Restoring trust

General Features | Management of taxes



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On 10 May 2016, *Professor Judith Freedman* gave the 2016 CTA Address on the topic of ‘restoring trust’

Key Points

What is the issue?

Sustainable tax systems rely on trust at various levels.

What does it mean for me?

Transparency alone cannot solve problems. Increasing transparency and data available from taxpayers will not achieve its aims without also taking measures to improve justified trust in tax authorities.

What can I take away?

In the end, only governments can levy taxes. By taking some relatively modest steps to improve resourcing, accountability and personal contact we could increase trust in our revenue authority with general benefits.

Tax is at the top of the political agenda and many substantial changes are taking place, partly as a response to political and popular pressure resulting in the Base Erosion and Profit Shifting (BEPS) Action Plan, EU initiatives and changes in domestic law and partly as a result of administrative pressures and the capacity for new technological developments, such as the Making Tax Digital plans. New technology has also had a part to play in ramping up the political agenda as it becomes easier to access and disseminate material and we cannot help being aware of the major impact of recent leaks of vast amounts of information.

The rapid pace of change has left many in the tax community gasping for breath. There is also some feeling of lack of direction. As a result, there were so many topics I could have chosen for this lecture that I was spoilt for choice, but one common theme emerged. This is ‘trust’.

The importance of trust

By ‘trust’ I mean the belief in the reliability, honesty and ability or capacity of someone or some group, institution, organisation or government. I argue that sustainable tax systems must rely on trust to a considerable degree. Systems dependent purely on coercion generally do not work in the long term. But trust is many layered – there will be interlocking networks of trust across different groups. We need trust of taxpayers in governments, politicians, revenue authorities, courts, international organisations and in each other; trust of the governments in the

taxpayers; trust of national governments in each other; trust of international organisations in domestic governments and also trust in what we, the public, are being told by the media and NGOs.

Some forms of trust, for example, between small elites, could exclude others and so make things worse. So, we need the right kind of trust, and checks on the wrong kind of trust.

Given the limits on space and time, I focus here on the trust of taxpayers in governments and revenue authorities. Although the relationship has been complicated by globalisation, taxation remains fundamental to the relationship between the citizen and the state. Only governments can levy and collect taxation.

We are currently on a trajectory that will increase transparency and regulation, but if transparency is increased without a commensurate increase in justified trust, the aims behind transparency (better tax collection, increased ‘fairness’) will not be served. We are likely to lower tax morale and raise distrust in the general population without necessarily increasing tax collection overall or improving its balance.

Increasing the amount of data available can be valuable if it reveals otherwise undetected problems, especially where there have been attempts to hide information for criminal and corrupt purposes. But once we have the information, we need to be able to trust that governments are dealing with the problems. If it is believed that tax authorities are unwilling to deal with this data, or cannot manage it and use it properly, we shall have a real crisis of confidence. So, we need to ensure that the revenue authorities have the resources to combat these activities and that there is a mechanism that makes them properly accountable to the public. This should not be seen as criticism of employees of the revenue authority but is a call to support and monitor the system in a constructive way to build trust. Relying on whistleblowers, media, NGOs and the public to administer taxation cannot be a sustainable or adequate answer to the problems. This is not an argument against increased transparency, but it is a warning that it cannot by itself solve our problems.

Evidence of a lack of trust comes up time and time again in the tax debate. For example, in its March 2016 report on tackling tax fraud, the Public Accounts Committee (PAC) expressed a lack of trust in HMRC because it did not feel it had the information it needed to assess what HMRC had done about fraud, despite having

received a National Audit Office (NAO) report. It felt it was forced to rely on what was available to it and commented that 'the perception that HMRC does not tackle tax fraud by the wealthy needs to be addressed.'

Whatever the truth of the matter, the perception is important. We need transparency and explanation from the tax collection agencies, not only to convince other taxpayers but also so that the agencies can defend their actions and protect their own staff from the current 'revenue bashing' (as Andrew Tyrie called it in his 2012 CIOT Address).

