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A Tale of the Merger between the Inland Revenue and HM Customs & Excise

Penelope Tuck, Dominic de Cogan and John Snape

ABSTRACT

The merger of HM Commissioners of Inland Revenue and HM Customs & Excise in 2005 stands out as one of the most instantly recognisable reforms of the UK civil service in recent times. A good deal has been written about the consequences of the merger, but we focus in this chapter on the period immediately before, culminating with the publication of the ‘O’Donnell Review’ and its recommendations that the old departments be merged and that key elements of the policymaking process be transferred to HM Treasury. We portray the merger as a collection of connected reform processes, embracing some although not all of the ideas for administrative change that were current in the early 2000s. The content of the reforms was not entirely revolutionary and shows strong continuity with previous and indeed subsequent initiatives. Yet the merger had a significance and scale that justifies its reputation as a landmark change in the UK tax system, as well as an ideological coherence as a belated application of market-inspired techniques to the tax authorities.

INTRODUCTION

A ‘major review’ was announced in July 2003 by the Rt Hon Gordon Brown, the then Chancellor of the Exchequer, to examine the organisations which dealt with tax policy and administration: HM Customs & Excise (HMCE), HM Commissioners of Inland Revenue (IR) and HM Treasury (HMT).¹ The Review was to be led by Gus O’Donnell, the then Permanent Secretary to HMT, and was intended to focus on the best organisational arrangements for achieving HM Government’s tax objectives. The UK, unlike most other tax administrations worldwide, had separate organisations dealing with direct taxes (IR) and indirect taxes and customs duties (HMCE). Both of these organisations had long histories, each with distinct cultures, modes of operation and workloads which had been built up over centuries. The findings of the O’Donnell Review were published in March 2004 and its recommendations that the IR and HMCE ought to be merged into a single tax department, HM Revenue and Customs (HMRC), with responsibility for policymaking partly transferred to HMT, were implemented promptly. A good deal of attention has been paid to the aftermath of these decisions,² but there has been no systematic study of the period immediately preceding the publication of the report.

In this chapter, for the first time, we present such a study. It is properly described as ‘history of tax law’ because it applies to relatively recent events similar types of examination as can be found in other parts of this volume, and in earlier volumes of *Studies in the History*

¹ See HM Treasury Press Release 78/03, *Chancellor Announces Major Review of Inland Revenue and HM Customs and Excise*, July 2, 2003 (reprinted at [2003] *Simon’s Weekly Tax Intelligence* 1202-1204).

² See e.g. CJ Wales and CP Wales, *Structures, Processes and Governance in Tax Policy-Making: An Initial Report* (Oxford: Oxford University Centre for Business Taxation, 2012); C Wales, ‘The making of tax policy in the post-O’Donnell world: can the HMT-HMRC “policy partnership” meet the challenge?’ [2009] BTR 245; C Wales, ‘The implications of the O’Donnell Review for the making of tax policy in the UK’ [2004] BTR 543. We record our gratitude to the Chartered Institute of Taxation for funding the travel and transcription costs of the interviews discussed within this chapter, as well as for funding a witness seminar on the merger held at Birmingham Business School.

of *Tax Law*. The difference is that the raw material for many of those other studies is documentary, whereas much of the information that we wished to write about was not documented but is rather in the memories of the people involved.³ Although our objectives are orthodox for this series of books, our methods are not. In order to gain understanding of the ideas, techniques and arguments in play during the period immediately before the merger, two of the authors carried out a series of seven interviews with key informants from the IR and HMCE who were significantly involved in the processes leading up to the merger. The third contributed insights gained from close study of contemporary political, and policy-making, ideas. Together, the three authors also held a ‘witness seminar’ at Birmingham Business School on 12 December 2016,⁴ funded by the Chartered Institute of Taxation, at which other key informants from the IR, HMT and professional firms discussed a series of questions relating to the period before the merger. All the quotations used in this paper are drawn from the interviews that were conducted by the two authors mentioned above. We particularly focused in our interviews on the period before the merger and did not cover the aftermath of the merger. Most of the interviews took place in late 2016 and early 2017, with a final one being held in March 2018. All interviews were recorded and transcribed. The interviews were coded for dominant themes which had arisen from the seminar but in addition codes were generated from the data itself. Our codes were focused on the perceived rival cultures of IR and C&E; on the so-called ‘Mapeley affair’, discussed below; on ministerial and other accountability issues; and on policy making (and *ex ante* scrutiny of policy and legislation more generally).⁵ In the final stage of the coding we sought relationships between the open codes and the themes until our categories emerged on the key aspects of the merger.⁶ This was carried out by all three authors separately and in discussion with each other.

Our examination of this new evidence proceeds as follows. The next section of this chapter underscores the historical continuities of the merger processes by outlining some older developments in UK tax administration. This brief review demonstrates the sheer range of tasks performed by tax officials and the extreme difficulty of identifying any immutable set of functions for a revenue administration.⁷ We then focus more squarely on the period of the merger, looking broadly at the various reforms being discussed and implemented in the early 2000s and noting that the O’Donnell review only concerned a subset of these. The subsequent section examines some of the big ideas articulated by the New Labour administration following the 1997 election, and which lend a sense of coherence to the merger as well as to the otherwise disparate reforms to tax administration that took place outside the scope of the O’Donnell Review. We then concentrate more squarely on the merger itself, looking in turn at the motivations for the merger; the intended consequences;

³ This is the problem that has inspired ‘oral history’: see P Thompson and J Bornat, *The voice of the past: oral history*, 4th ed. (Oxford: OUP, 2017); R Perks and A Thomson (eds.) *The Oral History Reader*, 2nd ed. (Abingdon: Routledge, 2006). Note that oral history has several well-known limitations including the reliance on memory, which may not always be accurate. Certain events have greater significance in memory than when they occurred, and may be shaped by memory in idiosyncratic ways when recalled.

⁴ This was with the further participation of Rodrigo Ormeno Perez (University of Chile), Kevin Holland (Cardiff Business School) and Elaine Doyle (Kemmy Business School, University of Limerick). The format for the witness seminar drew on K Burk (ed), ‘Witness Seminar on the Origins and Early Development of the Eurobond Market’ (1992) 1(1) *Contemporary European History* 65-87.

⁵ On the last of these, see J Snape, *The Political Economy of Corporation Tax* (Oxford: Hart, 2011) esp ch 4.

⁶ See J Corbin and A Strauss, *Basics of Qualitative Research: Techniques and Procedures for developing Grounded Theory*, 4th ed. (London: Sage, 2015).

⁷ See generally K Hickman, ‘Administering the tax system we have’ (2014) (63) *Duke Law Journal* 1717.

funding; the role of special advisors (or ‘SpAds’); and the role of civil servants. The commonly held notion that there was a culture clash between IR and HMCE is then examined. We conclude by highlighting some important ways in which our oral evidence converges with, and diverges from, commonly-held understandings of the merger.

HISTORICAL PRECEDENTS

It is an open secret that tax careers are more varied than many might imagine, but it takes a historical review of the tax departments to show just how varied.⁸ The Annual Reports of the revenue departments detail a breath-taking range of issues with which tax officials have had to deal. The following list is instructive but does not even attempt to be comprehensive: drugs, pornography, trade sanctions, university finances, property valuation, company registration, pensions, merchant shipping, food safety, lotteries, coinage, copyright infringement, agricultural statistics, health regulation, Royal Navy Reserve enrolment, national insurance, passenger traffic, bilateral trade agreements, smuggling, civil aviation, war damage compensation, wartime rationing, the welfare of the blind, trade statistics, competition law, postal services, diplomatic privilege, probate, natural resource exploitation, environmental protection, the promotion of plain English, Citizens’ Band Radio, the Channel Tunnel, the adulteration of alcoholic beverages, the procurement of munitions, the establishment of the Irish Free State, the encouragement of the Welsh language, high inflation, computerisation and the creation of international organisations such as GATT, the OEEC, the EEA and UNESCO.

