Tax Simplification

How, and why, it must be done

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THE AUTHOR

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PREFACE

I WAS FOR MANY YEARS a tax partner in a city law firm. I enjoyed the challenge of working on practical tax problems, and it was often possible to help clients with their tax position, whether by improved presentation or by more substantial tax planning.

But as time went on I increasingly felt that much of this work would be unnecessary if tax law were refocused on its primary goals, which in the case of most direct tax is identifying and taxing profit. Tax law could also then be made much simpler to use and easier to understand. However the trend in tax legislation was in the opposite direction, towards more and more complexity.

Does simplifying tax law mean throwing out the baby with the bathwater, because it can only be done by sacrificing important policy objectives? This paper argues that the answer is no, and that substantial reform is practicable.

David Martin
March 2005

SUMMARY

- Tax law is becoming more and more complicated: Tolley's Tax Handbooks 2004-2005 are now over 11,000 pages long. The Finance Act 2004, with 328 sections and 42 schedules, holds the record as the longest Finance Act ever. And the aggregation of tax law is accelerating.
- The complexity of tax law makes it difficult for ordinary citizens to understand their liabilities; is expensive; fails to provide certainty; and encourages artificial tax planning.
- The process of making tax law more complicated cannot last forever. Reform is now desirable and achievable.
- The Inland Revenue is currently engaged on a tax re-write project. This is intended to make tax law more intelligible, not simpler. Corporation tax is not expected to be addressed before late 2006.
- Simplification should precede the rewrite of tax law. This paper therefore focuses on the simplification of corporation tax.
- The following principles are recommended for the simplification of corporation tax:
  - it should be accounts based, not schedule based: all profits should therefore be computed on a similar basis without having separate rules for each source, and departures from accounting profits for tax purposes should only be made by reference to clear principles;

- it should be purposive: detailed rules should be abolished and replaced by clear statements of the underlying principles and purpose of any tax. This would be supported by a system of published pre- and post-transaction rulings;
- it should be reviewed to ensure that, unlike the current piecemeal system, all the different parts fit together coherently.

▪ It is considered that tax law should be cut by at least half, and perhaps by as much as three-quarters. For example, 55 of the 88 substantive provisions for companies of the capital gains tax regime could be abolished; the current law on depreciation could be simplified greatly; the need for much anti-avoidance legislation could be obviated; and most of the Schedule A legislation could be revoked. Complex rules such as those governing group relief in Schedule 18 Taxes Act 1988 could be improved and substantially shortened at the same time.

▪ Many of the lessons of corporation tax reform could then be applied to income tax and capital gains tax.

▪ The result would be to remove economic distortions, to reduce the scope for avoidance, to create a more transparent user-friendly system that would be the envy of our international competitors and to reduce compliance burdens on taxpayers.

▪ Finally, new procedures are required to improve new tax legislation.

CHAPTER ONE

THE PROBLEM

The complexity of tax law

Tolley's Tax Handbooks 2004-2005 are the standard manuals on current tax law for tax practitioners. They are about 11,000 pages long. They contain statutes and statutory instruments, mainly on income tax, capital gains tax and corporation tax, but they also cover other taxes – NICs, VAT, inheritance tax, petroleum revenue duty, stamp duty, insurance premium tax, landfill tax, aggregates levy and climate change levy. European law is included, because it can sometimes override UK tax law.

The Handbooks also contain Statements of Practice, and Concessions, and extracts from Revenue and Customs Manuals, Tax Bulletins, Press Releases, VAT Notices and other miscellaneous reports, guides and leaflets.

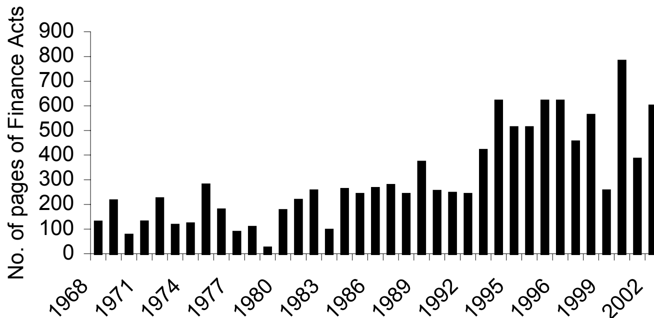
There are also thousands of precedents from decided tax cases that are not in the Handbooks. These precedents, together with the statutory material, make up UK tax law.

No one familiar with UK tax legislation would deny its complexity. The legislation is not only lengthy and intricate but is usually drafted in a dense style that makes it inaccessible to the layman. Further no one would deny that, where complexity cannot be justified, simplicity and user-friendliness are to be preferred. This paper seeks to analyse why tax law is so complicated, the extent to which simplification is possible, and also whether simplification can only be achieved by discarding other policy objectives that underlie tax law.

How has tax law become so complicated?

New tax law is enacted in the UK on an annual basis, and greatly exceeds in each year the amount of old law repealed. Tax law is generally more voluminous in advanced economies, where such a process has operated for a longer period. Further, the aggregation of tax law can tend to accelerate. For example, UK income tax and corporation tax law was all consolidated in 1988 into one act that had 845 sections and 30 schedules. This now seems a model of brevity by comparison with what has followed. Since 1988 annual Finance Acts have been on average about twice as long as they were in the 20 years before 1988. The Finance Act 2004, with 328 sections and 42 schedules of new law (requiring 634 A4 pages), holds the record for the longest Finance Act ever.

The growing length of the Finance Act



Notes: There were two Finance Acts in 1983, 1987, 1992 and 1997. The number of pages has been aggregated in these years. The figure of 634 pages for the Finance Act 2004 mentioned above refers to the Queen's Printers copy of the Finance Act, and is not directly comparable with the number of pages in the official handbook of legislation for the earlier years.

Why has tax law become so complicated? – Government, tax authorities and tax professionals

Governments are keen to introduce new tax law in the annual Finance Bill in order to implement political objectives and to differentiate themselves as the party in power from the opposition. They also come under pressure from outside special interest groups to enact legislation favourable to such groups. Many proposals for new tax law of a more technical nature are developed within the Treasury and the Inland Revenue or Customs & Excise, or are advanced by outside professional bodies.

Although only a small proportion of these ideas may survive the sifting process required before a Finance Bill is published, there is still much that remains, as demonstrated by the size of recent Finance Bills.

There has however been much less pressure to evaluate existing tax law and to remove that which is unnecessary, or which no longer represents policy, or which has become superseded by events, or which was poorly drafted in the first place, or which indeed was first introduced with insufficient weight being given to the policy objective of simplicity. Even tax professionals, who may have complained when a new law was introduced, become more willing to live with it once they have grown familiar with the law and can earn income from advising on it.

Policy considerations that may give rise to new tax law are discussed below. New tax law may also be introduced without new policy considerations but to amend earlier provisions which time has shown to be inadequate in some way.

It is worth noting a peculiar feature of tax law that explains to some extent its special proclivity for growth. Most law is born from the requirements to address problems or resolve conflicts of interest that already exist in some field of human activity. Businessmen would be in difficulty without contract law. Matrimonial property disputes would be even harder to resolve without law governing them. But if the law becomes too complicated, it ceases to be of benefit in situations where it was

intended to help. As far as tax law is concerned, however, this basic relationship is missing because it is not enacted primarily to help taxpayers resolve problems. Businessmen would prefer (from the point of view of their business) not to have any tax law at all. Tax law necessarily creates new conflicting interests between the tax authority and the taxpayer. The fact that tax law is not, for example, primarily intended to benefit businesses means that any criticism that it harms business, perhaps by over complexity, can be deflected. The criticism may nevertheless be justified.

The endeavour to resolve the tension between tax authority and taxpayer has been summarised in the old maxim that "The art of taxation consists in so plucking the goose as to obtain the largest possible amount of feathers with the smallest possible amount of hissing" (Jean-Baptiste Colbert). There is much to be said however for having healthy geese, who produce a lot of feathers, when perhaps a smaller proportion of their feathers need to be plucked. In human terms, the welfare of the plucked individual depends on whether he is free to get on with life without complicated rules and restrictions which he finds hard to understand, and which limit his vitality.

The experience of other jurisdictions

United States

The US is recognised as having a complex system of direct tax, even by comparison with other advanced economies. The availability of many reliefs, particularly for corporations, has also reduced overall federal tax receipts by the Internal Revenue Service (IRS). The Bush Administration has said that it wants to tackle fundamental tax reform in the coming four years and proposes to appoint a commission to study the issue. A variety of proposals are likely to be considered – for example a national sales tax, a value added tax, or a flat rate on earnings. Government initiatives to date suggest that a new consumption tax will be a strong candidate in the review process.

France

The French tax system is seen as complex and unclear, and tax laws are often “verbose”. Furthermore, there is a feeling among French taxpayers that the Human Rights Declaration of 1789 (which is part of the French legal system) is not applied because tax law is not the same for all citizens. Large French corporations and well-known taxpayers have easier access to the tax authorities to negotiate favourable tax rulings, while small to medium companies have the impression that they are harassed by the tax authorities. Moreover, the split between the French tax authorities and the French Treasury (i.e. the split between those in charge of tax assessment and those responsible for tax collection) reinforces this complexity, since taxpayers are facing two public authorities that do not communicate very well between themselves and often blame each other for the taxpayer’s problems.

That is why over the last seven years or so, French governments have attempted to modify the French tax system. The main reforms are the following: simplifying the French tax code by repealing some old tax provisions that were no longer useful; “closing” individual “tax shelters“ for certain professions where there was no benefit for the economy; giving taxpayers easier access to the tax authorities with a possibility to obtain clarifications on tax provisions in writing within a reasonable period of time; merging the French tax authorities and the French Treasury (this reform is still in process); and avoiding passing laws with retroactive effects when they aim at increasing the tax burden of citizens.

