A merger in a tale retold

General Features

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John Snape, Penelope Tuck and Dominic de Cogan review the origins of HMRC, drawing on the memories of those most closely involved

Key Points

What is the issue?

The merger of the Revenue Departments (Inland Revenue and HM Customs and Excise) in the UK resulted in one of the biggest shake-ups in taxation in the last two decades, with important lessons for contemporary reforms in tax administration.

What does it mean for me?

This CIOT-funded project seeks to obtain the human story of the merger and is a reminder that tax professionals must closely follow the processes by which institutional tax reform is effected.

What can I take away?

There is nothing dry and dusty about institutional reform when it comes to taxation. The factors driving aspects of the merger were often surprising and it hardly needs emphasising how relevant these stories are to current events.

Fundamental reform of the political institutions responsible for tax policy was last attempted when HM Revenue and Customs was formed around 15 years ago. It is now firmly back in the realms of the possible. In future tax discussions of institutional reform, records of the background to that attempt will surely prove invaluable. In particular, it will be useful to have the human story of the merger of the revenue departments, straight from the mouths of those involved. The reader is strongly recommended to visit bit.ly/3cxDsRS for a free download of the full published discussion.

With the aid of a grant from the CIOT, the writers are engaged in a long-term project. This is designed to show how precious insights can be preserved that would otherwise be completely lost, simply by listening to the tales of some of those people closely involved in tax reform.

A ‘major review’

Whatever happens over coming years, whether as regards HMRC or the UK civil service generally, policy makers should take account of the process by which HMRC emerged from the revenue departments in 2005. The process will be forever associated with the review chaired by Gus (now Lord) O’Donnell CB, published in March 2004, which recommended not only the revenue departments’ merger into a single new department, but also that responsibility for making tax policy should be transferred away from the newly merged department and into HM Treasury. (A copy of the review can be found at bit.ly/2IGyG6x.) O’Donnell was then permanent secretary to the Treasury and was therefore in a good position to assess whether and, if so, how so great a transformation might be accomplished.

What is remarkable about the O'Donnell Review is not only that these proposals were promptly turned into reality but also that the process leading to the review had itself been a swift one. When, that early spring day in 2004, the O'Donnell Review was published, it was not even a year since the chancellor of the Exchequer, Gordon Brown, had announced a 'major review' of the institutional framework of tax policy. The timing was crucial because, just like the administration elected in December 2019, the New Labour government, of which Brown was one of the two most prominent figures, had big tax policy objectives and it needed the departmental vehicle to achieve them. At a time when public policy making is often disparaged as slow, the sheer speed with which the O'Donnell Review appeared remains impressive.

In the CIOT funded project, the findings of part of which are analysed here, the writers have sought to produce a systematic, pioneering study of this remarkably short process, not primarily by reference to documentation but by reference to the memories of some of those people most closely involved. A witness seminar took place at Birmingham Business School in late 2016, with Professor Penelope Tuck as chair. Key people from the practising professions, HMRC and HM Treasury debated a range of issues arising from the period between the O'Donnell Review's announcement and the merger. Two of the writers conducted a series of interviews (seven in total, each one recorded and transcribed) with individuals from the Inland Revenue and from Customs who had been closely involved. Interviewees were identified by number without indicating their role. Major themes from the seminar were coded and given different labels and, while these were used for the interviews, further codes came out of the data that the interviews produced. A third writer, meanwhile, focused on the published literature on both policy making and political ideas current around the turn of the millennium.

Background to the merger

Whilst the revenue departments were largely concerned with direct taxes (the Inland Revenue) and indirect taxes (Customs) respectively, their staff had historically been engaged in a much wider range of activities than this would suggest. Groundbreaking in a sense though the O'Donnell Review and the subsequent merger were, they were by no means the first attempt to impart a coherence to a centuries old, adaptable and indeed vast system of administration. Not only, historically, had the revenue departments' officials been involved in the creation of international organisations (such as what became the OECD and the GATT) but they had also dealt with, among other things, merchant shipping, copyright infringement, environmental protection and the Channel Tunnel.

