

# Overcoming the barriers to tax reform

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# About this report

This report sets out the barriers that face governments in reforming the tax system, and highlights ways in which these could be overcome.

This report is the final written output of a programme of work examining why successive governments have found it so difficult to reform the tax system, and how this might be overcome. The programme builds on the Institute for Government's previous work on the budget-making process in *Better Budgets: Making tax policy better*.

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# Foreword

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This report was conceived and largely written before the coronavirus pandemic swept the globe. It focuses on an issue – tax reform – that may seem a long way from being a priority, as the government battles to contain the virus and pours billions of pounds into the economy to help keep businesses alive despite many being forced to shut their doors.

It is impossible to know now what the landscape for the government will look like after this crisis has passed. But there are reasons to think that – when the government turns its attention to rejuvenating the economy and rebuilding the public finances – tax reform will be even more critical than it was before.

There are long-standing and well-known inefficiencies and unnecessary distortions in the UK tax system, and behavioural and economic trends are undermining the government’s ability to raise revenue through the current tax system. The health and social care needs of the UK’s ageing population are also putting increasing pressure on public spending, requiring tax rises unless the scale and scope of public services is pared back. These all necessitate tax reform.

The coronavirus outbreak will add further fiscal pressures. The government’s economic rescue package will add many billions of pounds to public debt, may permanently reduce economic output and tax revenues, and may create public desire for a permanently larger role for the state – with higher spending to increase resilience in the public services and a more generous welfare system. That will increase the tax revenues that the government needs to raise and increase the cost of allowing inefficient and distortionary tax instruments to languish on the statute book.

As we set out in *Taxing Times: The need to reform the UK tax system*, published in July 2019, the UK tax system has long been in need of reform to shore up the tax base and address long-standing weaknesses – and that need for reform would be even greater if the government wanted to increase revenues significantly to enable the state to provide a more effective safety net. But despite public support for more spending on public services, successive governments have struggled to reform or raise taxes, instead choosing to tinker with the existing system while failing to address the underlying problems.

Convincing the UK public of the need for reform requires – in the words of former Treasury minister and shadow chancellor Ed Balls – “win[ning] the argument for why”. For now, the government’s attention is absorbed by battling coronavirus and propping up the economy and society while that happens.

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But after the crisis has passed, the UK public may – as happened after the second world war – hold fundamentally different views about the role of the state and who should pay for that. At the very least, a higher level of public debt and borrowing may create greater willingness for paying more tax, as they did after the global financial crisis.

That will not be enough on its own to facilitate reform, but it would be a start and this report sets out other ways in which the government can smooth the path to reform – measures that would also help do so even if public attitudes do not shift. Some tentative steps towards reform were taken in the March 2020 budget. But to go further, the chancellor and prime minister will need to be clearer about what their objectives are for the UK tax system, the government will need to explain the problems to the public and provide them with the evidence that will convince them, and start a discussion about how they can be addressed.

Ministerial leadership will be vital, but there are also changes that could be made by parliamentarians, civil servants and other public bodies to help support reform, as this report lays out.

A handwritten signature in black ink that reads "Bronwen Maddox". The signature is written in a cursive, flowing style.

Bronwen Maddox  
Director, Institute for Government

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# Summary

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The UK tax system needs reform. This should be done to address longstanding inefficiencies and distortions in the current system, to keep pace with behavioural and economic changes, to help raise the revenue that will be required to meet the health and social care spending needs of the UK's ageing population, and to help fund the transition to net-zero carbon emissions. The coronavirus pandemic will add further fiscal pressures. These spending pressures increase the cost of allowing inefficient and distortive tax structures to languish on the statute book.

But governments face substantial political-economy problems in reforming the tax system. It is difficult to construct a 'burning platform' for tax reform, and loud objections from those who lose out from tax changes usually drown out any positive response from those who gain.

Whether or not there is such a shift in attitudes, there are ways that the government could open the space for reform, as well as changes that others – from parliament and the civil service to external tax experts – could make to smooth the path of, and encourage, reform. These are the focus of this report.

Above all, the government needs to state more clearly what its objectives for the tax system are. Other positive steps would include: developing and disseminating evidence on the problems with the current tax system and the costs these impose more widely; making space for long-term policy development to allow government to make use of 'windows of opportunity' for reform; thinking carefully about how reform packages are constructed and implemented; and greater challenge from MPs of the merits of the existing tax system.

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# 1 Introduction

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The tax system is a crucial part of the state. Without it, the government could not pay for public services or infrastructure or choose to redistribute money to the less well-off. But it is not just how much it raises that is important: as the Mirrlees review of the UK tax system said, “the way in which these systems are designed matters enormously to economic welfare”.<sup>1</sup>

The UK tax system needs reform to address long-standing inefficiencies and distortions, to keep pace with behavioural and economic changes and to help raise the revenue that will be required to pay for public services and welfare. Even before the onset of coronavirus, there was growing pressure for higher public spending to meet the health and social care spending needs of the UK’s ageing population and to help fund the transition to net-zero carbon emissions. We set out these shortcomings and pressures in more detail in an earlier report, *Taxing Times: The need to reform the UK tax system*.<sup>2</sup>

The coronavirus outbreak adds new pressures. The government’s economic rescue package will add many billions of pounds to public debt, which will have to be financed. It may create public desire for a permanently larger role for the state – with higher spending to increase resilience in public services and a more generous welfare system. The aftermath of this crisis could provide an opportunity to address these long-standing problems and improve the way in which we raise tax – and indeed, to move to a higher tax system if that is indicated by public desire. But that will require tax reform that previous governments have struggled to deliver.

While UK governments over recent decades have made lots of changes to the tax system, there have been virtually no successful major reforms. This is despite those outside government having expended considerable intellectual effort on identifying the problems and making recommendations for change to achieve a more efficient, less distortionary tax system that would better deliver on a government’s revenue-raising and redistributive objectives.<sup>3</sup>

In this report we look at what stands in the way of governments reforming the tax system in the UK and what can be done to overcome these barriers. In doing this, we are implicitly claiming that such tax reform would be aimed at moving towards a better tax system. It is important to be clear what we mean by ‘better’. We regard a better tax system as one that more sustainably generates the revenue needed to fund public services and benefits (given a government’s preferences over levels of borrowing and debt) and that does so (in conjunction with other government policies, where relevant) in a way that achieves a government’s redistributive and other objectives, in a more efficient way – that is, imposing lower costs on individuals and the economy in terms of economic distortions and administrative and compliance costs.



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This may seem a very technocratic take on what constitutes a good reform. A policy could be politically successful, even if it failed to achieve the government's stated objectives or did so at unnecessarily high cost. Political acceptability is a necessary condition of reform that lasts – reforms that meet the technocratic tests but fail on the politics do not last and may shatter chancellors' reputations. However, too much tax policy is driven by the apparent need for short-term political wins and ends up making the system less efficient and less sustainable. Therefore, in this report, we focus on what needs to be done to help achieve a better tax system, recognising that doing so requires democratically elected governments to be able to implement policy changes. As Terry (now Lord) Burns – former Treasury permanent secretary – explained to us, good tax reform is about raising revenue in the most efficient way within political constraints.<sup>4</sup>

Tax reform – as we use the term in this report – is, therefore, not about making small changes to tax rates or tweaking reliefs and other provisions, which is what chancellors do in most budgets. As we set out in an earlier report (with the Institute for Fiscal Studies and the Chartered Institute of Taxation) entitled *Better Budgets: Making tax policy better*,<sup>5</sup> the exceptional processes around tax policy making – in particular, secrecy, limited scrutiny and challenge, and the power of the Treasury – make these types of tax change all too easy, contributing to an ever-lengthening tax code, beset with problems, creating confusion for taxpayers and leading to political reversals. But, while the processes around tax policy making make these sorts of changes too easy, governments find their options for tax reform constrained.

Tax reforms can be limited to a specific tax (for example, broadening the base for VAT or personal income tax) or can involve more complex packages – such as shifting from income to consumption taxes (as the then chancellor, Geoffrey Howe, did in the UK in 1979), from taxing petrol and diesel to road charging (as some have more recently suggested), or replacing council tax with a tax proportional to property values (as others have suggested).<sup>6</sup>

Reform of the tax system is generally more contentious than reform of other areas of policy. "It is an article of political faith," said Brazier and Ram in a report for the Hansard Society, "that very few issues concern the electorate as much as the amount of money taken from them in taxation."<sup>7</sup>

It is interesting to compare the limited progress on tax reform with the relative ease of reform in other areas. David Cameron's government managed to set in motion sweeping reforms of the benefit system for working-age people, through the introduction of Universal Credit. Although this policy has encountered problems and attracted criticism, most of these have stemmed from features of its practical design and its implementation (such as the initial six-week waiting period before claimants receive money) – and because the chancellor, George Osborne, ended up cutting the overall generosity of the system – rather than from the fact that the policy intentionally rebalanced benefit payments away from some groups and

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towards others.\* It is hard to believe that an equivalently wide-ranging set of reforms to rebalance the tax system would have got off the drawing board, not least because there would no doubt have been vocal lobbying by those who were set to lose out, while any gainers may not have noticed or not spoken up.

Between them, Tony Blair's Labour government and David Cameron's coalition government implemented major reforms of who pays for higher education in the UK. These changes have resulted in a large share of the cost of this service now being met by what amounts effectively, for most new graduates, to an extra tax on their earnings. These reforms faced opposition, but never to the point that ministers felt the need to reverse tack, as they have done with far less substantial tax reforms.

It is not only the UK government that has struggled to reform the tax system. The recent *gilets jaunes* protests in France initially stemmed from discontent at President Emmanuel Macron's proposal to increase tax on fuel, which he said was needed to help tackle climate change.<sup>8</sup> The Irish government's attempt in 2014 to charge households for water – standard practice in many other countries, including Great Britain – had to be repealed in 2017 after widespread protests. In Australia, the Minerals Resource Rent Tax – recommended by the Henry review of the tax system<sup>9</sup> – was introduced in 2012, but abolished in 2014 after the centre-right Liberal–National Coalition party fought and won the 2013 general election with a manifesto that promised to abolish it.

Most recent UK chancellors and prime ministers have – probably rightly – anticipated that the political cost of attempting tax reform would be high and so have been reluctant to pursue it. While some recent chancellors have championed particular tax changes, these have typically taken one of three forms. Some were simple changes to the tax rate – such as increases in the rate of national insurance contributions in 2002 and 2011, and the increase in the rate of VAT in 2011. Others entailed moving existing tax thresholds – such as increases in the income tax personal allowance since 2010. The final group of policies involved introducing relatively small new taxes or new tax reliefs, which were framed as having a specific desirable purpose – such as the Apprenticeship Levy or film tax relief. As former Treasury permanent secretary Nicholas (now Lord) Macpherson told us: "Recently politics has become far more managerial rather than ideological. The conventional wisdom is 'we don't want to upset small interest groups'."<sup>10</sup>

But, unless governments have a lot of money to give away, tax reform often necessitates upsetting small groups and that is what often prevents chancellors from pursuing much-needed tax reform. "Losers don't like losing," said Lord Macpherson, "and the media will build up their losses into very big things."<sup>11</sup> Sir Edward Troup, former permanent secretary of HMRC, noted that "it's only when there is a far greater threat than paying more tax – whether it's Napoleon, the French at the end of the

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\* In an analysis of the original white paper proposals for Universal Credit, the Institute for Fiscal Studies estimated that 2.5 million working-age families stood to gain from the replacement of existing benefits with Universal Credit, 1.4 million families stood to lose, and 2.5 million families were predicted to be unaffected. Overall, poorer families were expected to gain, while richer ones would lose. Couples with children were expected to gain more than those without children, and lone parents were expected to lose, on average. See Brewer M, Browne J and Jin W, *Universal Credit: A preliminary analysis*, Institute for Fiscal Studies, 2011, [www.ifs.org.uk/bns/bn116.pdf](http://www.ifs.org.uk/bns/bn116.pdf)

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17th century, the French again in the 19th century, the first world war and the second world war – that you can overcome the massive amount of resistance you get to anything which you would badge as being tax reform.”<sup>12</sup>

Arguably, the UK government missed an opportunity in the wake of the global financial crisis in 2008 – when there was broad public and political consensus around the need for a significant fiscal consolidation – to push through tax reforms. “Rather like [Chancellor George] Osborne in 2010, if you can persuade the British people that we’re in really tough times and that difficult decisions are being made, you can do quite big things,” said Lord Macpherson.<sup>13</sup> But while both the Labour and coalition governments raised taxes after the crisis – with new measures contributing a net tax increase of 2% of national income (or £44 billion a year in today’s terms) – the measures focused mainly on raising rates of existing taxes, rather than on tax reform. The current government may face another opportunity for tax reform in the wake of the coronavirus crisis.

Alistair (now Lord) Darling, chancellor at the time of the financial crisis, argues that it was inevitable that the government did not implement reforms under those circumstances: reflecting on whether he could have enacted more radical tax reform, he said that “we didn’t have the political space or time to do structural reform”.<sup>14</sup> But governments in other countries did manage to use the global financial crisis as an opportunity for reform. In Ireland in the years after the financial crisis, for example, the government introduced a broad-based tax (known as the universal social charge<sup>\*</sup>) and an annual property tax, as well as removing many tax reliefs from the system.

Without a major crisis, constructing a ‘burning platform’ for tax reform is difficult. As a previous report by the Behavioural Insights Team and the Institute for Government (which looked to apply behavioural insights to government decision making) noted, “attention is integral to politics and policy... the problem is that the issues that are powerful and salient may not be the most urgent or important (in a non-political sense)”.<sup>15</sup> As we set out in *Taxing Times*,<sup>16</sup> there are compelling reasons for the UK government to reform the tax system. The costs of failing to do so will eventually be significant, but they are less immediately apparent to current politicians than the upfront costs of change.

The next few years offer opportunities for change that have not been present in recent years. The current government has a strong parliamentary majority – and so political capital to spend – unlike the governments since 2005, which have had slim or non-existent majorities. The aftermath of the coronavirus crisis – when the government will need to rebuild the public finances – may also offer an opportunity for reform. During that period, the importance of a well-functioning state and the sacrifices that many have made will be fresh in people’s minds and may help build a case for reform.

However, other factors will make tax reform difficult for this government. The UK public is weary after a decade of austerity, and many people are making major sacrifices to help stem the spread of the coronavirus. As a result, they may be less receptive to any

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\* But opposition to this is now growing.

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suggestion from politicians that they must make sacrifices again. Growing pressure for higher public spending also means this government will have little or no money available to smooth the path of tax reform by compensating those who would most obviously lose.

Chancellor Rishi Sunak's first budget, in March 2020, did not hint at any significant plans for tax reform. As Paul Johnson, director of the Institute for Fiscal Studies, has said: "The package of tax changes looks piecemeal and it is not clear they are part of any long-term thought-through strategy."<sup>17</sup> However, Sunak did hint that tax reform may be the trade-off for coronavirus support offered to the self-employed at the end of March 2020. Furthermore, the Boris Johnson government's ambitions – for example, to solve the crisis in social care, improve the quality of other public services, substantially increase investment spending and put the UK on a path to net-zero carbon emissions by 2050 – increase Sunak's incentive to ensure the tax system is as robust as possible.

Without reform of the system, the government faces an uphill battle to protect tax revenues as – for example – changes in consumption patterns (such as the adoption of electric vehicles and declining tobacco and alcohol consumption), changes to working patterns and the growing importance of digital services undermine existing tax bases. It will also face increasingly difficult choices between funding the quality and scope of public services that the UK's ageing population expects, adhering to its fiscal rules, asking taxpayers to contribute more, and finding new ways to try to boost economic growth. As a result, the opportunity cost of allowing ineffective and expensive tax reliefs, distortionary tax structures and narrow tax bases to languish on the statute books will rise.

In this report we set out the barriers that tend to get in the way of tax reform. The major barriers to reform, as we explore in Chapter 2, are political economy ones, including the fact that those who lose from reform are usually very vocal, while those who gain are often silent. Chapter 3 examines the important role of ministers – particularly the chancellor and the prime minister – in leading the way on tax reform, and the importance of them being supported by an effective team of advisers. Chapter 4 sets out how civil servants in HM Treasury and HMRC support tax reform, including by helping to build a strong evidence base on the potential benefits of reform. Chapter 5 sets out the role that Parliament plays and, more importantly, could play in facilitating tax reform. Chapter 6 looks at the possibility of using an independent commission on tax to help build public awareness of the problems with the tax system and the need for reform, and to help generate debate about the options for reform.

Both the public and policy makers are affected by behavioural biases, which influence how they approach tax reform and respond to proposals. We highlight these behavioural biases – and how they might be addressed or worked around – throughout the report and summarise the key points in Chapter 7. That chapter also provides a thematic summary of the other main barriers to reform and the recommendations for overcoming them this report identifies.

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Throughout this report we draw on evidence from the UK and abroad. Our analysis and conclusions are based on (among other things) more than 70 interviews – both on and off the record – with current and former civil servants and special advisers, former ministers, members of parliament, parliamentary clerks, tax professionals, and other non-governmental tax and policy experts from the UK. We have also drawn on interviews with those involved in tax policy making in Australia, France, Ireland and New Zealand, and two private roundtables and one public event<sup>18</sup> held in London. We are grateful to Deloitte for funding one of these roundtables and the public event.

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## 2 The political economy of tax reform

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Tax reform in most countries faces major political economy challenges. These include problems with the poor-quality and uninformed nature of public debate about tax reform and issues that arise from behavioural biases among the public. These are the major barriers to tax reform in the UK, as elsewhere.

As Lord Darling told us: “The only popular tax in this country is the tax that somebody else pays. You have to be very careful what you do... and getting the politics right is the most important thing.”<sup>1</sup> It is possible that the aftermath of the coronavirus crisis may make the political case for reform easier, by creating a public desire for a permanently larger role for the state – with higher spending to increase resilience in public services and a more generous welfare system. This would ultimately have to be funded through taxation. At the very least, a higher level of public debt and borrowing as a result of the government’s economic response to the crisis may create greater willingness for tax increases, as they did after the 2007/08 global financial crisis. In either scenario, tax reform could help the system raise additional revenue efficiently and with fewer economic distortions.

However, even if public support for greater public spending and/or tax rises grows, it does not mean tax reform will be easy. One of the biggest problems that governments face is that, as Gus (now Lord) O’Donnell, former permanent secretary to the Treasury, told us: “Losers [from tax reform are] very specific, very clear, very loud about losses and gainers totally silent.”<sup>2</sup>

Special interest groups can also be very effective at influencing tax policy, skewing the tax system towards their interests and away from policies that might have broad-based gains for the wider population. At the launch of our *Better Budgets*<sup>3</sup> report in 2017, which we produced in conjunction with the Institute for Fiscal Studies and the Chartered Institute of Taxation, the then financial secretary, Jane Ellison, noted that there were few people putting forward disinterested proposals to improve the tax system. Instead, the chancellor faces special interest lobbying for new or enhanced tax reliefs in the run-up to every budget and proposals for lower taxes that are never balanced by proposals for how to raise the revenue to pay for them. The presence of this lobbying is a constant in Treasury life and our ministerial interviewees pointed to a number of examples of successful special pleading from external interests.

Disinterested attempts to promote more general changes have fallen on deaf ears. The two big blueprints for tax reform that have been produced in the UK did much less to shape subsequent discussion on the tax system than the weight of their contributors – and of their reports – might have suggested. Those reports were commissioned by the Institute for Fiscal Studies and chaired by distinguished economists James Meade (reporting in 1978)<sup>4</sup> and Sir James Mirrlees (reporting in 2011).<sup>5</sup>

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## Problems with public debate on tax in the UK

This is what former Treasury special adviser, Chris Wales, wrote in evidence to a Treasury Select Committee inquiry on effective tax policy:

**In most democracies, tax policy is set by the few for the many and serious policy debate is held among the few. The many are not equipped by the education systems to participate effectively. Public debate through the media is frequently led by misinformation of one sort or another, whether intentionally or not.<sup>6</sup>**

Widespread ignorance of the tax system is a major barrier to tax reform because governments wanting to make reforms must do so without provoking public outcry that could lead to parliamentary opposition – even for a government with a majority – or losing power at the next general election.

Governments are sometimes able to exploit the public's ignorance to push through policies. But this behaviour does little to engender trust in government, and the absence of a lively and informed debate about tax options contributes to the lack of external pressure for tax reform. Without this external pressure, ministers have to both make the case for reform and push it through, rather than being able to start with some ready-made support for change that they can respond to and use to build a wider coalition.

### The British public is not anti-tax per se

In 2014, YouGov asked people in the US and the UK whether they agreed with two statements: "People have the right to keep the money they earn" and "People have a duty to contribute money to public services". In the US, 53% agreed with the first statement and only 37% with the second;<sup>7</sup> in the UK, the positions were reversed: only 28% supported the first statement and 63% supported the principle of paying to support public services.<sup>8</sup>

More specific polling has also shown that in recent years a growing share of the British public claims it is willing to support higher taxes to pay for better public services. In recent years, polls have repeatedly found that more than 60% of the public are prepared to pay higher taxes to improve public services.\* This recent rise reverses a decline in support for this notion that occurred between the mid-1990s and the early 2010s.<sup>9</sup> Results from a recent Deloitte survey show that (all else equal) Labour voters, university graduates, younger people and those who knew more about the detailed workings of the tax system were more likely to agree that taxes should be increased.<sup>10</sup> However, in that survey, people were nine percentage points more likely to support raising taxes *in general* than if they were asked whether they were willing for their own taxes to be increased.

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\* For example, the 35th report of the British Social Attitudes survey found that 61% of people surveyed would be willing to accept tax rises to increase NHS spending (see Phillips D, Curtice J, Phillips M and Perry J eds, *British Social Attitudes: The 35th report*, National Centre for Social Research, 2018, [www.bsa.natcen.ac.uk/media/39284/bsa35\\_full-report.pdf](http://www.bsa.natcen.ac.uk/media/39284/bsa35_full-report.pdf)). Meanwhile, in 2018, Ipsos MORI found that 66% of those surveyed believed the government should increase public spending even if it means higher taxes or more borrowing (see Ipsos MORI, 'Two in three want the government to increase spending on public services', Ipsos MORI, 29 October 2018, retrieved 17 March 2020, [www.ipsos.com/ipsos-mori/en-uk/two-three-want-government-increase-spending-public-services](http://www.ipsos.com/ipsos-mori/en-uk/two-three-want-government-increase-spending-public-services)).



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The coronavirus crisis could change public attitudes towards taxation, potentially strengthening public support for contributing more money to fund public services.

But the public also has strong views on individual taxes. A specific bugbear is inheritance tax, which people see as double taxation and thus an unfair tax, even when it is pointed out to them that they are unlikely to pay it. Just over half (52%) of people in a 2015 survey for the Centre on Household Assets and Savings Management said that there should be no inheritance tax, and a further 18% said it should only apply to estates worth more than £1 million.<sup>11</sup>

### **The public's preferences are not consistent**

People's preferences are also not necessarily consistent. Climate change has risen in political salience, with comments from prominent people, like David Attenborough, about the world's "moment of crisis", generating numerous news stories.<sup>12</sup> But there is still resistance to taxes on fossil fuels – reflected in other news coverage<sup>13</sup> – even though these are potentially an effective policy tool to induce people to switch to lower- or zero-carbon alternatives.

### **The public has a poor understanding of the current tax system and why it needs reform**

One factor that may inhibit reform is that the public does not really understand who pays tax or how the tax system works and, therefore, struggles to understand why it needs reform.

The 2015 survey for the Centre on Household Assets and Savings Management,<sup>14</sup> cited above, found that people thought that some 25% of estates paid inheritance tax, when the actual figure is only around 4%,<sup>15</sup> which may affect their views on whether or not the tax is fair. Other surveys also underline the limits to the public's understanding of the tax system. In a 2019 survey on the 'tax education gap',<sup>16</sup> Deloitte found that those with a poor understanding of the tax system were more likely to view the tax system as unfair. In that survey, more than three quarters (78%) of people said they did not know enough about tax and 76% thought that tax education should feature more heavily in schools.

People's generally limited understanding of the tax system and the public finances means their views can be significantly affected by small amounts of information. For example, the Institute for Fiscal Studies conducted an experiment in which it gave respondents small amounts of (entirely true but differently framed) information before being asked: "Are the rich paying their fair share of taxes?". The information people were given heavily influenced their responses.<sup>17</sup> Similarly, Stanley and Hartman show that providing different sorts of information to people about how their tax payments are spent affects their views on whether the government spends their money well. In particular, in their study, people were less likely to think their money was well spent if they were told that a large fraction of this money was spent on 'welfare', than if that 'welfare' spending was broken down into its component parts – including state pensions, other pensioner benefits and benefits for those of working age.<sup>18</sup>



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A citizens' jury convened in 2014 by PwC and BritainThinks also found that initial levels of understanding were very low but, after the system was explained to people, support for apparently common-sense solutions such as flat taxes went down.<sup>19</sup> This suggests that the options that appeal to people depend on their underlying levels of understanding, but it is hard to replicate for the whole population the intensity of engagement in a citizens' jury.

It is not just the tax system that is poorly understood. There are also big misconceptions, not just among voters but also among MPs, about the shape of the income distribution (which matters for understanding what constitutes average and high earnings and who will be affected by specific tax changes) and about basic economic concepts. If the public does not understand ideas such as the difference between nominal and real terms (which means, for example, that freezing fuel duty is in effect a tax cut) or 'incidence' (that is, who is actually made worse off by a tax as opposed to who writes the cheque to HMRC), it is difficult to have a good discussion on many aspects of tax policy.

Tax economists also struggle to convince the public of well-evidenced but counterintuitive analysis. For example, the zero rate of VAT on children's clothes is widely believed to help low-income families but is in fact of much greater value to better-off families (who spend a lot more on new outfits for their children). The government could produce a more equitable result by imposing VAT on children's clothes, while recycling some or all of the revenue raised to lower-income families with children through the benefits system.<sup>20</sup>

### **The government is too ready to exploit low levels of understanding of the tax system**

Politicians can and do exploit this low level of understanding to push through some of their favoured policies or to stir up opposition to those they dislike. But this is a short-term strategy that limits the scope for deeper reform.

On tax, ministers too often try to conceal the consequences of what they do. The presence of the Office for Budget Responsibility (OBR) (to verify numbers before they are published) and the Institute for Fiscal Studies (to analyse the impacts of tax policy decisions afterwards) limits how far ministers can play fast and loose with the consequences of decisions. But that does not stop ministers from playing on public ignorance by, for example, claiming that cuts in stamp duty on housing will benefit first-time buyers, when OBR analysis showed that the principal impact was to increase house prices and thus benefit existing homeowners.<sup>21</sup>

Ministers have also repeatedly played on public misperception of the role of national insurance contributions (NICs). Ian Preston, a professor of economics at University College London (UCL), has shown that since the mid-1970s, while the main rates of income tax have been steadily cut, NICs have been increased.<sup>22</sup> This is despite the fact that national insurance acts much like an income tax – just one with less attractive features from an economic and equity perspective: national insurance is assessed on a weekly, not annual, basis; it covers only employment income, not other types of income

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such as from investments and pensions; and it is less progressive, with people lower down the income scale paying relatively more. But public belief in the 'contributory' properties of NICs makes it an easier tax to raise than general income tax.

Ed Balls, then adviser to Gordon Brown, described how in the run-up to the 2002 increase in NICs, ministers tested the options for raising taxes to pay for the NHS and why they chose NICs:

To retain public support, we needed to be very careful about how to raise the revenue we'd need... The preference of Number Ten and Treasury officials was to raise VAT, but the idea appalled Ed Miliband, Gordon and me, and – based on our polling – the public felt the same. An increase in income tax was slightly less unpopular, but an increase in national insurance contributions to fund the NHS actually commanded a substantial majority in favour. It was the symbolism of national insurance that made the difference: the feeling that you pay in when you're working to ensure that when you lose your job, when you need the NHS, when you retire, you're going to be protected and looked after.<sup>23</sup>

In a similar vein, the coalition government and the subsequent Conservative government made much of the fact that they had 'taken people out of tax' by raising the income tax personal allowance, even though these people remained liable for NICs. This was a line that was willingly picked up by some media outlets.<sup>24</sup> However, this presentation relies on poor public understanding of the income tax and national insurance system, and evidence from the PwC/BritainThinks citizens' jury on tax reform, mentioned earlier, suggests that the public view this as a 'pretence' once the system is explained.<sup>25</sup>

There are often accusations that ministers, unable to raise tax through the front door in an explicit way, look for back door 'stealth routes' to enable them to find the money they need. Sometimes ministers are found out and have to reverse – other times, not. When George Osborne, as chancellor, abolished the higher personal allowance for income tax payers aged 65 or over, he presented it as a change designed to make life simpler for older people, who would no longer have to claim it:

"We should also simplify the age-related allowances – which the Office of Tax Simplification have recently highlighted as a particularly complicated feature of the tax system. These allowances require around 150,000 pensioners to fill in self-assessment forms, and as we have real increases in the personal allowances, their value is already being eroded away. So over time we will simplify the tax system for pensioners by doing away with the complexity of the additional age-related allowances for anyone reaching the age of 65 on or after 6th April 2013 and I will freeze the cash value of the allowance for existing pensioners until it aligns with the personal allowance. This will protect the existing level of allowance pensioners have, while introducing a single personal allowance for all. It is a major simplification. It saves money."<sup>26</sup>

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A more honest way of putting it would simply have been to say: we no longer see the case for giving a higher allowance based on age, so we will get rid of it for all taxpayers who reach the age of 65. Osborne's reasoning was attacked but – unlike other measures in the 2012 so-called 'omnishambles' budget – it survived.