The Finance Bill for 2005 is also a step in the right direction on some of these issues.

Australia

Most Australian tax advisers believe that Australian tax, which includes Federal, State and Territory taxes, is hugely complex.

In August 1998, the Government announced a tax reform package that was intended to simplify the tax system. Soon afterwards the “New Business Tax System”, was introduced,

commencing with six tax acts. However, the majority of the measures that were effected by July 2001 led to more complexity. The so-called "Simplified Tax System" was introduced in July 2001, but that was only directed at simplifying compliance costs for small businesses.

Three years on it is still widely considered that the tax system continues to grow in complexity. At the time of the November 2004 election, for example, the Chief Executive of the Australian Chamber of Commerce and Industry said that the biggest problem faced by business was the level of taxation, closely followed by the complexity of tax legislation.

Germany

Tax legislation in Germany is becoming increasingly complex and confusing. There are many exemptions, and new anti-avoidance legislation is growing in tandem with increased tax planning and the need to conform to the requirements of European law concerning international tax and thin capitalisation rules.

The opposition parties (Christian Democrats and Liberals) have announced outlines or drafts of simplified tax legislation, and the Stiftung Marktwirtschaft (Market Economy Foundation) has initiated a working group trying to develop a new tax act. Leading professors in the field of taxation (such as Professor Kirchhof and Professor Lang) have also prepared drafts of simplified tax law. Although it is perhaps unlikely that changes will be implemented before the next election, due in the autumn of 2006, these developments may presage fundamental tax reform after that time.

The experience of taxpayers

The complexity of tax law today now makes it difficult for many ordinary citizens to understand their liabilities and to complete their tax returns. Interest and penalties may nevertheless be due under self-assessment to punish an incorrect return. The tax system is also burdensome for businesses, and a distraction from earning profit.

It is also expensive for many taxpayers to pay for the tax advice that they need. Indeed, for major transactions, several different specialist tax advisers may be required to advise at the same time. Although these compliance costs may be a direct cost for some taxpayers only, the costs of businesses are of course shared by everyone who purchases goods and services, as the price charged must take into account these costs incurred. Moreover, any extra administrative expenses incurred by the tax authorities caused by over complex tax law are shared by everyone through the extra taxation required to pay for them.

Further, the complexity and costs of the system might be accepted if they were a necessary price to pay for a system which is fair and which provides certainty to taxpayers as to their position. What we have, however, is a system that is obscure and ramshackle. Although it is sometimes argued that tax law must necessarily be lengthy in order to produce certainty, few would claim that our complicated law has produced certainty. It is largely because tax law is so complicated that it is often difficult to have a clear understanding of how much tax is due. The complexity also serves to encourage artificial tax planning and to maintain a cycle of further anti-avoidance measures and further artificial tax planning. These points are developed in more detail below.

The tax system depends in a fundamental way on compliance. The fear of being caught out by the authorities discourages cheating, but taxpayers know that it is not physically possible for the tax authorities to audit or investigate more than a small proportion of returns. There is evidence from behavioural studies by economists that compliance is encouraged where taxpayers perceive that other taxpayers are paying their fair share, but when the tax system gets too complicated it becomes less clear what a person's fair share is. If it is also perceived that some people do not pay their fair share because they can manipulate their way through a complex set of rules with the benefit of expensive tax advisers, the incentive on taxpayers generally to comply is further diminished.

TAX SIMPLIFICATION

Experience suggests that there is almost universal backing amongst taxpayers for simplification of the tax system. The professional tax and accounting bodies are also vocal supporters. These facts alone should offer encouragement to policy makers to pursue simplification.

CHAPTER TWO

THE SOURCES OF COMPLEXITY

IMPLEMENTING POLICY OBJECTIVES can result in complex law. An example of this is VAT on food. European legislation provides that national governments may apply a reduced rate of VAT on foodstuffs (including beverages but excluding alcoholic beverages) for human or animal consumption. This could have been enacted directly into UK law by simply zero-rating all food.

UK law however makes the effort to differentiate food products for VAT purposes between, broadly, the more essential items, which are zero-rated, and other, perhaps more indulgent items, which are standard-rated. The concept, reflecting earlier policy under the former Purchase Tax, is simple. Putting it into practice, however, can be very complicated.

There are seven lists of exceptions to the zero rate. For example, the first list of standard-rated items mentions ice cream, ice-lollies, frozen yoghurt, water ices and similar frozen products, and prepared mixes and powders for making such products. A list of items overriding the exceptions is then provided (so that an item in the overriding list is zero-rated after all). Yoghurt unsuitable for immediate consumption when frozen is such an item, overriding the first list of exceptions, which is therefore zero-rated.

The relevant Customs and Excise leaflet sets out detailed descriptions of products which are included or excluded from zero-rating. Thus sorbets are standard-rated, but baked alaska, which has to be cooked before eating, is zero-rated. Toppings, sauces and syrups for serving with ice cream are zero-rated, unless sold with the ice cream. Similar points apply in relation to wafers and cones.

There are further statutory lists of inclusions and exclusions concerning such further items as confectionery and biscuits, with even longer non-statutory lists of standard and zero-rated items based on the law as interpreted by the courts. Indeed a huge number of cases have been brought before the courts to resolve ambiguities.

VAT Quiz for Chocoholics

Which of the following items are standard-rated or zero-rated? The answers can be found on page 53, together with details of how one reader can win a bottle of champagne.

	Zero-rated	Standard-rated
1. Chocolate ice cream	☐	☐
2. Chocolate for diabetics	☐	☐
3. Chocolate chip cake decorations	☐	☐
4. Chocolate button cake decorations	☐	☐
5. Chocolate jaffa cakes	☐	☐
6. Chocolate spread	☐	☐
7. Nuts with chocolate coating	☐	☐
8. Gingerbread man with chocolate eyes and mouth	☐	☐
9. Drinking chocolate	☐	☐

It is easy to poke fun – but these examples do illustrate how the attempt to address a multitude of different situations differently, negates simplicity. They indicate how tax law may have an impact on behaviour through the price mechanism, and perhaps also illustrate how governments respond to pressure groups. Further they show how the more detailed tax law is, the more boundaries

it creates. Instead of merely having to decide whether an item is food for human consumption (the outer boundary) the courts have to decide on a large number of inner boundaries, which in borderline cases may often seem unfair.

Most people would probably feel that the many distinctions made for VAT purposes are not in fact justified. At least, however, one can understand the underlying policy preference to zero rate only some food that has led to the complexity, even if it has all been pushed too far. But in direct tax law, and in other aspects of VAT law, the underlying causes of complexity are often harder to pin down. Further, the detailed differentiation of goods and services for VAT purposes does not lead to tax law that is inherently difficult to understand, although there may be large numbers of borderline cases. But in direct tax law, and in other aspects of VAT law, complexity can make the law very difficult to understand, and be even harder to justify.

It is argued below that many features in current tax law, which do not seem to involve fundamental issues of policy, (such as the source system of taxation), can be removed. It is surprising how many other detailed provisions then fall away, because they no longer serve any purpose.

What are other policy objectives of tax legislation?

The taxation of business profits serves to illustrate further possible objectives of tax legislation, apart from raising tax, which may be in tension to the objective of simplicity.

Businesses are taxed on their profits. The accounts of a business produce a figure for profit, so why not just tax that amount? What could be simpler?

The Inland Revenue identifies a number of reasons for departing from accounting profits for tax reasons, which can also be considered as objectives of tax legislation in a more general context, not merely business taxation. The reasons given are public policy, fiscal incentives, true reflection, avoidance, transfer pricing, capital items, structural, tax neutrality, symmetry, tax capacity and miscellaneous.

Public policy

Public policy mainly results in denying tax relief for items, such as criminal expenditure, or bribes, or entertaining expenditure, or the hire of expensive cars, where the government does not wish to subsidise the expenditure by giving tax relief for it. There are not many matters affected by this policy consideration, all of which could be dealt with in a few pages of tax legislation, and this does not therefore produce significant complexity.

Fiscal incentives

Fiscal incentives are widely analysed in academic economic literature. It is often stated in this literature that, when people act for tax reasons, economic efficiency is impaired, even if those people obtain a financial advantage for themselves. Economic efficiency leads to maximising the goods and services that people value most. If tax (including incentives) distorts an otherwise efficient market there is a cost, referred to as the excess burden of taxation, which arises because people do things that they would not otherwise have done.

Notwithstanding the highly technical nature of much of the economic literature on this subject it is possible to draw some general conclusions. In efficient markets, taxes that have a wide base are less likely to create distortions and thereby reduce efficiency than taxes with a narrow base. Thus, in general, taxes applying to all supplies of goods and services are less likely to harm efficiency than taxes that apply only to some supplies. But in certain cases the market operates inefficiently. An example would be a polluter who can earn large profits, even though he imposes costs on the wider community; alternatively, a person could provide benefits for a wider community beyond his paying customers, but does not because he is not paid a price reflecting those benefits. There may be more scope to use tax as an instrument of policy in such cases. Thus it may be appropriate to levy taxes on pollution, which impose costs on the wider community, or to provide tax incentives where an activity is thought to confer benefits on the wider community. Research and development expenditure has been granted special relief for this latter reason.

Governments are often criticised for trying to "pick winners", meaning the attempt to identify sources of economic growth which they believe have not been recognised by the market. Tax incentives based on this premise are likely to prove unsatisfactory. Sometimes, however, the basis for providing incentives is just unclear, and then the consequences of such incentives may prove equally unsatisfactory.

