases at the time when draft legislation was issued for consultation.
19. With its response to the consultation and the draft Tax Consultation Framework, the Government published draft clauses and schedules for most of the measures destined for the 2011 Finance Bill along with their respective TIINs. A draft Protocol for announcing unscheduled changes to tax law was issued for comment at the same time.

The Treasury Committee's Principles of Tax Policy

20. The House of Commons Treasury Committee's report⁹ on its guiding principles for tax policy was published on 15 March 2011. It concluded that

⁵ *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, paragraph 2.44

⁶ *Ibid*

⁷ *Ibid*, paragraph 2.61

⁸ *The Government's Tax Consultation Framework: Summary of Responses and finalised Framework*, HMT and HMRC, March 2011, paragraph 4

⁹ *Principles of tax policy*, House of Commons Treasury Committee, Eighth Report of Session 2010–11, HC753, March 2011

tax policy should be fair and practicable, support growth and encourage competition, and provide certainty and stability, and that the tax system as a whole must be coherent. The Treasury Committee intends “to consider the measures contained in future Budgets against these principles.”¹⁰

The Tax Consultation Framework

21. The final version of the Tax Consultation Framework¹¹ was published on Budget Day 2011. It set out five stages in the development and implementation of tax policy:

- (i) setting out objectives and identifying options;
- (ii) determining the best option and developing a framework for implementation, including detailed policy design;
- (iii) drafting legislation to effect the proposed change;
- (iv) implementing and monitoring the change; and
- (v) reviewing and evaluating the change;

and committed the Government to full and open consultation at each stage, except in exceptional circumstances.

22. Responding to concerns about monitoring the Government’s compliance with the Framework, its final version provided that “The Tax Professionals Forum will consider the Government’s performance against this Framework and report on this in their regular meetings with Ministers.”¹²

The New Approach in Principle

23. All our witnesses welcomed the Government’s new framework for tax policy making. The new approach builds on the good practices developed by previous governments and on the analysis and conclusions of earlier reviews¹³, including recommendations about stakeholder consultation made in previous reports of this Committee.¹⁴

24. The Law Society of England and Wales (LSEW) wrote “The Society generally welcomes the Government’s commitment to a more considered approach to tax policy making as set out in its initial discussion document.”¹⁵ The Chartered Institute of Taxation (CIOT) commented that the Government’s new approach to tax policy making “is something we very much welcome. Many of the principles set out in the TPM approach reflect our own thinking ...”¹⁶ Ms Anne Redston thought “It is this type of policy making which preceded our most robust fiscal reforms, such as self assessment and many of the changes to capital allowances.”¹⁷ She also

¹⁰ Andrew Tyrie MP, Chairman of Treasury Committee Press Release, 15 March 2011

¹¹ *The Government’s Tax Consultation Framework: Summary of Responses and finalised Framework*, HMT and HMRC, March 2011

¹² *Ibid*, paragraph 10

¹³ The June discussion document cites *Making Taxes Simpler*, July 2008. This was the final report of the working party, chaired by Lord Howe of Aberavon, taking forward the recommendations of the Forsyth Tax Reform Commission Report, *Tax Matters—Reforming the Tax System*, October 2006.

¹⁴ For example, this Committee’s reports on both the 2008 and 2009 Finance Bills contained sections on how the consultation process had been carried out in developing the Finance Bill measures examined; highlighted good and bad practice; and made recommendations.

¹⁵ FBSC 1 paragraph 1

¹⁶ FBSC 3 paragraph 3

¹⁷ FBSC 2 paragraph 33

- commented “In contrast, most poor policy decisions are caused by jumping straight to the ‘solution’.”¹⁸ All other witnesses agreed.
25. Separating the policy-making process into five stages received particular approval. The Institute of Directors (IoD), for example, observed that “The most important innovation under the new Government is to separate out the five stages of policy-making, ...” and “It is essential to start by deciding on the objectives, and then think about how to achieve them, rather than to select a specific policy at the outset.”¹⁹
 26. Mr Chris Wales of FTI Consulting summed up the consensus “It is widely acknowledged that the present government has made good progress in formalising the best of the informal processes of the previous government and in correcting some of the flaws that have long added frustration and mystery to a process that can and should normally be open and transparent.”²⁰
 27. In many cases this warm welcome was tempered by caution: it remained to be seen whether the new approach would in fact be implemented consistently over the years. The Hundred Group’s submission, for example, concluded that “The new approach to tax policy making, if implemented, will be welcomed.”²¹
 28. Mr Ashley Greenbank (LSEW) took a similar view “We were generally very supportive of the new frameworks, but I think we regard them as statements of intent more than anything else.”²² Mr Frank Haskew of the Institute of Chartered Accountants in England and Wales (ICAEW) warned that the Government should not “underestimate that to do it properly will require improved scrutiny and improved resources to be put in over a consistent period of time.”²³
 29. This caution should come as no surprise. As some of the evidence noted, the Exchequer Secretary had recognised in his foreword to the December 2010 document that “good intentions here are welcome, but taxpayers and advisers will want to see consistency in putting them into practice.”²⁴
 30. **There was a clear consensus amongst our witnesses that, if implemented consistently, the Government’s new approach to tax policy making would represent a major step on the road to better tax legislation for the UK. We warmly welcome and commend the Government’s commitment to following the procedures outlined in the Tax Consultation Framework, and the quality of the consultation it conducted in arriving at the Framework and other aspects of its new approach.**
 31. Notwithstanding this general approval of the progress the Government has made, all our witnesses had views on how the new approach might be made more effective or extended. We return to these below. We also consider how to make sure that it is delivered effectively, after assessing how well the new policy cycle worked for Finance Bill 2011.

¹⁸ FBSC 2 paragraph 34

¹⁹ FBSC 7 paragraph 3

²⁰ FBSC 14 paragraph 8

²¹ FBSC 16 paragraph 4

²² Q 30

²³ Q 175

²⁴ *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, page 3

Finance Bill 2011

32. There was a general sense in the evidence we received that the new approach had improved the quality of much of the legislation in the Finance Bill, although it was clearly resource intensive on both sides. Of the process in general, Mr Wales wrote “The *New Approach* has delivered some benefits and will deliver more. Consultation is beneficial to all, if potentially so extensive now as to be exhausting.”²⁵
33. The CIOT concurred: “Exposing a large proportion of the draft Finance Bill legislation in December was constructive, although it has inevitably meant additional burdens on all sides in the first year of operation of the new procedures.”²⁶ And the EEF noted that “manufacturers have noticed a marked improvement in the quality of consultations, engagement and communication with government departments on proposed reforms.”²⁷
34. This view that the policy development and consultation process had generally worked well in its first cycle was reflected also in the oral evidence we heard. Mr Richard Woolhouse of the Confederation of British Industry (CBI) and Mr Richard Baron (IoD) both spoke of a noticeable improvement. Mr Jeegar Kakkad (EEF) added “there have absolutely been benefits from the new approach to tax policy making.”²⁸
35. Two examples received particular praise: the changes to the pensions tax relief provisions and the proposals for reforming corporation tax. On the first Ms Redston wrote, “The pensions changes at schedules 16–18 of this Finance Bill deserve praise for meeting, and then going beyond, the new consultation requirements.”²⁹ The Corporation Tax (CT) Roadmap was generally seen as providing an excellent model for the conduct of future consultations on significant tax reforms. We return in chapter 4 to the CT Roadmap and to the other measures in the CT reform package, some of which appear in the current Finance Bill, while others are due in later Bills.
36. Experiences of the policy making process running up to Finance Bill 2011 were not however universally positive. Ms Redston wrote: “Despite the excellent recipe set out in the *New Approach*, the Finance Bill disappointingly contains the whole gamut of consultation methodologies.”³⁰ The Finance Bill provisions brought to our attention for not measuring up to the new policy process included the change to the Bank Levy, announced in Budget 2011, and the PAYE security measure where the different stages of the new approach appear to have been conflated. But most of the criticism focused on the disguised remuneration provisions and the changes to the tax regime for oil and gas.

Disguised Remuneration

37. Clause 26 and Schedule 2 of the Finance Bill introduce measures to prevent the avoidance or deferral of income tax by dressing up what is effectively employment remuneration as a loan or payment from a trust or other third party. The legislation also seeks to counter schemes designed to avoid

²⁵ FBSC 14 paragraph 59

²⁶ FBSC 3 paragraph 6

²⁷ FBSC 8 paragraph 9

²⁸ Q 169

²⁹ FBSC 2 paragraph 36

³⁰ FBSC 2 paragraph 35

- restrictions on pensions tax relief. The nature of the legislation and its scope are discussed in Chapter 3. This chapter is concerned only with the process leading to the legislation in the Bill and whether it measures up to the principles of the new approach.
38. The intention to legislate against this abuse was announced in the Budget of June 2010, confirming an announcement made in the Budget of March 2010. Although there was broad agreement that the abuse needed to be tackled, consultation on the measure only began when the draft legislation was published for comment on 9 December.
 39. As will be seen further in chapter 3, the approach adopted in the draft legislation was widely regarded as casting a net so wide that it caught many *bona fide* arrangements using employee trusts. Although they stuck to their original approach, HMRC appear to have run a good consultation on the draft legislation, responding positively to comments. We sought to find out from our witnesses whether they thought the consultation should have started at an earlier stage, immediately after the June 2010 announcement.
 40. Our private sector witnesses agreed that there had been full consultation on the draft legislation on disguised remuneration after it was published. But they thought that the problems with these and subsequent drafts stemmed from the absence of consultation before the legislative approach to tackling disguised remuneration was settled. Mr Haskew, for example, said “I think the trouble is that we did not have a consultation on this at the very beginning about the right way of tackling it.”³¹ This was out of step with the policy process set out in the Tax Consultation Framework.
 41. Mr Greenbank contrasted the consultation process here with that adopted for the chargeable gains measures in the Bill, “The difference between the two was a focus at the beginning of the chargeable gains consultation on the underlying principles and a willingness to engage with taxpayers and their representatives on those principles, rather than the disguised remuneration case, where the framework was set in stone before any consultation took place.”³²
 42. The Tax Consultation Framework provides that the Government should “consult, where it can, on the policy design, draft legislation and implementation of anti-avoidance and other revenue protection measures, provided this does not present additional risk to the Exchequer.”³³ This raised the question of whether consultation in those early stages about the best way to tackle disguised remuneration was unduly risky.
 43. Asked whether consultations should have started earlier, Mr Dave Hartnett (HMRC) replied that it was “incredibly important to recognise that there has been very significant consultation here. We have had a lot of engagement with people who plan in this area.”³⁴
 44. We have not been offered convincing reasons for not opening consultations earlier, although we do recognise that the Government had only recently taken office when the June 2010 announcement was made. We agree with Mr Chas Roy-Chowdhury of the Association of Chartered Certified

³¹ Q 205

³² Q 30

³³ *The Government's Tax Consultation Framework: Summary of Responses and finalised Framework*, HMT and HMRC, March 2011, paragraph 3

³⁴ Q 276

Accountants (ACCA) that a clearer announcement in June 2010 of the Government's intended target, coupled with a warning that measures would be backdated to the announcement would have created a relatively safe interval for early consultation. Such an approach might well have led to better legislation; at the very least the Government's commitment to the new approach would have meant that the outcome would have had more credibility among stakeholders.

Flexibility and Changes to Oil and Gas Taxation

45. The Finance Bill increases the supplementary charge payable in respect of ring fenced profits from oil and gas production in the UK and UK Continental Shelf from 20 per cent to 32 per cent. This took effect from 24 March 2011. The change was announced in the 2011 Budget as a means of funding the reduction in fuel duty and the suspension of the fuel duty escalator announced on the same day. The Government was sharply criticised for announcing the changes to the oil and gas taxation regime without prior consultation.
46. Private sector witnesses recognised that the Government had made clear that it reserved the right to bypass its policy framework in exceptional circumstances. Our witnesses thought that even informal consultation would have enabled a better understanding of the implications of the proposed increase for investment and other decisions in the oil and gas industries. Peremptory announcements also risked devaluing public perceptions of the Government's commitment to the new approach and to a stable and predictable tax system.
47. The Hundred Group pointed out that "there was no consultation on the significant increase in the Supplementary Charge applicable to the UK oil and gas industry. We believe that significant increases in taxation which are introduced without consultation act to undermine business confidence."³⁵ The CBI wrote in similar terms. The Institute of Chartered Accountants of Scotland (ICAS) wrote of the "credibility gap between the Government's stated intentions and the legislation which it delivers."³⁶ Mr Wales thought that this change had "shaken confidence beyond the sectors immediately affected and damaged the Government's strong and growing reputation for maintaining a stable system."³⁷ Others agreed.
48. These and other concerns also emerged in evidence given to the House of Commons Treasury Committee's inquiry into Budget 2011 which concluded that the decision "may weaken the Government's credibility in seeking to establish a stable tax regime in this and other areas."³⁸
49. Mr Edward Troup (HMT) defended the Government's decision by arguing that the full consultation process had applied to over 80 per cent of the Bill and "The oil tax changes were an example of one of those measures where the Chancellor needs flexibility and needs to make a decision and an announcement without prior consultation. Do we feel embarrassed about that? No. In the context of what we did overall in the Finance Bill, we are

³⁵ FBSC 16 paragraph 5

³⁶ FBSC 10 paragraph 1.1

³⁷ FBSC 14 paragraph 61

³⁸ *Budget 2011*, House of Commons Treasury Committee, Tenth Report of Session 2010–11, HC 897, paragraph 157

extremely pleased that the very high proportion of pre-consultation committed to in the tax policymaking paper was put into effect.”³⁹

50. Asked about the pre-announcement analysis of the effects of the changes on the oil and gas industry, Mr Troup said the impact assessment in the relevant TIIN was based on a close knowledge of the industry built up by HMRC and HMT analysts over many years. He concluded that “Although since the Budget we have fleshed out a lot of the details of that and had a lot of engagement with industry, the broad thrust of what was said in here has stood up to that analysis and scrutiny.”⁴⁰
51. We do not accept that the good consultation record on the large majority of the Bill provides sufficient justification for not consulting on the remaining changes. We heard no convincing reasons why it was not possible, nor desirable, to consult stakeholders on the changes to oil and gas taxation, even on a confidential basis, before the Budget announcement. In the past we have had some concerns about informal consultations with selected stakeholders. However, we recognise, along with some of our witnesses, that such confidential discussions may help reduce the risks of unintended consequences in those very exceptional circumstances where the Government is unable to observe fully the requirements of the Framework.

The 2011 Finance Bill as a Whole

52. **We consider that most of the measures in Finance Bill 2011 were developed in accordance with the principles of the new approach to tax policy making. The corporate tax reform measures and the changes to pensions tax relief stand out as examples of best practice. We commend the Government accordingly.**
53. **We are concerned about instances where consultation failed to take place at some stages of the process for policy development outlined in the Tax Consultation Framework. The main examples brought to our attention were the disguised remuneration measure and the increase in the supplementary charge applicable to companies in the UK oil and gas industry. In the first case consultation began only after the first draft of the legislation was published and in the second after it was announced in Budget 2011.**
54. **We are not persuaded that consultation on the disguised remuneration measure could not have started immediately after an announcement and believe that full consultation at every stage might not only have improved the legislation but could also have won greater support and credibility among stakeholders.**
55. **We accept that the Government needs to maintain flexibility to respond quickly to immediate issues. However, even in these circumstances, the Government should do all it can to consult, albeit on an informal, confidential basis. We are not persuaded that the increase in the supplementary charge on oil and gas profits was a case which justified ruling out such informal, confidential consultations before the Budget announcement.**
56. **We are concerned that, if the Government does not abide by its own rules for tax policy making, it risks eroding the credibility of its**

³⁹ Q 238

⁴⁰ Q 238

commitment both to the new approach and to a stable and predictable tax system for the UK. We recommend that the Government observe the five-stage process for progressing from policy objective to final evaluation, with consultation at each stage, in all but the most exceptional cases, and that the reasons for any such exceptions be explained fully after the announcement.

