

TAXREP 32/08

Finance Bill 2008: Written evidence to the House of Lords Economic Affairs Finance Bill Sub-Committee

Written evidence on the 2008 Finance Bill submitted on 28 April 2008 by the ICAEW Tax Faculty to the House of Lords Economic Affairs Finance Bill Sub-Committee, together with a supplementary memorandum to the Sub-Committee on improving consultation dated 16 May 2008.

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Finance Bill 2008: Written evidence to the House of Lords

Economic Affairs Finance Bill Sub-Committee

Introduction

- 1 The Tax Faculty of the ICAEW welcomes the opportunity to submit evidence in response to the Sub Committee's 2008 inquiry.
- 2 Details about the Institute of Chartered Accountants in England and Wales are set out in Annex 1.
- 3 Overall, the Institute is most concerned about the absence of sound tax policy formulation in the months preceding the 2008 Budget. Both the Capital Gains Tax (CGT) and residence and domicile proposals in particular inadequately preserved the reasonable expectations of taxpayers, did not benefit from the proper consultation, and did not achieve an effective balance against fairness concerns. The Institute also believes that the intended revenue raising product of measures proposed as within a 'simplification programme' undermines public and stakeholder support for the simplification agenda.
- 4 The Institute believes that several measures can be taken at this stage, detailed below, to ensure more effective tax policy outcomes.

Executive Summary

- 5 Our key points are as follows:
- We are concerned about the way in which the CGT flat-rate was introduced and believe that tax policy formulation needs to be improved, incorporating a balance against fairness and the need for consultation and preserving the reasonable expectations of taxpayers. The policy formulation of the CGT flat-rate failed these requirements.
 - CGT is designed to increase revenue yield. The ICAEW believes that a tax simplification programme should be broadly revenue neutral.
 - The ICAEW believes that the 'Entrepreneurs' relief limit should be indexed in line with inflation and would benefit from alignment with the pensions lifetime limit. The limit should in any event be kept under review to see whether it discourages investment by serial entrepreneurs.
 - Residence & domicile proposals now place a fundamental importance on establishing whether a person is resident in the UK for tax purposes. This highlights the fact that the existing residence test, which is based primarily on old case law and HMRC practice, no longer provides a satisfactory basis for establishing liability to UK tax and introduces a level of uncertainty that places the UK at a disadvantage as compared to our international competitors.
 - The domicile and remittance rules announced in the 2007 Pre Budget Report demonstrate further lack of adequate tax policy formulation and consultation.
 - We continue to have concerns about the draft clauses of residence and domicile proposals. The legislation is highly complicated, much of it is incomprehensible and we think that taxpayers will find it hard to comply with these rules, thus undermining the culture of good tax compliance that is fundamental to the UK system.

- ICAEW believes that the overall changes, as opposed to the Budget Red Book projections, will result in a net loss of revenue to the UK due to unforeseen and unanalysed behavioural impacts.
- Many non-domiciles affected by the changes will not be particularly well off and may not even realise that they face an increased tax bill in the UK. The ICAEW remain of the view that the de minimis should be set at a higher level.
- We remain concerned that HMRC will also need extra resources to implement and monitor the proposed changes at a time when HMRC's budget is being cut in real terms over a three-year period.
- a detailed review of the various schemes in existence and whether they are cost-effective in generating successful investment in growing businesses that would not otherwise have been made;
- that there should be a survey of EIS investment levels pre and post the FA 2006 changes
- there should be a more general review of investment tax incentives including details of the schemes and their success in increasing investment, their costs to the Exchequer, how EU state aid rules are likely to impact on them and whether there is a principled case for change.

Capital Gains Tax and Entrepreneurs' relief: Clauses 6 and 7, schedules 2 and 3

CGT simplification

6 The move to a flat-rate CGT is a potentially welcome simplification, but we are concerned about the way in which the flat-rate was introduced and believe that tax policy formulation needs to be improved. Tax simplification is not a principle that can be considered in isolation: it needs to be considered within a broader framework of principles which we have identified as the ten tenets (set out in the Annex 2). In particular, tax simplification needs to be balanced against fairness and the need for consultation.

7 The rate of CGT is ultimately a political question for the Government. Whilst any tax simplification is likely to produce winners and losers, this measure was designed to increase the yield from CGT. We think that from a public perception viewpoint, a tax simplification programme should be seen as broadly revenue neutral. It will be more difficult to pursue a tax simplification programme in consultation with stakeholders if the perception is that one of the main drivers to the programme is raising revenue rather than making the UK tax system more straightforward and competitive.

