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Increasing Length and Complexity of Tax Legislation – Avoidable or Inevitable?

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The trend towards increasingly complex and lengthy corporate tax legislation is causing concern. Is it an inevitable consequence of the need to protect the tax base and tax take from sophisticated corporate and financial activity in a global economy, or are there other reasons contributing to the complexity of tax legislation?

A striking example of new corporate tax legislation which is so complex that it may prove difficult, if not impossible, to comprehend fully and administer fairly or cost-effectively, is the legislation in the Finance Act 1993 for a new tax regime for foreign exchange gains and losses (forex). An examination of the history of the introduction of these provisions, and an analysis of why and where the new legislation fails to comply with the basic principles of tax legislation, is instructive. Somewhat surprisingly it emerges that not just one or two, but all of the basic rules of tax legislation have been broken to some extent. The unavoidable conclusion is that the length and complexity is the result of a loss of and disregard for the art and discipline of tax legislation; there is no justification for the frequently given excuse that 'we are living in a complex world'.

The 'Ten Commandments' for new tax legislation are:

(1) do only what is absolutely necessary;
(2) do it timeously;
(3) respect the basic principles of the existing system;
(4) control and define any consultation process;

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(5) keep tax avoidance concerns within workable limits;
(6) do not legislate for questions of fact;
(7) respect the dividing line between primary and secondary legislation;
(8) maintain standards in legal drafting;
(9) remember that new legislation is a management as well as a technical process;
(10) legislative provisions must be workable in practice.

I. NEW LEGISLATION AND NECESSITY

The 'necessity test' for new legislation has two limbs, the 'whether' and the 'what': whether change is necessary and, if it is, what changes are necessary to meet the objective. In this case the need for change is clear, for the existing taxation system does not relate to or reflect the economic reality of commercial and investment transactions in an era of floating exchange rates.

Accordingly the 'whether' half of the necessity test is satisfied but the same may not be said of the 'what' half. It is seriously open to question whether the scheme of legislation that has emerged can be said to satisfy the objective of the change, i.e. to produce a workable tax basis in which the economic reality of floating exchange rates is reflected in the measurement of taxable profit.

In addressing the issue, the government opted for a major change by devising a new and separate tax code for calculating forex gains and losses, the idea being that this code would embrace all commercial forex transactions and provide a base for future developments, as well as complementing a similar code for financial instruments.

Mindful that such ambitious concepts always run the risk that they will not translate effectively into action, a number of persons involved in the consultative process (see Section IV below) had suggested that there might be merit in dealing with the issue by removing a couple of the major anomalies first (mainly relating to foreign currency finance) and then reviewing the situation. Other countries with an Anglo-Saxon corporation tax system (e.g. Australia) had demonstrated some success by limiting changes to the major problem area.

Though in a sense it was a brave decision to aim for a new and wide-ranging approach, the problem was that, when the proposed scheme (Inland Revenue, 1991) was considered more fully, it was found to be fixed firmly on the horns of the tax reform dilemma: the proposals solved existing problems only at the expense of creating a raft of new ones.

In the event, the government is pressing ahead with an extremely complex scheme which addresses the existing problem of forex gains and losses on foreign currency borrowings, but at the expense of taxing substantial unrealised gains (the deferral mechanism is inadequate); reflecting exchange risk management within

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a single company and not, as is commercially appropriate, within a UK group; and departing from accounting practice by substituting 60 pages of complex rules and formulæ and so establishing a legal framework which does not accord with the way in which foreign currency transactions are dealt with for commercial and accounting purposes.

Rather than achieve the objective of the reform – i.e. to provide a workable tax system which reflects the economic and commercial effects of floating exchange rates – the new tax scheme may be said to substitute one unsatisfactory tax regime for another. There will be more potential tax fragmentation traps than under the existing system, and even simple transactions like intra-group forex loans will now require careful scrutiny.

II. TIMING

Once a need for changes to legislation has been identified, it is important to decide upon the precise form and bring in the new legislation as soon as possible, firstly, to end uncertainty and, secondly, to contain the problem.