Delivering the New Approach

57. The Hundred Group’s written evidence pointed out that “the key to the success of the new approach will be (i) its delivery and (ii) the extent to which it becomes firmly embedded as standard practice.”⁴¹ We discuss each of these below taking the embedding process first and then various aspects of delivery.

Embedding the New Approach to Tax Policy Making

58. The response document of December 2010 set out that “The Government is committed to better tax policy making. It recognises that achieving this requires some real and substantive changes to the way in which tax policy is developed, communicated and legislated. Embedding this new approach and delivering these improvements will take time.”⁴² To help ensure this, the Tax Professionals Forum is charged with monitoring whether individual tax measures have followed the new policy making process. One of the functions of the Forum is “to challenge the Government if the new approach is not being followed or is not having a demonstrable effect on the predictability, stability and simplicity of the UK tax system.”⁴³
59. Although the Tax Professionals Forum and HMRC’s Consultation Coordinator⁴⁴ provide a degree of assurance, the Hundred Group were not alone in emphasising the need to establish the new approach in the policy making practices of Treasury Ministers and their officials. But witnesses did not offer many suggestions on how best to achieve this. Where they did their views differed.
60. Mr Malcolm Gammie QC of the Institute for Fiscal Studies (IFS) thought that embedding the new approach was probably best done gradually “through custom, through ensuring that, by building expectations, it is more difficult for a Minister to move away from what they have established as a good way of formulating and testing tax policy.”⁴⁵ Mr Paul Johnson (IFS) agreed. In contrast, Ms Redston, along with the CBI, preferred the new approach to be “made mandatory, even for Ministers with difficult budgetary decisions, and that obligation properly enforced.”⁴⁶ The ICAEW, on the other hand, called for “some independent oversight to determine whether the government has complied with the framework year on year”⁴⁷, and Mr Haskew suggested that the House of Commons Treasury Committee might take on that oversight role.

⁴¹ FBSC 16 paragraph 4

⁴² *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, paragraph 1.3

⁴³ *Ibid*, paragraph 1.7

⁴⁴ The Coordinator has responsibility for oversight of all HMRC and HMT tax consultation activity.

⁴⁵ Q 2

⁴⁶ FBSC 2 paragraph 60

⁴⁷ FBSC 9 paragraph 9

61. Asked how HMT and HMRC proposed to embed the new approach, Mr Troup stressed that both departments were “very keen that we hold ourselves to account and we are scrutinised”⁴⁸ and that the Exchequer Secretary wanted to make sure the new process is “embedded institutionally.”⁴⁹ Guidance and training had been produced for people working on tax policy across the two departments and they were looking for further ways of embedding the new arrangements. He stressed the role of the Tax Policy Forum and told us the minutes of its meetings would be published.
62. **We welcome the role of the Tax Professionals Forum in monitoring compliance with the new framework and were reassured to hear that the notes and conclusions of their meetings were to be published. We were not persuaded, at this stage, by the arguments for enhancing these monitoring arrangements. But we agree that the new approach needs to be firmly embedded in policy-making practice and we will monitor progress in this respect when reviewing future Finance Bills.**

Delivery: Tax and Policy Skills and Responsibilities

63. All our private sector witnesses believed that the successful delivery of the new approach depended critically on the availability of well-staffed, experienced and technically competent teams in both departments and on an effective partnership between them. Most thought there was considerable scope for improvement in this area.
64. The central issues identified by witnesses were staff turnover, particularly in HMT, lack of commercial awareness, technical tax knowledge and experience and the apparent difficulty of attracting and retaining talented people in tax policy jobs. The Hundred Group, for example, argued that “Successful implementation of the new approach will require well resourced and highly skilled teams”, with stability and continuity, and that “specialism should be recognised and encouraged.”⁵⁰
65. Much of the discussion turned on the effectiveness of the reorganisation which followed the O’Donnell review⁵¹ in 2004. This recommended the merger of the Inland Revenue and HM Customs and Excise to form HMRC and the realignment of responsibilities for tax policy making, with HMT responsible for tax policy development and HMRC for policy maintenance and the two departments supporting each other in their policy roles (the “policy partnership”).
66. The consultation on the new approach had raised similar issues and the document of December 2010 noted that “HM Treasury and HMRC are working closely together to help address the issues and concerns raised. A new approach to tax policy making and a strong emphasis on raising professionalism and expertise across the policy partnership is important. The Spending Review also provides an opportunity to look at how both departments can do things better. This will include being clearer about which department is leading on the development of a particular policy reform.”⁵²

⁴⁸ Q 243

⁴⁹ Q 243

⁵⁰ FBSC 16 paragraph 8b

⁵¹ G.O’Donnell, *Financing Britain’s Future: Review of the Revenue Departments*, Cm 6163, HMT 2004

⁵² *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, paragraph 2.83

67. These aspirations notwithstanding, our witnesses remained concerned. Mr John Whiting (CIOT) thought that some of the issues stemmed from the nature of career structures and incentives in the two departments. Rising Treasury officials tended to change jobs relatively frequently and lacked incentives to become tax specialists. Whereas, prior to the O'Donnell reorganisation, rising Inland Revenue officials sought careers in tax policy, now they had little incentive to do so because HMRC had become very much an operational organisation. So attracting talented people to a long-term specialist career in tax policy in either department was extremely challenging. This contrasted markedly with private sector tax careers where people were "used to plugging away and going up the tree."⁵³
68. Mr Gammie stressed the need to find ways of retaining tax policy knowledge when individuals moved and observed that "it was not entirely clear that Treasury and Revenue and Customs worked satisfactorily together in the sense of having clearly defined responsibilities."⁵⁴ Mr Johnson agreed adding that "the level of input made by those with expertise in tax policy can be quite variable."⁵⁵
69. Mr Woolhouse thought that improving matters while resources were tight was very difficult and suggested "either changing career structures overall and getting more embedded tax expertise or bringing in more people from business ... so that there is understanding not only of institutional memory or knowledge about the tax system but also about the way that business operates. HMRC are moving towards that but I think it is very gradual."⁵⁶
70. Mr Wales thought that the O'Donnell changes had created an imbalance of policy responsibilities between HMT and HMRC and that this had "weakened the policy process."⁵⁷ He expanded on this theme in his written evidence "In particular, the transfer of policy expertise from what is now HMRC to HM Treasury has disconnected policy-making too fully from the taxpayer interface. It has also reduced career opportunity at HMRC for those with potential as policy-makers. Over time, there is a risk that policy-making will lose the sharpness that taxpayer contact provides."⁵⁸
71. Mr Ian Menzies-Conacher (CIOT) called for a review of the current organisational split. Mr Whiting agreed and pointed to a recent report⁵⁹ by DEMOS which also called for a review of responsibilities for tax policy making. Mr Roy-Chowdhury thought that "tax policy is in the wrong place. It ought to go back into HMRC. HMRC have the tax expertise."⁶⁰
72. Officials responded vigorously to criticism by private sector witnesses. Mr Troup described private sector concern over continuity of personnel in Treasury teams as "fair, in the sense that they are having to bear some of the cost"⁶¹ of re-educating their new Treasury counterparts following a change.

⁵³ Q 77

⁵⁴ Q 1

⁵⁵ Q 6

⁵⁶ Q 166

⁵⁷ Q 12

⁵⁸ FBSC 14 paragraph 17

⁵⁹ Kitty Ussher and Imogen Walford, *National Treasure*, DEMOS, March 2011. T. Bowler, *Tax Policymaking in the UK*, Tax Law Review Committee, Discussion Paper 8, IFS, June 2010 made similar recommendations on this issue.

⁶⁰ Q 188

⁶¹ Q 245

But there were benefits to be set against that: the Treasury career model, which involved relatively frequent moves, attracted very high-calibre recruits and meant that when officials moved to tax policy posts they brought with them a broader perspective reflecting the full range of Treasury objectives and concerns. Mr Troup felt that the balance was generally positive. Citing the controlled foreign companies and pensions reforms as examples, Mr Troup also emphasised that “although we hear this general concern about lack of expertise, when you focus down on the detail and pick up any matter, we get some really good feedback.”⁶²

73. Asked whether there had been a formal evaluation of the policy partnership, Mr Hartnett said “Edward and I together have had a very good look at that over the last 12 months, with a number of colleagues.” They had identified things that had worked really well and others that could have worked better, and learnt and applied some lessons. He concluded that “We have reinvigorated the policy partnership recently. We are pretty sure it will work still better.”⁶³
74. Mr Troup added that the recent spending review had made them very disciplined about how they used the resources available to them and brought a sharp focus “on the importance of getting the relationships and accountabilities clear right down the chain.” He concluded that the high quality of the partnership’s product “is a reflection on how well we have collectively been working, with pretty limited resources. I really do not accept some of the criticisms in the evidence you have heard.”⁶⁴
75. **There appears to be a severe, and worrying, disconnect between the perceptions of HMT and HMRC and those of their customers about how well the policy partnership between the two departments is working. Many private sector witnesses expressed strong reservations about its effectiveness and about stability, continuity and tax knowledge in many tax policy teams. In contrast, officials assured us that, in spite of some difficult challenges, the policy partnership was working well. A recent joint review by senior officials had led to a “reinvigorated” partnership. These rebuttals were reminiscent of the line taken by officials in 2008 when our predecessor Committee last examined the policy partnership and recommended that HMT and HMRC should look at how well the two departments were working together.**
76. **We recommend that the findings of the internal review of the policy partnership should be published as soon as possible to assuage the concerns of our private sector witnesses. Unless already covered by the internal review, we further recommend a comprehensive audit of the tax skills and experience of HMT and HMRC staff working on developing tax policy and legislation and an assessment of whether the present arrangements provide sufficient incentives to attract and retain the best talents to this work.**

Delivery: Administering Tax Changes

77. Many of our witnesses thought that for good policymaking and legislation to lead to the outcomes intended by Parliament, any changes needed to be

⁶² Q 244

⁶³ Q 246

⁶⁴ Q 247

implemented and administered by appropriately trained staff, especially where application of the rules required informed judgement. There was generally thought to be a shortfall both in staff skill levels and numbers.

78. Ms Redston emphasised that successful delivery of new policies required “high-quality input after it has been implemented and become law, as well as beforehand.”⁶⁵ The ICAEW suggested: “There will be little benefit in having better tax policy formulation if the tax system is not administered efficiently. In our view HMRC’s poor service standards is one of the single biggest barriers to improving the efficiency of the UK tax system.”⁶⁶ The CBI agreed.
79. Mr Haskew said that the ICAEW had supported the merger establishing HMRC but that “five years into this, we and our members have seen a deterioration in service standards. That is a serious matter of concern.”⁶⁷ Mr Derek Allen agreed and complained of particular problems with complex legislation where staff “simply do not understand the law to apply it properly.”⁶⁸ Mr Richard Murphy of Tax Research spoke similarly, adding “it is quite clear that people are not being trained well enough”⁶⁹, a view seconded by Mr Menzies-Conacher.
80. The issues here concern the tax knowledge, training and number of HMRC front-line staff delivering particular policies and service delivery more generally. Mr Hartnett answered on both points. On the first, he described HMRC’s plans to “carry on growing our own cadre of tax professionals” and “ensure that they are qualified to the right level.”⁷⁰ Referring to HMRC staff working on implementing tax changes, he said that he was “certainly happy with the number of our people doing that and I am happy with the quality, too.”⁷¹
81. On service delivery more generally, Mr Hartnett referred to the assurances given to the Public Accounts Committee⁷² by Dame Lesley Strathie, chief executive of HMRC, that the department planned “to have cleared all our backlogs by the end of 2012. Those backlogs have been a huge inhibitor to the improvement of service.” He added: “We acknowledge and have apologised for the poor service and we are determined that by the end of 2012 people will see a big difference.”⁷³
82. **We recognise, as did our witnesses, the challenges HMRC face in improving service quality when their resources are being reduced and we welcome assurances from officials that training has been put in place to improve the technical tax skills of many of HMRC’s staff. Despite these assurances, we share the concerns of witnesses about the quality and training of frontline staff. We recommend that HMRC should carefully research the views of their stakeholders on this matter and address them urgently.**

⁶⁵ Q 40

⁶⁶ FBSC 9 paragraph 18

⁶⁷ Q 187

⁶⁸ Q 189

⁶⁹ Q 83

⁷⁰ Q 248

⁷¹ Q 248

⁷² *HM Revenue and Customs’ 2009–10 Accounts*, House of Commons Committee of Public Accounts, Eighteenth Report of Session 2010–11, HC 502, February 2011

⁷³ Q 314

Delivery: Widening Consultation with Smaller Businesses and Individuals

83. The Government's response to the new approach to consultation noted that representations emphasised "the need to consult more 'end users' such as small businesses, charities and members of the public as well as representative bodies, particularly to test assumptions and anticipated impacts"⁷⁴, but offered no further proposals for widening consultation. Some of our witnesses were concerned that, while the arrangements for consulting larger business interests and tax and accountancy groups were well-established, comparable arrangements for engaging with smaller businesses and with non-business taxpayers were lacking.
84. Mr Wales emphasised the importance of interacting with taxpayers of all types. Of consultation with business he observed: "Over the past 15 years, probably slightly more, tremendous progress has been made in the UK in improving the quality of consultation with business. Business expects to be consulted on tax issues."⁷⁵ But that was not matched by similar progress on consulting other groups.
85. The ICAS written evidence observed that consultation could often be with a very small group of representative bodies and that the 30 million or so taxpayers did not generally participate in tax consultations through lack of time and understanding of, often, very complex legislation.⁷⁶ Mr Murphy stressed that there had to be "broader representation of those who are asked to take part in consultations if they are to be meaningful or else, frankly, this process is going to fail."⁷⁷
86. Mr Troup observed in response that "Individual taxpayers do not really know how to engage with the tax system and may not be able to, so we have to push quite hard and get out and get views. We have spent an awful lot of time in my teams and in Dave's trying to engage on that."⁷⁸ He went on to explain how the Treasury website had been used to enable the general public make their Budget representations. Mr Hartnett added that, as part of its review of HMRC powers, his department had successfully brought together large groups of taxpayers to gauge their views and received markedly different responses from those they had got from representative bodies.
87. Mr Troup also assured us that HMT had very good engagement with small business representative bodies and HMT and HMRC both "have as much direct engagement with sample businesses as we can, to calibrate what we are hearing from the representative bodies."⁷⁹
88. In supplementary written evidence, HMRC's strategy for engaging with small business was outlined. This includes an SME Joint Opportunities Panel, consisting of the main bodies representing small and medium-sized enterprises. This aims to deepen HMRC's "knowledge, insights and experiences of SME customers, as well as the issues facing them"⁸⁰ and "to develop and test new proposals for changes in processes or customer services

⁷⁴ *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, paragraph 2.16

⁷⁵ Q 12

⁷⁶ FBSC 10 paragraph 1.2

⁷⁷ Q 69

⁷⁸ Q 251

⁷⁹ Q 313

⁸⁰ FBSC 18 paragraph 13

to improve the SME experience.”⁸¹ HMRC also undertake regular (qualitative and quantitative) research into the “needs, attitudes and behaviours”⁸² of SME customers and their staff are “encouraged to ‘*think small first*’”⁸³ in developing tax policy.

