



Merging the Inland Revenue and HM Customs & Excise – earlier debates

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In his 2004 Budget speech the Chancellor Gordon Brown announced that the Government would merge HM Customs & Excise with the Inland Revenue into a single department: Her Majesty's Revenue and Customs,¹ following the recommendation of a review chaired by Gus O'Donnell, permanent secretary to the Treasury,² which had been set up in July 2003 to review the three organisations dealing with tax policy and administration.³ The Government's intention to introduce the necessary legislation was included in the Queen's Speech on 23 November 2004,⁴ and the *Commissioners for Revenue and Customs Bill* (Bill 3 of 2004-05) was introduced in the Commons on 24 November 2004.⁵

In April 2000 the Treasury Committee produced a report on Customs, arguing that a merger of the two authorities “would improve compliance with taxation, reduce businesses' compliance costs and reduce the Government's revenue collection costs.”⁶ At the time the Government rejected the idea, arguing that the benefits of a merger could be achieved, avoiding its costs, “through a dynamic and focused programme of closer working [between the two departments].”⁷ However, the idea that the two tax authorities in this country should be merged into one department is not a new one. This note looks at three occasions prior to the Committee's report when the possibility of a merger was debated at length.

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¹ HC Deb 17 March 2004 c 331; HM Treasury press notice 27/04, 17 March 2004

² HM Treasury, *Financing Britain's future: review of the revenue departments*, Cm 6163 March 2004. This is commonly referred to as the O'Donnell review – and is cited here simply as *O'Donnell*.

³ HM Treasury press notice 78/03, 2 July 2003; HC Deb 2 July 2003 cc 270-1W

⁴ HL Deb 23 November 2004 c 3

⁵ HC Deb 24 November 2004 c 102. A Library Research paper is to be produced in time for the second reading of the Bill, which is expected on 8 December 2004.

⁶ *Second report: HM Customs & Excise*, 8 February 2000 HC 53 1999-2000 para 45. The previous Session the Committee had recommended a feasibility study for a merger (*Sixth report: Inland Revenue*, 25 May 1999 HC 199 1998-99 para 81).

⁷ Treasury Select Committee, *Second special report*, 18 April 2000 HC 442 1999-2000 p v

A. Discussion of a merger in the late 1800s

The amalgamation of the Inland Revenue with HM Customs & Excise was examined seriously on two occasions in the late 19th century. The question was considered by a select committee established for the purpose in 1862, and then by a Royal Commission in 1887. Interestingly enough the Revenue changed its view on the benefits of amalgamation between the two reports – coming out in favour of a merger on the second occasion. However the option was not pursued as a majority of the ‘Ridley Commission’, as it was known, decided against it.

A brief history of these debates was given in the report of the Keith Committee, set up in 1980 to investigate the enforcement powers of both authorities.⁸ The Committee observed “during the last 120 years there have been several proposals for the amalgamation of the two Departments. Indeed at one time the management of the excise duties was undertaken by the Commissioners of Inland Revenue and it was transferred to the Commissioners of Customs in 1909. However, none of the proposals for amalgamation came to fruition and the continued existence of two separate Revenue Departments with their particular divisions of functions was therefore largely a matter of historical accident.”⁹

A note to the Committee’s report provides a history of the two departments, and their possible amalgamation, and this is reproduced in full below:

1. We discuss in Chapter 23 the suggestion that the two Revenue Departments be amalgamated. Prior to 1833 the national revenue of the United Kingdom was collected by four Boards:¹⁰ the Boards of Customs, Excise, Stamps and Taxes. In 1834 the Board of Stamps was merged with that of Taxes, resulting in a saving of £18,342 per annum by way of salaries. In 1849 the Board of Stamps and Taxes was in turn amalgamated with the Board of Excise to form the Board of Inland Revenue. It was not until 1909, when the Excise was removed from the aegis of the Board of Inland Revenue and amalgamated with the Customs under one Board, that the present Customs and Excise Department was established.

2. Between 1849 and 1909 the excise duties of Inland Revenue were under the control of a number of commissioned officers from the Excise Surveying Establishment. Each part of the United Kingdom was divided into sections termed “Collections” and subdivided into districts. Officers were required “for the better prevention of fraud to visit their traders both when ‘silent’ and at work at uncertain periods”¹¹ Such “surveys” continue to this day.¹²

3. The amalgamation of Inland Revenue and Customs was considered in 1862, when a Select Committee was appointed to: “Inquire whether it would be practical and advantageous to consolidate any of the establishments now governed by the Boards of Inland Revenue and Customs respectively.” The Inland Revenue Department supported by Gladstone argued against amalgamation. Mr Gladstone stated that “in

⁸ *Committee on Enforcement Powers of the Revenue Departments*, Cmnd 8822 March 1983

⁹ *op.cit.* p 463

¹⁰ In 1823 the separate Scottish and Irish Boards responsible for collecting customs and excise duties were abolished.