The impression of tricky chancellors acting to take money away from people through sleight of hand is not conducive to creating an atmosphere of trust. That is one reason why so-called 'stealth taxes' are so controversial – they are viewed as an underhand way of taking money from people without them noticing.

### **Elections inhibit serious debate on tax policy**

Tax should be at the centre of debate during elections but in practice the main effect of elections is that politicians box themselves in to get elected. Lord Darling has said that a proposal to rule out a change in VAT ahead of the 2010 general election was "nice electoral politics but economic madness: no chancellor can tie his hands on tax".<sup>27</sup>

In the most recent general election, politicians made some attempts to show that their numbers added up and they were not just relying on a 'magic money tree' – but the Institute for Fiscal Studies judged that neither of the two main UK-wide political parties offered a "credible" prospectus in their tax and spending plans.<sup>28</sup> Both major parties suggested that their plans could be paid for without taxes having an impact on most taxpayers. Labour emphasised that only the top 5% would pay more.<sup>29</sup> The Conservative Party reiterated a pledge, which it also made in 2015, not to change the rates of income tax, VAT or national insurance; this was one of six personal guarantees from the prime minister.<sup>30</sup> The Institute for Fiscal Studies singled out this so-called 'triple lock' as inimical to a serious debate, saying it was "part of a fundamentally damaging narrative – that we can have the public services we want, with more money for health and pensions and schools – without paying for them. We can't."<sup>31</sup>

This means few chancellors enter Downing Street with a mandate for reform and it limits the topics that MPs feel they can openly discuss. Because of the House of Commons' privilege on financial matters, unlike other areas of policy, ministers do not need the cover of manifesto commitments to see off opposition from the House of Lords. There is, therefore, no real incentive to come clean in election campaigns. Chancellors are instead more likely to enter government with a set of constraints. Sometimes these constraints prove binding – as they did for Philip Hammond in 2017, when he tried to raise NICs for the self-employed.<sup>32</sup> In other cases, governments have observed them more in the letter than the spirit. The most notable example was in 1979 when the Conservatives had, during the general election campaign, ruled out doubling VAT – but then, in their first budget, they raised the standard rate from 8% to 15% to finance a big cut in income taxes.<sup>33</sup>

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## Media framing and reporting help to condition the public's reaction to tax policies

Former chancellors we spoke to emphasised the need to get the media onside with their tax policies, saying they devoted time and effort to editorial teams and specialist correspondents to try to land their messages. Balls, an adviser to Gordon Brown, as already noted, described their strategy:

**Staying on the front foot means arranging breakfasts, lunches, dinners and coffees with every key journalist and media outlet in the period, taking the arguments to them. The day after the Pre-Budget Report we went to *The Sun* to see the editor David Yelland. The day after, we did the same at the *Daily Mail*.<sup>34</sup>**

As we describe in more detail in Chapter 3, our interviews suggest that the behaviour that Balls describes puts Brown and his team at the higher end of media savviness and interest.

There is an interesting debate to be had about the role the media plays in the public discussion of tax. Chris Giles, economics editor at the *Financial Times*, told us that the media normally “amplifies” public opinion. Other commentators note the media’s role in simplifying issues and setting the agenda – not telling people what to think, but what to think about.<sup>35</sup> For example, *The Guardian* commentator Andrew Rawnsley noted that the proposal for a cap on energy prices cut through because “the proposals are ‘simples’ for the media to grasp and turn into a headline”.<sup>36</sup>

However, the media has also been accused of playing a more critical and less benign role, shaping both the public’s reaction to changes and the space in which ministers feel they can act. Wales and Wales, one of whom was a political adviser to Gordon Brown, argue that the media plays this more active role and influences political choices: “Perceptions of public opinion based on media and polling data are sometimes used as a substitute for informed engagement with the public, and can be a driver of policy choices by parties in power or opposition.”<sup>37</sup>

What is clear is that the media can make an issue salient when otherwise it might pass relatively unnoticed. Chancellors use their budgets to create what behavioural economists call “attention cascades”,<sup>38</sup> drawing public attention to an issue – but they can also be victims of those same attention cascades when the media picks up on an issue and play up outrage at a change, making it difficult to sustain.

Advisers generally bemoan the fact that a sensible proposal can end up as a sensationalised headline that undermines debate. But most news editors would rightly point out that they need to sell papers rather than conduct academic symposia for the public benefit – and that it was ever thus. This is facilitated by poor public understanding of the tax system. As Professor Andy Lymer of the Centre on Household Assets and Savings Management has put it, “instead of debating using facts and examining the challenges of a workable tax system in a complex world, the press tends to focus on a narrow selection of topics for headline grabbing purposes”.<sup>39</sup>

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As an example, a Labour adviser we interviewed pointed to the press reporting of an economically respectable proposal for a land value tax that the party put forward in 2019. The *Daily Mail* turned this suggestion into the following more attention-grabbing headline: "Labour's garden tax: party unveils new Corbyn cash-grab on your private green space and force the sale of vacant land on the cheap."<sup>40</sup>

"The influence of the tabloid media is a lot less than it was 20 years ago,"<sup>41</sup> Lord Darling told us. However, the challenge for the government and the Treasury in shaping public debate around tax has been increased by the rise of multiple media outlets, a speeded-up news cycle and, more recently, mainstream media's loss of monopoly as anyone can now post their news or reaction through social media platforms.

That fragmentation of the media has made it harder to have what Gordon Brown termed a "single national conversation".<sup>42</sup> He noted that in 2009, when he was trying to communicate about the government's response to the global financial crisis, "not only had newspaper readership halved, [but also] television was barely watched by young people... In a very real sense everyone has a platform with so many social media platforms on the one hand and so many voices competing for attention on the other, mobilising national opinion is far harder than before."<sup>43</sup> The difficulty is likely to be even greater now: back in 2009, Twitter was in its (relative) infancy, having been founded only three years before.

The same forces mean it is also now much easier to mobilise opposition to a policy rapidly, even to quite trivial changes. As Alt, Preston and Sibieta put it in their contribution to the Mirrlees review, "when the costs of a policy, though small, are easy enough to observe, extensive media coverage can result in mobilizing the otherwise unorganized 'cause groups'".<sup>44</sup> For example, the fuel price protests in 2000 not only provoked the chancellor's immediate action on fuel duty but also may have acted as a warning to future chancellors. Fuel duty has been frozen in cash terms since 2011, amounting to a real-terms cut of 17% (at an annual cost to the exchequer compared with indexation of £6 billion).<sup>45</sup>

### **The media is not a disinterested player**

There is a reason that newspapers remain zero-rated for VAT. As Lord O'Donnell told us, chancellors soon went off proposals to levy VAT on men's magazines like *Playboy* and *Mayfair* when it was explained that "there was no way we could differentiate between a magazine and a newspaper, and no politician ever wanted to take on newspapers".<sup>46</sup>

Editors and proprietors are unrepresentative of taxpayers overall and have shown particular concern about issues to do with inheritance tax, higher rates of income tax, higher-rate relief on pensions and stamp duty on high-end property. Many individual journalists are self-employed and therefore were directly affected by Philip Hammond's attempts to raise Class 4 NICs in March 2017.

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## **The constraints on public debate distort the tax options available to ministers**

The combination of poor levels of public understanding, the media ready to sensationalise and interested parties ready to mobilise, affects the way ministers approach reform. It means they choose sellable options (like NICs) over income tax, resort to stealth taxes or load a lot of revenue raising onto 'anti-avoidance' measures, while ducking more difficult issues about the sustainability of the overall system.

## **Problems that affect certain types of tax reform**

Many barriers to tax reform are common to all areas of the tax system, but some types of reform face some different barriers too.

## **Reforms to business taxes and personal taxes face different barriers**

The public is often more receptive to reforms to taxes remitted by businesses, rather than individuals – even those (indeed, sometimes, particularly those) that are intended to raise revenue. As a result, it can be easier for governments to reform and increase business taxes than personal taxes. "There really is no direct political gain from business tax cuts," said Rupert Harrison, former chief of staff to the then chancellor, George Osborne. "The politics of business tax is very, very different from personal tax, where it's very visceral and there are winners and losers."<sup>47</sup> In practice, all business taxes must eventually be paid by individuals – whether customers, employees or shareholders – but this incidence is usually not apparent to voters.

Given the resources available to them, businesses also have a more sophisticated understanding of the tax system than most individual taxpayers do. As a result, they tend to seek more structural reforms to the tax system, rather than simply asking for cuts to headline tax rates. Some recent examples are pressure to overhaul the UK's system of business rates<sup>48</sup> and the Confederation of British Industry's calls for the government to prioritise changes to capital allowances over further cuts to the headline rate of corporation tax.<sup>49</sup>

However, business lobbyists also often play a less constructive role (in terms of contributing to creating a better tax system) by campaigning effectively for new tax reliefs to benefit their sector. Many of the former Treasury ministers we interviewed highlighted with pride their decisions to introduce or expand business tax reliefs – such as for the film and computer games industries. Each year the Treasury puts out a press release lauding the support that has been provided to the UK's creative industries through these schemes.<sup>50</sup> But many of the former Treasury permanent secretaries we spoke to questioned the value of these reliefs. "Every chancellor would be bowled over by the luvvies and we'd come away with a film allowance," said Lord O'Donnell. "Nearly all of these allowances meant that... really rich people with smart tax advice paid very little tax, which is, alas, the same today."<sup>51</sup>



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## Taxes requiring international co-operation are harder to reform

As already noted, the public is generally more receptive to proposals to increase taxes on businesses than on people and – particularly recently – there has been support for taxes on activities that create environmental damage. Despite this public support, however, raising corporate taxes including through taxing environmental damage (and also raising taxes on the highest-income and wealthiest people) can be difficult because of the need to take into account how other countries tax businesses and people.

First, all countries are effectively engaged in tax competition for these companies and people. High-income people and companies can move – or move income – abroad to lower-tax locations, meaning that a tax increase may raise much less than the public hopes or expects. Acknowledging this, the government has, for example, decided to allow Northern Ireland to apply a different rate of corporation tax than the rest of the UK because of the competition Northern Ireland faces from the Republic of Ireland, which has a much lower rate.

Taxes with an international dimension – and affecting other countries' companies and citizens – also risk a response from other governments. A good recent example is the UK government's proposal to levy an additional tax on the revenues of digital services companies. This tax is intended to capture some of the value created by social media platforms, search engines and online marketplaces with users in the UK, such as Facebook, Google and Amazon. Public opinion is supportive of this proposal.<sup>52</sup> However, the US government has made clear that the UK could face retaliation if it goes ahead with these plans.<sup>53</sup>

For corporation tax, in particular, there is also a broader problem that the 'system' is international rather than domestic. Reforms to that system are not in the UK's gift to make but require international co-operation. The UK and other countries do try to co-ordinate matters. The programme of work on base erosion and profit shifting (BEPS) of the Organisation for Economic Co-operation and Development (OECD)<sup>54</sup> has had some success. But the recommendations agreed so far represent tweaks to, rather than fundamental reform of, the system. More fundamental reforms – such as the European Union's (EU) proposed common consolidated corporate tax base, which would calculate global corporate profits before allocating that profit to individual countries based on an agreed formula – have not got off the ground, as some countries (such as Ireland and the Netherlands) benefit from the existing system and are resistant to change.<sup>55</sup>

One area where the BEPS process has yet to reach agreement is on how to tax digital platforms. In the absence of a system-wide comprehensive and co-ordinated reform, some countries like the UK and France have tried to go it alone. But in doing so, the UK government has acknowledged that this is not an ideal solution, stating that "the government still believes the most sustainable long-term solution to the tax challenges arising from digitalisation is reform of the international corporate tax rules and strongly supports G7, G20 and OECD discussions on the different proposals for reform".<sup>56</sup>

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As former financial secretary, Stephen Timms, told us, “[efforts at international co-ordination] always feel very cumbersome... and very slow moving and you certainly can’t depend on them to deliver an outcome in order for you to do what you want to do”.<sup>57</sup>

Ultimately, the UK’s ability to act unilaterally on taxes affecting multinational companies and high-income people depends on:

- other attractions of the UK that might outweigh higher taxes
- the ease with which companies and individuals can avoid being liable for UK tax
- the UK’s diplomatic clout relative to other countries that may step in to defend their businesses and tax revenues.

### Visible taxes are harder to reform

Governments tend to find it harder to increase the rates of, and make reforms to, taxes that are more visible to people. As Tony Travers, a professor at the London School of Economics and Political Science, wrote:

**Despite being no more than 5 per cent of all state revenues, council tax is the only government tax most people are aware of... householders, particularly pensioners, hate it... what the council tax story tells us is that if people feel a tax or charge, they don’t like it.**<sup>58</sup>

Governments tend to find it easier to make changes to indirect taxes – that is, taxes that are collected by an intermediary, typically those levied on the purchase of goods and services – rather than to direct taxes on income or wealth. In the UK, indirect taxes are wrapped up in the sale price of goods and services (apart from those targeted at businesses) and so are not very visible to consumers.\* International evidence also suggests that the public is more opposed to taxes in countries, like the US, where people are required to fill out lengthy tax returns<sup>59</sup> rather than tax being deducted at source – as, for example, it is for employees in the UK through pay as you earn (PAYE).

Governments also tend to find it easier to increase the rates of lesser-known or less-well-understood parts of the tax system than they do to increase or broaden the base of well-known taxes.

The importance of visibility has been apparent in the UK in two ways in recent years. First, the coalition and subsequent Conservative governments chose to increase taxes on consumption more than taxes on income, wealth or corporate profits. This happened in 2011, when the rate of VAT was increased to 20% and more recently through successive increases to smaller consumption taxes, like air passenger duty and insurance premium tax.\*\*

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\* There are, however, exceptions to this rule – fuel duty being perhaps the most obvious, as an indirect tax that has provoked angry protests when governments have tried to increase it in the past.

\*\* Previous chancellors have also followed a similar approach. As one of our interviewees noted, Ken Clarke created a series of new taxes during his time as chancellor – such as air passenger duty and insurance premium tax – as this was politically easier than raising the rate or extending the base of existing taxes.



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They have also raised tax revenues by making adjustments that are less obvious than transparent changes to either the rate or base of taxes – for example, income tax revenues have been increased by reducing people’s ability to claim tax relief for pension contributions. Second, both the Conservatives and Labour have felt compelled in recent general election manifestos to rule out increases in the rates of some or all of the three main taxes – income tax, NICs and VAT.

Unfortunately, both of these tendencies have been to the detriment of the health of the UK tax system. Taken together, they have tended to increase existing distortions – for example, increasing the standard rate of VAT exacerbates the distortions created by the UK’s narrow VAT base. They have also made tax revenues increasingly reliant on a small group of high-income people – various changes to the taxation of those on the very highest incomes (including the higher additional rate of income tax and restrictions on the annual tax-free allowance for pension contributions for those earning more than £150,000 a year) have increased the share of income tax revenues coming from those at the top.<sup>60</sup>

### **Overcoming political economy barriers to reform**

Past experience of efforts at tax reform in the UK and elsewhere suggests that reforms can be easier to achieve early in the parliamentary cycle, when there is time for the costs of reform to fade from voters’ memories and for the benefits to become apparent. But even early in the parliament the government is likely to have a limited amount of political capital to push through reform and limited fiscal space for giveaways to smooth the way. It should use both carefully, focusing on securing what it sees as the most important reforms. Ministers need to use their political capital sparingly: there is a strong case to be made that ministers in the past have expended too much political capital on minor changes, even though many argue that it is easier to sell larger-scale reform than tinkering.

The major tax reforms that have happened in the UK – such as Geoffrey Howe’s reforms in 1979 and Nigel Lawson’s overhaul of personal and corporate taxation in the 1980s – have usually been accompanied by significant overall tax cuts. More recently, George Osborne’s reform of corporate taxation – cutting the rate of corporation tax but broadening the base by reducing the generosity of capital deductions – was also done in a way that amounted to a large net tax cut for businesses.

Without large amounts of money to compensate the losers, governments have found it difficult to reform the tax system. Recent examples of efforts to reform the tax system in a way that raised revenue include Philip Hammond’s attempt as chancellor to increase NICs for the self-employed in 2017 and the attempt to bring pasties and static caravans within the scope of standard-rate VAT in 2012. These announcements were quickly reversed. As Sir Danny Alexander, chief secretary to the Treasury under the 2010–15 coalition government, told us, one of the reasons that policies like the so-called ‘pasty tax’ in the 2012 budget failed was that “particular interest groups [feel] like they’re being singled out”.<sup>61</sup>

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Previous governments have also found that even revenue-neutral changes – that is, ones that are not intended to raise money overall – can be difficult to implement. This is particularly true if the government tries to use only the tax system to implement reform, while also trying to compensate the losers. It can be virtually impossible to construct a package that offsets everyone’s losses, and those who continue to lose out are invariably much more vocal than those who might gain, as Gordon Brown, then chancellor, found when he attempted to abolish the 10p tax rate in 2007.

The current and future UK governments are unlikely to have the luxury of large amounts of money to give away to compensate those who might lose out. However, other experiences of attempts at tax reform in the UK and elsewhere provide lessons on how governments have managed – or might have managed – to implement some types of reform.

### **Timing matters**

One of the ways to reduce the political costs of tax reform is to announce and implement policies early in a parliament. Doing so helps ensure the costs are well out of the way before voters are likely to go to the polls again, and that the expected benefits have time to materialise. Immediately after an election, the government’s majority is also likely to be at its most secure, allowing it to act while it is benefiting from a post-election honeymoon. “You should think about doing whatever it is you’re going to do at the beginning of the parliament, not as you approach the end of it,” Lord Darling told us.<sup>62</sup>

However, many of our interviewees also emphasised the importance of taking enough time to build the case for reform and to understand all the possible unintended consequences. If a new government has not spent time designing and making the case for reform before an election, acting quickly may not be possible.

### **Creating a compelling narrative is important**

If a tax reform requires making difficult trade-offs, the government needs to build and make a persuasive case for change. As Balls put it:

**“One of the things which is really important is to win the argument about why the objective’s important, why the tax system is relevant to meeting that objective, why the tax system at the moment is not as good as it could be, and the kind of principles which could guide our approach in thinking about using the tax system to meet that objective.”<sup>63</sup>**

Brys and colleagues note that:

**By considering the tax system as a whole, rather than focusing on isolated elements, policy makers can better communicate the issues involved... Lobby groups might have an interest to frame particular tax policy reforms narrowly, for instance by focusing on each tax in isolation, but this approach is unlikely to be in the interest of the general public.<sup>64</sup>**

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A compelling case is important not only for smoothing the way for reform but also in ensuring reforms endure. Gordon Brown admits that a failure of presentation meant he never built significant political support for his system of tax credits, even though they enabled substantial redistribution in favour of low earners, during his chancellorship.<sup>65</sup>

After 10 years of cuts to many areas of public services, it is likely to be harder for the UK government to convince even a subset of the public that they need to contribute more through taxes. Reform depends on an element of trust, and trust in ministers and government. Notoriously low levels of public trust in government in the UK, which have fallen further recently, are therefore likely to make it harder for politicians to build a compelling narrative for change. In response to a 2019 survey by Ipsos MORI, just 14% of adults in the UK said they trusted politicians to tell the truth, rising only marginally to 17% for government ministers.<sup>66</sup> No survey specifically asks about trust in chancellors, but that might make for even less comfortable reading.

Lord Darling (speaking to us in early October 2019 at the height of parliamentary gridlock over Brexit) cautioned that:

**“The public’s confidence in politics and politicians at the moment is pretty low. To sell a [tax reform] message, the first thing you need is for people to trust you and the current climate is probably not a good one to be opening up a whole debate about these things.”<sup>67</sup>**

### **Use spending to compensate losers**

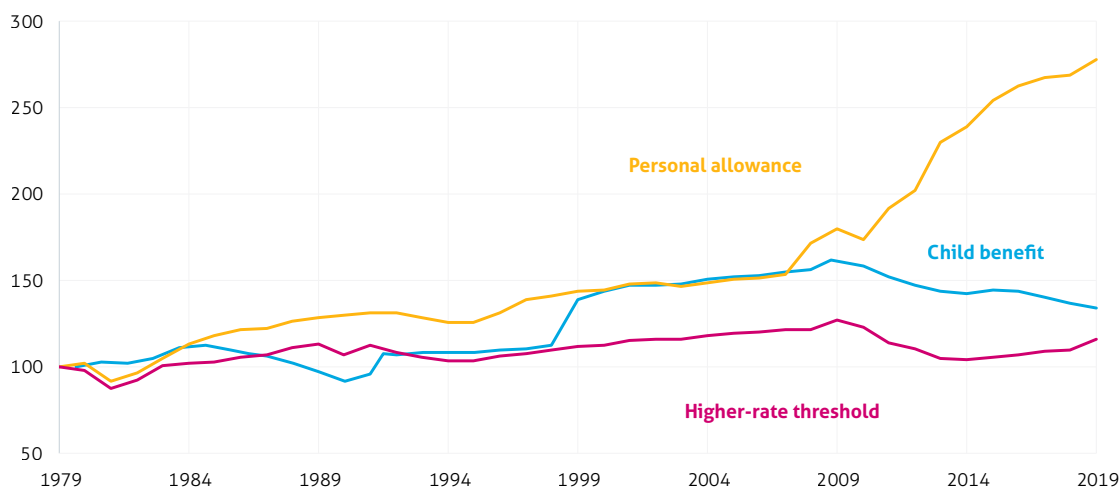
The path for reform can be smoothed by using spending policies to offset losses from tax reform. The Conservative government’s inability to impose the standard rate of VAT on fuel and power in the 1990s can be partly explained by the Treasury’s failure to work with other government departments to construct a package of spending to help compensate low-income households for the resultant higher energy costs. Ultimately, the government ended up not being able to complete its reform and losing a substantial chunk of the revenue it had sought in a hastily constructed compensation package.

Similarly, it would probably have been easier for a government to increase NICs for the self-employed if this policy had been announced at the same time as state pension entitlements for the self-employed were increased (in 2011) or at the same time as the government responded<sup>68</sup> to the Taylor review’s<sup>69</sup> recommendations for stronger employment rights for workers and the self-employed (in February 2018). Instead, the tax increase was announced in isolation in March 2017 and quickly reversed, after a backbench rebellion by Conservative MPs. Reassuringly, the current chancellor, Rishi Sunak, appears to have learnt from this mistake, suggesting that tax reform might be the trade-off for coronavirus support for the self-employed.<sup>70</sup>

However, the public can be suspicious of these sorts of promised compensation schemes. In particular, people may fear that the government will implement the tax increase but then scale back or fail to implement the compensation. Figure 1 suggests this may have happened after the replacement of child tax allowance with child benefit in the late 1970s. Since then, the value of the main income tax allowance – the personal allowance – has increased more rapidly than the value of child benefit.

This suggests the value of support for those with children may have grown more quickly had it remained a tax allowance, rather than becoming a benefit. However, generally, this evidence is not clear cut as the level of the income tax higher-rate threshold has increased less quickly than the value of child benefit over this period.

**Figure 1: Change in the real-terms value of child benefit and income tax thresholds since 1979 (index: 1979 = 100)**



Source: Institute for Government calculations using Institute for Fiscal Studies, Child Benefit, Guardian's Allowance and Child's Special Allowance, [www.ifs.org.uk/uploads/publications/ff/childbenguardian.xlsx](http://www.ifs.org.uk/uploads/publications/ff/childbenguardian.xlsx); Institute for Fiscal Studies, Income Tax, [www.ifs.org.uk/uploads/publications/ff/income.xlsx](http://www.ifs.org.uk/uploads/publications/ff/income.xlsx); and Bank of England, A millennium of macroeconomic data, [www.bankofengland.co.uk/-/media/boe/files/statistics/research-datasets/a-millennium-of-macroeconomic-data-for-the-uk.xlsx?la=en&hash=73ABBF603A709FEEB1FD349B1C61F11527F1DE4](http://www.bankofengland.co.uk/-/media/boe/files/statistics/research-datasets/a-millennium-of-macroeconomic-data-for-the-uk.xlsx?la=en&hash=73ABBF603A709FEEB1FD349B1C61F11527F1DE4). Deflated using the Consumer Price Index.

Tatsos notes that “in order to be successful, reforms need an electoral mandate for reform or visible benefits very rapidly”.<sup>71</sup> In future, new technologies may offer scope for tying compensation packages more closely to the original tax change, which could help to dispel any disquiet over the packages. For example, Rita de la Feria, a professor of tax law at Leeds University, has proposed a way for governments to apply standard-rate VAT to children's clothes, while compensating low-income parents by giving them a tax 'credit' (equal to the amount of VAT they had just paid) each time they buy an item of children's clothing.\*

At the moment, in the UK, this would not be possible to implement but it could become possible in future if administrative systems were to become sophisticated enough to identify qualifying people at the point of purchase and to credit them immediately – with the credit, for example, showing up on their bill. If it could be done, it would offer more direct and immediate compensation than the approach suggested in the Mirrlees review, which proposed increasing welfare benefits to offset – on average – the higher tax that low-income families would owe if standard-rate VAT was charged on food and children's clothing.<sup>72</sup>

\* This work is currently unpublished.

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As we have explained in more detail in our report *Taxing Times*, implementing such a reform to the VAT base would reduce the economic distortions created by the current system and allow the government either to raise substantially more revenue or to reduce the standard rate of VAT (or make other tax cuts), while nonetheless compensating lower-income families.<sup>73</sup> The Mirrlees review, for example, showed that such a reform could raise an additional £11bn of revenue (£15bn in today's terms), while leaving the lowest-income two fifths of households no worse off on average.<sup>74</sup>

### Exploit periods of high inflation

Governments in the past have also exploited periods of high inflation to gradually shift the structure of the tax system in the desired direction. For example, the Conservative government in the 1990s managed to phase out mortgage interest tax relief – a subsidy to mortgage holders that lacked a good economic rationale – by freezing the cash amount of mortgage borrowing eligible for an interest deduction for tax purposes and relying on price inflation to erode the real value (and thus cost to the taxpayer) of this tax relief. The relief was eventually abolished altogether in 1999, by which time not only had price inflation reduced the value of the relief but so too had sharp falls in mortgage interest rates. As a result, the eventual abolition resulted in only a muted defence from the mortgage industry and little public outcry.\*

This approach exploits the public's tendency to suffer from 'money illusion' – that is, people tend not to notice they are worse off if they have the same amount of cash in their hands, even if the real value of that money has been eroded by inflation. However, there has been less scope for governments to use this mechanism over the past 20 years as inflation has generally been low.

### Periods of high earnings growth offer opportunities

Governments also tend to find it easier to alter the tax base or make other structural changes when incomes are growing quickly. People tend to kick up less of a fuss if the government takes a larger share of their income if that income is also increasing, ensuring that their disposable income continues to rise. As Andrew (now Lord) Turnbull, former permanent secretary to the Treasury, told us, undertaking tax reform "when the economy is growing is much easier, because you don't have to put taxes up, or you just allow fiscal drag to do the work".<sup>75</sup>

Political advisers who we spoke to noted that one of the difficulties in reforming taxes in recent years has been the fact that incomes have been growing so slowly. Income growth has been weak in the UK over the past decade because productivity growth has been very low, for reasons that economists do not fully understand. As a result, there has been less scope to introduce tax changes that impose cash losses on people without those changes resulting in people seeing their take-home income fall from one year to the next.