It is difficult to discern any natural way of classifying these tasks, which is a point that will become important in relation to the merger itself. There are, however two compelling *reasons* why tax officials have become involved in this huge range of activities. The first is that the activities of officials are bound to track the multifarious nature of the activities being taxed. If tax is imposed on shipping, for example, the tax authorities will need at least some degree of shipping expertise. The nature of this work depends in turn on the changing practices within the shipping industry as well as on other important contextual factors such as membership of the European Single Market. The second reason is that once tax officials are in post, they may become useful for other things that might not otherwise have been part of their role. Staying with the shipping example, if the shipping tax specialists are physically present at the ports, why not ask them to inspect the shipping documents, check for contraband, ensure that goods landed at the port meet safety standards and so forth? This point is made explicitly in the 1951 report of HMCE⁹:

In addition to its primary revenue work, the Department does much non-revenue work. Of particular interest ... is the monthly summary of the trade of this country prepared by the Department and published as the monthly Trade and Navigation Accounts; this work was a natural development of the control exercised at the ports for some hundreds of years of goods entering and leaving the country ... The network of Customs and Excise control which covers the country is also a suitable and economical instrument for other forms of non-revenue work for which separate staffs in other Departments would not be justified.

⁸ See also J Brewer, *The Sinews of Power* (Cambridge Mass: Harvard University Press, 1990) Ch. 4 for a vivid review of an even earlier period of administration.

⁹ HM Customs & Excise, *Forty-second report of the Commissioners of His Majesty’s Customs and Excise for the year ended 31st March, 1951* (Cmd. 8449, 1951-52), 7.

There were also instances of tax collection being assisted by non-revenue departments such as the Post Office,¹⁰ the Office of Works and the Stationery Office.¹¹ The Munitions Levy was for a while collected by the Ministry of Munitions¹² and HMCE also collected on behalf of the IR.¹³

To say the least, therefore, the tasks of revenue administration were not allocated in a theoretically clean manner, even setting aside all the non-tax activities of tax officials. However, the disjuncture between the time before and after the O'Donnell report ought not to be exaggerated. It is clear from the Annual Reports of the departments that the generally pragmatic orientation towards tax administration was tempered by a continual reflection on what officials were doing, how and why. In some cases, this reflection was prompted by external stimuli such as the creation of the Irish Free State or the accession of the UK to the European Communities. In other cases, it was simply recognised that a period of reflection was overdue.¹⁴ Sometimes, the definite imprint of political ideology can be seen, most notably in the 1980s when not only the content but also the layout of the reports became notably more managerial.¹⁵ The division of responsibilities over time between the IR, Excise and Customs departments reflects this patchwork of inherited systems of administration, pragmatism, self-reflection and political ideology. On the one hand, there was no natural way of sub-dividing government, and it is clear from the O'Donnell Review that very different approaches were taken in other jurisdictions.¹⁶ On the other hand, it is natural that the self-understanding of the departments as reflected in their Annual Reports reflected the range of work that they did. To return once again to the shipping example, the presence of large numbers of customs officials at the major ports contributes to a self-understanding of HMCE as a frontier force, even though much of the department's work happened inland. Thus, even after the Single European Act prompted a conscious switch of HMCE away from the borders and towards inland work,¹⁷ the department was in an obvious position to perform drug enforcement duties.

The institutions of taxation were no more immutable than their workload. In 1834 the Board of Stamps was amalgamated with the Board of Taxes, and in 1848 Excise was added in order to form the Board of Inland Revenue.¹⁸ In 1909 responsibility for Excise was

¹⁰ Inland Revenue, *Fifty-second report of the Commissioners of His Majesty's Inland Revenue for the year ended 31st March, 1909* (Cd. 4868, 1909), 97.

¹¹ Inland Revenue, *Seventy-fourth report of the Commissioners of His Majesty's Inland Revenue for the year ended 31st March, 1931* (Cmd. 4027, 1931-32), 5-6.

¹² Inland Revenue, *Sixtieth report of the Commissioners of His Majesty's Inland Revenue for the year ended 31st March, 1917* (Cd. 8887, 1917-18), 4.

¹³ Inland Revenue, *Fifty-sixth report of the Commissioners of His Majesty's Inland Revenue for the year ended 31st March, 1913* (Cd. 7000, 1913), 5.

¹⁴ See eg Inland Revenue, *Twenty-eighth report of the Commissioners of Her Majesty's Inland Revenue on the duties under their management, for the year ended 31st March 1885, with some retrospective history, and complete tables of accounts of the duties from 1869-70 to 1884-5 inclusive* (C. 4474, 1884-85). For a convenient history of merger proposals dating back to the mid-nineteenth century, see House of Commons Treasury Committee, *Second report: HM Customs and Excise* (HC 53, 1999-00), xvii ff.

¹⁵ P Tuck, *A study of the changing relationship between large corporates and the Inland Revenue*, Unpublished PhD Thesis, University of Warwick, 2007.

¹⁶ G O'Donnell, *Financing Britain's Future: Review of the Revenue Departments* (Cm 6163, 2003-04), Annex A.

¹⁷ HM Customs & Excise, *Eight-first report of the Commissioners of Her Majesty's Customs and Excise for the year ended 31st March 1990* (Cm 1223, 1989-90), 12-13.

¹⁸ Inland Revenue, *First report of the Commissioners of Inland Revenue on the inland revenue* (C 2199, 1857 Session 1), 39-40.

transferred to the Commissioners of Customs in order to form HMCE.¹⁹ More recent changes have been transfers of pension responsibilities from HMCE to the Assistance Board in 1943,²⁰ the functions of the War Damage Commission to the IR in 1964,²¹ probate functions from HMCE to dedicated probate offices in the late 1960s,²² the introduction of VAT in 1973, the conversion of some customs duties into excise duties in the late 1970s²³ and the subsequent rebalancing of customs and excise work towards other matters such as drugs enforcement and immigration control.

The reforms that the New Labour government carried out to tax administration are notable for their ambition, scale and sense of ideological consistency. However, it would be a mistake to see them as a radical departure from previous decades and centuries, which, as we have seen, involved a series of attempts to impose order upon wide-ranging, pragmatic and very old systems of administration.

CONTEMPORARY REFORMS

The New Labour government of 1997 embarked upon an ambitious programme of reform relating to some of the most fundamental aspects of the UK constitution. Amongst other things, it started the processes of devolving executive and legislative powers to Scotland and Wales; engaged in the Northern Irish peace process to the extent that it was possible to devolve powers to Stormont; enacted the Human Rights Act 1998; pursued reforms to the House of Lords although more narrowly than was first envisaged; and for a while examined the possibility of voting reform. Whilst some of these initiatives represented a radical break, in other respects there were striking continuities from the previous Conservative administration. For example, the new government – continuing an approach based on the New Public Management (NPM)²⁴ initiative begun under the Conservatives – strengthened the emphasis on managerialism, insisting on targets for efficiency savings and performance management indicators at the organisational level.²⁵

Even if we confine ourselves narrowly to the reform of tax administration, a lot of reforming activity took place after the 1997 election. Self-assessment had already been introduced, but in 1998 the IR became involved with the collection of Student Loans repayments.²⁶ In 1999 the IR merged with the Contributions Agency, in the process assuming

¹⁹ For older history see HM Customs, *First report of the Commissioners of Her Majesty's Customs on the customs* (C 2186, 1857 Session 1), 1 ff.

²⁰ HM Customs & Excise, *Thirty-eighth report of the Commissioners of His Majesty's Customs and Excise for the year ended 31st March 1947* (Cmd. 7252, 1947-48), 8.