A major factor in the difficulties now faced in introducing a new tax regime for exchange gains and losses is that successive governments have been loath to deal with the issue and action has been put off for two decades. The opportunity to deal with a tightly defined problem early on was lost; and so in consequence was the ability to let the tax system develop in tandem with commercial expansion.

The need for changes to the United Kingdom corporate tax law to cope with floating exchange rates was acknowledged as early as 1976[1] when it had become clear that attempts to set up a fixed exchange rate regime to replace the Bretton Woods Agreement were unlikely to meet with success. However, it was not until 1991 that Treasury ministers authorised the Inland Revenue to put forward a scheme for change. In the intervening 15 years the problem had mushroomed. It was no longer a case of fairly straightforward foreign currency borrowings conveniently 'policed' by the Exchange Control provisions in force until December 1979. Highly sophisticated worldwide financial markets had developed which provided a range of products for exchange risk management, a number of them tailored (for a fee) to assist companies operating in the United Kingdom to manage exchange risk in a manner in which the tax system would recognise a commercially matched transaction. Moreover, the development in the 1980s of the now widely criticised creative accounting techniques had meant that a serious question mark hovered over the reliability of accounting treatment as a measure of profit, particularly when extraordinary items and foreign exchange movements were in point (Smith, 1992). Sophisticated taxpayers had located their group treasury

[1] See Budget Statement (1976) for confirmation.

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function offshore in countries which offered a fiscally neutral tax system for foreign exchange risk management; the more enterprising still had taken advantage of the opportunities to avail themselves of tax-free foreign exchange gains in onshore United Kingdom. Tax tail has been wagging commercial dog for two decades.

It is difficult to find any justification for the 15-year delay. All other countries with an Anglo-Saxon style corporate tax system (including the United States of America and Australia) had introduced amendments to their tax system by the mid-1980s to eliminate the worst problems in relation to floating exchange rates. For the last eight years the United Kingdom has stood alone as the one developed nation with a corporate tax system that has failed to recognise the economic realities of floating exchange rates.

When Treasury ministers finally accepted that reform was necessary, no attempt seems to have been made to evaluate the options available. It was all (i.e. a grand scheme involving a new code) or nothing. The 1989 ministerial excuse for non-action, 'one of the most intractable [problems] encountered' (Budget Speech, 1989), had been taken all too seriously and the question of whether the problem might have been more efficiently addressed by limited and carefully targeted action remained unexplored.

III. PRINCIPLES OF THE EXISTING SYSTEM

There are two main systems for corporate taxation. There is the Continental style system which measures profit on an annual revaluation basis, closely following accounting practice, and the Anglo-Saxon style system which relies on a strong capital/revenue divide combined with a realisation basis for calculating profit, both aspects overriding accounting practice. Another distinguishing factor is approach. Some countries adopt a businesslike approach legislating on matters of clear principle and leaving some freedom in interpretation, depending upon the facts and circumstances of each case. Other countries insist upon certainty and write everything down in enormous detail. The rule is that additional tax legislation should follow the principles and approach of the existing tax system.

Failure to observe this rule results in three problems. First, there are difficulties in administration and compliance; taxpayers, tax advisers and tax administrators alike have to become familiar with a new code for specified transactions which bears no resemblance to the existing tax code which governs all other transactions. Second, it is a legal draftsman's nightmare; not only must they start from the beginning and painstakingly legislate for a previously unrecorded basis, but they must also take care to cover areas where there will be overlap between the existing tax system and the new legislation. Third, the body of case law, often built up over

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more than a century, and which underpins the tax law of a country, cannot assist in the interpretation of the new legislation.

In the proposed forex scheme, the United Kingdom has not only sought to follow the approach of the Continental style tax system rather than relax its own Anglo-Saxon style system, but it has also abandoned its businesslike approach for an American style preoccupation with detail. The result is a somewhat schizophrenic scheme which goes so far with the detail but pulls back from completeness and, at the same time, fails to establish a clear Continental-style principle for the legislation. It is neither one thing nor the other. Moreover this inappropriate alliance has to reflect and interact with the rather different United Kingdom corporate tax system which applies to everything which is not a forex transaction.