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\* The eventual abolition of mortgage interest relief was also packaged with other measures to reduce the basic rate of income tax and introduce a 10p starting rate of income tax, which will also have helped offset the losses for many people.

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The current government has said that boosting UK growth and productivity – particularly outside London and the south-east – is a priority.<sup>76</sup> However, it is not the first government to try to do this and any results are unlikely to manifest quickly.

### Changes can be phased in

Certain types of tax reform can be facilitated by phasing them in gradually. This can be done in two ways. First, reforms can be made in such a way that no current beneficiaries lose but no new cohorts of beneficiaries are added (sometimes known as 'grandfathering'). Second, changes can be made gradually over time but which nonetheless affect everyone.

George Osborne adopted a combination of these two approaches when he announced in 2012 a plan to phase out the higher income tax personal allowances for people aged 65 or over. Those who were already aged 65 or more on 5 April 2013 continued to benefit from a higher personal allowance, but those who turned 65 after this date did not. As a result, the main losses experienced were by people who would have expected to receive the more generous tax treatment in future, but had not yet experienced the benefit of it. At the same time, Osborne also froze the cash value of these additional age-related personal allowances. Increases to the standard personal allowance after then meant that, from April 2016, all taxpayers had the same personal allowance regardless of age.<sup>77</sup>

The downside of 'grandfathering' is that it can mean that there are persistent differences in how the tax system treats people, which can create inequity and complexity. There are also only limited circumstances in which these sorts of approach can be used.

### Taking something away is harder than never having offered it

While there are ways to smooth the path of reform, governments will encounter far more resistance to removing a tax benefit than the praise they get for introducing one – meaning it is better not to offer it in the first place without good evidence that it will be effective. This is because – in the terminology of behavioural economics – people suffer from loss aversion, that is, they prefer avoiding losses to acquiring equivalent gains. As Alt, Preston and Sibieta noted in their contribution to the Mirrlees review, introducing new tax expenditures or special tax treatment for particular groups can in itself create new special interest groups that will be resistant to future reform.<sup>78</sup>

Lord O'Donnell's advice to future chancellors is as follows:

**"Mistakes are almost impossible to reverse, so always err on the side of... don't just do something, stand there! Be very, very careful about doing things until you really understand what they are... [Tax policy] is a really important weapon in your arsenal. But it's very powerful and therefore use with great care."**

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## **Sometimes – but not always – it is easier to make ‘big bang’ reforms**

While it may at first seem counterintuitive, history suggests that tax reform can sometimes be easier to achieve if it is done as a ‘big bang’ reform, rather than a series of incremental steps. As Roger Douglas, former New Zealand minister of finance during the country’s radical reforms of the 1980s, said: “Big packages are good because incremental reforms means the losers shout like hell and the gains are insignificant.” Moving quickly is also advantageous, he said, because “the fire of opponents is much less accurate if they have to shoot at a rapidly moving target”.<sup>79</sup>

Implementing reform all at once also reduces the risk that the impetus for reform fizzles out – or the government comes under pressure to stop – before all the work is done. This happened in the 1990s when the Conservative government tried to impose the standard rate of VAT on fuel and power: the government successfully increased the rate from 0% to 8% in 1994, but was unable to legislate for the second planned rise (to 15%) in 1998. As Cedric Sandford wrote in a recent update to his seminal comparative study of the political economy of taxation, “success in major tax reform is more likely to follow from a carefully crafted package than from an incremental approach”.<sup>80</sup> This is because it is easier, with a large package of measures, to trade off gains and losses.

However, this is not a hard-and-fast rule. There is a greater risk with big bang reforms that HMRC will encounter administrative problems with implementation. There were widespread problems, for example, of overpayments after the Labour government introduced tax credits in the early 2000s, which were a major change to the tax and benefits system. As a number of the examples above highlight, some reforms can also be achieved with minimal fuss by taking a more incremental, phased approach.

## **Talk to the public and key interest groups**

In Chapter 6, we set out the advantages of the government setting up a tax commission. Even if the Treasury does not set up a tax commission, it should still consider some of the techniques of engaging people on issues in advance of decisions that characterised the way the Turner Commission built consensus on its proposed pensions changes.<sup>81</sup> The Turner Commission effectively brokered a package that both employer and employee organisations could support. In contrast, the normal practice now for tax reforms is to second-guess who might support a package – and then for Treasury officials or ministers to call them straight after the budget to put out a supportive statement. But that is skin-deep support and people do not necessarily feel any need to sell changes – especially as they may be lukewarm about elements of the package. People attach a high priority to ideas of fairness and of making a contribution.

Wider use of more deliberative techniques in advance of changes being made can help government anticipate objections and think through how to construct the case for change.



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## Be persistent

There are times when ministers do need to expend political capital in the face of vocal opposition from the media and other stakeholders – successful reform often requires persistence.\* This is important for three reasons. First, persistence can be an effective way of making the political case for change. As Deborah Mattinson, former public opinion adviser to Gordon Brown, wrote, it is “only when you’re getting bored with saying it [that] they start to hear it”.<sup>82</sup> Second, persistence can prevent proposed reforms coming unstuck by vocal opposition before they have had a chance to bed in. In his memoirs, Balls wrote:

**There are crucial times in politics, when you have to ignore the front pages, stick to your strategy and trust that you can win the argument you’ve started. Most importantly, you have to stay on the front foot, because as soon as you even look like you’re reconsidering, you’re sunk.**<sup>83</sup>

Third, evidence suggests that the public often respects politicians who ‘stick to their guns’ and do not make U-turns on policy, which the media often presents as a sign of political weakness.<sup>84</sup>

## Improving tax education could help improve public debate in the long term

In the longer run, it is worth investing in better education of the public on tax issues to create a more conducive environment for tax reform, since survey evidence suggests that those who currently know more about the system are more likely to think it is unfair. However, investing in education will not ease the challenges of tax reform in the short term.

Tax education can take one of two forms:

- practical education – helping people understand how to navigate the existing tax system
- citizenship education – covering the role of the tax system in raising money for public services.

Both forms of education are important, but the latter is likely to be most beneficial in improving the quality of public debate on tax reform.

There are already welcome educational initiatives in place – predominantly aimed at school- and university-aged students. For instance, since 2015, HMRC has run a ‘Tax Facts’ programme of animations aimed at teaching eight- to 17-year-olds about the tax system and their responsibilities as future taxpayers, which includes resources that teachers can use as part of their citizenship curriculum.<sup>85</sup> A ‘Junior Tax Facts’ scheme aimed at primary school-aged children was launched in 2016.

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\* For example, post-crisis Greek examples fell short as poorly designed policy required modification and successive changes in ministers and parties in power led to a lack of commitment to policy (see Tatsos N, ‘Political challenges to reform taxation in Greece’, in Princen S ed, *Political Economy of Tax Reforms: Workshop proceedings*, European Commission, 2016, [https://ec.europa.eu/info/sites/info/files/dp025\\_en.pdf](https://ec.europa.eu/info/sites/info/files/dp025_en.pdf), pp. 29–35).



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The Centre on Household Assets and Savings Management – based at the University of Birmingham – also runs programmes aimed at improving the level of tax understanding among university students.\*

Other organisations – such as the Office of Tax Simplification (OTS), the Chartered Institute of Taxation (CIOT), the Institute of Chartered Accountants in England and Wales (ICAEW) and the Low Incomes Tax Reform Group – also seek to improve tax education of the public more generally, holding public events and publishing material to explain topical tax issues. But despite these initiatives, understanding of the tax system remains poor. Realistically, there are limits on how much most members of the public are willing to engage on tax.

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\* These can be found at [www.birmingham.ac.uk/research/chasm/index.aspx](http://www.birmingham.ac.uk/research/chasm/index.aspx)

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## 3 Ensuring ministers can drive tax reform

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For tax reform to happen, ministers (and specifically the chancellor) need to set a clear direction for policy. It will always be up to ministers, rather than civil servants, to lead a reform agenda. In the words of one Treasury official, “the chancellor of the day has a big impact on the approach to tax”.

### Current practice

As set out in our *Better Budgets: Making tax policy better* report,<sup>1</sup> which we produced in conjunction with the Institute for Fiscal Studies and the Chartered Institute of Taxation, the chancellor has autonomy in this policy area to an extent not matched by ministers in other areas. There is no real collective Cabinet discussion about tax measures nor a need to jostle for legislative time, as the finance bill (which enacts the budget) is guaranteed a slot each year.<sup>2</sup>

There are five Treasury ministers in addition to the chancellor: the chief secretary, the financial secretary, the exchequer secretary, the economic secretary and the minister of state. One or more of these ministers – usually the financial secretary – has tax in his or her portfolio of responsibilities. The chancellor and other tax ministers, alongside their advisers, set the priorities for the budget (and for tax policy more generally), propose or request specific policies, and ultimately sign off the policies that make it into the final budget scorecard. However, despite their formal tax brief, the tax ministers can sign off only tax measures that are small in both profile and revenue terms, leaving the prime minister and the chancellor with the final say over big policy choices.

Most of the time, the chancellor, in conjunction with the prime minister, will decide on the contents of the budget – and therefore make the ultimate decision on tax. An exception to this in recent history was the coalition government from 2010 to 2015, where the ‘quad’ of George Osborne, David Cameron, Danny Alexander and Nick Clegg\* agreed the contents of budgets – but that still did not broaden the discussion beyond the prime minister, the deputy prime minister and the Treasury.

### Limitations of current practice

#### Recent chancellors have not had clear objectives for the tax system

Although chancellors see budget day as the big occasion in their political calendar – and a chance to make the political weather – few of them since the Thatcher government have shown an interest in tax reform, as opposed to using tax policy either to make the numbers add up or as a political tactic to garner support from particular constituencies. Many of our interviewees noted that there had been a run of ‘tinkers’ rather than big-picture thinkers as chancellor.

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\* The chancellor, prime minister, chief secretary to the Treasury and deputy prime minister respectively.

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For example, former financial secretary Stephen Timms, reflecting on New Labour's time in government, told us that: "I'm sure that you could look at those 13 years, and indeed I'm pretty sure that if you look at what's happened in the subsequent nine, you'd be hard pressed to find a coherent vision being worked out over that period on tax."<sup>3</sup>

Lord Burns, former permanent secretary to the Treasury, contrasted Conservative chancellors Geoffrey Howe and Nigel Lawson, who were very interested in tax policy, with Gordon Brown, who was much more focused on achieving redistribution through tax credits. Early on, Gordon Brown dipped a toe in the water for environmental tax reform but it received only a lukewarm reaction and did not become a theme of his chancellorship.

Successive governments have lacked an overarching set of objectives for the tax system to guide new policy. Instead, the focus of tax policy has been predominantly short term and political. Lord Turnbull, former permanent secretary to the Treasury, has said:

**"The budget should be a strategic statement but... it has degenerated into a highly tactical event. You've got to find a little bit of money here and a bit of money there and you give all this budget stardust... Having in effect two budgets a year... meant that there were two occasions a year where you had to play Santa Claus."**<sup>4</sup>

The main exception in recent years was the 2010 corporate tax roadmap,<sup>5</sup> which businesses welcomed as giving a clear direction, and which the government then followed. However, the roadmap approach was not extended to other areas of tax policy and the 2016 business tax roadmap was of much less use than the first as it mostly just restated existing miscellaneous policy commitments.<sup>6</sup>

The consequences of the prevailing tactical approach are clear. Our report *Better Budgets* showed that recent years have been characterised by a proliferation of budget measures and a lengthening of the tax code.<sup>7</sup> We showed in our report *Taxing Times: The need to reform the UK tax system*, that that has left us overly dependent on a narrow range of taxpayers and with a system riddled with anomalies.<sup>8</sup> These problems were particularly acute when chancellors delivered two full-blown fiscal events a year. Philip Hammond moved to having just one fiscal event a year in 2017 – a move that the Institute for Government had called for and welcomed – and there has been less hyperactivity on tax in the past couple of years.

This short-term focus makes it difficult for civil servants to devote enough time to 'horizon scanning' – that is, developing and adding to the evidence base and preparing longer-term reform packages. We return to this in more detail in the next chapter.

The lack of clear and transparent objectives for the tax system, combined with the ability of the prime minister and chancellor to act unilaterally on tax without collective discussion, also means that tax policy does not work as well as it could with other policy levers to achieve the government's objectives and can lead to them operating in conflict. For example, the Treasury has promoted alternative long-term savings vehicles (for example the Lifetime ISA) at the same time as pensions policy (in particular, automatic

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enrolment) has looked to encourage pension saving. In 2012, when pensions tax relief was altered, pensions minister Steve Webb did not even find out until budget day.<sup>9</sup>

However, the recent government response to the coronavirus crisis shows what is possible when there is a clear government objective (in this case, to minimise the economic impact of the pandemic on UK businesses and households), coupled with a willingness for all departments to work together. In this instance, the chancellor has been able to rapidly deliver strategic joined-up thinking across policy areas. When this happens it often leads to good policy outcomes, but it does not happen in all cases.

### **Budget secrecy prevents effective 'pitch-rolling'**

Chancellors prize budget secrecy – 'rabbits' to pull out of the hat on budget day. But while they clearly perceive this to be advantageous, it prevents effective 'pitch-rolling' of reforms. For some policies, where there is a forestalling risk if measures are announced in advance, such secrecy is necessary. But too often – even when there is no forestalling risk – measures are sprung on the public cold, without the government having had the chance to make the case for the reform in advance. This leaves the government with limited opportunity to road-test possible policy changes or to make a positive case for difficult reforms. It also contributes to poor public understanding of measures and makes the immediate media framing especially important in determining how the public reacts.

Some recent examples show that pitch-rolling can be effective. For example, the VAT threshold was frozen in cash terms at the 2018 budget after the Treasury had asked the Office of Tax Simplification (OTS) to look at the threshold in a 2017 report.<sup>10</sup> The OTS review created an expectation that the threshold might be cut in cash terms, making a nominal freeze more palatable. The reduction in the generosity of entrepreneurs' relief in the March 2020 budget also came after a lively public discussion, partly initiated by think tanks,<sup>11</sup> about how ineffective the relief was. However, while these positive examples show the value of pitch-rolling, there are many other policies where a lack of pitch-rolling has led to policies being watered down or reversed.

One such example was the 2012 so-called 'omnishambles' budget. Ahead of that budget, David Cameron, the other members of the quad, the Treasury and serried ranks of advisers had considered numerous options for raising revenue, which was needed to help balance a budget that also included increases in the income tax personal allowance and cuts to the top rate of income tax and to the main rate of corporation tax. Having discarded what they thought were politically unwise options – including various options for rectifying anomalies in the VAT system – ministers settled on announcing, among other things, plans to extend VAT to pasties and static caravans. As Cameron wrote in his autobiography: "Far from thinking we were running into a hail of bullets, we believed we had dodged the worst of them."<sup>12</sup> But, of course, the public had never been aware of the options that ministers had considered but rejected. Assuming the public would approach the final proposals in the same mindset as ministers and officials was, therefore, "a big mistake".

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## Chancellors have not always hired the right team of advisers

A further way in which the chancellor and prime minister can help to deliver tax reform is to appoint good advisers, who can play a major role in delivering a reform agenda. Given the various different sets of expertise that are needed to support tax reform, the chancellor and prime minister are likely to need a team of people to fulfil all the necessary functions.

Due to the technical nature of tax policy and typically limited tax expertise among Treasury ministers, one role special advisers can play is as a go-between between ministers and civil servants – being both attuned to ministers’ political objectives and vision and sufficiently expert on tax and economic issues to understand civil servants’ workings. In the words of Ed Balls, there needs to be someone “credible with both audiences. You have to be credible with your minister, and you have to be credible with the people who are actually going to implement the policy.”<sup>13</sup> Previous ministers have found this role invaluable. Reflecting on how Gordon Brown brought in advisers with technical backgrounds, former Treasury minister, Dawn (now Baroness) Primarolo, noted that one special adviser, Chris Wales, “was brilliant then and he’s brilliant now”.<sup>14</sup>

Special advisers can also play an important role in ‘sense checking’ tax policy for issues that may pose political handling risks and prompt an adverse reaction from the media, business, parliamentarians and the general public. Steps can then be taken to mitigate these risks – such as explaining and framing the policy in a way that softens its reception.

This ‘political awareness’ role is integral to the policy-making process and a skill that all civil servants should possess – as reflected in the civil service competency framework.<sup>15</sup> However, civil service impartiality limits the political considerations that civil servants can take into account and they are likely to lack the close relationship of trust with ministers needed to fully understand politicians’ political preferences. This is therefore an important role for special advisers to fulfil. In the words of one former politician, special advisers “sustain a detailed analysis of all the various political nuances of policy” that ministers alone cannot provide.<sup>16</sup>

The chancellor and prime minister also need special advisers working on tax policy who can build a constructive relationship with the media and be trusted by the chancellor to speak to the press on their behalf. Reflecting on the steps taken to prepare the ground ahead of the increase in national insurance contributions (NICs) to fund the NHS in 2002, Balls (who was a special adviser at that time) highlighted the value of his relationship with the press:

**“Staying on the front foot means arranging breakfasts, lunches, dinners and coffees with every key journalist and media outlet in the period, taking the arguments to them... we went to *The Sun* to see the editor David Yelland. The day after, we did the same at the *Daily Mail*.”<sup>17</sup>**

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Conversations with current and former special advisers, officials, politicians and journalists suggest that former chancellors Gordon Brown and George Osborne were particularly adept at appointing special advisers who could fulfil these functions. They both appointed advisers (Balls, Ed Miliband and Damian McBride in the case of Brown, and Rupert Harrison in the case of Osborne) with economic backgrounds who could engage with the detail of tax policy, while also having the political skills, experience and media contacts to identify political risks and effectively explain difficult policies to the press.

The consensus among those we spoke to is that the special advisers appointed by Brown and Osborne were more effective at anticipating the potential political pitfalls of policies and maintaining close relationships with the media than those appointed by Lord Darling and Philip Hammond.

Edward Troup singled out Shriti Vadera – Brown’s special adviser – for her role scrutinising policies for their political saleability. She was “absolutely feared by officials,” he said, and policy successes were often “down to the degree of rigour and scrutiny which Shriti brought to every single policy before they got near Gordon”. Troup contrasted this with Darling’s special advisers, who were “nice people but they didn’t have the, you know, bite-your-leg-off tendency that Gordon’s did. So, we were inevitably less feared and less respected and that was not good for fulfilling [that challenge function].”<sup>18</sup>

Over his time as chancellor, Hammond had much less interaction with the media than Osborne did.<sup>19</sup> On average, Hammond had fewer than three meetings each quarter (or fewer than one a month) with newspaper or other media representatives, whereas Osborne averaged eight such meetings per quarter (or more than two a month). The hostile reaction to the government’s proposed changes to Class 4 NICs in 2017 is an example of the problems that can occur when political factors – in that case a perceived breach of the 2015 Conservative Party manifesto – are not identified before a policy is announced.

However, episodes such as the 10p tax debacle (announced by Brown in 2007) and the ‘omnishambles’ budget (presented by Osborne in 2012) show that – even with experienced special advisers – Treasury ministers are not infallible. However, there is a consensus among the current and former journalists, civil servants and politicians who we have spoken to that good special advisers can play a valuable role.

## **Recommendations for change**

### **Ministers must set clear objectives for the tax system and a strategy for achieving reform**

Tax reform is unlikely to be completed in one fiscal event, or even over two years, so consistency of policy is important. A minister committed to tax reform should first set out his or her overall objectives and then work with civil servants and others to devise reforms that meet them. Such an approach would ensure tax reform stays on course, and there is an especially strong case for this approach to be pursued after the coronavirus crisis.

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The government needs to set out its view of what the tax system should achieve and when the tax system should be used to deliver broader social and economic objectives. The New Zealand government, for example, publishes objectives for the tax system that include: “a system that promotes long-term sustainability” and “a system that treats all income and assets in a fair, balanced and efficient manner”.<sup>20</sup>

While it is responsible for only a small number of devolved taxes, the Welsh government has also issued a tax policy work plan that sets out its objectives – for example, that Welsh taxes should be “clear, stable and simple”.<sup>21</sup> These objectives do not delve into the detail of policy; instead, they are a clear statement of what the government is trying to achieve, helping people in government and externally to evaluate whether tax policy is achieving its objectives.

The UK government should consider adopting this approach, especially in the aftermath of the coronavirus crisis when it will need to set out clearly what it wants the tax system to achieve, how much revenue it would like to raise, and when. The benefits would be five-fold:

- First, having clear objectives would allow ministers – in the words of Balls – to make the “argument for why” when explaining tax reform proposals to the public.<sup>22</sup> That is, it would allow the government to create the sort of clear narrative that we described in Chapter 2 as being important to help persuade the public to support difficult policies. Setting out what the government’s objectives are and why tax is the right tool to achieve them can help to get initial public agreement on the case for action before focusing on specifics. In contrast to risky ‘budget rabbits’ that are announced with little pitch-rolling, a tax strategy would give the government more time to make the case while also leaving good time for the development of the policies. For example, setting out clear objectives shortly after the coronavirus public health crisis has passed, when the reasons for action are fresh in the public’s mind, would help to maintain momentum for reform when memories have faded further down the line.
- Second, clear objectives would allow the government to plan effectively over longer periods, opening up the possibility of sequencing reforms and ensuring that revenue is available when it is needed. Many chancellors have failed the tax equivalent of the marshmallow test: opting for the instant gratification of a short-term giveaway (such as a hike in the personal allowance), meaning the money is never available for overdue and potentially longer-lasting structural reform. Much like fiscal rules, clear objectives for the tax system would make deviating from the intended path more costly, and so help the chancellor to resist demands from colleagues or lobby groups that conflict with the overall direction of travel.
- Third, declared objectives should enable other departments to engage better with the Treasury on the right mix of policies to deliver these and ensure consistency between policies. It is very unclear, for example, how the Treasury’s approach to pensions tax relief fits with the Department for Work and Pensions’ policy on automatic enrolment.



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- Fourth, if the government was clearer about its overarching objectives for the tax system, MPs would be better able to hold the government to account for whether or not the policies chosen contribute effectively to achieving the government's own stated goals – even if MPs do not personally agree with those goals. In contrast, at the moment – as we describe in more detail in Chapter 5 – discussion of tax policies tends to focus on the merits of the political value judgments that underlie specific policies.
  - Finally, a more strategic approach opens the possibility of building an enduring cross-party consensus on the shape of the tax system. New Zealand is perhaps the best example of this: there the notion that the tax system should have a broad base and low rates is shared by ministers, the tax community and the wider public. That consensus has existed since the late 1980s when New Zealand had to take stock and reboot its economy, after failing to adapt to the shock of losing access to UK markets after the UK joined the European Economic Community in 1973.

### **Retain Philip Hammond's commitment to one fiscal event a year**

A considered medium-term strategy should be conducive to having only one fiscal event a year. Rather than announcing surprise measures twice a year (as was the case before 2017), the chancellor should stick to announcing longer-term measures consistent with his broader strategy once a year.

### **The chancellor and prime minister should ensure the team of advisers working on tax policy has the necessary skills**

As highlighted above, an effective team of special advisers can better equip the government to deliver successful tax reform. The new chancellor now shares his team of special advisers with the prime minister.<sup>23</sup>

When putting together his or her team of special advisers, any chancellor (and No.10) should ensure it contains the right balance of skills. He or she should appoint someone with enough knowledge and experience to understand the technical detail of tax policy as well as understanding ministers' political goals, such that they can liaise effectively with both civil servants and ministers to facilitate the design of policies that meet ministers' objectives. The chancellor also needs advisers with the political antennae to spot potential stumbling blocks and recommend ways to mitigate the risks. Finally, the chancellor needs to appoint people he or she trusts to speak to the media on his or her behalf about tax and sustain a constructive relationship with the press.

As in the past, it may be possible to appoint a special adviser who can fulfil all these functions, although this is not essential so long as all the skills are present in the team of special advisers working on tax policy as a whole.



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## 4 Helping civil servants support tax reform

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While it is ultimately ministers who decide on tax policy and tax reform, civil servants still have an important role to play. Ministers rely on civil servants for advice and to implement decisions. There are three broad ways that civil servants can make tax reform easier to achieve.

First, they can assemble the solid evidence base for reform, including the costs and consequences of the existing weaknesses in the system. Lord O'Donnell emphasised that, when communicating with ministers about tax reform, the first question to convince them of is "where do we want to get to",<sup>1</sup> before getting into the detail.

Second, analysis produced by civil servants could play a role in developing public debate. As we noted in Chapter 2, public debate is crucial to delivering tax policy and it can shift over time – Ed Balls argued that "to make good policy you have to open up the space and you have to move into it".<sup>2</sup> Policies that might not be politically acceptable now, or would not be acceptable if announced 'cold' without pitch-rolling, may nonetheless be deliverable in the future. The sort of analysis that is produced within government of the costs and consequences of the weaknesses in the tax system could be used to inform the public.

Third, civil servants play a crucial role in designing and implementing packages of reform in collaboration with ministers. This requires technical tax knowledge and other forms of expertise (for example, microeconomics). One insight from a report entitled *Behavioural Government*, from the Behavioural Insights Team, is that slow-burning problems tend not to get attention, while politicians have a tendency to over-react to problems that suddenly appear. One solution that report proposed was to "invest for windows of opportunity".<sup>3</sup> There may be a limited time when a problem is salient, and at that point civil servants need to have plans and policy proposals already worked up. This means that tax policy development work needs to be forward-thinking and strategic, looking beyond the annual budget cycle.

In this chapter, we first describe current practices in the Treasury, HMRC and other public bodies that play a role in tax policy making, and set out the ways in which current practice is not conducive to promoting tax reform. We then make recommendations for improvements that could be made to help ensure civil servants are as effective as they can be in supporting tax reform.

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## Current practice

Tax policy operates through the Treasury and HMRC. Since the O'Donnell review in 2004<sup>4</sup> – which recommended the merger of the Inland Revenue and HM Customs and Excise to create HM Revenue and Customs (HMRC) and a new policy partnership between the Treasury and HMRC – three groups of civil servants have played an important role in the tax policy-making process. The current system puts responsibility for policy development with the Treasury, whereas this had fallen to the Inland Revenue and Customs and Excise before the O'Donnell review, with the Treasury merely playing a co-ordinating role.<sup>5</sup>

### Box 1: the Treasury's 'new approach' to tax policy making

The Treasury's 'new approach' to tax policy making, initially set out in June 2010<sup>6</sup> and reaffirmed in December 2017,<sup>7</sup> sets out three stages in the tax policy making process:

1. Set out objectives and identify options.
2. Determine the best option and develop a framework for implementation, including detailed policy design.
3. Draft legislation to effect the proposed change.

The Tax Consultation Framework,<sup>8</sup> published in 2011, added a further two stages to the cycle:

4. Implementing and monitoring the change.
5. Reviewing and evaluating the change.

There are **around 200 staff working on tax policy in the Treasury**.<sup>9</sup> Most are divided into policy teams, which take responsibility for particular taxes or groups of taxes (such as 'enterprise and property taxes', which include stamp duty and capital gains tax). Their role is to work with ministers and special advisers on 'strategic work' to identify weaknesses and priorities for tax policy and to develop policies within their tax area.

A smaller group of civil servants works in the Strategy, Planning and Budget (SPB) team, which is responsible for co-ordinating the budget process, including setting the theme and priorities of each budget and whittling down an initially very large number of measures into the final budget scorecard of confirmed policies. Outside budget periods, the SPB team plays a co-ordinating role – alongside cross-cutting groups in each of the business and personal tax directorates – to identify long-term challenges (which may cut across tax areas) and to bring them to the attention of ministers.

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The **HMRC tax policy teams**, consisting of around 1,000 people in total,<sup>\*</sup> are responsible for policy maintenance, which “aims to protect the tax system against challenge”.<sup>10</sup> In practice, this means they play a proactive role in proposing policies to protect the tax system against avoidance, to ensure its smooth operation, and to enhance compliance. These teams also assist with the details of policy implementation, such as legislation and the implementation time for a measure to take effect. In general, the civil servants in these teams have more experience in tax, and a more detailed knowledge of the workings of (specific parts of) the tax system, than their Treasury counterparts.