²¹ Inland Revenue, *Report of the Commissioners of Her Majesty's Inland Revenue for the year ended 31st March 1965* (Cmnd. 2876, 1965-66), 2.

²² HM Customs & Excise, *Fifty-ninth report of the Commissioners of Her Majesty's Customs and Excise for the year ended 31st March 1968* (Cmnd. 3873, 1968-69), 24.

²³ HM Customs & Excise, *Sixty-seventh report of the Commissioners of Her Majesty's Customs and Excise for the year ended 31st March 1976* (Cmnd. 6694, 1976-77), 10. As the report explains, the old 'customs revenue duties ... comprised both a fiscal element and a small protective element (neither of which was separately identified in the law)'. These 'were replaced by (a) new excise duties chargeable at the same rate on both home produced or imported goods and (b) separate protective duties chargeable on imports'.

²⁴ Snape, above n 5, 105.

²⁵ See generally J Newman, *Modernising Governance: New Labour, Policy and Society* (London: Sage, 2001).

²⁶ Student Loans Company Limited, *Annual Report 1999-2000*, 13, available at https://www.slco.uk/media/5530/slco_annualreport_2000.pdf (accessed 14 November 2018).

responsibility for tax credits and effectively taking over functions previously associated with the welfare system.²⁷ This was followed in 2003 with the transfer to the IR of the Child Benefit Office.²⁸ Meanwhile, Sir Andrew Leggatt's review into tribunals was concluded in 2001,²⁹ leading ultimately to a radical restructuring of the system in the Tribunals, Courts and Enforcement Act 2007. This ultimately led to the creation of the tax tribunals on 1 April 2009, which replaced various older institutions including the General and Special Commissioners of Taxation.

These reforms represented important changes to the structure and functions of the revenue authorities, yet not one of them was contained within the ambit of the O'Donnell review. The merger was not only far from unique historically; it was only a subset of a much wider series of administrative reforms to the tax system within its own time-period.

NEW LABOUR IDEOLOGY

All the same, dissolving both the IR and HMCE, and transferring their respective functions to the newly-created HMRC,³⁰ was a bold legislative move. Such boldness now looks like an hubristic exploitation of the vast range of possibilities open to the New Labour government and illustrates a dangerous tendency, on the part of government ministers and their advisers, to view the practice of politics as a predominantly technical activity.

To understand the boldness involved in merging two revenue departments in HMRC, it is important to appreciate the parliamentary conditions under which the 1997, 2001 and 2005 Labour governments operated. Those who had contemporaneous knowledge of the merger, whether as participants or observers, tended perhaps to take those conditions for granted. The late nineties and early twenty-hundreds were, as Janan Ganesh has written, a time of parliamentary landslides.³¹ Though possibilities form and re-form almost daily, this has not been so since the 2005 General Election.³² In an atmosphere dominated by the feverish need to assemble Commons majorities from truculent and unpredictable party members, much legislation must be fought-over tooth and claw. 'It is unclear', concludes Ganesh, 'what voters want these days, other than their rulers on the shortest of leashes'.³³ Not so, in 2005, when a government Bill would pass without effective opposition. In an atmosphere dominated, too, by populist mistrust of representative institutions, MPs seem, perhaps more than ever, to try to gauge the transient preoccupations of their constituents. Not so in 2005 when, as yet unchastened either by the scandal of parliamentary expenses,³⁴ or by the mistrust of elites, parliamentarians seemed secure in their status. In hindsight, Europe also

²⁷ Inland Revenue, *One hundred and forty-first report of the Commissioners of Her Majesty's Inland Revenue for the year ending 31st March 1999* (Cm. 4477, 1998-99), 5, 27. The merger also encompassed the Northern Ireland Contribution Unit and the Department of Social Security's National Insurance Contributions Policy Unit.

²⁸ Inland Revenue, *Annual report and accounts for the year ending 31st March 2004* (HC 1062, 2003-04), 37.

²⁹ Andrew P Leggatt, *Tribunals for Users: One System, One Service: Report of the Review of Tribunals* (London: Stationery Office, 2001).

³⁰ Commissioners for Revenue and Customs Act 2005, s 48.

³¹ J Ganesh, 'Britain Opts For Weak Government By Popular Design' *Financial Times* (8 May 2018)

11.

³² *Ibid.*

³³ *Ibid.*

³⁴ Daily Telegraph, *The Complete Expenses Files* (London, Daily Telegraph, 2009).

seemed non-salient; the divisions that had riven Conservative governments before 1997, and do so to this day, had been replaced by constructive engagement under the Prime Minister, the Rt Hon Tony Blair, and Brown as Chancellor.³⁵ The economy seemed to be thriving, too, the clouds of 2007-2008 being yet in the future. Brown had stated in 1997 that: 'I want British economic success to be built on the solid rock of prudent and consistent economic management, not the shifting sands of boom and bust'.³⁶ The fall-out from Iraq had created some clouds but was yet to play out.³⁷ In short, well ahead of its landslide 1997 General Election victory, New Labour had a very clear idea of the tax policies it wanted to implement, and had assembled a package of measures that they wanted to take (interview #6).

So, in reality, all that was needed, in 2005, to pass radical legislation, was to present a bill to Parliament, while the government whips would ensure its passage with minimal debate. This facility illustrates the hubris, since it was at one and the same time, both the great strength – and the great weakness – of the New Labour government: get the calculation right and no-one notices, indeed if things go well, public opinion and vested interests may even concur; get it wrong, though, and there can be big trouble. The biggest tax policy embarrassment New Labour was living with in 2005 were the problems that had arisen from the introduction of tax credits in April 2003: their extreme complexity; IR staff shortages and a consequent lack of administrative capacity; the dislocation between the basis on which they were paid and the intervals between payments; chronic IT problems, and so on.³⁸ In 2005, though, it seemed possible to see the tax credits debacle as a matter of faulty administration. The managerial approaches already alluded to were at home in this environment, though journalistic polemics already doubted, not only the place of 'managerialism' in politics, but in business too.³⁹ In such calculations, enduring values get pushed aside, not least experience. Instead, as one of the co-authors has argued elsewhere, a certain Machiavellianism had free rein.⁴⁰ Referencing Machiavelli's account of Philip of Macedon, indeed, Jonathan Powell (Blair's Chief of Staff, 1997-2007) writes that '[l]eaders should ... have an overall plan, choose their target and aim high'.⁴¹ In relation to getting it right, there were few naysayers, so only Machiavellian political prudence guided success, in a kind of elite despotism. 'As the Tax Credits Bill progressed through Parliament in 2001-2002', write King and Crewe, 'Conservative and Liberal Democrat MPs and peers were muted in their criticism, partly because many of them found the government's overall welfare-to-work concept congenial'.⁴² Moreover, the scandals surrounding large scale international 'tax planning', which first piqued the interest of a disaffected Public Accounts Committee were far in the future.⁴³ Only the House of Commons Treasury Select Committee took a close interest in tax matters and that was stacked, its chair unelected, its members often supine, sometimes apparently even in awe of Brown's forceful manner.⁴⁴ Even more problematically, the early 2000s had seen a

³⁵ BBC Radio 4, 'Blair, Brown and a Bike Ride' *Brexit: A Love Story?* (Episode 9) (19 July 2018), available at <https://www.bbc.co.uk/programmes/p06f4mdc> (accessed 28 November 2018); J Powell, *The New Machiavelli: How to Wield Power in the Modern World* (London: Bodley Head, 2010) ch 10.

³⁶ G Brown, *Moving Britain Forward: Selected Speeches 1997-2006* (London: Bloomsbury, 2006) 87.

³⁷ Powell, above n 35, Ch. 11.

³⁸ A King and I Crewe, *The Blunders of our Governments* (Oxford: Oneworld, 2013), 147-151.

³⁹ See e.g. C Dillow, *The End of Politics: New Labour and the Folly of Managerialism* (Petersfield, Harriman House, 2007) 277 ff.