Another problem when a country adopts an idea from another country's tax system is that of selectivity. You choose the parts you like and leave out the parts you do not like. Provisions from other tax systems are used out of context.

A clear example of selectivity in the proposed new tax scheme arises in the manner in which the Continental tax system has been adapted. Because an annual revaluation basis can produce a difficult situation for foreign exchange gains arising from annual revaluation on substantial long-term foreign currency borrowings (any gains are purely notional at accounting year exchange rate and could in theory disappear the following day should the functional currency of a commercial enterprise weaken), many countries with a Continental tax system rely on the imparity principle. This means that taxable profit may follow accounting prudence and practice in that losses must be recognised when accrued, but profits not recognised until realised. The United Kingdom forex scheme rejects imparity, viewing – rightly or wrongly – such a principle as a licence for tax planners to accelerate relief for forex losses and defer taxation on forex gains. There is recognition that some form of relief is necessary from taxation of substantial unrealised exchange gains, but the solution is a complicated and limited deferral formula which discriminates against major trading companies which do not arrange foreign currency borrowings through a separate subsidiary.

IV. RULES FOR A CONSULTATIVE PROCESS

There is wide acceptance that a measure of consultation with taxpayers and professional advisers may be a useful exercise when major new legislation is in prospect, and particularly when it relates to complex international and financial transactions. However, there are basic rules that need to be adhered to. First, the subject matter for consultation and the objective of the consultative process must be tightly defined. Second, the government must not abrogate to the taxpayer its duty to decide tax policy. Third, the consultation process must be completed before legislation is introduced.

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In the consultations over the proposed forex tax scheme, all these rules have been broken. The consultation process has more or less emerged on an ad hoc basis, the government has effectively abrogated responsibility for tax policy in the forex area, and legislation has been introduced when the consultative process is only halfway through.

As a result the consultative process has become a process of negotiation and negotiating attrition rather than an expression of views. Apart from raising major points for consideration, both the consultancy bodies and the Inland Revenue have introduced further points which individually are not thought worthwhile sacrificing the whole process over and which are therefore mutually conceded. Had the scheme as it has now emerged been presented as the scheme for consideration at the outset, it is likely to have been rejected outright by government and taxpayers alike.

The present consultative process can be traced back to early 1987 when, building upon the contacts which had been made in the consultations on Statement of Practice SP 1/87 Exchange Rate Fluctuations, the Inland Revenue sought to put a more formal consultative process in operation. A representative of each of the major professional and commercial bodies (later known as the Group of Nine) was invited to a series of meetings to see whether it might be possible to reach broad agreement on a new system for exchange gains and losses. At the time this was seen as a positive step forward. It might have remained so, had the consultations been no more than a brainstorming and information-gathering exercise by the Inland Revenue and stopped there. In fact what happened was that the Group of Nine became regarded as a vehicle through which to obtain consensus and approval for the scheme subsequently proposed.

This was wholly unrealistic. Though representatives of the Group of Nine are experienced tax practitioners, many with a personal intellectual interest in tax policy, they attend in their professional and commercial capacities. They cannot be expected to speak with one voice nor to put the interests of the government ahead of the views they hold and the interests they represent. Government reliance on the Group of Nine to such an extent may also be said to be in breach of the principles of the administrative process in that it has the effect, albeit unintended, of turning what should be an open consultative process into a discussion between a privileged few.

When, in March 1991, proposals for a new tax scheme for exchange gains and losses emerged, the Group of Nine were summoned into action. Though there was a welcome for the broad (and unexpected) idea of departure from the rigid capital–revenue distinction and realisation basis, faced with firm proposals the representatives had to consider the pros and cons as regards the various interests they represented. No one accepted the proposals as they stood. However, if there was consensus in principle on some aspects that needed attention (e.g. the need to retain

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the right for a functional currency other than sterling and for something better than the bald changeover plan), this consensus did not extend to the detail of how those problems could be dealt with. In other instances, certain powerful interests demanded additional features, such as matching provisions, as a quid pro quo for their continued support of the proposals.