8 The change will create a considerable number of business losers. In particular, many businesses and employee shareholders who previously would have qualified for the 10% CGT rate will not qualify for entrepreneurs' relief and will therefore face an 18% CGT rate rather than a 10% rate.

Preserving reasonable expectations

9 We think it is important for the integrity of the tax system that it should respect taxpayers' reasonable expectations. When taper relief was introduced in 1998, the existing entitlement to indexation was preserved, which was a measured and reasonable transition to the new taper relief system. The blanket withdrawal of indexation and taper relief fails to respect this need.

The need for wide consultation

- 10 In view of the fundamental change which is proposed, this measure should have been first subject to wide consultation. This principle of full consultation on all proposed policy changes is reflected in the Code of Practice for consultation for the Revenue departments, which states that *The Government intends to consult on tax policy matters wherever it is reasonable to do so*.
- 11 The Code sets out four benefits arising from consultation, namely that it:
- allows a national debate to take place on the major tax policy decisions that affect all taxpayers;
 - enables everyone to have a better understanding of the likely impact of proposals on businesses and individuals;
 - enables Ministers and officials to consider the merits of alternative suggestions, or whether the Government's proposals can be improved in the light of comments made;
 - improves the quality of any resulting draft legislation, in particular by ensuring that it works in the real world.
- 12 We believe that the proposed CGT reforms clearly met the criteria for consultation and that a full public consultation would have provided all four of the benefits set out above. We accept that there may be some times when consultation is not appropriate, and the Code sets out four possible areas:
- where there is a significant risk of forestalling;
 - which are market sensitive and could lead to significant temporary distortions in taxpayers' and market behaviours;
 - where it is necessary to act swiftly (eg to take anti-avoidance measures); and
 - where policy develops significantly in the period between the pre-Budget Report and the Budget proper.
- 13 We appreciate that a major reform CGT is market sensitive and is likely to lead to significant distortions, but we do not think that these concerns were sufficient to outweigh the benefits that would have arisen if there had been proper consultation beforehand.
- Clause 7 and Schedule 3*
- 14 These enact the new 'entrepreneurs' relief', which was announced on 24 January 2008. This relief, which is based upon the Capital Gains Tax (CGT) retirement relief rules which were phased out beginning in 1999, provides that gains of up to £1m on the disposal of all or part of business are taxed at an effective rate of 10% rather than 18%. We recognise that the £1m limit is a policy decision and understand the rationale for it. However, given that the new relief is aimed at entrepreneurs rather than business people looking to retire, we are concerned that the £1m limit will not necessarily encourage 'serial' entrepreneurs to reinvest in new businesses. We think that the limit should be indexed in line with inflation and to simplify matters there would be some logic in aligning it with the pensions lifetime limit. The limit should in any event be kept under review to see whether it discourages investment by serial entrepreneurs.
- 15 We appreciate that this new relief includes a number of welcome simplifications as compared to the old retirement relief rules, but those rules were not without problems

and many of these are re-enacted in the new relief. The rules for partnerships and companies are not identical, with the latter being generally more restrictive in that the shareholder must be an officer or employee and own 5% or more of the voting rights. We question whether the old retirement relief restrictions on personal holding companies are still appropriate, particularly given the advent of LLPs as an alternative business structure.

- 16 The legislation reintroduces the 'whole or part of the business' test that was such a problem for retirement relief for unincorporated businesses. This contrasts with the position for shares and securities where it seems that any disposal, however small, can qualify.
- 17 The 12 month ownership compares favourably with the ten year ownership period for retirement relief. Nevertheless, it would have been simpler if the definition had been aligned with the substantial shareholding exemption. This allows for any 12 month period within the previous 24 months. This change would mean that there was one common definition and would allow slightly more flexibility to a taxpayer who is in the process of extracting himself from a business.

Restriction on let property (s 169P)

- 18 The rules will operate to deny relief for associated disposals in circumstances where we think it should be available. The point is best illustrated by using an example which was set out in a document which was published on Budget Day providing examples of how the new relief would work in practice.