¹¹ 13th Report of the Commissioners of Inland Revenue.

¹² S112 Customs and Excise Management Act 1979.

the case of the Board of Inland Revenue, consolidation had been carried to the very furthest point to which it was possible to carry it without great mischief to the Public service.”

4. The question of amalgamation of the two departments was next considered in 1887 by the Royal Commission on Civil Establishments.¹³ This time the proposed merger was supported by Gladstone and the Inland Revenue but rejected by Customs as “highly undesirable”. Customs argued that “no bona fide amalgamation can be accomplished unless the officers in the respective departments are capable of undertaking, when required, all the detailed duties of the amalgamated department. We do not believe that any such exchange of duties is possible in the Customs and Excise.”

The Inland Revenue argued that each successive previous amalgamation had resulted in a saving to the state and pointed to the instance whereby warehouses at some 41 ports had been transferred from Customs to Revenue with a saving of £15,000 per annum, as a result of the recommendation of an 1880 Departmental Committee which had been appointed to enquire into the bonding systems of the Customs and Inland Revenue Departments.

5. However, a majority¹⁴ of the Ridley Commission decided against amalgamation as they considered the evidence before them did not justify “drawing the inference that a scheme of amalgamation could be satisfactorily and economically worked out”. The Commission stated in their report¹⁵ that, “Even if we were in favour of the amalgamation of the Boards, we could not endorse the suggestion that the united Board should sit at Somerset House, and the present Customs House be sold ... we are convinced that the removal of the controlling authority from the neighbourhood where it is at present located would meet with most strenuous opposition from the trading community of the Port of London, who would be most seriously inconvenienced by it.”

6. After the Commission’s report, the possibility of a merger between the two Departments was dropped. The possible amalgamation of the Customs and the Excise was however mooted from time to time and a decision to undertake this was finally taken by the Chancellor of the Exchequer in 1908, following advice from the (retiring) Chairman of the Board of Customs. The “Excise transfer” took place in 1909, but the style of working in the Excise and the Customs remained rather different and the enforcement codes for the two sets of duties were not fully harmonised until the thoroughgoing consolidation with amendment embodied in the 1952 Customs and Excise Act. Purchase tax, introduced in 1940, was assigned to Customs and Excise to administer, so as not to prejudice the collection of income tax, and VAT, the successor to purchase tax, was also allocated to Customs and Excise. While suggestions of amalgamation or reallocation are made from time to time, there have been no recent published studies.¹⁶

For its own part the Keith Committee did not examine the possibilities for amalgamation, though it looked at the advantages of closer co-operation between the two departments. Though the exchange of information between the two bodies was provided for under law (specifically, section 127 of the *Finance Act 1972*), controversy at the time this measure was passed had meant this was only done at a Head Office level in practice. The Committee noted that exchanges done at a local level had been carried out in Leeds from 1977 to 1981 with great

¹³ The Ridley Commission.

¹⁴ A minority report by a member of the Commission, C E Lewis favoured amalgamation.

¹⁵ Report of the Royal Commission on Civil Establishments 1889.

¹⁶ Cmnd 8822 March 1983 pp 786-787

success and recommended that this should be extended on a nationwide scale,¹⁷ which indeed was done in 1988.¹⁸

The Committee also discussed possible co-operation in making joint visits to trading taxpayers. This represented potential savings both in official manpower, and for businesses, who could deal with their VAT and PAYE responsibilities at one time. The Committee recommended that a pilot scheme be set up to explore the feasibility of this proposal, which was done in 1986, though the Committee's separate suggestion, for joint investigations, seems not to have been taken up. In October 1988, the Government announced that the feasibility study had found that joint visits had not cut either department's costs, nor substantially reduced the numbers of visits the authorities had had to make.¹⁹ As a consequence, the proposal was dropped:

Mr. Robert Banks: To ask the Chancellor of the Exchequer what has been the outcome of the pilot study of joint pay-as-you-earn and value added tax visits which the Inland Revenue and Customs and Excise undertook in the Nottingham area.

