

## **REGULATORY IMPACT ASSESSMENT (RIA)**

### **Tax Law Rewrite: the Income Tax Bill**

#### **Purpose and intended effect**

##### **Objective**

1. The Tax Law Rewrite project (the project) aims to rewrite all of the United Kingdom's primary direct tax legislation so that it is clearer and easier to use, without changing or making less certain its general effect.
2. To date the project has delivered three rewrite Acts - the Capital Allowances Act 2001, the Income Tax (Earnings and Pensions) Act 2003 (ITEPA) and the Income Tax (Trading and Other Income) Act 2005 (ITTOIA). The project has also rewritten the PAYE Regulations in response to requests by users and representative bodies. These regulations (SI 2003/2682) came into force in April 2004.
3. This impact assessment relates to the fourth rewrite Bill (the Income Tax Bill) which will complete the project's work on income tax.

##### **Background**

4. The project was set up in 1996. Its key objectives and characteristics are:
  - clearer, more user-friendly tax legislation;
  - a new, more logical structure for rewritten legislation;
  - shorter sentences and better use of definitions;
  - use of modern language - as long as this can be done without changing the law or making its effect less certain;
  - better signposts and similar rules grouped together, to make the rules easier to find;
  - no change in the underlying tax system (but the work of the project will not prevent any such changes);
  - some minor changes, where these further improve the legislation;
  - full consultation with interested parties throughout the life of the project; and
  - a specific streamlined parliamentary procedure for enactment of rewrite Bills.
5. The project is rewriting income tax legislation – that is the legislation which, broadly, deals with who pays the tax, on what income and with what exemptions and reliefs – in a series of three Acts. The first, ITEPA, was concerned with the taxation of employment, pensions and social security income. The second, ITTOIA, was

concerned with the taxation of trading, property, savings and investment and miscellaneous income. The Income Tax Bill will complete the process of rewriting the income tax legislation. After this, the project will be rewriting corporation tax legislation.

### **The Income Tax Bill**

6. The Income Tax Bill will cover:

- general rules about tax rates, allowances and reliefs;
- special rules about trusts (including charitable trusts), exemptions, deduction of income tax at source, and tax avoidance material;
- how a person's income tax liability is computed; and
- general definitions that apply for income tax purposes.

### **Rationale for Government intervention**

7. A Government commitment was made in 1996 to rewrite all of the direct tax legislation. And this continues to have full cross-party support.

8. There are two specific risks of *not* rewriting this income tax legislation in Bill 4.

9. The first is that users will continue to struggle to understand the legislation and/or will misconstrue it – the benefits of the rewrite will not extend to legislation to be covered in the Income Tax Bill.

10. The second is that the income tax code will be arranged partly in accordance with the old legislation in the Income and Corporation Taxes Act 1988 (ICTA) and partly in the new rewritten form in ITEPA and ITTOIA. Following ITEPA and ITTOIA, it is highly desirable and logical for the remainder of the income tax legislation to adopt the rewrite terminology, style and structure. Not to do so would be to miss an opportunity to bring greater coherence to the income tax legislation. Understanding would be impeded and future amendments to the code would be made more difficult.

11. There is one risk inherent in rewriting this income tax legislation in the Income Tax Bill. It is that the project may inadvertently change the law. The project has minimised this risk by consulting extensively on the new clauses both inside and outside HMRC. The consultation with the specialist interest groups helped to minimise the risks in those areas where the law is particularly complex (eg anti-avoidance) or principally affects specific categories of person (eg rules about the enterprise investment scheme, charitable trusts).

12. The whole consultation process has allowed the project to ensure, as fully as possible, that it has not changed the law in any way other than through minor identified changes (such as the incorporation of extra-statutory concessions or dropping redundant material) to improve the legislation.

13. The risk of inadvertent changes is also mitigated by the “continuity of law provisions” contained in the Bill, and by the ability of the Government to use powers in the Bill to amend other legislation by regulations to that end.

### **Consultation**

14. Full consultation with interested parties has been a key feature of the project.

15. There are two outside Committees which are concerned with the workings of the project. They are:

- the Steering Committee, which provides strategic guidance to the project. Its members include MPs, the judiciary, and representatives of the legal and accountancy professions and consumer interests.
- the Consultative Committee, whose role is to ensure continuous consultation on the rewritten law with all the main private sector interests. Its members include representatives of the CBI, CIOT, ICAEW, ICAS, ACCA, Law Society and other bodies.