The **Knowledge, Analysis and Insight (KAI) team** is the centre of data analysis at HMRC and has around 150 (full-time-equivalent) analysts working on policy development, monitoring and evaluation.<sup>\*\*</sup> Only officials in HMRC (as the revenue collection authority) have access to confidential taxpayer records; officials in the Treasury do not. Therefore, the KAI team undertakes analysis of tax records that is required to help with the design and implementation of policies. In particular, the team is responsible for producing policy costings (that is, estimates of how much a policy will raise or cost the exchequer over the five-year period included in the budget scorecard). These costings are then scrutinised by the Office for Budget Responsibility (OBR), which may request changes to be made to the modelling or assumptions before they are signed off. These costings include estimates of the likely behavioural response of taxpayers to the proposed change.

The division of labour described above means that the Treasury leads on tax reform.

The budget process drives the operation of the tax teams and the development of tax policy. Since 2017 when the then chancellor, Philip Hammond, switched back to the practice of having only one fiscal event a year – now a budget in the autumn – the budget process ‘officially’ starts when the Treasury notifies the OBR of the planned date of the budget (ideally 10 weeks before the budget).<sup>\*\*\*</sup> As a result, the Treasury’s tax teams spend much of the summer working up policy ideas that could form part of that autumn’s budget. The autumn is spent managing the budget process and agreeing with ministers the final measures that will appear. In recent years with a minority government, a non-negligible part of the six months after the budget was then spent on managing the legislation that underpins the announced measures. This left little time for Treasury officials to engage in longer-term, more strategic thinking about the overall strengths and weaknesses of the tax system and to build the evidence base needed to underpin tax reform.

However, the current process is still a large improvement on the pre-2018 period when there were two full-blown fiscal events a year and, with a majority government, Treasury officials should need to spend less time shepherding budget legislation through parliament

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\* Not all of these people work full time on policy maintenance. Many are involved in litigation and providing other support to the operational side of HMRC.

\*\* Out of a total KAI workforce of around 450 full-time-equivalent staff.

\*\*\* However, this timetable has been – at least temporarily – abandoned after the government chose not to hold a budget in autumn 2019, instead holding one in March 2020.

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Two other public bodies also play a role in supporting tax policy making and tax reform. The OBR, a non-departmental public body set up in 2010, is the government's independent forecaster, publishing two fiscal and economic forecasts each year.

For all budget tax measures, it scrutinises and signs off government costings prepared by KAI analysts. It also publishes *Fiscal Sustainability Reports* and *Fiscal Risks Reports* biennially (in alternating years), which examine (respectively) the long-term sustainability of the public finances and the main risks facing the public finances, including risks to the UK tax base. Although the OBR is prevented from making policy recommendations, its reports provide detailed analysis of some of the longer-term problems facing the UK tax system that affect fiscal sustainability and so can play a role in building public and political understanding of the need for tax reform.

The Office of Tax Simplification (OTS) – an independent office of the Treasury – was also set up in 2010. Its remit is to recommend ways in which the tax system can be simplified. The OTS has around 10 full-time-equivalent staff producing reports on specific areas of the tax system. Its areas of focus may be at the request of the chancellor or the discretion of the OTS. Since it was set up, it has expanded and, since 2015, is now on a statutory basis, meaning it is officially independent of the Treasury. In recent projects, its effective remit – the simplification of the tax system – has been broadened. For example, in a recent report on inheritance tax, the scoping document included “the scale and impact of any distortions to taxpayers’ decisions and behaviour”,<sup>11</sup> which goes some way beyond whether the system is simple to interact with administratively.

## Limitations

### The Treasury is limited in its ability to support tax reform

The Treasury has several important roles to play to facilitate and support tax reform but it currently operates within constraints that mean it cannot fulfil these functions completely effectively. There are two broad problems: capacity and access to expertise.

#### Capacity

For civil servants to play an effective role in tax reform, they need to have the capacity to engage in long-term strategic thinking and planning – investing for windows of opportunity. This needs to take place alongside pressing short-term work, most notably preparing budget policies.

Since 2005, responsibility for tax policy development has sat in the Treasury (having previously been held by the Inland Revenue and Customs and Excise). The O'Donnell review stated that this transfer was designed to “ensure coherence across the tax system and with other Government policies”.<sup>12</sup> Tax reform requires consideration of the system as a whole and joined-up thinking between tax and other levers. Since the Treasury is responsible for allocating spending and setting the direction of broader economic policy as well as tax, it is better placed than HMRC (or its predecessor departments) to design comprehensive reform.

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However, the 15 years during which this new policy partnership has been in place has not been a period of substantial tax reform. Indeed, few policies have been implemented over this period that would meet our definition of tax reform. Many of the weaknesses that we can now identify in our tax system were identifiable and identified 15 years ago as well. While the movement of tax policy development to the Treasury enhanced capacity for tax reform on paper, it does not appear to have done so in practice – or at least other barriers to reform have predominated.

The structure of tax policy making in the Treasury is not inherently problematic. The SPB team and cross-cutting groups in each of the tax directorates, alongside senior civil servants in the tax teams, play a co-ordinating role both during and outside budget periods, helping to overcome a tendency for individual tax teams to be somewhat siloed. This should be conducive to developing long-term strategy and is a sensible organisational structure for the many civil servants in the tax teams, given the detailed work that needs to be done.

However, this setup has not always led to successful co-ordination of Treasury effort. For example, we have heard that civil servants in tax teams sometimes ask the question 'How can we change our tax to deliver the government's objectives?' rather than considering whether their tax – as opposed to some other tax or policy tool – is the best way to meet the objectives. This is despite the fact that, at more senior levels, the Treasury has a steering group on tax and growth that considers tax and spending policy together. In recognition of the need to improve co-ordination, the Treasury has introduced a new 'tax strategy' role within the SPB team and increased resources dedicated to strategic oversight over the past few years. Civil servants believe this has enhanced their ability to provide strategic and co-ordinated advice to ministers.

However, the co-ordination of the tax teams on long-term planning is only part of the problem. More importantly, civil servants have not had enough time and resources to develop longer-term plans away from the pressures of the budget cycle. This stems from ministers not leading on tax reform. Lord Macpherson said: "The better chancellors usually come to office wanting to do some things, and they will have ideas of where they want the tax system [to get to]."<sup>13</sup> If a chancellor is not interested in long-term reform, it will be difficult for civil servants to invest time and resources in so-called 'horizon scanning' – that is, preparing for reforms and other policy changes that are not a priority now but might become pressing in future.

Successive ministers' prioritisation of short-term, tactical budgets has led to civil servants' time being taken up almost entirely by the short-term work accompanying fiscal statements. Civil servants typically prepare hundreds of possible measures for a fiscal event, which are then whittled down to the final scorecard of measures. Our *Better Budgets* report, which we produced in conjunction with the Institute for Fiscal Studies and the Chartered Institute of Taxation, identified this problem,<sup>14</sup> as did then chancellor, Philip Hammond.

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Reflecting on his decision to move to having just one fiscal event a year, Hammond said:

**"Having to do two big fiscal events a year effectively made the Treasury pretty dysfunctional. It meant that business-as-usual business really didn't get done, because you had the summer period, then you were straight into the autumn statement, and then it was Christmas. You had a really very short period – January and February – and then you were heavily into budget preparation and the finance bill and then it's the summer again. It just made the department dysfunctional, so I think it was the right decision."<sup>15</sup>**

That move to one fiscal event a year should have freed more time and resources for horizon scanning and preparation for longer-term reforms. Interviewees noted that tax policy has been less frenetic since then – and, indeed, fewer measures have been announced each year since 2017. However, in practice, this new model of working has yet to be tested in 'normal times'. There were two budgets in 2017 and from then on a minority government, where the parliamentary arithmetic has required Treasury civil servants to pay more attention than usual to the post-budget legislative process. Furthermore, preparations for exiting the EU and responding to the economic impact of Covid-19 have diverted resources. For example, in October 2018, Tom Scholar, the permanent secretary to the Treasury, told a select committee that 400 of the Treasury's 1,300 staff were working on Brexit.<sup>16</sup>

### ***Access to expertise***

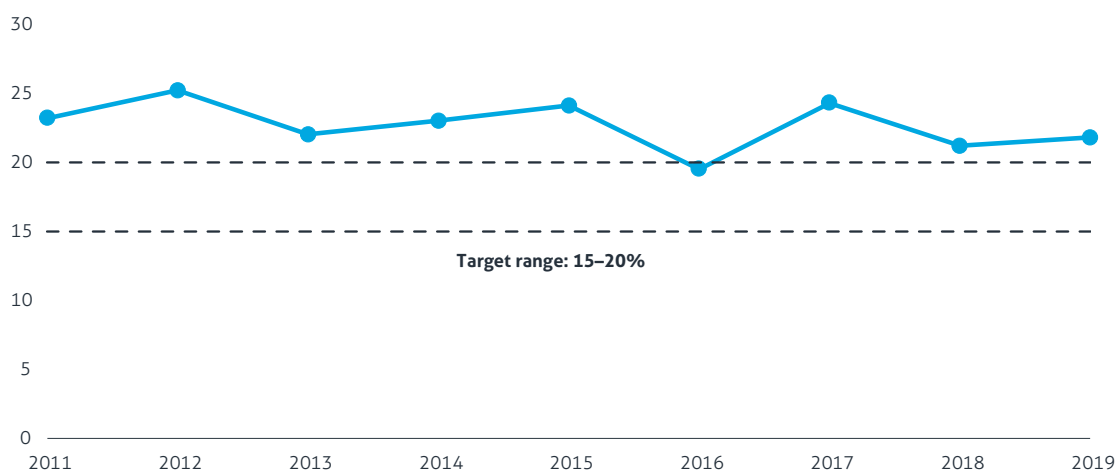
To play their part in tax reform, civil servants need the necessary expertise. In the words of Lord Macpherson, a challenge in tax policy making is "maintaining sufficient numbers of genuine tax experts as opposed to here-today-gone-tomorrow Treasury amateur officials".<sup>17</sup> Developing enough knowledge of the tax system to appreciate the need for reform and understanding how this can be achieved require tax expertise – understanding the economics of taxation as well as practical details about the system. Given that tax reform is likely to be a longer-term process, there is also a benefit to having people in post (at the very least in some form of tax role) for an extended period and maintaining strong institutional memory to ensure that longer-term goals are pursued consistently.

But, as is true of the civil service more broadly,<sup>18</sup> the Treasury's normal structures and career paths are not ideally suited to developing such expertise and longevity.

First, tax accounts for a minority of policy roles within the Treasury. Civil servants, especially at junior levels, will often move between policy areas to gain experience. The ability to work on a range of topics is often one of the attractions of joining the Treasury and a varied career has traditionally been seen as the best way to gain promotion and advance into the senior civil service within the Treasury. This means that developing expertise in tax has not been encouraged or rewarded as much as holding a variety of jobs.

Second, the Treasury has high levels of staff turnover: a large proportion of Treasury staff leave the department each year.<sup>19</sup> The White report in 2012 identified this problem and set the Treasury a target of reducing exit rates to 15–20% a year.<sup>20</sup> That figure is still high by the standards of many other similar types of organisations but the Treasury has still missed it in every year but one since then (see Figure 2). High turnover combined with a recent growth in numbers means that, in 2019, half of Treasury civil servants had worked in the department for 2.3 years or fewer.<sup>21</sup> Civil servants also often move rapidly between roles and teams within the Treasury, although no figures are publicly available on how rapidly this occurs or whether there has been any reduction over time.

**Figure 2: Staff turnover in the Treasury (%)**



Source: Institute for Government analysis of various Treasury annual reports, 2011/12 to 2018/19.

A combination of rapid turnover and people moving between tax and other roles means that – as of summer 2019 – 80% of the Treasury’s tax policy personnel had experience in the Treasury of five years or fewer. Even in that time, many had worked in multiple jobs. At senior grades, 50% had tax experience of five years or more and a number had more than 10 years’ experience.<sup>22</sup>

The Treasury has recognised the importance of tax expertise and the weakness of the traditional Treasury staffing model in supporting this. In response, the department introduced a new tax career offer in 2016. Treasury staff working in tax roles are offered the opportunity to study for professional tax qualifications, with the Treasury covering the costs of their exams and offering paid time off for study. The Treasury has also introduced a ‘professional tax allowance’ (equal to around 10% of base salary), which is given to people who display commitment to working on tax. The head of the tax profession in the Treasury has discretion about who receives the allowance, but in general it is paid to people who take a second tax job at the same level of seniority and who are working towards (or have completed) a professional tax qualification.

This initiative is welcome and interviews with junior Treasury officials suggest it has encouraged people to join tax teams, to study for professional qualifications and to remain working on tax for longer than they might otherwise have done. However, the



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Treasury has not so far collected the data that would be needed to evaluate properly the impact of these changes on recruitment, retention and skills acquisition within the tax teams.

Civil servants now see a career focused predominantly on tax as a viable route to promotion into the senior civil service. But for many Treasury officials, one of the attractions of the organisation is the ability to work on a range of topics, and there will always be a limited number of senior roles in tax, so there is likely to be a limit to how far financial incentives will encourage civil servants to specialise exclusively in tax.

Given the inherent difficulty for the Treasury of retaining enough tax expertise and knowledge in its staff, one option is to acquire that expertise from elsewhere, including from HMRC. When the new policy-making partnership was set up, the O'Donnell review intended for "frequent interchange between the new department [HMRC] and the Treasury".<sup>23</sup> Initially, this worked well: 150 roles from the newly created HMRC moved to the Treasury, with half of those filled by former Inland Revenue or Customs and Excise staff.<sup>24</sup> However, and as noted in our *Better Budgets* report,<sup>25</sup> in subsequent years this flow of people from HMRC to the Treasury slowed down. Partly this is because, for many HMRC staff, a transfer to the Treasury would mean lower pay and longer hours. Some HMRC staff also believe that time spent in the Treasury will not be rewarded when later applying for promotion in HMRC – a department that prizes operational experience.

Another way of acquiring tax expertise is by hiring from the private sector. The Treasury has also increased its focus in this area, running three rounds of general recruitment for tax specialists in recent years. However, interviewees suggested that the Treasury is not making as effective use of these new hires as it could. We were told that, once hired, these people's careers were managed in the same way as other members of the tax team who had no specific external tax experience. As a result, there is a risk that the department will not make use of the specific knowledge and experience these people have – and for which they were deliberately recruited.

Designing tax reforms requires not only technical tax expertise but also a good understanding of microeconomics. As the Mirrlees review states: "Thinking hard about the economics of the tax system is essential if it is to work effectively."<sup>26</sup> Enhancing the role of economists in the tax policy process was a motivation for moving more tax policy-making responsibility into the Treasury. As the economics ministry, the Treasury traditionally had more economists – and a more economic approach – than the Inland Revenue and Customs and Excise. According to Lord O'Donnell, whose review recommended the switch, the intention was to redress (at least in part) the balance of public sector economists:

**"I wanted strength in Treasury's tax policy and capacity... If you think about the allocation of economic resources, the biggest misallocation, I guess, is the Bank of England devoting millions and millions of economists to only one thing. Let's take half of them and put them into tax policy."<sup>27</sup>**

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The Treasury does now approach tax questions with a microeconomic framework – for example, valuing the neutrality of the tax system and thinking about market failures that would justify divergence from this. This is very different from the situation that Lord O'Donnell encountered when he joined the Treasury during Margaret Thatcher's premiership: "The influence of economics was quite limited... Budgets were mostly... run by people who were good at adding up and understood the tax system... there wasn't a lot of microeconomic analysis."<sup>28</sup>

Most of the tax teams now have at least one formally trained economist and there is a formal process by which the Treasury's economics team (led by the chief economic adviser) considers the indirect macroeconomic effects from major tax measures, although this process is not principally concerned with good tax design. This is a process that civil servants believe works well, allowing them to draw on economic expertise when needed.

However, while this setup seems to work well in the current policy environment – where most policies are tweaks to the system – it would not necessarily be enough for designing and implementing more complex packages of tax reform. These sorts of more complex packages would be needed to address some of the more entrenched problems with the UK tax system, such as the unequal taxation of employees, the self-employed and company owner-managers. In more complicated packages there could be multiple parts of the system changing at once, with complex and sometimes counterintuitive implications for changing economic incentives. In these instances, it may be necessary to develop more formal processes by which economic expertise could be fed in.

### **Too little external input**

The Treasury may not have in-house all the expertise that is required to design and implement successful tax reform. There is, therefore, an important role for external organisations to play as well. The Treasury explicitly acknowledged this in its 2010 report *Tax Policy Making: A new approach*<sup>29</sup> and reaffirmed it in 2017.<sup>30</sup>

The main formal way in which external views are sought on specific policy areas or proposals is through the open consultation process. As we noted in *Better Budgets*,<sup>31</sup> most measures are now subject to consultation at some stage – the exceptions being rate and threshold change, and those where prior announcement would lead to forestalling. In 2011, in its *Tax Consultation Framework*,<sup>32</sup> the Treasury committed to consulting at all stages of the policy process, where possible.

There are specific examples where this process has been followed and worked well. A recent example is the digital services tax. The government published a position paper in November 2017, to which it invited responses.<sup>33</sup> Hammond then announced a consultation on the details of tax design and implementation in November 2018, and the policy came into force on 1 April 2020.<sup>34</sup> The March 2020 budget provided other examples, with the chancellor, Rishi Sunak, announcing calls for evidence on business rates and Vehicle Excise Duty (VED). However, these were still fairly limited consultations and there were none relating to the bigger picture of how the

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government could “redesign the tax system so that it boosts growth, wages and investment and limits arbitrary tax advantages for the wealthiest in society” – as promised in the Conservative Party’s general election manifesto.<sup>35</sup>

In most other cases, tax policy consultations have focused only on the detail of implementation – after the government has already made the substantive policy decisions. We analysed the 179 consultation documents on tax that the government has issued a ‘summary of responses’ to since January 2012. Only 15 (or 8%) of those could be classified as ‘early-stage’ consultations,\* including a somewhat higher 16% since January 2017 – when the Institute for Government published *Better Budgets*, which also highlighted this paucity.<sup>36</sup>

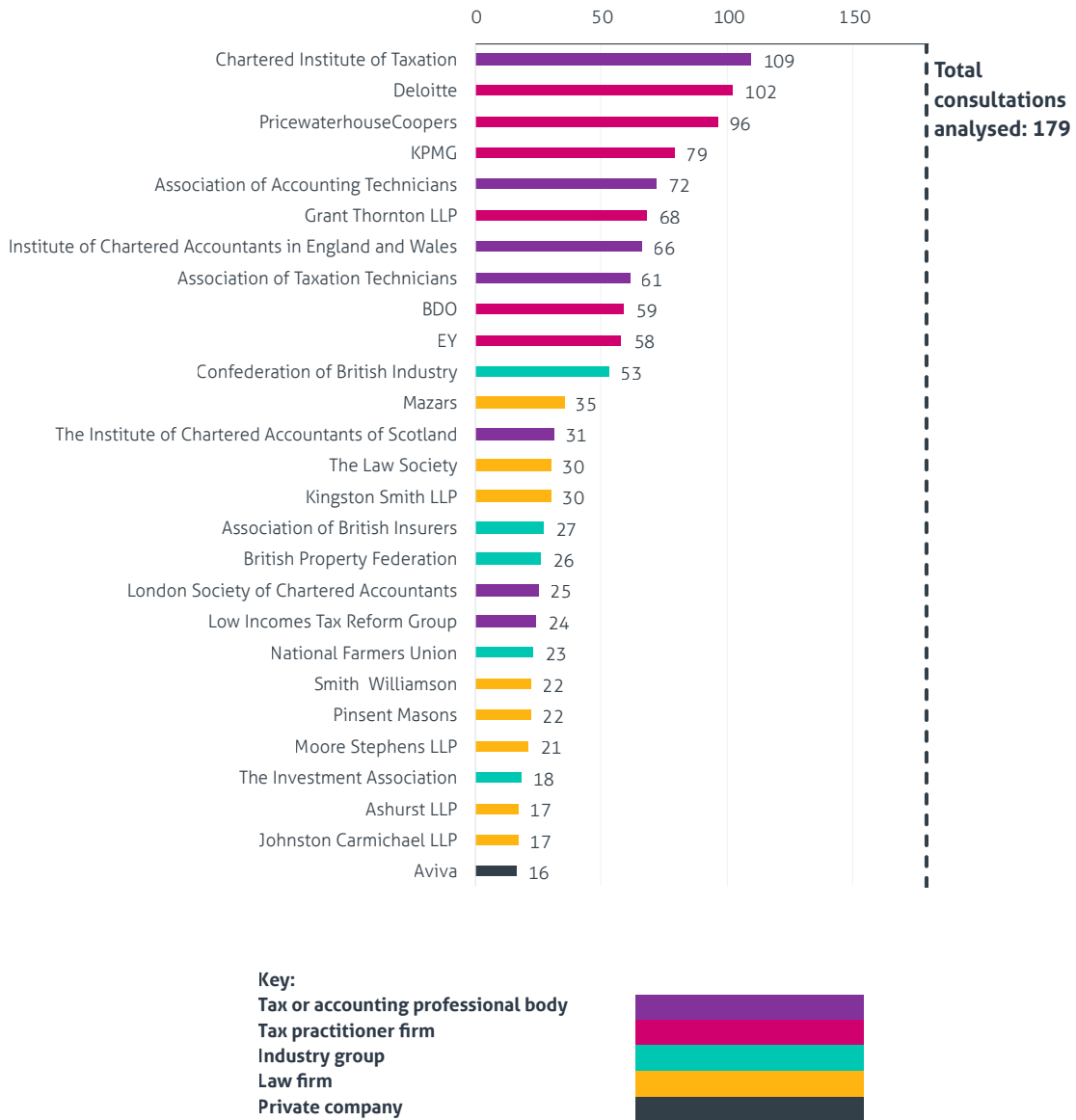
The consequence is that the most frequent responders to consultations are those with expertise in the implementation of tax law and the practical operation of the tax system. As Figure 3 shows, the Chartered Institute of Taxation (CIOT) and big accountancy firms are especially prolific in this regard. Input from these organisations is valuable and important to ensure the smooth operation of new tax measures. But these are not the only organisations that can provide valuable insights on tax policy – particularly when thinking about tax reform.

Organisations whose expertise is in policy design and evaluation – rather than in the taxpayer experience and implementation – such as the Institute for Fiscal Studies, the Resolution Foundation and academics working on the economics of tax, rarely if ever respond to tax consultations (neither the Institute for Fiscal Studies nor the Resolution Foundation is listed as a respondent to any of the 179 consultations). These groups have little to add on questions of precise practical implementation, but they have a wealth of knowledge and expertise on the broad principles of policy design. They are also well placed to generate evidence on the impact of current and potential future policies. These external experts have formal economics training, quantitative skills and research time that allow them to provide valuable input into the policy-making process.

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\* These were consultations on the VAT retail export scheme (July 2013), penalties applied by HMRC (February 2015), business rates (March 2015), deeds of variation (July 2015), pensions tax relief (July 2015), the treatment of travel and subsistence payments (September 2015), promoting energy efficiency (September 2015), child life trusts (March 2016), treatment of sports teams (March 2016), methods of VAT collection (March 2017), employee expenses (March 2017), the treatment of intangible fixed assets (February 2018), tackling plastic use (March 2018), taxation of training (March 2018) and VED on vans (May 2018).

**Figure 3: Organisations responding most often to tax consultations, 2012–18**



Source: Institute for Government calculations based on 'summary of responses to consultation' documents published by HMRC or HM Treasury, at [www.gov.uk/search/policy-papers-and-consultations](http://www.gov.uk/search/policy-papers-and-consultations) and including the keywords 'tax', 'charge' or 'levy'.

The government and civil servants also consult informally with external organisations. While transparency is to be valued, budget secrecy or market sensitivity will sometimes mean that open consultation is not possible, meaning on those occasions the government and civil servants sometimes interact privately with a small number of trusted organisations. However, prominent practitioners and economic experts have told us that this happens rarely. Beyond seeking views on specific proposals or policy areas, external input from think tanks and academics can provide fresh policy ideas and ensure that the government has access to the relevant available evidence. But this is not working effectively.

Think tanks develop many proposals for tax changes but we have heard that, from a Treasury perspective, these proposals rarely engage sufficiently with questions of practical implementation, making them less useful than they could be to government.

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For example, the Mirrlees review,<sup>37</sup> which proposed widespread changes across the tax system, did so at quite a high level. The review deliberately did not provide a detailed blueprint of the legislative changes that would achieve the proposed reforms but – as a result – was difficult for governments to adopt. This is entirely understandable given the limited number of people working on tax in the think tank community, but it does mean that this work does not influence the policy-making process as strongly as it might.

While the Treasury makes use of published reports from academics and think tanks, its interaction with the tax academic community beyond this is limited. Academic work often has longer timescales than shorter-term civil service projects, and can sometimes seem to be of (at best) tangential policy relevance. However, there are two ways in which engaging with academia could provide benefits to the Treasury and to the process of achieving tax reform.

First, the Treasury can direct academics' research agendas so that researchers are answering the questions that are of interest to policy makers. One option is to commission work directly. HMRC manages a £2 million annual budget for research on tax issues and one member of the board who decides what work gets commissioned is a Treasury official. In recent years the board has commissioned research relevant to tax policy making – mainly in the form of bespoke surveys or qualitative analysis in order to learn about economic activities (such as the scale and nature of untaxed wealth transfers<sup>38</sup> or untaxed benefits in kind<sup>39</sup>). This research is useful, but there are other forms of quantitative research – such as detailed economic analysis of existing government datasets – that the board does not currently fund.

A much lighter-touch and lower-cost approach to guide other research is to publish Areas of Research Interest (ARIs). Every government department is supposed to publish these to indicate to research funders and academics what questions the department would like answered. But the Treasury is so far the only ministerial department not to have published any.

Second, as previous Institute for Government research has argued, another benefit is that a detailed dialogue with academics (beyond ARIs, which are only a starting point) can help officials to keep up to date with new research and research techniques and help civil servants to apply this work to the particular problem they are facing.<sup>40</sup> While Treasury civil servants' grasp of economic concepts is sound, there will still be complicated scenarios that require deeper expertise and where relationships with academia would be valuable. Treasury civil servants are currently heavily reliant on reading published research papers, rather than having more direct contact with a network of tax researchers. This approach is not conducive to getting maximum value from the knowledge and work of academics.

### **Lack of research and evidence to inform the tax reform debate**

Having links with academia that ensure the Treasury is aware of and correctly interpreting available research is only helpful if there is evidence to draw on. Civil servants need a convincing evidence base for the problems caused by the existing system and for the benefits of reform if ministers are to be persuaded. This evidence

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can be generated internally by HMRC and Treasury civil servants and by external researchers. But both internally and externally this evidence is not being developed as extensively or effectively as it could be.

As noted earlier in this chapter, evaluation of measures after their implementation is the fifth stage in the Treasury's tax policy-making process. Understanding the impact of previous measures helps guide future policy by providing information about how behaviour responds to tax and ensuring any mistakes are not repeated, but there is not a systematic process within the Treasury that ensures this fifth step is undertaken. We heard that, for some policies, post-implementation review would not be possible because policy in that area is changed so often, making it impossible to isolate the effect of a specific policy change. This is a reason to stop shifting policy so frequently before the impact of previous changes are understood, rather than a good reason not to evaluate policies.

Broader review of the tax system, in particular tax reliefs, is crucial to identifying weaknesses in the system and to begin building the case for tax reform. Tax reliefs are carve-outs in the tax base, generally designed to pursue social or economic objectives. They resemble spending measures in the sense that they forgo revenue to achieve the government's objectives, but (as laid out in our *Better Budgets* report<sup>41</sup>) the UK's scrutiny of tax reliefs is far weaker than for spending measures.

The National Audit Office (NAO) recently reviewed the government's evaluation of tax reliefs, and concluded that the process has improved in recent years.<sup>42</sup> HMRC has, since 2015, published evaluations of a minority of reliefs and the Treasury has, since 2017, developed an informal process for assessing the value for money of tax expenditures (that is, the subset of reliefs that are considered not to be integral to the tax system). But this is still incomplete: HMRC's evaluations capture only 7% of the total cost of tax reliefs, and the Treasury's reviews – none of which have been published – cover 63 (of the total 362) reliefs but the quality of data underpinning them is of variable quality and the processes are not yet joined up. This means the UK still falls short of international best practice. As the NAO notes, Canada, France, Germany, Ireland and the Netherlands all report on tax expenditure more comprehensively than HMRC does and all approach evaluation in a more systematic way than the Treasury.<sup>43</sup>

The government's relatively limited evaluation – of both policies post-implementation and tax reliefs – is a missed opportunity. The availability of data makes high-quality evaluation more possible now than even 10 years ago. HMRC has a wealth of administrative tax data that, if used well, could provide a more solid evidence base that would strengthen the case for reform.<sup>44</sup> One of the potentially powerful, newly available pieces of information is from the real-time information (RTI) that is collected monthly from employers on people's earnings and will soon be collected on businesses' VAT and corporation tax positions. This promises to provide data in a much more timely fashion to allow research to be conducted closer to policy changes.<sup>45</sup>

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Administrative tax data can be even more valuable if it is used by external researchers who have the technical skills and research time that civil servants do not. Allowing academics access to the most detailed data will enable their research to better inform the evidence base. There is high demand from academics to use administrative data. The number of peer-reviewed economics papers using the term 'administrative data' tripled between 2010 and 2017,<sup>46</sup> while 26% of papers published in the *American Economic Review* – one of the top economics journals – used tax microdata in some way in 2014.<sup>47</sup> This means that providing good access to administrative data could stimulate a substantial body of tax policy-relevant research, as well as helping UK researchers to publish in the world's top journals.