Mr. Norman Lamont: The pilot study, which took place in the last quarter of 1986, was designed to test the Keith committee's suggestion that joint visits, rather than separate visits for PAYE and VAT purposes, could be mutually beneficial to traders and to the Inland Revenue and Customs and Excise. The findings are that, while joint visits are feasible and acceptable to most of the traders who received them, in only 2 per cent. of cases would a joint visit replace two separate visits. So, in most instances, a joint visit would add to, rather than reduce, the inspections of a business's records. Furthermore, a system of joint visits would add substantially to the departments' costs. In the light of these results, it is not proposed to implement a programme of joint visits at this stage. But both departments will continue to improve the information and other services they provide, especially to small businesses.²⁰

Prior to the establishment of the O'Donnell review in July 2003, these two studies appear to have been the only official published reports on the costs and benefits of a merger. For its part *O'Donnell* makes no reference to any earlier studies, though it provides evidence on tax administration in a number of other countries, which, to its mind, "suggests that organisation by customer and function is more effective and better at meeting customer needs than organisation by tax type."²¹ In November 2004 the Treasury Committee published a report on the potential merger, noting that the merger "has been proposed several times before", although the Committee cites only the 1862 select committee, and the recommendations concerning a merger made by its predecessor committees in 1999 and 2000.²²

¹⁷ *op.cit.* p 581

¹⁸ HC Deb 8 March 1988 c.128W

¹⁹ HM Customs & Excise press notice, *HM Customs & Excise/Inland Revenue joint inspection visits*, 21 October 1988

²⁰ HC Deb 20 October 1988 c 990W

²¹ *O'Donnell* p 39. Annex A to the review presents this international data in some detail (pp 127-142).

²² *Ninth report: the merger of Customs & Excise and the Inland Revenue*, 3 November 2004 HC 556 2003-04 para 5

B. The Fundamental Expenditure Review 1993-94

In February 1993 the then Conservative Government announced it would conduct in-depth reviews of all public spending by every department of state. In a statement to the House the then Chief Secretary to the Treasury, Michael Portillo, explained, “the exercise will require Secretaries of State in each Department to conduct searching studies of their programmes in co-operation with me. The process will start this year with four of the largest programmes ... the particular aim is to distinguish clearly between the essential costs of high priority spending, which we will continue to fund, and avoidable spending which we cannot afford ... we will be seeking to identify areas where better targeting can be achieved, or from which the public sector can withdraw altogether.”²³

At the time of the November 1993 Budget it was announced that the Revenue, Customs and HM Treasury would all be included in the next batch of reviews.²⁴ In March 1994 it was reported in the press that one option being discussed was merging those sections responsible for collecting tax from small businesses, although in response to these reports both revenue departments simply stated that the purpose of the survey was to examine all potential cost savings.²⁵ Following this in May a DTI white paper on competitiveness noted that the boundary between the two departments was being reviewed, and the Government would be considering “how the work of the Inland Revenue, Customs & Excise, and the Contributions Agency can best be co-ordinated to minimise cost on business arising from tax collection and compliance.”²⁶ The terms of reference of this boundary review were as follows:

CUSTOMS & EXCISE AND INLAND REVENUE: "BOUNDARY REVIEW"

- (i) To carry out, as part of a fundamental expenditure review (FER), an examination of the revenue collecting responsibilities, including policy formulation and advice, of the Inland Revenue and Customs & Excise to determine whether the current structure of the two departments with the tasks assigned between them on the present basis gives best value for money.
- (ii) To identify options for change and, for each option:
 - an estimate of the savings and costs involved;
 - the likely timescale in which net savings could be achieved; and
 - the main issues—including the implications for revenue and compliance, for deregulation, customer service and policy formulation—that would need to be addressed.
- (iii) To identify in broad terms common areas of activity where improvements in efficiency, revenue and compliance, deregulation and customer service could be achieved without major structural changes.

²³ HC Deb 8 February 1993 c 683

²⁴ *Financial Statement and Budget Report 1994-95* HC 31 30 November 1993 p 95

²⁵ “Review of tax departments threatens thousands of jobs”, *Financial Times*, 11 March 1994

²⁶ Dept of Trade and Industry, *Competitiveness: helping business to win*, Cm 2563 May 1994 para 13.61

(iv) To produce a note of the emerging findings by the end of October 1993, including recommendations for further more detailed work on the main options, to be completed by mid-December.²⁷

In November 1994 when these reviews had been completed, the Government announced that one of the outcomes had been “not to merge the departments but for them to work together more closely.”²⁸ In evidence to the Treasury Committee in November 1999 Customs explained that “the conclusion at the time was that, although a merger could produce savings in staffing, IT and accommodation, the short-term costs were likely to outweigh the efficiency gains.”²⁹ In preparing its report on Customs that session, the Committee requested to see the ‘boundary review’ report, but this was turned down on the grounds that “the report itself was advice to Ministers in the previous Administration and, under the terms of the Code of Practice on Access to Government Information, it would not be appropriate for it to be released.”³⁰