Over time many incentives have been introduced and then withdrawn within a short period because of problems associated with them. Profit-related pay was a good example of a relief framed with the apparently good intention to incentivise staff by enabling them to share in their company's profits with a tax-free bonus. What happened, however, was that a substantial number of large employers set up a special service company to employ their staff. Payments were made to the new service company from the operating company that were sufficient to enable the service company to pay a tax-free bonus to the staff. The payments by the operating company might however have had only a very limited connection to its own profits. Therefore all that happened was that steps were taken to enable a proportion of salaries to be paid tax free, and one could say (to put it provocatively) that the relief introduced a large swathe of commerce and industry to tax avoidance.

The business expansion scheme is a relief that has survived for many years, although it has been heavily amended and is now called the enterprise investment scheme. It was introduced to provide income tax relief for the cost to individuals of new shares issued by companies in order to raise cash for new qualifying business. When the relief was introduced a number of funds were established in which the public could invest under the scheme. A high proportion of the funds invested were however used for transactions such as management buy-outs, where the new company used the money raised to purchase an existing business. In other words, the money raised did not directly expand the business. It merely refinanced it. Of course the business might well prosper under its new ownership, but it is doubtful that the

scheme could have been sold to Parliament as a means of financing management buyouts. Worse, planning became very common for ensuring a positive return to investors who benefited from the tax relief, who therefore ceased to take any real risk. In other words the scheme had also encouraged tax avoidance.

Ministers are in fact usually conscious of the possibility that incentives they introduce may be used for avoidance. This means that incentives may have so many restrictions and conditions that businessmen come to see the tax relief as a possible bonus, but not one on which they can necessarily rely when evaluating a proposal. This problem can sometimes be alleviated by an advance clearance procedure, but this procedure is normally only available when all the details of a proposal have been worked out, and it can be time consuming. Further, as mentioned above, it often occurs that the incentive is used for tax avoidance in ways not originally anticipated by the tax authorities.

It is not suggested that, by reason of the above arguments, governments should cease altogether to provide tax incentives. It is emphasised, however, that caution is appropriate and the potential disadvantages over and above the cost to taxpayers generally of providing tax incentives need to be fully weighed before the introduction of new incentives. "Sunset clauses" might be more commonly employed, to ensure that incentives only continue after a defined period if a fresh decision is then made that the incentives are still justified.

True reflection

The Revenue states that there are some tax provisions which reflect the fact that accounting principles do not give what is thought to be a true reflection of the profit or loss which is to be charged to tax. The special rules for taxing sovereign debt provide an example of this, where, in the Revenue view, the accounting rules for making provisions against non-payment of such debt may be too generous, leading to too small a figure of profit for tax purposes.

Yet the courts increasingly accept accounting profits for tax purposes. A recently decided case illustrates this point. A firm of solicitors made a large provision in their accounts for future rentals payable on a building that they had vacated. This provision was required by generally accepted accounting practice. The Revenue considered however that this was an instance of anticipating a loss for tax purposes, and that tax relief should only be given for the rents when they became due and payable. The court nevertheless held that there is no tax rule independent of the accounting rules for determining that a loss had been anticipated for tax purposes. The accounting measure of profit was therefore held to apply for tax purposes.

There are some principles that may justify or require departing from accounting profits for tax purposes. A good example of this is the argument that only realised profits should be taxed. Nevertheless a departure from accounting profits for tax purposes has to be made on the basis of principle, (and legislated for appropriately) and should not happen merely by an assertion made on an *ad hoc* basis that the accounting figure is incorrect for tax purposes. This question is addressed further below.

Anti-avoidance

Avoidance may refer to the diversion of profits from a taxpayer to another person who is more lightly taxed, or perhaps not taxable at all (such as a non-resident).

Another major form of avoidance, which is probably the most common, is the manipulation by a taxpayer of his affairs to take advantage of other rules of tax law. Thus the more tax law there is, the more possibilities for manipulation to exploit that law may arise. New tax law often creates new boundaries for tax purposes, rather than merely defining boundaries. The more boundaries are created, the more tax planning will take place by taxpayers who wish to fall on the lower taxed side of the boundary. This may involve artificial steps, or worse, encourage the misdescription of activities that constitutes evasion rather than avoidance.

Anti-avoidance legislation is thus required, but because of the particular risks of obscurity and complexity associated with such legislation it needs to be accurately targeted and as clear as possible to achieve the objective without imposing unwarranted costs.

Transfer pricing
Transfer pricing, the next matter on the Revenue list, can also be seen as an anti-avoidance measure, to prevent saving tax by the diversion of taxable profits.

Capital Expenditure
Capital expenditure is not deductible under current tax law in the absence of some special relief. This is because when income tax was first introduced, and capital gains were not brought into charge, it would have been illogical to allow capital expenditure as a deduction. In 1965 capital gains realised on the disposal of capital assets became chargeable, but effective relief for the acquisition cost of an asset was only available at the time of its disposal in order to calculate the gain.

Thus if expenditure of a capital nature does not result in the acquisition of an asset which can later be disposed of, no tax relief is generally available for that expenditure, although it may be a legitimate or even a necessary business expense. A one-off compensation payment, for example, may be capital and not deductible. A payment to "preserve goodwill" should however be deductible as a revenue expense. It is not surprising therefore to read in a contract to settle a dispute that a payment of compensation is agreed upon in order to preserve goodwill, so as to provide evidence for tax relief in due course. These are in fact artificial distinctions that should not be recognised for tax purposes. A payment that is for business purposes impacts on business profits and should be allowed whether it is capital or revenue in nature.

Further, if it is accepted that tax relief should be available for capital expenditure which is immediately written off in the accounts, it would seem logical to give tax relief for expenditure written off over a period, in other words tax relief should in general be available for depreciation.

The current artificial distinction between capital and income has many other ramifications, causing complexity. Why, for example, should a premium paid on the grant of a five-year lease be treated any differently for tax purposes than five years' rent paid in advance, when they have the same economic effect?

The capital allowances code of allowances for specified items of capital expenditure is also very complex. Other special rules for capital items have been introduced, including rules giving relief outside of the capital allowances code for certain types of capital expenditure. Much of this law could be substantially simplified, and made more fair as between taxpayers, if relief were given for all business expenditure, whether "capital" or "revenue", with only limited specified exceptions.

Structural reasons

Structural reasons for departing from accounting profits include such matters as not allowing foreign tax as an expense if credit for it against UK tax is claimed, not taxing payments made for surrenders of tax relief, and provisions relating to the boundary between dividends and interest payments.

Tax neutrality

Tax neutrality refers for example to provisions enabling transfers to be made tax-free between companies in a group, and recognising that there should be continuity of tax treatment where there is no substantive change in ultimate ownership of companies.

Symmetry

Symmetry refers to treating payments in a similar way for both payer and payee – so that, for example, payment of remuneration made late to an employee is tax deductible for the payer at the same time as it is taxable for the employee who receives the payment.

Tax capacity
This refers to such special rules as averaging for farmers and for creative artists, who may have large profits in some years but minimal profits in other years.

Miscellaneous
Finally there are other miscellaneous rules said to be introduced for administrative convenience or other pragmatic reasons, such as the exemption for small amounts of interest that are paid by the Revenue on tax refunded to a company in its final accounting period before liquidation.

It will be seen that of the above headings, arguably only three give expression to basic policy preferences– fiscal incentives, public policy and true reflection. The third reason was criticised above as not necessarily justifying a departure from accounting profits. As argued above the provisions affecting the capital/income divide are largely there for historic reasons, and might only be preserved to enhance tax revenues – an issue addressed below.

Most of the other headings are more technical in character and could be broadly described as being there to make the tax system work. If, however, such policy considerations that are designed to promote the functioning of tax law take up a large proportion of the thousands of pages of legislation, they have become self-defeating. The policies are not meeting their objective of enabling the tax system to work because they are clogging it up.

Other policy objectives leading to complexity

There are two other possible policy objectives that serve to complicate tax law. First, some tax complexity is introduced or preserved as a way of raising revenue without attracting the headlines that a simple increase in tax rates would provoke. This may, in the short term, satisfy the maxim about plucking feathers with the least amount of hissing, but it seems far from satisfactory as a long-term strategy. What may be called stealth taxes only

postpone the hissing problem until a future date when the extra taxation becomes more apparent, and they appear less than ideal in a mature democracy.

Second, some tax law is introduced to bolster earlier tax law that is shown to be inadequate in some way. A good example of this was the introduction in 2003 of the zero rate of tax for companies having profits not exceeding £10,000. A company could however earn almost £15,000 of gross profit, pay a salary of almost £5,000 to a shareholder who was a director or employee of the company, and pay out the balance of £10,000 as a dividend. The salary would be covered by the personal income tax allowance of the shareholder, and he would pay no tax on the dividend because of the tax credit that attaches to dividends. Further, no corporation tax would be payable on the net profit of £10,000 of the company. This conferred a substantial advantage on small incorporated businesses compared with unincorporated businesses (a sole proprietor would have a liability to income tax and NICs of about £2,500). A new rate of tax was therefore introduced in 2004 to reduce the advantage. This special rate, the non-corporate distribution rate, applied to tax the profits of small companies paid out as dividends to individuals. The new rules are clever, but complicated and required about eight pages of legislation. Already tax advisers are working out ways round this new law, and so the cycle continues. It is perhaps unlikely that the zero rate would have been introduced in the first place if the ensuing complications had been appreciated.

CHAPTER THREE

A STRATEGY FOR SIMPLIFICATION

The current situation

The Inland Revenue is currently working on a tax re-write project. This project is often referred to as providing tax simplification, but it is important to recognise that it is not intended to alter the effect of tax law but to rewrite existing law in order to make it more intelligible. So far the Capital Allowances Act 2001 and the Income Tax (Earnings and Pensions) Act 2003 have been finished. The PAYE regulations have also been rewritten. Another income tax act covering trading and other income is about to be enacted, leaving one more income tax act covering miscellaneous provisions, which is expected to be finalised in late 2006. It is anticipated that after this the law relating to corporation tax will be rewritten, although that will depend on the progress of the consultation exercise currently being undertaken on corporation tax.