Example

Mr R has been a member of a trading partnership for several years. He leaves the partnership and disposes of his interest in partnership assets to the other partners, realising gains of £125,000, all of which qualify for entrepreneurs' relief. He also sells the partnership office building which he owned outright, but let to the partnership, realising a gain of £37,000. The disposal of the office building is "associated" with Mr R's withdrawal from the partnership business, and the £37,000 gain therefore also qualifies for entrepreneurs' relief (assuming there is no restriction on the amount of the gain qualifying for relief as a result of non-qualifying use).

- 19 Our understanding is that entrepreneurs' relief will only be available in relation to the office building if it was let 'rent-free' to the partnership for the whole of the period of ownership. The problem is that even if rental arrangements are changed from 6 April 2008 and any property is let rent-free, the test of whether the asset was an investment is by reference to the complete period of ownership, which will include any period of ownership prior to 6 April 2008. It therefore seems to us that the requirement to include the period of ownership prior to 6 April 2008 will restrict the availability of relief even if the taxpayer seeks to amend the position for the future. We appreciate that this provision is subject to a 'just and reasonable' test but we believe that the period of ownership prior to 6 April 2008 should not be taken into account for these purposes.

Disposals by trustees - section 169J

- 20 In relation to disposals by trustees, it is necessary for the company to be the qualifying beneficiary's personal company, ie the beneficiary needs to own 5% or more of the company. This seems unduly restrictive given that the beneficiary may

not own shares personally in the company and we think that the provision should be amended and that the condition is by reference to the shares owned by the trustees.

Residence & Domicile: Clause 22, Clause 23 and Schedule 7

Clause 22, Periods of residence

- 21 The clause amends the way in which days of presence are counted for determining the amount of time spent in the UK. Given the fundamental importance of establishing whether a person is resident in the UK for tax purposes, this change highlights the fact that the existing residence test, which is based primarily on old case law and HMRC practice, no longer provides a satisfactory basis for establishing liability to UK tax. Current HMRC practice in this area is unclear, often ambiguous and highly uncertain in application. The result is that individuals can be present in the UK without knowing if they are or are not tax resident. The lack of certainty puts the UK at a disadvantage as compared to our competitors.
- 22 The explanatory notes state that the Finance Bill change was introduced because 'the UK was out of step with ...its international partners.' However, the more important reason the UK is out of step is because it is one of very few developed countries that does not have a statutory test. We believe that there are suitable models of statutory residence tests that the UK could use to develop its own rule. A suitable example is the Irish statutory residence rule, which was first introduced in 1994 (subsequently consolidated in 1997) and which we understand works well although we recognise that it is (by UK standards) quite generous. An alternative less generous model is the US residence test.

Clause 23 and Schedule 7, Remittance basis

The drafting of the legislation

- 23 The reform of the domicile and remittance rules was announced in the 2007 Pre Budget Report (PBR). Whilst reform of these rules was expected, as with the CGT changes described above we are concerned at the approach adopted to tax policy formulation and think that it needs to be improved in consultation with stakeholders. More time should have been given to consult on any proposed policy changes and then an adequate transitional period given so as to ensure that taxpayers' legitimate expectations are respected.
- 24 In addition to the increase in tax charges on non-domiciles, the proposals impose potentially onerous new compliance requirements on many non-domiciles. Many of the original proposals also imposed tax charges which went against the legitimate expectations of taxpayers, although we recognise that many (although by no means all) of these concerns have been addressed in the draft legislation. However, a significant part of the legislation remains unfinished even though it comes into effect on 6 April 2008. We do not think that this is a satisfactory situation and it certainly does not provide certainty. We remain of the view that it is unfair to taxpayers not to have deferred the implementation of these aspects of the legislation until 5 April 2009.
- 25 We continue to have concerns about the draft clauses. The legislation is highly complicated, much of it is incomprehensible and we think that taxpayers will find it hard to comply with these rules, thus undermining the culture of good tax compliance that is fundamental to the UK system.

The economic justification for change

- 26 We remain concerned that the changes will result in a net loss of revenue to the UK. Whilst the Budget Red Book predicts that the changes will increase revenue, we remain concerned that no economic and sensitivity analyses have been prepared to support the change and that behavioural impacts will result in the opposite effect to that intended.

The impact of the changes on 'ordinary' non-domiciles

- 27 The focus of these changes is on extracting more tax from the 'super rich' but the need to formally claim the remittance basis and the loss of personal allowances and the CGT annual exemption will increase the tax rate on all non domiciles, many of whom will not be particularly well off and who may not even realise that they face an increased tax bill in the UK.

