

Summary and recommendations

Tax and tax policy are at the heart of the state, reflecting decisions on how public services are financed. Tax policy has developed far beyond its traditional focus on revenue raised (and its stability and predictability), to encompass assessment of the effects of taxation on efficiency, fairness, incentives, and competitiveness, as well as taking account of compliance and administration costs. The challenges for tax policy increasingly relate to ensuring coherence across the tax system, to using tax in support of the Government's wider social, economic and environmental objectives, ensuring that the system adapts to change in the UK and internationally, and ensuring policy is based upon firm evidence and best use is made of information.

The Government has pursued an active tax policy agenda, and has ensured coherence despite organisational arrangements, rather than because of them. Building on this success, and reflecting the recommendation that a new department should be created, it is sensible to consider the arrangements for tax policymaking to ensure continuous improvement in the ability of the Government to respond to a dynamic environment. The review recommends creating new and clearer roles for the new department and the Treasury, under which the Treasury would take a greater responsibility and corresponding accountability for tax policy.

This change will present a considerable challenge for the Treasury and the new department. Both will need to adapt swiftly to the new arrangements, with internal reorganisation to take account of the new situation. The change will need a significant management effort to establish and sustain. To be successful, the new arrangements will need to be founded on a new culture based on the best of the existing cultures and founded on evidence, analysis and active engagement with external stakeholders.

The review recommends that:

- the Treasury should have lead responsibility and accountability for tax policy, with support from the new department, and subject to this, the new department should lead on policy maintenance, with support from the Treasury; and
- the Treasury's capability for high-level analysis of the tax regime should be strengthened, to develop a better evidence base for tax policy and a clearer focus on tax policy objectives.

Flowing from these recommendations:

- the new arrangements should be founded on an outward facing culture of policymaking, with greater contact between officials and external stakeholders. To facilitate this and to broaden the perspectives on tax policymaking, the number of external secondees in the policy centre should be increased;
- the Treasury and the new department should ensure that the links between implementation and policy continue to improve as a result of the proposed changes to policy arrangements; and
- a significant new tax analysis and statistics unit should be established in the new department, with a work programme and resources governed by a steering group including important Government stakeholders, incorporating and building on existing analysis and research functions in Customs and the Revenue.

INTRODUCTION

5.1 Just over 1% of the staff in the three departments work on policy, with more than 90% of these in the revenue departments.¹ As the Chancellor has stressed, they have played a key role in support of the Government's agenda. The review is designed to build on that success, augment the skills mix, and enhance career opportunities for those working on tax policy.

Remit on tax policy

5.2 The Chancellor tasked the review with examining the most appropriate structure for providing tax policy advice to Ministers. The review remit noted that currently officials working on strategic tax policy are spread across three departments, and that a more coordinated approach to tax policy advice was desirable. The review was therefore asked to look at how best to create a new focus for tax policy work. The aim of the review has been to recommend arrangements that will be effective, flexible and durable, providing objective advice that more easily brings together all relevant considerations, and based on strong evidence and making good use of information, allowing Ministers to exercise their responsibility to Parliament and the public.

5.3 As already noted, both revenue departments carry out important work outside the area of tax, which is guided by other areas of policy. For example, Customs apply international trade rules and enforce prohibitions and restrictions. The Revenue enforces the minimum wage, collects student loan repayments and, through the Valuation Office Agency, provides valuation services to Government. Often in these areas, the revenue departments work with a department other than the Treasury, with that other department's Ministers setting the policy to be applied. The review has not considered those policy relationships, but its outcome should be consistent with continued strong performance in these other areas. In line with the Government's reforms of the tax and benefit systems, the review has construed 'tax policy' to include policy on National Insurance Contributions, tax credits and Child Benefit, and, where relevant, their interactions with the social security system.

5.4 Organisational arrangements are not the end of the story for successful policymaking. Central to the review is that objectives and outcomes matter more than structures. The review does not attempt to cover all these factors exhaustively, but they remain crucial to success in any future arrangements, and some recommendations are made where there are particular links to structural questions.

5.5 This Chapter:

- comments on the development of tax policy, its importance as an economic lever, and the approach of the Government since 1997;
- outlines a model of effective tax policymaking;
- describes the current arrangements for tax policymaking;
- describes the framework for assessment used in the review and summarises models and conclusions; and
- sets out and examines in more detail a recommended model of tax policymaking.

¹ These percentages are approximate because of problems in deciding, for example, the exact proportion of a person's time spent working on tax policy.

TAX POLICY

Importance and role of tax policy

5.6 Decisions on tax and expenditure are at the heart of the state and its relationship with individuals and households. In its decisions on the overall size and composition of Government spending, the Government defines ‘common’ goods for those it represents. At its most basic, tax policy reflects a set of decisions as to how to distribute the cost of those goods between those within its jurisdiction. These decisions reflect judgements about fairness, freedom and the nature of society that are fundamental to national sovereignty. This is one reason the Government supports the preservation of unanimity on tax in the European Union.

5.7 Because of the complexity of the tax system, it tends to evolve slowly and in response to a variety of factors. At any given time it reflects both implicit and explicit judgements made by the current Government, but also to an extent those of previous Governments.

5.8 In the past, taxation has been seen rather narrowly as a means of raising revenue to meet a given level of public expenditure. Modern approaches to tax reflect not only the need to raise revenue, but also the effects of raising revenue in a particular way. These include:

- fair distribution between taxpayers. Tax policy influences the distribution of incomes and wealth, and reflects judgements about the balance between current and future economic welfare, and fairness between current and future taxpayers. Avoidance and evasion also have a bearing on fairness in practice;
- minimising the economic cost of raising revenue from distortions and disincentives to economic activity and growth. Often this points to low marginal rates and a broad tax base;
- minimising compliance and administration costs, preserving and promoting enterprise;
- addressing market failures by reflecting external costs, for example by using taxation to reflect the environmental costs of fuel consumption, and as an instrument of wider economic policy, for example by improving incentives to work, save and invest; and
- considering macroeconomic effects, particularly on economic stability.