⁴⁰ Snape, above n 5, 81.

⁴¹ Powell, above n 35, 171.

⁴² King and Crewe, above n 38, 146.

⁴³ See M Hodge, *Called to Account: How Corporate Bad Behaviour and Government Waste Combine to Cost Us Millions* (London, Little Brown, 2016), ch 3.

⁴⁴ Snape, above n 5, 72-74.

dramatic increase in the use of ‘the guillotine’, a procedure for curtailing debate (and hence the *ex ante* scrutiny of legislation), notoriously in relation to the 2003 Finance Bill.⁴⁵

Such an approach tends, of course, to close off the possibility of debate about the end of public policy and instead to focus attention on the means by which ends can be attained and the stated rationales for the merger of the two revenue departments illustrate the narrowness of this conception of politics. The modernising end of public policy under New Labour was expressed in the 1999 White Paper, *Modernising Government*.⁴⁶ ‘Modernisation, though, had to be for a purpose’, it read, ‘to create better government to make life better for people’.⁴⁷ The means were to be threefold: the careful devising of ‘policies and programmes’; appropriate delivery of ‘services to individual citizens and businesses’; and appropriate performance of ‘all the other functions of a modern government’.⁴⁸ As Newman elegantly puts it, this focus on modernisation was drawn from selective ‘appropriation and trends and tendencies of the modern world’.⁴⁹ The reference to ‘customer focus’⁵⁰ represented a repackaging and extension of the ideas of the previous Conservative administration. Other elements of the White Paper were based variously on previous ideas of standardisation, Fordist production methods, measurement and evidence-based policy making and practice.

The rationales for the merger of the IR with HMCE were consistent with the White Paper. As we shall see below in the words of our interviewees, the merger took place in the context of two serious controversies that, at worst, posed a general threat to public consent to taxation. One, the Mapeley Affair, had seen the last chairman of the IR, Sir Nicholas Montagu, apparently sanction the transfer of the title to the IR’s estate to offshore companies.⁵¹ The other, which involved HMCE losing some high-profile VAT prosecutions, had resulted in Customs and Excise’s prosecution functions ‘being brought under the direct supervision of the Attorney-General’.⁵² More generally, mistrust of ideology and, in an ironic twist, a dogmatic assertion that the values of economic governance could be reduced to the single value of efficiency as being the best route to ‘fairness’. Brown, no less, had himself written in the 1990s a Fabian Society pamphlet to this effect.⁵³ It meant, in practice, that tax measures had to be justified by the need to remedy ‘market failures’,⁵⁴ not by reference to ideological dogma. New Labour’s meticulous planning of its path to power before 1997 took full note of these points. Conservative governments since that led by the Rt Hon Margaret Thatcher had fostered a mistrust of the state and promoted free market values, which, rather than seek to overturn, Brown and Blair (the latter influenced by the LSE academic, Professor Anthony Giddens)⁵⁵ had tried to accommodate within a social democratic framework. Moreover, in a clever twist, rather than invoking those doyens of the twentieth century intellectual left, RH Tawney, Harold Laski, Keynes, etc, Brown had turned to that doyen of

⁴⁵ J Snape and J de Souza, *Environmental Taxation Law: Policy, Contexts and Practice* (Aldershot, Ashgate, 2006) 66, 66n.

⁴⁶ Cabinet Office, *Modernising Government* (Cm 4310, 1998-99).

⁴⁷ *Ibid.*, 13

⁴⁸ *Ibid.*

⁴⁹ Newman, above n 25, 173.

⁵⁰ Cabinet Office, above n 46, 32.

⁵¹ Snape and de Souza, above n 45, 79.

⁵² *Ibid.*

⁵³ G Brown, *Fabian Pamphlet 563: Fair Is Efficient – A Socialist Agenda for Fairness* (London, Fabian Society, 1994).

⁵⁴ Even for green taxes (see Snape and de Souza, above n 45, 115-120); also Snape, above n 5, 186.

⁵⁵ A Giddens, *The Third Way; the Renewal of Social Democracy* (Oxford, Polity Press, 1998); A Giddens, *The Third Way and its Critics* (Cambridge, Polity Press, 2000). (See also, though for a later period, A Giddens, *Over To You, Mr Brown: How Labour Can Win Again* (Cambridge, Polity Press, 2007).)

laissez-faire, the moral philosopher Adam Smith.⁵⁶ Prior to the 1997 election, memories of the tax policies of the Callaghan era were still vivid in the memories of older voters. These tended to focus on income tax rates (hence New Labour's carefully-guarded campaigning on tax policy in 1997)⁵⁷ but, more relevantly here, they had resulted, too, in an exponential extension of the institutional competences of the revenue departments in the 1976 Finance Act.⁵⁸ Even more generally, New Labour had big ambitions for the tax system centred on this central value of efficiency and its enhancement to enhance fairness, something that was thought to require expertise to be concentrated in a single institution. All of the taxes needed attention and new ones had to be introduced, admittedly a process begun under the Conservatives before 1997. High marginal rates of income tax for those on low incomes needed to be mitigated.⁵⁹ All this involved a blurring of the boundaries between tax and social security, a blurring that was quite deliberate. The idea was that if a wider range of people could conceivably be both potential income taxpayers and benefits claimants, the social stigma associated with welfare might be reduced, along with popular opposition to greater generosity towards claimants.⁶⁰ Our interviewees supported the idea that this was a designed consequence of Blair's programme of modernisation. The allocation of responsibility for tax credits to the IR was, in part, so motivated. According to one of our interviewees, 'Gordon [Brown] and Ed Balls had got the idea on the Earned Income Tax Credit in the United States' (interview #3).⁶¹ The reform of the obsolescent tax treatment of corporate financial instruments, again begun under the Conservatives, had to be further enhanced.⁶² To further enhance EU environment measures, environmental taxes had to be introduced and expanded.⁶³ Indeed, in retrospect, this says something about the role of HMRC in an EU-focused governance structure and may go a long way to explain how, by and large, New Labour's green taxes were of low salience and unloved.⁶⁴ As Snape and de Souza explain,⁶⁵ New Labour's green taxes (national in origin)⁶⁶ were nonetheless often grafted onto EU regulatory structures, notably for waste management and climate change.

One of the most haunting images of Sir Edward Coke (1552-1634) is his definition of the surrender of a life estate, or of a term of years, in land, to the holder of the greater estate, as meaning that the former 'may drowne *by mutuall agreement betweene them*' in the latter.⁶⁷ In this chapter, we make no judgment as to whether, in fact, either department was 'drowned' in the other when the two became HMRC. However, some hold this to be the case, and hints

⁵⁶ See S Lee, *Best for Britain? The Politics and Legacy of Gordon Brown* (Oxford: Oneworld, 2007) ch 2; 'Introduction' in G Himmelfarb, *The Roads to Modernity: The British, French and American Enlightenments* (London: Vintage, 2008) ix, xiii.

⁵⁷ S Richards, *Whatever it Takes; The Real Story of Gordon Brown and New Labour* (London: Fourth Estate, 2010) 89-95.

⁵⁸ See e.g. J Snape, 'WT Ramsay v Commissioners of Inland Revenue (1981): Ancient Values, Modern Problems' in J Snape and D de Cogan (eds), *Landmark Cases in Revenue Law* (Oxford, Hart Publishing, 2019) 223.

⁵⁹ W Keegan, *The Prudence of Mr Gordon Brown* (Chichester: Wiley, 2003) 249; King and Crewe, above n 38, Ch. 10.

⁶⁰ King and Crewe, above n 38, 141-146.

⁶¹ This is well-documented (see e.g. Richards, above n 57, 115; King and Crewe, above n 38, 141).

⁶² Snape, above n 5, 142-146.

⁶³ Snape and de Souza, above n 45, Ch. 11.