The increased administration burdens

- 28 In addition to the increased tax charges, the changes will also impose significantly higher administrative burdens and associated costs on many non-domiciles. This is because they will now need to take advice on their UK tax position and they may now need to complete a UK tax return whereas currently many non-domiciles do not need to do so. The raising of the de minimis limit from £1,000 to £2,000 announced in the Budget was a welcome announcement and this will help to alleviate some of the compliance burdens, but we remain of the view that the de minimis should be set at a higher level.
- 29 We remain concerned that HMRC will also need extra resources to implement and monitor these changes and that the strains that will be imposed could be considerable at a time when HMRC's budget is being cut in real terms over a three-year period.

Encouraging enterprise: Clause 28, Clause 29 and schedule 11

- 30 These schemes are aimed at encouraging investment but we are not convinced that taken as a whole they are as effective as they once were and that the changes in this Finance Bill are unlikely to improve the attractiveness of the schemes.
- 31 We also note that EU state aid approvals for EIS and VCTs are still being sought and there must be some doubt as to whether these will be forthcoming or whether further changes might still need to be made to make the schemes acceptable (or indeed whether state aid approval is refused).
- 32 We believe that the halving of the gross assets limits in 2006 so as to comply with EU state aid rules have generally rendered these schemes much less attractive than hitherto. Anecdotal evidence suggests that few investments are made using EIS and we suspect that the increase in the limit from £400,000 to £500,000 will have little practical effect. It would be useful if the Government made a survey of EIS investments before and after the 2006 changes as we believe that this would identify more clearly the reduction in the number of EIS investments.
- 33 The list of excluded activities is also extensive and again EU state aid rules are merely likely to restrict further the activities that qualify. In this context we note that shipbuilding, coal and steel production are now also excluded activities for the purposes of the EMI scheme (see clause 30). Our conclusion is that investment reliefs such as these are likely to remain under pressure at the EU level and that the

continued attractiveness of these schemes in encouraging general investment is likely to be limited.

34 More generally we are concerned that:

- there are too many investment schemes, leading to confusion;
- they are too restricted in terms of investment limits and activities;
- the detailed rules are too complicated, thus adding to the complexity of the tax system at a time when the government is committed to simplifying the tax system; and
- they are too vulnerable to challenges under the EU state aid rules which are likely to preclude addressing the above issues.

35 The studies and consultation documents are useful but we think that the time has come for a more general review of tax incentives for investment and, in particular:

- a detailed review of the various schemes in existence and whether they are cost-effective in generating successful investment in growing businesses that would not otherwise have been made;
- what are their costs to the Exchequer;
- how the EU state aid rules are likely to restrict any schemes;
- whether there are other more cost effective ways of encouraging investment that do not fall foul of state aid rules; and
- whether there is a principled case for simplifying or even abolishing these schemes whilst improving the general climate for business investment.

Further information

36 Please do contact the ICAEW if you require any further information:

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WHO WE ARE

1. The Institute of Chartered Accountants in England & Wales is a professional body representing some 128,000 members. The Institute operates under a Royal Charter with an obligation to act in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).
2. The Tax Faculty is the centre for excellence and an authoritative voice for the Institute on taxation matters. It is responsible for tax representations on behalf of the Institute as a whole and it also provides services to more than 11,000 Faculty members who pay an additional subscription.
3. Further information is available on the ICAEW Tax Faculty website at www.icaew.com/taxfac or telephone 020 7920 8646.

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. **Statutory:** tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. **Certain:** in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. **Simple:** the tax rules should aim to be simple, understandable and clear in their objectives.
4. **Easy to collect and to calculate:** a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. **Properly targeted:** when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. **Constant:** Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. **Subject to proper consultation:** other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. **Regularly reviewed:** the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. **Fair and reasonable:** the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. **Competitive:** tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as **TAXGUIDE 4/99**; see <http://www.icaew.co.uk/index.cfm?route=128518>.

