

PRESIDENT'S ADVISORY
PANEL
ON FEDERAL TAX REFORM

2005 JUL 21 A 11: 08

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8th June 2005The Honorable Connie Mack Chairman
The Honorable John Breaux Vice Chairman
The Presidents Advisory Panel on Federal Tax Reform
1440 New York Avenue, NW
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USA

Dear Chairman Mack and Vice Chairman Breaux,

I am aware that you are currently leading an Advisory panel which is undertaking a reform of the US federal tax system. Given that the UK's "Return-Free" tax system and our "self-assessment online" tax return have been cited as working models for consideration in the United States, I am taking the opportunity to outline some thoughts and background for your consideration. As an elected Conservative Member of the House of Commons and a Member as well of our Select Committee on Public Administration, I have observed our tax system closely and wanted to ensure that you have a complete picture of the UK system model before any decision is taken to consciously emulate it.

PAYE or "Return-Free" System

It may be helpful if I begin by outlining the basis of the UK's Tax system.

Every UK citizen who works pays income tax. This tax is automatically collected by the HM Revenue and customs, a department of HM Treasury in collaboration with a citizen's employer.

Tax is paid based on a citizen's income during the tax year, which starts on April 6th and ends on April 5th in the following year.

In the 2002/3 tax year (for income earned between April 6th 2002 and April 5th 2003), the income tax bands were as follows:

0% on the first £4,615 (a citizen's personal allowance, equivalent to about £89 per week, or £385 per month) 10% on the next £1,920 (equivalent to about £37 per week, or £160 per month) 22% on the next £27,980 (equivalent to about £538 per week, or £2,332 per month) 40% on any income above this.

If a citizen has paid tax and their total taxable income for the year doesn't go above their personal allowance, they may claim a refund. They can even do this during the tax year if their income for the tax year is likely to remain below their personal allowance.

Income Tax is collected via a system known as *Pay As You Earn* (PAYE) -- the "Return-Free" example being cited in the US -- which is collected at the employment source. Citizens will receive a note from the IR advising the rate at which they will be taxed based on their previous years earnings. Under this system the taxpayer prepares no tax return, and the government instead simply takes the amount of tax revenue it determines the citizen ought to be paying.

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Those who have any source of income that does not come under the PAYE system, ie, self employed, people with a second income etc are required by law to complete their own tax self assessment detailing their income earned to which HM revenue and customs will then advise the tax they are required to pay.

So in effect, the PAYE is a government-oriented solution which allows the UK Government to assume the comprehensive responsibility for the process of taxation on the front end *as well as* the back end of the process, either through an automatic payment and tax liability determination that eliminates the role of the citizen from the process completely, or through playing the role of calculator and determiner of tax liability even for those who self-prepare. It is a centralised system in which the vast majority of the UK public do not query the tax they pay because it is deducted at source and the tax return is eliminated.

In the event the government's tax calculation is questioned, the experience is that those who muster the courage to do so are commonly subjected to an on-going detailed scrutiny of their financial affairs by the HM revenue and customs, sometimes going on several years after their initial query. This leads to a feeling in the UK that where tax is concerned, it is best to "let sleeping dogs lie." This has unfortunately also produced a cultural disconnect from the concept of "voluntary compliance", as citizen participation in the tax process is generally viewed as ill-advised at best, or a "fool's errand" at worst. This is particularly reflected in the low take-up rate for the government's self-assessment online service for higher income taxpayers, which I discuss below.

In sum, PAYE is a "Return-Free" system in which the same agency that collects the taxes, writes the tax regulations, collects the revenues, and enforces compliance, is also the tax preparer. In so doing, the tax collector's interest in maximizing revenue completely subsumes the citizen's interest in minimizing their tax liability. Despite lofty rhetoric at the outset, over the years this government-centric system has effectively eliminated the role and voice of the citizen in the process.

UK onLine system

In order to comply with their strategy for delivering Government services "online", the HM revenue and customs established the Self-assessment on-line service in April 2000 with an declared national objective of achieving a 50% electronic filing by 2005. However despite the Government allocating considerable sums in promoting this service, the HM revenue and customs on-line self -assessment service only enjoys a 3% public take-up rate despite hundreds of millions of pounds spent over several years on public promotion and advertising.

The 50% electronic filing objective has now been officially reduced to 25%.

The self-assessed on line service is expensive - HM Treasury has admitted that the cost of the current system exceeds the equivalent of £30 per return.

The self-assessed online system has also been beset with privacy and security problems and in May 2002 had to be taken down for over 30 days it was discovered that some taxpayer's personal income and tax information was being disclosed to other taxpayers on line.

Accordingly, in the tax preparation arena, the HM revenue and customs has belatedly tried to now enter into partnerships with the private sector, in order to try and inject vibrancy and a competitive edge to the empowerment of consumers in the management of their own personal finances. However, private sector firms have begun exiting the UK market for such services, as public interest in "voluntary compliance" is moribund at best.

Unique US approach

All countries tax regimes are different and reflect their traditions, experiences and what they feel best works for them.

Within the US, the system is has been a citizen-oriented approach in contrast to the UK government-oriented system. Which system you select to adopt for the future depends entirely on the end outcome you are seeking and which cultural attitudes toward tax obligation you are seeking to achieve.