The drafting of the rewrite bills has certainly made the provisions easier to read, and has proved worthwhile from that point of view. The underlying complexity in the law remains, however. In addition, this underlying complexity has contributed to the relatively slow progress of the tax rewrite project.

As a starting point for the reform of tax legislation, it now appears natural to focus on corporation tax. This is because there is now an opportunity to review corporation tax before it is referred to the tax rewrite team. Following a review of corporation tax the lessons that have been learnt would then assist in a review of income tax and the other taxes.

Guidelines for simplification and rationalisation

The Inland Revenue and the Treasury are engaged in a consultation process concerning certain corporation tax reforms. They issued a consultation document in August 2002, followed by a further consultation document in August 2003. The second paper requested views on the tax treatment of capital assets, the schedular system of taxation, and also the distinction between trading companies and investment companies which is made for many purposes in tax law. This second paper made clear that the Government favoured aligning tax profits with accounting profits unless there are good policy reasons for a difference, and the overall direction of the paper was to be welcomed. Less welcome, however, is the recent Corporation Tax Reform Technical Note of December 2004, which suggests that compromises may be made that could mean that the opportunity for rationalisation will be missed. (This consultation process could perhaps be criticised for the failure in the early documents to paint a fuller picture of the possible advantages of an accounts-based approach, instead of focussing on isolated issues).

Combining the Inland Revenue and Customs and Excise into one department should bring about substantial administration benefits, as reflected in the recent announcement to create a single tax return for small businesses. The December 2004 Press Release on Small Companies and the Self-Employed also confirms that strategic thinking will be required concerning aspects of underlying tax law.

A thorough review of corporation tax law is needed now, not only to take into consideration the factors mentioned in the consultation papers, but also because much of this law was made many years ago when the world was different, in particular when other tax legislation was different. Improvements could therefore be made, following which the tax rewrite team could redraft surviving legislation to make it more intelligible and user-friendly.

The following guidelines are suggested for a review.

An accounts based approach

An accounts based approach will enable much redundant legislation to be repealed.[1]

Corporation tax is a tax on profits. Traditionally tax statutes have provided detailed tax rules but have not made explicit the fundamental principles as to how taxable profits should be measured. Nevertheless the starting point for calculating trading profit has always been the profit as shown in the accounts of the business, which is subject to any adjustments required by tax legislation or by the case authorities.

However, when tax was first charged on trading profits, accounting was relatively undeveloped. Expert accounting evidence before the courts was often unpersuasive, or it was missing entirely. As a result, the courts became involved in making their own judgements on what the profit should be for tax purposes. In doing so they enunciated those principles that they thought appropriate for balancing the conflicting interests of the taxpayer and the taxing authority, such as the principle that neither profit nor loss should be anticipated for tax purposes.

Since 1971, standard setters have sought to limit and rationalise the range of acceptable accounting practices by the issue of accounting standards, initially through an arm of the profession itself, but latterly through the Accounting Standards Board set up under the Companies Act 1989. Increasingly the courts have recognised the standards issued as authoritative in determining the taxable profit of a trade, unless there is an express rule of law requiring otherwise. This position is now reflected in statute, which expressly provides that trading profits are to be computed in accordance with generally accepted accounting practice, subject to any adjustment required by law. As a result of recent changes this principle also now extends to Schedule A income from land.

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1 This point was discussed in a paper published by the Tax Law Committee of The Institute of Fiscal Studies. See Graeme Macdonald and David Martin, *Tax and Accounting: a Response to the 2003 Consultation Document on Corporation Tax Reform,* IFS, February 2004. Some of the text from that paper is repeated here.

A STRATEGY FOR SIMPLIFICATION

To a large extent, the complexity in direct tax law has occurred because it has its origins in the source system of taxation. This involved setting different computational rules for each source, and for different items within each source. However, it has given an inadequate tax base. Tax law has needed constant revision in order to plug holes – and the more legislation that is introduced in a piecemeal way in an attempt to fill gaps and make it function well, the more legislation is subsequently required to deal with further loopholes and discrepancies thereby created.

One of the most significant omissions from the schedules was what is referred to as "capital" as opposed to "income" profits. This statutory omission meant that until the advent of capital gains tax, these profits escaped the tax net, creating substantial opportunities for tax avoidance. Although capital gains tax has now been introduced, and might be viewed as another schedule with its own computational rules, it still does not always result in a comprehensive tax base. No tax is due unless there is a disposal or deemed disposal of a capital asset, and no relief is available for capital expenditure which does not result in the acquisition of an asset. Many exemptions are available which, while perhaps understandable in the context of a tax on individuals, are not appropriate for a tax on business entities.

In some respects, the basic computational distinctions between the schedules have now been removed, and the basic approach that taxable profits should equal accounting profits, subject to any rule of tax law to the contrary, has been extended beyond trading income to income from other sources. But the accounts based approach has not yet been applied to transactions in capital assets, where tax law remains a mess, nor has it been applied in general to Case III of Schedule D. Even where the accounts based approach is applied, the accounting profit can still be adjusted by a large number of tax rules that are really only a hangover from the old "bottom-up" approach to tax law, which are now no longer needed.

Corporation tax, and indeed income tax and capital gains tax, are all in essence taxes on profit. Profit for a period can be broadly

defined as the amount that can be consumed or withdrawn in that period whilst remaining as well off at the end of the period as at the beginning. It will be seen that a natural definition such as this embraces capital gains. Of course the satisfactory definition of the tax base is not quite so easily resolved, but there is now a new resource made available by modern accounting practice that provides a satisfactory starting point for the definition of profit for tax purposes. But the ingrained "bottom-up" approach to tax law still manifests itself on occasions when a new set of tax rules is invented to apply to a situation, without focusing first on the basic question of what is the profit derived from that situation.

The fundamental approach for a review of corporation tax should be, therefore, that all profits (not just trading and schedule A profits), including capital gains, should be computed in accordance with generally accepted accounting practice, save where tax law expressly provides otherwise.

International Accounting Standards are likely to mean that more assets will be revalued in the balance sheet, and this will impact on accounting profit. It would be inappropriate to tax such unrealised profit. The "profit" is too uncertain, and variations in asset values from year to year would produce too much volatility in tax payments, both for taxpayers and the Revenue. Further, it may be difficult to fund payments of tax due from unrealised profits. For tax purposes it is therefore suggested that the basic concept of profit should correspond to the concept of realised profit for company law purposes. Under current law only realised profit can be distributed to shareholders, and it seems reasonable that the basic tax approach should be that the amount of tax that is paid to the Revenue should be equal to a share of realised profit that is available for payment to shareholders. This is an example of a principled departure from a possible accounting definition of profit for tax purposes. This departure ought not, however, to undermine the basic accounts driven approach, or result in undue complexity in tax law. From a technical point of view it is not hard to legislate to exclude from tax revaluation gains on the relevant assets.

A COMPARISON OF A SCHEDULAR APPROACH

AND AN ACCOUNTS BASED APPROACH

An example illustrates the difference between the two approaches.

Five years ago, Fred set up a company that paid £200,000 to acquire a 50-year lease and fit out a High Street shop in which to run a new dry cleaning business. Unfortunately Fred was making losses and realised that he needed to cut his expenses while he built up his business. So he decided to put up a temporary partition and sub-let half of the shop for 10 years to a boot repair business. The new sub-tenant paid a premium of £50,000 for the sub-lease, and Fred's company paid £2,000 to install the partition.

Fred's accountant warned him that his tax affairs would be complicated, as he would now have three sources of income from his Case I dry cleaning business, his Case III investment income earned on the £50,000, and deemed Schedule A income as well as capital gains on the sublease. Separate calculations would be needed for all these. Fred was a pragmatic fellow, and assumed it would all turn out OK.

Schedular approach

Fred's accountant explained that under the tax rules for premiums 82% of the £50,000 would be taxed as income in the year that the sublease was granted, and the balance less a calculated proportion of the £200,000 first paid for the shop would be subject to tax on capital gains. This calculation proved immensely complicated, because the original 50-year lease was now a wasting asset, and only part of the £200,000 could be used.

There was a long correspondence with the Inspector of Taxes concerning the further proportion which related to the part of the shop which was sublet. The Inspector also argued for a disallowance for part of the fit out costs that no longer enhanced the property when the sublease was granted. The indexation allowance helped, but that was also difficult to work out.

All Fred's company expenses had to be apportioned to set against either the trading income, the deemed letting income, or the investment income. This was because there were complicated rules restricting the way in which losses from one activity could be set against profits from another activity for tax purposes. This proved to be a much more serious problem than he had anticipated.

Fred's accountant claimed plant and machinery allowances for the cost of the movable partition, but the Inspector refused because it was not provided exclusively for the purposes of either the dry cleaning business or the letting business. Eventually a compromise was agreed on this.

Fred's eventual bill from his accountant for tax advice was enormous. He wondered if he could deduct it for tax purposes, but reckoned a request for further tax advice would generate a further bill. Fred suffered from constant headaches by this stage, and he decided that tax law was crazy.

Accounts approach

On an accounts based system of tax, Fred's company would simply pay tax on the aggregate accounting profit, which would include the £50,000 premium spread over the 10 year period (i.e. £5,000 a year) with a deduction for the £2,000 spread over the 10 year period (i.e. £200 a year).