HMRC does allow external researchers access to the tax data through the HMRC Datalab, which has been a positive development. This has resulted in several interesting, policy-relevant findings, for example that:

- research and development (R&D) tax credits for medium-sized businesses are effective at stimulating R&D and are therefore good value for money<sup>48</sup>
- random audits raise substantial sums for the exchequer in part because they also influence audited taxpayers' reporting in future years<sup>49</sup>
- entrepreneurs' relief does not lead owner-managed companies to invest more, contrary to popular opinion.<sup>50</sup>

The first and last of these provided evidence that was relevant for assessing commitments that were made in the 2019 Conservative Party manifesto to increase the generosity of R&D tax credits and to review entrepreneurs' relief.<sup>51</sup> Changes to entrepreneurs' relief were announced in the 2020 budget, although the budget document does not explicitly reference the research on entrepreneurs' relief that used administrative data.

While the Datalab has already led to useful outputs, the consensus among researchers is that the data is difficult to access and the process for getting access to the data and then getting permission to remove and share research results can take too long. The Datalab is difficult to access physically for those based outside London, as it is located in Canary Wharf.

It is also difficult to get approval for projects. To be allowed to use the data, researchers must show that their project will serve one of HMRC's functions. These do not explicitly include policy development or policy evaluation, which limits what researchers can do on these questions – even though any such results would be likely to be of interest to Treasury officials and ministers. At the very least, this requirement necessitates that researchers reframe their projects as contributing primarily to HMRC's core functions rather than providing evidence for the policy development process. As a result, research that may be of value to the Treasury to support policy design is being discouraged.



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Researchers have also indicated that the process once they have been granted access to the Datalab – including getting access to the right data – is often slow, which means that the research is produced in a less timely manner. The main reasons for this are that some of the documentation is poor (requiring a detailed knowledge of the tax system to understand what data to ask for and to interpret the data once it has been provided – in part because this data is inherently complex) and that the Datalab is under-resourced (meaning it takes time for HMRC staff to approve and release outputs).

### **Very little is done to 'open up the space for reform'**

A stronger evidence base is important for making the case for tax reform within government to ministers, but for tax reform to become a reality, the public also needs to be convinced. In general, as described in Chapter 2, there is little public debate about possible tax reforms or the weaknesses in the tax system.

Treasury officials write lots of advice for ministers that sets out weaknesses in the tax system and this would generate public debate if published. Good examples are the 63 value-for-money reviews of tax reliefs that the Treasury has written since 2017. However, because these informal assessments do not represent a formal department view and are part of policy advice to ministers, the Treasury argues they should not be published. Both civil servants and ministers are understandably nervous about publishing such analysis, fearing that it would be interpreted as government policy, even if it is not. But the consequence is that there are few ways in which the government can start or contribute to a public debate on the problems with the tax system. In the next section, we set out examples of where civil servant-authored papers have successfully promoted public debate in Ireland and New Zealand.

One way that the government can generate public debate on tax issues is through early-stage consultation. An open call for evidence can generate public debate on an issue but, as we noted earlier, these calls are only rarely issued.

Another way in which the public debate on tax reform can be opened up is through reports from other public sector organisations, which are seen as being independent of government and therefore whose reports would be less likely to be construed as government policy. On this front there have been improvements in recent years. Since 2010, two institutions – the OBR and the OTS – have been set up. The OBR has, through its *Fiscal Risks Reports* published in 2017 and 2019,<sup>52</sup> identified threats to the UK's tax base. This is a positive development and it is welcome that the government has a statutory duty to respond to such *Fiscal Risks Reports* within a year of their publication.

The OTS has published papers on specific areas of the tax system, which have set out the problems and possible reforms in difficult areas. For example, it has published reports on the closer alignment of national insurance contributions and income tax,<sup>53</sup> the VAT registration threshold<sup>54</sup> and inheritance tax.<sup>55</sup> The last of these, released in 2019, was successful in generating press coverage and public discussion – for example with articles in the *Financial Times*,<sup>56</sup> *The Times*,<sup>57</sup> the *Daily Mail*<sup>58</sup> and on the BBC.<sup>59</sup> It also contributed to an All-Party Parliamentary Group (APPG) recently publishing

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a report on possible reforms to inheritance tax.<sup>60</sup> The OTS report set out problems with the existing system and options for reform, generating discussion without its recommendations being construed as government policy.

The OBR and the OTS have been welcome innovations but their impact in this space, while positive, has been limited. Both have limited remits. The OBR is able to consider fiscal sustainability, but it is not able to comment on the merits of tax design. The remit of the OTS is superficially very narrow – focusing on simplifying the system; however, the OTS and the Treasury have broadened the interpretation of this remit in recent years, judging for example that “distortions to taxpayers’ decisions” was in scope in its recent inheritance tax review.<sup>61</sup> The OBR’s impact in this space has been limited by the lack of attention paid to the tax elements of its *Fiscal Risks Reports*, including a lack of interest from the Treasury Select Committee (as we discuss in Chapter 5). The OTS is also restricted by its resourcing, with only a small budget and 10 full-time-equivalent staff, although this is a considerable expansion since the early 2010s.

## Recommendations for change

In this section we outline various changes that could be made to enhance the Treasury’s and HMRC’s ability to support tax reform. The most important way they could do this would be by opening up the space for tax reform. The next priority should be taking steps to develop a strong evidence base for tax reform. Finally, we lay out recommendations to help ensure civil servants can design and implement effective tax reform packages.

### Opening up the space for tax reform

#### **Consult earlier, more often**

Consulting at an earlier stage, including issuing calls for evidence on major tax policy areas, is both a way in which those with relevant external expertise can be brought into the process more effectively, and a way to enhance public debate.

Philip Hammond, when announcing as chancellor the shift to a single fiscal event a year, said that spring statements would be used as an opportunity to consult earlier on policies, and publish more calls for evidence and early-stage consultation.<sup>62</sup> However, early consultation on substantive issues remains rare. Ministers should conduct more early-stage tax consultations.

The first benefit would be input from a broader range of experts into tax policy design. Those with expertise in tax design will engage at this earlier stage but would have little to add on precise policy implementation.

Second, early-stage consultation is a way to generate public debate before the government commits to a course of action, especially if it is backed up by strong ministerial support. A call for evidence is a good way to debate an existing problem with the tax system. For example, the call for evidence on plastic packaging came at a time when the damage caused by plastic waste was in the news already (as a result of the television programme *Blue Planet II*). Michael Gove, environment, food and rural affairs secretary at the time, led this agenda, and the call for evidence led to news stories that focused on the role of the tax system in discouraging the use of plastic.<sup>63</sup>

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### ***Publish more civil servant-authored analysis***

A more active research community would help to develop a better public debate on tax, but this could be enhanced even further if ministers were willing to allow the Treasury to publish its own analysis of some of the problems with the tax system and options for reform. We noted above that Treasury officials already write lots of advice for ministers on the tax system. There are understandable reasons why the government might be nervous of publishing this – the main perceived risk being that any such analysis would inevitably be interpreted as government proposals and that ministers would therefore need to defend their contents.

However, in other countries, civil servant-authored papers are regularly published without them being interpreted as government proposals, suggesting that this could also be possible in the UK. Box 1 sets out how this happens in New Zealand and Ireland.

New Zealand is often held up as a model of tax policy making and the Revenue department there has a degree of independence from ministers that is different from the Treasury's position in the UK. However, Ireland's system is much more similar to the UK; there, civil servant-authored analyses of tax issues and options for reform are published and debated in the media every summer in advance of the budget. This situation came about gradually. Like in the UK, these papers were originally confidential briefings. Over time, a subset of these papers was published after the budget in response to Freedom of Information requests. In 2013, the Irish Department of Finance started publishing the papers in full after the budget and, finally, in 2016, it started to publish them before the budget. Interviewees in Ireland agreed that the publication of these papers generates a lively public discussion on tax, while ministers retain plausible deniability. The Irish case suggests that similar papers authored by the Treasury – setting out weaknesses in specific areas of the tax system and options for reform – could play a productive role in the UK tax debate if ministers were willing for them to be published.

#### **Box 2: Publication of civil servant-authored analyses of tax issues**

##### ***Ireland***

In Ireland, in July (before the autumn budget), a group of civil servants and political advisers, known as the Tax Strategy Group, meets to discuss options for tax and benefit reform. The group has no decision-making power; its purpose is to discuss strategy for the tax and benefit system and air disagreements rather than to make detailed policy.

The Tax Strategy Group was set up in 1993 to co-ordinate tax policy across government and facilitate discussion among rival coalition partners.<sup>64</sup> The group discusses papers prepared by Department of Finance officials on weaknesses in, and options for reform of, different areas of the tax system.<sup>65</sup>

Then, in July 2016, the papers were – for the first time – published before the budget, at the same time as the Tax Strategy Group met. This allowed the media to analyse possible budget policies using the papers in the lead-up to the budget. We heard from interviewees that the media tends to cover the papers in some detail over a number of days and weeks in the slow-news summer months.

The papers are not treated as strict statements of government policy nor are ministers bound to defend their contents. For example, when a paper in 2018 pointed out that primary residence relief from capital gains tax was exceptionally expensive,<sup>66</sup> ministers dissociated themselves from any suggestion that they planned to adopt one of the options outlined in the paper, which was to remove or limit the relief. Several interviewees in Ireland – both inside and outside the civil service – thought that the publication of these tax strategy papers before policy decisions are made has been a welcome development in tax debate policy there.

### ***New Zealand***

In New Zealand, civil servants have a degree of independence from ministers. As in the UK, all of their advice is politically neutral and provided in writing, and various parts of this advice are published. For example, the Revenue department publishes its advice to incoming ministers as a way to publicly put ideas and options on the government’s radar.<sup>67</sup> Cabinet discussion papers, which are discussed as an agenda item at Cabinet meetings, are also published – including, for example, a recent report on options for taxing the digital economy.<sup>68</sup>

This setup has been in place for a long time in New Zealand. There are examples of published pieces going back at least as far as 1987.<sup>69</sup>

### ***Enhance the role of independent bodies to make the case for reform***

As well as allowing the Treasury to publish documents, the government should make greater use of independent bodies to generate and inform debate on tax reform.

The government could make more use of the OTS to carry out and publish more work analysing current weaknesses in the tax system and to consider options for reform. Unlike the Treasury, the OTS is independent of ministers and so there is less risk of any of its analysis being interpreted as government proposals. The inheritance tax report in July 2019 showed that the OTS can attract media attention without its recommendations being treated as government policy.<sup>70</sup> To ramp up its activities, the OTS would need to be better resourced. To contribute most constructively to the government’s tax reform objectives, the government would need to give the OTS a clear view of what these were, to enable it to prioritise its activities. The government should also ensure that the OTS’s remit is sufficiently broad that it is able to consider whether policy is meeting those objectives.

The OTS and the OBR should consider whether their analysis could be presented more effectively to communicate the need for reform – where relevant – to a broader audience, in order to generate a productive public debate.

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There are two aspects to this. First, the focus and framing of the analysis could be adjusted to communicate the urgency and need for action. This is especially the case for the OBR's analysis of tax revenue risks and trends. The OBR currently presents five-year forecasts (in its *Economic and Fiscal Outlook*) and 50-year forecasts (in its *Fiscal Sustainability Reports*). However, while five years is not long enough for the longer-term pressures to clearly emerge, 50 years is too long a time horizon to generate a sense of urgency. Its projections might have more impact if it were to focus the presentation of some of its longer-term analysis on the fiscal sustainability issues that are projected to emerge over the five- to 20-year horizon. For example, it should reinstate the tax-focused 20- to 30-year-ahead forecast chapters in *Fiscal Sustainability Reports*, which were part of those reports until 2014, but have not been since.<sup>71</sup>

The OBR could also create capacity for additional analysis of tax trends by publishing its *Welfare Trends Report* once every two years, rather than every year. The *Welfare Trends Report* is less pressing now that the government does not have a welfare cap limiting its social security spending.

Second, both organisations could provide different outputs for their reports and analysis that might reach different audiences. Big reports may put off, among others, parliamentarians looking to educate themselves on the tax system and its weaknesses. By providing short and accessible summaries of findings, and disseminating them widely, the OBR and the OTS could extend their reach and impact.

## **Building the evidence base for tax reform**

### ***Improve the systematic evaluation of policies and reliefs***

Monitoring and evaluation of tax reliefs by the Treasury and HMRC have improved in the past few years.<sup>72</sup> But the UK's processes are far from 'best in class' internationally, even though the cost of reliefs in the UK is among the highest. Effective evaluation of reliefs would generate a valuable evidence base of the strengths and weaknesses of the existing tax system and the benefits of reform and, in theory, ought to constitute the fifth stage of the policy-making process.

The Treasury should formalise the 'informal' process of evaluating reliefs that it has developed in recent years and the SPB team should ensure that these are joined up across the tax teams. The Treasury should set out clear conditions under which a relief would be reviewed, and publish the list of reliefs being reviewed internally each year so that the coverage of reliefs under this process can be externally monitored. The Treasury should also consider publishing these value-for-money evaluations.

The Treasury should also ensure that these evaluations are as rigorous as possible. This should include, as is the case in the Netherlands, applying a standard set of questions in the evaluations.<sup>73</sup> Where the evidence base is insufficient to answer these questions, the Treasury should work with the Knowledge, Analysis and Insight (KAI) team to identify any necessary analysis that should be undertaken. They should also follow the Irish example of having tax expenditure guidelines that specify when it is appropriate for the tax system to be used to promote or deter specific behaviours – for example, where there are demonstrable market failures.<sup>74</sup>

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A more systematic and rigorous process should also be applied to ex-post evaluation of policies more generally. This starts during the policy development stage, where the Treasury should specify how a policy could be evaluated against its objectives after its implementation. Giving thought to this during the policy development process should help to avoid the complaint that there is no rigorous way to evaluate whether a policy is achieving its objectives. The KAI team and the Treasury should work together to identify ahead of time when the necessary data will be available to evaluate the impact of major tax policies and prioritise timely evaluation.

Where those new policies are tax reliefs, the government should consider (where appropriate) incorporating 'sunset' clauses (as the guidelines in Ireland recommend).<sup>75</sup> This means that the policy would automatically stop taking effect unless it was explicitly renewed. The decision to renew should then be based on ex-post evaluation. To make this possible, the window before the relief expires should be chosen such that it is possible to evaluate the policy by that date. This process should help a government that wants to remove reliefs that are not successfully promoting objectives by requiring an active (rather than passive) policy choice to continue offering the relief.

For the Treasury to be able to evaluate tax policies and tax reliefs in this way, it is first necessary for the government to state what its objectives for policies are. This is supposed to be the first stage in the 'new approach' to tax policy making outlined earlier in this chapter and is generally articulated in Tax Impact Information Notes (TIINs).<sup>76</sup> The Treasury should explicitly refer to these objectives, and explain how they would measure success, when undertaking evaluation.

### ***Expand data resourcing and access***

The UK is behind other countries – in particular, the US and many Nordic countries – in using administrative tax data for research and policy development. Over a decade ago, researchers in the US were using tax microdata to estimate the 'taxable income elasticity' around kink points (that is, income levels at which the marginal tax rate increases) – such analysis allows policy makers there to understand precisely the impact of raising or lowering income tax rates on hours worked and tax revenues.<sup>77</sup> More recently, administrative data about parents and children has been linked together in the US to shed new light on social mobility,<sup>78</sup> while corporate tax returns have been used to show that a cut in dividend taxes in 2003 did not stimulate investment (contrary to popular belief).<sup>79</sup> Data in Norway has helped researchers to understand how business ownership affects inequality.<sup>80</sup> In Finland, research has quantified the effects on employment rates of extending unemployment benefits for older workers and shown how tax evasion increased in response to a change in car taxation.<sup>81</sup>

The government should allocate more resources in HMRC to the maintenance and analysis of tax policy to allow the government to make more effective use of the administrative data it holds, including new real-time information, and to learn more about how taxpayers respond to the tax system.



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This is an area where the interests of the academic community and the government align. The government does not need to carry out all possible analysis internally but should leverage the expertise and technical skills of academics and think tanks who are also interested in using the data to answer policy-relevant questions about the design of the tax system and its impact on the economy, people and tax revenues.

This process has started, but the HMRC Datalab is not leading to as many useful outputs as there could be. The problems are threefold.

First, access to the data is limited to research that helps HMRC to carry out its core functions, which excludes tax policy making. In theory at least, this prevents the government's data being used for research that the Treasury would find useful. Access to the data should be broadened. Under the Digital Economy Act 2017, data can be provided to researchers at the Datalab for any research deemed to be 'in the public interest'. This requires the Datalab to become an 'accredited processor' under the Act. HMRC should prioritise achieving this status.<sup>82</sup>

Second, researchers are only able to access the data in a secure room in Canary Wharf. This limits access for those researchers based outside London. At the very least, this slows down research. Other government data providers are able to provide researchers with secure remote data access. For example, the Secure Data Service (run by the UK Data Service) allows remote login from approved institutions.<sup>83</sup> HMRC should explore this model of data access, especially for the longer term.

Finally, the research process itself is slow because the Datalab is understaffed and researchers feel the data is sometimes poorly documented. An increase in Datalab resources – which are a modest part of the HMRC budget – would speed up the research process, allowing for more timely outputs and higher-quality analysis. This, in turn, would lead to more researchers using the data, answering policy-relevant questions and building up a richer academic tax community more generally.

### ***Work better with researchers***

As well as providing better access to data, there are other ways in which the Treasury can interact with researchers to ensure that they are feeding useful information into the policy process.

First, the Treasury should publish ARIs (covering both tax and non-tax areas) to indicate to research councils and academics which research would have most impact. This would benefit the Treasury because academics eager to affect policy will tailor their research agenda, while research councils are more likely to fund work that seeks to answer key policy-relevant questions for the government of the day. HMRC and the Treasury could also consider publishing a joint tax ARI document. As previous Institute for Government research has highlighted, good ARIs should be detailed and specific rather than vague and generic.<sup>84</sup>



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But ARIs should not be the end of the interaction with academics. While research of interest to the Treasury will often be fundable elsewhere, there may be specific questions that the Treasury would like to answer quickly. In these cases, they should consider commissioning research directly. Thus far, the research commissioned by HMRC mainly focuses on bespoke surveys that inform the government about economic activities not captured in administrative tax data. This is useful, but there are other ways HMRC's research budget could be used to promote tax policy making. Other departments have models for working with academics that have proved successful. For example, the Department for Education has built up a group of academics that it commissions to undertake rapid evidence reviews.<sup>85</sup> More formal engagement with academics would also help Treasury teams to build relationships with relevant researchers and mean that they could access their input when required, and when not curtailed by budget secrecy.

As well as considering whether the research budget controlled by HMRC with Treasury input can be used for broader types of research, the Treasury could also allow other departments to commission research on tax. It has been reluctant to do this in the past, but, for example, the Department for Environment, Food and Rural Affairs (Defra) could commission work on environmental taxation if the existing tax research budget was unable to accommodate it. As well as informing tax policy making in general, this would also allow a more informed discussion between departments on the role taxation might play in delivering government objectives.

## **Designing and implementing tax reform packages**

### ***Create space for long-term thinking***

If civil servants are to support reform effectively, they need to have the time and space to engage in longer-term thinking, and permission from ministers to use their time in that way. For many years, the tax teams' workloads have been dominated by the budget (or other fiscal event) timetable. The welcome move to a single fiscal event a year was designed to allow more time for this longer-term thinking, but a minority government and the diversion of resources towards preparing for Brexit (and more recently to tackling the economic impact of Covid-19) mean that this has not yet been realised.

The chancellor should in future hold a single fiscal event a year and avoid a return to the hyperactivity on tax that characterised the decade or so up to 2016.

Even with one fiscal event a year, the budget process can be more time consuming than it needs to be because a very large number of possible measures are prepared ahead of the budget. If the chancellor adopts a clear tax strategy, as we recommend above, this should enable civil servants to work on a better-targeted set of possible policies for the short term, allowing more capacity for long-term work and planning. A clear set of tax priorities and objectives from ministers would also help to direct the focus of long-term policy development.

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### ***Formally review the division of responsibilities in the tax policy partnership***

We noted above that the post-O'Donnell review division of tax policy-making responsibilities appeared to be well designed to promote strategic thinking and tax reform. However, not all aspects of the HMRC–Treasury partnership have worked as originally intended – for example, there has not been as much interchange between the departments, especially from HMRC to the Treasury, as was the case initially. Given it has been more than 15 years since the O'Donnell review, a formal review of the setup – to ensure it is conducive to meeting the government's objectives – is long overdue. Lord O'Donnell himself said that “it's terrible we haven't reviewed this”.<sup>86</sup>

### ***Monitor and improve the Treasury's development and deployment of tax expertise***

The tax career offer is a welcome development that looks to address a long-standing weakness in the Treasury tax teams: high turnover and a lack of deep tax expertise. Anecdotal evidence from junior Treasury officials suggests that the offer has made a positive difference and has led more people to stay in tax roles for longer. But to date, the Treasury has not collected the data needed to allow it to evaluate the impact that the offer has had. Monitoring this scheme is important. The offer is a generous salary increase. If it is not leading more people to stay in tax jobs for longer and develop their expertise, it might be an inefficient use of that money.

Where possible, the Treasury should try to increase the interchange with HMRC – including Treasury secondments into HMRC as well as the other way around. This would help to improve the tax knowledge of the Treasury teams and help the policy partnership to operate effectively in practice. The policy partnership board, which is headed up by directors-general from HMRC and the Treasury, should oversee this.

In recent years, the Treasury has also made greater use of external hires from private practice to enhance expertise. This is welcome, but while tax practitioners are hired in specific recruitment rounds, once inside the Treasury tax teams their careers are managed in the same way as those hired through a generalist route. As a result, their expertise is not necessarily exploited as effectively as it could be. The Treasury should manage these individuals better, either by assigning them to roles that make use of their expertise or at least by maintaining a central, accessible list of people's experience to which other civil servants could refer.

### ***Mitigate problems caused by high turnover***

Even if the tax career offer is successful in prolonging careers within tax teams and the Treasury continues to hire a steady stream of former tax practitioners, the broad nature of the Treasury's work and the desire of most civil servants within the department to experience a range of different policy areas mean that relatively rapid turnover will always be a feature of the workforce, which needs to be managed.

The Treasury therefore needs to mitigate problems caused by high turnover – in particular, by improving institutional memory so that civil servants do not have to 'reinvent the wheel' or repeat previous policy research and mistakes. This means that the memory is dependent on people, but if they move around often, this is problematic.

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Whitehall's knowledge management systems are generally poor, but the Treasury is ahead of many other departments: each team has 'knowledge management champions' and knowledge management is a part of every civil servant's objectives. However, there are further steps the Treasury could take to improve its institutional memory. In 2014, Dominic Cummings, when special adviser to the education secretary, proposed that Whitehall in general needed to create "'libraries plus internal historians' connected to departments' analysis teams that could not only answer the question 'did we already fail with X?' but would also be able to make public, on proper websites, as much information as possible for researchers and the general public to examine".<sup>87</sup>

At the very least, and as previous Institute for Government research has recommended,<sup>88</sup> the Treasury should publish research papers (either conducted internally or commissioned externally) as a way to improve institutional memory. Publishing papers makes them searchable for future civil servants, rather than relying on internal handover processes that risk knowledge being lost.

***The Treasury and HMRC should help think tanks deepen their understanding of implementation***

Think tanks put forward numerous tax policy proposals but often they are not as useful as they could be because they do not engage sufficiently with the difficulties of implementation. While there is a temptation to consider this as a 'next stage' that can be dealt with in isolation from policy design, in practice, design will need to be informed by implementation.

Think tanks that want their policy proposals to feed into the Treasury's process helpfully should take the time, where possible, to think through the practical implementation issues. This may include working with practitioners and tax lawyers who have expert knowledge of how the tax system works in practice and also consulting with Treasury officials. A recent project at the Institute for Fiscal Studies is a welcome example of a think tank trying to adapt its proposals and take implementation seriously. The project is looking to overcome practical and administrative barriers to implementing the ambitious proposals for reform to capital taxes set out in the Mirrlees review a decade ago.<sup>89</sup>

Acknowledging that think tanks' tax research resources are often very small (a team no bigger than a few people in most instances), Treasury officials should take the lead and talk to think tanks to help them understand the nature of implementation challenges and to explain how their work and proposals could be more impactful. This could be done through seminars or more informal conversations.

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## 5 Parliament's role in tax reform

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Tax reform combines high politics and deep technicality. Parliament is at the heart of this tension – charged with both the highly political task of authorising who the government taxes (and how much), and the technical task of legislating so that the complex tax system functions effectively. Any government seeking to make big changes to the UK tax system will need to secure parliament's approval, making it a powerful veto player.

Used sensibly, this veto power can prevent bad policy, enabling parliament to hold the government to account for poorly designed policies even when the government has a sizeable majority. For example, in 2008, the then chancellor, Alistair (now Lord) Darling, was forced to compensate those who lost out from the abolition of the 10p income tax rate – which Gordon Brown had announced the previous year – after vocal cross-party criticism of the effects of the policy on the low paid and the government's poor handling of the change,<sup>1</sup> despite the Labour government's majority of 66.<sup>2</sup>

But past practice shows it can also stand in the way of sensible reform. Philip Hammond came unstuck in 2017 when MPs criticised his attempt to (partially) address the preferential tax treatment of self-employment (relative to employment) by increasing Class 4 national insurance contributions (NICs). Many MPs became vocal mouthpieces for opponents of the reform despite economic commentators supporting it, with the Resolution Foundation describing it as a "small and sensible" change to address an anomaly in the tax system.<sup>3</sup>

### **How can parliament contribute to the tax reform debate?**

'Parliament' comprises various institutions and groupings, including the House of Commons and the House of Lords, committees in both chambers and backbenchers. Working well, it can contribute to the debate on tax reform in three ways.

First, effective scrutiny of new policy – which is predominantly undertaken in the Commons chamber and Commons Finance Bill Committee (with some input from the Lords Finance Bill Sub-Committee) – can reward the government for pursuing measures that contribute towards its tax objectives or address weaknesses in the existing system, while increasing the political cost of pursuing measures that do not. As we, along with the Institute for Fiscal Studies and the Chartered Institute of Taxation, showed in our *Better Budgets* report, parliamentary scrutiny of new tax policy is poor.<sup>4</sup> However, there are rare occasions when good scrutiny has promoted tax reform. One of the few effective parliamentary revolts on tax was in 1978 when Labour backbenchers Jeff (now Lord) Rooker and Audrey Wise inflicted a defeat on the Callaghan government and made inflation indexing of tax allowances the legislative default.

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This amendment helped prevent the erosion of non-taxable income in real terms, but also reduced the boost to the public finances that ministers received automatically from so-called 'fiscal drag', which had been a huge issue during the 1970s when inflation rates were in double digits. While scrutiny of new policies can facilitate tax reform, we do not focus on this aspect of parliament's role in tax in this report, as we covered it extensively in the *Better Budgets* report.

The second way in which parliament can contribute to tax reform is by highlighting problems with existing tax policy and how the system functions, and making the case for reform. This provides the government with ready-made support for change that it can react to. Select committees, which have access to additional resources and are well placed to build political consensus and hold the government to account, are a good vehicle for this work.\* Before the 2019 general election, the Treasury Select Committee (TSC) examined how well business rates adhered to its pillars of good tax policy.<sup>5</sup> The TSC also (as part of its report on the 2017 budget) questioned the effectiveness of the council tax precept in meeting increasing demand for adult social care.<sup>6</sup> The Public Accounts Committee (PAC) has also examined tax – publishing a report in 2015, which highlighted the poor scrutiny of whether tax reliefs provide value for money.<sup>7</sup>

Third, parliament can raise awareness of wider fiscal challenges – such as growing demand for social care or the desire to reach net-zero carbon emissions – that may necessitate tax reform. If parliament highlights these issues, it can increase the cost to the government of failing to act and so provide an incentive for the government to expend political capital to address them. Both Commons and Lords select committees have highlighted the challenge of funding adult social care and the need for tax reform to be part of the solution<sup>8</sup> – but there is little evidence to date to suggest this has shaped government action.