The fact that the proposals were conditional upon the support of the Group of Nine[2] may be regarded as remarkable. Power to say 'no' meant power to taxpayers to say 'not unless' which goes to the heart of the issue of government control over tax policy.

A genuine desire on both sides to achieve workable proposals – and credit must be given to a hard-working and committed Inland Revenue team – avoided serious conflict and breakdown at that stage. However, it does seem that the avoidance of breakdown paid a heavy price in terms of complexity.

Having agreed numerous modifications, the Inland Revenue then instructed the parliamentary draftsman to prepare draft legislation for further consultation with the Group of Nine. Only half the draft legislation (the clauses for the primary legislation) emerged before the publication of the Finance (No.2) Bill in April 1993, giving a wholly inadequate six weeks for consultation. Despite written assurances (Inland Revenue, 1991, para 7) that primary legislation would not be enacted before the complete scheme (including the secondary legislation in the form of regulations) had been produced and consulted upon, and despite the reservations of a number of members of the consultative bodies on these 60 pages of flawed and complex clauses remaining in the Finance Bill, the Financial Secretary to the Treasury decided, in his wisdom, that the primary legislation should so remain and the clauses were the first to be approved by the Standing Committee a month later.

Against this unhappy background, the consultative process is still continuing with subcommittees dealing with the detail of special issues to be covered in the secondary legislation. Some subcommittee representatives, being tax managers of multinational corporations or financial institutions, are in the incredible position of putting forward detailed examples which the regulations must cover and which inevitably are examples of what will be the template for calculating their own company's Corporation Tax liability two years on. Moreover, as one problem is solved, then another one is raised. It is never-ending process, descending into ever greater detail, with the original aim of the proposals getting further and further out of sight.

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[2] See Inland Revenue Consultative Document March 1991, para 1.10. The government sees is as essential that if proposals for reform in this area are to be implemented they should 'carry a substantial measure of support across all sectors of industry and commerce'.

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V. TAX AVOIDANCE CONCERNS

All developed nations have a legitimate concern in preserving the tax base from corporate and financial activity. There are three ways in which tax legislation may address tax avoidance concerns:

(1) it may seek to limit the transactions to which a particular tax treatment will apply by resorting to fine detail and specifying each type of transaction within the provisions;
(2) it may contain specific tax avoidance provisions;
(3) it may contain a general tax avoidance provision to counteract the effect of any transaction undertaken for a tax-saving motive.

The new foreign exchange gains and losses tax scheme contains several elements of (1) and (2) above. The use of detailed rules is particularly prevalent because, although the thrust of the new scheme is to follow accounting treatment under UK Standard Statement of Accounting Practice for Transactions in a Foreign Currency (SSAP 20) as far as possible, the very flexibility of accounting treatment and the fact that SSAP 20 may not be followed to the letter in preparing accounts, means that the accounting base is considered to be open to manipulation in the interests of obtaining the most desirable tax treatment. Therefore, the primary legislation contains detailed rules for measuring (in time and quantity) exchange gains and losses. Accepting, for the sake of argument the doubtful premise that it is possible to replicate current accounting practice in detailed tax rules and formulæ, the serious problem with this approach is a lack of flexibility. Commercial and accounting practice is of necessity a flexible and developing concept, but the detailed rules seek to cast it in legislative stone with the result that the rules will, as each year passes, become increasingly divorced from reality.

In addition to numerous detailed rules, there are no less than four specific anti-avoidance provisions. There is the main benefit test, aimed at preventing a company from creating an allowable loss by choosing to borrow or lend in a particular currency in which it anticipates that a currency loss would arise. There is an arm's length test devised to ensure that exchange losses on non-arm's length transactions are ringfenced, and so available for relief only against future gains arising on the same transaction. Another anti-avoidance provision is specifically aimed at changes of accounting period where a tax inspector may make a 'just and reasonable' adjustment and ignore a change of accounting date if the change has been effected solely or partly for tax purposes. The fourth provision concerns interest not to be allowed as a tax deduction and is aimed at the situation where a loan is advanced in one currency and is to be repaid in another currency, a high interest rate being charged, calculated on the weakest of the two currencies. All

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these provisions are widely drafted and could potentially apply to transactions not specifically aimed at.