Naturally some other adjustments will always be required to the accounting profit for tax purposes. Subject to compliance with EU requirements, the UK is sovereign in tax matters, and it would not be satisfactory or democratic if International Accounting Standards prevailed in every respect so as to define taxable profits in the UK. Parliament can and should continue to provide for adjustments to accounting profits for tax purposes in circumstances where it is appropriate. Such adjustments should be possible without sacrificing the objective of simplicity, provided the adjustments do not proliferate and are not made ad hoc but on the basis of principle.

Tax law makes many distinctions that favour trading companies compared with investment companies. Many of these, relating for example to roll-over relief, demergers, company reconstructions and loss relief now appear anachronistic. The distinctions would be largely removed in a more accounts-based system.

A further benefit of the accounting approach is that it would substantially reduce the "all or nothing" outcomes that currently bedevil tax law. Usually an item of expenditure is either tax deductible or it is not, and a receipt is either taxable or it is not. Tax specialists are constantly confronted with situations, perhaps involving substantial sums of money, which might fall either side of a boundary defined for tax purposes. There may be doubt on which side it falls as a matter of statutory construction, and little reason to prefer one answer to another from an underlying policy perspective. Accounting issues are however much more likely to be concerned with the timing of the recognition of receipts or expenses, rather than whether a receipt or an expense should be recognised at all. Moving to a more accounts based system for tax purposes therefore would enable businessmen to plan with more confidence because there would be less fundamental uncertainty.

Of course timing issues can still be significant, but one other aspect of this issue should be mentioned. Companies are at present only able to pay dividends out of realised profits. Suppose that a company has a dispute with the Revenue concerning, for

example, whether a provision is correctly made in accordance with generally accepted accounting practice. If the company wins the argument, the provision would be allowed for tax purposes, but the company's profit is reduced and its ability to pay dividends is correspondingly reduced. This means that the company must retain the corresponding value and could therefore be expected to earn a higher profit in succeeding years than if it had paid out a higher dividend. Thus higher tax payments could be expected in future. This argument cannot be pressed too far, since the Inland Revenue needs to protect its own cash flow, and cannot be expected to share too much of the risk of reinvestment of the company's retained value. But it does illustrate another way in which the risks to both the taxpayer and the revenue are reduced by a more accounts based approach.

If therefore accounting output were used as the starting point for taxing all transactions, much simplification would become possible, the schedules would be abolished, the capital/income divide, as we know it, would be removed, trading and investment company distinctions would go, much anti-avoidance legislation could be abolished, and tax law would be given a coherence that has been lacking since the breakdown of the schedular system.

The schedular system is not an effective way of capturing all those transactions that go to make up an entity's profits. If a transaction cannot be attributed to a source as legally defined in the schedules, it is excluded from the tax base. By contrast, accounting will account for all transactions, even if some of them may not appear in the profit and loss account.

The Technical Note on Corporation Tax Reform issued on 2 December 2004 proposes a halfway house solution of merging trading and letting and certain miscellaneous items for tax purposes, but leaving other investment income and capital gains to be dealt with separately. This proposal will not achieve substantial benefits in terms of simplifying tax law, but much new tax law would be required to implement it. It would be much better to abolish the schedular system entirely.

A comparison of an accounts based approach with the existing schedular approach

Accounts Based Approach	Schedule Based Approach
"Top-down" – accounting profit applies unless good reason to depart from this	"Bottom-up" – different tax rules for each situation, aggregating results for total profit
Capital and income profits pooled	Capital and income profits calculated under different rules
Tax distinctions between trading and investment activities not recognised	Tax distinctions made between trading and investment activities
Disputes more likely to concern timing	Disputes more likely to be "all or nothing"
Simpler and less distortive	More complicated and distortive

A purposive approach

A more purposive approach to drafting which clearly revealed the underlying tax principles and underlying objectives of Parliament would also cut through many of the ad hoc rules in tax law. The argument to the contrary is that detailed rules are required in order to give certainty of tax treatment for particular situations. This is sometimes true within a limited context. Given the infinite variety of possible actions available to taxpayers, however, it is not possible for Parliament to anticipate them all in tax legislation. Furthermore, it is not worth the effort, because introducing too many rules obscures the principles involved – complexity in drafting can thus give rise to new doubts concerning interpretation.

Moreover, the tax consequences that may first appear to result from an analysis of complicated tax legislation may not in fact apply by reason of recent anti-avoidance cases decided in the courts. These cases have given rise to a huge debate concerning their scope and tax effects, but they have not produced certainty as to how complicated tax legislation is to be applied.

A more purposive and principled approach to drafting tax law would lead to clearer legislation. It could be supported by a system of pre- and post- transaction rulings, so that when necessary a taxpayer can test how the tax authorities consider the law to apply to his own circumstances. To a large extent such a system is already in place. The Revenue is committed to providing a post-transaction ruling where there is doubt as to the tax treatment of a transaction that has occurred, to enable the taxpayer to complete his self-assessment. They will also give a pre-transaction ruling on legislation (including its application to a proposed transaction) contained in the last four Finance Acts, or within an area of major public interest within an industry or in the financial sector.

Of course, in order to be fair between taxpayers, the tax authorities need to be consistent in their application of the law, and may need to publish their decisions. This need not replicate the problems of over-complex legislation, however. The law would remain simple, and be readily understood by all. Taxpayers would be able to check whether their circumstances fell within those of an earlier ruling, and in limited situations where it remained necessary reserve the right of appeal before a tax tribunal.

A purposive approach to a review of corporation tax would however extend beyond eliminating unnecessary rules and detail. There are situations which are similar to each other but which have been addressed by tax law at different times. The tax law for one situation resembles the tax law for the other, but there are nevertheless differences that are hard or impossible to account for. Where a common policy should apply, tax law should conform so as to avoid duplication and to simplify the law. Examples of this might be the taxation of different benefits in kind provided to employees, or anti-avoidance provisions applicable to loan relationships, intangible fixed property or other “capital” assets. The rules could be combined and streamlined.

A comparison of a purposive approach with the existing approach

A more purposive approach	Existing approach
Makes underlying principles clear	Can obscure underlying principles
Fits more comfortably with recent case law	Recent case law does not fit comfortably
Tax rulings helpful	Tax rulings still helpful, even though tax law is intended to address more situations
Applies similar rules to similar situations	Applies different rules to similar situations

The various parts of tax law should fit together well
The review of corporation tax law should also clarify how the various areas of tax law should fit together. At present, because tax law has grown piecemeal, there are separate systems for income, capital gains and capital allowances that do not always fit comfortably. To take some simple examples, there are different rules for establishing the time of a disposal for capital gains and for capital allowances purposes, and different definitions of what incidental costs are to be included for both purposes. Complex rules are currently required to ensure that expenditure, profits and losses are not recognised more than once by virtue of the separate tax regimes.

In the Revenue Technical Note of December 2004 it is proposed that the profits from the sale of plant and machinery should be included within the capital allowances code, thereby simplifying matters by avoiding the need for a separate capital gains code. This could be criticised however as a piecemeal suggestion which does not deal with other assets qualifying for different capital allowances or not qualifying for capital allowances at all. Second, it further obscures the basic objective of corporation tax: that it should be a tax on profit. When tax law tries to construct its own “bottom-up”

rules for producing a figure for taxable profit, so that for example gains on sales are not taxed immediately but over a period of time through the capital allowances system, avoidance is likely to follow, to be followed as ever by further anti-avoidance legislation, complication and obscurity.

The accounts based tax code that already exists for intangible fixed assets, and which provides a complete code for taxing such assets within a single schedule, would be an appropriate template for a much more comprehensive class of assets. The intangible fixed asset legislation does away with separate capital gains legislation and capital allowances legislation, and there seems no good reason why this approach should not be adopted more generally.

The original policy should be checked

Many tax rules were introduced at a time when circumstances were different, and also when the framework of tax law was different. For example an anti-avoidance provision introduced before capital gains were taxed may now be unnecessary. The review should also take into account whether sufficient weight was given to simplicity when the legislation was first introduced.

CHAPTER FOUR

THEORY INTO PRACTICE

Corporation Tax

Theorising over tax simplification can only take the matter so far. There is no substitute for examining some of the legislation, having the above principles in mind, to discover what might be achieved in practice.[2]

Capital Gains

It would appear sensible that those parts of the Taxation of Chargeable Gains Act (TCGA) 1992 that are applicable to companies should be enacted in any new corporation tax act. An analysis is therefore required of the provisions of the TCGA 1992 in so far as they apply to companies.

Although accounts will not reflect the tax distinction between "capital" profits and "revenue" profits, some issues arise in connection with the taxation of capital assets that have particular importance having regard to a more accounts based approach. A "capital" transaction is perhaps more likely to be a "one-off" transaction, opening the possibility of the taxpayer choosing an accounting treatment or policy with that specific transaction in mind so as to minimise tax. Gains or losses may be more substantial than those that arise on trading assets. Nevertheless,

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[2] Some of the topics discussed below are based on Graeme Macdonald and David Martin, *Aligning Tax and Accounting Profits – The Need to Review Current Legislation*, IFS, November 2004. It is recognised that much of what follows in this section may not be readily comprehensible by someone who is not a tax specialist, but it is hoped that it may convey an impression of what is considered possible.

the introduction of a more accounts based approach which ignores the distinction between capital and revenue items in relation to loan relationships, derivatives and intangible fixed assets has been broadly successful, and has demonstrated that the numerous separate rules contained in the TCGA 1992 in order to tax these assets are not needed.

The code for intangible fixed assets in schedule 29 FA 2002 is perhaps the most comprehensive of the three. It supplies practical evidence that the approach could be adapted for other capital assets so as to avoid duplication and simplify and rationalise corporation tax. Naturally certain additional provisions and exceptions would also need to be included for certain other assets or situations, not relevant for intangible fixed assets, such as rollover relief, share reorganisations, value shifting and so on.