## **What does parliament do and is it falling short?**

Parliament is not as active in the tax reform debate as it needs to be if it is effectively to help overcome some of the barriers to reform.

### **The political nature of tax means consensus can be hard to reach, especially in a Westminster parliamentary system**

For many politicians, tax is simply too political to separate scrutiny of the system from the policy goals being pursued. This, coupled with the fact that many parliamentarians enter politics with clear political views on tax, makes it difficult for parliament to play a constructive role in the debate on tax reform.

The political nature of tax means that the economic and legal arguments around tax policy are sometimes swamped by political ones, making political consensus difficult, even within the TSC. For instance, TSC member John Mann was highly critical of the so-called 'pasty tax' in the 2012 budget, which sought to apply VAT to a small subset of hot food that was exempt. This policy was economically sound, marking a small step towards broadening the VAT base in the way the Mirrlees review advocated.<sup>9</sup>

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\* Select committees typically have four roles: holding the government to account, influencing policy, setting the agenda and engaging the public. See White H, *Select Committees Under Scrutiny*, Institute for Government, 2015, [www.instituteforgovernment.org.uk/sites/default/files/publications/Under%20scrutiny%20final.pdf](http://www.instituteforgovernment.org.uk/sites/default/files/publications/Under%20scrutiny%20final.pdf).

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But it proved politically untenable because it was seen as a 'tax hike' for ordinary people and little effort had been made to explain the need for reform.<sup>10</sup> On other occasions, such as when developing its 'principles of tax policy', the TSC has reached consensus, but largely by finding the lowest common denominator, agreeing on relatively uncontentious 'principles' that already had widespread support.<sup>11</sup>

Manifesto commitments ruling out increases in some, or all, of the main taxes<sup>12</sup> only serve to make the politics of tax reform more difficult, by limiting the sorts of tax reforms that politicians feel able to discuss openly.<sup>13</sup>

Extensive international comparative research by Wales and Wales suggests that, to some extent, the Westminster system of government, with an executive drawn from the legislature, tends to limit the ability of parliamentarians (that is, MPs and peers) to participate in the tax reform debate.<sup>14</sup> This is largely because of the government's near monopoly on policy initiation and the asymmetry of information and resources between the executive and parliament. These issues are exacerbated in the UK because the first-past-the-post electoral system commonly returns large parliamentary majorities; combined with traditionally strong party loyalty, this helps to concentrate power in the hands of the executive and makes effective parliamentary scrutiny of tax policy difficult.<sup>15</sup>

In contrast, the US congress has far greater powers to take part in tax policy – with greater powers of initiation and enough political independence from the executive to exercise its veto powers more actively. However, as Wales and Wales note, this does not contribute to better tax policy. The large number of potential veto players in the US system means that US tax reform has been "piecemeal and often unsatisfactory" as a result of policies needing to be constructed in such a way that they "simply command enough votes to become law".<sup>16</sup>

### **Most parliamentarians show little interest in tax reform, and when they do pay attention they are often reactive and focus on specific issues**

Conversations with current and former civil servants, politicians and practitioners confirm the view that, generally, parliamentarians are simply not interested in tax. One practitioner put it bluntly, telling us that "parliament doesn't do tax", while Lord Macpherson told us that "since the House of Commons came into existence because of the King wanting to tax his subjects, I'm surprised it doesn't take more interest".<sup>17</sup>

Parliamentarians tend to adopt a narrow and reactive approach to tax, often focusing on issues that their constituents or special interest groups have raised, such as the recent examples of IR35 off-payroll working (a form of disguised remuneration) and the loan charge. These sorts of issues can attract a level of parliamentary attention that is disproportionate to the numbers of people or amounts of money involved, in part because politicians often use 'rules of thumb' to determine which of the many issues that demand their attention they should respond to – including whether something is attracting media (or constituents') attention.<sup>18</sup> This is an example of what the Behavioural Insights Team have referred to as the 'availability bias' – that is, the tendency to think that an issue is important because it comes to mind easily.<sup>19</sup>



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It is an important and legitimate part of an MP's role to raise salient issues on behalf of their constituents – such as the loan charge, the implementation of which has caused substantial hardship to some people. But MPs must also look at other important issues. The matters raised by lobby groups may be powerful and salient but they are not always the most urgent or important aspects of tax policy in a non-political sense. There is a risk that narrow – but high-profile – aspects of the tax system attract political attention, at the expense of structural reform that would deliver much wider economic benefits.

Analysis of backbench business debates (that is, debates held on topics chosen by a committee of backbench MPs) during the 2017–19 parliamentary session illustrates the narrowness of MPs' focus. There were four backbench debates explicitly related to tax.<sup>20</sup> All covered very specific tax issues that had gained significant media and political attention (namely, air passenger duty, beer taxation and pubs, IR35 changes and the loan charge).<sup>21</sup> In contrast, many of the debates on another pressing policy issue – housing – covered broader topics, such as 'social house building' and 'British homebuilding activity'. Of the 476 subject-specific All-Party Parliamentary Groups (APPGs) (that is, groups established by parliamentarians to discuss topics of interest) registered as of February 2020,<sup>22</sup> only one is expressly related to taxation.\*

### **Most parliamentarians have a limited understanding of tax and related economic issues**

MPs – like the public more generally – tend to have a limited understanding of the tax system and wider economic concepts that are relevant to the tax reform debate (such as the shape of the income distribution).<sup>23</sup> Few MPs have professional or academic backgrounds in tax.\*\* Arguably, greater tax expertise is found in the House of Lords – including several former chancellors and Treasury permanent secretaries – but their knowledge may be dated.\*\*\* In any case, the House of Commons' primacy over financial matters<sup>24</sup> – that is, the special right of the Commons to decide public taxes and public spending, without challenge from the Lords – limits the role the upper chamber can play. The role of the Lords is generally restricted to technical issues of tax administration and simplification, primarily undertaken by the Lords Economic Affairs Finance Bill Sub-Committee.<sup>25</sup> The difficulty some MPs have in participating in tax debates is neatly illustrated by Ian Paisley's comments during the 2005 Finance Bill debates:

**"I am not an expert on tax, but I welcome the Bill even though I find many of its paragraphs hard to understand. I shall not go into detail, lest my ignorance be seen... In tax matters, one needs to consider the policy issues that lie behind proposed changes, and whether the changes will deliver the stated objectives. As the Bill makes its way through the House, I hope that hon. Members of all parties will have a full understanding of the consequences of what is proposed. The parliamentary process can struggle with such technical matters, in which very few hon. Members are expert."<sup>26</sup>**

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\* Some other APPGs – such as the APPG on Inheritance and Intergenerational Fairness – also consider tax.

\*\* As of 2017, only 3% of MPs were accountants. See, for example, [www.accountancydaily.co/3-mps-are-accountants](http://www.accountancydaily.co/3-mps-are-accountants), retrieved 24 March 2020. Only two MPs are chartered tax advisers.

\*\*\* One practitioner told us that the level of expertise in the House of Lords is often exaggerated, with House of Lords' experience commonly "20 years out of date".



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While effective scrutiny of the finance bill may require more technical knowledge than participation in the tax reform debate more generally, anecdotal evidence suggests parliamentarians are not always well equipped to engage with evidence on the need for tax reform or, therefore, to participate in debates on the trade-offs involved. We have heard that, in some cases, MPs rely on briefings provided by external interest groups, which can shape how MPs view tax issues and the points they subsequently raise in parliament.

Even within the TSC – the committee responsible for scrutinising tax policy – there is no guarantee of expert knowledge on tax or economics. Existing subject knowledge is not a precondition of select committee membership – subject matter expertise often derives from membership, rather than the other way around. However, parts of the election process do now favour those with expertise. Since 2010, the whole House has elected Commons committee chairs. This has incentivised those standing to highlight their credentials, including their interest and experience in the subject matter. All recent TSC chairs have experience as Treasury ministers or special advisers.

But political factors are usually still the main determinants of committee membership: by convention, the TSC is chaired by an MP from the party of government and being a member of the TSC is typically deemed one of the most influential and prestigious committee posts. Opposition parties can find that their scrutiny of the government is more effective if they elect members who understand the subject. However, the governing party often views expertise as a disqualification because of the risk that expert members will rock the boat and ask difficult questions of government.<sup>27</sup>

Several current TSC members have experience as Treasury ministers (or shadow ministers/spokespeople) or in financial services,<sup>28</sup> but none have an extensive background in tax.

### **Parliamentary committees do not focus on tax very often**

The TSC's high profile, cross-party composition and ability to adopt a holistic view of the tax system means it is well placed to examine the system as a whole and consider questions of tax reform.\* The committee's oversight of the Treasury and HMRC, and its ability to call Treasury ministers to give evidence (which other committees struggle to do), also allow the TSC to hold the government to account on the performance of the tax system.<sup>29</sup>

However, the TSC has been accused of neglecting the subject. Lord Macpherson remarked that "the Treasury Select Committee's interest in tax policy verges on the risible. What the Treasury Committee likes doing is beating up bankers and doing things which only have tangential relevance to the Treasury... there is virtually no scrutiny of strategic tax policy."<sup>30</sup> However, in part, this reflects the difficulties the committee faces in assessing tax policy in the absence of the government setting out a clear tax strategy or objectives for the tax system.

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\* Select committees' reports can be tagged to debates.

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The TSC tends to dedicate time and resources to high-profile issues of the day – such as the UK’s economic relationship with the EU,<sup>31</sup> IT failures in the financial sector,<sup>32</sup> the LIBOR scandal<sup>33</sup> and issues of tax administration such as making tax digital<sup>34</sup> – at the expense of long-term challenges such as reform of the tax system, which are likely to attract a much lower public and media profile.

Some of this limited focus on tax may be explained by the committee’s incredibly broad remit, encompassing all aspects of the economy as well as the work of the Treasury, HMRC and various arm’s-length bodies.<sup>35</sup> The TSC also holds a far larger number of pre-appointment hearings than other committees – including, for instance, for prospective members of the Bank of England’s Monetary Policy Committee. Understandably, the committee faces a daunting task in prioritising its limited time and resources in the face of such wide-ranging demands.

The TSC meets more frequently than any other Commons select committee – it met on 40% of sitting days during the 2017–19 parliamentary session – enabling it to manage a heavy workload.<sup>36</sup> However, the committee’s wide remit risks crowding out tax reform from its agenda – as has happened in the recent past – unless an active decision is taken to prioritise it.

Just 28 out of 203 (13.7%) TSC inquiries since the start of the 2010 parliament have covered tax in depth.\* This includes inquiries on budgets and autumn statements (which also cover wider economic matters). Beyond these, nearly all the other inquiries focused on specific taxes\*\* or issues of tax administration.\*\*\* Only one – the 2010 inquiry on the ‘principles of tax policy’<sup>37</sup> – addressed the structure of the tax system in detail. While the committee has referred to the conclusions of this inquiry report in its subsequent budget inquiries, this makes up only a very small part of its budget scrutiny and does not appear to have had a significant impact on government policy. The TSC does undertake a lot of work outside of formal inquiries and written publications – but it only occasionally sends letters on tax or raises tax issues in pre-appointment hearings.<sup>38</sup>

In contrast, it is common for other select committees to launch broad-based inquiries examining the functions of entire systems or policy areas. For instance, the Commons Environment, Food and Rural Affairs Committee has recently held inquiries on topics including improving air quality,<sup>39</sup> regulation of the water industry<sup>40</sup> and plastic food and drinks packaging.<sup>41</sup> The Business, Energy and Industrial Strategy Committee has held inquiries on thematic issues such as small businesses and productivity.<sup>42</sup> There is evidence that these inquiries have raised the public profile of the issues considered<sup>43</sup> and they show that parliamentary committees can play a valuable role in setting the agenda.<sup>44</sup>

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\* Institute for Government analysis of TSC inquiries, 2010–19 parliaments. Includes all inquiries on budgets and autumn statements and other inquiries explicitly on tax or where tax was a major topic of the inquiry.

\*\* For instance, ‘The impact of business rates on business inquiry’ (see [www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2017/inquiry3](http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2017/inquiry3)).

\*\*\* For example, the ‘UK tax policy and the tax base inquiry’, which focused predominantly on tax administration (see [www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/tax-policy-base-15-16](http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/parliament-2015/tax-policy-base-15-16)).

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Some of the gap caused by the TSC's limited focus on tax is filled by other committees – although the scope of inquiries launched by other committees is often limited. For instance, the PAC, which is responsible for scrutinising public spending, has reviewed tax expenditures<sup>45</sup> and played a key role in raising the profile of tax avoidance by multinational companies.<sup>46</sup> The PAC has a page on the parliamentary website dedicated to its tax work, unlike the TSC.<sup>47</sup> This is surprising given the TSC's primary responsibility for tax. Other select committees occasionally discuss the tax system as it relates to issues within their remit – including making recommendations for reform. For instance, the Commons Health and Social Care Committee recommended that a new 'social care premium' should be introduced to fund adult social care, with reform of council tax valuations and bands as an interim solution.<sup>48</sup>

Although it is welcome that departmental committees other than the TSC are looking at tax, there is a risk that such ad hoc scrutiny can lead to fragmented proposals for reform – often involving hypothecated taxes to fund particular public services – rather than considering reforms to the system as a whole.<sup>49</sup>

Despite not covering tax as often as it could, given the economic importance of the topic, the TSC is unlikely to be willing to relinquish responsibility for tax. Evidence submitted by the TSC<sup>50</sup> to the Commons Procedure Committee's inquiry on the establishment of a standalone budget committee (confusingly, to consider public spending, as opposed to the budget) shows that 'ownership' of policy issues can be highly contentious and spark 'turf' wars between committees. Such public tensions between committees can be counterproductive and prevent effective joint working that could help alleviate heavy workloads.

### **Parliamentary resources are used ineffectively**

It has often been said that parliamentarians lack the informational resources needed to play an effective role in holding the government to account on tax.<sup>51</sup> Many other legislatures – such as those in Australia<sup>52</sup> and Ireland<sup>53</sup> – provide expertise to parliamentarians through dedicated parliamentary budget offices, which the UK lacks.

However, while the UK does not have a parliamentary budget office, MPs and peers nonetheless have access to a comparable level of support. The only notable gap is that MPs in the UK do not have access to resources to cost their own policy proposals, which some parliamentary budget offices – like Australia's – provide.<sup>54</sup>

Members of the TSC are currently able to draw on a staff of 14 officials\* – including four economists and a secondeed from HMRC – who provide written and oral briefings to members, including on a one-to-one basis. Further specialist financial expertise is also available to select committees from the staff of the House of Commons Scrutiny Unit.<sup>55</sup> The National Audit Office also provides material (primarily on public spending but also covering tax reliefs and expenditures) to support parliamentary committees, most commonly the PAC.<sup>56</sup>

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\* This figure includes two administrative staff and a media officer, who do not brief members.

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Committee staff and MPs who are not members of any committees can make use of extensive publicly available information. For example, the Office for Budget Responsibility (OBR) fulfils many of the functions undertaken by parliamentary budget offices in other countries – such as producing independent fiscal forecasts, scrutinising costings of government policies, monitoring compliance with fiscal rules, and producing and publishing independent analysis and research. Much of the analysis the Office of Tax Simplification (OTS) produces is also relevant to MPs interested in scrutinising the effectiveness of the tax system. Further information is available from HMRC, which produces ‘issue briefings’ that provide MPs an overview of topical tax issues – although these are currently limited to specific areas of topical tax policy or administration, rather than issues of tax reform.<sup>57</sup> The House of Commons Library also produces useful briefings – often summarising the material produced by organisations like the OBR – to equip MPs to play a greater role in discussions on tax.\* Parliamentarians can also rely on research undertaken by their office, party staff, trade unions and select committees.

In some cases, there is informal co-operation between these different resources to ensure consistent briefing is provided to parliamentarians. For instance, the House of Commons Library’s specialists on financial matters are co-located with the TSC staff in the House of Commons offices.

The TSC has said the OBR could additionally be tasked with providing MPs with costings of their own tax policy proposals.<sup>58</sup> This could encourage MPs to propose reforms and may facilitate more informed debate, but would face some difficulties in practice, not least because the OBR currently relies on civil servants in other government departments to produce policy costings, rather than producing them in-house.<sup>59</sup>

In the UK parliament, the most pressing issue appears not to be the absence of expert support, but rather that the support that exists is diffuse, not always readily accessible and underused by parliamentarians. A former adviser to the TSC remarked that during their time helping the committee, few members sought sessions to help their understanding of tax. Similarly, some practitioners and civil servants have told us that when MPs have been offered briefings on tax matters from external experts, attendance has tended to be poor and that awareness among parliamentarians of material produced by independent bodies, such as the OBR, is low.

## How could things be improved?

Despite the difficulties identified, parliament has the potential to play a greater role in tax reform by putting issues on the agenda, holding the government to account for problems with the existing tax system, rewarding the government for acting appropriately to address these and increasing the political costs of failing to do so, and shaping public debate about the need for reform. Several changes could help parliament play a more effective role.

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\* For instance, its recent briefing paper on tax statistics includes contextual information, such as the impact of taxes across the income distribution, showing the disproportionately high impact of council tax on lower-income households (see Keep M, *Tax Statistics: An overview, Briefing Paper Number CBP – 8513*, House of Commons Library, 2019, <http://researchbriefings.files.parliament.uk/documents/CBP-8513/CBP-8513.pdf>).

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## Expert material and support should be made more accessible and attractive to parliamentarians

It is unrealistic to expect all MPs to have a detailed understanding of the tax system and the economics of taxation. They must balance the substantial and often-competing demands of representing their constituents, responding to events and pursuing their own political interests. As one former parliamentary adviser told us, MPs tend to “know as much about an issue as they need to”. However, it is important that MPs – particularly those sitting on committees – can make use of the information available so they have enough knowledge and understanding of tax to play an effective part in the tax reform debate.

Behavioural science suggests that making information easily accessible can reduce the barriers to engagement and help overcome any lack of interest. More could be done by those championing reform or those providing impartial information on the public finances to make politicians aware of their work and frame material on tax in a way that engages them.

The Behavioural Insights Team has highlighted research which indicates that politicians are more likely to support risky policies (that is, they are more likely to be risk-seeking) if they believe they are facing potential losses, while they are more likely to support less risky options (that is, they will behave as if they are risk-averse) if they believe they face potential gains as opposed to losses.<sup>60</sup> In the context of tax policy, this means politicians may be more likely to support tax reform (which could be seen as the risky option as it deviates from the status quo) if information given to them is framed to focus on the likely costs of failing to address problems with the tax system, rather than focusing on the gains that might be available from reform. For example, anyone seeking to persuade MPs of the merits of tax reform might have more luck if they highlight how MPs’ own constituents lose out under the current system rather than focusing on what they might gain from a new system. Parliamentary staff have told us that charts and infographics are also a useful means of communicating the trade-offs in tax policy to MPs.

The timeframe in which a policy issue is considered can also affect its salience. Understandably, politicians are partly driven by the electoral cycle, often making it hard for long-term policy challenges – such as tax reform – to gain political traction. The recommendation in Chapter 4 that the OBR and other organisations – such as think tanks – should present some of the material in the OBR’s *Fiscal Sustainability Reports* and *Fiscal Risks Reports* over a shorter – say 10-year – horizon could help address this concern, by highlighting those issues that will manifest more quickly.

Those seeking to increase the salience of tax reform among MPs and peers should also think about when it is most effective to intervene. Parliamentarians’ (and the public’s) attention can suddenly be directed at issues or events that are seen as needing a policy response. These behavioural shifts are known as ‘attention cascades’.<sup>61</sup> This tendency suggests that if an issue pertinent to tax reform – such as concerns about the fairness of pension tax reliefs<sup>62</sup> – hits the headlines, that is a good time to try to get politicians interested in related issues of long-term tax reform.

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Organisations that provide expert resources to parliamentarians could also make better use of formats that engage politicians. International practice suggests that presenting information in a form that politicians can put to immediate use and that is tailored towards their scrutiny function can increase engagement. For instance, the US Government Audit Office (equivalent to the UK's National Audit Office) provides background material on tax expenditures in the form of questions that members of Congress should ask about tax reliefs – such as whether a relief meets its stated purpose and how it relates to other government policies.<sup>63</sup>

Parliamentary staff could also do more to signpost existing material to politicians. Understandably, the induction process for new MPs is primarily focused on administrative matters, such as setting up offices and explaining the expenses system.<sup>64</sup> However, the House of Commons Library does publish helpful *Key Issues* briefings for MPs at the start of each parliament, which often contain material on topical tax issues.<sup>65</sup> These could be enhanced to set out more clearly the trade-offs involved in tax policy and the longer-term structural problems, and point MPs towards additional sources of information, such as material produced by the OBR, the OTS, HMRC and think tanks.

Expanding the remit of HMRC issue briefings to include more introductory material on the structure of the tax system, and the challenges facing it, would also be beneficial. Structured briefings from the OBR and the OTS to new MPs could also provide useful context and highlight the valuable contributions made by both organisations to the tax reform debate. As acknowledged above, previous efforts to offer such briefings have suffered from poor uptake by MPs. While this will remain a challenge, offering such briefings ahead of high-profile events such as the budget could help to increase participation.

### **The TSC chair should champion tax reform**

The TSC chair has the potential to act as an influential non-government spokesperson on the economy and could be key to raising the salience of tax among parliamentarians and the public. As a member of the governing party, they are also well placed politically to work with the government to create political space for reform.

It is welcome that the current TSC chair, Mel Stride, expressed interest in reviewing certain aspects of taxation – such as business rates and tax reliefs – both when first elected<sup>66</sup> and when reappointed in January 2020.<sup>67</sup> Building on this mandate, his valuable experience as the Treasury minister responsible for tax, and after a period with numerous TSC chairs, he should ensure tax reform is firmly on the committee's agenda.

### **The TSC should focus on tax more often**

Given the TSC is well placed to consider tax matters – and given its apparent discomfort at other committees looking into the subject – it needs to put tax on its agenda more often. The committee should commit to a long-term programme of work on tax, focused on the principles of an effective tax system and the government's long-term tax strategy.



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One of the strengths of committees is their ability to influence political debate and government policy over time. For example, the PAC's work on the taxation of multinationals raised the public profile of the issue and put pressure on the government to act. Similarly, the recent parliamentary attention on the loan charge – partly driven by the APPG on the subject – has maintained political focus on the issue. Evidence from the Behavioural Insight Team's *Behavioural Government* report suggests that policy makers tend not to act immediately on policy issues, but rather 'wait and see' if anyone else acts and then follow suit.<sup>68</sup> The TSC could, therefore, play a powerful role in influencing how policy makers behave, if they highlight tax reform issues. The committee's cross-party nature also means its work can provide government with a sense of where political opinion in the House of Commons lies.

'Standing inquiries' (those repeated at regular intervals) can provide a useful hook to support this activity, by helping committees maintain a dialogue with the government and key stakeholders over time. This work can also bring matters to the attention of MPs on a regular basis. Helpfully, much of the TSC's work is of this nature – such as its routine inquiries into budgets. These include oral evidence sessions with the chancellor, senior civil servants and representatives from the OBR, followed by a report usually published within a matter of weeks (and before parliament has approved the finance bill).<sup>69</sup> Such standing scrutiny focuses the attention of the committee and requires the government to respond.

At the moment, these inquiries provide only a limited forum to address the need for tax reform. For instance, OBR evidence to budget inquiries draws on the OBR's *Economic and Fiscal Outlook* report – published alongside the budget – which highlights areas where the government has introduced measures that only temporarily help meet the fiscal rules but do not support longer-term fiscal sustainability. The TSC could go further in these inquiries to support tax reform by probing whether new tax policy measures contribute to fiscal sustainability and to the government's other objectives for the tax system. This would reward the government for taking decisions that did contribute in this way but impose political pressure if the government's adopted measures did not.

The TSC's ability to act in this way would be helped by the government clearly articulating its objectives for the tax system and explaining how policies furthered those objectives. As former Treasury permanent secretary Andrew (now Lord) Turnbull told us, "parliamentary scrutiny is not helped by the lack of a framework on fiscal policy or taxation that outlines what they are trying to do. Those frameworks need to be better articulated, so that each time a measure comes up you can see how it fits into it."<sup>70</sup> Producing a list of objectives could help counter the political divisions over tax policy noted above, by providing parliamentarians with a set of external standards against which to judge government policy, even if committee members disagree on the substance of the objectives.



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This approach has worked in other areas of policy. For instance, one of the key objectives of Universal Credit was to get people into work. During the 2017 budget inquiry, the TSC was able to evaluate whether the high taper rate on Universal Credit payments supported this objective.<sup>71</sup> Adopting clear objectives for the tax system has also been supported by the former TSC chair, Andrew Tyrie, who said: "Discussions about many tax policy measures are partisan... Scrutiny should focus on whether the measure is likely to achieve its stated objectives..."<sup>72</sup>

However, there is a risk that the highly political nature of tax means politicians may disagree over the substance of the government's objectives for the tax system to an extent that they do not provide a common metric against which to scrutinise government policy – meaning clearer objectives would not guarantee more effective parliamentary scrutiny.

The TSC could also do more by holding inquiries into the OBR publications that are most pertinent to tax reform, which it has not routinely done in the past. For instance, the OBR produces biennial *Fiscal Risks Reports* and *Fiscal Sustainability Reports* – examining the sustainability of the UK tax base and the future risks that may necessitate tax reform.<sup>73</sup> The TSC should commit to holding inquiries in response to these publications in order to provide regular opportunities to review the long-term fiscal sustainability of the tax system as a whole and the adequacy of the government's response. The committee could try to cover these issues in its budget inquiries – pressing the issues in oral evidence sessions with Treasury ministers and the OBR – but that approach may be less effective, given the risk that budget inquiries become dominated by high-profile budget measures.

Making greater use of the Treasury sub-committee could help manage the TSC's heavy workload. The sub-committee has typically comprised of all the members of the TSC, but with a different chair, who has typically been from the main opposition party. Using this format may be an effective way of focusing the TSC's attention on tax and raising the salience of tax issues within parliament. The sub-committee chair – being from the opposition – is also likely to be more willing to ask difficult questions of the government. The sub-committee has been used to examine tax issues in the past, though typically focuses on issues of tax administration or narrow, high-profile topics. During the 2017–19 parliamentary session, the sub-committee published just one report, entitled *Disputing Tax*, examining public concerns about tax avoidance and evasion and HMRC's approach to tax disputes.<sup>74</sup> The chair of the sub-committee also wrote to the chief executive of HMRC about the loan charge.<sup>75</sup> However, while there is scope to use the sub-committee more extensively, it has previously suffered from periods of inactivity and there is a risk that some people could see it as a downgrade in the level of political importance given to tax.

Other tax issues – such as the taxation of specific parts of the economy, particularly where tax is only one of the levers at the government's disposal – are more amenable to ad hoc inquiries that could be tied to specific events and take place over a longer period, allowing more in-depth examination of the issues. As discussed below, these inquiries may benefit from greater co-operation between committees.

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## Parliamentary committees should work together more often

Given the wide-ranging economic, social and political impact of the tax system and tax reform, it often makes sense to consider tax issues holistically. Better co-operation between existing parliamentary committees could be a constructive way to address this wide-ranging impact and draw on different sources of expertise and political influence within parliament. It could also help to address fears that fragmented parliamentary scrutiny of tax can encourage fragmented solutions rather than system-wide reform. Under existing parliamentary rules, there are various ways committees can work together.<sup>76</sup>

Committees can already hold joint inquiries. For example, there was a recent inquiry on the long-term funding of adult social care, undertaken jointly by the Commons Health and Social Care Committee and the Housing, Communities and Local Government Committee – although, given the subject matter, it is notable that the TSC was not also involved.<sup>77</sup> It is likely that some aspects of taxation would benefit from joint inquiries. For instance, an inquiry on the housing market and property taxation would benefit from the combined input of the TSC and the Housing, Communities and Local Government Committee.