Information by itself is not helpful. It needs interpretation. As Baroness Onora O'Neill commented in her 2002 Reith lectures on *A Question of Trust*:

'…. Increasing transparency can produce a flood of unsorted information and misinformation that provides little but confusion unless it can be sorted and assessed. It may add to uncertainty rather than to trust. And unless the individuals and institutions who sort, process and assess information are themselves already trusted, there is little reason to think that transparency and openness are going to increase trust.'

Further, she points out, 'Perhaps it is not … surprising that public distrust has grown in the very years in which openness and transparency have been so avidly pursued. Transparency certainly destroys secrecy: but it may not limit the deception and deliberate misinformation that undermine relations of trust. If we want to restore trust we need to reduce deception and lies rather than secrecy. Some sorts of secrecy indeed support deception, others do not. Transparency and openness may not be the unconditional goods that they are fashionably supposed to be.'

So we need to consider the downsides as well as the upsides of demanding more information. For example, were tax returns to be public, a taxpayer not wanting his neighbours to know the full extent of his wealth might fail to declare information to the revenue authority when he would make a fuller return if it was not public.

Was there ever trust?

The historian, Martin Daunton has shown that trust was foundational to the relationship between taxpayers and the tax authorities in the UK in the 18th century and again in the second half of the 19th century. In his book, *Trusting Leviathan*,

Daunton shows how the ability to collect taxation efficiently and without public unrest is connected not only with the economy and the form of the state but also to the institutional procedures in place and the social norms created. The UK system was strengthened by the fact that the central state delegated the assessment and collection of income tax to members of the taxpaying public: law commissioners chosen by the local business and professional community. Involving people with local knowledge made the assessment and collection feel more personal. After this system was dismantled, general commissioners of income taxation were considered able to know the norms in their local population and this was an important basis for trust that taxpayers generally were paying their share. This system lasted until 2009, when the tax tribunals took over. Although the previous system could not have been maintained, the current total removal of links between taxpayers and individual revenue officials is having an effect on trust.

Restoring the trust

It is no surprise that calls for transparency and fairness in relation to large businesses are reaching a crescendo in the UK at a time when personal contact with HMRC is being lost as we move to call centres, centralised functions and digital returns.

The current sense of unfairness is compounded by the feeling that large companies have a relationship of trust through co-operative compliance that is denied to others. Although it is clear that the large business arrangements could not be replicated for smaller taxpayers, it is ironic that such efforts are being made to build trust with large businesses at the same time as it is being lost with small businesses and individuals. Although there will be a small increase in HMRC customer services staff over the next couple of years, it has been made clear that the ultimate aim is to cut numbers substantially as digital tax collection is introduced.

The substantial backlash against the Making Tax Digital plans to date suggests that this is not going to be easy. Taxpayers required to deal with HMRC entirely through computers may have less and less trust in HMRC. Investing in some high quality human interaction to run alongside the machines would be advisable to maintain trust. Digitalisation should not be seen as an excuse to cut staff yet further in the customer services arena.

In relation to large businesses, the perception that HMRC is doing ‘deals’ has not been displaced, despite a report from the NAO, including the Park investigation, that largely supported the claim that HMRC was following its published Litigation and Settlements Strategy. Unfortunately there was some evidence of non-ideal behaviour from HMRC officials, highlighted in the *UK Uncut litigation* ([2013] EWHC 1283)) and this has given rise to a concern that the trust being developed here is reserved for elite groups and is insufficiently monitored.

Many in the tax community consider that perception is unfair. It would be inefficient if not impossible to take every case to court. Where there are issues of valuation in transfer pricing, for example, current law does not render a precise answer, and discussion within a range may be needed. Under the Litigation and Settlements Strategy the outcome of a tax dispute, when achieved by agreement between HMRC and the customer, must be consistent with the law. Even extensive reform of tax law is unlikely to provide a system that could render a precise answer in every case. In any event, HMRC has to apply the law as it is.