There are also provisions in TCGA 1992 that may be appropriate for individuals outside a business context but are not appropriate for companies. These provisions should be omitted from a new corporation tax act, thereby resulting in further simplification and rationalisation.

Of approximately 88 provisions in TCGA 1992 which could result in tax profits differing from accounting profits for companies, it is suggested that approximately 55 could and should be abolished, either because of the more accounts based approach, or because they are inappropriate for companies, or because there is duplication with law now contained in the intangible fixed asset legislation which could be extended to other "capital" assets. Some of the other provisions should be simplified.

Depreciation

The issue of tax relief for depreciation has a long history. Following unsuccessful attempts by traders to obtain a deduction for depreciation of fixed assets an allowance was introduced in 1878 for the diminution in value of plant and machinery due to wear and tear. The Income Tax Act 1945 substituted the system of capital allowances for plant and machinery, industrial buildings and the costs of certain other items such as patents.

All this occurred before the taxation of capital gains was introduced in 1965. As discussed above the separate codes for capturing capital and revenue profits serve to produce confusion and complexity, and this point was reflected in the August 2002 Consultation Document. This made it clear that at that time the Government was attracted towards aligning accounting and tax profits, and thereby reducing capital/ revenue tax distinctions, subject to any costs to the Exchequer of doing this.

In the 2004 budget it was announced that the Government had decided to keep the capital allowances system, a decision which ran contrary to the earlier objectives, and which (because tax depreciation under the capital allowances system generally runs ahead of accounting depreciation) costs the Government money.

The Revenue Technical Note of December 2004 reports that businessmen like the capital allowances system for providing tax depreciation for the cost of machinery and plant for the certainty it provides, for avoiding the need to track individual assets, and for the incentives that it gives.

It is not clear, however, what is the justification in the modern world for giving accelerated tax relief for machinery and plant, having regard to the arguments above concerning distortion and incentives. It is necessary to calculate depreciation for accounting purposes already, and so no extra work should be required for tax, save possibly for checking the depreciation rates against guidelines that would need to be issued by the Revenue. Certainty would be available if the rates of depreciation claimed are not aggressive.

Under the capital allowances system tax profits can differ from accounting profits not only because the tax depreciation differs from accounting depreciation on particular assets, but also because under the pooling system the sale of one asset can change the tax depreciation on other assets. The reconciliation of accounting and tax profit becomes that much more difficult. It is the theme of this paper that when steps are taken to make tax profits different from accounting profits the result can be great complexity which was not originally foreseen. Thus, in order to

establish a capital allowances regime, and then to try and reduce some of the distortions thereby created we now have a Capital Allowances Act 2001 which has 581 sections and 4 schedules. It contains separate systems of allowances for plant and machinery, industrial buildings, agricultural buildings, mineral extraction, research and development, know-how, patents, and assured tenancies. The system of allowances for plant and machinery, in particular, contains a large number of sub categories for which different rules apply. Even so the Act does not contain all the rules for tax depreciation, some of which are to be found in other acts. The generous tax depreciation afforded to plant and machinery is the basic cause of much subsequent legislation directed at the leasing industry in an attempt to limit the difference between tax and accounting profit of lessors. Almost all of this law could be abolished if accounting depreciation were to be followed more closely for tax purposes.

Of course, if capital allowances were abolished in favour of a general allowance for depreciation, disputes would still arise as to the rate of depreciation. At least, however, such disputes would be grounded in physical and economic reality, rather than in the meaning of complex capital allowances legislation. Also such disputes would be readily comprehensible to an ordinary businessman not trained in tax law, in contrast to many disputes concerning capital allowances legislation, and would be very suitable for resolution (if need be) by a local tax tribunal.

In common with many accounting questions, disputes over the rate of depreciation concern the timing of relief, rather than the amount to be relieved. At present, by contrast, disputes over capital allowances are likely to concern the question of whether allowances are available at all. The issue sometimes arises for example of whether assets qualify for capital allowances as machinery or plant. The case authorities show that plant and machinery must be "functional", in contrast to assets that are merely be part of the "setting". Arguments over this can provide a good example of where tax practitioners appear to operate in a

world separated from reality. Hands up those who really believe that cold water systems should normally not qualify for relief, whereas hot water systems should!

It is suggested that, as far as possible, the system should be modernised so as more closely to reflect commercial reality. The capital allowance pool, which currently includes such disparate items as books and buses, teapots and turbines, should be modified to include only smaller items, where the identification of individual assets might indeed be more difficult. The economic case for accelerated allowances for larger items should be reviewed. Tax depreciation for fixtures should be dealt with in accordance with rules that should apply for the building as a whole. Where possible the rules for the other capital allowance regimes for other assets should be aligned.

Tax relief should also be given on an accounting basis for the cost of assets that do not currently qualify for capital allowances. This also implies that immediate relief should be available for capital expenditure that does not result in an asset that is recognised in the accounts. There is no justification for not allowing tax relief for business expenditure consumed in earning taxable profits.

This process would reduce the existing potential for "all or nothing" disputes on the boundaries. It would also reduce the distortive effects of the current system. These do not only relate to the relative positions of taxpayers who have a small or a large proportion of capital expenditure on plant and machinery, or the decision as to which assets to buy or to sell, having regard to their different tax treatment. The distortive effects extend to a myriad of such other matters as whether to buy or lease assets, whether to buy or sell assets or the shares in a company owning the assets, or whether to buy a new or a used industrial building. The process should also aim to reduce the many limits and special rules applying for example to expenditure on expensive cars, long life assets, or office accommodation within an industrial building, and so on, which currently complicate and distort the system.

Anti-avoidance Provisions

Detailed consideration of anti-avoidance provisions leads to the conclusion that the rules can often be substantially simplified in order to focus clearly on what is the mischief. In its determination to attack avoidance, Parliament often adopts a scattergun approach that is too wide for the intended target and which stimulates taxpayers who would not normally be aggressive in their approach to tax matters to take further avoidance steps. At the same time, separate sets of rules are too often directed in this unfocussed manner at separate targets, when similar principles are involved and the rules could usefully be combined in a single clear approach.

The accounts of a company, if properly prepared, provide a comprehensive reflection of all transactions undertaken by the company. As mentioned above, it is necessary of course to consider the circumstances in which a company might wish to reduce its accounting profit for tax reasons. In particular the circumstances need to be identified in which a profit that would otherwise accrue to the company is diverted to a different entity that is more lightly taxed. Anti-avoidance legislation is likely to be required in these circumstances.

Much anti-avoidance legislation is also directed at preventing a company manipulating its affairs to exploit tax differences between the schedules, or between income and capital receipts or expenses, or between trading and investment activities and so on, even though its aggregate accounting profits may be unaffected by such arrangements. The best place for such anti-avoidance rules, such as the *bona fide* commercial requirement for roll-over relief on share for share exchanges, or the precise conditions for enhanced relief for expenditure on research and development, or relief for gifts to charities, is often within the provisions themselves, rather than in generalised anti-avoidance rules. In this way they can be accurately targeted.

This also illustrates the general point that the more distinctions are introduced into tax law, the more taxpayers will have the desire and also the scope for taking artificial steps to take advantage of

favourable distinctions and to avoid detrimental distinctions. Some statutory tax adjustments to accounting profit will remain appropriate, such as, for example, the general exemption from corporation tax for UK dividends; anti-avoidance rules will still need to catch artificial arrangements for exploiting such provisions. The abolition of many other distinctions would however enable avoidance legislation to be considerably simplified.

Much anti-avoidance legislation was introduced when other circumstances, not merely the development of accounting standards, but also other tax legislation current at the time, was different to the present. There is for example anti-avoidance legislation on the statute book which was introduced before capital gains tax, corporation tax or the imputation system, or the abolition of repayable tax credits on dividends, and which may no longer be accurately focussed having regard to the original mischief. Further, some anti-avoidance legislation is only appropriate in relation to non-company taxpayers and could be omitted from a new corporation tax act.

Where two or more accounting treatments are available, tax law can if desired be introduced to prevent a company using the accounting treatment that minimises the profit for tax purposes. Such possibilities for tax legislation do not fall within the scope of an analysis of anti-avoidance law, although they need to be identified.

Analysis leads to the following conclusions about the anti-avoidance sections that are grouped in Part XVIII of the Taxes Act (TA) 1988:

- Sections 730, 736, 757-764,780, 781, and 782 TA 1988 should all be abolished. This is either because they have no function for companies in an accounts based tax system, or because they are only appropriate for individual taxation, or because they promote avoidance.
- Sections 703 to 709 TA 1988 are inappropriate in their current form for company taxation. Section 730A should be simplified.

- Sections 768, 768A, 768B, 768C, 768D and 768E TA 1988 should be substantially simplified and rationalised following the abolition of the schedular system.
- Section 774 TA 1988 should be amended.
- Section 776 TA 1988 should be substantially restricted so as to apply only to "diversion schemes" for passing profits from transactions in land to lower taxed entities.
- Section 779 TA 1988 should be substantially restricted in an accounts based system of tax.
- Section 786 TA 1988 should be expressly restricted to tax avoidance.

Opinions may differ in relation to the detailed analysis of the sections but it clearly demonstrates that there should be a review of the anti-avoidance legislation before it is re-enacted in a corporation tax act.

It is understandable that the Revenue would be reluctant to see anti-avoidance legislation removed from the statute book. It is under pressure to enforce the collection of tax and there is no benefit from being, or being seen to be, soft on avoidance. However, the current anti-avoidance legislation should be tested, perhaps by reference to precedents available to the Revenue, to see if it is still needed. The law should be amended if it appears to be mandatory but nevertheless is not generally applied by the Revenue, and/or results in double taxation, and/or could be more focussed so as to address the real mischief. Anti-avoidance legislation would become more effective if it were clarified in these ways.