Similarly, tax policy may play a key role in addressing climate change – inviting co-operation between the TSC and the Environment, Food and Rural Affairs Committee. The TSC and the PAC also share a common interest in tax reliefs – and joint working could be an effective way of limiting unhelpful tension between these two politically powerful committees. As Treasury ministers are usually reluctant to appear before parliamentary committees other than the TSC, joint working could be an effective way of directing ministers' attention to broader tax and fiscal issues.

Beyond formal joint inquiries, greater use could be made of the 'guesting' procedure, which enables committee chairs to permit members of other select committees to take part in committee proceedings – such as evidence sessions – but not to vote. The TSC recently made use of this procedure during its inquiry on business rates, inviting members of the Housing, Communities and Local Government Committee to attend oral evidence sessions.<sup>78</sup> It is also common for committee chairs to write joint letters to the government on matters of mutual concern, which provides a useful way of signalling the strength of parliamentary feeling on important issues.<sup>79</sup> The TSC chair should make greater use of such letters, when relevant.

There may also be scope for greater joint working between the Houses of Parliament, to make use of the tax expertise and capacity in the Lords. As recommended in our *Better Budgets* report, the upper chamber – either through the Lords Economic Affairs Committee or an ad hoc committee – could play a greater role in post-legislative review to assess the extent to which tax policy has met its objectives and to hold the government to account for the quality of its decisions.<sup>80</sup> Given post-legislative review does not directly interfere with new policy, it is less likely to be perceived of as a threat to Commons financial privilege.

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As former chancellor, Lord Darling told us, “something else the House of Lords can do... probably due to the benefit of not having to get re-elected, is... float ideas”,<sup>81</sup> citing the recent Lords Economic Affairs Committee report on funding long-term social care,<sup>82</sup> which achieved cross-party support that “the House of Commons might find more difficult”.

However, given the sensitive nature of Commons financial privilege, any greater role for the Lords would need to be sanctioned by the Commons; and peers, as ever, would need to be mindful of the need to avoid undue duplication of work.

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## 6 A tax commission could pave the way to reform

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As the earlier chapters have shown, one of the main reasons governments find it difficult to make reforms of the tax system is that there is widespread ignorance of how the tax system currently operates, what its shortcomings are and, therefore, the need for change. This pervades not only the general public but also politicians. While it is perfectly understandable that levels of knowledge are low, given the complexity of the tax system and the technicality of principles of good tax policy, it severely hampers efforts to improve the system. A tax commission could help address this.

Contentious policy areas are often subject to external reviews, inquiries or commissions, with varying levels of government involvement, which can help establish the facts, encourage debate and develop consensus on the issues. Our analysis of tax commissions and reviews in other countries – and commissions on non-tax policy questions in the UK – suggests that this could be an effective way of improving public debate and making space for reform. For ease of exposition, we will refer to all of these as ‘commissions’.

The UK government has never set up such a commission on tax, although it has used this approach for other contentious policy areas – such as the Pensions Commission led by Adair (now Lord) Turner and the commission on social care led by Sir Andrew Dilnot. The only comprehensive reviews of the UK tax system have been conducted entirely independently of government – notably, the Meade review (1975–78)<sup>1</sup> and the Mirrlees review (2006–11).<sup>2</sup> But in several other Westminster-style democracies, governments have from time to time commissioned independent reviews on tax, notably in the 1970s and in the run-up to, and the aftermath of, the financial crisis in 2008. Examples include the Asprey review (1975)<sup>3</sup> and the Henry review (2008–10)<sup>4</sup> in Australia, the New Zealand Tax Working Groups (in 2009 and 2017) and the Irish Commission on Taxation (2008–09).<sup>5</sup> These have had differing degrees of success.

Some of these previous commissions have expended a lot of time and effort into establishing and laying out the intellectual underpinnings of good tax design and identifying where the rules of the system fall short. For the UK, a lot of this work has already been done by the Mirrlees review. A new tax commission could draw heavily on this intellectual effort and instead devote its energies to strengthening the empirical evidence base on the scale of the problems and opening up debate more widely to educate the public, while also developing a deeper understanding of how they view these issues. A tax commission could also provide a forum to debate how the state should be funded after the Covid-19 crisis.

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We therefore focus our remarks in this chapter on identifying the features of a tax commission that would maximise its effectiveness in:

- building an evidence base for reform that is comprehensible to a non-expert audience and, as far as possible, quantifies the costs of failing to act
- convincing the public of the need for change and laying out options for reform
- providing governments with political cover to take difficult decisions.

To do so, we draw on evidence from previous commissions. Table 1, overleaf, provides a summary of the commissions we refer to. More detailed information on the tax commissions is provided in the Appendix; and further information on the non-tax commissions is available in an earlier Institute for Government report entitled *How to Fix the Funding of Adult Social Care*.<sup>6</sup>

**Table 1: Commissions used in report research**

		Features of a successful commission							Factors to consider	
		Government buy-in from the start and a formal government response after publication	Chair able to advocate for the commission, sell the reforms and manage other commissioners	Appointment of commissioners with a variety of expertise, experience and perspectives	A clearly defined purpose and scope	Sufficient resources and access to government data to build a strong evidence base	Extensive public engagement	Two-stage reporting: interim report providing evidence base, final report making recommendations	Number of people on the panel	Length of time
Tax commissions	Meade (1975–78)	✗	Vice-chair played key role	Partially	Scope limited during review	No government resources	✗	✗	11	2 years
	Mirrlees (2006–11)	✗	✗	✓	✓	No government resources	✗	(✓)	10	5 years
	Henry (Australia, 2008–10)	✓	✗	✓	✗	Predominantly civil service secretariat	Limited	✗	5	19 months
	Ireland (2008–09)	✓	✓	✓	✓	Limited civil service secretariat	✓	✗	18	19 months
	Tax Working Group (New Zealand, 2009–10)	✓	✓	✓	✓	Predominantly civil service secretariat	✓	✗	19	20 months
	Tax Working Group (New Zealand, 2017–19)	✓	✓	✓	✓	Predominantly civil service secretariat	✓	✓	11	15 months
UK non-tax commissions	Pensions Commission (2002–06)	Prime ministerial buy in. Chancellor reluctant	✓	✓	(Chair redefined) ✗	Commissioned external resources	✓	✗	3	4 years
	Dilnot Commission (2010–11)	✗	✓	✓	✓	Commissioned external resources	White paper consultation period after publication	✗	3	1 year
	Parliamentary Commission on Banking Standards (2012–13)	✓	✓	✓	✓	Commissioned external resources	✗	Multiple reports on different topics	10	12 months

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## Government buy-in and a formal response is important

Successful commissions have typically been established by – or received explicit support from – the government and have strong buy-in from senior ministers, including the prime minister and the chancellor in the UK. Ensuring political commitment from the outset makes it more likely that the government will engage constructively with the commission and its recommendations.

Commissions that are too distant from government are often criticised for not paying enough attention to the political context in which reform must take place. “You can have a great policy, and it’s just not implementable,” warns Ed Balls.<sup>7</sup> Ultimately, only the government of the day can decide what political trade-offs it is willing and able to make to achieve reform.

The Mirrlees review failed to gain traction, Lord O’Donnell told us, because “it was someone [else] telling government what to do”<sup>8</sup>. Summarising the problems in trying to get government buy-in at a later stage, Sir Edward Troup said: “Let me be brutal, the Treasury tax teams were just rubbing their eyes when somebody came in and talked about Mirrlees.”<sup>9</sup>

But even commissions that have been established by the government have sometimes suffered from a lack of political support. In earlier work at the Institute for Government we described the Dilnot Commission as “a prime example of an inquiry undermined by a lack of high-level political support”, as it failed to secure the full support of the then chancellor, George Osborne.<sup>10</sup> Conversely, Osborne’s strong support for the Parliamentary Commission on Banking Standards (PCBS) helped ensure the government took the recommendations seriously.

As several of our interviewees noted, Gordon Brown was renowned during his time as chancellor for using notionally independent commissions to provide evidence to support a course of action the government already wanted to pursue. Lord O’Donnell told us that, “in general [Brown] knew what he wanted, [the] Treasury knew what it wanted, and it was obvious what was needed. There were plenty of serious independent experts who felt the same. All we needed was to have one of them lead the process, with Treasury staff writing the report. That way we had one of the great and good advocating a sensible solution which we could then implement knowing it had ministerial backing”. This was the case, for example, with the Wanless review,<sup>11</sup> which laid the groundwork for the Blair government to announce a large increase in NHS spending alongside an increase in national insurance contributions. With a large parliamentary majority at the time, the Labour government had less need to use these commissions also to build cross-party support.

However, commissions are more likely to provide a valuable contribution when they have the freedom to assess the evidence impartially and make unencumbered recommendations for change. Some independence from government can afford the commission greater freedom to consider the subject in depth and make ‘the best’ recommendations from an academic standpoint, even if they are politically unpopular. A commission that is seen as being somewhat independent from government can also help the government ride out political opposition to its findings. As Balls told us, once it publishes its findings, the commission becomes the ‘seller’ of its recommendations



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to the government, and a degree of distance from government gives ministers a degree of flexibility in how to respond.<sup>12</sup> If the government chooses to adopt the recommendations, an independent chair becomes a credible advocate for the policies, providing the government with some political cover.

In their study, Wales and Wales concluded that the 2009 New Zealand Tax Working Group “probably got the balance about right” between government involvement and independence.<sup>13</sup> It was led by the University of Victoria, with government support from the New Zealand Treasury and Inland Revenue departments. It was tasked with considering the medium-term direction of the New Zealand tax system and the pros and cons of options for reform in the wake of the financial crisis. Its set-up meant it was able to draw on government resources, but without conceding drafting rights.

To help ensure that the government does engage constructively with our proposed tax commission and its recommendations, it is important that the government commits to respond publicly, in a timely manner, to the findings after they are published. Although governments can and do renege on such promises,<sup>\*</sup> such a commitment makes it harder for the government to ignore politically difficult findings and helps promote a wider public dialogue about the commission’s report. The Henry review in Australia<sup>14</sup> provides a cautionary tale – in that instance, the commission’s recommendations lost momentum after the government took a long time to allow the publication of, and then respond to, the commission’s findings.<sup>15</sup>

## **A chair to advocate for the commission, sell reforms and manage other commissioners**

Chairing a commission on a contentious policy area – like tax – is a difficult task. Experience suggests that commissions are more likely to be successful when chaired by someone perceived as independent of government, capable of making a compelling case for reform and able to manage the competing views represented on the commission.

While the chair needs to have the intellectual ability to grasp the complexities of the issue at hand, deep expert knowledge may be counterproductive. An expert chair may be constrained by what they have previously said on the subject and be open to accusations of bias that undermine the credibility of the commission. For example, the findings of the Oakervee review into the High Speed 2 (HS2) rail project<sup>16</sup> were brought into question (in part) by the chair’s pre-existing position on the subject matter. A good example of a non-expert chair is Lord Turner, who chaired the Pensions Commission. As a former consultant and director-general of the Confederation of British Industry (CBI) from 1995 to 1999, he was well respected among stakeholders, had the skills to grasp the subject matter and could distil a simple and compelling message from a mass of technical evidence.<sup>17</sup> Mary Warnock, an academic philosopher, who chaired the Inquiry into Human Fertilisation and Embryology, was also widely praised, with former health secretary Frank Dobson describing her as an “inspired choice” who was “clear, concise, persuasive and to the point”.<sup>18</sup>

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\* For example, the government committed to respond within a year to the July 2018 National Infrastructure Assessment from the National Infrastructure Commission (National Infrastructure Commission, *National Infrastructure Assessment*, National Infrastructure Commission, 2018, retrieved 20 March 2020, [www.nic.org.uk/publications/national-infrastructure-assessment-2018](http://www.nic.org.uk/publications/national-infrastructure-assessment-2018)). But that response has yet to appear.

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It is helpful if the chair of the commission is willing to hold the government to account publicly on an ongoing basis, even after the commission's work has ceased, so that the government continues to be challenged on whether it has adequately responded to and implemented the promised reforms. Lord Tyrie in particular, as chair of the Treasury Select Committee (TSC), had a good platform from which to do this after the findings of the PCBS were published.<sup>19</sup>

One of the difficulties commission chairs can face is disagreement among commissioners. As we describe in the next section, there are benefits to having a range of different perspectives represented on the commission but public disagreement between members and the production of dissenting reports can undermine the commission's success.\* An effective chair must therefore be able to manage the competing views and interests of commissioners. Lord Tyrie – as chair of the PCBS – skilfully showed this by setting up panels (akin to sub-committees) through which members could pursue their interests without compromising the overall focus or findings of the commission.<sup>20</sup>

### **Appoint commissioners with a variety of expertise, experiences and perspectives**

Commissions are most likely to be successful when they include a range of commissioners, who are able to secure support from key stakeholders. The 2009 New Zealand Tax Working Group, for example, is widely seen to have been successful, at least in part, because it comprised a wide-ranging panel “of [19] academics, tax practitioners, business people and tax officials”.<sup>21</sup> The Turner Commission also managed to reflect a range of perspectives among its three commissioners, who provided perspectives from business (Lord Turner), workers (Jeannie Drake, who had been president of the Trades Union Congress) and academia (Professor John Hills).

However, while they have worked in the past, having a large number of commissioners can make it more difficult to reach unanimous agreement on a set of recommendations. Commissions that fail to reach a unanimous conclusion or publish dissenting findings – such as the 1999 Royal Commission on Long Term Care<sup>22</sup> – are less likely to be successful in building consensus and may make it easier for the government to reject recommendations.<sup>23</sup> Larger commissions can also face greater logistical challenges, such as diary clashes. If a government favours a large commission, it should carefully consider how this could complicate the group dynamic.

Not all interest groups need to be represented on the board of commissioners, however. Too large a board can be unwieldy<sup>24</sup> and make it difficult to reach agreement. There are other ways that interest groups can be brought on board instead. The PCBS, for example, was comprised entirely of parliamentarians (including non-political appointees, such as the Archbishop of Canterbury, Justin Welby).

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\* A counter example is the Warnock report into human fertilisation and embryology (Warnock M, *Report of the Committee of Inquiry into Human Fertilisation and Embryology*, HMSO, 1984). As this issue involved strong moral and ethical positions, Mary Warnock included expressions of dissent in the report, stating that if it had been undivided “then it would inevitably also have been unrepresentative”.

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The commission compensated for the lack of stakeholder representation on the panel by holding extensive evidence sessions with the support of a QC (an experienced barrister), hearing from more than 250 witnesses and publishing 5,000 pages of evidence in total.<sup>25</sup>

Past practice suggests that allowing the chair a degree of influence in the composition of the commission can be an effective way of ensuring it works well together. For instance, Lord Tyrie liaised with the then chancellor and shadow chancellor to select the membership of the PCBS. While governments are usually unwilling to grant the chair such autonomy, the appointment procedure should always be transparent.<sup>26</sup>

When appointing commissioners, the chair and government must also be mindful of public perceptions, particularly in a subject area as politically sensitive as tax. For instance, appointing a capable tax expert with a history of advising politically controversial clients could undermine public trust in the commission and weaken its authority. The recent resignation of a member of the ongoing inquiry into the Grenfell fire tragedy – after it emerged she had links to the charitable arm of a firm that supplied the tower block’s cladding – shows how inquiries can come unstuck if the impartiality of commissioners is called into question.<sup>27</sup>

### **Clearly define purpose and scope**

Commissions are more likely to be successful when the purpose and scope of the review are clearly defined and thought through before the commission is established – and certainly before the commission issues any call for evidence. The scope should focus on the problem to be addressed, rather than predefining a solution. The Chilcot Inquiry into the Iraq war, for example, failed to satisfy stakeholders because they had differing expectations about what the review was trying to achieve.<sup>28</sup>

Balls, recalling his experience working on inquiries during the New Labour government, explained that “the purpose of the review [has] to be clear from the start,” advising that commission chairs “should wait a few weeks before they go out with their call for evidence because actually the first thing they have to do is absorb what the issues are and make sure the questions they’re asking are really the right questions”.<sup>29</sup>

The scope of previous tax commissions has been broad – although there has been some variation. For instance, the Mirrlees review looked at the tax system in its entirety, while the 2017 New Zealand Tax Working Group was prohibited from considering large parts of the tax system, including increases in income tax or general sales tax, inheritance tax or the taxation of the family home and the land under it.<sup>30</sup> Both tax commissions with and those without limitations on their scope have had success in the past. Restricting the scope of commissions can be appropriate – for instance to exclude areas that are so politically sensitive that there would be no scope for action and could simply unduly politicise the commission’s findings. The 2009 Irish Commission on Taxation, for example, was told from the outset that it could not recommend changes to the 12.5% rate of corporation tax.

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This restriction on the remit resulted in one of the 18 commissioners (a trade union representative) refusing to sign up to the final recommendations – but the disagreements may have been more severe or the government may have been less likely to adopt the recommendations if reforms of corporation tax had been in scope.\*

However, governments should be careful not to define the scope of a commission too narrowly, as doing so may prevent effective consideration of the subject matter. Such narrow drafting nearly undermined the Pensions Commission – its terms of reference were initially drafted to exclude consideration of the state pension. This glaring omission led the chair of the commission – Lord Turner – to effectively rewrite the terms of reference to ensure the commission could properly review the UK pension system.

Unclear terms of reference can, however, be more harmful than those that are restricted but clear in scope. The limited political success of the 2009 Henry review in Australia has partly been attributed to a lack of clarity about its scope. It was initially pitched as a “comprehensive ‘root and branch’ review of the tax system”,<sup>31</sup> only to then be restricted from examining the Goods and Services Tax.<sup>32</sup> The commissioners then chose to restrict themselves further, ruling out changes to other areas of tax policy such as carbon pollution policy and legislative drafting.<sup>33</sup> As two Australian officials involved in the Henry review told us, it was undermined by disagreement on the panel as to what it was hoping to achieve: the governing panel was torn between producing a comprehensive description of the ideal tax system and putting forward a package of reforms that the government could deliver immediately.

## **Provide enough resources and access to government data**

Commissions rely on the support of secretariats to conduct research, organise evidence sessions and analyse data. These secretariats constitute the biggest expense for commissions.<sup>34</sup> Most commissions established with government support are able to draw on a secretariat at least partly made up of civil servants, although these are commonly supplemented by secondees with business or academic expertise.

Tax commissions are likely to be able to build a more convincing evidence base – of the sort described in more detail in Chapter 4 – and make stronger and clearer recommendations if they are able to access administrative tax data. This data is needed to analyse the existing system properly and accurately estimate the cost and impact of proposed reforms. Since access to this data is restricted in the UK, as discussed in Chapter 3, a tax commission would need to be supported by analysts from HMRC’s Knowledge, Analysis and Intelligence (KAI) team.

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\* There has been political consensus on corporate tax rates between both main political parties in Ireland – Fianna Fáil and Fine Gael – since the 1950s, suggesting there has been little political space for corporation tax reform. In the 2007 general election, preceding the 2009 Commission on Taxation, both parties had committed to the 12.5% rate of corporation tax (Fianna Fáil, *Now, the Next Steps: Fianna Fáil manifesto 2007*, Fianna Fáil, 2007, [www.drugsandalcohol.ie/6306/1/3823\\_now\\_the\\_next\\_steps.pdf](http://www.drugsandalcohol.ie/6306/1/3823_now_the_next_steps.pdf); Fine Gael, *General Election Manifesto 2007*, Fine Gael, 2007, <http://michaelpidgeon.com/manifestos/docs/fg/Fine%20Gael%20GE%202007.pdf>).

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Involving civil servants in commissions not only allows them to develop a strong evidence base, including by drawing on government data, but can also help create a climate for action within government once the commission has reported. Due to their high profile and intellectually stimulating subject matters, commissions in the UK have tended to attract high-calibre civil servants.

## **Undertake extensive public engagement**

Tax reform is often complicated and technical, making public debate difficult. However, as our previous work on commissions has shown, extensive public engagement can be an effective way of ensuring better policy making, building public awareness and proving to key stakeholders that the public argument for reform can be won.<sup>35</sup>

The 2009 New Zealand Tax Working Group is a good example of how to hold a transparent public engagement process. It published the minutes from its meetings online and commissioners undertook extensive media engagement.<sup>36</sup> Similarly, the UK Pensions Commission took a “very active stakeholder approach” to build support among the pensions industry and the general public. The commission held several ‘pension days’ involving focus groups across the country.<sup>37</sup>

Public engagement is likely to be most effective when undertaken from the beginning of the process, as it can reveal the existing state of public opinion, expose problems that expert stakeholders alone may not detect, and identify solutions that politicians may assume are politically unpalatable but which enjoy surprising levels of public support. A lesson from officials involved in the Henry review in Australia is that discussions with members of the public have less impact if they happen later in the process. A failure to engage the public early enough in the decision-making process has also undermined the delivery of major infrastructure projects in the UK.<sup>38</sup> Improving public understanding would be an important by-product of a tax commission that communicated effectively with the public.

## **Separate the evidence of the case for reform from the recommendations**

“One of the mistakes you could make in tax policy making is just assuming that the case for change is clear and therefore you just jump straight into the measures,” said Balls.<sup>39</sup> However, as Chapter 2 makes clear, public understanding of the tax system and the need for reform is limited. It is, therefore, important for a tax commission to establish the evidence before moving on to setting out possible reforms and its preferred options. “[It is] important to have an interim report which wasn’t about policy,” Balls said, but about “purpose and principles.” “That is the point when you really start to win the argument... if you get a good reception from stakeholders to your interim review, they’re then with you on the ‘how’, whereas if you haven’t won that argument, they’re never going to come with you on the ‘how’.”<sup>40</sup>

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Publishing an interim report provides an opportunity to draw together the relevant stakeholders and use high-quality evidence to build a compelling case for change. Once the interim report is published, a second report recommending solutions to the problems identified stands a greater chance of being implemented.

The Wanless review on the future of the NHS used such a two-stage process well. An interim report, published in November 2001, showed that the UK had fallen behind other countries in terms of health outcomes; and the final report, five months later, built on this to recommend a substantial increase in resources for health and social care.<sup>41</sup> Similarly, the interim report of the Pensions Commission<sup>42</sup> was crucial in building a broad consensus on the problems of long-term pension inadequacy in the UK, ahead of the commission publishing its recommendations.<sup>43</sup> The interim report allowed Lord Turner to declare convincingly that anybody who tried to offer an easy solution was a “charlatan”.<sup>44</sup>

The Tax Working Groups in New Zealand are also good examples of a clearly outlined, multi-stage process for reporting. The first Tax Working Group, in 2009, focused significant attention on convincing the public and politicians of the need for reform. By January 2010, a poll conducted by Shape New Zealand indicated that 79% of people thought the tax system needed reforming<sup>45</sup> – despite the fact that, in the words of its chair, “just 12 months earlier, the tax system barely rated a mention in public debate”.<sup>46</sup> As Christensen observed, “it... appeared that officials used the TWG [Tax Working Group] as a vehicle for transporting their tax policy ideas into the public sphere – that is, ‘to socialise and road-test their proposals’”.<sup>47</sup>

Formed in December 2017, the latest Tax Working Group published an interim report in September 2018 and a final report in February 2019. The group received 618 submissions on its interim report, and it undertook a “targeted consultation on the implications of the proposals” contained in it for the final report.<sup>48</sup>

However, multiple reports in and of themselves will not guarantee success. The Mirrlees review produced two large reports.<sup>49</sup> The first<sup>50</sup> was designed to compile and build on the existing evidence base but it was focused on an academic tax audience, rather than at the broader public audience, which is needed to create political space for reform. With the Mirrlees review having done much of the necessary intellectual legwork, a new tax commission in the UK could focus its efforts on building the empirical evidence base and presenting this in such a way that the broader public can develop a better understanding of the existing problems with the tax system and the need for change.

### **There are attractions of both long and short timescales**

As Lord Darling told us, it is best to avoid trying to “sell something that is highly controversial and very complicated and fraught with difficulty near to election time, because the chances are that people will not come with you on it”.<sup>51</sup> If the government wanted to use a tax commission to stimulate public debate and lay out options in order to pave the way for tax reform within a single parliament and sufficiently far ahead of the next election, the tax commission would need to work quickly.



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To enable such a commission first to build and present an evidence base and then to outline options for reform, the government would likely need to limit its scope.

There is precedent for tax commissions undertaking such rapid working. The first New Zealand Tax Working Group took 14 months to publish both an interim report and a final report, allowing the main recommendations to be implemented ahead of the 2011 general election. Ireland's Commission on Taxation took a similar length of time, although it produced only one report. Excluding the government-enforced delay in publication, Australia's Henry review took just 11 months.<sup>52</sup> The short timescales of the New Zealand Tax Working Group and the Henry review did not appear to come at the expense of the evidence they produced – both these reviews produced a “remarkably similar” output to that produced by the Mirrlees review, which took five years to complete.<sup>53</sup>

However, experience suggests that it is not essential for a commission to report within one parliamentary term. In some cases, spanning parliamentary terms can be beneficial, especially for a government expecting to win another term in office. Working to such a timetable means that controversial recommendations can be made at the start of a parliamentary term when the government is best placed to implement reform. For instance, the Pensions Commission's interim report was published in 2004, but – at the behest of Gordon Brown, the then chancellor – the commission was given an unusually long timetable, with its final report not published until after the 2005 election. This allowed the politically challenging recommendations to be implemented early in a new parliamentary term.<sup>54</sup>

When deciding on a timeframe, the government needs to balance political expedience against ensuring there is enough time to build a convincing evidence base for reform and for public opinion to shift.

### **Summary: characteristics of successful tax commissions**

A tax commission could be an effective way of building public understanding of the need for reform of the tax system and consensus around the right way to do this, particularly following the government's unprecedented economic interventions in response to Covid-19. International experience of tax commissions and UK experience of commissions on non-tax topics suggest that, to be successful, a tax commission should:

- Have support from the start from the government, in particular the prime minister and the chancellor. It is also important that the government commits at the outset to responding formally to the commission's recommendations.
- Have a chair who is perceived as independent of government, is capable of advocating for the commission's recommendations and who can manage potentially competing views among the other commissioners.
- Appoint commissioners with a range of perspectives to ensure that the concerns of major constituencies are reflected in the commission's work. As it may not be possible to encompass all perspectives without the size of the commission panel



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becoming unwieldy, the commission should also ensure it offers the opportunity for other interest groups to provide their evidence.

- Have a clear purpose and scope from the start. There may be good reasons for limiting the scope of the commission – for example, to ensure it reports in a timely manner or to avoid proposals that would never be politically sellable. But the commission’s purpose and scope must be broad enough to allow it to tackle the questions effectively and need to be clear from the start to ensure its work and outputs are clearly focused.
- Be supported by a civil service secretariat to help develop the evidence base. Depending on what is needed, the secretariat could either do the work themselves or commission external researchers to contribute. At a minimum, the commission should be able to draw on civil servants in the HMRC’s Knowledge, Analysis and Intelligence (KAI) team, who have access to administrative tax data that could provide valuable evidence on how the tax system currently functions and the potential impact of reforms.
- Provide the public with the opportunity to feed in views, and devote time and effort to communicating its findings to the wider public.
- Publish its findings in two stages – the first report setting out the evidence of the problems, which can be used to build public acceptance of these problems, before a second report lays out recommendations for change.

In addition, the government should think carefully about how much time the commission should be given to carry out its work. Experience suggests that it is most effective for commissions to report early in a parliamentary term, to allow the government time to implement recommendations before the next general election. This implies that a tax commission established by a new government needs to either work quickly – to report early enough within the current parliamentary term – or be given a longer timescale so that its final recommendations are published at the start of the next parliamentary term.

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## 7 Conclusions

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Governments face substantial political economy problems in reforming the tax system. The public has a poor understanding of the tax system. Those who lose out from tax reform almost invariably make far more noise than those who gain: losses are often concentrated, while gains are usually diffuse. Special interest groups are highly effective at lobbying ministers for special treatment, while disinterested calls for reforms to improve the structure of the tax system tend to fall on deaf ears.

Therefore, even though the UK public is not anti-tax per se, it has been difficult in the past for UK governments to make tax reforms unless it has had the luxury of being able to cut taxes substantially at the same time. However, the government is unlikely to have that option in the future. The demands of an ageing population for health and social care are already putting upward pressure on public spending and thus the need to raise revenues.

The Covid-19 pandemic will increase the scale of the public finance challenge: the costs of supporting the economy through the crisis will further increase government debt and the costs of servicing this in future. Should it lead the public to desire a permanently larger state, this would also require raising more revenues in the future to fund it. The aftermath of this crisis may provide a rare opportunity to address long-standing weaknesses in the tax system and improve it – possibly in conjunction with moving towards a system that raises more tax. But if the government does attempt major reform of this sort, the usual rules will still apply and it will need to tackle the barriers which previous governments have faced that have prevented radical reform.