89. **We recognise that some good work has already been done by both HMRC and HMT to improve the way in which they consult with small and medium-sized businesses. However, we are concerned that this consultation is almost exclusively with representative bodies which, because of the number and diversity of smaller businesses, may not reflect the full range of views. We therefore recommend that HMT and HMRC extend their current initiatives aimed at consulting smaller businesses so as to engage more directly with specific types of enterprise.**
90. **Our predecessors have drawn attention in past reports to the need for consultation to be as open as possible and to cover the full range of interests affected by proposed tax measures. We recognise that consulting non-business stakeholders poses very difficult challenges and that HMT and HMRC already engage with some organisations representing the interests of lower-income households. But we think it is important that the Government finds effective ways of consulting a wider range of taxpayers, especially when considering changes to the personal tax system. We therefore recommend that HMT and HMRC develop and publish a comprehensive strategy for consulting non-business stakeholders on tax proposals likely to affect them.**

Delivery: Consulting on Tax Information and Impact Notes

91. As part of the process of policy formulation, the Tax Consultation Framework requires HMT and HMRC to share their “current assessment of the impacts of the proposed change and seek to engage with interested parties on this analysis. A final assessment of impacts will be published once the final policy design has been confirmed.”⁸⁴ Although this requirement had been added to the Framework to meet concerns expressed in the consultation, witnesses told us that such engagement rarely occurred before TIINs were published and, as a result, they tended to underestimate business compliance costs.
92. Mr Haskew considered such cost underestimates occurred because HMRC used out-of-date information and, more importantly, did not allow for the fact that decisions about business system changes needed in response to a tax change often involved senior managers and external consultants rather than account clerks. He pointed to the impact assessment for the disguised remuneration measure which concludes that “most businesses will discontinue the use of these arrangements” so that “compliance costs to businesses overall are thought to be insignificant”. In fact, the advice employers were receiving was that “almost every single employee benefit arrangement will have to be scrutinised in detail.”⁸⁵

⁸¹ Ibid, paragraph 13

⁸² Ibid, paragraph 13

⁸³ Ibid, paragraph 5

⁸⁴ *The Government’s Tax Consultation Framework: Summary of Responses and finalised Framework*, HMT and HMRC, March 2011, paragraph 4

⁸⁵ Q 182

93. Mr Roy-Chowdhury confirmed that, although the ACCA had been involved in the consultation on the disguised remuneration provisions, they had not been consulted on its compliance costs.⁸⁶ Mr Haskeew considered that impact assessments could be improved significantly if HMRC were to engage with advisors and businesses “at an early stage in the process and explain the policy change they are looking to do, and just run through the sorts of things that businesses, advisors and agents need to do to implement it.”⁸⁷
94. In response, officials said that the initial impact assessment was based on internal analysis, supported by (growing) commercial knowledge within the two departments. Mr Troup pointed out that “In the policymaking process, we have sought to publish these as late in the cycle as possible to allow for consultation so that what is then published can be informed by what we get from the commercial interests who have some concern with the particular measures.”⁸⁸
95. **Tax Impact and Information Notes (TIINs) represent significant progress in making tax policy development more transparent and we welcome their introduction. But for TIINs to play their proper role in the policy-making process, they must provide as accurate and comprehensive a picture as possible of the impact of a measure on those taxpayers it affects. Painting such a picture requires full consultation with those interests from the outset and we recommend that this be done in all cases.**

Extending the Scope of the New Approach

Post-implementation Review

96. In its June document the Government said that it was “committed to evaluating the effectiveness of tax reforms, to ensure that they are meeting their objectives.”⁸⁹ The December response confirmed that the new Tax Information and Impact Notes would set out how the Government planned to monitor the effectiveness of individual policies. It would consider “the appropriateness of a sunset clause, or alternative trigger for formal evaluation, on a case by case basis.”⁹⁰
97. Some witnesses proposed that the new approach to tax policymaking should include a firm commitment to formal post-implementation reviews of significant changes. They felt that such reviews were unlikely to happen as a matter of course. Mr Johnson, replying to a question on the extent to which HMT carried out impact analyses of policies, observed that from his experience “the sort of ex-post bit probably does not happen very much. In other words, three years after you have introduced the policy, do you ever really look back at what the impact really was? I think there is very limited evidence that that is happening.”⁹¹ Mr Wales added “From the work I have done internationally, it is quite clear that post-implementation review is one of the weakest parts of the tax policy-making process in most countries.”⁹²

⁸⁶ Q 185

⁸⁷ Q 183

⁸⁸ Q 240

⁸⁹ *Tax policy making: a new approach*, HMT and HMRC, June 2010, paragraph 3.17

⁹⁰ *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, paragraph 2.77

⁹¹ Q 28

⁹² Q 28

98. Mr Wales also wrote “Given the cost of tax expenditures, it is astonishing that post-implementation review has not become a mandatory requirement for all significant tax measures. This is particularly true where tax changes have been introduced to achieve specific policy objectives.”⁹³ He suggested, as did ICAS, that, in certain circumstances, it might be appropriate to couple the mandatory requirement with a sunset clause.
99. Officials told us that a great deal was already being done by way of policy monitoring, post-implementation review and evaluation, and that over the past 10 years more than 120 research reports had been published. HMRC had more than 300 analysts and this was a major part of their work and some post-implementation analysis was also commissioned from universities or research centres. But resource constraints meant that reviews had to be prioritised. Mr Troup thought that more could be done to publish the research that was undertaken.
100. Asked about benchmarking policy outcomes against policy objectives, Mr Troup said that TIINs and the new tax policymaking process, “explicitly attempts to set out for every policy measure what the intended effects are. That has not been done systematically in the past. I hope we will do it even more systematically in the future and it will give us something a bit more qualitative to benchmark against. Yes, I agree that we should be doing more of that and we probably have not done enough benchmarked evaluation in the past.”⁹⁴
101. **We recognise that HMT and HMRC already devote significant resources to monitoring and evaluating tax policies after they have been implemented, and that many of their findings are published. We also welcome the inclusion in individual TIINs of clearer statements of policy objectives and a note on the (largely internal) monitoring arrangements. Nevertheless we think there is scope for the process to be extended and formalised.**
102. **We agree with those witnesses who argued for a more formal commitment to post-implementation review. We recommend that the Government add to the new framework a formal requirement for all significant tax reforms to be evaluated against their stated objectives once they have bedded in. We also recommend that such evaluations should be carried out with the support of independent experts and that their results should be published. The appropriate time for such an evaluation should be the subject of consultation when the initial policy is being developed.**

Outlining the Government’s Tax Strategy

103. Another area where the new approach was thought by some not to have gone far enough was in failing to include a commitment to outline strategic objectives and plans for different parts of the tax system in the same way as the Government had for, say, the welfare system and the state pension system. It was felt that “roadmaps”, similar to the highly praised CT Roadmap, might be set out for other major areas of the tax system. These would provide a template against which to assess individual tax proposals and help enhance the certainty, predictability and stability the new approach aims to achieve.

⁹³ FBSC 14 paragraph 35

⁹⁴ Q 259

104. Mr Johnson thought “we have historically often known very little, with some notable exceptions, about where the Government are intending to go on tax policy. That makes the scrutiny difficult and it makes challenge from elsewhere difficult. You end up looking at very particular parts of the system rather than seeing where the system is going as a whole.”⁹⁵
105. From a more commercial perspective, Mr Hardwick observed that “One of the things that it is important to be able to tell the client is whether there are changes on the horizon that would impact his decision. Knowing the overall strategy is of considerable importance.”⁹⁶ Mr Richard Stratton (LSEW) and Ms Redston shared his view.
106. Describing the CT roadmap as “a shining example of where the Government has set out a clear strategy”, Mr Troup pointed out that “The Chancellor set out in his Budget speech his guiding principles for the tax system, which were around efficiency, certainty, simplicity and fairness ... Those are capable of being applied to particular tax areas.” He pointed to the “ambition to integrate the operation of income tax and NICs” and “the intention to increase the proportion of tax revenue accounted for by environmental taxes” as strategy statements, albeit high level ones. He concluded that “the tax system as a whole is too large and too horrible to set out in a single strategy, but the Government has shown that it can take different bits of it and, with some principles, set out where it wants to go.”⁹⁷
107. **We recognise the political dimension to tax reform. Furthermore, clearly any Government cannot bind the hands of its successor. But we think that that the Government should be able to identify further areas of the tax system where it can set out its strategic direction without unduly compromising its room for manoeuvre.**
108. **We were persuaded by the argument that the Government should seek to outline its strategic objectives for different parts of the tax system. We recognise that the Government has already taken some significant steps in this direction, not least by outlining its guiding principles for the tax system and by publishing the CT Roadmap. Clearly outlining its strategy for other areas of the tax system in a similar way, even where the Government has no immediate plans for change, would help enhance the certainty, predictability and stability the new approach aims to achieve. We recommend that this be done in those further areas of the tax system where it is possible.**

Enhancing Parliamentary Scrutiny of Tax Legislation

109. The Government’s discussion document of June 2010 recognised that a number of earlier reviews⁹⁸ of tax policy making in the United Kingdom had called for enhanced Parliamentary scrutiny of tax legislation, and invited the Treasury Committee of the House of Commons to consider “how Parliament’s role could be strengthened in relation to scrutiny of tax legislation.”⁹⁹

⁹⁵ Q 6

⁹⁶ Q 36

⁹⁷ Q 260

⁹⁸ *Tax Matters—Reforming the Tax System*, Forsyth Tax Reform Commission Report October 2006; *Making Taxes Simpler*, Report of Working Party chaired by Lord Howe of Aberavon, July 2008; *The Making of Tax Law*, CIOT, June 2010

⁹⁹ *Tax policy making: a new approach*, HMT and HMRC, June 2010, paragraph 3.11

110. The Government's response to the consultation in December 2010 reported that the Treasury Committee "has welcomed the Government's commitment to publish draft legislation at least three months in advance of introduction of the Finance Bill. It has confirmed that it intends to take a more active role in scrutinising proposals on taxation and has recently launched an inquiry into principles of tax policy."¹⁰⁰
111. On improving the effectiveness of Parliamentary scrutiny, the Treasury Committee report on tax policy principles in March 2011 concluded "Since we recognise that tax law can be a complex and technical subject, we have invited the tax professional bodies to brief us on the Government's proposed tax changes, so that we are in a position to comment at the time of the Budget. This will, we hope, assist colleagues in their consideration of the Finance Bill. We continue to believe that the Government should examine how consideration of the Finance Bill can be structured in order to facilitate engagement between experts and Members, and allow Members the time to debate both technical and politically controversial matters in Committee."¹⁰¹
112. Notwithstanding these plans, our private sector witnesses called for the House of Lords to become more involved in the detailed scrutiny of tax legislation, drawing on the experience and expertise of its Members. A number of suggestions were made.
113. The CIOT, citing its June 2010 report *The Making of Tax Law*, called for the establishment of a Parliamentary Joint Committee on Taxation made up of a combination of MPs and peers.¹⁰² This would adapt the model of the Congressional Joint Committee on Taxation which scrutinises tax legislation in the United States. "The primary responsibility of the Committee would be to review proposed tax law put forward by the government and to think through its policy and implementation implications."¹⁰³ This proposal was supported by ICAS and the CBI.
114. But Mr Wales did "not believe that there is anything that the House of Lords would do better or more easily, from a constitutional standpoint, in a Joint Committee of both Houses, than they could do alone."¹⁰⁴ One important issue concerns resources: such a committee would, as Mr Menzies-Conacher noted, need to be "permanent, properly resourced and staffed."¹⁰⁵
115. Others suggested that Parliamentary scrutiny would be improved by dividing the contents of the annual Finance Bill between two Bills to allow more time for detailed scrutiny of more detailed matters in a separate "technical" Bill. The CBI argued that this should apply particularly to corporate tax legislation, most of which is highly technical.
116. Mr Wales was keen that the role of this Committee's Sub-Committee should not be diminished as a consequence of the new policy cycle "The creation of a Finance Bill Sub-Committee for the Economic Affairs Committee of the House of Lords has proved to be a valuable development. Although it has accepted significant limitations on its role, it has nevertheless been a source

¹⁰⁰ *The new approach to tax policy making: a response to the consultation*, HMT and HMRC, December 2010, paragraph 2.53

¹⁰¹ *Principles of tax policy*, House of Commons Treasury Committee, Eighth Report of Session 2010–11, HC753, March 2011 paragraph 82

¹⁰² FBSC 3 paragraph 8

¹⁰³ *The Making of Tax Law*, CIOT, June 2010, paragraph 6.4

¹⁰⁴ FBSC 14 paragraph 52

¹⁰⁵ Q 70

of intelligent questions and useful commentary on Government proposals. I do not believe that the House of Lords should ever do less than it does today in this area.”¹⁰⁶ He and others suggested that it could “look at some of the more difficult long-term issues that need to be properly thought-through and need to be in the public domain, but are on no one’s agenda for the next Finance Bill.”¹⁰⁷

117. The CIOT recognised that their proposal for a Joint Committee might prove a step too far. They considered that the new policy cycle offered the opportunity for the Sub-Committee to become involved in the process leading up to the Finance Bill at an earlier stage. Mr Whiting argued that “the real debate on tax legislation is going to happen much earlier” because the new cycle meant that the Finance Bill would be “fairly well knocked around and into a pretty final form”¹⁰⁸ by the time it was published.
118. The CIOT’s written submission suggested that “a two-stage approach of the EAC/FBSC considering the initial proposals for change during the summer consultation period (probably taking evidence from witnesses) and then returning to the topic in the late autumn/winter to reflect on how the proposals are evolving (possibly in the light of the draft legislation) could be a very powerful and constructive influence.”¹⁰⁹ The ICAEW agreed.
119. The LSEW supported the CIOT’s line of argument, but proposed a more modest approach whereby this Committee “might review legislation in draft (and report upon it) in the three month period prior to the publication of the Finance Bill so that the Committee’s report could be available to MPs who have to consider the proposals in the Bill.”¹¹⁰ Mr Wales came to much the same view.
120. Asked whether Finance Bills got sufficient scrutiny as they went through Parliament, Mr Troup, having noted that this was a matter for Parliament, replied “I think taken together with the new tax policymaking approach, which allows a heavy degree of exposure and consultation on the drafting, and then following it up with the parliamentary scrutiny, particularly in the Standing Committee, there is now a good balance.”¹¹¹
121. **All the private sector organisations which submitted evidence advocated that the new tax policy-making process should trigger consequential changes to enhance Parliamentary scrutiny of tax legislation and, while recognising that these are matters for Parliament, put forward a number of proposals.**
122. **Most witnesses proposed that better use should be made of the expertise and experience of Members of the House of Lords in matters of tax policy and legislation. One option would be to adapt the remit of our Sub-Committee to the new tax policy-making cycle so that it could examine tax proposals being consulted on before publication of the draft Finance Bill and inquire into the draft Finance Bill when it is published some three months before the Budget. Another option would be for the Sub-Committee to begin its inquiry at the time the draft Finance Bill is published.**

¹⁰⁶ FBSC 14 paragraph 45

¹⁰⁷ Ibid, paragraph 54

¹⁰⁸ Q 61

¹⁰⁹ FBSC 3 paragraph 11

¹¹⁰ FBSC 1 paragraph 6

¹¹¹ Q 256

123. **Proposals for enhancing Parliamentary scrutiny of the Finance Bill are, however, outside the remit of the Economic Affairs Committee and its Finance Bill Sub-Committee. We are aware, however, of the proposals in the recent Leader's Group report for an extension of the committee work of the House of Lords and record these proposals for the consideration of the House.**

CHAPTER 3: ANTI-AVOIDANCE WITH SPECIAL REFERENCE TO DISGUISED REMUNERATION

Context

124. This chapter examines the latest Government initiatives in combating avoidance and assesses their impact and acceptability to outside commentators. In addition to the anti-avoidance strategy generally, it focuses on the draft legislation on disguised remuneration in the current Finance Bill.
125. In its latest figures¹¹² for the tax gap¹¹³, HMRC estimated that the total for 2008/09 amounted to £42 billion. Of this¹¹⁴, avoidance represented around 17.5%, some £7.4bn. Evasion, the hidden economy, criminal attacks and ‘failure to take reasonable care’ taken together amounted to 52.5%, some £22bn.