Schedule A

Welcome steps have been made towards aligning the principles of Schedule A taxation of land with the principles of taxing trading profits, and thereby aligning Schedule A taxable profits more closely with accounting profits. In particular the abolition of the rules that Schedule A income and expenditure were recognised

for tax purposes when they became due and payable led to much abuse, which is no longer possible now that an ordinary accounting accruals basis applies.

Most of the remaining Schedule A rules apply to the taxation of lumps sums which may be received as a premium on the grant of a lease or as the sale price for the sale of rents. The accounting treatment of such lump sums for the landlord is to spread them over the period to which they relate as if they were rents. For tax purposes, however, a variety of rules have accumulated to tax the lump sums.

An accounts based system of corporation tax would enable most of the sections (namely 34, 35, 36, 37, 40 43A to G of the Taxes Act 1988) to be abolished. This is perhaps not very surprising since the sections (save for 43A to G) were introduced to define what the taxable profit should be in circumstances where an accepted accounting treatment was missing, and in circumstances where it was necessary to plug holes created by other tax law to ensure that an appropriate level of tax was paid. The sections now stimulate tax planning, rather than the reverse.

Schedule 18 Taxes Act 1988

There are rules for permitting one company in a group to surrender tax losses of an accounting period to be set against tax profits realised in the same accounting period of another company in the group. This is reasonable, and respects the fact that the businesses of group companies are in substance under the same ownership even though the businesses are in form separately owned by two companies.

In order to prevent abuse, however, rules are necessary to ensure that the two companies are truly under common economic ownership and not linked by artificial shareholdings which do not carry genuine economic rights.

The rules now appearing in schedule 18 of the Taxes Act 1988 were first introduced by the Finance Act (FA) 1973, although significant amendments have been made subsequently, such as the provisions governing option arrangements in 1992. The substance

of the schedule 18 rules is that a parent company not only requires at least 75% by nominal value of the ordinary share capital of a subsidiary for group relief, but also an entitlement to at least 75% of the profits of the subsidiary and of the assets of the subsidiary available for distribution to all "equity holders" in the subsidiary. Further, for relief to be available in the current accounting period, these conditions must not only be satisfied in the current accounting period but also, having regard to such matters as varying share rights and option arrangements, in future accounting periods. Although the rules have been developed and modified over the years, problems and inconsistencies remain. They still leave scope for tax planning which the draftsman would not have intended.

The legislation is lengthy and complex, and the analysis that is required is necessarily also lengthy and detailed. At heart, however, the provisions that are required to achieve the tax objective need not be that complicated The more important points are mentioned below.

New, clearer, definitions of profits and of assets attributable to equity holders should be provided. The concept of "equity holder" should be aligned with the concept found elsewhere in tax legislation, since there is no reason for distinctions to be made; the definition of loans that are not normal commercial loans in schedule 18 should therefore be aligned with the definition of loans on which interest is deemed to be a distribution; the definition of shares that are not fixed rate preference shares in schedule 18 should aligned with the definition of ordinary share capital. The concept of the entitlement of shares or loans with limited rights being determined as if those limited rights were waived should be amended. The possible effects of variable rights and option arrangements at any future time should be taken into account, but the possible effects of variable rights at any future time should not be taken into account together with the possible effects of option arrangements at any other future time.

The surprising consequence of the above changes is that it appears that the legislation can be substantially simplified and be reduced to about one fifth of its present length, and achieve its intended purpose more successfully.

Income tax

Many of the lessons of corporation tax reform could be applied to income tax. Substantial rationalisation and simplification should be possible.

The Income Tax (Earnings and Pensions) Act 2003 has almost 750 sections and eight lengthy schedules. Hundreds of sections are, for example, devoted to the taxation of benefits. It should be possible to extract the principles involved, to conform the position in relation to separate charging provisions where no real issues of principle are involved, and to have a simpler and shorter act.

The new Income Tax (Trading and Other Income) Bill is likely to have about 900 sections and four schedules. Given the will to simplify, and the additional policy of a more accounts based approach, this could also be substantially simplified. In due course the tax profits of a business should be defined for an individual in the same way as for a company. Most of the points made above in relation to corporation tax would then be valid in relation to the taxation of an unincorporated business.

Work is also commencing on a third miscellaneous provisions act, many of which (such as the anti-avoidance provisions mentioned above), are likely on analysis to prove unnecessary or to be capable of being rationalised and improved.

Given however that these bills have only recently been enacted, or are just about to be enacted, it is suggested (as mentioned above) that the best practical approach is first to concentrate on the reform of corporation tax, and then to apply the fundamental lessons that have been learned to income tax and capital gains tax in due course.

This approach should not result in unnecessary delay in some well-defined areas where earlier reform may be practicable. It is notable that even the rates of income tax are complicated. Not

only is there a starting rate (currently 10%), a basic rate (currently 22%), and a higher rate (currently 40%), there is also a lower rate (currently 20%, for certain savings income) and the schedule F ordinary rate (currently 10%) and the schedule F upper rate (currently 32.5%). Anyone who wishes to discover how these various rates apply will find the details in sections 1, 1A and 1B of the 1988 Taxes Act. But they would need a lot of time to master these details. These rates should be simplified.

There are further complexities that have recently had an impact on many ordinary taxpayers. One good example is known by the title of the Inland Revenue booklet "IR35", which applies to people who set up their own companies to carry out work for third parties. It provides for the individual to be liable to tax on a deemed employment payment if it is not paid out to him as salary. There is a complicated formula for the deemed employment payment. In the view of many commentators the law was introduced without compelling reasons, and made new distinctions between taxpayers that appear artificial.

Another example is the recent application by the Revenue of anti-avoidance legislation to companies owned jointly by husbands and wives. Under this legislation dividends received by a wife are deemed to be income of the husband unless the wife makes a full working contribution to the company herself.

Neither the new legislation (in the first case) nor the new approach (in the second case) appears justified by any abuse, but both have created widespread uncertainty. They are piecemeal measures that do not reflect a coherent approach to the problems arising from taxing earned and investment income, and the family unit.

Capital Gains Tax

Capital gains tax can be almost frightening in its complexity. The complexity of capital gains tax is also a cause of it being a very expensive tax to administer.

Anyone who has held shares over a period of time, and perhaps added to that shareholding through purchases or by

rights or bonus issues, and then sells some shares, is likely to be flummoxed by the rules for identifying shares acquired with shares disposed of, and by the rules for taper relief. The formulae for calculating the gain on the grant of a lease are unnecessary and illogical. Many other examples could be given.

The review of the TCGA 1992 that is proposed for corporation tax purposes would substantially simplify the position for companies. It is suggested that most of the analysis for companies could also be applied to individuals (and partnerships of individuals) if they are in business, so that business profits would be calculated in the same way as for companies.

The capital gains rules for individuals who do not conduct a business could be improved by revising the list of assets outside the scope of capital gains tax as appropriate for the non-business context. Many miscellaneous small reliefs and exemptions should be repealed, particularly in circumstances where there is in any event an annual exemption for the first £8,200 of gains in any year. Detailed changes for such matters as shares and land should be introduced, as mentioned above.

It is sometimes argued that capital gains tax should be abolished altogether. This could, however, open the way for all kinds of avoidance. There are strong arguments in favour of roll-over relief in certain situations, so that no immediate charge to tax then arises when the proceeds of sale of assets are reinvested in other replacement assets. But any tax should become due when these assets are sold and not replaced.

VAT

VAT must satisfy the requirement of the European law from which it is derived, and that clearly reduces the scope for reform. Some of the complexity in VAT legislation is due to the detailed differentiation between standard-rated, zero-rated and exempt supplies, as was touched on above. Detailed improvements may be possible, but VAT is not likely to be susceptible to major rationalisation in the same way as other taxes.

National Insurance Contributions (NICs)

Heavy compliance costs are imposed by the complex rules for NICs. A high proportion of businesses now outsource payroll services to third parties, largely by reason of the difficulties associated with NICs.

The rules for defining income subject to NICs should be aligned with the rules defining income for income tax purposes, so that the PAYE regulations would apply in the same way for both. This should, eventually, lead to NICs and income tax being combined into one system, (and of course thereby lead to the end of complicated schemes for avoiding NICs on employee benefits).

The difficulties in achieving this would appear to be political and procedural, rather than technical tax law, because it would have finally to be recognised that NICs are in reality a form of income tax, and there would be losers as well as winners when the rules are combined.

Inheritance tax, stamp duty, environmental and other taxes

These taxes may not be susceptible to fundamental rationalisation, and the only major possible change might therefore be the complete abolition of a tax. Detailed improvements are of course possible.

Although stamp duty has been substantially simplified by the fact that it no longer applies to transfers of most assets, some old stamp duty law could perhaps be tidied up. Stamp duty should be made more fair, by the reform of the current banding system which results in large incremental tax liabilities at the lowest level of each band.

Measures introduced to prevent avoidance of inheritance tax will need to be well focussed and clear, particularly where (as is the case under the rules for pre-owned assets), they may apply to commonly held assets and common transactions, such as equity release schemes for houses.

CHAPTER FIVE

THE IMPACT OF REFORMS

Summary of what may be possible

Given the political will, substantial simplification and rationalisation is possible. This optimism, it is fair to note, is not shared by everyone. It can be argued that efforts at simplification have been tried and failed, for example in Australia and New Zealand. It could also be argued that there are moves in some countries, such as Germany, which have historically had a strong dependence for tax law purposes on accounting, to depart from this by introducing more special tax rules. These changes often appear to reflect an effort to raise taxation, however, rather than a deficiency in the accounts based approach. They result, as has been noted above, in additional complexity, and contribute to a spiral of avoidance and further counter measures that we well recognise in the UK.