⁶⁴ J Snape, 'The Green Taxes of the Brown Chancellorship, 1997-2007' (2007) 19 *Environmental Law and Management* 143-158.

⁶⁵ Snape and de Souza, above n 45, Chs. 8, 12.

⁶⁶ i.e. on the basis that the EU Emissions Trading Scheme (see Snape and de Souza, above n 45, Ch. 28), while an 'economic instrument', is not properly a 'tax'.

⁶⁷ *Coke's Commentary upon Littleton* (1832), vol II, s 636, p 337b.

of that surfaced in the interviews. What remains strange is that, in an era of landslides, New Labour should have devoted such energy and political capital to the endeavour discussed in these pages. Stafford Cripps in the 1930s had looked forward to Labour landslides as resulting in the passing of socialist laws.⁶⁸ The HMRC merger is perhaps a telling illustration of the preoccupations that a vast socialist legislative endeavour did not in fact happen when, at last, the opportunity arose. As it was provoked an unlikely nostalgia for revenue departments, a mistrust of perceived dominance by the tradition if not the personnel of HMCE in the new institution and an implausible nostalgia for a gentlemanly Revenue.⁶⁹

THE INTERVIEWS

We now move to our interviews on the O'Donnell review and the process of the merger itself, which elaborate many of the themes just sketched although in a more conversational manner. The process of coding the interviews highlighted a number of discrete areas of interest which we now consider in turn: the motivations for the merger; the allocation of functions; the funding of the merger; the role of special advisors; the role of civil servants; and the distinctive cultures of the IR and HMCE.

Motivations for the merger

Our informants were unable to settle on a single, core, reason or driver for the merger. However, they were able to provide some detailed substance to the emphases on efficiency and the transformation of policy-making in the O'Donnell review⁷⁰ and indeed the *Modernising Government* White Paper.⁷¹ One suggestion was that Brown, as Chancellor of the Exchequer, spotted an opportunity to enhance his control over tax policy:

Why did the merger happen? The official reason is that the Chancellor had given up effective ownership of the Bank of England; there weren't many other levers for him and therefore he wanted to be able to control taxation or tax policy in a way that he hadn't before. (Interview #4)

The following very revealing extract confirms that the question of control was closely connected to the overall approach that HM Government wished to take to policy, moving away from the more tax specialist approach typically associated with the IR:

But I think when the Labour government arrived they were shocked about a number of things and their special advisers, Ed Balls,⁷² Ed Miliband, Chris Wales, weren't able to get what they really wanted and that was polymaths to talk to about the tax system. There were lots of, as the Scots would say, stooshies about who owned the tax system, and that was genuinely difficult.

⁶⁸ M Loughlin, *Public Law and Political Theory* (Oxford, Clarendon Press, 1992) 236.

⁶⁹ Belied, surely, by the *Rosminster* case (see N Tutt, *The History of Tax Avoidance* (London, Wisedene, 1989), originally published as *The Tax Raiders: The Rosminster Affair* (London, Financial Training, 1985)).

⁷⁰ Other motivations mentioned in the O'Donnell review include the reduction in taxpayer compliance costs, the better use of information, better customer service and better accountability: see O'Donnell, above n 16, 3-4; House of Commons Treasury Committee, *The merger of Customs & Excise and the Inland Revenue* (HC 556, 2003-04), 3-8. It is interesting that our evidence overlaps with, but does not replicate, this list of motivations: see text at n 104, below.

⁷¹ Cabinet Office, above n 46.

⁷² See e.g. W Keegan, *The Prudence of Mr Gordon Brown* (Chichester: Wiley, 2003) 128-141.

... You'd have arguments about who was in charge and who owned the tax system broke out all over the place on a fairly regular basis.⁷³ (Interview #4)

The suggestion that political motivations underlay the commencement of the O'Donnell review, with the outcome a foregone conclusion, was contradicted by an interviewer but not terribly forcefully:

Foregone is strong. I think if we're honest with ourselves, there was a pattern to the way Brown in particular operated, that he had a penchant for reviews, which as he would've seen them corroborated independently a conclusion. Now I'm not saying all the time that Brown said that 'It has to be X, just get a whole lot of academics and make sure it says X and just weigh the stuff'; that's a caricature I think. But on the other hand, the sense that there's a very likely outcome in this case, was the case. (Interview #1)

The same interviewee thought that the transfer of policy functions to HM Treasury 'was always going to happen' on account of inadequacies with the existing way of doing tax policy.⁷⁴ The degree of secrecy around the decision to initiate the review strengthens the impression that the merger process involved decisions at a very high level of government:

I think like all great decisions, the decision was made and they had to put something around it. So I was at the Treasury Select Committee with Dawn [Primarolo] and just as they started asking questions she said, 'I've got an announcement I'd like to make, would you mind?' And she announced the review and the whole room gasped. Well I knew – I got it in the neck from [the Chairman] because I'd known for an hour maybe and he said, 'You didn't tell me.' I said, 'I'd no idea where you were.' So that will give you a feel for how close this was kept. (Interview #4)

A second perspective, which emphasises underlying policy considerations rather than Brown's personal role, was that existing arrangements were dysfunctional and out of step with comparable jurisdictions.⁷⁵ On this view, Brown did not so much initiate the process as accede to a widespread view that something had to change:

I think Brown did have a think about it and then said 'No, not now' or 'I can't be bothered' or 'it's too difficult'; I think it was, I'm pretty sure it was Brown because he was quite a cautious dot dot dot; and in the end I don't know enough actually as to what was the particular trigger – was it that Gus [O'Donnell] finally decided that we had to nail the tax policy issue maybe, and was it the conjunction of things that said 'this is more and more self-evidently eccentric at least, at worst dysfunctional, that you're not maximising the joined-upness – not a very elegant word – that you could achieve. (Interview #1)

Exactly what these dysfunctions consisted of are spelled out in the following extract, dealing with what the interviewee described as (what must have been unusual at the time) 'a very difficult Treasury Select Committee':

Dawn [Primarolo] had got in front of it and she was a bit panicky because things were difficult, but the Mapeley thing was simmering on, and with the Tax Credits and the EDS

⁷³ John Tiley quoted the memoirs of Denis Healey (Lord Healey), Labour Chancellor 1974-1979, as writing that the Inland Revenue, like Customs & Excise, 'considered itself to be at least as independent of the Treasury as the three armed services were of the Ministry of Defence!' (J Tiley, *Revenue Law*, 4th ed. (Oxford: Hart Publishing, 2000) 58n, quoting D Healey, *The Time of My Life* (London: Michael Joseph, 1989) 373.

⁷⁴ Interview #1 but also commented on by interviewee #6.

⁷⁵ See similarly O'Donnell, above n 16, 34-35, 40-43, Annex A.

systems, and saying that there was going to be an inquiry helped to defuse things, so there was that element of it. (Interview #3)

At the risk of repetition, the Mapeley affair involved the indirect transfer of IR buildings to a Bermudan-registered company, which was widely interpreted as the tax authorities themselves being involved in tax avoidance.⁷⁶ The introduction of tax credits in 2003 was mishandled with a large number of claimants receiving excessive awards that the Revenue later tried to claw back, with the predictable outcome of pushing low-income families into hardship.⁷⁷ EDS was the IR's IT supplier, which was replaced in 2003 after taking some of the blame for the tax credits failures.⁷⁸

According to the following interview extract, the problems at HMCE were even worse, and reinforced existing concerns about the allocation of functions over taxation within government:

Well looking back on it, all the alleged objective reasons given were valid in that only three other countries had VAT separate from the rest of tax administration and so it made sense to – to bring it under the roof of tax administration. Everyone always talks in terms of the review happening because in some ways the Revenue was getting itself into trouble but nothing like the trouble [Customs] were getting into. I mean they had really got themselves into some holes and all their policy was done in the Treasury and it was very substantially divorced from their operational teams. (Interview #4)