It is always difficult to strike a balance with anti-avoidance provisions, but it is submitted that the balance has been lost in the forex tax legislation.

The reason for this loss of balance would seem to be that there are no less than three special problem areas which have each rung tax avoidance bells. First, the abandonment of the known (realisation basis) for the unknown (annual revaluation basis) has created a feeling of uncertainty in the Inland Revenue team and parliamentary draftsman (see Section III above). Second, the explosion of creative accounting techniques in the 1980s has served to bring the reliability of accounting procedures and audited accounts into serious question with a consequential reaction against the adoption of accounting treatment as a measure of taxable income and expenditure. Lastly, the runaway consultative process (see Section IV above) under which taxpayers have insisted that their agreement to the new scheme be conditional on special types of transactions being covered, has resulted in the Inland Revenue giving agreement but on the most restrictive and narrow basis possible.

VI. LEGISLATION AND QUESTIONS OF FACT

The principle that tax legislation should not seek to define what is a question of fact in the particular circumstances of a case is well established. It has the advantage of allowing the tax legislation sufficient flexibility to adjust to the changes in personal and commercial behaviour over a period of time.

The foreign exchange gains and losses legislation has been designed to leave virtually nothing as a question of fact; there is a formula or detailed regulation on all the major aspects of the new scheme. Therefore, it has no flexibility. Yet, management of exchange risk is one of the fastest developing areas of the 1990s and the present difficulties with the European Exchange Rate Mechanism indicate that there is no prospect in the medium term of stabilising exchange rates.

For example, in addition to the rules designed to supplant accounting treatment (see Section V above) the new forex scheme goes as far as to set out, in the primary legislation with detailed regulations to follow, what criteria a corporation must meet for it to be regarded as carrying on a trade in a currency other than sterling. It is submitted that the question of what is the functional currency of a business is very much a question of fact on the particular set of circumstances of each case. There is no one factor that alone could reliably determine the functional currency of a business. It is, rather like the question of whether a transaction constitutes trading, a fact that is determined from considering a number of criteria, none of which is essential in itself to underpin the concept of a functional currency, although some may carry more weight than others.

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To illustrate just how far removed from commercial reality the provisions relating to qualification for a functional currency other than sterling are, there is no recognition that the basis of management of exchange rate risk should be taken into account. Yet, this is certainly a major factor in determining the functional currency of a business.

VII. PRIMARY AND SECONDARY LEGISLATION

The constitutional position is that the right to levy taxation is held by Parliament and that right cannot be delegated. Accordingly, all tax legislation must be passed by Act of Parliament. For administrative convenience, a form of delegated (secondary) legislation is permitted by Parliament enacting provisions to allow the making of detailed regulations supplementary to the provisions of the various Taxes Acts by Statutory Instrument, rather than by Act of Parliament. Although Statutory Instruments are technically laid before Parliament, they are not subject to parliamentary debate and voting divisions. There is a parliamentary Committee which may review Statutory Instruments but it has the power only to accept or reject and not to amend. In practice, the passage of a Statutory Instrument is a rubber stamping formality and there is no precedent for a Statutory Instrument concerning taxation having been rejected.

The divide between primary and secondary legislation is that the former must contain all principles of taxation and that the latter may deal only with what are in essence administrative matters. However, the aspects which remain to be dealt with by regulations for the proposed forex tax regime have more technical detailed content than any previous tax regulations and go to the root of critical issues, e.g. the transitional and matching provisions. This is why they were scheduled to be drafted by parliamentary draftsmen (now officially referred to as parliamentary counsel in the interests of political correctness) and not by technical administrative staff.

