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House of Representatives Standing Committee on Economics
Inquiry into tax deductibility

Submission by the UK Office of Tax Simplification

The Office of Tax Simplification (OTS) is grateful for the invitation to make a submission to the Standing Committee on Economics' inquiry into tax deductibility. We base our comments on our experience in the area of tax simplification, which has included work on the UK's tax reliefs and exemptions.

The Office of Tax Simplification

The OTS was established in 2010 by the UK's then newly-elected coalition government. We were set up as an independent office of HM Treasury, with the task of studying areas of the UK tax system and developing recommendations for simplification. Such recommendations are published in reports addressed to the Chancellor of the Exchequer; the OTS has no power to actually change the tax system.

The OTS has always been a small unit – always less than six full-time equivalent staff – those staff being a mix of civil servants and private sector people. Our recommendations are firmly evidence-based, coming from extensive stakeholder meetings and consultations with a wide variety of businesses, individuals, representative bodies, advisers, academics, front-line HMRC tax staff and others.

In the first five years of our operation, the OTS carried out ten major projects, published 33 reports and papers and made 402 recommendations. Just over half these recommendations have been accepted, with a further quarter still under consideration.¹

The new UK government elected in 2015 announced in July 2015 that the OTS would be made a permanent operation, with its role and resources expanded. Draft legislation to

¹ All our reports can be found on our website <https://www.gov.uk/government/organisations/office-of-tax-simplification> ; a summary of the recommendations and how these are being taken forward is at <https://www.gov.uk/government/publications/ots-list-of-recommendations> .

formalise our operation (which remains as an independent office of HM Treasury) and remit was published in December 2015 and will be included in the 2016 Finance Bill.²

The Committee's terms of reference

We note the Committee's focus on:

- The personal income tax system as it applies to non-business income
- The company tax system with particular reference to interest deductibility

We are not in a position to comment specifically on the Australian system and so restrict ourselves to general comments, based primarily on our own Reliefs project. We would emphasise that our work and findings cover both personal and business tax systems but we have not so far looked specifically at deductibility of interest or the wider questions of debt vs. equity (it is on our list of possible future projects).

Some key findings from our work

The details of our recommendations will only be of passing interest to the Committee. In carrying out our work we have developed a range of principles and general findings which are probably universal and applicable to any tax system.³ Our ideas consider all users of the tax system – taxpayers (business and individual), agents and the tax authorities.

A very early conclusion was that simplifying the tax system had to consider two broad routes:

- Technical simplification – simplifying the legislation, which would include streamlining or repealing provisions
- Administrative simplification – making it easier to deal with the tax system, encompassing easier interactions, delivering greater certainty, simpler forms and other aspects

Another early finding, which has been reinforced regularly, is that the greatest source of complexity is change. The more frequently the tax system changes, the more involved it becomes.⁴

As well as studying specific areas of the tax system, we have done considerable work on complexity in general. We would draw the Committee's attention to two particular products of this work:

- A paper on Principles for avoiding complexity⁵

² Previously the OTS had no formal statutory authority or constitutional position.

³ It is worth pointing out that on all our projects we have gathered evidence of other countries' tax systems and drawn lessons for the UK. As an example, our current project on Small Company taxation has involved discussions on both the Australian and New Zealand experiences in taxing small businesses.

⁴ This point is a challenge to our own work: if we make a recommendation for simplification, we are well aware that implies a change, which means a measure of further complexity. We have to be sure that the gain from simplification is worth the pain of change!

⁵ Published at <https://www.gov.uk/government/publications/how-to-avoid-complexity-in-the-tax-system>

- The OTS's Complexity Index, developed primarily to identify areas for us to study by giving complexity 'ratings' to areas of the tax code⁶

Tax reliefs and exemptions project

One of the OTS's early projects was to look at the tax reliefs and exemptions within the UK's tax system.⁷ The stages included:

- Listing and codifying all reliefs (our list ran to 1,042)
- Carrying out an in depth study of a sample of 155 reliefs
- Developing some principles for evaluating those reliefs
- Recommending over 40 reliefs for abolition and some for enhancement to simplify their operation

In studying 'reliefs' we were conscious that there are various ways of categorising the ways that tax system allows taxpayers to reduce their tax bills. At its simplest, there are reliefs and exemptions; how they operate can then be categorised in different ways. We did not concern ourselves with such categorisations, preferring to take a fairly simplistic approach that allowed us to look at any and all ways that the system allowed tax bills to be reduced. Accordingly, the 1,042 reliefs we listed encompassed all reliefs and exemptions, all taxes (direct and indirect) and both business and individual taxpayers.

The principles we developed for our work included looking at:

- The original policy rationale for the relief
- How the relief is being used today
- Evidence of its operation: ease of claim and monitoring
- Cost
- Some assessment of how effective the relief was proving

We found that a number of reliefs seemed no longer to adhere to the original policy rationale. This was behind some of the recommendations for abolition. In some cases we also questioned why tax reliefs had been chosen as the route to take action on an issue, rather than another route, such as a grant.

In many ways our key point was a systemic one: that the UK did not have a mechanism to keep the effectiveness and value for money of tax reliefs under review. Accordingly, we recommended that there should be such a system. We thought that HM Revenue & Customs, HM Treasury and the National Audit Office (NAO) would all have a role to play in this process, as would Parliament itself.⁸

We have intended to return to the subject of tax reliefs in another project but have not so far been able to do so. However, in our major study on Improving the Competitiveness of

⁶ See <https://www.gov.uk/government/publications/office-of-tax-simplification-complexity-index>

⁷ The reports can be found at <https://www.gov.uk/government/publications/tax-reliefs-review>

⁸ As the Committee may be aware, the Public Accounts Committee (PAC) of the UK Parliament and the NAO have taken forward this work with a number of studies of tax reliefs.

the UK's tax system⁹ we covered various aspects of tax reliefs. One point we emphasised is that with the reduction in rates of corporation tax in the UK¹⁰, the value of many business tax reliefs is much less than used to be the case.¹¹ This should be a factor in considering ways of streamlining and simplifying the system. It is interesting to us to see the Committee's focus on this issue.

Concluding comments

As requested, we have only made a short submission. We hope that our comments are of interest and use in the Committee's inquiry. We would be pleased to develop our comments further on any aspect if that would assist the Committee.

John Whiting
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12 January 2016

⁹ Report published <https://www.gov.uk/government/publications/competitiveness-of-uk-tax-administration-review>

¹⁰ The current rate of corporation tax is 20% and is scheduled to reduce to 18% in 2020; it has reduced rapidly from 28% and was 30% as recently as March 2008.

¹¹ A key example is the capital allowance (tax depreciation) system where a set system of tax allowances replaces depreciation in the tax computation.