One interviewee believed that these public embarrassments served more as the occasion than the motivation for the O'Donnell review and the merger processes:

... this was a political decision at the end of the day, don't let's be under any delusion. Customs had had a problem with the Hoverspeed case,⁷⁹ which I think they'd lost because they were going hard on the booze cruises and things. The Revenue had their tax credit problems. And this is my own personal view, it's typical, it's an almost British thing which we're seeing every day of the week: you get a problem so what do they do? 'Oh, we'll have an inquiry' or 'we'll have a review.' Don't say, 'Go away, it's rubbish.' We'll have an inquiry, and you can see how these things just go mad. (Interview #7)

A third consideration cited by our interviewees was the reputation of HMCE for relatively heavy-handed administrative tactics, and the opportunity for the IR to adopt a similar approach and thereby reduce the incidence of tax avoidance.⁸⁰

... the thing that struck us all on the merger was actually the tax risk in the Revenue. We did a review of anti-avoidance to try and see how much tax was at stake. Well, the VAT at stake was, I don't know, probably a few billion, but on the direct side we got to about 16 billion and we got fed up counting, so you suddenly realised what a huge problem this was. And I suspect that was a key driver for the merger, that the government probably saw that Customs were pretty good. (Interview #7)

⁷⁶ Phillip Inman, 'Inland Revenue's property sold to company in tax haven', *The Guardian* (24 September 2002).

⁷⁷ L Chong and M Atherton, 'Revenue accused of failure on tax credit system', *The Times* (13 October 2005); King and Crewe, above n 38, Ch. 10.

⁷⁸ 'Inland Revenue dumps IT provider', *BBC News* (11 December 2003).

⁷⁹ See House of Commons Treasury Select Committee, Tenth Report of Session 2002-03, *Inland Revenue Matters* (published July 23, 2003).

⁸⁰ Though to anyone familiar with the *Rossminster* saga, this may seem strange.

In particular, the same interviewee continued, Customs had been quicker in initiating the practice of calculating the ‘tax gap’, which is the difference between the respective calculations of tax owed and tax collected.⁸¹ The interviewee reinforced the same point in a different way:

I’m trying to think back. I suppose we felt that being the smaller department we were likely to be swallowed up, but equally we felt that actually what the government was looking for, and I’ve said this already, that actually the way that Customs handled the tax, they wanted that translated into the Revenue ... (Interview #7)

The curious point here is that our informants variously cited the heavy-handed tactics of Customs as arguments in favour of the merger both in a positive way (as a model for the IR to follow in order to improve collection) and in a negative way (as a public relations nightmare). It is not clear how these considerations were reconciled, but the adverse publicity certainly left an imprint on some of our interviewees. At one point, Customs practices generated such extreme hostile attention that the need to investigate its officials almost exhausted the resources of several police forces:

We got into a terrible space in this sense because then you had those investigations running, you had people suspended pending various of these things, you had multiple police forces tripping over themselves. I’m not kidding: we ran out of police forces practically to do this because you ended up in situations where the Met were themselves conflicted, hence we had Thames Valley Police one time coming in ... you know, it was like next police force down the list, very very difficult times ... it was hugely destabilising ... there was a point at which even the director general in charge of law enforcement was suspended, and our chief lawyer. (Interview #1)

These woes did not stop with enforcement activities but extended even to Customs’ conduct during litigation:

Now this was on the law enforcement side of the business, where for a variety of reasons we got ourselves into deep deep water on cases where, if I remember, predominantly we were found to have failed on issues of due process; in simple terms failure to adequately have disclosed relevant documentation to the defence. We got crucified for those failings in some very very critical judgments, ie we were very very heavily criticised, and that sparked further judicial examination of some of these ghastly stories; it sparked a raft, frankly, of police investigations, many of which as I recall actually didn’t come to anything but we were deeply troubled by that scale of challenge. (Interview #1)

What is clear is that the IR and HMCE were experiencing serious problems in the years leading up to the merger, and that these problems were often widely publicised. In contrast, what is absent from our interviews is any sense of deep conviction that having a single revenue department is in some fundamental sense better than having two. The nearest approximation to such an argument is the mention of the possibility of cost savings by a number of our informants, a point which was also brought out by the O’Donnell Review.⁸²

⁸¹ See J Mirrlees, S Adam, T Besley et al, *Tax by Design* (Oxford: Oxford University Press, 2011) 42-43.

⁸² There is, however, a difference in emphasis in that our informants spoke principally of potential savings in the *administrative* costs of the tax authorities, whereas the O’Donnell review also forecasted savings in the *compliance* costs of taxpayers: see O’Donnell, above n 16, 29.

The allocation of functions

Even before the O'Donnell review was commissioned, it is clear that a substantial amount of thought had been put into the allocation of responsibilities between departments. Several interviewees cited the allocation of VAT to HMCE in 1973⁸³ as a particular oddity, although one that might perhaps be explained by the accumulated experience of Customs officials with the older Purchase Tax that was replaced by VAT:

I believe that in 1973, Inland Revenue ... or 72, was offered VAT. And I believe the Chairman turned it down. He thought it was inappropriate for what they did. And I think a lot of people ever since have thought that that was a missed opportunity ... I think VAT would have grown up with a different culture. (Interview #2)

The following excerpt once again brings in the unusual arrangement in the UK as an argument in favour of change, without quite explaining why it was wrong to be different:

I remember arguing to Gordon [Brown], ages before there was any question of a merger, for Customs to go to the Home Office and Border Control, and Taxes to come to the Revenue. In my time, only three of the administrations in the world, three direct tax, didn't do VAT, Malawi, Israel and us, and it was barmy. And Gordon was sympathetic, but he was against it because he didn't think that the Home Office would give sufficient priority to the Revenue. I think he's right there, because Customs revenues are pretty small. (Interview #3)

An interesting feature of our interviews was that despite the label 'merger', much of the discussion of high-level questions concerned not the consolidation of the tax departments but rather the other questions of control over tax policy and efficiency in administration. As discussed above, this was closely bound up with New Labour's emphasis on managerial administration. As early as 1999, the *Modernising Government* White Paper included a commitment to make policy making 'forward looking' rather than 'reacting to short-term pressures'.⁸⁴ It also discussed 'ways of tackling cross-cutting policies', including, significantly, a commitment to closer collaboration on policy matters between the two revenue departments:

Customs & Excise/Inland Revenue have agreed cross-representation on each other's Boards and appointed a joint programme director to improve co-ordination of their tax policies, secure increased compliance and deliver better and more efficient services to businesses.⁸⁵

Another example of an attempt to impose greater efficiency and professionalism on the revenue departments can be seen in a September 1999 report of the Strategic Policy Making Team at the Cabinet Office.⁸⁶ The report discusses policy making widely, but includes a pertinent example relating to the debt recovery policy of HMCE. In an early echo of *Tax Policy Making: a New Approach*,⁸⁷ the development of this policy involved relevant trade

⁸³ See e.g. D Johnstone, *A Tax Shall be Charged: Some Aspects of the Introduction of the British Value Added Tax* (London: HMSO, 1975) 7 ff.

⁸⁴ Cabinet Office, above n 71, 7.

⁸⁵ *Ibid.*, 18.

⁸⁶ Cabinet Office, *Professional policy making for the twenty-first century: report by Strategic Policy Making Team*, 30 September 1999, available at <https://ntouk.files.wordpress.com/2015/06/professional-policy-making-for-the-21st-century-1999.pdf> (accessed 14 November 2018).

⁸⁷ HM Treasury and HM Revenue & Customs, *Tax policy making: a new approach*, June 2010, available at http://webarchive.nationalarchives.gov.uk/20130102201052/http://www.hm-treasury.gov.uk/d/junebudget_tax_policy_making.pdf (accessed 14 November 2018).

organisations and professional bodies together with those staff who had operational responsibility for implementing the policy.

