

REGULATORY IMPACT ASSESSMENT (RIA)

Tax Law Rewrite Project: Income Tax (Trading and Other Income) Bill

The policy objectives

1. The Tax Law Rewrite project (the project) aims to rewrite all of the UK'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 two rewrite Bills. The first became the Capital Allowances Act 2001. The second became the Income Tax (Earnings and Pensions) Act 2003 (ITEPA for short). The project has also rewritten the PAYE Regulations in response to requests by users and representative bodies. These regulations come into force from April 2004.
3. This impact assessment relates to the third rewrite Bill (Income Tax (Trading and Other Income) Bill) which will cover the main income tax charging provisions for trading, property, savings and investment and miscellaneous income and also the special rules for foreign income.

Background and introduction

4. Direct tax legislation has grown in the last 25 years. In general this is not because new taxes have been introduced but because existing taxes have become more elaborate. Also, some of the existing language and terminology is outdated or conceptually difficult and cannot be adapted easily to reflect modern usage.
5. The Tax Law Rewrite project was set up in 1996 in response to such concerns. The key objectives and characteristics of the project are:
 - ◆ clearer, more user-friendly tax legislation incorporating;
 - ◆ 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
- ◆ new streamlined parliamentary procedures for enactment of Rewrite Bills.

Income Tax (Trading and Other Income) Bill

6. The project intends to rewrite 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, is concerned with the taxation of employment, pensions and social security income. The Income Tax (Trading and Other Income) Bill will become the second income tax Act. It will cover trading, property, savings and investment and miscellaneous income.

7. The Bill will also rewrite the special rules for taxing foreign income and partnerships and also the rent-a-room and foster carers reliefs.

8. The rewritten material in the Bill has been subjected to a wide-ranging consultation process. In addition to making all the relevant material available to the members of the project's two external Committees, the project has published six Exposure Drafts and other consultative papers on the Internet. These documents contained draft clauses and accompanying commentary and invited and encouraged interested parties to give their views. Additionally, the project published a near-complete draft Bill with accompanying explanatory notes for a final round of consultation. The results of these consultations have been published in Response Documents and taken into consideration in drafting the clauses.

The risks being addressed

9. There are two main risks of not rewriting this income tax legislation.

10. The first is that users will continue to struggle to understand the legislation and/or will misconstrue it. If the legislation in the remaining schedules of the Income and Corporation Taxes Act 1988 is not rewritten then the benefits of the new, clearer legislation will not extend to people whose affairs are covered by that legislation.

11. The second is that the income tax code will be arranged partly in accordance with the old Schedules in the Income and Corporation Taxes Act (ICTA) and partly in non-schedular form in ITEPA. Following the rewrite of Schedule E in ITEPA (the project's second Act) it is highly desirable and logical for the remainder of the income tax legislation to adopt the rewrite

terminology, style and structure. If this is not done there will remain substantial differences within the income tax code. Understanding will be impeded and future amendments to the code will be made more difficult.

12. There is one risk inherent in rewriting this part of the income tax legislation. 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 the Department. This 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.

Options

13. There are two options available; either to rewrite the remainder of the income tax legislation in the same style as ITEPA or to leave it as it is. As the project was set up to rewrite all direct tax legislation and has successfully delivered part of this task it is desirable to finish the job. Failure to do this would incur the risks outlined in paragraphs 10 and 11.

Business sectors affected

14. All taxpayers with income within the scope of the Income Tax (Trading and Other Income) Bill, and their advisers, are potentially affected. In practice it is mainly tax practitioners who will be affected but some 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.

Issues of equity and fairness

15. 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.

Benefits

General

16. It is generally agreed by those we have spoken to during our consultations 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. This is because it is difficult to gauge what the benefits of rewritten legislation are until it has been tested over time.

17. 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.

18. The Capital Allowances Act 2001 was well received both outside and within the Inland Revenue. As this legislation has been in existence now for some time giving tax practitioners the chance to experience how it works in practice, the project's Steering Committee recently felt that it was appropriate to assess its effectiveness.

19. The Committee commissioned a survey, which was carried out by a firm of private consultants, Opinion Leader Research, in the last quarter of 2003. The survey consisted of 25 in-depth interviews across a range of professional user groups and geographical locations. It is expected that this will be supplemented at a later stage by a larger number of shorter telephone interviews.

20. The survey judged the Capital Allowances Act 2001 a success. The majority of respondents believed the objective of modernising the legislation to make it clearer and easier to use had been achieved.

21. ITEPA has been equally well received. For example the Institute of Chartered Accountants in England and Wales described the draft Bill as "another major step forward in improving the intelligibility of UK tax legislation in areas of the law that affect a large number of taxpayers".

22. The benefits of the Bill are likely to be widespread. This is because it applies to all persons liable to income tax who have income from trading activities, property, savings and investment and miscellaneous income.

23. The following table gives some idea of the numbers of taxpayers potentially affected and the amounts of tax involved. The figures are estimates for 2001-02 and are projected forward from the Survey of Personal Incomes for 2000-01 using 2003 budget forecasts.

	Number of taxpayers	Tax
Savings (interest)	20,380,000	£3.28 billion
Dividends	8,720,000	£4.11 billion
Income from Property	870,000	£1.34 billion
Trading income	3,310,000	£14.05 billion

24. The project's Consultative Committee suggests that the numbers potentially affected will also include claimants of tax credits and their advisers. In 2003/04 around 5.7 million families benefited from Child and Working Tax Credits payments to the value of £13.5 billion.