16. The rewritten material in the Income Tax Bill has been subjected to a wide-ranging consultation process. As well as making all the relevant material available to the members of the project’s two Committees, the project has published a considerable number of consultative papers on the internet. These documents have contained draft clauses and accompanying commentary and have invited and encouraged interested parties to give their views. The project has also consulted with specialist interest groups on a range of issues.

17. Additionally, the project published a draft Bill in February 2006 with accompanying explanatory notes for formal consultation.

18. The reactions to draft clauses included in consultation documents and the draft Bill have been positive and it is clear that support for the project among the tax community continues to be strong.

19. The results of all these consultations have been published in Response Documents<sup>1</sup> (or in the commentary on the draft Bill itself) and have been taken into consideration in drafting the clauses.

20. As the Bill only rewrites existing legislation and does not change the law (except for minor identified changes at the margins intended in the main to bring clarification or consistency or to bring the law into line with well established practice), there has only been limited consultation within government.

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<sup>1</sup> <http://www.hmrc.gov.uk/rewrite/exposure/menu.htm>

## Options

21. There is a clear Government commitment to rewrite all the primary direct tax legislation. The project was set up to rewrite all direct tax legislation and has successfully delivered part of this task. This Bill will help finish the job of rewriting income tax legislation in the same style as ITEPA and ITTOIA.

22. There are no other viable options. If the Government commitment is to be met, the job of rewriting income tax legislation must be completed. Additionally, failure to complete the job would incur the risks outlined in paragraphs 9 and 10.

## Costs and benefits

### *Sectors and groups affected*

23. All taxpayers subject to income tax, and their advisers, are potentially affected. In practice it is mainly tax advisers who will be affected but a small minority of individual taxpayers, who deal with their own tax affairs, may also consult the legislation directly. Where they do the rewritten provisions will enable them to understand their obligations more easily, helping them to deal with their tax affairs more efficiently. Where they do not, tax guidance and tax textbooks will also be improved by better legislation.

24. Trusts (including charitable trusts), personal representatives, non-resident companies and those who are obliged to deduct tax at source from payments will also be affected.

25. In addition, certain bodies (eg venture capital trusts) that are required to meet scheme rules, so that investors can benefit from the various forms of relief available to those schemes, will also be affected.

26. The Bill makes no changes, other than minor agreed changes, to existing tax law. But the legislation will become more transparent. So the Bill will contribute to equity and fairness by making the law more accessible to all.

27. The following table provides an indication of the numbers of taxpayers and institutions potentially affected and of the amounts of income tax they pay. The majority of figures are for 2004-05, the last year for which we have reasonably accurate statistics. The figures have been rounded up or down as appropriate.

Category of Person	Numbers	Tax paid
Individuals	28.9m	£117,000m
Trusts, charitable trusts and estates	218,000	£485m <sup>2</sup>
Building societies, deposit-takers and others deducting tax at source	49,800 <sup>3</sup>	£2,253m <sup>4</sup>

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2 Figure is for 2003/04 and includes tax deducted at source

3 total number of s350(1) assessments and CT61 returns

4 £2,242m from deposit-takers, building societies & UK companies and £11m from individuals, local authorities and non-resident companies

28. The following table provides an indication of the amount of income tax relieved or repaid under provisions rewritten in this Bill. The figures are for 2004-05 and have been rounded up or down as appropriate.

Category	Main effect on	Numbers	Amount of relief/repayment
Loss relief	Those claiming loss relief	192,600	£1,171m <sup>5</sup>
Gift aid	Individual donors claiming higher rate tax relief	450,000	£230m <sup>6</sup>
Gift aid	Charities claiming gift aid relief	57,400	£625m <sup>7</sup>
EIS/VCT/CITR	Those claiming relief	32,000	£754m <sup>8</sup>

29. It is generally agreed that the benefits of the rewritten legislation can become clear only when a particular block of rewritten legislation has been in force for some time.

30. The project carried out a stocktake in late 1998, sending a questionnaire to some 200 people involved in the consultative process. They were asked about the likely costs and benefits of the project. All agreed that it would be difficult to quantify most of the costs in advance, and all but impossible to arrive at any objective measure of the benefits. But the interested parties still firmly believe that any costs will be more than outweighed by the benefits flowing from the project.