Government’s approach

5.9 This Government’s tax objective is to create a fair and efficient tax system with incentives to work, save and invest. The Government has pursued its objective by:²

- adopting the golden rule as a framework for fiscal policy, allowing the automatic stabilisers to operate over the cycle, and borrowing for capital investment within the constraints imposed by the sustainable investment rule;

² For background see, for example, *Reforming Britain’s Economic and Financial Policy: Towards Greater Economic Stability*, HM Treasury, 2002 (Palgrave), and *Microeconomic Reform in Britain: Delivering Opportunities for All*, HM Treasury, 2004 (Palgrave).

- introducing tax credits to enable the tax system to recognise the needs and circumstances of particular households and provide the greatest support for those who need it most. Tax credits are specifically designed to provide support for families with children and to improve work incentives. Their introduction has not only changed the role of the Revenue but also transformed the debate on the purpose and nature of the tax system;
- using the tax system to address environmental externalities more actively, both through the reform of existing taxes and through the adoption of new taxes, with revenue recycling, alongside measures financed through Government expenditure;
- introducing a range of tax-favoured savings products to encourage savings;
- using business taxation to promote economic growth and efficiency, by addressing failures in the market for research and development through the research and development tax credit, reducing the tax burden faced by SMEs, and by lowering the rate and broadening the base of Corporation Tax; and
- reflecting the globalisation and rapid change of the economy in an increasingly active approach to combating tax avoidance and evasion, and adopting a more strategic approach to improving tax compliance.

5.10 These trends are likely to be sustained. Furthermore, new trends are emerging, which are likely to affect further the tax policy landscape, including:

- analysis of the potential and possibilities for the use of fiscal policy as an economic stabiliser, particularly important if the UK were to join economic and monetary union;
- any future developments in tax-benefit integration, and the move towards more integrated service delivery and a more coordinated, 'E-enabled' and efficient financial relationship between citizens and the state;
- making changes to combat ever more sophisticated activities directed at avoiding paying tax that is due;
- a stronger interest in the balance between local and national taxation, and in the use of the tax system as a means of reflecting localised increases in land values;
- a greater international dimension to tax policymaking, in the context of European integration and the development of the single market, and in responding to the challenges of globalisation, rapid economic change, and tax competition; and
- a greater focus on the overall economic impact of taxes levied on businesses, through a better understanding of the impact of the tax system on investment choices.

Importance of coherence **5.11** These trends will reinforce the importance of tax policy as an element of broader micro and macro economic policymaking. Together with others that cannot now be anticipated, they will create challenges to look across the tax system at its overall

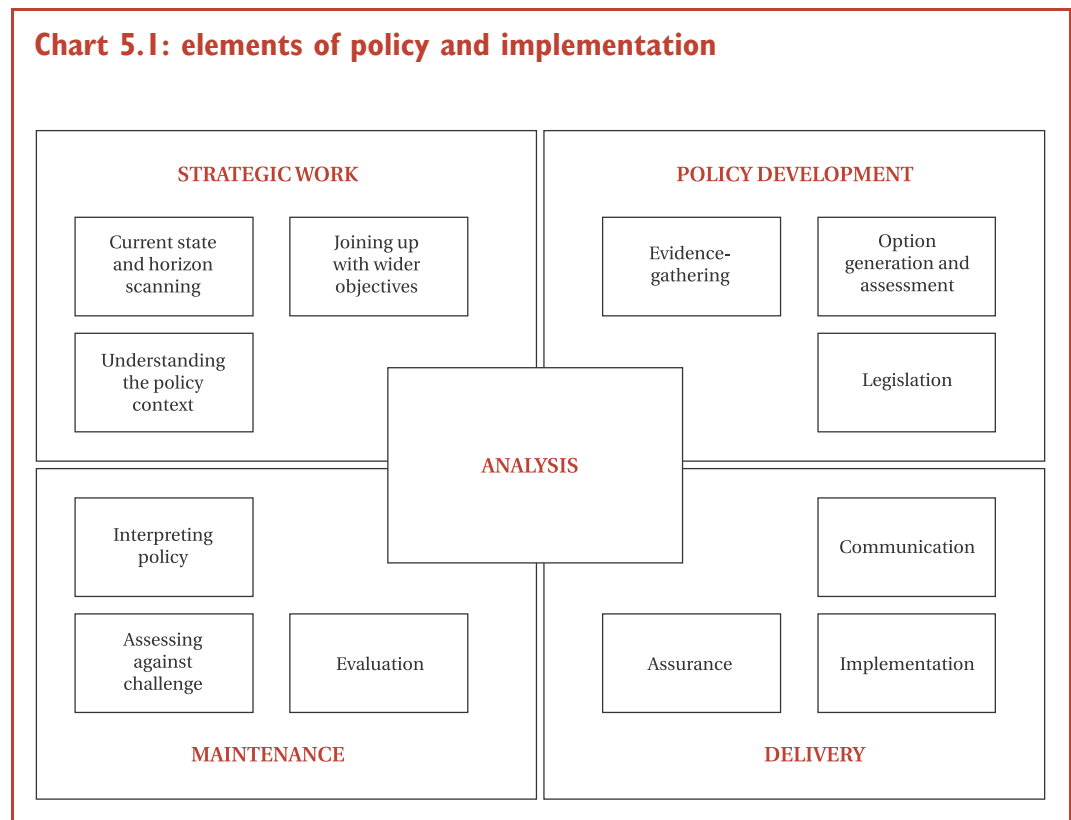
economic impact rather than to consider individual taxes or sets of taxes in isolation, as well as to integrate tax and non-tax analysis. There will also be a continuing requirement to be forward-looking, and to respond to rapid change.