Improving the consultation process

A supplementary memorandum from the ICAEW Tax Faculty to the House of Lords Economic Affairs Finance Bill Sub-Committee on improving consultation

Introduction

Consultation is fundamental to the development of a reasonable, usable and acceptable tax system. It allows the airing of views and the deliberation of issues. It can help build upon a sound idea, turning it into good legislation. It can also prevent poorly conceived ideas from becoming tax law. Consultation is important to the integrity and credibility of the tax system. It is for these reasons that we identified consultation as one of our ten tenets of excellence in the Tax Faculty's discussion paper entitled *'Towards a better tax system'*.

What should consultation be seeking to achieve?

What should consultation be seeking to achieve? The dictionary defines 'consultation' as an 'exchange of opinions', a 'discussion, especially in order to ascertain opinions or reach an agreement' or the 'process of discussing something either with experts or with other participants and asking for their opinions or advice'. The underlying theme is a 'two-way' process, where both the originator of the proposal and the person being addressed can debate and learn from each other.

The less obvious theme is that if you are going to embark on a consultation process, it should be with the intention of noting that advice (even if you do not always want to follow it) and explaining the resulting course of your actions.

Government recognises the importance of consultation. There are frequent requests for views and comments from interested parties. These take the form of formal and informal consultations.

Consultation should harness the experience of those who have detailed technical knowledge and who can pinpoint the possible traps new legislation may bring. A detailed knowledge of previous tax legislation is frequently helpful in considering new legislation, and many experienced tax practitioners, as well as others, freely give their time to assist with consultations.

We recognise that the consultation process should not take-away from the overriding principle that it is the Government that should be applying authority in the development of the tax law. The authority it has to do this is conferred by Parliament. Those asked to participate in the consultation process are not being substituted to take over this constitutional role. Nevertheless, once it has been accepted that consultation is an essential aid to the tax law process, it become necessary to ensure that consultation is undertaken in a manner which does more than pay lip service to the notion. Few would argue against the premise that consultation can play an invaluable part in the development of tax law.

Problem areas

However, recent events such as the 2007 PBR policy announcements on CGT and residence and domicile have highlighted the need to improve tax policy formulation through improved consultation. There is a clear need to:

- consult at a much earlier stage in policy formulation; and
- ensure that proper consideration needs to be given to the comments that are made in the consultation process.

The need to consult before tax policy is decided

The theoretical approach to consultation as set out in the Code of Practice (see below) is not always reflected in the practical implementation. There is a need to consult much earlier in the process, ideally before the key policies have been decided.

In 2000, we remarked that the introduction of taper relief, which was a fundamental change to the taxation of individual capital gains, was introduced without any substantive consultation, either beforehand or at a later stage when draft legislation was included in the 1998 Finance Bill. The result was predictable, with the rules already having to be amended to correct poor legislation.

In 2008, we have faced exactly the same problem over the withdrawal of taper relief and its replacement with the 18% flat-rate. There was no prior consultation and the change has proved to be highly controversial with a number of amendments made to ease the transition to the new rules. This was not the only example of a lack of consultation - the proposed changes to the residence and domicile rules were similarly highly controversial. This lack of consultation on key policy changes is a recurring theme. In 2006, for example, changes to the inheritance tax rules for trusts were again announced without consultation even though a consultation process was in place about the income and CGT treatment of trusts.

The need to listen and act on consultation

Our experience is that once the Government formulates an idea, it is very reluctant to change or modify the proposal, except to a very limited extent. This merely fosters a widely held view that the Government pays lip service to consultation, even if sometimes it might take note if there is sufficiently strong opposition. In other words, whilst HMRC/HM Treasury may be consulting, are they actually listening?

If we take the example of the ongoing HMRC powers consultation, whilst on the face of it the consultation process has been very good, the many concerns that have been raised about these proposals do not often appear to be listened to and acted upon. There is little point in undertaking detailed consultation if genuine concerns raised are not acted upon. Again, this merely confirms in the eyes of many that the consultation process is little more than a rubber stamping of decisions that have already been made. This was not helped by the fact that decisions were announced in the Budget on 12 March 2008, a mere six days after the closure of the consultation period. We do not see how the responses could have been assimilated, summarised and decisions then taken and announced only six days later.