Some of these discussions may reflect the omission of previous Conservative administrations fully to extend the logic of ‘Thatcherite’ public service reforms to the tax authorities. A particular feature of those earlier reforms had been the separation of the delivery of the policy-making and delivery aspects of public services,⁸⁸ yet by the time of the merger the IR retained responsibility both for direct tax policy and the administration of direct taxes:

... the inquiry wasn’t simply, ‘Shall we merge Revenue with Customs?’ it was also, ‘What about the Tax Policy branch line in Revenue?’ Because we were unique amongst advanced western tax administrations responsible for tax policy. The States, Australia and New Zealand, and I can’t remember about Canada, the Treasury was responsible for it, and the Treasury would always want to get its hands on Tax. (Interview #3)

Apart from, yet again, revisiting the unusual nature of the UK’s arrangements, this also returns us to the question of control over the tax system. The point is made even more explicitly in the following extract:

The standout drivers ... which Gus [O’Donnell] would doubtless articulate very lucidly, is the issue of where is the anchor of tax policy? Is the Treasury appropriately equipped? Are we able to service ministers appropriately? And clearly Gus’s diagnosis to that was ‘no’, and I suspect that will have been the judgment of our political masters at the time, Brown, and Dawn Primarolo in particular given that Dawn had experienced both of the departments for a very long time even by then and doubtless did, I’m sure, have very strong views. So Gus felt very powerfully that there was a pressing need to get to a much more better place in terms of our ability to do tax policy. (Interview #1)

The bottom line is that the merger had the potential to equip HM Treasury with an extremely powerful set of instruments for influencing events.

They saw it as an entry into power and the Treasury like power. And the great plan - and this is very, very important - there were two rigged appointments in the Treasury that Gordon [Brown] led ... and one was the appointment of Nick Stern from being Chief Economist at the World Bank to being the Second Permanent Secretary ... And Nick was also on Gus’s inquiry and was a critical factor in this. The idea was that the Revenue Tax Department would move to the Treasury under Nick, who, for the first time, would bring together a macroeconomic and fiscal policy. (Interview #3)

A different perspective is that HM Treasury already had plenty of work on its hands with respect to tax, but lacked the necessary human resources.⁸⁹ On this view, the merger was not so much an opportunity to expand the power of Treasury as to consolidate a significant number of the people with policy aptitude in one place in order to make the workload more manageable and also to prevent inappropriate policy choices.

But I think one of the problems was simply that the Treasury had too few people. So it was very stretched and they were covering an enormous front across the whole of the tax system. I don’t know what exactly the background was to the O’Donnell review in terms of the policy

⁸⁸ N Flynn ‘Modernising British Government’ (1999) 52(4) *Parliamentary Affairs*, 582-597.

⁸⁹ On the expansion of HM Treasury in this period, see e.g. C Thain and R Christie, ‘Treasury Power: Past, Present and Future’, presented at JUC PAC Conference (Belfast, 3–5 September 2007).

changes, but I think one of the things that might well have contributed to it was the zero rate of corporation tax,⁹⁰ which was not a good move at all. And certainly in retrospect proved not to be. (Interview# 6)

A number of interviewees expressed the same point in reverse, highlighting the difficulties of in-house policy making within the revenue departments.

... my own experience of Customs was that we were okayish at doing some policy work, at times not, at times dysfunctional; at times we frustrated Dawn [Primarolo] intensely because we just didn't get with her or on her wavelength, and the Treasury machinery was slight at this end ... (Interview #1)

The notion that HMCE suffered from especial weakness in respect of policymaking recurred a few times:

[X] had a fantastic ability, one has to say, to read the Chancellor especially. That was fine on politics but the substantive policy thinking development etcetera etcetera I think was relatively poor; we weren't great at it in Customs for all sorts of reasons, despite efforts to try and bolster it – or I was partly supposed to be trying to bolster it but there you go, as we had a little central strategy component etcetera – but my broad reflection is that's right we were weak at it; you can see why Gus [O'Donnell]'s conclusion was this is odd. (Interview #1)

The IR had a more developed capacity but also experienced difficulties.

Revenue had a different but equally troubled relationship with ministers and the Treasury machinery, a much bigger relationship; far more players in the Revenue were interacting with [HMT], whereas proportionally only a few were in our space [HMCE] – and that was before Dawn [Primarolo] said she'd only meet certain people but anyway that's a different story – but joking apart clearly the scale of engagement was larger but I can say that there were lots of instances where it still was frustrating ministers, and I think quite reasonably frustrating Gus [O'Donnell] and others. (Interview #1)

A particular controversy that was mentioned a few times involved the 0% starting rate for Corporation Tax that was introduced in 2002,⁹¹ only to be repealed in 2006 after causing an entirely predictable but apparently unwanted rash of tax-motivated incorporations of previously unincorporated businesses.⁹² One interviewee attributed the original flawed policy to a decision of the Chancellor of the Exchequer in close collaboration with his special advisors, which is worrying in view of the belief – mentioned above – that the merger itself originated from a similar decision.⁹³

Yeah. So I think there had been a ten per cent rate and then it went down to zero. In the same way that Treasury didn't have very many policy people, Inland Revenue didn't have very many policy people either. And so I was also covering a massive waterfront. So the corporate tax change down to zero was not a very good move. And the way that that was decided was also a bit strange. And, again, I think it was probably the interaction with the special advisors and wasn't really clear who was calling the shots. And so the Chancellor very much wanted to do it and it proved to be a very unfortunate move because you had hairdressers incorporating

⁹⁰ See C Crawford and J Freedman, 'Small Business Taxation' in S Adam, T Besley et al. (eds), *Dimensions of Tax Design: The Mirrlees Review* (Oxford: OUP, 2010) 1028, 1054-1059.

⁹¹ Finance Act 2002, s 32.

⁹² Finance Act 2006, s 26; Crawford and Freedman, above n 90.

⁹³ Refer to text at n 95.

their businesses to take advantage of the zero rate of corporation tax, which was really not the idea at all. (Interview #6)

In the view of some interviewees, this translated into more general doubts as to the wisdom of the merger project, and in particular about the division of policy and operational decisions in the tax field:

The Treasury had always wanted to control tax policy as far back as I can remember, completely. And lots of ministers had said, no, no, no, because I think they were – and I think they were wise because you can't make good tax policy without operational input and experience. It's a waste of time and I can remember saying that till I was blue in the face with Treasury officials but they wanted to control tax policy. And I think going back to [special advisors] and the like, he wanted to control tax policy and I think a lot of his criticism of the old Inland Revenue was borne of that. (Interview #4)

The removal from the revenue departments of one of their most prestigious streams of work also did not go unnoticed, despite the decision to leave 'policy maintenance' in HMRC.⁹⁴

And what they call policy maintenance was left in the tax department, so the Inland Revenue, Customs and then HMRC. And one thing that I think is quite important to recognise is that, for the people in HMRC or in the Inland Revenue as it then was, it was actually quite a difficult time. I felt personally at that time that the essence of my job was being taken away and given to Treasury. And it wasn't clear how the roles would interact. But certainly the bit of my job that I'd always regarded as the most interesting seemed as though it was being taken away and given to Treasury. (Interview #6)

The same interviewee reinforced this point.

So it was quite a difficult time personally for a lot of people on the policy side in HMRC. And so what happened to me personally at that time was I thought, "Well I enjoy the policy job I'm doing."

So even people who stayed behind in Inland Revenue probably felt quite a loss that part of their role had been moved and actually probably the more interesting bit of their role had been moved to Treasury. (Interview #6)

Those who moved from the revenue departments into HM Treasury were also keenly aware of these sensitivities.