Domestically, governments find it easier to reform corporate, rather than personal, taxes and to impose high taxes on the richest rather than raising tax more broadly. However, government's ability to do either of these things is limited by the need for international co-operation when taxing internationally mobile companies and high-wealth people. Focusing tax liabilities on a small group of people and companies also increases risk to the public finances, as it makes revenues heavily dependent on the fortunes (and presence) of a small group of taxpayers.

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Tax policy is an area riddled with behavioural biases among both the public and policy makers. Politicians tend to focus on prominent tax issues (such as outrage at recent proposals for taxing off-payroll working) but place too little weight on slower-burn issues (including long-running weaknesses like the bias in the tax system against being an employee, which incentivises off-payroll working in the first place). This reflects what is termed their 'availability bias' – that is, they tend to think that an issue is important because it comes to mind easily.

They also adopt 'rules of thumb' in how they respond to information – including determining their own reaction based on whether an issue attracts media attention and whether other MPs react. This can result in 'attention cascades', with issues suddenly rising up the political agenda. Meanwhile, the public suffers from loss aversion, meaning it is much more concerned about losing out from reforms (even if those losses are small) than they are pleased when they gain.

These inherent difficulties in tax reform are currently compounded in the UK by the way that ministers, policy-making institutions and parliamentarians behave. Recent governments have had no clear objectives for the tax system, making it far harder to build a case for change. The secrecy surrounding budget announcements also means chancellors have often done little to prepare the ground – with either their ministerial colleagues or the public – before announcing tax changes, limiting the sorts of changes they have been able to make.

Most MPs have limited knowledge of, or interest in, taxation, meaning most backbench MPs and select committees rarely raise questions about tax – and even less frequently raise them about the need for tax reform. This is in contrast to other policy areas, where MPs often do push for major reform.

When there is debate about tax in parliament, the lack of clear objectives from the government makes it highly politicised. While there ought to be quite wide-ranging principles of good taxation that MPs could agree on, in practice it has been very hard to reach consensus across party lines, other than on already widely accepted points. As a result, most parliamentary discussion is on the political merits of individual tax proposals, rather than holding the government to account for improving the structure and efficiency of the tax system.

Our research suggests several ways that these barriers to tax reform could be overcome or worked around. Our recommendations are summarised below, with greater detail provided on these and other recommendations in earlier chapters of this report.

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## Timing and circumstances matter

Some points in time are better suited than others to making reforms (as we discuss in Chapter 2). Economic crisis can create – and, in some times and places, has created – an opportunity for reform. However, governments may not have the political or intellectual space needed for fundamental change at those times. The current Covid-19 crisis has placed huge demands on the Treasury and the rest of government to devise emergency support packages for businesses and people. As a result, the Treasury does not at the moment have the capacity to think about tax reform. However, once the crisis has passed, the need for tax reform is likely to be more acute than it was. The UK will have a much higher level of government debt and thus will have to devote more money to servicing it in the long term. That will require raising more revenue to fund the same scope and quality of public services, increasing the cost of allowing inefficient and distortive tax structures to languish on the statute book.

In normal times, it is easier for governments to reform the tax system when they have a strong parliamentary majority, although even a government with a large majority needs to use its political capital wisely and should focus on the most important aspects of major reform, rather than squandering capital on a series of minor changes.

It is also easier for government to reform the tax system when the next general election is some way off – to ensure that the pain of any changes has faded from voters’ memories and the benefits of the reform have become apparent before the next election. However, most tax reforms will require the government to make the case for change with the public. If a government does not have a mandate for reform from its election manifesto – and few governments do – ministers should take time to build the case for change (as we discuss in Chapter 2). Failing to do so is likely to restrict the reform options that are available, or risks reforms being quickly reversed.

History suggests that reform is also usually easier when the economy and incomes are growing quickly. That is not the case at present, but the government should be ready to take advantage of such an opportunity, were it to come.

## Government must have clear objectives for the tax system

Any government that wants to implement tax reform needs to set out clear objectives for what it wants to achieve (as we discuss in Chapter 3). As we set out in our report *Taxing Times: The need to reform the UK tax system*,<sup>1</sup> a review of the economic and other tax literature suggests there is broad agreement about the sorts of characteristics any good tax system should have. It should be:

- sustainable
- horizontally equitable
- procedurally fair
- economically efficient
- simple, comprehensible and transparent
- cost-efficient
- stable
- able to effectively address market failures
- coherent, both internally and with other areas of government policy.

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Each government may also have specific political objectives for the amount of money it wants to raise and the degree and type of redistribution it wants to achieve. Setting out such objectives would help to smooth the path of tax reform in several ways:

- It would help the government to present the public with a compelling narrative about why reform is needed and how the pain of any individual measures contributes to the bigger goal of achieving a better tax system (we set out the importance of this in Chapter 2).
- It would help the government to plan over longer periods, ensuring that successive rounds of tax changes pull in the same direction. This would help the chancellor to avoid the temptation that many previous chancellors have succumbed to of spending scarce resources on minor giveaways, meaning they are left without the scope for more fundamental reform (as we describe in Chapter 3).
- It would focus the efforts of civil servants in the Treasury's tax teams on the government's priorities, streamlining their work in the run-up to fiscal events and so help create space for the longer-term thinking that is needed to build the evidence base and develop options for reform (as we describe in Chapter 4).
- It would make it easier for civil servants in HMRC and the Treasury to evaluate the effectiveness of tax policies after they have been implemented, since the purpose of each measure would be clearer (we set out the importance of this sort of evaluation in Chapter 4).
- It would help other government departments to engage more effectively with the chancellor and with the Treasury to ensure that policies as a whole pull in the same direction and that the most effective policy lever is pulled to achieve each objective (as we discuss in Chapter 3).
- It would help parliament to scrutinise tax policy better. If the government was clear about its tax objectives, the Treasury Select Committee (TSC) and other parliamentarians would be better able to scrutinise whether the government's policy choices (including new measures announced in each budget) are consistent with achieving the government's objectives – providing the government with positive reinforcement if they do and censure if they do not. This could help to avoid parliamentary debate on tax being so politically charged and partisan – although tax will always be 'political' and politicians may enter parliament with preconceived views on tax that can be hard to change (as we discuss in Chapter 5).

It will be particularly important for ministers to set out objectives for the tax system in the aftermath of the Covid-19 crisis as the government makes a plan for repairing the public finances. Doing so shortly after the public health crisis has abated – when it is fresh in people's minds – would help the government to maintain momentum for its reforms later on when memories have faded. If it became standard practice for governments to set out and justify their objectives for the tax system, this could eventually help to create enduring cross-party agreement on the shape of the tax system, as happened in New Zealand after the radical reforms there in the 1980s.

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## Be aware of behavioural biases

Ministers and civil servants need to be aware of, and try to overcome or work around, the behavioural biases that abound in relation to tax reform.

First, governments must be aware that voters' tendency to suffer from loss aversion means the government will always attract more criticism for taking tax advantages away than they will receive praise for introducing them. Chancellors should therefore be very wary of introducing tax advantages that they might later want to reverse (as we describe in Chapter 2).

Second, as we describe in Chapter 2, governments can exploit the public's money illusion to gradually phase out unwanted elements of the tax system. However, the government should not limit its ambitions to reforms that can take advantage of such behavioural bias nor should it exploit public ignorance to make changes that make the tax system less efficient, such as introducing tax breaks for special interest groups at a cost to most other taxpayers or raising revenue through national insurance contributions rather than income tax simply because the public (falsely) believes that national insurance is a 'contributory' system.

Civil servants and those outside government seeking to push for tax reform also need to be aware of the behavioural biases that affect politicians and work with those.

Slow-burning issues like tax reform are rarely top of the political agenda. However, occasionally events conspire to put these issues on MPs' radar. Before that happens, as we describe in Chapter 4, civil servants need already to have done the deep thinking and policy development needed to take advantage of these 'windows of opportunity'. As discussed further below, this requires ministers to allow Treasury civil servants the time to do this deeper longer-term thinking.

The Office for Budget Responsibility (OBR), the Office of Tax Simplification (OTS) and those outside government could also do more to persuade ministers and other politicians of the need for tax reform by changing how and when they present information to them (as we describe in Chapter 3). Opting for tax reform might be considered the risky option, while sticking with the status quo might be considered safe: behavioural science research suggests that politicians are more likely to plump for a risky course of action if the issue is presented to them in terms of the losses they might incur, rather than the gains they might accrue.

Politicians are also likely to be more interested in, and receptive to, information about the need for tax reform if they receive it at a time when the issue is at the forefront of their minds. Those interested in drawing political attention to the need for tax reform should make use of 'attention cascades', when MPs' attention is suddenly gripped by issues related to tax reform.

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## Generate and disseminate better evidence

Clear, good-quality evidence on the impact of the current tax system – who pays what, who benefits from tax advantages, and how existing tax structures affect behaviour and revenues – is important for building support for tax reform and strengthening policy development. Compelling evidence that makes clear the cost of failing to act can convince ministers of the need for reform. Good evidence can also raise public awareness of the problems with the current tax system and open up the space for change. Better understanding of the impact of previous tax changes will also help to prevent governments repeating past mistakes.

### How can the evidence base be improved?

There are several changes that should be made within government to help improve the quality of evidence on the tax system, which we describe in more detail in Chapter 4.

The Treasury and HMRC have improved their monitoring and evaluation of tax reliefs over the past few years but practice in the UK remains far from ‘best in class’ internationally, even though this ought to be one of the formal stages of the policy-making process. The Treasury should formalise the ‘informal’ process of evaluating reliefs that it has developed in recent years, set clear conditions under which a relief would be reviewed and the questions to be asked, and publish the list of reliefs being reviewed internally each year so that the coverage of reliefs under this process can be externally monitored.

The government should allocate more resources in HMRC to the maintenance and analysis of tax data to allow it to make more effective use of the administrative data it holds, including new real-time information, and to learn more about how taxpayers respond to the tax system. The government should also work to ensure that HMRC is able to provide access to administrative tax data to external researchers to do research on tax design and not only on tax administration. The UK is behind other countries – in particular, the US and many Nordic countries – in using this administrative tax data for research and policy development. As a result, UK policy makers have less good-quality evidence to draw on when making policy, and the UK has a less vibrant tax economics research community (because academics find it far harder to publish in top economic journals and thus harder to attract research funding).

HMRC should explore the steps required to move to a remote access model for external researchers accessing administrative tax data to facilitate access for researchers based outside London. The current Datalab, based in Canary Wharf in London, is hard to reach from most of the major London train stations and so it is difficult to get to, particularly for researchers based outside London.

The Treasury should – as all other departments have – publish its Areas of Research Interest, including its priorities for understanding more about the tax system. This would help researchers focus their analysis on questions that are likely to have greatest policy impact and help them to secure research funding, since the research councils prioritise investment in research that is likely to have policy impact. HMRC, with Treasury input, already commissions research to address gaps in civil servant



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knowledge concerning economic behaviour not captured on tax returns. It should also consider commissioning work to address other questions that need to be answered quickly. It should also allow other government departments to undertake or commission research with a tax element if this overlaps with policy areas led by those departments – for example, allowing Defra to examine environmental taxes alongside other policies for tackling environmental damage.

### **How can evidence be disseminated better?**

There are several ways that existing and future (improved) evidence could be disseminated more widely to help smooth the path for reform by encouraging a better-informed debate among parliamentarians and the public.

One potentially effective way of doing this would be to hold a tax commission (as we describe in detail in Chapter 6), which could be tasked with gathering and laying out the evidence on problems with the current tax system and then presenting options and making recommendations for reforms. The aftermath of the Covid-19 crisis would be a natural time to set up a commission to provide a forum to debate how the state should be funded as the government looks to repair the public finances and – possibly – plans to spend more in future.

To be successful, such a commission needs to have government buy-in from the start and the government must commit to responding formally to any recommendations. The commission's purpose and scope should be clearly defined and not so narrow as to prevent the commission from developing sensible packages of reforms. However, there is a trade-off between the breadth of the commission's scope and how quickly the commission can be expected to report. The chair of the commission needs to have the ability to act as an advocate for the proposals, the political skill to sell the reforms and the ability to manage the other commissioners. The other commissioners should have a variety of expertise, experiences and perspectives. However, having too many commissioners can be cumbersome and so the commission should find other ways to ensure they incorporate and shape other points of view, such as through witness sessions. Past experience in the UK and abroad suggests that a tax commission will be most effective in preparing the ground for change if it publishes its findings in two parts, with a first report laying out the evidence to build consensus on the need for change, before a second report presents the commission's recommendations.

To help ministers develop policy in advance of each budget, the Treasury currently produces a lot of internal analysis of existing problems with the tax system and options for reform. In the UK, both ministers and civil servants are often uncomfortable about the idea that such analysis should be put in the public domain. Such documents are considered to be confidential internal briefings, containing policy options that may never see the light of day – if they did, officials fear, the options outlined would be interpreted as government policy, requiring ministers to step in to defend or reject them. However, experience in other countries – particularly Ireland – shows that it is possible to move gradually to a situation where such options briefings are published as standard before the budget (as we describe in Chapter 4).

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Doing so facilitates a better public debate of the issues and the options for reform, building an understanding of the need for change and promoting public debate of the different options before the government plumps for a particular solution. Treasury ministers should consider allowing Treasury civil servants to replicate the Irish model or make more use of the OTS to improve knowledge and generate discussion in this way.

There is a vast array of information on the tax system already available to MPs – for example, the *Fiscal Sustainability Reports* and *Fiscal Risks Reports* produced by the OBR. However, as we describe in Chapter 5, MPs often do not use this information effectively – because they are unaware of it or lack the time or inclination. Organisations interested in promoting understanding and scrutiny of the tax system – such as the OTS, the OBR and external organisations – should try to ensure their materials are accessible to parliamentarians.

They could, for example, follow the approach taken by the US Government Audit Office, which provides members of Congress with background material on tax expenditures in the form of questions that should be asked – such as whether a tax relief meets its stated purpose and how it relates to other government policies. Parliamentary staff could also help signpost members towards the wealth of information that is available – for example, expanding the information on tax that is provided in the ‘Key Issues’ briefings for MPs at the start of each parliament.

### **Tax reform packages must be carefully constructed**

As we describe in Chapter 2, whether or not reforms are successful depends to a large degree on how they are packaged and presented to the public and how they are implemented. Developing a package of reforms, with a clear narrative about why the proposed changes are needed, should help to convince the public and MPs to support the changes. Packaging measures together can also help to ensure that some losses can be compensated for by gains elsewhere, through either other tax policies or new spending policies.

The government should also think carefully about how reforms are implemented. Past experience in the UK and abroad suggests that it can be most effective to implement reforms in one big bang. Doing so can help reduce opposition that might accumulate to a government trying to implement a succession of smaller measures – with a raft of reforms coming at once, people will find it more difficult to pinpoint exactly how they will win or lose. Doing reform quickly also reduces the risk that the government will stop short of full implementation. However, this is not a hard-and-fast rule. Big bang reforms can be administratively complex and sometimes slower; in contrast, incremental change can be effective. For example, some policies can be easier to adopt if they are phased in gradually (perhaps using inflation to erode the value of a particular allowance or other feature of the tax system) or if the policy is only shut down for new – rather than existing – claimants.

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## **The Treasury's ability to support tax reform could be strengthened**

The Treasury's tax teams do undertake long-term thinking about the structure of the tax system and use this to inform ministerial briefings. However, as we describe in Chapter 4, too much of the Treasury's tax teams' time has been consumed with short-term policy development for fiscal events. Other aspects of the way the Treasury operates also weaken its ability to develop ideas for and support the adoption of tax reform.

To ensure that the Treasury's tax teams have time for long-term thinking, the chancellor should stick to the commitment of former chancellor, Philip Hammond, to have only one fiscal event a year. However, the Treasury's tax teams will continue to be stretched while the government responds to Covid-19 and prepares for a new trading relationship with its closest trading partner – the EU. As outlined above, civil servants' time could also be better focused on longer-term thinking if the government was clear about what its objectives for the tax system are.

To further strengthen the Treasury's ability to develop strong recommendations for long-term tax reform, the department should do the following:

- It should formally review the division of responsibilities in the tax policy partnership to ensure it is conducive to producing co-ordinated and robust tax policy.
- It should build on the welcome introduction of the tax career offer by collecting data to monitor properly the impact it is having and refocus the programme, if needed, to maximise its impact.
- It should draw more effectively on external expertise – in particular, those with views on tax design, rather than the operation or detailed implementation of policies. The Treasury makes too little use of early-stage consultations and so rarely gets input into its consultations from economists and others who would be well placed to offer views on the structure of the tax system. Better informal contacts with tax academics would also mean access to experts who could provide rapid answers to specific questions, drawing on the broader literature.
- It should provide information to think tanks to deepen their understanding of implementation so that their proposals take these concerns into account and can be of more practical value to the Treasury's tax teams.

## **Parliament's ability to promote tax reform could be strengthened**

In the past, parliament has often vetoed tax reform. It far less often plays a more constructive role in encouraging the government to tackle long-standing problems with the tax system. However, it has the potential to play a more constructive role, as we set out in Chapter 5.

The TSC chair has the potential to act as an influential non-government spokesperson for the economy and could be key to raising the salience of tax among parliamentarians and the public. As a member of the governing party, they are also politically well placed to work with the government to create political space for reform.

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Given the TSC is well placed to consider tax matters – and its apparent discomfort at other committees looking into the subject – it needs to put tax on its agenda more often. One of the strengths of committees is their ability to influence political debate and government policy over time. The TSC could make more use of its standing inquiries on the budget to put more pressure on the government to adopt more fiscally sustainable policies, including on tax, and to assess whether the government is addressing the fiscal risks that the OBR highlights. If the government were clearer about its tax objectives, the TSC could also assess whether new tax policies contribute to achieving these objectives. The TSC should also hold inquiries on the OBR reports that relate more directly to tax structures – the *Fiscal Sustainability Reports* and the *Fiscal Risks Reports*.

The TSC and other parliamentary committees should also work together on topics where tax needs to be considered alongside other policies – for example, on climate change. Greater use of the guesting procedure and joint committees would be beneficial.

## **Summary**

Tax reform is difficult to achieve but the tax system is vital to the effective functioning of government. Taxes raise the revenues needed to deliver public services and welfare. By taking money away from people, all taxes will impose some discouragement and distortions on the private sector. But a well-designed tax system will minimise these distortions and can mitigate market failures. There are many long-standing problems with the UK tax system and ongoing behavioural and economic trends are undermining the tax system's ability to raise revenue. These issues need to be addressed.

Growing pressure for extra spending on public services for the UK's ageing population – along with the future cost of servicing the large amounts of public debt that will be accrued through issuing support to businesses and people to help them through Covid-19, and the need to rebuild the economy after this crisis – will increase the cost of allowing inefficient and distortive tax structures to languish on the statute book. Enacting reform will not be easy but, as we have outlined in this report, there are changes that government – from ministers and MPs to officials in the Treasury, HMRC and other public bodies – could make to smooth the path of tax reform.

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# Appendix: Tax commissions

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In Chapter 6, we discussed the role commissions can play in building and disseminating an evidence base for reform of difficult areas of government policy and improving public debate of the options for change. Many of the examples used have been discussed at length in Institute for Government reports, most notably our June 2018 report entitled *How to Fix the Funding of Health and Social Care*.<sup>1</sup> In this appendix we provide additional details on the tax-specific commissions discussed in Chapter 6.

## UK examples

### Meade review (1975–78)

The Institute for Fiscal Studies established the Meade review in 1975 in response to concerns that, for too long, tax reforms had been approached in an ad hoc manner without regard to their effects on the structure of the system as a whole. The review initially planned to consider the entire tax system and report within 12 months, although this was later considered too ambitious, resulting in the review's remit being limited to direct taxation and the length of the review spanning two years. A single report was published in 1978,<sup>2</sup> containing many recommendations, including a call to rebalance the tax system to reduce tax on income and increase tax on spending. Many of the recommendations in the Meade review – including the shift from taxing income towards taxing spending – were subsequently implemented during the 1980s, although it is difficult to assess how many of these changes were directly attributable to the review.

The review's panel of 11 was chaired by Sir James Meade, Nobel Prize winner and professor of political economy at the University of Cambridge, although the deputy chair, Donald Ironside (a partner at a chartered accountancy firm) played a key role in organising proceedings, chairing meetings and planning programmes of work. The panel was comprised of academics, practitioners and a former member of the board of the Inland Revenue (at the time, one of the UK's two revenue departments). The review was completely independent of government – it was not commissioned by ministers, did not receive a government response and did not rely on a civil service secretariat. However, a seminar was held with officials from the Treasury and Inland Revenue.

### Mirrlees review (2006–11)

The Institute for Fiscal Studies formally established the Mirrlees review in 2006. The review sought to identify the characteristics of a good tax system for an open economy in the 21st century, the extent to which the UK tax system conformed to those ideals and how it could be reformed to bring it closer to the ideals. The review was designed to coincide with the 30th anniversary of the Meade review. The scope of the Mirrlees review was broader than the Meade review, encompassing the whole tax system and some aspects of its interaction with the social security and tax credit systems. Wales and Wales have said of the Mirrlees review that “as an examination of the UK tax system it is unparalleled”.<sup>3</sup>

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The review was published in two stages: *Dimensions of Tax Design* (2010), which analysed different areas of the tax system, and *Tax by Design* (2011), which set out the review's conclusions and made 18 recommendations for reform.<sup>4</sup>

High-profile international tax experts, supported by early-career economic researchers, presented the analysis in the first report. The second report represented the views of the 10-person review panel, which comprised six leading tax economics academics, three tax policy experts from the Institute for Fiscal Studies and a leading tax barrister.

The review was notionally chaired by Sir James Mirrlees, a Nobel Prize-winning economist, although in practice he played a limited role in the day-to-day co-ordination of the review and in publicising the findings and publicly advocating for the proposals. The review was completely independent of government – it was not commissioned by ministers, did not receive a government response and did not rely on a civil service secretariat. Evans believes that this independence from government allowed the Mirrlees review to be “far more considered, reflective and comprehensive”.<sup>5</sup> As Wales and Wales identify,<sup>6</sup> such distance from politicians means the review's recommendations have had less traction in the short term. However, the review's analysis has provided valuable direction and information to policy makers in the medium and longer term, and it is widely read by civil servants working on tax in the Treasury and HMRC.

## **International examples**

### **Irish Commission on Taxation (2008–09)**

The Irish Commission on Taxation was established in February 2008 to consider the fitness for purpose of the Irish tax system. In part, the commission was motivated by a sense that the Irish tax system had not been subject to review in a long time. The remit of the commission was constrained in some ways, including a prohibition on recommending changes to the rate of corporation tax and a requirement that the overall tax burden needed to remain low. The commission received around 170 submissions, held 12 oral hearings with select witnesses (including trade unions, industry bodies and an academic) and 37 meetings with a wider range of stakeholders (including government departments, tax specialists and businesses).

The commission published a single report in September 2009,<sup>7</sup> containing 240 recommendations, including the introduction of a new self-assessed property tax, a carbon tax and domestic water charges. The 2008 global financial crisis took place between the start of the commission and its final report. Wales and Wales argue that this change in circumstances limited the effect of the review.<sup>8</sup> The review was also published in the middle of the 2009 referendum campaign on the Lisbon Treaty, timing that the *Irish Times* said “defied all political logic”.<sup>9</sup> The government response to the report was lukewarm, although some of the most controversial recommendations – such as the introduction of a property tax and water charging – have since been implemented.



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The Irish Commission on Taxation does appear to have helped the Irish government adopt tax reforms in response to the financial crisis. In contrast, the UK government responded to the financial crisis predominantly by changing the rates of existing taxes, as opposed to introducing fundamental reform.

The 18-strong working group was chaired by Frank Daly, former chair of the Irish Revenue Commission, and comprised of members representing a range of expertise, including tax practitioners, academics and businesses. It was supported by a secretariat of civil servants.

### **Henry review (Australia, 2008–10)**

The Australian government established the Henry review as part of the 2008 budget. It was designed to be a 'root and branch' review of the Australian tax system and its interaction with the welfare system. However, the government subsequently limited the scope of the review, ruling out changes to Goods and Services Tax – Australia's equivalent of VAT – or the treatment of pensions tax reliefs. The review further limited its own scope, choosing not to consider industrial policy, carbon pollution policy or legislative drafting.

During the review process, a series of background papers were published. The final report was submitted to the Australian Treasury in December 2009, but the government did not publish it until May 2010 (alongside the government's response).<sup>10</sup> The final report made 138 specific recommendations, very few of which have been implemented. The Kevin Rudd government did introduce the proposed Resource Super Profits Tax, although this subsequently proved controversial and the political fallout contributed to the fall of the Rudd government.

The Henry review's panel of five was chaired by the secretary of the Treasury – Ken Henry – and comprised of another politician (Jeff Harmer, secretary of the Department of Families, Housing, Community Services and Indigenous Affairs), two academics and one industry representative. A secretariat, 95% of which comprised Australian Treasury officials, supported the review.

### **New Zealand Tax Working Groups (2009–10 and 2017–19)**

New Zealand has held two 'Tax Working Groups', the first in 2009 and the second in 2017. The Victoria University of Wellington, in conjunction with the New Zealand Treasury and Inland Revenue department, established the 2009 Tax Working Group. Although it was established as an independent group, it was formed with the express support of the ministers of finance and revenue. The government established the 2017 Tax Working Group. Both working groups received support from a civil service secretariat comprised of officials from the New Zealand Treasury and Inland Revenue department.

The 2009 working group was established in May 2009 to describe the characteristics of a good tax system, identify problems with the existing tax system and consider the merits and disadvantages of possible reforms. The review followed the 2008 global financial crisis and came at a time of growing concern among some politicians and practitioners that New Zealand's tax system was too heavily weighted towards



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taxing income over consumption. The working group met on six occasions between June and December 2009, including a one-day conference with wider stakeholders. It published its final report – containing 13 main recommendations – in January 2010.<sup>11</sup> This was preceded by 19 background papers published during the review. Nine of the 13 recommendations were fully or partially implemented, including the ‘tax switch’ in 2010, which involved a revenue-neutral reduction in income tax rates and an increase in the main rate of Goods and Services Tax – equivalent to VAT in the UK.

The working group’s 19-member panel was comprised of academics, tax practitioners, business people and tax officials from the New Zealand Treasury and Inland Revenue department. The panel was supplemented by tax experts who were invited to attend some sessions. It was chaired by Professor Bob Buckle from the Centre for Accounting, Governance and Taxation Research at the Victoria University of Wellington.

The 2017 Tax Working Group was established in November 2017 to consider what improvements could be made to the New Zealand tax system to improve its structure and fairness, taking account of the likely economic environment over the next decade. The government asked the working group to pay particular attention to the possibility of introducing a system of taxing capital gains (although not applying to the family home or the land under it), whether a progressive company tax would improve the tax system and what role the tax system could play in delivering positive environmental outcomes. However, the group was prohibited from considering some areas of the tax system, such as any increase in income tax or the rate of Goods and Services Tax or inheritance tax, or the adequacy of the personal tax system and its interaction with the welfare system.

The 2017 working group published an interim report in September 2018 – which reviewed the tax system and set out the main options for reform<sup>12</sup> – and its final report (including recommendations for reform) in February 2019.<sup>13</sup> Labour members of the coalition government welcomed the main proposal – to introduce a capital gains tax (which would not apply to the family home) – but this has not been implemented due to opposition from the other coalition partner – the New Zealand First party.

The 2017 working group’s panel of 11 was chaired by former New Zealand politician Sir Michael Cullen and comprised of tax experts and academics, union and Maori community representatives and a representative from the New Zealand Inland Revenue.

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## Acknowledgements

We are incredibly grateful to all those who have helped us in the process of producing this report. In particular, we would like to thank all those that agreed to be interviewed both on and off the record, those who attended our private roundtables and took part in our public event 'Pitching Ideas for Tax Reform', officials in HM Treasury, HMRC and parliament for their input, and Sir Edward Troup for reviewing a full draft of the report.

We would also like to thank colleagues at the Institute for Government, particularly Bronwen Maddox, Hannah White for their helpful feedback, and Will Driscoll, Melissa Ittoo, Sam Macrory and Rowena Mayhew for their support with publication.

Any remaining errors are the authors' alone.

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### 3 Ensuring ministers can drive tax reform

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