The Government’s Anti-Avoidance Strategy

126. In June 2010 the Government launched its new strategic approach to tackling avoidance, as part of the consultation document on tax policy making.¹¹⁵ In March 2011, alongside the Budget, HMT and HMRC published a document specifically on combating avoidance. This stated that “The key elements of this new approach are:
- making the most of opportunities to make the tax system more watertight against avoidance, for example, as part of wider policy reform;
 - reviewing areas of the tax system that have been under repeated avoidance attack, to get to the heart of the problem and develop sustainable solutions; and
 - creating new generic defences against avoidance, going beyond closing identified avoidance loopholes, including considering the case for a General Anti-Avoidance Rule (GAAR).”¹¹⁶
127. In the foreword to the March 2011 document, David Gauke MP, Exchequer Secretary to the Treasury, wrote “But I want to be clear that being open for business does not mean being open to tax avoidance ... We inherited a tax system with a ‘tax gap’ of around £40 billion ... one-sixth is estimated to be due to tax avoidance—that is, reducing tax liabilities by using the tax law to get a tax advantage that Parliament never intended ... Clearly, there is a problem we need to tackle and we are committed to tackling it differently from our predecessors. That means a more strategic approach that gets to the root of the problem, rather than treating the symptoms.”¹¹⁷
128. Chapter 1 of the March document introduced HMRC’s new anti-avoidance strategy, showing how HMRC’s activities will put the Government’s approach into practice. It focused on “three core elements:

¹¹² *Measuring Tax Gaps 2010: An Official Statistics Release 2010*, HMRC, September 2010

¹¹³ “Defined as the difference between tax collected and the tax that should be collected (the theoretical liability). The theoretical tax liability represents the tax that would be paid if all individuals and companies complied with both the letter of the law and HMRC’s interpretation of the intention of Parliament in setting law (referred to as the spirit of the law).” *Ibid*, paragraph 1.1

¹¹⁴ *Protecting Tax Revenues 2009*, HMRC, December 2009

¹¹⁵ *Tax policy making: a new approach*, HMT and HMRC, June 2010, paragraphs 2.14 and 2.15

¹¹⁶ *Tackling Tax Avoidance*, HMT and HMRC, March 2011, page 5, Executive Summary

¹¹⁷ *Ibid*, page 3

- preventing avoidance at the outset where possible;
 - detecting it early where it persists; and
 - countering it effectively through challenge by HMRC.”¹¹⁸
129. Chapter 2 “sets out four strands of work on legislative defences:
- a new proposal to reduce the cash flow benefits that taxpayers can gain from using high risk avoidance schemes;
 - a new rolling programme of reviews on high risk areas of the tax code;
 - work in hand on a GAAR; and
 - the targeted tax measures that sit alongside this strategic work to address specific avoidance risks that have emerged.”¹¹⁹
130. Chapter 3 “looks at the operational effort by HMRC in support of the anti-avoidance strategy.”¹²⁰ Inter alia, the chapter sets out how HMRC is addressing risk within and across the large business and wealthy individual customer groups, including by taking appropriate action through litigation.
131. Chapter 4 set out the final version of a protocol on unscheduled announcement of changes to tax law setting “out the criteria that Ministers undertake to use in deciding whether an announcement of immediate change to tax legislation is justified, and the process that will be followed for announcements.”¹²¹ This followed a discussion document published in December 2010¹²² which invited comments on a draft protocol.

Finance Bill Measures

132. The Finance Bill contains a number of provisions to tackle avoidance. Chief amongst them is Clause 26 and Schedule 2, which will raise an estimated £750 million per annum throughout the years to 2015/16. The legislation is designed to tackle third party arrangements which seek to avoid or defer the payment of income tax or national insurance contributions due on employment income or avoid restrictions on pensions tax relief (the so-called “disguised remuneration” legislation).
133. The proposal to legislate to combat the avoidance around disguised remuneration was announced in the emergency Budget of June 2010 (confirming an announcement in the Budget of March 2010). Draft legislation was published on 9 December 2010 and at that stage extended to 25 pages. The draft Explanatory Note identified the purpose of the legislation as introducing rules that will tax “certain loans of money or assets by third parties to the employee; the earmarking of money or assets for the employee by a third party; and to the outright payments of money or transfers of assets to the employee by a third party where these are not otherwise charged to tax as earnings from the employment.”¹²³
134. The draft legislation met with much criticism that it went too wide by not excluding many bona-fide arrangements. As a consequence of the large number of comments received, a list of frequently asked questions (FAQs) was

¹¹⁸ Ibid, paragraph 1.4

¹¹⁹ Ibid, paragraph 2.3

¹²⁰ Ibid, paragraph 3.2

¹²¹ Ibid, paragraph 4.2

¹²² *Tax Policy Making: Draft Protocol on Announcements Outside Scheduled Fiscal Events*, HMRC, December 2010.

¹²³ *Finance Bill 2011: draft clauses and explanatory notes*, HMT and HMRC, December 2010

published by HMRC on 21 February 2011 and a second version on 31 March 2011, the date the Finance Bill was published. The introduction to the later version of the FAQs accepted that the draft legislation had raised concerns on the part of external commentators and confirmed that the legislation had been “extensively refined to take account of concerns raised in areas where the Government agreed that changes should be made ... The primary aim of the legislation remains to protect the Exchequer ... [and] ... the relatively complex nature of many vehicles used in this sphere means that the legislation is also necessarily comprehensive.”¹²⁴ The draft legislation had grown to 59 pages.

135. Against that background, we wanted to hear whether the changes made to the draft legislation satisfied our witnesses that it no longer caught unintended situations. We turn to the evidence on this after looking at the Government’s new anti-avoidance strategy in general.

Anti-Avoidance: The Government’s Strategy

136. The Government’s anti-avoidance strategy and the focusing on the three elements set out earlier met with wide-spread approval from our private sector witnesses. The CIOT thought that “the idea of a strategic approach to tackling avoidance is sensible and in many ways much needed.” They continued “We are pleased to note that the new Protocol on unscheduled announcement of changes to tax law explicitly recognises that retrospective changes to tax legislation will be wholly exceptional ... It is good to see that the Forum for Tax Professionals will be monitoring the operation of the Protocol and recommending changes where appropriate.”¹²⁵
137. The IoD thought that although the “detailed articulation of the strategy may be new, we would be surprised and concerned if more than a small proportion of the practices that it mentions were new.”¹²⁶ They agreed with taking “away the cash-flow advantage of using high-risk avoidance schemes that fail.”¹²⁷ The CBI echoed this “We support the Government’s adoption of a more strategic approach to tax avoidance.”¹²⁸ The ICAEW thought that “*Tackling Tax Avoidance* makes a number of sensible recommendations. We have welcomed previously the new Protocol on unscheduled announcement of changes to tax law which reiterates the fundamental principle that any tax changes should be made prospectively and not retrospectively.”¹²⁹
138. Mr Alex Jackman of the Forum of Private Business (FPB) was positive “I appreciate the Government’s need to crack down on tax avoidance.” But he had a concern “We do not want to see small business unfairly targeted. The government has given something like £900 million to HMRC to tackle tax avoidance and, while there are a few big wins out there, I think the view might be taken by HMRC that there are a few more easy wins at the lower end of the business spectrum. That is something we would be seeking to avoid.”¹³⁰
139. On the rolling programme of reviews of high-risk areas of the tax code, most of our private sector witnesses were content with HMRC having chosen

¹²⁴ *Finance (No.3) Bill: Disguised Remuneration Legislation—Frequently Asked Questions*, HMRC, March 2011

¹²⁵ FBSC 3 paragraphs 24 and 25

¹²⁶ FBSC 7 paragraph 21

¹²⁷ FBSC 7 paragraph 22

¹²⁸ FBSC 6 paragraph 6a

¹²⁹ FBSC 9 paragraph 45

¹³⁰ Q 231

income tax losses and unauthorised unit trusts as the first two areas to be considered. Only Mr Murphy thought that these areas “seem to be relatively minor compared to major issues such as profit shifting, the use of tax havens, the abuse of the domicile rule, the residence rules and what they are giving rise to.”¹³¹

140. **We welcome the introduction of the strategic approach to anti-avoidance set out in *Tackling Tax Avoidance*. If the measures set out in the document are pursued vigorously, it should improve the tackling of avoidance and reduce the loss of tax therefrom.**

Tackling Avoidance Early

General

141. Some of our private sector witnesses were of a mind that avoidance should be tackled early before it became widespread with the potential to affect voluntary compliance. For example, Ms Redston thought that “Left unchecked, avoidance corrodes compliance. Successful avoiders pay less than their share; those who see others succeed feel betrayed by the system and resent their own contributions.”¹³² She saw a need for early action to nip avoidance in the bud.
142. We asked officials what they were doing in practice to implement the commitment in the anti-avoidance strategy to detect avoidance early. Mr Hartnett referred to the disclosure rules which require the promoters of avoidance schemes to notify HMRC of the nature of the scheme and to whom they had provided it. He went on “Over five years, there have been 62 anti-avoidance measures informed by the disclosure rules, blocking £12.5 billion of tax avoidance and bringing in some money as well. That is our key and crucial tool for dealing with avoidance.”¹³³
143. Ms Walton expanded on the approach to the disclosure rules “The earlier we get information, the better chance we have of taking action to disrupt avoidance activity ... We see the disclosure regime as something that needs to be dynamic. We keep revisiting it to make sure that it is working effectively. We also see people applying their ingenuity to getting round the disclosure requirement just as much as they do inventing tax avoidance schemes.”¹³⁴

Disguised Remuneration: The Cost of Not Tackling it Early

144. Current Exchequer losses from avoidance around disguised remuneration, estimated using HMRC data on known schemes, suggest that Exchequer losses in 2008/09 were in the region of £1.1 billion. The loss in the current year would have risen to around £1.54 billion, had no action been taken. After taking into account behavioural responses (including shifting to other avoidance devices and making use of acceptable incentive schemes) which are expected to reduce the yield by between 50% and 60%, the yield from enacting the legislation is estimated to be around £750 million for each year from 2011/12 to 2015/16. According to the policy costings document “The main uncertainties in this costing relate to the size of current tax losses,

¹³¹ Q 90

¹³² FBSC 2 paragraph 9

¹³³ Q 262

¹³⁴ Q 265

- which are projected from 2008–09 data, and predicting the different ways in which employers will respond to the measure.”¹³⁵
145. The Tax Information and Impact Note for disguised remuneration states that “In relation to the arrangements known to HMRC, there are approximately 5,000 employers who are currently using these schemes, with an estimated 50,000 employees thought to be indirectly benefiting. The take up is likely to be wider than this as there has been extensive marketing and widening accessibility of the arrangements over the last few years.”¹³⁶
146. The OBR endorses these figures, with a general caveat around all avoidance measures that “the main uncertainty associated with these measures is the sustainability of the yield over time. In general, the costings in this document assume that some individuals switch to other forms of tax avoidance. By its nature, this effect is subject to a wide margin of error.”¹³⁷
147. In her evidence, Ms Redston used the disguised remuneration situation as an example. She put it to us that “The issue with disguised remuneration is ... the size and difficulty of the underlying problem. This avoidance began on a small scale, years ago. By the time the legislation was formulated, avoidance was endemic, packaged and easily available.”¹³⁸
148. We asked our other private sector witnesses whether they agreed with Ms Redston’s view that avoidance around disguised remuneration was endemic by the time action was taken to combat it and that the action should have been taken much earlier. They also commented on her view that it was not just wealthy people who were involved. Mr Greenbank said “But it is probably true to say that it starts with the very wealthy. The marginal cost of doing these things decreases all the time and eventually you get a mass market scheme.”¹³⁹
149. Mr Stratton’s experience was to have “encountered it with what you would regard as highly remunerated people. It appears to be widespread among highly remunerated people ... but I have encountered it there more than among the lower paid. It could be rolled out to the lower paid, so something needs to be done.”¹⁴⁰
150. Mr Whiting thought “the scale is evidenced by the number of schemes that we have seen around and the number of specific instances. We have seen data from HMRC in terms of the likely loss or the amount of tax at risk and we think that seems very plausible.”¹⁴¹
151. Mr Menzies-Conacher agreed and emphasised the wide-spread nature of the avoidance “Certainly they are sold if you have any set of employees, and this is not just major companies. This runs all the way down.”¹⁴² Others agreed, though some were unsure how far down the income scale the avoidance went. Mr Woolhouse thought “You have to earn quite a lot to make it worthwhile bothering to do it.”¹⁴³

¹³⁵ *Budget 2011 policy costings*, HMT, DWP and HMRC, March 2011, pages 46 and 47

¹³⁶ *Overview of Tax Legislation and Rates*, HMRC and HMT, March 2011, page A144

¹³⁷ *Budget 2011 policy costings*, HMT, DWP and HMRC, March 2011, page 75

¹³⁸ FBSC 2 paragraph 22

¹³⁹ Q 44

¹⁴⁰ Q 53

¹⁴¹ Q 99

¹⁴² Q 101

¹⁴³ Q 156

152. We asked officials why they had not acted earlier to tackle the disguised remuneration problem and why the disclosure regime had not made action possible. Mr Hartnett thought that the disclosure regime “did everything that it could, but where you have promoters outside the UK ... the disclosure regime has no bite. That has been the difficulty.”¹⁴⁴
153. As to why HMRC did not move earlier and faster, he told us “Some of the offshore arrangements have been pretty opaque to us for some time.”¹⁴⁵ He continued “some of this is very difficult stuff. Is it right to tax a loan? That is something we wrestled with for a while. How do you get the offshore information? Eventually, our advice was that this needed to be all-embracing and to take out things that did not need to be taxed. We looked at targeted anti-avoidance rules, but we did not think that we could make that work in the context.”¹⁴⁶
154. **We fully agree that avoidance needs to be tackled early before it gathers momentum. We are pleased to see the emphasis on early action in the anti-avoidance strategy. We are concerned, however, that it was not until this year’s Finance Bill that action was taken to tackle avoidance through disguised remuneration. Very large amounts of tax were being lost as a result of this avoidance. HMRC should have realised that this avoidance was mushrooming and Governments should have acted earlier to stem the loss of tax.**
155. **HMRC should learn the lessons from the case of disguised remuneration. We recommend that HMRC carry out a review to establish why the avoidance activity was not detected sooner, or if it was, why its growth potential was not recognised and action taken at that earlier stage.**