It is not disputed that the parliamentary draftsman has given thought to the need to control the technical input from regulations, for the primary legislation contains a number of provisions setting down detailed parameters for each set of regulations. However, a powerful indication that the primary legislation has not succeeded in retaining appropriate control comes from the government itself. Quite simply, the assurance to the consultative bodies that the new tax regime will not come into force until there has been full consultation on the regulations[3] is based on the fact that it is impossible to assess the new tax regime coherently until the considerable detail delegated to the regulations has been produced. The detail in

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[3] See Standing Committee A, Finance (No. 2) Bill, 18 May 1993, col. 24.

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the regulations is to be decisive as to whether the principle in the primary legislation is upheld or not.

It may be that United Kingdom tax legislation of the future will follow to some extent the United States prescriptive approach of detailed regulations. But if this is so, then there needs to be a completely new set of procedures for secondary legislation allowing scrutiny by an independent committee and realistic timetables for open public consultations and representations on the draft secondary legislation. Under the present system, regulations are designed by the Inland Revenue yet have the force of primary legislation passed by Parliament; this is acceptable when regulations deal only with administrative matters, but not when they embrace technical provisions.

VIII. THE ART OF DRAFTING LEGISLATION

The art of drafting tax legislation requires an ability to marry brevity and clarity of expression with definition of extremely complex issues. Parliamentary draftsmen who are recruited from the ranks of double firsts have undoubted academic ability but the plethora of lengthy and complex tax legislation that has emerged over the last 10 years must raise some doubt as to whether the appropriate standards of clarity of expression are being demanded, encouraged or upheld.

The policy direction on the forex proposals was certainly a difficult brief, seeking to incorporate the principles or approach of three different types of tax system in a new code limited to forex transactions, with the added challenge to restrict reliance on accounting practice to prevent tax avoidance. Whether the parliamentary draftsman was also trapped in time pressures is not known. The facts are that the Inland Revenue delivered the brief for the new forex scheme in early August 1992, on line for the considered reasonable timetable of a draft of the full legislative package (primary and secondary estimated at a total of 60 pages) by the end of December and what finally emerged in February was 60 pages covering just the primary legislation. These 60 pages were complex beyond expectations and contained serious flaws which were identified in the frantic six-week period for consultation before the Finance Bill was printed. It appears that the draftsman had an ample six months and the consultative bodies a wholly inadequate six weeks. However, it is not impossible that the draftsman was assigned other legislative work during the six-month period.

The basis on which parliamentary draftsmen are accountable has some part to play in upholding standards. The role of the Inland Revenue is strictly limited to agreeing with Treasury ministers the policy which is to be implemented, communicating the details of the policy with the parliamentary draftsman, and advising the minister in due course as to whether the draft legislation as produced meets the policy objective. Quite specifically it is left to the parliamentary draftsman to

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decide how to interpret the policy in legislation. For example, in the forex scheme, it was the draftsman's decision to deal with the question of reliability of accounting practice by designing formulæ or rules to be followed for every forex transaction.

In the final analysis, a Treasury minister, usually the Financial Secretary to the Treasury, will have a veto over the draft tax legislation and this veto can be expected to be exercised if there are serious grounds for concern that the legislation is too lengthy and complex. Given that the draft primary legislation emerged as twice the original estimated length, and that work on the supporting draft regulations had no chance of commencing until after the Finance Bill had been enacted, it might normally have been supposed that it would at least have been put on hold if not rejected outright by the Financial Secretary.

At the end of the day, there have been no effective checks and balances to ensure that quality legislation emerged. For reasons unknown the parliamentary draftsman released a lengthy, complex, imperfect, and incomplete package of draft legislation. The surprise is that it was accepted.

Whatever the fate of the proposed forex tax regime, the primary legislation may be set to be a footnote in tax history. Before the Finance Bill had even passed through Parliament, one leading professional institution had lodged a formal request to the Chancellor of the Exchequer for a review of the procedure for drafting of tax legislation citing the forex clauses as an example of the unacceptable (ICAEW, 1993). This was swiftly followed by a formal recommendation by the Special Committee of Tax Law Consultative Bodies that the parliamentary draftsman should take part in the consultative process.