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

- ◆ tax practitioners;
- ◆ taxpayers; and
- ◆ the Inland Revenue.

Tax practitioners

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

- ◆ tax advisers: these may be advisers within the legal or accountancy professions or tax managers working in house for companies and organisations; and
- ◆ legal and accountancy publishers, both in the context of printed material and software.

27. 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 the Inland Revenue about the meaning of legislation; and
- ◆ quicker lead-in time for training of new professionals.

28. 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 exposure drafts and other publications. The project has been particularly encouraged by the positive responses received to the exposure drafts and other consultative material published on its Internet site.

29. The Consultative Committee suggests that, although it is very difficult to quantify the benefit to practitioners, the following figures give a very conservative indication of the likely scale:

- ◆ if a practitioner charges £50 per hour and works 40 hours a week, 46 weeks a year;
- ◆ and if using the rewritten legislation saves him 5% of his time;
- ◆ the practitioner will have an annual saving of £4,600 a year.

30. The best estimate we have of the number of registered practitioners who will be affected by this legislation is 47,900. This suggests a cost saving on this basis of just over £220m a year.

31. An assumption of £75 per hour charged by the practitioner takes the estimate for the cost saving up to £330m. An assumption that the practitioner charges for 30 hours a week reduces it to £165m.

32. If the time saved on average by a practitioner is only 1% the cost saving would be in the region of £44m a year where the rate is £50 per hour and £66m where the rate is £75 per hour.

33. Our overall conclusion on the issue of cost savings is that they will be significant but (at this stage) very hard to estimate. We suggest that in these circumstances the best course is to put forward a range. Taking a cautious approach, we suggest a range of £40m - £100m. We would hope to refine this estimate when we carry out a post-implementation review of the Act, in the light of the actual experience of practitioners.

Taxpayers

34. Affected taxpayers will comprise persons who have income which is taxed under this Bill.

35. There is a high probability that this group of taxpayers will continue to employ the services of professional advisers to resolve questions about their tax liabilities. The greatest benefit to this group will probably be indirect, i.e. derived from the greater ease of use for their advisers (which should result in lower fees for advice). And clearer legislation should also mean fewer disputes and resultant litigation.

36. Taxpayers will be able to consult the legislation themselves to resolve the more straightforward questions. It is not possible to quantify the number of taxpayers who may take this route to resolve questions about their own tax liability. But with more than 20 million taxpayers in receipt of the various forms of income covered by this Bill, even if only a small proportion did, it is still a worthwhile number of customers who will benefit.

The Inland Revenue

37. Inland Revenue staff are in a similar position to other tax practitioners. 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 but this is impossible to quantify. The production of training and guidance material should be easier and more straightforward.

38. Moreover, as the legislation becomes easier to understand more resources can be released to concentrate on other issues, for example the provision of extra help and support to customers. Again this is impossible to quantify.

Costs

Policy costs

39. 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.

Implementation costs

40. The project has considered this aspect by reference to the three affected groups.

Tax Practitioners

41. Although there is no major change to the underlying tax system there may be some retraining costs for tax practitioners 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.

42. Retraining costs are difficult to estimate, as they will vary depending on how any training is organised. But the Consultative Committee suggests retraining should not take longer than a day. For the practitioner in paragraph 29 this will be a one-off cost of £400 to set against the annual saving of £4,600.

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

44. Inevitably some costs in terms of time expended have fallen on the practitioners, 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.

45. There will be no significant changes made to the existing self assessment returns and other relevant forms, but these forms should be easier for tax advisers to complete because the new legislation will be written in language that provides a better and more logical link between the statute and the compliance procedures.

Taxpayers

46. Taxpayers (whether or not through tax advisers) may have to make themselves familiar with the new legislation. It is doubtful if any additional cost is involved but if there is it will be of a one-off nature and quickly offset by the benefits of clearer legislation.

Publishers

47. 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.

48. Reproducing the Bill and detailed guidance material might cost a publisher up to £50,000. To the extent that the Bill obviates the need for consolidation of the Income Tax Acts (see next paragraph) this is not all additional cost.

Inland Revenue

49. The cost to the Inland Revenue in producing the Bill is approximately £8m, spread over the years 1997 - 2003. These costs can in part be offset by the costs that would have been expended on any consolidation of ICTA 1988 and subsequent Finance Acts which would otherwise be necessary, probably within the next 5 years or so.

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

Small Business impacts

51. The project has considered the impact on small businesses generally (other than tax practitioners dealt with above). It concluded that as the Bill does not materially change the law in any way the demands put on small businesses will remain much as before. The costs and benefits for the small business sector will be the same as for taxpayers generally.

52. A draft of this RIA has been shown to 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.

53. This RIA has been sent to the Small Business Service (SBS) who are content that there are no adverse impacts on small businesses.

Competition assessment

54. The Bill is not expected to have any significant impact on competition in the tax consultancy market or any other markets.

Securing compliance

55. Since the law is not being changed materially, securing compliance is not an issue.

Consultation

56. Full consultation with interested parties has been a feature of the project. The reactions to exposure drafts and other 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.

Monitoring and evaluation

57. The effectiveness of the rewritten legislation will be monitored and evaluated but this task cannot be undertaken until the provisions have been in force for a number of years.

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Income Tax (Trading and Other Income) Act

Statement of Ministerial Approval

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

Signed by the responsible Minister:

Dawn Primarolo

Paymaster General

Date *23 November 2004*