The reasons for this wide-ranging involvement of officials were well-founded. First, tax officials naturally wanted to understand the range of commercial activities to which tax consequences were sought to be attached. Secondly, once civil servants were in post, there was a tendency to deploy them in roles related to, but not the same as, those prompting their original deployment. Our contemporary policy discussions of how government could learn from business and around reducing the cost of the public service could usefully draw on this precedent.

These practices helped both to promote good mutual understanding between the revenue departments and business, and also made effective use of scarce public resources. Moreover, it was not only the workload of the revenue departments that varied over the years; so too did their organisation. The Inland Revenue itself only dated from 1849, following the transfer of Excise to the amalgamated Board of Taxes and Office of Stamps. Even Customs, often traced back to the Stuart monarchy, in reality had only existed as such since 1909, when Excise was re-transferred to the Commissioners of Customs. What O’Donnell advocated, in context, was in an important sense yet another in a long line of reallocated responsibilities, underlining that the merger was arguably far less radical than might be imagined.

Connected reforms

Added to the element of continuity that the merger demonstrated was the fact that, because of its centrality to the delivery of New Labour tax policy, the merger took place in the context of a range of other initiatives that have had far-reaching effects. The end of the 20 th century and the beginning of the 21 st century in the UK saw: the devolution of legislative and executive competences to Wales and Scotland; the Good Friday Agreement; the Human Rights Act 1998; and the devolution of certain competences to Northern Ireland.

All of this illustrated the fact that there was not only a certain continuity in O’Donnell’s recommendations. There was also a continuity of ideas, in that New Labour continued to espouse the Conservative government’s unfinished business of a New Public Management (NPM) approach to public policy, emphasising targets, managerialism and performance indicators.

In the context of the revenue departments, this had led to further incremental change, even before the O'Donnell Review was announced. 1998, for example, saw the beginning of the Inland Revenue's involvement with student loan repayment collection. 1999 was the year of the merger of the Contributions Agency with the Inland Revenue, a move that made explicit the innovative insight involved in the link that Brown held to exist between tax and welfare. There are other examples too, but these are enough to show that the merger of the Inland Revenue and Customs was not only part of tax policy but also of a much wider programme of radical reform. This point retains its relevance amid talk of the sweeping reorganisation of the Whitehall civil service to advance the current administration's objectives of 'levelling up' and to facilitate the secession of the UK from the EU.

New Labour's view of the world

What may differ today from the conditions of the first five years of the century is the fact that New Labour ideas – their ideology, one might say – were not only very well-informed and documented but also highly technical. As it turned out, they unfolded under not dissimilar parliamentary conditions to those of the present day. In 2005, following New Labour's landslide victory of 2001, a government bill would go through its various stages and become law without significant opposition. This, for so long not the case, is today once more the reality. There are opportunities for HM Government under such commanding circumstances, but there are also terrible dangers.

For New Labour, its majority eventually led to a kind of technical hubris, resulting not least in the massive problems arising from the introduction of tax credits in 2003. This politically damaging episode consisted of tax credit claimants being made awards greater than their entitlements, with the Inland Revenue trying to recover the excess amounts and poorer families being plunged into often severe financial hardship.

Where the current administration's large majority will lead is, of course, anyone's guess. At around 80 MPs, though, the Conservative majority does suggest a certain similarity of the circumstances then and now. In other respects, things are very different. In 2005, the fiscal and financial crises were in the future. Unlike now, Select Committee scrutiny of the government was relatively weak, with unelected committee chairs often (though not always) being placid New Labour admirers. The parliamentary expenses scandal was far in the future and, although politicians have never been popular, their unpopularity was perhaps not then as deep as it is now.

Government ministers today seem, at least temporarily, to recognise the fragility of their position, in a way that was not the case following the New Labour landslide of 2001. Something else is different too, and this relates to the ideas that informed the New Labour project. These were overwhelmingly expert-led, technocratic ideas, justified often by welfare economics theories. It was expected that tax changes had to be explained by arguments based on the need to correct ‘market failures’, both as regards corporate tax avoidance issues and in the area of environmental taxes. Even Brown, prior to taking office, had written a Fabian Society pamphlet in which he had asserted the validation of fairness on efficiency grounds, rather than appealing chiefly to the doyens of 20 th century Labour thought (such as Tawney and Cripps).