IX. THE MANAGEMENT OF NEW TAX LEGISLATION

The introduction of new tax legislation requires management. The first element of management is to make policy decisions concerning what is to be done, how it is to be done, and when it is to be done. Unless those decisions are made, it is impossible to devise and keep to a workable timetable and to instruct technical staff efficiently.

All policy decisions relating to new tax legislation fall to be made by Treasury ministers.[4] The role of the Inland Revenue is restricted to advising ministers on the implications of alternative strategies and then carrying out the ministerial decisions to the best of their ability regardless of whether those decisions are in accordance with advice or not. Unfortunately, it is difficult to identify a single definite policy decision in relation to changes to the tax system to reflect the economic and commercial realities of exchange rate fluctuations.

[4] See resignation speech of Rt Hon. Norman Lamont MP, Chancellor of the Exchequer, November 1990 to May 1993.

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The central problem is that there is no ministerial enthusiasm for change, just the realisation that the pressure for change (both from major business and financial interests and from the Inland Revenue who are facing administrative difficulties in operating an out-of-date tax system) will not abate until something is done. Faced in 1990 with proposals for change from the Inland Revenue, ministers reacted by imposing the condition that those proposals would require taxpayer consent, both to the broad principle and to the fine detail. This put the Inland Revenue in an extremely difficult position. What followed was two years of 'bargaining' with constant changes and additions which precluded the operation of an efficient legislative timetable. This problem is continuing in relation to the aspects to be covered by secondary legislation.

Another area of difficulty in the proper management of new tax legislation, is the sheer quantity of new legislation and the strain this is putting on already stretched resources. The reason that the lengthy and still flawed primary legislation on the forex tax regime was included in the Finance (No.2) Bill was that space in the next Finance Bill (and possibly the one after that) is already taken up by legislation covering other tax reforms. Moreover, all the parliamentary draftsmen are now working on those other reforms, and there is no one available to draft the secondary legislation for the forex regime.

The present party of government has been in power since 1979, but there seems to be no let up in the constant stream of new fiscal legislation being introduced. Although the stated policy of the government is to simplify taxation, the amount of tax legislation on the statute book has approximately doubled since 1979 and the number of staff available to deal with it has remained static. Quality of legislation suffers in these circumstances.

But quantity of new legislation has limits other than staff resources. There is a limit to the amount of new legislation that can be assimilated by taxpayers and tax administrators alike over a period of time. Tax reforms have to be carefully planned and staggered. This has not been happening and there are now clear examples of government departments not being sufficiently prepared at changeover dates to administer the new tax rules.[5]

The new forex tax regime legislation has therefore suffered from a serious lack of management for its introduction. There has been a lack of firm policy decisions on what is to be done, and the reforms are being introduced at a time when the system is already overloaded with other current and proposed tax reforms.

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[5] Note the various public apologies by Valerie Strachan, Chairman of the Board of Customs & Excise on the difficulties of operating the new VAT rules which came into force on 1 January 1993 for exports and imports within the EC.

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X. ADMINISTERABILITY

A tax system must be workable in practice, as the 1991 consultative document conceded. This means administerable by the general staff of the Inland Revenue and capable of reasonable and cost-effective compliance by taxpayers. The difficulty with the proposed forex tax regime is that it already runs to 60 pages of complex primary legislation with a similar amount of complex secondary legislation awaited. Although the provisions will apply to all corporate taxpayers which undertake transactions in a foreign currency, it seems they will have little chance of assimilation and reasonable comprehension by the majority of corporate taxpayers, lawyers, accountants, those in the financial sector, and by Inspectors of Taxes.

Those who will acquire a reasonable understanding of the new forex regime will be restricted to a few specialist lawyers and accountants, the tax managers of multinational corporations and financial institutions, a small team of specialists in the Financial Institutions Division of the Inland Revenue, and one or two District Inspectors of Taxes who have charge of the tax districts handling the affairs of the multinationals and financial institutions. Even this select band of tax specialists will have difficulty in working with the provisions, particularly as exchange risk management techniques and accounting practice continue to develop.