EFFECTIVE POLICYMAKING

5.12 A wide range of activity includes some policy element. This section sets out a simple model that describes the main elements of effective policymaking. The model does not attempt to reflect the interactions between the elements, or between those who contribute to the policy process, inside and outside Government. There are in reality strong connections between all areas of work, and cooperation and openness between all those involved are prerequisites for success. The policy process is iterative, with an on-going debate between those with expertise in different areas to try to find the best overall balance between legal, policy and delivery considerations.

Policymaking model

Classification of activity **5.13** The sections below group work into four categories, shown in Chart 5.1.



Strategic work... **5.14** Strategy in this context involves gaining a perspective across the tax system, allowing advice to be provided on, for example, the best balance between different sources of revenue. In the light of the trends set out above, this is an increasingly important role. It covers:

- current state and horizon-scanning: monitoring external policy drivers, such as changes in demographics, consumer behaviour or technology, international or legal developments and political factors that may affect tax policy;

- joining up with wider objectives: ensuring that economic, social and environmental policy take account of tax as a possible instrument, and that tax policy development takes account of the interaction between tax and other policy instruments; and
- understanding the policy context: gaining an understanding of the impact of the economy on the tax system and vice versa, influencing the political process and expectations of stakeholders through various channels, successfully anticipating behavioural responses to tax changes, and articulating any trade-offs that arise from action through the tax system, as opposed to using other policy instruments.

...policy development **5.15** Strategic work drives and is informed by policy development. Thorough policy development is required to enable policy advisors and analysts to provide Ministers with the information and advice they need to take informed decisions. Policy development ranges from major tax reform to minor technical changes. It covers:

- evidence-gathering: working with analysts to identify and assess the importance of the issues to be addressed and to quantify (as appropriate) evidence, including evidence of market failure, distributional effects, macro and micro economic effects, and the UK and EU legal position, ensuring close involvement with external stakeholders where possible;
- option generation and assessment: identifying and assessing a range of possible solutions for their impact against a range of variables, testing the options and working up detail, considering the implications of change for the revenue departments' operations, opportunities for avoidance and fraud, consistency with existing legal frameworks and legal certainty and deliverability, considering the relative risks of different options and their external presentation, and providing advice to Ministers; and
- legislation: negotiating in the EU and drafting UK legislation in consultation with stakeholders, fine-tuning legislation, and supporting Ministers as they steer it through Parliament.

...policy delivery... **5.16** Policy delivery involves implementing legislation, providing a good customer service, and ensuring that the flow of revenue to the Government is not interrupted. It covers:

- communication: which is two way, including making internal and external announcements, providing internal and external guidance on existing arrangements, briefing staff to deal with queries, and listening to what customers have to say;
- implementation: making changes to administrative and computer systems, as necessary, to support policy and legislation; and
- assurance: setting up mechanisms to ensure that policy or legislation is being followed by taxpayers or others affected.

...and policy maintenance **5.17** Policy maintenance is the process of ensuring the ongoing 'fitness for purpose' of legislation and policy. It covers:

- interpreting policy: advising operational staff and others on the interpretation of relevant legislation, adjusting internal and external

guidance in the light of changes in the interpretation of policy, for example following litigation, and exercising powers conferred by Parliament;

- assessing policy against challenge: overseeing the handling of litigation that reaches the Courts or is otherwise sensitive (e.g. EU infraction cases), closing loopholes or avoidance schemes, working with investigators to identify legislative changes to tackle fraud or evasion; and
- evaluation: checking whether policy is being applied consistently and effectively on the ground and achieving its objectives, and getting feedback from operational staff and businesses about how policy is working in practice.

Policy challenges are generic...

5.18 In many ways the challenges of making good tax policy are the same as those of making good policy in other areas. Good policymaking entails being clear about the intention of the policy, understanding whom it will affect and how, the context in which it will operate, and assessing the importance of addressing the issues involved. In all cases there is a process of identifying and working up options and assessing their costs and benefits against the Government's objectives, on the basis of evidence and analysis. Compliance costs must be factored in, particularly for small businesses. External stakeholders should be consulted where possible and plans adjusted in the light of new evidence, including through evaluation of policy in practice.

...but tax has particular features

5.19 In other ways tax policy is different. The levying of a tax is a particularly sensitive political act, and the tax stance is at the heart of the Government's programme because of the need to fund expenditure within the fiscal rules. As well as raising revenue, the Government must take into account the effects on behaviour that any tax will have. Indeed, such behavioural effects may be at the heart of the policy intention. Tax law is particularly complex. It affects large numbers of personal and business taxpayers, each in different circumstances.

5.20 As a result, new tax policy operates in an environment in which a changed rule may have effects that are particularly difficult to predict. There is an increasingly active industry set up to enable taxpayers to identify and take advantage of particular tax effects, including avoidance opportunities. Thus legislation must be both precise and comprehensive. Stability is important in the tax regime, particularly for small firms, for whom making the investment to understand a new set of rules that potentially affect business practice is a proportionately greater burden than for larger companies.

5.21 Because of the potential for wide-ranging and unpredictable effects, it is especially important that tax policy is anchored in the real world, and underpinned by high quality, comprehensive and robust evidence and analysis. There is a strong need for dialogue with external stakeholders and customer focus. This dialogue should include academics, both those working in economics and in other areas, such as law. Policy also has to be receptive to signals from the operational network, to pick up early warnings of problems on the ground, and to ensure that action is taken to address areas where tax is being lost, for example through fraud. Although frequent evaluation can pick up such problems, experience suggests that this more formal process is not in itself adequate to allow policy to keep pace with developments in the real world.