Despite a protracted correspondence on the issue the Committee was unsuccessful in obtaining a copy,³¹ and they were quite critical of this in their final remarks.³² That said, the then chairman of Customs – Dame Valerie Strachan – gave some details of this work in oral evidence to the Committee in November 1999; an extract from this is given below:

I am happy to give you the information I can under the normal conventions about this ... Under this Government I think it is fair to say no work has gone on concerning the merger because that was not what the Government wanted. We do not do work that the Government does not want, we do the work they do want. As regards the review that was done before ... I can give you a general account of it and some of the facts that came out of it so you have some idea of where it happened. It was conducted in 1993 and it was conducted as a preliminary to the fundamental expenditure review that all departments were going through. It was done very confidentially, there was absolutely no publicity given to it.

At the time it was conducted jointly by the Inland Revenue, by Customs & Excise and Treasury officials and they were steered by a group of senior officials which was chaired by the Treasury. You already have the terms of reference for that review, from which you will be able to see the review itself was unconstrained about matters it could look at. The review considered a number of options. It considered full merger over a period of time. It considered the possibility of just merging the head offices and the regional offices. It considered the possibility of moving VAT and intrastate, that is the system for community trade statistics, to the Inland Revenue. It also

²⁷ HC 53 1999-2000 Ev p 263

²⁸ Inland Revenue Budget press notice IR49, 29 November 1994

²⁹ HC 53 1999-2000 Ev p 6

³⁰ Letter from the Department to the Clerk of the Committee, 26 November 1999 (HC 53 1999-2000 Ev 262).

³¹ In her final response on the matter in January 2000 the Paymaster General, Dawn Primarolo, cited the code of practice on government information in her decision not to release the report (HC 53 1999-2000 Ev 262).

³² HC 53 1999-2000 para 22. In their response the Government noted that as it had been prepared for the previous administration, “current Ministers have not seen the report or discussed its contents” (HC 442 1999-2000 p vi).

considered the possibility of moving business taxation from the Inland Revenue to Customs & Excise. It also considered the possibility of Closer Working between the two departments, merging processes where it looked as though it would yield benefits. It fairly well concentrated on full merger over time and the Closer Working option that I have just mentioned. It had a good deal of difficulty in quantifying costs and benefits across the whole range of a full merger because that would have depended very much on the speed with which a government would want to move, how it would want to do it, how it would want to tackle things like location of offices, and so forth.

What it did was to make pretty well an assumption about what one would achieve from merging the head office and regional office functions, essentially the corporate services I was mentioning just before, and those savings. They reckoned, however—it was rather by and large reckoning, it was a finger in the air estimate, you might say—they had approximately 800 staff years between the two departments and they reckoned over a five year period that might save a little over £50 million, that is over the full five years, starting with a benefit of £7 million in year one and going through to £13 million in year four onwards. That amounted to actually a very small percentage, possibly less than half a per cent of the two departments' combined rent costs. It recognised there were large uncertainties over those savings, depending on the timing the savings could be plus or minus £20 million in the £50 million-ish that I quoted. The review said that in some circumstances if it were done very, very quickly there could be no net financial saving and possibly a net cost in year one. That is really all that it was able to quantify. That calculation did not include all the possible savings because it could not quantify them. It could, as it were, identify where they might come from, however it did not include all of the transitional costs, for example relocation of offices, nor did it attempt to quantify opportunity costs or possible costs in the form of reduction in input in the two departments while the merger was happening. It also recognised that there was about to be a fundamental expenditure review which could be expected to yield savings and as the two departments continued to make efficiency savings then the base against which you could estimate the savings would shrink. Indeed, if you look at what has happened since then both departments have continued to make savings.

I would guess, although I have not done the sums, if we were to try to do the same exercise again the base would have shrunk quite a bit. That was essentially the nature of the work done, it was what you might call a preliminary study. If ministers had said, "Tell us more, here are some assumptions for you to work on", no doubt that would have been developed into a fuller study with more of the uncertainties quantified. In the event the then Chancellor decided that he did not want to proceed with that. The reason you have not had the paper itself is simply because it was confidential advice to a previous administration, so under the convention we could not send it to you as such. I hope I have given you the basics of what it said.³³