The most worrying aspect of the re-emergence of the large companies ‘deals’ issue earlier this year over Google is that procedures were set up in 2012 precisely to create trust in HMRC’s dealings with such matters. New forms of governance were introduced, including the appointment of the ‘assurance commissioner’ whose very name relates to trust. Yet these had no discernible impact on the debate when Google was discussed in Parliamentary Committees, the public and the media. This does not mean that the procedures were not robust – but it does mean that they have not been well explained and that they do not go far enough to satisfy the public, so that they do not achieve their objectives. HMRC was inhibited from responding by rules on confidentiality and the general response it gave was considered too little and too late. As a non-ministerial department, it could not be defended by a minister.

In a 2013 *British Tax Review* article, I suggested that the appointment of the tax assurance commissioner might not address the need for reassurance in this area. This proved to be correct. Once again we face suggestions that more transparency is needed, companies need to publish their tax returns and that the PAC needs greater powers to examine the tax affairs of individual companies. The problem with all these suggestions is that, in the end, however much information is available HMRC must apply the law to the facts and collect the tax due. This requires not only data but also analysis.

In 2012, following the Park review, the NAO stated that ‘There should not be a need for external reviews of settlements, such as this one, to provide this assurance. The NAO will have a role in providing assurance that the Department’s arrangements are operating efficiently and will continue to have access to the details of individual settlements.’

This suggests a way forward. Currently the role of the NAO and the PAC is to review whether HMRC are operating efficiently. This is the correct role for the PAC: politicians should not be involved in the tax affairs of individual taxpayers as a matter of constitutional propriety. But an expert unit of the NAO could provide external scrutiny of a random sample of settlements on a regular, routine basis. This would be far preferable to special inquiries by non-experts emerging periodically as a response to particular events, because only a routine check will provide the reassurance necessary. The press release announcing the appointment of Edward Troup as first permanent secretary at HMRC stated that the arrangements for assuring large tax settlements in HMRC are under review. This is a perfect opportunity for a re-think of the 2012 arrangements.

The way forward

My lecture aimed to raise questions about trust and the relationship between trust and transparency. I propose that the trust of UK taxpayers in HMRC and the tax system could be increased in various ways.

- It goes without saying that improved tax design, both on an international and a domestic front would increase trust, but that is easier said than done. It is not clear that the Tax Consultation Framework is offering increased engagement beyond a small group of experts. Expert input is vital but may invite (often unfair) mistrust. Better ways need to be found to engage all those affected, not just the experts, through serious informed discussion (not market research). At the same time HMRC needs to have the expertise to spot self-interested lobbying. Proper consultation takes time and too many changes are still rushed or pulled as rabbits out of the Chancellor’s hat.
- NGOs and the media are good at highlighting problems, but ultimately only governments and revenue authorities can implement solutions. So, increasing trust at a national level requires us to have a well-funded, well-staffed and well-trained revenue authority.

- Trust between HMRC and large companies has been increased through co-operative compliance, though misperceptions about cosiness and deals may threaten this. The benefits of personal contact need to be extended to other taxpayers to give validity to cooperative compliance for business.
- Given the above, there is a need to give assurance about settlements reached by HMRC with taxpayers by having a unit of the NAO or other similar body checking on this as a matter of routine.
- Trust requires personal contact with taxpayers at all levels. The Making Tax Digital strategy and other new technologies may help to streamline administration but should not be used as an excuse to reduce the work force – rather it is a chance to improve relationships by releasing the workforce from mundane tasks.
- HMRC should be represented in Parliament by a minister with accountability, which would assist HMRC to explain issues. It should be possible to achieve this without breaching taxpayer confidentiality.
- Questioning whether transparency is always useful is not supporting deception or misinformation. Demanding information that will not be useful or that will turn into a tick box exercise could be counterproductive. Important information may not be examined because resources are being wasted on information that will reveal nothing useful. Transparency initiatives need to be well targeted and supported by resource.

This is not a revolutionary menu – it is a very modest one. But these recommendations suggest a way forward to restore trust in our revenue authority and our tax system. Failure to do so will result in a dangerous situation. A tax system cannot be operated by public opinion but it needs consent, for it is impossible for it to function without a large measure of voluntary compliance. I am not asking for blind trust but for reasonably placed trust. For that we need certain kinds of transparency but also checks and balances.