Tackling Avoidance Effectively

General

156. Our private sector witnesses also commented on the broad approach to combating avoidance more effectively which we record for HMRC’s consideration.
157. Mr Gammie thought that “too often, legislation has addressed perhaps a symptom of avoidance rather than the actual cause. Certainly, the current strategy has said very clearly that what the Revenue wants to look at and address is the cause. To the extent that they can go to the heart of the matter they will.”¹⁴⁷
158. Commenting on the review of other countries’ approach to tax policy making and in this context to anti-avoidance legislation in particular, Mr Wales’s view was that “Getting things right in the anti-avoidance areas is notoriously difficult. From my point of view, the UK has got itself into something of a bind, a difficult position. Over the years we have produced reams and reams of very detailed legislation which, because it is so detailed, encourages people to pore over it in immense detail to find things that it does and does not cover, and behave accordingly.”¹⁴⁸

¹⁴⁴ Q 268

¹⁴⁵ Q 267

¹⁴⁶ Q 274

¹⁴⁷ Q 16

¹⁴⁸ Q 18

159. The ICAEW considered “that the right approach to counter tax motivated behaviour that is considered unacceptable is through properly targeted anti-avoidance legislation.”¹⁴⁹ Mr Baron provided us with a helpful insight into this, based not only on his time at the IoD but also his 3-year secondment to HMRC. He was asked how to draft anti-avoidance legislation successfully and responded:

“I think there are two different things we have to distinguish here. One is that where there appears to be an avoidance problem, the Treasury and Ministers feel that action needs to be taken but they do not feel it needs to be announced today with effect from today. In that case by far the best thing to do is to do as much talking to industry as possible and be upfront with industry about what they think the problem is, what all their fears are, because they may be hitting the wrong target ...

You have a different problem with cases where the Treasury or the Revenue have noticed a problem and feel that the announcement must take effect immediately, that they cannot risk talking to outsiders before taking action. I think there it may be that they should think differently about the type of announcement that is made ... and say, ‘Maybe we should say, “With effect from today transactions that achieve the following effect aren’t going to work.” Now, having made that announcement, we have a breathing space to talk to outsiders about exactly what we ought to be hitting so as to try and create space for policy development for something that has already come into effect.’”¹⁵⁰

The Effectiveness of the Disguised Remuneration Legislation

160. Our private sector witnesses were very critical of the legislation produced. They were still unhappy with the unintended consequences that it could deliver.
161. The LSEW wrote “The first comment to be made about the Disguised Remuneration draft legislation is its length. There are 59 pages in Schedule 2 of the Finance (No. 3) Bill. The first 5 pages describe the circumstances in which the charge arises. The next 27 pages contain exclusions from those circumstances ... it looks pretty likely that the legislation has been drawn too widely and charges too many ‘innocent’ situations while also taxing the ‘guilty’.”¹⁵¹
162. The LSEW summarised their understanding of the three principal areas that the legislation was seeking to cover. They went on “The Society believes that the draft legislation does not comply with the Government’s own proposals concerning the formulation and implementation of tax policy, contradicts the FSA Remuneration Code, severely restricts the scope for (commercial, but bona fide) flexible arrangements for wider share ownership in companies and is at best difficult to understand and at worst virtually incomprehensible.”¹⁵²
163. The Quoted Companies Alliance (QCA) wrote “the current draft legislation ... is overly complex and not sufficiently targeted. This goes against the Government’s current commitment and the coalition agreement to reduce red tape for business and simplify regulation.”¹⁵³ The QCA’s view was that “a significant number of

¹⁴⁹ FBSC 9 paragraph 41

¹⁵⁰ Q 148

¹⁵¹ FBSC 1 paragraph 7

¹⁵² FBSC 1 paragraph 8

¹⁵³ FBSC 19 paragraph 1

simple share scheme arrangements, including HMRC qualifying options and share rights for ordinary employees, will incur unintended tax and national insurance liabilities.”¹⁵⁴ “The legislation is very difficult to understand even for experienced share scheme practitioners and is incomprehensible for many of those in companies responsible for operating the rules.”¹⁵⁵

164. The CIOT considered that “The proposed revisions to the draft legislation on disguised remuneration answer some of the concerns we expressed on the initial draft but the rules remain very widely drafted and the new exclusions are intricate and heavily qualified.”¹⁵⁶
165. The ICAEW “support the policy purpose behind these measures” but consider that “it is important that any such measures are properly targeted, proportionate and as far as possible do not hinder growth. While we recognise that HMRC have consulted extensively and have been willing to listen to, and act on, the concerns that have been raised, these rules continue to be a cause for major concern. We do not think that the rules are properly targeted and proportionate and that the extra burdens they will put on employers will stifle growth and damage the UK’s competitiveness.”¹⁵⁷
166. Mr Whiting told us that the CIOT had just submitted to the Revenue an 18-page paper on remaining concerns. Mr John Kimmer of the Association of Taxation Technicians (ATT) suggested “... why not start from somewhere else and say, ‘These arrangements are fine, everything else is not’? I am sure that could be done in a lot less than 59 pages and it would be much more certain than all these clauses and paragraphs and the possibility of other loopholes coming in. I think that would be a much more practical way of solving the problem.”¹⁵⁸
167. Mr Roy-Chowdhury supported the view that the legislation started in the wrong place “On disguised remuneration, I think the point is that it is unprecedented that they consulted on anti-avoidance legislation, but the problem they have is ... they consulted once [the legislation had become effective] ... They had to find ways of excluding the unintended consequences of the legislation, which is the wrong way around to do it.”¹⁵⁹
168. Mr Allen, when asked how the legislation could have been done better, commented “I do not think it reflects a lack of competence. I think this is a very difficult area, but I do think it could have been done much better ... if it could have been started earlier with the opportunity of an independent review to consider the legislation and its policy objectives, identify the high risks and try to get it in a closer-to-final agreed state with consultation at an earlier date.”¹⁶⁰
169. Mr Haskew was particularly critical “I think it is an object lesson in how not to frame tax legislation ... it is bad enough to have 60 pages of this, and the comments I have had from my specialists in this area say that this is the worst legislation they have ever seen. It is totally incomprehensible. I have to say, from looking at it myself, I would probably agree.”¹⁶¹

¹⁵⁴ FBSC 19 paragraph 3

¹⁵⁵ FBSC 19 paragraph 4

¹⁵⁶ FBSC 3 paragraph 28

¹⁵⁷ FBSC 9 paragraphs 52 and 53

¹⁵⁸ Q 107

¹⁵⁹ Q 206

¹⁶⁰ Q 209

¹⁶¹ Q 210

170. On 19 May, while we were still taking evidence, the Commons Public Bill Committee on the Finance Bill made 90 Government amendments to Schedule 2. The Exchequer Secretary stated that they would add another 7 pages to the schedule. In justifying these amendments, Mr Gauke said
- “Yes, we have tabled a number of amendments, and in an ideal world we would not need to do that. We would publish legislation with which no one found fault. However, it is important that we continue to listen and engage. Indeed, a number of sensible and constructive comments came in after 31 March, and we have tried to reflect them.”¹⁶²
171. Commenting on the amendments which had been tabled just before he gave evidence to us, Mr Allen said “when we have ... a list of amendments tabled on Monday, that is not really in anybody’s interests. It is good that they are listening. It is good that they have tabled the amendments. Most of them are actually quite welcome, but I would have hoped it could have been done much earlier to give greater certainty.”¹⁶³
172. We put these criticisms to officials. Mr Hartnett, probably referring to the analysis by the LSEW of the three principal areas that the legislation was seeking to cover, commented “I think one of the most interesting suggestions put to you, and one of the most worrying from my perspective, was ... focusing on the three main areas of disguised remuneration would catch most of it. I have to say that all my experience ... is that if that is what had happened, coaches and horses in vast numbers would have gone through those gaps and the nation would have lost an absolute fortune.”¹⁶⁴
173. Asked if there were lessons to be learned, Mr Hartnett agreed that there were. “One of them—we have learnt the lesson but we have not got the answer yet—is that in a very dynamic tax planning area such as this, how do we really get on top of things that are outside the disclosure regime, that are offshore and the like ... If I had to pick up the biggest lesson of all, it is that engagement of the tax industry has been very good on this, even though the tax industry has not liked the outcome ... your witnesses gave you a very good idea of what this was broadly about, but as far as I can recall none of them brought forward their most aggressive schemes and said, ‘... Have a look at this.’ That is our job.”¹⁶⁵
174. **The legislation to address disguised remuneration avoidance is extremely complex and beyond the scope of most business people to decide whether or not it applies to them. One witness called it ‘the worst legislation he had ever seen’. There was clearly a very wide and deep unhappiness with this draft legislation.**
175. **Many of our private sector witnesses said that ‘they would not have started from here’ if they had been constructing this legislation. Notwithstanding the justifications put forward by the Exchequer Secretary in the Commons Public Bill Committee and by officials to us, we remain unpersuaded that there was no alternative to this complexity.**
176. **Although it is clearly too late to change the legislative approach at this stage in the Finance Bill cycle, we recommend that HMRC should**

¹⁶² *House of Commons Official Report, Public Bill Committee Finance (No 3) Bill Col 282*

¹⁶³ Q 209

¹⁶⁴ Q 274

¹⁶⁵ Q 276

carry out an in-depth examination of the alternative approaches that would have been open to them in framing the disguised remuneration legislation. This could be part of the review that we recommended earlier. The lessons learned should help HMRC to avoid similar pitfalls when tackling other avoidance schemes.

The Primarolo Statement

177. This was raised by Mr Murphy and Mr Whiting in their oral evidence¹⁶⁶. Subsequently the CIOT prepared supplementary written evidence which noted that “In December 2004, the Government made a statement regarding the possibility of retrospective taxation in relation to the avoidance of tax (including NICs) on pay, especially bonuses, commonly referred to as the Primarolo statement.”¹⁶⁷ The Primarolo statement¹⁶⁸ included the following paragraph:

“However, experience has taught us that we are not always able to anticipate the ingenuity and inventiveness of the avoidance industry. Nor should we have to. Our objective is clear and the time has come to close this activity down permanently. I am therefore giving notice of our intention to deal with any arrangements that emerge in future designed to frustrate our intention that employers and employees should pay the proper amount of tax and NICs on the rewards of employment. Where we become aware of arrangements which attempt to frustrate this intention we will introduce legislation to close them down, where necessary from today.”

The CIOT told us that “The Primarolo statement has led to one piece of retrospective action to date”, but that “More generally, it does seem that the statement has been effective.”¹⁶⁹

178. In 2009 HMRC carried out a review¹⁷⁰ of the effectiveness of the Primarolo statement in its early years of operation. This showed that the statement was effective in the part-year 2004/05 and in 2005/06. Additional tax collected as a consequence of the statement was estimated to have exceeded £300 million. The assessment stated that the final revenue collected for these years was likely to be higher. “Some of the forecast yield [from the Primarolo statement] was expected to come from retrospective payments and HMRC investigation settlements. This part of the yield is not evaluated by this working paper because complete information to do so is not yet available.”
179. The CIOT’s view was that they “will always call for tax to be imposed by clear primary legislation rather than general statements” but that “The change of government has led to questions about the continuing applicability of the Primarolo statement. Nothing has been said on this by a Government Minister and so the position remains uncertain.”¹⁷¹
180. In his oral evidence, Mr Whiting commented on using the Primarolo statement, or something like it, in the context of the legislation on disguised

¹⁶⁶ QQ 107 and 109

¹⁶⁷ FBSC 13 paragraph 1

¹⁶⁸ FBSC 13 Appendix

¹⁶⁹ FBSC 13 paragraphs 5 and 6

¹⁷⁰ Working Paper 6: Evaluation of Anti-Avoidance Announcement at <http://www.hmrc.gov.uk/research/working-paper6.pdf>, HMRC April 2009

¹⁷¹ FBSC 13 paragraphs 7 and 8

remuneration “We always prefer tax by law and not tax by concession or whatever. But I think now we are looking at 59 pages and saying, ‘Whoa, this is just getting too much’, particularly when you need a lot more changes to it. I go back to my comment: it is the infamous joke of ‘If I wanted to get there I wouldn’t start from here’, and ideally we would go back.”¹⁷²

181. We asked officials about the Primarolo statement. Mr Hartnett commented “The first reaction is a wry smile, if I may. When the Primarolo statement was issued, I do not think it would be an overstatement to say that in some areas of the tax industry there was complete uproar. They did not like it. It was not legislation; it was a promise of what was going to happen. A huge amount was written in criticism. So I am surprised that there is some thinking that it could be useful ... What about the present Government? It has made it very clear that it sees retrospective legislation of the sort promised in the Primarolo statement as wholly exceptional ... If ever HMRC was to make a case to Treasury Ministers that something was exceptional ... then a hunch ... is that this might be [such] an area ... We are going to be monitoring it carefully, because it is really important that we advise our Ministers on how this legislation works.”¹⁷³
182. In their supplementary written evidence, the CIOT added “Developing/adapting the Primarolo statement might have been a better route than developing 59+ new pages of legislation and also mean less chance of creating new loopholes. We could not accept any of the legislation being made retrospective: we have a fundamental objection to retrospective legislation in any event, but here there had been no warning of the continued use of the Primarolo statement in this way. However, the legislation might have been limited to specific provisions to make it clear what was being targeted, coupled with a warning to the effect that the government wants to stop people exploiting EBTs etc and will consider further legislation with retrospective effect if further avoidance in the area emerges.”¹⁷⁴
183. **We recognise that in its anti-avoidance strategy, the Government stated that it would legislate retrospectively only in the most exceptional circumstances. It seems to us that a tax loss of over £1 billion each year from avoidance involving disguised remuneration is a truly exceptional circumstance. We think that the willingness of our private sector witnesses to consider the Primarolo statement is an indication of how unhappy they are with the disguised remuneration legislation. We therefore recommend that the status of the Primarolo statement should be clarified and, as necessary, further consideration be given to a revised statement to help deter future avoidance in this general area of the tax system.**

Principles-Based Drafting

184. We asked our witnesses about principles-based drafting, that is setting out in legislation the principle of what you are seeking to achieve without attempting to cover every situation in detail. Three recent examples of this approach are the legislation in Schedule 24 Finance Act 2009 on disguised interest, that on transfers of income streams in Schedule 25 FA 2009 and that in Schedule 5 of the present Bill on group mismatch schemes.