Simplicity is possible and desirable. Simplification does however require the following preconditions:

- detailed and careful consideration of the legislation;
- the clear policy objective of achieving greater simplicity.

The process could to some extent be incremental over a period, provided the general objectives had been decided on and announced in advance.

This process would remove many economic distortions, reduce the scope for avoidance, create a much more user-friendly system which could be envy of our international competitors, and reduce compliance burdens on taxpayers.

Companies would pay tax on their accounting profits, save for limited exceptions where policy considerations require adjustment. Individuals would pay tax on a similar basis if they were in business. Employees would have a simpler code for taxing income and benefits. Other taxes, in particular capital gains tax, would be reformed as well.

The transitional position

There is a natural tendency to view regulatory or tax changes as unwelcome, particularly where such changes are not accepted as necessary. Reform of tax law is essential, however, and would result in substantial simplification and rationalisation. Provided the broad impact of the proposed changes were understood in advance it is suggested that they should be well received. The end result will be worth the effort, and there would be a sense of direction inherent in the proposed changes that would contrast to the complaint of "endless fiddling" often levelled at new tax law.

Impact of the reforms on the Treasury

Clearly if depreciation on a wider range of assets is allowed for business tax purposes, there could be a significant tax loss to the Treasury. Set against this would be the possible reduction or elimination of accelerated tax relief for certain assets under the capital allowances system.

The abolition of the schedular system would also result in more tax losses becoming utilised, assuming the current restrictions on setting losses from one source against profits from another source were removed. If "capital" losses were put in the same pool as "revenue" losses, this would also result in a tax cost to the government.

While an economic analysis of corporation tax rates is beyond the scope of this paper, it should be noted that the rate of corporation tax has been held at 30% for several years, whilst rates in competitor countries have fallen. For economic as well as political reasons, it is unlikely that increasing headline rates to

compensate for allowing depreciation for tax or the pooling of losses would be attractive. It would appear attractive, however, to give priority to rationalising these matters over further reductions in the headline rate of corporation tax. Naturally there would still be some relative losers, being for example those taxpayers who do not happen at present to have unallowed capital expenditure. If the policy change is correct, however, it would be right to regard these "losers" as former "winners" who have benefited in the past at the expense of other taxpayers, who have had legitimate business expenses disallowed, and all should now operate on a level playing field.

Unless extra profits are genuinely earned by overseas subsidiaries, a more accounts based approach would restrict ways in future in which accounting profits in the corporate sector and tax receipts from that sector could diverge.

Reduced administrative costs by the tax authorities would also help headline tax rates to be kept down. Furthermore, the simplification would have a positive impact on business, and attract business from overseas, so as to increase overall UK taxable profits and enable headline rates of tax to be kept down.

CHAPTER SIX

MAKING NEW TAX LAW

Limitations of the current review process

While much progress has been made in producing draft legislation for comment in advance of the Finance Bill, few significant changes to legislation occur during the passage of the Finance Bill through Parliament. The process is left in the hands of Junior Treasury Ministers whose remit is to get the Bill through with the minimal fuss. Since the opposition has little prospect of success in making changes, it often contents itself with rude criticism in the Budget Debates before moving on to other more rewarding activity.

New procedures should be developed to improve new tax legislation, to create truly democratic control, and to give due weight to the policy of simplification and user friendliness. In March 2003 a report of a working party chaired by Sir Alan Budd, building on recommendations of the Modernisation Select Committee, concluded that Parliament should involve itself at an earlier stage than is presently the case in the process of examining the government's tax proposals and legislation. It is also noteworthy that the House of Lords Economic Affairs Subcommittee has recently considered technical issues arising out of draft tax legislation, and done so in a manner that was far less politicised than in deliberations in the Commons.

Lord Howe of Aberavon, for example, has expressed the view that what is needed is to establish and institutionalise a process whose continuing insistence on simplicity is as irremovable, and as constantly present, as the voice of the tax-raising departments –

and as the politically restless, impatient, input of successive Chancellors. He has suggested that there should be a tax law review programme, working alongside the tax law rewrite project, whose remit would be working for simplification and stability in tax law.

An improved foundation for new tax law

The process of making tax law more complicated cannot continue forever. There comes a time when confidence could be lost in the whole edifice, and at that point voices would be raised in favour of complete demolition rather than reform. It is suggested that this point has not yet been reached in the UK, but it may not be long coming. Reform of direct taxation in particular is desirable and practicable. A government that achieved this might have a more enduring legacy compared with a government that only adds to existing legislation.

Rationalisation and simplification of tax should begin with a review of current law, and in particular the opportunity should be taken to review corporation tax law before it is passed to the tax rewrite team. The lessons learned could then be applied to an overall review of other taxes, although detailed improvements to those other taxes need not be delayed until then.

The pressures on government to make new tax law are understood. Future changes in tax law will always be required to reflect changes taking place in the world and to reflect changes in policy. If however current tax law can be revised to make it much easier to understand and to use than it is at present, unwarranted complexity in future legislation could be more easily identified and rejected, and the benefits of reform could therefore be lasting.

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The answers to the quiz on page 10 are below. However, one of the answers is deliberately wrong. A bottle of champagne is offered for the first postcard identifying which answer is wrong, and the reason why it is wrong. Please send answers to The Editor, Centre for Policy Studies, 57 Tufton Street, London SW1P 3QL. The editor's decision is final.

	Zero-rated	Standard-rated
1. Chocolate ice cream	☒	☑
2. Chocolate for diabetics	☒	☑
3. Chocolate chip cake decorations	☑	☒
4. Chocolate button cake decorations	☒	☑
5. Chocolate jaffa cakes	☑	☒
6. Chocolate spread	☑	☒
7. Nuts with chocolate coating	☒	☑
8. Gingerbread man with chocolate eyes and mouth	☑	☒
9. Drinking chocolate	☑	☒

SOME RECENT CPS PUBLICATIONS

THE PRICE OF PARENTHOOD **£7.50**

Jill Kirby

For many ordinary families – particularly two parent families with only one earner – the price of parenthood is too high. A couple on average income with two children pay over £5,000 a year more in tax than they receive in benefits. If they break up, they can receive nearly £7,000 a year more in benefits than they pay in tax. Why, asks the author, does the state subsidise family breakdown when it is so damaging for all concerned? America experienced a similar pattern of spiralling welfare costs but took radical steps to reform welfare in the mid-1990s and has since reduced welfare dependency by more than 50%. Jill Kirby concludes that in order to rebuild family life and cut welfare dependency, Britain must learn some of the lessons of US welfare reform – and support rather than penalise two-parent families.

"Rarely can there have been a more glaring example of a government lost in a fog of its own making than the extraordinary affair of family taxation, as exposed by the Centre for Policy Studies" – leading article in the *Yorkshire Post*

REFORMING THE PRIVATE FINANCE INITIATIVE

Philippa Roe and Alistair Craig

Britain is a world leader in developing PFI projects. However, if we are to remain ahead of the pack, and export best practice to other countries, reform of PFI is now necessary. For, despite clear evidence that PFI has provided good value for money for the taxpayer, a number of criticisms have been made. For example, the uses of PFI to classify a project as "off-balance sheet" should be stopped; equally the Public Sector Comparator (the means by which a value-for-money comparison is made between the private and public contractor) should be abolished and replaced, where possible, by sector-specific benchmarking. The authors also recommend greater transparency in government liabilities for PFI projects; enhanced public sector expertise in negotiating PFI contracts; and the introduction of compulsory tendering for all the professional advisers to PFI transactions.

"Leading think tank, the Centre for Policy Studies has launched a wide-ranging attack demanding a shake-up of how major public sector projects are delivered – Evening Standard

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Social services and the NHS are failing the 49,000 severely disabled children in this country. Care is fragmented, seemingly arbitrary and often inadequate. It is time to give disabled families more control over their own lives. To this end, the money spent by social services on 'assessment and commissioning' tasks (over a quarter of the total spent by social services on disabled children) should be paid directly to disabled families. In addition, the supply of respite and residential care homes should also be liberated by modernising the regulatory approach (through the adoption of the ISO 9000 quality control system) and by providing a more attractive fiscal regime. These proposals are consistent with the broad direction of public sector reform: they are based on giving greater choice to disabled families and greater freedom to suppliers of care to respond to that choice.

"An important and eloquent pamphlet" – Minette Marrin in *The Sunday Times*

"It comes to something when some of the most practical and insightful recommendations for improving the lot of families with disabled children come not from the political left, but from the right" – leading article in *The Independent*

WHY BRITAIN CAN'T AFFORD *NOT* TO CUT TAXES **£5.00**

Lord Blackwell

The main political parties are asking the wrong question about tax. The right question is not "can we afford to cut taxes?", but "can we afford ***not*** to cut taxes?" For cutting taxes is not only desirable both morally, economically and in terms of wealth creation. But, crucially, after a period of huge increases in public sector spending, it will also impose an essential discipline to constrain the further growth of the public sector. Blackwell proposes five reforms: raising income tax thresholds to £7,500, and introducing transferable allowances for parents with children; rescinding the £5 billion of taxes taken from pensions; increasing ISA limits to £20,000; abolishing inheritance tax; and reversing the increase in employers' national insurance contributions.

"Stopping the insidious economic damage done by bad and excessive taxes ought itself to be a key economic policy objective… If you start from that point, Lord Blackwell says, instead of assuming that spending is sacred and tax cuts are, therefore, impractical, you begin to think differently" – Patience Wheatcroft in *The Times*

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