³³ HC 53 1999-2000 Ev Q 336

A possible merger of the Contributions Agency into the Revenue was also ruled out at this time³⁴ – although this was something the succeeding Labour Government brought about in April 1999.³⁵ As part of the ‘Closer Working programme’ a number of projects were proposed, including “the introduction of shared telephone helplines, joint educational seminars, and jointly-run Mobile Advice Centres.”³⁶ A pilot scheme for a shared helpline – covering employers’ enquiries on PAYE, National Insurance Contributions, VAT, excise and customs duties – was set up in Scotland in September 1995,³⁷ and this was rolled-out nationally in October 1996, apparently with some success.³⁸ A longer list of projects – involving the Revenue, Customs and the Contributions Agency – was published at this time, reproduced below:

1. A joint leaflet, (CWL “Starting your own business?”), for people starting up in business on their own which explains tax, national insurance issues and VAT and guides them through the notification procedures, was published in November 1995 and updated in April 1996.
2. A single notification form for people starting up in business was introduced in April 1996. Linked to the joint leaflet this joint notification form allows new businesses to simultaneously notify all three departments that they have started up in business.
3. The Employers Telephone Helpline (0345 143 143). Following the successful pilot in Scotland this service was made available nationally from 7th October 1996. The helpline gives general advice, at local call rates, on Pay as You Earn (PAYE) and National Insurance issues’. along with advice on VAT registration.
4. Review of leaflets and forms. A review of all leaflets and major forms published by IR, CA and C&E and develop common versions where appropriate.
5. Piloting Touch Screen Information Kiosks. The touch screen pilot is an initiative designed to help ordinary people understand the complexities of dealing with government. It uses new technology to make things simpler, and brings together information from three government departments in one place. The system was demonstrated at the launch of the Government Green Paper on Information Technology on the 6th November 1996.
6. Linking the departments via the Internet and exploiting and developing opportunities for communicating joint working on the Internet.
7. Development of staff interchanges and loans between departments. Closer working links between departments, with greater use of staff interchanges.
8. Maximise compatibility of Information Technology between departments.

³⁴ HC Deb 14 June 1995 c 516W

³⁵ The background to the merger is examined in *Social Security Contributions (Transfer of Functions etc.) Bill [HL]*, Library Research paper 99/12, 5 February 1999.

³⁶ HM Customs & Excise press notice, *Closer Working*, 29 November 1994

³⁷ Inland Revenue press notice, *Tax and national insurance red tape cut for business*, 19 September 1995

³⁸ HC Deb 4 December 1996 c 657W

9. Exchange of information and common access to stored data subject to taxpayer confidentiality, and within the terms of the legislation governing the use of information.
10. Co-ordinating cross departmental training opportunities.
11. Phoenix Companies. Exchange of information about “phoenix” directors between IR, CA, C&E and DTI. (Phoenix Companies are those which go out of business and are immediately replaced by another company with the same directors).
12. Piloting a Combined Enquiry Office. A Combined Enquiry Office has been running in Cardiff since March 1996. The potential for further combined offices is to be evaluated.³⁹

In its report on Customs for the 1999-2000 session the Treasury Committee were strongly critical of the Closer Working programme – particularly in its early years. An extract from the Committee’s analysis is given below:

We agree wholeheartedly with the *aims* of the Closer Working programme.

Although we acknowledge that the programme appears to have delivered some benefits, particularly in terms of more coordinated policy making, we are not convinced that the programme as a whole is sufficiently well designed or managed to achieve its aims. Our impression is that, at least until early 1999, the Closer Working programme consisted of a series of unrelated projects, progressing at their own pace, with little, if any, management of the programme as a whole. Even now, we detect an absence of strategic thinking on the part of Customs and Excise as to how Closer Working can develop in future. This is evidenced by the inadequate provision for evaluation of Closer Working and the apparent lack of an underlying purpose or philosophy linking the various Closer Working projects. Customs and Excise has been able to point us towards few if any tangible results or benefits of Closer Working, which seems as vague a concept at the end of this inquiry as it did at the beginning.

In its evidence, the department has not convinced us that Closer Working would be a central theme of the department's future development, for instance by emphasising that the potential for economies of scale in working jointly with the Inland Revenue were "across a fairly narrow field" and by indicating that Closer Working projects in the procurement and information technology areas would be subsumed by pan-Government initiatives. The Public and Commercial Services Union told us that "if Closer Working does not achieve its benefits and objectives, then quite clearly the more dramatic resolution of merging and changing the department's responsibilities...will invariably come on the agenda". **We do not believe that the Closer Working programme will fully achieve its objectives and deliver the benefits claimed by Customs and Excise. Consequently, the option of merger requires serious consideration.**⁴⁰

³⁹ Deposited paper Dep 3/4210, 25 November 1996. This paper had been deposited in the Commons Library in answer to a PQ: HC Deb 21 November 1996 c 648W.