Skills mix...

5.22 An important part of the flexibility the review is seeking in the policy area will involve deploying people with the right skills swiftly in response to developments. This in turn means both that the Civil Service must nurture its own pool of talent and experience and be able to bring in talent from outside where necessary. As part of this

the Civil Service should be encouraging people inside and outside the revenue department to develop tax as a career anchor, and to work in a variety of areas. These include various areas of tax, more general policymaking and in implementation to gain a portfolio of skills, including economics, law, finance and accountancy and an understanding of operational realities as well as more traditional policy skills.

- ...bringing in external secondees...** **5.23** External secondees can bring specific skills and experiences not always readily available within Government, and can inject external perspectives – particularly business experience – to supplement the wider process of consultation.
- ...encouraging flexibility** **5.24** It also means encouraging a culture in which team and project working becomes more prevalent, to promote joint ownership of work and improve the ability to respond quickly and deploy resources flexibly to new areas of work.
- Clarity of responsibility** **5.25** Another priority in creating durable arrangements is ensuring that there is clarity of responsibility, which assists cooperation within Government and between Government and other interested parties. Clarity helps the departments to become settled and confident in their roles, which helps to ensure better performance. It also promotes the effective provision of advice, by minimising second guessing and reworking between organisations, so long as the culture is one of trust, co-operation and communication, and mechanisms are built in to ensure inter-departmental partnership when necessary for the delivery of common objectives. These issues are explored further in Chapter 6.

CURRENT ARRANGEMENTS

- The three departments' approaches** **5.26** At present there are three departments responsible for providing advice on tax policy: Customs, the Revenue and the Treasury. As discussed in the next Chapter, the precise formal role of each department is ill defined. During the work of the review, it has become clear that, to differing degrees, this has translated into lack of clarity on policy roles both internally and externally. The relationships are not formalised, and the work pattern in a particular area tends to be adapted in practice according to the particular circumstances of the policy and of the different teams involved. Box 5.1 describes current practice. Box 5.2 describes two expert functions that support policy-making at present.

Box 5.1: current policy-making arrangements

Under the current arrangements, broadly speaking the revenue departments lead on policy development for individual taxes, and on the ‘care and management’ of the tax system – for example by identifying the need for anti-avoidance measures. They submit advice directly to Ministers, though generally discussed in advance with Treasury officials, who can also be asked by Ministers to provide a secondary source of advice on issues of particular concern. The revenue departments are responsible for analysis of the tax system as well as its administration, for compliance and enforcement, and for managing the relationships with taxpayers. This work is conducted within a broad framework set by the Treasury.

Treasury officials are generally responsible for: coordination and presentation of overall tax policy, particularly for the Budget and Finance Bill; exercising powers allocated to Treasury in various ways; managing the links between tax and other economic policy instruments and objectives, often playing an important role in managing the relationship with other departments; and providing a strategic input into the work of the revenue departments. Treasury officials tend to take on a greater responsibility for the development of new taxes, for example in the environmental field and on other Ministerial policy initiatives. They also coordinate the economic forecast and analysis of the distributional impact of taxation, in both cases drawing on data and analysis from the revenue departments.

Officials in the three departments tend to operate in different ways. In broad terms:

- Customs has recently reorganised to draw a distinction between the officials responsible for high level policy, referred to as ‘ministerial facing teams’, and the officials responsible for tax practice and the more technical aspects of tax policy;
- the Revenue’s policy officials and analysts tend to cover the full spectrum of activity, while relying on Treasury input on more crosscutting areas of work (e.g. on small businesses). The same teams are generally responsible for policy advice to Ministers, for instructing Parliamentary Counsel and the Revenue’s implementation teams on the detail of any new policy, and for policy and technical advice to the network; and
- Treasury officials are at the ‘ministerial facing’ end of the spectrum, although in some areas of particular interest (for example anti-avoidance and spend to save measures) have been involved in more detail. Treasury officials do not and should not have access to taxpayer confidential information.

Responsibility for explaining decisions publicly and managing their presentation are shared. For example, revenue department officials often take the lead in consultation processes, even where Treasury officials initiated the policy. Treasury officials often lead on briefing for Ministers, and attend the Treasury Select Committee to assist with explaining Budget decisions. External stakeholders quite reasonably do not generally draw a distinction between tax policy initiated by one department or another, and will tend to talk to the department with which they are most familiar.

Box 5.2: expert support under existing arrangements*Analysis*

In order to safeguard taxpayer confidentiality, Treasury officials are not permitted access to confidential taxpayer information without taxpayer consent. This limits access at the centre to data necessary for detailed modelling. Partly because of this and partly because of the traditional roles on tax, most analysis is conducted in the revenue departments. Analysis supports strategic policymaking, policy development, and operational work including compliance, service delivery, and resourcing. Both departments maintain central analytical units as well as analysts ‘bedded out’ with teams working on specific areas. These teams have an important role in deploying evidence in support of policymaking.

A linked area of work is producing the forecasts that are a key element of the fiscal framework. The forecasting process is a joint exercise between the Treasury and the revenue departments.

Legal advice

Both revenue departments maintain significant legal expertise, particularly to deal with litigation and provide advice to policy makers. They have different approaches to the involvement of lawyers in the development of legislation. Customs follow the normal pattern across Whitehall, with policy officials instructing departmental solicitors, who in turn draft instructions for Parliamentary Counsel on primary legislation. Departmental lawyers are responsible for drafting the extensive secondary legislation used to specify the detailed requirements of the indirect taxes. The Revenue’s officials are unusual in that they draft instructions for Parliamentary Counsel themselves, with input from lawyers, particularly on cross cutting issues such as human rights legislation.