31. The Capital Allowances Act 2001 was well received both outside and within HMRC. As this legislation had been in existence for some time giving tax practitioners the chance to experience how it worked in practice, the project's Steering Committee felt that it was appropriate to assess its effectiveness (see paragraph 75).

32. The project's first income tax Act, known as ITEPA, has been equally well received. For example the Institute of Chartered Accountants in England and Wales (ICAEW) described the draft Bill as "another major step forward in improving the

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5 relief claimed for losses on trade, property and shares

6 Figure is for 2003/04 and relates to the higher rate relief claimed by donors - the difference between the amount claimed by the charities (22%) and the higher rate (40%) - and includes relief on gifts of shares and property

7 relief claimed by charities - total repaid to charities in respect of gift aid

8 amount on which relief claimed

intelligibility of United Kingdom tax legislation in areas of the law that affect a large number of taxpayers”.

33. The second income tax Act, known as ITTOIA, was also well received; the ICAEW said that “the draft Bill was well constructed and we commend its drafting. It covers important ground and, as it facilitates taxpayers' easier understanding of legislation which will affect very many of them, it is a useful addition to the rewritten legislation”.

34. The benefits of the Income Tax Bill are likely to be widespread. This is because it applies to all persons liable to income tax who are eligible to claim allowances and reliefs. It also applies to financial institutions who are required to deduct tax at source on payments they make to investors.

35. The project has analysed the benefits and costs by reference to the three main groups affected by the Bill:

- tax professionals;
- taxpayers; and
- Her Majesty's Revenue and Customs (HMRC).

### ***Tax professionals***

#### *Benefits*

36. These are people who use tax legislation in the course of their work. They include:

- tax advisers: this is the main group of people affected and includes advisers within the legal or accountancy professions and tax managers working in house for companies and organisations;
- legal and accountancy publishers, both in the context of printed material and software;
- academics, teachers, Special Commissioners and the judiciary.

37. The benefits to this broad group of users will come from the clarification of existing law and the clearer expression of future changes to that law. They potentially include:

- less time construing legislation and fewer errors caused by misunderstanding of the law;
- fewer issues on which time needs to be spent on obtaining specialist advice;
- less resource expended on interpretation-type queries;
- fewer disputes with HMRC about the meaning of legislation; and

- less time for training of new professionals.

38. One indication of the impact of the project is that these users' representatives continue both to support the project and to contribute substantially by commenting on the draft clauses and other publications. The project has been particularly encouraged by the positive responses received to the draft clauses and other consultative material published on its internet site.

39. It is very difficult to quantify the actual benefits to users of a particular body of rewritten legislation until it has been in force for some time. Questions about benefits were put to users of the rewritten Capital Allowances Act (CAA) and more recently to users of the rewritten legislation covering employment and pension income (ITEPA) by consultants who carried out post-implementation reviews.

40. Users of CAA agreed that there was a time saving when using the new provisions, but they were unable to quantify it at all precisely. Answers were rather vague and where quantified they ranged from a "few hours per year" to "maybe an hour a month".

41. Users of ITEPA also said that after the normal initial investment in time in learning new provisions, they were confident that there would be time and efficiency savings. Though many tax professionals may not be in a position to do so, a few had already found it easier to delegate work to junior staff because they were confident that those with less experience would be able to understand the rewritten legislation better than ICTA. The rewritten legislation is also considered to be particularly helpful when a tax practitioner is called upon to deal with a point which is outside the range of matters normally encountered. Time is saved in such circumstances and this is beneficial to both the tax professional and the client.

42. Despite the absence of precise details about savings in relation to either of the Acts, it is possible by building on the general indications given by the users of these two Acts to illustrate the likely benefits for users.

43. We believe that the income tax legislation is used more than the capital allowances legislation and so the time saved by users of this legislation should be correspondingly greater. So building on the responses obtained for the Capital Allowances Act, as we do in the following paragraphs, should give a conservative indication of the likely benefits for users.

44. One indication of these benefits is provided by considering the time saved by tax professionals. If we assume a saving of time for each tax professional of just three hours per year and an average hourly charge-out rate of £50 then, on that basis, the value of the time saved will be £150. According to HMRC management information there are approximately 120,000 active tax professionals who deal with the Department on a regular basis. Most, if not all, will benefit in some respect from the rewritten income tax legislation. This suggests an overall potential benefit of around £18m.