⁴⁰ HC 53 1999-2000 para 34

C. Public debate about a merger in 1997

One of the witnesses who gave evidence to the Treasury Committee in preparing their report on Customs in April 2000 was Edward Troup – a former adviser to Kenneth Clarke when Chancellor, and then head of tax strategy at Simmons & Simmons.⁴¹ The Committee’s report is not discussed at length in this note, but on that occasion Mr Troup argued that there were problems within Customs and Excise, relating to the culture of the department and the consistency of the approach of VAT officers, which could only be solved by merger.⁴² Mr Troup noted on this occasion that in evidence to the Committee the previous session he had advocated a merger on slightly different grounds: that “maintaining separate departments imposes unnecessary compliance costs on business [and] results in inefficient tax collection for Government and poorer policy making.”⁴³ Prior to this a long piece by Mr Troup – published by the *Financial Times* in June 1997 – set off a short public debate about the merits and demerits of a merger. His piece is reproduced in full below:

Britain is destined to enter the 21st century unenviably unique among the developed world in having two national tax collecting departments - the Inland Revenue and Customs & Excise. This peculiarly British anomaly has, in recent years, quietly contributed to bad policy-making, poor tax collection and the continued frustration of businesses. And there seems little prospect that the new government will do any more than the previous one to address it. The Inland Revenue is the younger department, but is charged with collecting the more interesting - some would say the more civilised - taxes: income tax, corporation tax, capital gains tax, inheritance tax, stamp duty and some lesser duties. Customs & Excise, the elder, slightly rough-edged sister, has the unglamorous share of the work, collecting the so-called sin taxes on alcohol, tobacco and gambling, together with fuel duties, value added tax and a host of minor charges. This is the rougher end of the tax trade where enforcement has been more likely to involve a knock on the door in the small hours than a letter requesting prompt payment.

The origins of this curiously British system lie in the perception that the excise and similar levies involve trade with foreigners, while the direct taxes, by and large, relate only to domestic transactions. The separation was encouraged by the touchingly naive hope of the early 19th century tax raisers that no single officer of the Crown should ever be in possession of all the information relating to one of its citizens. The most recent opportunity to address this division was hopelessly ducked in 1972 when responsibility for the new value added tax, adopted as part of the terms of Britain’s accession to the then European Economic Community, was given to Customs to administer. This was largely based on the argument that, as purchase tax had been collected by Customs, giving its replacement to the Inland Revenue would have left Customs with time on its hands. The consequence has been that the overwhelming majority of businesses in the land now deal with two separate tax authorities.

⁴¹ In May 2004 Mr Troup was appointed Director of Business and Indirect Tax, on the Treasury’s Budget and Public Finances Directorate (HM Treasury press notice 48/04, 17 May 2004).

⁴² HC 53 1999-2000 Ev Q 264

⁴³ HC 199 1998-99 Ev p 29

Such an oddity might be justifiable if it produced some gain for the government, but the reverse is the case. The government finds itself framing tax policy for business through two entirely separate organisations. The departments are run in parallel right up to senior Treasury policy officials, so their functioning is only brought together at ministerial level. Duplication abounds and the mismatch of approach and skills in the two departments leads to poor, inappropriate or simply uncoordinated advice on both sides. The traditional skills of the Inland Revenue lie in the desktop approach - the analysis of accounts, the review of spending patterns. Customs excels at the hands-on approach; detection of fraud at a takeaway restaurant is far better conducted on the spot than by reading accounts. Policy advice for ministers reflects these differing cultures. The Revenue is meticulous to the point of obsessiveness, while Customs relies as much on gut feeling as on the analysis of detail. Yet both organisations deal with the same businesses - financial conglomerate or fish and chip shop. From tax collection to the broadest application of policy, those businesses find themselves subjected to wildly differing approaches. At the wider policy level Customs has found itself having to adjust from a simple sales-based purchase tax to a tax based on European law, involving complex legal principles and analysis, where frequent challenge in both the UK and European courts has become the norm.

Without the legalistic background of the Inland Revenue (which can at times hamper that organisation) Customs has floundered, finding itself too often on the wrong end of court decisions. The VAT refunds to opticians enforced by the European Court of Justice left many members of that profession collecting fat cheques and thumbing their noses at the Treasury. Duplication runs riot, with each department running its own forecasting team, legal department and press office. Failure to exchange expertise and to co-ordinate policy advice leads to bad decision-making, wasted revenues and unnecessary costs for business and government. Political priorities ensure that, by the time any government wakes up to the defects in the current arrangements - typically after two years or so - it is too close to the next election to justify the inevitable short-term disruption and cost which merger would bring.