THE REVIEW’S APPROACH

Objectives 5.27 The review has developed four criteria for the policymaking arrangements, which have been used to assess various models. These are:

- clarity of responsibility and corresponding accountability for policy functions, subject to retaining an efficient process and the timely involvement of people with the skills and knowledge on a given issue;
- a coherent and ‘joined up’ policy process. This means ensuring that Ministerial objectives are set out and shared as appropriate at an early stage; that advice is based on high quality, comprehensive and robust analysis of economic, legal, regulatory, operational and other issues, looking across the tax system; that policy officials engage effectively with external stakeholders, including influencing international organisations; and that evaluation is strengthened;
- achieving an effective combination of both technical expertise and awareness of and sensitivity to wider issues; and
- a better overall service to Ministers, giving them the advice they need to reach informed decisions and providing other material that is consistently ‘right first time’; and a better service to operational staff and taxpayers in the shape of guidance and advice.

Assessment

Areas for improvement **5.28** There are a number of areas in the current arrangements where improvements could be made:

- increased capacity for high level economic analysis of tax issues and for taking a strategic overview of the tax system. Since 1997 numbers in the Treasury working on tax have increased, but capacity in this area has not changed adequately to meet the long-standing policy challenges. Strategic overview must be informed by understanding of the detailed working of the tax system. While staff in the revenue departments are well placed to consider parts of the tax system, they are not well placed to take a holistic view;
- increased focus on cross-cutting issues and coherence. Many of those working on tax in the revenue departments cover single taxes and are often experts in that tax. This structure means that while there is a good capability to make adjustments on a tax-by-tax basis, it is much harder to make policy on issues that touch on a large number of taxes or assess likely effects of specific changes that have consequences in other areas; and
- greater clarity of roles on policy both as a desirable outcome in its own right, and because it became apparent in informal discussions with external stakeholders that the respective policy roles of the Treasury and the revenue departments were not well understood.

Increased economic and strategic capacity **5.29** The first issue is separable from the others, and relatively simple to address. There is a need to strengthen the Treasury's capability on high-level economic analysis of the tax regime, and to provide a more comprehensive and strategic approach to tax policy. In practice this will mean devoting additional resources to these questions, probably through a mixture of dedicated posts, greater strategic content in posts that deal with other issues, and a more strategic use of data and analysis from the new department and elsewhere.

5.30 The number of additional staff required could be limited, so long as those with specialist analytical modelling skills and access to data adequately support them. The work will by its nature tend to cut across different tax regimes, and so require a co-ordinated approach among those with access to data from across the new department. This suggests a greater need than before for analysts from the existing revenue departments to work together. Although the overall number of people involved in this analytical support role is also likely to be relatively small, it is hard to know in advance the extent of resources necessary to provide the right level of service. In any case the level of work is likely to change over time. This points to a need for a single point of contact able to manage work levels and ensure that appropriate trade-offs are made between work in support of the high level function and work in support of other activities such as operations or assessment and development of options. This is discussed further below and in Box 5.5.

5.31 Overall however the review concludes that increased economic and strategic capacity, while desirable in itself, would not significantly enhance the ability more generally to make policy on cross-cutting issues in a coherent way. It would also do little to improve the clarity of current arrangements.

Description of three main models

5.32 Three main policy models have been examined as possible responses to the need for increased focus on crosscutting issues and coherence and greater clarity, each of which could be combined with changes in the way that the revenue department and Treasury organise themselves more generally. These models reflect the range of arrangements that exist in other countries (see Box 5.3). The models are:

- *status quo*;
- consolidating all strategic, policy development and maintenance work in the Treasury, with the new department focussing purely on delivery. This would create a single body responsible for advising on and framing policy and legislation, and then turning that into guidance that is applied by staff in the new department; and
- establishing new and clearer roles within a co-operative structure, under which Treasury would lead on strategic work and policy development, and the revenue department would lead on policy maintenance and delivery, but each department would assist the other in the discharge of its duties.

Box 5.3: international comparisons of policymaking³

There is a range of international models of tax policymaking. In New Zealand, policy responsibility has shifted between the Inland Revenue Department (IRD) and Treasury a number of times, but reverted to the IRD in the mid 1990s in a bid to improve customer focus. There is a highly open policymaking process, including the publication of advice to Ministers once a decision has been taken.

In the Netherlands, the Dutch Tax and Customs Administration is part of the Finance Ministry. Within the Finance Ministry, responsibility for policy and legislation is separated from administration, although in practice all sides adopt a highly collaborative approach.

In Australia, the Treasury has always been responsible for high-level policy, and the Australian Taxation Office (ATO) had responsibility for legislative design (part of policymaking in the review's classification) following a policy decision. In 2002 that function was transferred to the Treasury following a report that identified a perception that the legislation was overly biased towards meeting the compliance and administrative objectives of the ATO. There is now a system of close relations between officials working on policy maintenance and those working on legislation, governed by a formal protocol (see Annex A).

Status quo model

5.33 The *status quo* has a number of advantages:

- familiarity and minimal short term risks;
- proven ability to develop, manage and complete large and complex policy projects to a high standard in line with Ministerial requirements;
- by conducting a large proportion of policy work in the departments also responsible for delivery, providing good opportunities for making links between policy and delivery. This is particularly important for ensuring assessment of practicality is built into policy development, and that developments in the field are fed back to the centre to inform future thinking; and

³ Source: review team interviews and research.

- proven ability of the revenue departments to attract, retain, develop and motivate high quality staff.