¹⁷² Q 110

¹⁷³ Q 277

¹⁷⁴ FBSC 13 paragraph 10

185. Mr Gammie thought that “you have to take a value judgement as to whether or not you are going to have legislation that expresses the general principle but allows the Revenue effectively to spell out, through practice statements and other materials, precisely where they think the boundaries should be drawn.”¹⁷⁵
186. Mr Stratton’s view was that “As a general matter, we are not particularly in favour of principles-based drafting ... In an area like [disguised remuneration], where it is difficult to distinguish what you are trying to target and the Government are nervous about the constant evolution of the industry in the area to get round what they are trying to stop, we feel it would have helped and it might have got a better result.”¹⁷⁶
187. The possibility of a principles-based approach, or smaller targeted measures, to the disguised remuneration problem was raised during the debate in the Commons Public Bill Committee on this legislation. Responding to this suggestion, the Exchequer Secretary said “having looked at that suggestion closely over some time, we are not convinced that it would be effective against the widespread, diverse and, in particular, informal avoidance that occurs.”¹⁷⁷
188. We asked officials about their approach to principles-based drafting. Ms Walton confirmed “We are in favour, and we want to develop our use of principles-based legislation ... Our feeling is that it does not necessarily work everywhere. As ever with avoidance, you have to pick the most appropriate route to tackle something. We like principles-based legislation because we see it as being better proof against new forms of ingenuity.”¹⁷⁸
189. Specifically on disguised remuneration, Ms Walton thought “Had we gone to a principles-based approach, we would still have needed to list the exclusions where we did not want the principle to apply, so I am not convinced it would have led us to something shorter. But that is not to say that this is not an approach that we want to develop for the future.”¹⁷⁹
190. **We agree that principles-based drafting is an approach that should be developed for the future in appropriate situations. It seems likely that the more it is used, the easier the approach will be to develop in a wider range of situations.**

A General Anti-Avoidance Rule (GAAR)

191. The document *Tackling Tax Avoidance* refers to the announcement in December 2010 that a study group led by Mr Graham Aaronson QC was being set up to explore the case for a GAAR in the UK. The study group will complete its work by 31 October 2011.
192. We did not find great enthusiasm amongst our private sector witnesses for a GAAR. The IoD thought that “We must wait to see what the study group ... concludes, but the main concern will be the need to provide certainty.”¹⁸⁰ The CBI considered a GAAR “both burdensome and unnecessary”¹⁸¹ ICAS

¹⁷⁵ Q 22

¹⁷⁶ Q 49

¹⁷⁷ *House of Commons Official Report, Public Bill Committee Finance (No 3) Bill*, Col 279

¹⁷⁸ Q 283

¹⁷⁹ Q 283

¹⁸⁰ FBSC 7 paragraph 23

¹⁸¹ FBSC 6 paragraph 6c

thought “There are considerable improvements to the drafting process that can occur without consideration of a general anti-avoidance provision.”¹⁸²

193. The CIOT were less hostile. Mr Menzies-Conacher said “There is no doubt it is worth looking at. The issue still remains that the big prize that would make this worthwhile was if you could design a proper GAAR that allowed you to take away the three or four other tiers of anti-avoidance legislation that clutter up the code ... so you could simplify the legislation; although that puts a huge amount of faith on getting the wording of any GAAR right and the experience overseas is a bit mixed on that.”¹⁸³
194. We agree that a GAAR is worth examining again and we look forward to Mr Aaronson’s report.

Evasion

195. Some of our witnesses enjoined us not to forget about evasion. In their evidence, the CIOT wrote “As a final point in this section, we would urge the Government not to lose sight of evasion and other criminal activity, which can have a far greater impact on Exchequer revenues than avoidance.”¹⁸⁴ Mr Whiting reinforced this in his oral evidence “One of the pleasing things ... is that there is more emphasis coming on evasion not just a total focus on avoidance.”¹⁸⁵
196. Mr Murphy agreed “Let’s be blunt about it; the biggest issue with regard to loss of revenue is not with regard to avoidance, it is with regard to evasion, and most people who are evading would in fact be basic rate taxpayers, probably not high rate taxpayers at all. This is cash put in pockets ... and a lot of those people will not be making £40,000-plus a year but they will still most certainly be putting cash in pockets.”¹⁸⁶
197. Mr Hartnett outlined for us what was happening to tackle evasion and stated that he was “expecting our numbers from compliance interventions to be very good for 2010–11—probably our best ever.” He went on “Under the recent spending review settlement, we have obtained funding from the Government to increase the staff in compliance activity. We are in the throes of recruiting 200 more criminal investigators. We particularly want to focus on people who have hidden money offshore over a number of years, as a product of tax fraud. We have set up new groups around the country, with task forces looking at particular industries ... We have teams of specialist investigators who are pursuing people working in the hidden economy.”¹⁸⁷
198. **On the basis of HMRC’s figures the tax lost from all forms of evasion and default is very much greater than that lost from avoidance: £22 billion compared with £7.5 billion. We welcome action to tackle evasion. We recommend that the Government should publish an anti-evasion strategy in the same way as for anti-avoidance.**

¹⁸² FBSC 10 paragraph 4.3

¹⁸³ Q 96

¹⁸⁴ FBSC 3 paragraph 33

¹⁸⁵ Q 95

¹⁸⁶ Q 85

¹⁸⁷ Q 270

CHAPTER 4: CORPORATE TAX REFORM

Context

199. In the Budget of June 2010, the Government announced a package of reforms to corporation tax: a reduction in the main rate from 28% to 24% over the four year period from April 2011; a reduction in the small profits rate from 21% to 20% with effect from April 2011; a move to a more territorial basis for taxing the profits of foreign branches; a commitment to reform the rules for controlled foreign companies (CFCs); consultation with business to review the taxation of intellectual property (IP) and the support research and development (R&D) tax credits provide for innovation; from April 2012 a reduction in the rates of capital allowances for plant and machinery from 20% to 18% on the general pool and from 10% to 8% on the special pool and a reduction in the annual investment allowance from £100,000 to £25,000.
200. The commitment to consult was followed up in a document¹⁸⁸ published in November 2010. The introduction to this document said that “the Government will work with business to enhance UK tax competitiveness. It is designed to provide business with certainty over the Government’s plans and support the recovery by giving business the confidence needed to invest in the UK. By collecting a series of reforms into a single programme, it will allow Government and business to examine the interactions between different elements in a coherent and systematic manner.”
201. Part I of this document set out “The Corporate Tax Road Map” which included the principles for corporate tax reform: lowering rates while maintaining the tax base; maintaining stability; being aligned with modern business practice; avoiding complexity; and maintaining a level playing field for taxpayers. Part II of the document went on to describe the proposals for reform of the rules for CFCs and IP and invited views. Part III detailed interim improvements to the CFC regime and the reforms to foreign branch taxation, both to be legislated in the current Finance Bill.
202. Budget 2011 firmed up these proposals and announced:
- that the main CT rate was to be reduced to 26% from April 2011 and thereafter by 1% each year down to 23% by 2014;
 - that businesses incurring expenditure on plant and machinery which they expect to sell or scrap within an 8 year period would be able to make a short life asset election so that the capital allowances claimable would match the true economic depreciation;
 - enhanced capital allowances for energy saving technologies;
 - reform of the Enterprise Investment Scheme (EIS) and Venture Capital Trusts including raising the rate of EIS income tax relief to 30% from April 2011;
 - an increase in the rate of the additional deduction for expenditure on R&D for small and medium-sized companies (SMEs) from 75% to 100% from April 2011, giving a total deduction of 200%;
 - confirmation that legislation would be introduced in Finance Bill 2011 to deliver a package of interim improvements to the CFC rules ahead of full

¹⁸⁸ *Corporate Tax Reform: delivering a more competitive system*, HMT and HMRC, November 2010

reform in 2012 which would allow groups based in the UK to compete more effectively with those based overseas, while protecting against the artificial diversion of UK profits;

- that in May 2011 further consultation would be published on the introduction of a patent box¹⁸⁹ and on R&D tax credits¹⁹⁰; and
- confirmation that legislation would be introduced in Finance Bill 2011 to provide an opt-in exemption from corporation tax on the profits of foreign branches of UK companies.

CT Road Map and the Move Towards Territoriality

203. Most of our private sector witnesses thought that the CT road map was a welcome move forward. CIOT's comment was typical "We are encouraged at the development of the framework for corporation tax. The UK is very much in need of a long-term route map for its corporate tax system. The government is rightly aiming to make the UK's corporate tax system as internationally competitive as possible—but it needs to bear in mind that the most important aspects of the system are that it is stable, consistent and delivers certainty."¹⁹¹
204. Even the EEF, which had some concerns about the content of the CT reform package, were positive about the general approach "The government's commitment to reforming the corporate tax system, therefore, has been commendable in that it has sought to provide stability and to reduce the tax burden on business."¹⁹²
205. Territoriality involves taxing only those profits that arise from activities carried on in the UK, or under the CFC rules, those profits artificially diverted from the UK. Most of our private sector witnesses welcomed the moves in this direction. For example, the IoD wrote "The programme of reform of the taxation of multinationals, including changes to the regime for controlled foreign companies and the move towards a more territorial system, strikes us as going well."¹⁹³
206. The one dissenting view was from Mr Murphy, who wrote "The tax base is being cut because a) the UK will now only tax UK source profits and will exclude from UK tax charge the worldwide profits of companies resident in this country."¹⁹⁴ Mr Murphy added in oral evidence "So however this policy is constructed, it appears to completely miss the point. I cannot see it is going to bring profits here but I do believe it will reduce our tax base, which this policy says it will not but I am quite sure it will. I do not see how you can cut out the world and say our tax base will be as big."¹⁹⁵
207. Mr Menzies-Conacher disagreed "I think we would disagree with Richard on his general conclusions as well. As far as I can see from the figures, the proportion of corporate tax in the total tax take remains pretty much the same going forward, around 8% of the total, and that seems to have been done via the traditional means of base broadening as the rate has come

¹⁸⁹ *Consultation on the Patent Box*, HMT and HMRC, June 2011

¹⁹⁰ *Research and Development tax credits: response and further consultation*, HMT, June 2011

¹⁹¹ FBSC 3 paragraph 13

¹⁹² FBSC 8 paragraph 3

¹⁹³ FBSC 7 paragraph 8

¹⁹⁴ FBSC 5 Summary paragraph 5 (second)

¹⁹⁵ Q 111

down. So I do not think there is any particular reduction in the benefit or the cost to the Exchequer in that.”¹⁹⁶ There followed a detailed exchange between Mr Murphy and his fellow witnesses, but no meeting of minds.

208. We asked officials about a specific aspect of moving towards territoriality—interest deductibility—and why in 2009 they had justified not moving closer to a territorial system because it would involve restricting the deductibility of interest. Mr Troup said “I do not think there has been a change of heart ... A full territorial system, which is not what we are adopting, would require some sort of allocation of interest ... That would have been damaging on business, as was accepted by the Government ... Getting the policy right here is a balance between raising the revenue, making sure that the tax system is competitive for the UK and ensuring that there is no opportunity for diversion of genuinely UK profits overseas, which is what the CFC rules are about.”¹⁹⁷
209. **The publication of the Government’s strategic direction for reforms to the corporate tax regime is welcome. It should promote the stability, consistency and certainty which many of our witnesses saw as so important.**

The Main Elements of the CT Reform Package

The Balance Between the Elements of the Package

210. Here again there was a very interesting divergence of views, especially over the balance between cutting the CT rate and reducing the capital allowances on expenditure on plant and machinery.
211. Mr Baron said “We have done some member surveys that certainly indicate that that was something they would like to see, that is favouring getting rid of special reliefs, getting the rate down, and very much favouring the reductions in the corporation tax rate that have been announced in recent budgets.”¹⁹⁸ Asked whether their small and medium-sized members shared the enthusiasm for this type of settlement, Mr Baron responded “so far as we can tell from our survey evidence, yes.”¹⁹⁹
212. The Hundred Group was very supportive of the Government’s overall approach but accepted that “it is important when costing tax policy proposals ... that the impact on all business sectors is properly understood ... consultation should begin as early as possible in the policy development process, to prevent inadvertent imbalances being introduced.”²⁰⁰
213. Others were worried about imbalances. The ATT commented “It is not just the rate of corporate tax which influences the attractiveness of a jurisdiction as a place to base a business. Reliefs available in respect of capital expenditure must also be taken into account. The proposed reduction in the rate of [capital] allowances ... will have the opposite effect to the reduction in the rate of tax ... [it] is not helpful to the smaller company.”²⁰¹ Mr Whiting

¹⁹⁶ Q 113

¹⁹⁷ Q 289

¹⁹⁸ Q 138

¹⁹⁹ Q 139

²⁰⁰ FBSC 16 paragraph 10d

²⁰¹ FBSC 4 paragraph 12

- pointed out that “Of course, for many businesses that are not incorporated they were seeing lower capital allowances but no benefit.”²⁰²
214. It was the EEF, representing the manufacturers, who seemed most concerned with this aspect of the CT reform package. They thought that “the benefits of a reduction in the headline rate of corporation tax have been more than offset by the reduction in capital and investment allowances and a rise in other business taxes, in particular for SME manufacturers.”²⁰³ They wrote “The government’s current approach to corporate tax reform will deliver an internationally competitive headline rate of corporation tax. But as reform stands, it is unlikely to generate the balanced economy the government desires or the broader business tax competitiveness it seeks.”²⁰⁴
215. Underlining this view in his oral evidence, Mr Kakkad said “The cut in the headline rate only benefits approximately 50,000 companies that pay the high rate of corporation tax whereas capital allowances are paid by every business, not just anybody paying corporation tax. So the reduction in capital allowances ... will raise the effective tax rate.”²⁰⁵ Mr Patel (FSB) made the point that “the accelerated reduction in corporation tax of the top rate is welcomed and it affects lots of our members, but a lot of our members play in the smaller rates field and we would like to have seen an accelerated scheme for that as well.”²⁰⁶
216. Mr Wales, speaking generally and not specifically in the context of capital allowances, said that “the issue is not always what the nominal rate of tax is; it is what the effective rate of tax is. It is true that there are a surprising number of large businesses still whose investment intentions are somewhat driven by the nominal rate of tax, but really you should focus on what the effective rate is.”²⁰⁷
217. We asked officials about the balance of the CT reform package. Mr Troup told us “Most unincorporated business are quite small. Small businesses can benefit from an investment allowance of £25,000, which gives them a full 100% write-off for all capital expenditure ... on the central point about the manufacturing sector ... it is very difficult to do sector analysis, although it is one of those things that we have come back to and looked at with hindsight, but it is very difficult to do forecasting. We have a certain amount of data on the manufacturing sector. The figures we have are that by 2014, we expect the tax liabilities of the manufacturing sector ... to fall by around £700 million ... So this is not a set of changes that is in some way disadvantaging manufacturing.”²⁰⁸

Reform of the CFC Rules

218. These comprise interim reforms included in this year’s Finance Bill and ongoing consultation on a full reform package for next year. We confined ourselves principally to testing whether the consultation was heading in a satisfactory direction and whether the proposals would be likely to strike an

²⁰² Q 114

²⁰³ FBSC 8 paragraph 7

²⁰⁴ FBSC 8 paragraph 46

²⁰⁵ Q 134

²⁰⁶ Q 234

²⁰⁷ Q 26

²⁰⁸ QQ 304–305

appropriate balance between protecting the Exchequer and producing a regime which would be internationally competitive.