It is always the case that the policy and detail of a corporate tax system will be decided upon with the wide-ranging and sophisticated operations of major business and financial institutions in mind, for these taxpayers will account for the majority of corporate tax revenue. Because it is not possible to have one tax system for large companies and another for small companies, there is always a two-level administrative element. Large and medium-sized companies will attract expert scrutiny from the Inland Revenue; smaller companies usually occasional detailed checks at best.

However, companies cannot be so easily divided. Small companies may engage in complex foreign exchange transactions; no company is static, healthy ones grow. The effective tax administration of smaller companies currently relies on both tax adviser and tax inspector having a broad idea of the principles of the corporate tax system and a commonsense approach to questions of fact. Potential problem areas can be identified and specialist advice taken when required. The problem with the new forex tax regime is that it consists of highly detailed and complex rules with virtually no issues left to a question of fact or to general tax or accounting principles (see Sections III and V above). Moreover, most of the underlying tax principles which the detailed rules replace or supplement come from the alien Continental-style tax system. It would seem that tax compliance for close to 90 per cent of companies with foreign exchange transactions will be by

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default due to lack of familiarity with and understanding of over 100 pages of complex rules designed to apply to every transaction in foreign currency.

CONCLUSION

This article has sought an answer to the question of whether increased complexity in corporate tax legislation is necessary to protect tax take from corporate activity in the global economy, using the United Kingdom's proposed foreign exchange tax regime as a basis for analysis. The answer that emerges is that the length and complexity of this legislation has arisen largely because of a lack of government commitment to dealing with the issue and not directly as a necessary response to sophisticated corporate activity.

As stated in the Introduction, where the proposed forex tax regime is concerned, it can be contended that all of the Ten Commandments for new tax legislation have been broken. The result that the legislation is seriously flawed. Different systems of taxation have been indiscriminately juxtaposed, questions of fact have been replaced by rules which are incapable of reflecting the economic reality of the facts and circumstances of each case, the dividing line between primary and secondary legislation has been overstepped, tax avoidance concerns have taken undue precedence, standards of legal drafting have not been upheld, and Parliament has been placed in the ridiculous position of being requested to vote for legislation which covers only half of a whole tax regime, without the opportunity to consider the other half even though, when it eventually appears, it will impact considerably on the provisions they have voted through.

An impartial observer may well question why the 60 pages of complex, flawed and incomplete legislation were allowed to be pushed through in such indecent haste. Why not accept a further year's delay in the interests of achieving improvements and being able to assess the scheme as a whole? After all, whenever such complex and detailed tax rules are under consideration in the United States, the process may take 18 months or more and not the less than 18 weeks that the UK draft legislation took from first publication to Parliamentary Standing Committee. The United States experience has shown that it takes a few months for all the implications of complex rules to be properly understood.

The answer is not easy to find. One factor is that some were fearful that if the draft clauses were not allowed to remain in the Finance Bill, ministers would withdraw from reform altogether and introduce instead 'cherry picking' provisions which would eliminate tax opportunities in the existing system. It was considered that living with a tax system which did not follow economic or commercial reality and contained only pitfalls would be a disaster. These fears were no doubt real, but were they justified? They involve the somewhat illogical proposition that the government will abandon its current action on the basis that

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the forex scheme does not command the support of industry and commerce and will then introduce legislation which would cause an outcry by industry far greater than anything that has been heard in the current process. In any case, taxpayers would not have been rejecting the proposals outright but merely asking for proper time for consideration and also making constructive proposals.

Another possible factor is that some taxpayers may have actually structured their affairs and foreign currency borrowings for coming years on the assumption that the new forex regime would come into effect. Whatever the truth of this, those who counselled for more time to assess the complex primary legislation certainly came under pressure not to rock the boat.

The draft secondary legislation is expected some time in Autumn 1993. Whatever the final outcome of the forex tax proposals, it is hoped that future tax reform projects will benefit from the lessons learned in the forex experience.

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