The departments are their own fiefdoms. Unwritten, unspoken mandarin convention ensures that, if the M-word is ever mentioned, ministers are left in no doubt that merger could provide benefits only well beyond the political horizon of any single parliament and would involve resource costs which would put tax-raising at risk for several years. Perhaps, this time, there is a small chance that good sense will prevail. Within the next month a successor has to be chosen for the outgoing chairman of the Inland Revenue. This is the opportunity for the new government to act boldly, to combine the boards of the two organisations with a remit to work towards the ultimate combination of these two unloved bodies. A decision to merge the revenue departments would be universally welcomed by business and, with few exceptions, by the staff in both departments. I am not holding my breath. History would suggest that we appear doomed to the inevitable short-term perspective which our five-year parliamentary cycle creates.⁴⁴

⁴⁴ “Double trouble over tax: Personal View: Edward Troup: Two national collection departments are one too many in Britain”, *Financial Times*, 2 June 1997

Of the letters and articles that appeared in the wake of this piece,⁴⁵ the most interesting may have been by Richard Watson, head of indirect taxation at Price Waterhouse, who set out the case against a merger in quite some detail. Again this appeared in the *Financial Times*, and is reproduced in full below:

There is an idea gathering force that to have two revenue departments is something of an extravagance and that Gordon Brown will choose his first budget to announce the amalgamation of Customs and Excise with the Inland Revenue. This view seems to be based on the fact that a number of other countries divide their tax gathering capabilities in a different way and that our choice is inefficient. The argument focuses particularly on value added tax, because it is one tax administered by Customs which impacts mostly on business in general, as opposed to specific types of businesses. It is also based on a view of how the two departments operate. Customs is seen as very much based in the past, dealing in their 'rough and ready' way with the business community and paying little heed to the subtleties of legislation. The Inland Revenue is a much more sophisticated department, perhaps a little over-legalistic in its approach, but much more successful in collecting taxes.

This approach immediately raises two questions. The first is whether those views are correct and, secondly, whether there would be any gain by combining the two. It is quite true that Customs and Excise reveres its history but that is not to say it has not caught up with the 20th century. It also deals with some pretty rough customers. Smuggling is not a nice occupation. However, that aspect of the department's operations is a relatively small one. Nor would it be right to ignore the fact that the Inland Revenue has its share of the rough end of the trade. What matters in terms of the approach of the two departments is not so much where they have come from as what they are now being expected to do. If we focus on taxes which impact on business, the differences become immediately apparent.

The Inland Revenue is collecting taxes which are intended to fall on business profits, which in turn are determined by accounting concepts used in the preparation of a business's annual accounts. The taxes are annual and what matters is the profit rather than how it has been achieved. VAT, in contrast, is a tax on consumption. As with all Customs and Excise taxes, it is an indirect tax collected on behalf of the government by businesses which produce and distribute goods and services. The ultimate taxpayer is the consumer. As a result, successive governments have used VAT to place the tax burden on consumers to suit their own political ends. That is why we have VAT on orange juice but not on caviar; on chocolate covered biscuits, but not on chocolate covered cakes; on CD-Roms but not on books. These decisions are the responsibility of politicians, not of Customs and Excise, but the latter is expected to police and enforce the law.

That of course explains another feature of VAT. It is a tax on transactions at the time they take place. Unlike income tax and corporation tax it cannot be left until the end of the year, until the annual accounts have been submitted and until after the ritual

⁴⁵ examples include, "A marriage that could tax two minds", *Financial Times*, 9 October 1997 & "Tax policy in the UK: a legacy of confusion", *Taxation Practitioner*, January 1998 pp 13-14

arguments with the inspector of taxes. These two factors mean Customs has a very different job from the Inland Revenue in terms of policing the collection of its tax. It also has a very different body of legislation, which impacts on just about any area of business operation. Add to that an easily accessible VAT tribunal system, which enables the taxpayer to question Customs rulings, and it is no surprise that there are a large number of court cases over VAT payments. All this means that Customs is a far more legalistic department than the Inland Revenue. It knows perfectly well that it is comparatively easy to go to law over its interpretation of legislation, and that the arguments that will be put there will be extremely detailed and based on real circumstances rather than conceptual accounting principles.

This forces it into a much more black and white approach than that of the Revenue. A supply is either zero rated or it is not: Customs cannot decide that the amount of revenue it wants from these particular supplies can be somewhere between the two extremes, as the Revenue might decide on the amount of tax it might want from a particular taxpayer. The result is that Customs digs deep into the detail of businesses' affairs because that is the only way it can control the tax. If there is a fault, it is that this probing is not as well directed or as technically proficient as it could be.