5.34 There are also a number of problems with the current arrangements:

- they have a heavy emphasis on tax-specific expertise. There will always be an important role for such expertise. In particular when ensuring the on-going integrity of a particular regime, it is vital. But the discussion above indicates the growing importance of linking that experience to those able also to focus on taxes across the board, whether in terms of the incentives on taxpayers, or the effect on markets or the broader economy. To some extent restructuring of policy units within a new department would address this, and both Customs and the Revenue have moved in this direction internally over the past few years. But such approaches are constrained when they occur within the overall framework of departments focussed on particular parts of the tax system;
- the difficulty in developing the links across the board between tax and other policy instruments. With tax one of a range of possible levers to promote efficiency or particular incentives, assessing trade-offs between achieving outcomes through the tax system and through other means has become more important. This means that even with the creation of a new department, there would be a strong case for some movement of policy functions to take place; and
- lack of clarity of roles, which complicates the tax policymaking process. Although performance has been high, this had been despite organisational arrangements rather than because of them, reflecting a willingness to work around problems rather than the strengths of the current arrangements.

Consolidation model 5.35 The second model would consolidate all strategic, policy development and maintenance work in one department. This would be a radical change for the UK, although other EU states run similar systems. Given the overall coherence agenda, including greater emphasis on the links between tax policy and other types of economic policy, and the importance of the links between revenue and spending, the review considers that removing tax policy from the Treasury is not a desirable outcome. It would also not be desirable to move all policy functions to the new department, which would break the links with other economic policy levers. As a result, this model would in effect mean Treasury expanding to take on a great deal of work currently done by people in the revenue departments.

5.36 Such a model would clarify responsibility. If an issue related to setting of policy or legislation, the expanded Treasury would be responsible. The revenue department would be responsible for turning policy into operational reality through delivery.

5.37 This model would also join up the policy process between Ministers, policy development and instructions for those implementing it. There would be scope for particular people to work on issues from inception to completion of the legislative process and then on providing guidance to the network. There would be no division of the policy expertise that is currently within the revenue departments, and tax expertise would be co-located with those working on other economic questions. There could be synergies in bringing together those with direct and indirect tax experience.

5.38 However, there are a number of significant risks with this approach:

- many of those with an in-depth knowledge of the law and the underlying policy would be part of the Treasury and this could lead to some divergence between the policy and application of the law in the field. In seeking to avoid this problem, the new department might develop new centres of expertise that may or may not align with the understanding at the Treasury. This would certainly lead to duplication and possibly also to inconsistency;
- by drawing a clearer divide between setting the framework and applying it, it could become more difficult for policy makers fully to understand and factor in delivery considerations and constraints, leading to less good outcomes. Close links between policy and delivery are also at the heart of Customs' strategic approach to tackling revenue losses and a new divide might make forming these links more difficult;
- the numbers of people involved in the new body could run into the high hundreds, potentially unbalancing the Treasury (and its existing staff of around 1,000)⁴ and its broader work on economic issues; and
- it could be more difficult to assure the public that confidential taxpayer data were being safeguarded in this model. The operational network would be likely to seek guidance from the centre in novel situations, particularly when a great deal of expertise had been centrally located. In practice this could mean Treasury officials would need to have access to some confidential taxpayer information. While it could be possible to legislate to put in place new legal safeguards on the protection of data, this would blur a bright line in an undesirable way.

5.39 Because of these risks, the review does not recommend the consolidation model be pursued.

New and clearer roles model...

5.40 The final model would entail a new division of responsibility. It is designed to build on the comparative advantages of a small, integrated finance and economics Ministry with a particular focus on general economic and policy skills, and the new department's administrative expertise, more detailed knowledge of the tax system and tax law, and access and ability to analyse information on individual taxpayers' circumstances.

5.41 In some situations, tax work is driven by policy objectives that are general in nature and long standing. Examples here could include ensuring that the tax regime remains modern and effective, by adapting in response to court judgements or new avoidance schemes where that can be done without changing the general approach of the tax in question. The skills necessary for this sort of work are more heavily weighted towards traditional revenue department strengths such as in-depth knowledge of tax law and practice than traditional Treasury strengths of general policy analysis and economics. This is referred to here as technical development and protection of the tax regime.

5.42 Other areas of work are not so clear-cut, and the work entails striking the right balance between objectives, deliverability and other factors throughout the policy process. In these areas the challenges of understanding the intention of Ministers and of ensuring that all relevant inputs are brought together in a coherent way are greater.

⁴ Home Civil Service Staff In Post, Summary April 2003, available at www.civil-service.gov.uk/statistics

5.43 The broad division of work suggested under this model is that Treasury would lead on strategic work and policy development, and the new department would lead on policy maintenance and delivery.

...working together to achieve the Government's objectives

5.44 Both departments would be subject to an overall shared responsibility to work together to achieve the Government's objectives. Beyond this, the main responsibility for the Treasury would be for the direction of tax policy, and the main responsibility for the new department would be for providing an effective and efficient administration, minimising compliance costs and providing high levels of service. In more detail:

- the Treasury would be responsible and accountable for strategic work, and for leading tax policy development. In discharging this role, Treasury would either set general objectives that would help define the new department's remit (for example on policy maintenance) or lead and manage particular tax policy development projects;
- the new department would lead on policy maintenance to meet their remit, and on delivery; and
- both departments would support the other in their activities. Where Treasury leads on an issue, the new department would provide input on technical and operational aspects of work and help to work up policy in detail. Where the new department leads on an issue, Treasury would provide input on individual measures or packages to ensure they take account of the broader picture.

5.45 The logic of this division would be that the Treasury would be responsible for ensuring that appropriate evaluation of policy was conducted, and advising Ministers on any changes to tax policy that should be made as a result of that – either to the general remit or on particular issues. A large part of the work of gathering information on the impact of policy in the field would however continue to be with the new department. The implications of this model for tax policy advice in practice are set out in Box 5.4.