One of the few examples where the Government appears to have listened was the decision to 'shelve' (rather than drop) the Income Shifting proposals as set out in the

2007 Pre Budget Report (the 2007 PBR). This followed on from detailed adverse criticisms from representative bodies.

Codes of Practice on Consultation

In order to have a workable consultation process there is a need to have some form of structure on which the process is based. This has been rightly recognised by the former Inland Revenue and Customs & Excise, who first published a Code of Practice on Consultation in January 1998. This arose as an adjunct to the Tax Law Rewrite Project and from an Inland Revenue report suggesting the need for a code of practice in this area. The Code was later updated in July 1999. The 1999 Code of Practice (the 1999 Code) has been further superseded by the Cabinet Office Code of Practice on Consultation, published in January 2004 (the 2004 Code). HMRC has also published a *Consultation Framework* which is designed to supplement the 2004 Code. The 1999 Code is still on HMRC's website although its precise status is no longer clear. Some of the statements in the 1999 Code are not reflected in the 2004 Code but are, we believe, still valid.

The 1999 Code starts with the statement that the Government 'intends to consult on tax policy matters wherever it is reasonable to do so'. We noted at the time that there is no definition of 'reasonable', and this provided the Government with an open-ended opportunity for avoiding the necessity to consult.

The Introduction to the 2004 Code states:

Ministers retain their existing discretion not to conduct a formal written consultation exercise under the terms of the code, for example where the issue is very specialised and where there is a very limited number of stakeholders who have been directly involved in the policy development process. In these circumstances the general principles of the code should still be followed as far as possible, and departments should consider how to ensure that the public is made aware of the policy, for example through a press notice or statement on the department's website. This should state the Minister's reason for their decision.

Paragraph 1.1 of the 2004 Code states:

*Consultation is a continuous process that needs to be **started early** (note emphasis) in the policy development process.*

The inference from the 2004 Code is that consultation should be the norm in most circumstances where there are proposed major policy developments that affect a wide variety of stakeholders.

In relation to tax, the 1999 Code sets out circumstances when consultation might not be possible. These were:

- Where there is the risk of significantly forestalling activity by existing or prospective taxpayers;
- Where the area is market sensitive and where consultation could, of itself, lead to significant temporary distortions in taxpayers' and market's behaviours. For example, where consultation could create an unacceptable

level of uncertainty, with a detrimental effect on major transactions and aggregate business activity until final decisions are announced and enacted;

- Where Ministers deem it necessary to act swiftly (e.g. take anti-avoidance measures); and
- Where policy develops significantly in the period between the pre-Budget Report and the Budget proper.

It also referred to the possibility of not consulting where a tax measure is minor, straightforward and non-contentious (cf the 2004 Code above) so that it does not justify the resources of full consultation.

On looking at the list of exceptions above, several points come to mind. Firstly, the genuine occurrence of these events tends to be small. They are the exception and not the norm. Therefore, it should be very rare for these incidents to be cited as a reason for not consulting and they should not be used as an excuse to avoid the consultation process.

Our view is that any Code of Practice should start from the position that Government must always consult on all major tax policy matters, except where it is likely that the Government's revenues will be seriously prejudiced (for example the need to act quickly to counter avoidance). Such circumstances will be quite rare, and the substantive reasons for the decision must be explained and published. Further, these reasons should be subject to review by an 'independent' body, for example a parliamentary committee.

For these reasons we think that announcements such as those made in the 2007 PBR announcements on CGT and residence and domicile (to give but two examples) should have been subject to prior consultation in accordance with the principles set down in the 1999 and 2004 Codes.

As noted earlier and as confirmed in the 2004 Code, consultation should take place early in the policy development process; ideally before key policy decisions have been taken. If a wider written consultation is not possible in the very early stages, then we think that there should be informal consultation with the professional bodies and other stakeholders who are likely to be affected by any policy proposals.

Following the consultation, there should then be a period for consideration of the points raised by respondents and any arising modification of ideas. This would lead in such instances into a revised paper on the tax policy which may or may not at that stage include draft legislation. This would be fed back to those who had contributed at the initial consultation phase, plus any other relevant person, for any remaining comments and a detailed explanation as to why particular ideas were accepted or rejected..

Conclusions

It is clear that consultation is an invaluable part of the process of making tax law. It should be the foundation upon which all tax legislation is developed. Consultation should be open and constrictive and not secret and unsatisfactory. The Code is an important part of this process. It should be rewritten so that there should be a clear obligation to consult on tax policy issues. Any exceptions should be extremely rare, clearly defined and explained and also subject to independent scrutiny. It should also

be made clear as to what is, and is not, within the consultation. The emphasis should be on consultation right at the start of policy formulation, well before policy decisions have been made.

FJH
16 May 2008