Given all this, the question comes back to the starting point; should there be one or two Revenue departments? I think there should always be a separate department concerned with the collection of Customs duties at importation and an anti-smuggling drive. The excise duties on tobacco, drink and oil require little control and are largely in the hands of multinational corporations which are capable of calculating their tax liabilities with little support. The call is therefore always for VAT to be controlled at the same time as Corporation tax. However, the nature of these two taxes is so different that it would almost certainly involve different people controlling the taxpayer in very different ways. An alternative approach to amalgamation would be redistribution.

There is one element of income tax which is an indirect tax. The collection of income tax on individuals through PAYE is very similar to the collection of VAT. In both the final taxpayer is the individual and businesses are being used as unpaid tax collectors. The tax collection involves visits to business premises and an audit of the appropriate systems. There would be considerable benefit to both business and to the Revenue departments if these processes were combined. Businesses frequently complain that they have to take management time in handling the visit of the VAT inspector only weeks after the PAYE audit team has visited. How much easier it would be to deal with a combined team which would audit PAYE (and of course the associated National Insurance Contributions) at the same time as VAT. Similarly, Customs would gain a greater insight into the workings of a business if it was looking at employment records at the same time as purchase and sales records. It would then possess full knowledge of a business's operations.

I do not suggest giving control of income tax policy to Customs, a responsibility I am sure it would not wish to take on, but merely suggest that it takes on the collection side of income tax through the PAYE system. This would give a more efficient collection mechanism, but not create an artificial combination between those who collect very different types of tax and whose policy responsibilities should reflect that fact. All change needs to be viewed in the context of what it is trying to achieve,

rather than meeting some idealistic management theory. If there is to be change, it should focus on the benefits for business of simplifying the administration, and not the illusory benefits for government in making its own organisation look tidier.⁴⁶

Of course the debate followed hard on the heels of the Labour party's victory in the General Election in May 1997. Dawn Primarolo, then Financial Secretary and now Paymaster General, gave an interview to the *Financial Times* following the appearance of Mr Troup's piece. Naturally the question of a merger arose, although on this occasion the Minister was not to be drawn; an extract from the interview is given below:

Mr Gordon Brown has dropped so many bombshells since arriving at the Treasury that some other significant changes have gone largely unnoticed. Take the role of Ms Dawn Primarolo, financial secretary to the Treasury. The first woman to hold the post, she is also the first to combine responsibilities for both direct and indirect taxation. For almost 200 hundred years, sales duties and income taxes have been collected by two different departments, which have reported to different ministers. Prompted originally by the belief that no single government official should know everything about a taxpayer, the division has become entrenched through tradition rather than logic. Mr Brown has little time for such traditions and at the end of last year Ms Primarolo was given both responsibilities in opposition. With no fanfare, the same structure has been adopted in government. In her first interview since the election, Ms Primarolo is quick to play down the obvious conclusion that Mr Brown would like to merge the Inland Revenue with Customs & Excise. 'There are no plans at the moment,' she says carefully.

Such a merger has long been advocated by business. A renewed call came last week from Mr Edward Troup, the previous chancellor's tax adviser and now head of tax strategy at Simmons & Simmons, the City law firm. In an article in the *Financial Times*, Mr Troup said the division led to duplication and lack of co-ordination, and increased costs for business. He claimed a merger, although opposed by senior officials, would be welcomed by most staff. But Ms Primarolo insists there are important differences between the two departments and dismisses the argument that no other leading country separates the two. 'Just because nowhere else in the world does it, doesn't make it wrong,' she says. Conscious of the inevitable apprehension among officials over the new government's plans, one of Ms Primarolo's first moves was to visit both departments and meet as many of the staff as possible. She explained that she wanted to foster closer working and develop a consistent approach across the two departments. 'But I needed to make sure their morale was not further damaged by what is a logical step as opposed to them thinking there was a hidden agenda.'⁴⁷

⁴⁶ "A tale of two taxes: The tasks of Customs and the Inland Revenue need different skills, says Richard Watson", *Financial Times*, 19 June 1997. In the wake of the Treasury Committee's report on the Revenue in the 1989-90 session the case against merger was made in an editorial in the *Tax Journal* – "The case for a separate identity", 8 November 1999 – to which Mr Troup responded in person: "Revenue & Customs", *Tax Journal*, 6 December 1999.

⁴⁷ "Doubly taxed at the Treasury", *Financial Times*, 9 June 1997