Box 5.4: policy advice in practice

Under the proposed new arrangements, the accountability for advice to Ministers would be clearer across the range of roles played by the Treasury and the new department. How these arrangements, if implemented, will work in practice will of course depend upon evolving experience of the new arrangements, with a degree of learning by doing.

Treasury would lead proposals for new policy development, and take on responsibility for ensuring coordinated advice to Ministers. In doing so they would work in partnership with the experts in the new department charged with responsibility for overseeing the relevant aspect of the tax system, and with the new department's analysts. In particular, they would need to rely on the expertise available in the new department on issues of tax law. Experts in the new department would draft instructions to Parliamentary Counsel, with Treasury officials maintaining an overview, and provide Parliamentary support on detailed issues to Ministers during Committee.

(continued overleaf)

Box 5.4: policy advice in practice (continued)

As well as ensuring coherence across the tax system as a whole, the Treasury directorate responsible for the tax system would also need to make the necessary internal links to ensure that advice on tax policy is joined up with the Treasury's responsibilities for other aspects of economic policy. Recent examples of policy developments which would be handled in this way include the development of the R&D tax credit, the recent proposals on reform of North Sea taxation, and the one percentage point increase in NICs to finance the NHS.

Major policy reforms have wide-ranging implications for economic policy, and for the operation of the tax system. Recent examples include the Government's comprehensive modernisation of Stamp Duty, the proposals for reform of Corporation Tax, and the simplification of pensions tax. The largest single project since 1997 was the introduction of new tax credits for working families, a major reform requiring consideration of both strategic and detailed policy issues, creating major operational challenges. In these cases it is necessary to bring together the widest possible range of expertise, on strategic, policy and operational aspects. The responsibility for ensuring this coordinated approach to major reforms would lie with the Treasury, which should enhance its project management capacity and build its skills in leading major policy reforms. As projects move from the policy to the implementation or delivery stage, the balance of responsibility would shift towards the new department, which would continue to be responsible for ensuring effective implementation within the new accountability arrangements. But, since major reforms are characterised by the close interaction between policy and operational issues at all stages, they should be managed as a partnership between departments, with a clearly accountable lead official for each project strand.

One of the general objectives set by the Treasury for the tax regime might be that it responds to abusive practices. The new department would have responsibility for advising Ministers on legislative measures to protect the tax system against abuse, and on the powers they need to carry out their responsibilities. Recent examples of such work include the package of loophole-closing measures in this year's Budget, the Tax Law Re-Write Project, reforms to the customs penalty regime, and modernising the tax system to take account of E-commerce.

In preparation for the Pre-Budget Report and Budget and where urgent action is required, the new department would provide coordinated advice to Ministers on the legislative and other measures that they judge necessary to meet the objectives given to them by Ministers (one possibility is that this package might respond to an element of the Chancellor's Remit – see Chapter 6). It would need to work with Parliamentary Counsel and others as appropriate to ensure that new proposals for legislation were robust, and efficiently drafted. The Treasury, to ensure that their proposals took account of any wider policy implications, would support them. Treasury Ministers would assess these proposals, and decide on the package of legislation to put before Parliament in the annual Finance Bill.

Clear responsibility and flexibility

5.46 This model would clarify responsibilities while ensuring flexibility to the extent that the Treasury would be responsible for tax policy work, while the new department would be responsible for work in pursuit of the standing objectives remitted to them by Ministers. In particular it should clarify the distinctive contributions of the Treasury and the new department. Where issues emerge for example from a court case but raise more general considerations, there could be some difficulty of knowing immediately where the centre of gravity lies. The departments in question will need administrative mechanisms for allocating the marginal work, although where agreement cannot be reached, the logic of the system is that the Treasury as guardians of the objectives should decide. Since the Treasury would have a greater overview of work in all areas,

external stakeholders wanting to discuss particular issues who are not already aware of the most appropriate contact should be able to use the Treasury as their first port of call.

...in the new accountability arrangements

5.47 While there is a big potential advantage in clarifying the new department's responsibilities for delivery, the policy model could introduce more separation between tax policy and high-level work on one hand and delivery, technical development and protection issues on the other. To some extent this could be a strength, in that any trade-offs between administration and policy are likely to be more transparent. Such debates are currently internalised and may be less visible to decision makers. Such advantages would be lost however if the new arrangements resulted in a disconnection between delivery and policy. It would be important for managers to address the issue systematically at the start of any change. Ways in which this could be done are set out below. Overall, however, the judgement of the review and officials in all three departments is that the risks are manageable, and that any risks are outweighed by the benefits of increasing the capacity to join tax policy to the wider policy perspectives of the Treasury.

Recommendation: the Treasury's capability for high-level analysis of the tax regime should be strengthened, to develop a better evidence base for tax policy and a clearer focus on tax policy objectives.

Recommendation: the Treasury should have lead responsibility and accountability for tax policy, with support from the new department, and subject to this, the new department should lead on policy maintenance, with support from the Treasury.

IMPLEMENTATION

Extent of change

5.48 This model of new and clearer roles will mean a significant increase in the numbers of people working on tax in the Treasury. This opens up the possibility of creating flexible, multi-disciplinary, cross-cutting teams with single reporting lines, for example examining small firms, as well as improving the scope for synergies between tax and other economic policy issues. There would need to be a significant reallocation of resources for the business and international areas of tax, as well as more coverage of areas such as personal tax, and a central group to drive the change. It will be important to provide adequate resources for the new Treasury role in this model, as well as ensuring adequate resources remain in the new department. Too few resources allocated could mean that the centre is not properly able to understand the overall picture, particularly on the technical changes. That said, establishing the total numbers necessary to make the model operate effectively is not an exact science. But there is a clear presumption that the total number of people working across the departments on policy will not increase.