219. Mr Woolhouse commented on the interim reforms “Very broadly, we welcome the interim changes. Together these are steps in the right direction in terms of getting a more coherent regime for taxing foreign profits, so the overall direction is positive.”²⁰⁹
220. The CIOT saw the main CFC reforms as very significant. The Hundred Group agreed “taken together, these proposed exemptions evidence the Government’s commitment to target the CFC rules only at the artificial diversion of UK profits, and provide a welcome indication of the direction of travel towards full reform.”²¹⁰
221. The ICAS were very supportive “HM Treasury officials are to be commended for the quality of their engagement with businesses.”²¹¹ The CBI was supportive with a caveat “The proposals in this area contain some very useful pragmatic ideas, and the overall direction of travel is clearly positive. However, some of the proposals reflect excessive concern over avoidance and artificial diversion.”²¹²
222. The partial exemption for finance companies was a bone of contention amongst our witnesses. The proposals, which depend on the nature of the funding for the finance company, broadly taxes its profits at a maximum effective rate of one-quarter of the main rate (5.75% when the main rate has fallen to 23%). The LSEW “generally welcomed [this] as a relatively pragmatic way in which the conflicting aims would be met.”²¹³ The CBI agreed.
223. However, Mr Murphy was much more concerned “if these group treasury operations are located in a tax haven with a 0% tax rate then the UK will treat them as being CFCs but will only subject them to a special low rate of tax of 5.75% by 2014 ... As a consequence the tax rates on the profits in the treasury function of this group ... will reduce by 75%. It will be easy to manipulate this to ensure UK source operating profits move for tax purposes into such treasury companies.”²¹⁴
224. We asked officials about the cost of the full CFC reforms which will build up to an estimated £840 million by 2015/16. Mr Troup thought “The finance company exemption is likely to be the major element of the costing ... the CFC breakdown in the costings document has quite a lot of information about where it comes from.”²¹⁵ Asked to justify such a large cost for this exemption Mr Troup said “The rate settled ... is a classic example of the balance. What was the right level to pitch the CFC charge which would ensure that UK companies would not have a disproportionate incentive to divert profits overseas, while at the same time ensuring that we did collect a reasonable level of tax from UK-based businesses? International comparisons were very important here ... The Dutch have a rate of approximately 5%.”²¹⁶

²⁰⁹ Q 129

²¹⁰ FBSC 16 paragraph 10b

²¹¹ FBSC 10 paragraph 2.3

²¹² FBSC 6 paragraph 5c

²¹³ FBSC 1 Appendix 4 paragraph 12

²¹⁴ FBSC 5 section 7

²¹⁵ QQ 295 and 297

²¹⁶ Q 297

Reform of IP/Introduction of Patent Box

225. The CT reform document identifies the Government's approach to the review of IP "Although the Government recognises the value of all types of IP, it is focusing on scientific and high-tech IP because of their particularly strong link to Research and Development (R&D) and technical innovation activities and in order to protect the UK's status as a world leader in patented technologies ... The Government intends to introduce a preferential regime for profits arising from patents, known as a Patent Box."²¹⁷ "The Government proposes to introduce a 10 per cent rate for profits arising from patents, to apply from 1 April 2013."²¹⁸
226. We asked our private sector witnesses for their early reactions to the proposed patent box. The CBI were positive "Equally supported is the Government's intention to introduce a Patent Box regime from 2013 and its commitment to develop the implementation strategy in partnership with business."²¹⁹ The Hundred Group saw it as "a bold first step towards an internationally competitive regime in which to locate high added-value technical activity and the commercial exploitation of valuable IP."²²⁰ Mr Hardwick saw a case for extending its scope beyond patents. Mr Kakkad argued this more strongly, particularly given that since "the Netherlands and others on the Continent do have innovation boxes we are going to be a step behind them from the start."²²¹ Responding to Mr Kakkad's comments, Mr Baron "was less worried about this. You cannot give tax concessions to everything."²²²
227. Mr Wales had an interesting take "It is difficult to ascertain with any degree of certainty the strength of the Treasury's evidence-base for this proposal ... I understand that the Treasury, in putting together the proposal, has not seen any empirical work" by way of post-implementations reviews of the patent box in other countries. "This implies that the evidence used has been entirely theoretical in nature."²²³
228. We asked officials whether they thought the patent box was going to be sufficiently competitive as presently proposed. Mr Troup said "A patent box effectively provides a significant incentive for multinational groups to locate their patent ownership in the UK, to keep the income here and pay a level of tax on it, rather than seeking to transfer either their entire business or their patents overseas, or to find ways in which the patent income is diverted overseas, even though it really 'belongs' here."²²⁴

Foreign Branch Taxation

229. This measure provides an optional, but once effective irrevocable, election for the profits of foreign branches of UK companies to be exempt from UK tax. Where profits would be exempt, losses are not allowable for UK tax purposes. The provisions contain an anti-diversion rule to prevent the

²¹⁷ *Corporate Tax Reform: delivering a more competitive system*, HMT and HMRC, November 2010, paragraphs 1.3 and 1.4

²¹⁸ *Ibid*, paragraph 3.10

²¹⁹ FBSC 6 paragraph 5c

²²⁰ FBSC 16 paragraph 10c

²²¹ Q 130

²²² Q 130

²²³ FBSC 14 paragraph 74

²²⁴ Q 298

exemption from being used to avoid taxation on profits in a UK company. Where an election is made and a branch has accumulated losses over the last 6 years, any subsequent profits are not exempt until the aggregate profits exceed those losses.

230. Mr Wales's reaction was typical of our witnesses "the proposals are a logical extension of recent changes in the way in which the overseas subsidiaries of UK companies are taxed and has been the subject of extensive discussion between officials and taxpayer groups ... The changes will provide additional flexibility, particularly for some sectors."²²⁵

Overall

231. **Given that:**

- **the package of reforms may be unbalanced across business sectors, disadvantaging small and medium-sized businesses and manufacturing;**
- **the scope of the relaxations being introduced is very significant, particularly for controlled foreign companies and for intellectual property; and**
- **the evidence for the patent box seems largely theoretical;**

we consider that post-implementation reviews of the outcomes of this reform package are highly desirable, as they are with all significant tax reforms. We recommend that the timing of these reviews should be agreed with business now and carried out with their involvement, so that the analysis and conclusions are agreed.

Implications for Growth and Tax Competitiveness

232. Finally, we look at the implications of the CT reform package for UK growth and tax competitiveness. The Government's principal objective in developing the CT reform package is to enhance UK tax competitiveness. The introduction to the document states that "The Coalition Agreement sets out the Government's aim to create the most competitive corporate tax regime in the G20 ... the Government believes that the corporate tax system can and should be an asset for the UK, improving the business environment and helping to attract multinational businesses and investment to the UK to support the recovery."²²⁶
233. We discussed with some of our witnesses how the UK compared with our main competitors on international tax competitiveness. Mr Gammie commented in the context of CT rates "I suspect that when we are down to 23%, we will be significantly towards the lower end for economies of our size. Obviously there are many other jurisdictions out there which will have lower rates, but they will be very much smaller economies."²²⁷ Mr Menzies-Conacher's view was that "The headline rate reduction we do see as being a positive and I think it is a positive in the sense that, if you look at the international comparisons, we are looking to attract in people who look at the headline rate and, therefore, that is very significant."²²⁸

²²⁵ FBSC 14 paragraph 70

²²⁶ *Corporate Tax Reform: delivering a more competitive system*, HMT and HMRC, November 2010, paragraph 1.2

²²⁷ Q 25

²²⁸ Q 113

234. We asked our private sector witnesses to what extent the CT reform package, and other proposed changes, would enhance the UK's tax competitiveness. ATT saw "a number of other incentives which are included within the Finance Bill which will encourage businesses to come to or remain in the UK. These include the [changes] to the entrepreneurs' relief rules and the improvements with regard to both the Enterprise Investment Relief and Venture Capital Trusts."²²⁹ They thought the planned reduction in the main rate of corporation tax as improving "the competitiveness of the UK for the siting of major business."²³⁰
235. The ICAEW supported the Government's drive to increase R&D spending, "but nevertheless we believe that further work is needed to examine whether R&D tax relief meets the needs of smaller companies which undertake innovative activity."²³¹ The EEF thought that "further corporate and business tax reforms are necessary if tax reform is to support the government's aim of generating long-term balanced growth and significant improvements to business tax competitiveness."²³²
236. In a full paper discussing the link between CT rates and growth, Mr Murphy's view was that there are "weak associations between declining tax rates and increased growth rates and declining tax rates and increased rates of employment, but the relationships do not prove causality ... It therefore suggests that no link is proven and that growth prospects will not be enhanced as a result of such cuts."²³³ In his oral evidence Mr Murphy concluded "I think that the focus of this policy is seriously mistaken ... To get a competitive advantage we are seeing a perverse incentive created and, as a result, we have seen a policy put forward that is going to be significantly costly to the Treasury."²³⁴
237. Other witnesses disagreed. Mr Woolhouse said "the Emergency Budget [in June 2010] essentially gave a very, very slight reduction in the business tax burden when you combined rates and allowances. That has been accelerated in the last Budget so that is very welcome."²³⁵
238. Mr Wales commented on the link between CT rates and growth "As regards the reduction of the rate of corporation tax by an additional 1%, the expectation is that it will provide a 'nudge' that will encourage much-needed investment by the corporate sector ... It was clear from the Chancellor's first Budget that the programmed series of cuts in corporation tax was not going to be enough to deliver the surge in private sector investment that the UK required, given the course he had set on fiscal policy. I and others have argued since last June for further support for investment."²³⁶
239. The Hundred Group thought that "Business is unanimous that lower CT rates—both the headline rate and the effective rate—relative to global competition attract a greater proportion of investment ... The UK is moving

²²⁹ FBSC 4 paragraph 15

²³⁰ FBSC 4 paragraph 11

²³¹ FBSC 9 paragraph 26

²³² FBSC 8 paragraph 22

²³³ FBSC 5 Summary paragraph 7

²³⁴ Q 111

²³⁵ Q 134

²³⁶ FBSC 14 paragraphs 79 and 80

towards a more competitive regime and is fortunate to have HMRC to administer and support business better than most other countries.”²³⁷

240. Mr Jackman expressed concerns about the impact of complexity on growth “The complexity of the material coming out for small business owners cannot be overstated. We did some polling at the start of this year, which suggested that over half of our member businesses were prepared to pay more tax just to see a simplification of the administration around form-filing. You have small and medium-sized businesses there that are willing to pay more so they have more freedom to spend time on growing their business, so they have more certainty in planning ahead.”²³⁸
241. One of our witnesses was very sceptical about any link between corporation tax rates and growth. Some thought that the benefit from reduced rates was likely to be outweighed by the reduction in capital and investment allowances and other changes. Others were positive about the likely effect on growth.
242. **The difference between those witnesses who were positive and those who saw the impact of the CT reform package as marginal or negative may have been influenced by the sectors they had in mind when making their assessment. Overall, and particularly for large business, we consider that the reform package makes the UK CT regime more competitive. The effect on small business and manufacturing should, however, be assessed carefully by way of the post-implementation reviews we have already recommended.**

²³⁷ FBSC 16 paragraph 10e

²³⁸ Q 227

CHAPTER 5: CONCLUSIONS AND RECOMMENDATIONS

The New approach to Tax Policy Making

The New Approach in Principle

243. There was a clear consensus amongst our witnesses that, if implemented consistently, the Government's new approach to tax policy making would represent a major step on the road to better tax legislation for the UK. We warmly welcome and commend the Government's commitment to following the procedures outlined in the Tax Consultation Framework, and the quality of the consultation it conducted in arriving at the Framework and other aspects of its new approach. (paragraph 30)

Finance Bill 2011

244. We consider that most of the measures in Finance Bill 2011 were developed in accordance with the principles of the new approach to tax policy making. The corporate tax reform measures and the changes to pensions tax relief stand out as examples of best practice. We commend the Government accordingly. (paragraph 52)
245. We are concerned about instances where consultation failed to take place at some stages of the process for policy development outlined in the Tax Consultation Framework. The main examples brought to our attention were the disguised remuneration measure and the increase in the supplementary charge applicable to companies in the UK oil and gas industry. In the first case consultation began only after the first draft of the legislation was published and in the second after it was announced in Budget 2011. (paragraph 53)
246. We are not persuaded that consultation on the disguised remuneration measure could not have started immediately after an announcement and believe that full consultation at every stage might not only have improved the legislation but could also have won greater support and credibility among stakeholders. (paragraph 54)
247. We accept that the Government needs to maintain flexibility to respond quickly to immediate issues. However, even in these circumstances, the Government should do all it can to consult, albeit on an informal, confidential basis. We are not persuaded that the increase in the supplementary charge on oil and gas profits was a case which justified ruling out such informal, confidential consultations before the Budget announcement. (paragraph 55)
248. We are concerned that, if the Government does not abide by its own rules for tax policy making, it risks eroding the credibility of its commitment both to the new approach and to a stable and predictable tax system for the UK. We **recommend** that the Government observe the five-stage process for progressing from policy objective to final evaluation, with consultation at each stage, in all but the most exceptional cases, and that the reasons for any such exceptions be explained fully after the announcement. (paragraph 56)

Delivering the New Approach

249. We welcome the role of the Tax Professionals Forum in monitoring compliance with the new framework and were reassured to hear that the notes and conclusions of their meetings were to be published. We were not

persuaded, at this stage, by the arguments for enhancing these monitoring arrangements. But we agree that the new approach needs to be firmly embedded in policy-making practice and we will monitor progress in this respect when reviewing future Finance Bills. (paragraph 62)

250. There appears to be a severe, and worrying, disconnect between the perceptions of HMT and HMRC and those of their customers about how well the policy partnership between the two departments is working. Many private sector witnesses expressed strong reservations about its effectiveness and about stability, continuity and tax knowledge in many tax policy teams. In contrast, officials assured us that, in spite of some difficult challenges, the policy partnership was working well. A recent joint review by senior officials had led to a “reinvigorated” partnership. These rebuttals were reminiscent of the line taken by officials in 2008 when our predecessor Committee last examined the policy partnership and recommended that HMT and HMRC should look at how well the two departments were working together. (paragraph 75)
251. We **recommend** that the findings of the internal review of the policy partnership should be published as soon as possible to assuage the concerns of our private sector witnesses. Unless already covered by the internal review, we further **recommend** a comprehensive audit of the tax skills and experience of HMT and HMRC staff working on developing tax policy and legislation and an assessment of whether the present arrangements provide sufficient incentives to attract and retain the best talents to this work. (paragraph 76)
252. We recognise, as did our witnesses, the challenges HMRC face in improving service quality when their resources are being reduced and we welcome assurances from officials that training has been put in place to improve the technical tax skills of many of HMRC’s staff. Despite these assurances we share the concerns of witnesses about the quality and training of frontline staff. We **recommend** that HMRC should carefully research the views of their stakeholders on this matter and address them urgently. (paragraph 82)
253. We recognise that some good work has already been done by both HMRC and HMT to improve the way in which they consult with small and medium-sized businesses. However, we are concerned that this consultation is almost exclusively with representative bodies which, because of the number and diversity of smaller businesses, may not reflect the full range of views. We therefore **recommend** that HMT and HMRC extend their current initiatives aimed at consulting smaller businesses so as to engage more directly with specific types of enterprise. (paragraph 89)
254. Our predecessors have drawn attention in past reports to the need for consultation to be as open as possible and to cover the full range of interests affected by proposed tax measures. We recognise that consulting non-business stakeholders poses very difficult challenges and that HMT and HMRC already engage with some organisations representing the interests of lower-income households. But we think it is important that the Government finds effective ways of consulting a wider range of taxpayers, especially when considering changes to the personal tax system. We therefore **recommend** that HMT and HMRC develop and publish a comprehensive strategy for consulting non-business stakeholders on tax proposals likely to affect them. (paragraph 90)
255. Tax Impact and Information Notes (TIINs) represent significant progress in making tax policy development more transparent and we welcome their

introduction. But for TIINs to play their proper role in the policy-making process, they must provide as accurate and comprehensive a picture as possible of the impact of a measure on those taxpayers it affects. Painting such a picture requires full consultation with those interests from the outset and we **recommend** that this be done in all cases. (paragraph 95)