45. If the time saved were one hour per month at £50 per hour the overall benefit would increase to around £72m.

46. Based on this we estimate that after a transitional period the total annual benefit by reference to time saved as a result of this Bill could be somewhere between £18m and £72m.

47. These savings may or may not be passed on from practitioners to businesses. Even if they were, the actual saving per business is likely to be very small indeed because the 3 to 12 hours time saved per practitioner would be shared between all clients.

48. There is a further benefit for another important constituency – a variety of advisers who serve people on low incomes in need of help with their tax affairs. Such advisers include TaxAid, and increasingly organisations such as Age Concern and welfare rights offices which are being drawn into the need to consider relevant income tax law by the tax credits legislation's reliance on income tax law to determine the income of claimants. The rewritten legislation should be of direct and indirect benefit to this growing group of advisers, and ultimately to the members of the public they serve.

#### *Costs*

49. Although there is no major change to the underlying tax system there will be some retraining costs for tax professionals to enable them to become familiar with the new structure, section numbers and language used in the Bill. There will also be some impact from the minor agreed changes made by the Bill. However, because the underlying legislation is not changing significantly, the impact on the administrative burden is likely to be very small.

50. Retraining costs are difficult to estimate, as they will vary depending on how any training is organised. But these are expected to be modest and offset by lower training costs in the long term.

51. People new to tax should need less time than at present to learn the legislation – for example trainee accountants and HMRC staff.

52. Inevitably some costs in terms of time expended have fallen on the tax professionals and representative bodies that have taken part in the consultation process. Again these costs are difficult to quantify. But those consulted continue to urge the project to maintain the same level of consultation.

53. There will be no significant changes made to the existing self assessment returns and other relevant forms. But because the new legislation will be written in language that provides a better and more logical link between the statute and the administrative procedures, it will be easier for the adviser to understand and apply the law when completing these forms.

## ***Taxpayers***

### *Benefits*

54. All those who are liable to income tax are potentially affected whether or not they are required to complete an annual self-assessment tax return.

55. Many taxpayers who have more complex tax affairs (eg people with trading, property and other miscellaneous income) will probably continue to employ the services of professional advisers. The greatest benefit to this group will probably be indirect, ie derived from the greater ease of use for their advisers. And clearer legislation should mean fewer disputes and resultant litigation.

56. A further benefit identified in the post implementation review of ITEPA is the scope for greater transparency and therefore trust between tax professional and client. The simpler language should help to break down any perception on the part of a client that a tax professional might be “pulling the wool over their eyes by using complex terms that no-one outside the industry could understand”.

57. Some taxpayers will also be able to consult the legislation themselves to resolve the more straightforward questions and ultimately also be able to benefit from more user friendly software based on the rewritten legislation. It is not possible to quantify the number of taxpayers who may take this route to resolve questions about their own tax liability, but it will be small.

### *Costs*

58. The majority of taxpayers who do not use tax advisers will rely on the guidance material when dealing with such matters as completing tax returns. Such taxpayers will not have to make themselves familiar with the new legislation. For the very few taxpayers who may consult the legislation when dealing with their tax affairs there may be of a one-off cost in familiarising themselves with the new structure and language but this will be offset by the benefits of clearer legislation.

## ***HMRC***

### *Benefits*

59. HMRC staff are in a similar position to other tax professionals. Clearer legislation is likely to reduce the number of disputes over interpretation and the number of cases which need to be referred to Head Office for a definitive ruling. Training and guidance material should be easier to use and more straightforward to produce.

60. Moreover, as the legislation becomes easier to understand more resources can be released to concentrate on other issues, for example the provision of better guidance and extra help and support to customers.

### *Costs*

61. The cost to HMRC in producing the Income Tax Bill is approximately £6m, spread over the years 2003 to 2007. These costs can in part be offset by the costs that would have been expended on any consolidation of ICTA and subsequent Finance Acts which would otherwise have been necessary, probably within the next five years or so.

62. There will also be a small cost to HMRC in updating the relevant parts of the guidance manuals and internal training material. But this is done on a regular basis in any event.

### **Other Costs**

#### ***Policy costs***

63. Policy costs represent the essential costs of meeting policy objectives. Because the rewrite of this legislation does not involve changes in the law, apart from some minor ones, policy costs arising from the rewrite will be minimal.