Whether that UK system would work well in the US, a country which has historically sought to limit the role of Government and encourage citizen empowerment and responsibility, is one in which only the US can determine. The need for increased tax revenue, and the government control over the ebb and flow of the

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same which a "return-free" system embodies and enhances, may ultimately outweigh the value of a "voluntary compliance" culture. Given the adverse effect of the "Return-Free" model on public involvement in the tax process, the primary advantages of the solution must be viewed in terms of expediency, revenue enhancement and increased government control. However, given the experience of the tax system in the UK, and some of the unanticipated outcomes which have resulted, I would encourage placing a significant degree of citizen control as a cornerstone of any reform.

That is certainly my view of the need for tax reform in the UK, as a result of the lessons learned through our experience.

If any other information is need please get in touch.

Yours sincerely,

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22/06/2005

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3rd June 2005

The Honorable Connie Mack
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Dear Chairman,

I was interested to read that you are currently undertaking a review of the US federal tax system and I thought that I would take this opportunity to provide you with my own personal views given that some members of your Panel have indicated their interest in a return-free tax system.

Perhaps if I begin my advising that I am a former Member of the European Parliament and during my term of office I was a member of the Economic and Monetary Affairs Committee. I was also the Rapporteur for the Parliament on Public Service reform with particular emphasis on the future of postal services across Europe.

Following my retirement from the Parliament in 1999, I was elevated to the House of Lords by the Prime Minister and in 2000 was asked by him to become the Chairman of Catalyst Corby, an Urban Regeneration programme charged with the task of building a new town based on the old steel town of Corby in Northamptonshire re-generation agency.

Within House of Lords, I am a member of the Ministerial team for the Department of Culture, Media and Sport and a Member of the European Select Committee and the European sub Committee for Agriculture, Health and Consumer protection.

I also serve as a senior advisor to Sovereign Strategy, a Public Affairs company with offices in London, Newcastle & Brussels. Sovereign has previously represented interested parties in similar tax policy debates in the UK.

I have followed with interest discussions within the UK on the need for a greater partnership approach to the delivery of public services, no more so, than in HM Treasury where I still believe there exists greater potential to inject a degree of competition particularly within HM Revenue and Customs Agency.

During my political career, I have always believed in a stable mixed economy and that I have always attached the highest importance to the need for consumers to be given the widest possible information and choice. In effect a citizen-centric approach, which places the emphasis on the citizen as a consumer.

Having read about the work of your Panel, it appears that there is some support for the US Government to replace this approach with a Government-centric solution which removes obligations from the citizen and places the emphasis upon the State to assume responsibility for tax preparation and filing.

I genuinely believe that this would be a mistake for two main reasons.

Firstly, experience within the UK demonstrates that HM Revenue and Customs (formally the Inland Revenue) is seen as a body which merely does as it is told by the Government. I have found it intriguing that testimony before your panel in advocacy of a "Return-Free"



system in the US has suggested a clamor of public support for government taking over the process of tax compliance on their behalf. If this is true, it is in sharp contrast to our experience here in the UK where the Inland Revenue has done exactly that through two different services, PAYE and Self-Assessment OnLine. In 2002, an extensive independent survey conducted by Gavin Anderson & Co on attitudes towards the Inland Revenue (IR) and its tax services found that respondents' reactions were almost universally negative with a general belief that the IR was incompetent, distrusted by the public, and its behaviours and performance were judged to be unfriendly and obsessional.

The same survey indicated that the public would welcome and prefer opportunities to prepare and file their tax returns on-line via *independent* providers who by their very nature would be "On the consumer's side" because the aim of the independent provider would be to minimize the tax paid by the consumer. The aim of the Inland Revenue, by virtue of the public's assessment of its actual performance through its electronic tax services, was uniformly seen as placing greater emphasis on the need to maximize the tax paid the consumer -- which was viewed as obvious given that IR is the revenue collection arm the Government.

Secondly, the UK Government has set itself ambitious new targets for the delivery of services electronically in the future. In October 2003, the then Minister of State for the Cabinet Office, Douglas Alexander, launched a report entitled *Policy Framework for a mixed economy in the supply of e-Government services*. The overriding conclusion of the report was that intermediaries, from the private and non-profit sectors, acting on behalf of individuals or businesses, had the potential to make a much more significant contribution to the Government's overall objectives by the value they could uniquely add in providing associated services and advice.

Given the move by the UK Government towards a mixed-economy policy and public-private partnership approach, it would be intriguing if the US Government - who has always placed great store on decentralisation, the engagement of citizens in "voluntary compliance", and the exercise of an individual's public duty - were to seek to move towards centralising tax compliance by the introduction of a return-free tax system under the auspices of the tax collection authority.

Whilst I appreciate there may be flaws in your current tax system - thus the purpose of your reform undertaking - moving away from a citizen-based concept would necessitate a much greater role for Federal government and within time, would inevitably lead not only to growth in the central bureaucracy and its costs, but the same perceptions of the IRS by the US public as those experienced by their UK counterparts towards the IR as outlined above. Before voluntary compliance is discarded in favor of a bigger role for government in citizens' financial lives, I would urge you to study the actual experience of the United Kingdom in our experiment in this area, as opposed to academic rhetoric about how such an initiative might work in theory. In practice, a model of increased government centralisation and reduced citizen participation in the tax area has not delivered on its promises, but has produced unintended consequences which might give one pause.

I offer these comments respectfully, given the citation of the UK experience by many in the US debate, and trust you will take my comments on board when you continue your deliberations on this matter.

Yours sincerely,

Baroness Billingham of Banbury