5.49 The review's assessment is that the additional staff required in the Treasury would be significant in Treasury terms, doubling the Treasury's capacity on tax policy (with perhaps more in the transition). This would be a mixture of people with traditional revenue department skills, traditional policy skills, and external secondees.

...will be a considerable challenge

5.50 The change recommended in this Chapter would be a considerable challenge for the departments concerned. Both would need to adapt swiftly to the new arrangements, and would be likely to require some internal reorganisation to take account of the new situation. To be successful, the new arrangements will require a culture centred on greater tax and economic expertise, use of data and information to

provide evidence, and engagement with stakeholders. The new organisation would want to build on the success the revenue departments have had in attracting a diverse range of people into policy work including those with alternative working patterns and people from outside the Civil Service. Overall the change would need a significant management effort to establish and sustain.

Recommendation: the new arrangements should be founded on an outward facing culture of policymaking, with greater contact between officials and external stakeholders. To facilitate this and to broaden the perspectives on tax policymaking, the number of external secondees in the policy centre should be increased.

5.51 In adapting to the new arrangements, the new department and Treasury would also need to examine carefully their structures to ensure that they mesh most effectively. The review team has stimulated discussions in both Treasury and the revenue departments, but has not attempted in the time to devise a blueprint for the departments concerned. In any case, structural flexibility will be important in ensuring that the new arrangements can respond swiftly to new challenges.

5.52 The Treasury should use its expanded policy skills resource to establish better links with the new department on delivery matters, and both departments should ensure that tax administration is well co-ordinated with overall policy direction. There are a number of ways in which an effective dialogue could be cemented. One is nurturing a culture in which joint working and shared ownership is the norm, so that continual testing of evolving ideas by policy, technical and delivery experts is standard practice. Another is to ensure a degree of mutual dependency between the players involved. For example, since the new department will continue to be responsible for technical development and protection of the tax regime (which often accounts for the bulk of legislation) and on-going interpretation of the law, it will inevitably have a stronger and more detailed knowledge of tax law than the Treasury. The Treasury should always at least draw on that expertise, just as the new department should always seek input on wider objectives that could be affected by their activities. The recommendations on new governance structures established between the new department and the Treasury – see Chapter 6 on accountability – would also help to address this issue.

Recommendation: the Treasury and the new department should ensure that the links between implementation and policy continue to improve as a result of the proposed changes to policy arrangements.

Information analysis and policy links

5.53 Chapter 4 on information and Chapter 3 on administrative arrangements make clear that the right approach to handling information in the new department will be central to its effectiveness, and make recommendations aimed at aligning the approaches of the existing departments and improving performance. Information and knowledge is also at the heart of successful policymaking. The increased need identified in this Chapter to ensure policy is coherent across direct and indirect taxes points to the need for a similar mechanism for bringing together analysis and evidence for policymaking as part of the new department.

5.54 This is important given the need to ensure effective support for the greater high level analysis of the tax system identified above, but is also important in other areas (see Box 5.5). In particular, it will be important to ensure that tax forecasting staff in the revenue departments are brought together, and work effectively with the Treasury and others under the new arrangements, in order to support forecasting. Ministers rely on

forecasting to make budget judgments, and therefore rightly expect that this draws on the best expertise and information available both internally and externally (subject to confidentiality). This helps to ensure that the quality of the forecasts is as high as possible.

Recommendation: a significant new tax analysis and statistics unit should be established in the revenue department, with a work programme and resources governed by a steering group including important Government stakeholders, incorporating and building on existing analysis and research functions in Customs and the Revenue.

Box 5.5: expert support under the new arrangements

Analysis

As noted in Box 5.2, both revenue departments maintain central analytical units and also ‘bed out’ analysts with teams working on specific areas. If the thrust of this review is accepted, these central units will continue to provide analyses of compliance and customer issues for operational areas and those working on new policy developments, and contribute to the forecasting process. But the central units will also increasingly provide analysis and advice cutting across specific taxes and contribute to strategic policy development. There needs to be a way to ensure:

- this increase in activity is managed and accommodated in the context of informed trade-offs on relative priorities. It is particularly important that high level work does not crowd out existing essential operational analyses and forecasting work, or the quality improvements needed in these areas;
- synergies between areas of work (for example parallel work to model the response of the same taxpayer group to different taxes) are identified and used to promote efficient working and better quality advice; and
- a broad view can be taken about investments necessary (for example in flexible data systems or analytical models) to achieve objectives.

To address these points, the review has recommended setting up a substantial shared Analysis and Statistics Unit, encompassing the analysts currently in central teams in the revenue departments. Staff working in the Unit would remain an integral part of the new department enabling them to access confidential taxpayer data. Objectives and work programmes, including the balance of resources devoted to different stakeholders, would be governed by a steering committee including the key stakeholders in the new department and the Treasury.

Legal advice

Normal practice is that Government lawyers should be located in the same department as their main client. If the recommendations of this Chapter are accepted, this is unlikely to mean significant changes. Nevertheless, some further thought might be given to enhancing the Treasury’s capacity for assessing technical measures, asking the right questions, considering cross-cutting issues such as state aid or human rights law, and for providing legal input to horizon-scanning to ensure that important developments are identified and fed into the policy debate as early as possible. In line with greater use of external expertise on the policy side, there is also a case for greater use of external legal experts, including Counsel, to inform and improve the policy approach.

5.55 Building upon the recommendations on organisational arrangements for tax administration, the recommendations set out here on policy will improve the capacity to produce policy that looks across the tax system, thereby improving revenue and customer outcomes, in support of the Government's tax objectives. This model will need new and clearer accountability arrangements to get the most out of it. This is addressed in the following Chapter on accountability.