#### ***Publishers***

64. Commercial publishers and software suppliers will need to update their products. These costs are likely to be passed on to the end users but, as many of these are updated on an annual basis in any event, the level of extra costs passed on should be minimal.

65. Reproducing the Bill and detailed guidance material might cost the two major publishers up to £50,000 each. To the extent that the Bill obviates the need for consolidation of the Income Tax Acts (see paragraph 61) this is not all additional cost.

### **Small firms impact test**

66. The project has considered the impact on small businesses generally (other than tax professionals dealt with above). It concluded that as the Bill does not materially change the law the position of small businesses will remain much as before. The costs and benefits for the small business sector will be the same as for taxpayers generally.

67. A draft of this RIA has been discussed with the project's Consultative Committee. The Committee has a representative from the Federation of Small Businesses and members from other representative bodies which cover small business interests.

68. The Small Business Service was consulted during the development of the impact assessment and they were content that there were no adverse impacts on small businesses.

### **Charitable trusts**

69. The project has considered the impact on charitable trusts generally (and the operation of gift aid). It concluded that as the Bill does not materially change the law the position of charitable trusts will remain much as before. The costs and benefits for charitable trusts, and in relation to gift aid as it affects individuals, will be the same as for taxpayers generally.

70. A draft of this RIA has been seen by the Charities Commission.

### **Competition assessment**

71. The competition filter test was applied to this Bill with the assistance of our economist. The test confirmed that the Bill is not expected to have any significant impact on competition in the tax consultancy market or any other markets.

### **Enforcement, sanctions and monitoring**

72. Since the law is not being changed enforcement or securing compliance will be largely unaffected and no new sanctions are needed. However, the clearer and easier to use legislation should lead to greater voluntary compliance.

### **Implementation and delivery plan**

73. The Bill will be introduced into Parliament early in the second session (November/December 2006) and enacted in time for it to come into force from 6 April 2007.

### **Post implementation review**

74. The effectiveness of the rewritten legislation will be monitored and evaluated but this task cannot be undertaken until the legislation has been in force for at least a couple of years.

75. A post-implementation review and a follow-up review have been carried out on the Capital Allowances Act 2001, the project's first rewrite Act, which has been in force since April 2001. The first review was carried out in November 2003 and the follow-up in February 2005. Both surveys were carried out by Opinion Leader Research and consisted of in-depth interviews across a range of professional user groups and geographical locations. The surveys judged that the Capital Allowances Act 2001 had been a success. The majority of respondents believed the objective of modernising the legislation to make it clearer and easier to use had been achieved.

76. A post-implementation review was also carried out by MORI Social Research Institute in late 2005 on the project's second Act – the Income Tax (Earnings and Pensions) Act 2003 (ITEPA). The review found that overall the tax community were very positive about ITEPA. The Act is seen to be of particular help to those newly entering the profession and users were very complimentary about the extensive consultation process. Users also felt that after a transitional period the new Act will lead to time and efficiency savings in the professions.

77. The conclusion from the feedback from these two reviews is that the benefits of rewriting the legislation might be difficult to quantify but that rewriting the legislation is definitely worthwhile.

78. It is expected that the first review of this legislation will be carried out two years after the Act comes into force, ie in 2009.

### **Summary and recommendation**

79. The policy objective is to make the direct tax legislation more accessible. This objective of rewriting income tax legislation has already been achieved in part through the first two income tax rewrite Acts (ITEPA and ITTOIA). This Bill will complete the rewrite of income tax legislation.

80. The benefits of rewritten legislation will largely come from less time being spent by tax practitioners on understanding and applying the legislation. This should also lead to fewer disputes with the department about the meaning of legislation. It is estimated that the value of these benefits will be between £18m and £72m for

the 120,000 or so tax professionals who deal with the Department on a regular basis. In some cases there will be a modest one-off retraining cost to set against this saving.

81. This Bill fulfils a Government commitment to rewrite the United Kingdom's direct tax legislation in simpler language to make it more accessible.

### Summary costs and benefits table

<b>Total potential benefit per annum</b>	<b>Total cost</b>
£18m - £72m (estimate) <sup>1</sup>	£6m (estimate) <sup>2</sup>

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<sup>1</sup> Estimate based on time saved by tax practitioners in understanding and applying the legislation

<sup>2</sup> One-off cost to HMRC of producing the Bill

## **Declaration and publication**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

**John Healey**

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