It was not all easy sailing for New Labour. There was the tax credits fiasco, as just mentioned, but the merger also took place in the aftermath of two hugely problematic scandals: the so-called ‘Mapeley affair’ (involving the transfer, indirectly, of title to Inland Revenue buildings to a company resident in Bermuda) and the re-assignment of Customs’ prosecution functions to the Attorney General, following the failure of some high-profile VAT prosecutions.

Interviews

Coding the interviews, as mentioned above, focused attention on six areas, namely:

- the motivations for the merger;
- the allocation of responsibilities between the revenue departments;
- the fact that no extra funding was provided for the merger, the cost having to be met from savings in the revenue departments;
- the cautious welcome accorded to three special advisors (or SpAds) appointed by Brown: Chris Wales, Ed Miliband and Ed Balls;
- the distant relationship between ministers and civil servants, as mediated by the SpAds; and
- the divergent cultures of the Inland Revenue and Customs, producing a sense of the superiority of tax inspectors over customs officers, and generating the caricature that, according to one interviewee, Customs officials were seen by Inland Revenue officials as ‘a bunch of gangsters’, whilst Inland Revenue officials were seen by Customs as ‘a bunch of effete liberals’!

It was very striking how the interviews revealed no one central motivation for the merger. One explanation was Brown’s desire to control tax policy. Another was the concern of his SpAds to wrest control of the tax system from the specialist, narrowly focused intellects in the Inland Revenue and to transfer it to civil servants with a high-level overall sense of New Labour policy. Surprising was the fact that, whilst Mapeley and tax credits had raised anxieties about the division of responsibilities between the revenue departments, many interviewees were far from convinced that the outcome of the O’Donnell Review was a foregone conclusion.

A further explanation, though, appeared to be Customs’ heavy handed litigation tactics. What was odd about this, however, was how different interviewees attached a divergent significance to it. Some took it as an indication that Customs needed greater supervision. Others saw Customs’ aggressive stance as an exemplary modus operandi for an eventual merged department. Even so, the interviews did not disgorge a policy conviction that a single revenue department was better than two, except in the limited sense that there might be cost savings.

When it came to whether the old allocation of responsibilities between the revenue departments was illogical, no clear consensus emerged. The strong New Labour attachment to managerialism, together with a desire to avoid inconsistent and antagonistic policies, was certainly an important motor of the merger. What was clear was that a merged department would likely be a powerful way of assembling a toolkit of effective policy instruments. Some interviewees recollected that HM Treasury lacked the human resources needed to develop tax policy, so moving policy people from the revenue departments into HM Treasury seemed a pretty smart move. Others remembered matters from the opposite perspective, suggesting that Customs – especially – had shown itself to be woefully lacking in relation to policy making. Occasionally, interviewees were resistant to both perspectives, linking the merger to the presence of the SpAds and associating it with the incoherent 0% corporation tax starting rate in force between 2002 and 2006.

On this view, the separation of policy development from operational measures was a bad idea, not least because HMRC’s policy involvement would be limited to the tediously named ‘policy maintenance’. Whilst civil servants transferred to HM Treasury from the revenue departments were alert to the sensitivities of this, those left to deal with policy maintenance in the merged department felt that their professional worlds had disintegrated.

Conclusions

It hardly needs emphasising how relevant all of these stories are to current events. Personal recollections bring to life what would otherwise be rather dry accounts of administrative reform. Led by the interviewees, rather than by any preconceptions, certain surprising factors behind the merger have been revealed. The work has introduced a strong human element to discussions of the background to the merger. Differences of recollection have proved equally as interesting, if not more so, as the similarities. The writers feel certain it will evoke not only a wry smile, but also a strong sense of what it was really like to be involved in this remarkable tale.