Extending the Scope of the New Approach

256. We recognise that HMT and HMRC already devote significant resources to monitoring and evaluating tax policies after they have been implemented, and that many of their findings are published. We also welcome the inclusion in individual TIINs of clearer statements of policy objectives and a note on the (largely internal) monitoring arrangements. Nevertheless we think there is scope for the process to be extended and formalised. (paragraph 101)
257. We agree with those witnesses who argued for a more formal commitment to post-implementation review. We **recommend** that the Government add to the new framework a formal requirement for all significant tax reforms to be evaluated against their stated objectives once they have bedded in. We also **recommend** that such evaluations should be carried out with the support of independent experts and that their results should be published. The appropriate time for such an evaluation should be the subject of consultation when the initial policy is being developed. (paragraph 102)
258. We recognise the political dimension to tax reform. Furthermore, clearly any Government cannot bind the hands of its successor. But we think that that the Government should be able to identify further areas of the tax system where it can set out its strategic direction without unduly compromising its room for manoeuvre. (paragraph 107)
259. We were persuaded by the argument that the Government should seek to outline its strategic objectives for different parts of the tax system. We recognise that the Government has already taken some significant steps in this direction, not least by outlining its guiding principles for the tax system and by publishing the CT Roadmap. Clearly outlining its strategy for other areas of the tax system in a similar way, even where the Government has no immediate plans for change, would help enhance the certainty, predictability and stability the new approach aims to achieve. We **recommend** that this be done in those further areas of the tax system where it is possible. (paragraph 108)

Enhancing Parliamentary Scrutiny of Tax Legislation

260. All the private sector organisations which submitted evidence advocated that the new tax policy-making process should trigger consequential changes to enhance Parliamentary scrutiny of tax legislation and, while recognising that these are matters for Parliament, put forward a number of proposals. (paragraph 121)
261. Most witnesses proposed that better use should be made of the expertise and experience of Members of the House of Lords in matters of tax policy and legislation. One option would be to adapt the remit of our Sub-Committee to the new tax policy-making cycle so that it could examine tax proposals being consulted on before publication of the draft Finance Bill and inquire into the draft Finance Bill when it is published some three months before the Budget. Another option would be for the Sub-Committee to begin its inquiry at the time the draft Finance Bill is published. (paragraph 122)

262. Proposals for enhancing Parliamentary scrutiny of the Finance Bill are, however, outside the remit of the Economic Affairs Committee and its Finance Bill Sub-Committee. We are aware, however, of the proposals in the recent Leader's Group report for an extension of the committee work of the House of Lords and record these proposals for the consideration of the House. (paragraph 123)

Anti-Avoidance with Special Reference To Disguised Remuneration

Anti-Avoidance: The Government's Strategy

263. We welcome the introduction of the strategic approach to anti-avoidance set out in *Tackling Tax Avoidance*. If the measures set out in the document are pursued vigorously, it should improve the tackling of avoidance and reduce the loss of tax therefrom. (paragraph 140)

Tackling Avoidance Early

264. We fully agree that avoidance needs to be tackled early before it gathers momentum. We are pleased to see the emphasis on early action in the anti-avoidance strategy. We are concerned, however, that it was not until this year's Finance Bill that action was taken to tackle avoidance through disguised remuneration. Very large amounts of tax were being lost as a result of this avoidance. HMRC should have realised that this avoidance was mushrooming and Governments should have acted earlier to stem the loss of tax. (paragraph 154)
265. HMRC should learn the lessons from the case of disguised remuneration. We **recommend** that HMRC carry out a review to establish why the avoidance activity was not detected sooner, or if it was, why its growth potential was not recognised and action taken at that earlier stage. (paragraph 155)

Tackling Avoidance Effectively

266. The legislation to address disguised remuneration avoidance is extremely complex and beyond the scope of most business people to decide whether or not it applies to them. One witness called it 'the worst legislation he had ever seen'. There was clearly a very wide and deep unhappiness with this draft legislation. (paragraph 174)
267. Many of our private sector witnesses said that 'they would not have started from here' if they had been constructing this legislation. Notwithstanding the justifications put forward by the Exchequer Secretary in the Commons Public Bill Committee and by officials to us, we remain unpersuaded that there was no alternative to this complexity. (paragraph 175)
268. Although it is clearly too late to change the legislative approach at this stage in the Finance Bill cycle, we **recommend** that HMRC should carry out an in-depth examination of the alternative approaches that would have been open to them in framing the disguised remuneration legislation. This could be part of the review that we recommended earlier. The lessons learned should help HMRC to avoid similar pitfalls when tackling other avoidance schemes. (paragraph 176)

The Primarolo Statement

269. We recognise that in its anti-avoidance strategy, the Government stated that it would legislate retrospectively only in the most exceptional circumstances.

It seems to us that a tax loss of over £1 billion each year from avoidance involving disguised remuneration is a truly exceptional circumstance. We think that the willingness of our private sector witnesses to consider the Primarolo statement is an indication of how unhappy they are with the disguised remuneration legislation. We therefore **recommend** that the status of the Primarolo statement should be clarified and, as necessary, further consideration be given to a revised statement to help deter future avoidance in this general area of the tax system. (paragraph 183)

Principles-Based Drafting

270. We agree that principles-based drafting is an approach that should be developed for the future in appropriate situations. It seems likely that the more it is used, the easier the approach will be to develop in a wider range of situations. (paragraph 190)

Evasion

271. On the basis of HMRC's figures the tax lost from all forms of evasion and default is very much greater than that lost from avoidance: £22 billion compared with £7.5 billion. We welcome action to tackle evasion. We **recommend** that the Government should publish an anti-evasion strategy in the same way as for anti-avoidance. (paragraph 198)

Corporate Tax Reform

CT Road Map and the Move Towards Territoriality

272. The publication of the Government's strategic direction for reforms to the corporate tax regime is welcome. It should promote the stability, consistency and certainty which many of our witnesses saw as so important. (paragraph 209)

The Main Elements of the CT Reform Package

273. Given that:

- the package of reforms may be unbalanced across business sectors, disadvantaging small and medium-sized businesses and manufacturing;
- the scope of the relaxations being introduced is very significant, particularly for controlled foreign companies and for intellectual property; and
- the evidence for the patent box seems largely theoretical;

we consider that post-implementation reviews of the outcomes of this reform package are highly desirable, as they are with all significant tax reforms. We **recommend** that the timing of these reviews should be agreed with business now and carried out with their involvement, so that the analysis and conclusions are agreed. (paragraph 231)

Implications for Growth and Tax Competitiveness

274. The difference between those witnesses who were positive and those who saw the impact of the CT reform package as marginal or negative may have been influenced by the sectors they had in mind when making their assessment. Overall, and particularly for large business, we consider that the reform package makes the UK CT regime more competitive. The effect on small business and manufacturing should, however, be assessed carefully by way of the post-implementation reviews we have already recommended. (paragraph 242)

APPENDIX 1: THE FINANCE BILL SUB-COMMITTEE

The members of the Sub-Committee which conducted the inquiry were:

Lord Bilimoria
 Lord Griffiths of Fforestfach
 Lord Hollick
 Baroness Kramer
 Lord McFall of Alcluith
 Lord MacGregor of Pulham Market (Chairman)
 Lord Maples
 Lord Moonie
 Baroness Noakes
 Lord Shipley
 Lord Wakeham

Dr Trevor Evans CBE JP and Mr Tony Orhrial CB, retired senior officials of HM Revenue and Customs and HM Treasury, were appointed as Specialist Advisers to the inquiry.

Declaration of Interests

Members of the Finance Bill Sub-Committee declared the following interests as relevant to the inquiry:

BILIMORIA, Lord

In addition to that which is declared in my Register of Interests, including being Chairman of the Cobra Beer Partnership Limited, President of the UK India Business Council, and non executive director and senior independent director of the Booker Group PLC, I also qualified in 1986 as a chartered accountant with what is today Ernst & Young and am an alumnus of Ernst & Young. Through my companies I also work/have worked with several accounting and law firms including: KPMG, Price Waterhouse Coopers, Grant Thornton, PSJ Alexander and Company; law firms include Clyde and Co, Olfwang, Weil, Gotshal & Manges, and Clifford Chance. The banks that I deal with on a personal and corporate basis are, HSBC, Barclays, Coutts, and ICICI. Brokers include Investec and JP Morgan Cazenove and I also hold quoted and unquoted investments. I am also a patron/trustee/commissioner of various charitable organisations as listed in my Register of Interests.

HOLLICK, Lord

*Director, Diageo plc
 Director, Honeywell Inc
 Director, BMG Rights Management
 Partner, G.P. Bullhound
 Partner, Strand Film Partners*

MAPLES, Lord

*Chairman, Foresight Solar VCT (venture capital trust investing mainly in solar power generation)
 Non-executive Director, Agatha Christie Ltd (owner of literary copyrights)
 Non-executive Director, Value Retail plc (owner of shopping malls in the UK & other EU countries)*

MCFALL OF ALCLUITH, Lord

*Director (Chairman, Audit Committee), NBNK Investments plc (banking).
Complete list of interests are declared in the Register*

NOAKES, Baroness

*Director of and shareholder in companies, all listed in the Register of
Members' Interests*

SHIPLEY, Lord

*Membership of Newcastle City Council and the Board of One North East in
relation to taxation policy on public bodies
Membership of the Board of several charities including the Theatre Royal
Newcastle and the Princes Trust N.E. in relation to taxation policy on
charitable bodies.*

WAKEHAM, Lord

Client of Marcfarlanes (as declared on 27 April 2011).

A full list of Members' interests can be found in the Register of Lords' Interests:

<http://www.parliament.uk/mps-lords-and-offices/standards-and-interests/register-of-interests>

APPENDIX 2: LIST OF WITNESSES

Oral Evidence

27 April 2011

Mr Chris Wales, FTI Consulting, Mr Paul Johnson, Institute for Fiscal Studies and Mr Malcolm Gammie QC

Supplementary written evidence, Mr Chris Wales, FTI Consulting

Mr Ashley Greenbank, Mr Richard Stratton, and Mr Mike Hardwick, Law Society of England and Wales, and Ms Anne Redston, Barrister and Visiting Professor, King's College London

Written evidence, Law Society of England and Wales

Written evidence, Ms Anne Redston

4 May 2011

Mr John Whiting and Mr Ian Menzies-Comacher, Chartered Institute of Taxation, Mr Simon Braidley and Mr John Kimmer, Association of Taxation Technicians, and Mr Richard Murphy, Tax Research LLP

Written evidence, Association of Taxation Technicians

Written evidence, Chartered Institute of Taxation

Written evidence, Tax Research LLP

Supplementary written evidence, Association of Taxation Technicians

Supplementary written evidence, Chartered Institute of Taxation

11 May 2011

Mr Richard Woolhouse, CBI, Mr Richard Baron, Institute of Directors, and Mr Jeegar Kakkad, EEF

Written evidence, CBI

Written evidence, Institute of Directors

Written evidence, EEF

18 May 2011

Mr Frank Haskew, Institute of Chartered Accountants in England and Wales, Mr Derek Allen, Institute of Chartered Accountants of Scotland, and Mr Chas Roy-Chowdhury, Association of Chartered Certified Accountants

Written evidence, Institute of Chartered Accountants in England and Wales

Written evidence, Institute of Chartered Accountants of Scotland

Mr Priyen Patel, Federation of Small Businesses and Mr Alex Jackman, Forum of Private Businesses

Written evidence, Forum of Private Businesses

23 May 2011

Mr Dave Hartnett CB, Permanent Secretary for Tax, HMRC, Ms Sue Walton OBE, Head of Anti-Avoidance Group, HMRC, and Mr Edward Troup, Director-General, Tax, Welfare and Budget, HM Treasury

Written evidence, HM Revenue & Customs and HM Treasury

Supplementary written evidence, HM Revenue & Customs

Further supplementary written evidence, HM Revenue & Customs

Written Evidence

Evidence marked * is associated with oral evidence. The evidence is published online at <http://www.parliament.uk/hlfinancebill> and available for inspection at the Parliamentary Archives (020 7219 5314).

Numerical Order

- * Law Society of England and Wales (FBSC 1)
- * Ms Anne Redston (FBSC 2)
- * Chartered Institute of Taxation (FBSC 3)
- * Association of Taxation Technicians (FBSC 4)
- * Mr Richard Murphy, Tax Research LLP (FBSC 5)
- * CBI (FBSC 6)
- * Institute of Directors (FBSC 7)
- * EEF (FBSC 8)
- * Institute of Chartered Accountants in England and Wales (FBSC 9)
- * Institute of Chartered Accountants of Scotland (FBSC 10)
- * Forum of Private Businesses (FBSC 11)
- * Association of Taxation Technicians (FBSC 12)
- * Chartered Institute of Taxation (FBSC 13)
- * Mr Christopher Wales, FTI Consulting (FBSC 14)
- * HM Revenue and Customs and HM Treasury (FBSC 15)
- * The Hundred Group of Finance Directors (FBSC 16)
- * HM Revenue and Customs (FBSC 17)
- * HM Revenue and Customs (FBSC 18)
- * Quoted Companies Alliance (FBSC 19)

Alphabetical Order

- * Association of Taxation Technicians (FBSC 14) (FBSC 12)
- * CBI (FBSC 6)
- * Chartered Institute of Taxation (FBSC 3) (FBSC 13)
- * EEF (FBSC 8)
- * Forum of Private Businesses (FBSC 11)
- * HM Revenue and Customs and HM Treasury (FBSC 15)
- * HM Revenue and Customs (FBSC 17) (FBSC 18)
- * The Hundred Group of Finance Directors (FBSC 16)
- * Institute of Chartered Accountants in England and Wales (FBSC 9)
- * Institute of Chartered Accountants of Scotland (FBSC 10)
- * Institute of Directors (FBSC 7)

- ★ Law Society of England and Wales (FBSC 1)
- ★ Mr Richard Murphy, Tax Research LLP (FBSC 5)
Quoted Companies Alliance (FBSC 19)
- ★ Ms Anne Redston (FBSC 2)
- ★ Mr Christopher Wales, FTI Consulting (FBSC 14)