And so one of the challenges we faced, so then moving into Treasury, was working with people in HMRC who had just had part of their jobs taken away. So it made for quite an interesting relationship in that you had to take quite a bit of care to make sure that the relationships worked well because it was not an easy time. (Interview #6)

The following extract suggests that the decision to allocate 'policy maintenance' to HMRC was informed by pragmatic considerations concerning the capacity of HMT, conceivably at the expense of more fundamental thought as to how responsibilities relating to tax might best be allocated within government.

⁹⁴ This concept is not explained in detail in the O'Donnell review, which states merely that 'Policy maintenance, which aims to protect the taxation system against challenge, depends particularly upon a detailed practical understanding of how the law works': see O'Donnell, above n 16, 10. In broad terms, HM Treasury developed ideas for tax policy, whereas HMRC was responsible for ensuring that they were and remained practicable.

So a thing that Gus [O'Donnell] grappled with and then fought shy of, for I think logical reasons is: you could have either made the split more dramatic and hived off even more of policy maintenance and said 'That's right, you're just an agency that executes, you just do all the doing, just collect debt, manage compliance and do other things that you're tasked with doing; we'll capture all tax policy and maintenance and have this thing. Well, one, that then is completely disproportionate in terms of the Treasury machinery; even the numbers that they brought in under this was a heck of a scaling up, wasn't it ... Surely what absolutely is the case and you probably know very well, the question of maintenance and managing challenges to the tax framework, litigation for pity's sake, where are you going to put that? Are you going to get the Treasury doing all this litigation? You've got to be kidding! (Interview #1)

Nevertheless it might be said that the major problem with 'policy maintenance' was not the principle so much as the rather boring terminology.

I think the term is a bit unfortunate and certainly at the time it wasn't really very clear. So what was clear was that the strategic end was going to Treasury and what was left was just the bits that weren't as strategic. But actually how it all panned out in practice was, certainly in the corporate tax area that I was in, there was still an awful lot to be done in HMRC on the policy side, particularly instructing parliamentary counsel on new legislation, working with colleagues in HMRC to make sure that measures were practicable and very much working on the detail, the very fine detail of the policy.

So the Treasury would work on the high level principles, but HMRC would have to fill in an awful lot of the detail. So actually, as it turned out ... in 2009, there was still an awful lot of the very interesting work on the policy maintenance side. Calling something policy maintenance is not necessarily very conducive to people thinking it's a terribly interesting job. (Interview #6)

Funding

A point that occupied a small amount of time in our interviews but seems very significant is that the merger was unfunded, unlike corporate mergers and acquisitions which are routinely expected to generate significant transition costs. We did not gain a clear sense of the reason for this decision, but it immediately placed constraints on what the newly merged entity could achieve:

And I mean the real problem with the merger and I see it in some of the other countries I work in now, is you cannot hope to do something big like a merger without some funding and not a penny of funding was provided. The two departments had to find the funding. (Interview #4)

One interviewee recalled a discussion in which one-off transition costs, relating in particular to the integration of the two former departments, were raised.

I think Gus [O'Donnell] said 'Hey, thanks for telling us, that's really interesting but let's be clear the Chancellor is not going to stand up and say "I've created a new department and it cost more."' (Interview #1)

In view of the willingness of HM Government to learn from and draw upon business practices in other respects, it would be useful to understand this curious decision more clearly through further research.

The role of special advisors

Perhaps in line with the suggestion that the transfer of policymaking functions to HMT allowed the Chancellor of the Exchequer to extend his personal control over tax policy, a conspicuous feature of the merger processes was the centrality of Special Advisors (SpAds). SpAds are appointed by Ministers to give input on the political aspects of their Departmental work. The Public Administration Report in 2000 noted that the number of SpAds had doubled since the election in 1997 and that they had ‘consolidated senior positions in the machinery of government’.⁹⁵ This deepening of roles is reflected in our interview evidence. The special advisors in question, Chris Wales, Ed Balls and Ed Miliband, seem to have played a key role in the relationship between HM Treasury and the Departments.

The other thing that was very much a feature of those kind of late nineties and early 2000s was that the special advisers were really quite influential. So there was probably less interaction directly with ministers and more interaction with special advisers. (Interview #6)

There was also, drawing on transatlantic experience, a Council of Economic Advisers, on which Chris Wales sat from 1997 to 2003.⁹⁶ These appointments seem to have been part of a more general strategy to bring ‘new blood’ into government, which created difficulties despite having some positive aspects.

The Treasury brought in an increasing number of really young people from the accountancy profession, some from the legal profession, mainly from the accountancy profession. They were very clever, I have to say that some were outstandingly good; others were just deeply knowledgeable in particular areas, and I think what came with that knowledge was a rigidity; and no real effort was being made other than by a few of us in the Revenue to build relationships ... (Interview #4)

Other interviewees were more cautious still, whilst acknowledging the ability of special advisers and HM Treasury to work together in order to produce results:

The people in the Treasury and those coming into the Treasury from outside cosied up a lot to the special advisers, and the three special advisers were brilliant at using them as their sort of storm troopers to get things done. (Interview #4)

The role of civil servants

In mirror image to the enhanced status of special advisors, the relationship between Ministers and civil servants was distant. In line with the discussion above, the special advisers acted as a conduit between civil servants and the Minister.

Gordon Brown ... rarely saw officials in the Revenue – you had to be doing something really interesting to get in to see him. (Interview #4)

⁹⁵ Public Administration Select Committee, *Third report: Special advisors: boon or bane: the government response to the committee’s fourth report of session 2000-01* (HC 463, 2001-02), vi.

⁹⁶ Snape, above n 5, 82, 83, 109, 126.

The relationship between Sir Nicholas Montagu and the Paymaster General, Dawn Primarolo, was even more strained. A House of Commons Treasury Committee report examined IR matters including the use of offshore tax structures by bidders, tax credit implementation and the suspension of National Insurance Contributions Deficiency Notices.⁹⁷ It highlighted the infrequency of contact between the Chairman of the Inland Revenue and the Paymaster General.⁹⁸ It also observed the conflicting evidence between these two individuals in relation to the Mapeley affair.⁹⁹

Nick [Montagu] was asked, now this is a matter of public record, at one Public Accounts Committee Hearing, how many times he'd seen the Chancellor and Dawn Primarolo the previous year and he said, 'I haven't seen the Chancellor in the last 12 months and I've seen the Paymaster General once.' I mean what was actually going on wasn't great. I mean I was busy seeing them because we could talk about the taxation issues and it was – and I took people with me all the time, but it was, it was jolly difficult. And the Chancellor naturally tended to turn to the Treasury for new policies; [Treasury] wanted to get in with him, so they would try and do it on their own. (Interview #4)

This is not an encouraging description of the traditional institutions of government, to say the least.

Culture

One of the most common reactions to the merger, amongst the authors, their interviewees, seminar attendees and others, is to wonder about the difference in organisational culture between the IR and HMCE. It has been suggested above that the reputation and self-image of an institution is closely connected to the range of functions that happen to be delegated to it at any given point in time.¹⁰⁰ This point was mentioned specifically by some of our interviewees:

... in the early days, People worked boarding ships and then next day they would do a [VAT assessment]. There wasn't the sort of separation of...? Of expertise? It was all one role.

And they functionalised it. And they had a culture of secrecy, because they'd got intelligence functions and people ... information that was important. (Interview #2)

⁹⁷ House of Commons Treasury Committee, *Inland Revenue matters* (HC 834, 2002-03), 14-19.

⁹⁸ *Ibid.*, Ev 17 [Q 166].

⁹⁹ *Ibid.*, 5-6.

¹⁰⁰ The organisational identity literature is helpful here. Organisational identity represents the interaction of the internal social identity of managers and employees, and the external image of an organisation held by others, such as customers and the public: see B Ashforth and F Mael, 'Organizational identity and strategy as context for the individual' in JAC Baum and JE Dutton (eds.), *Advances in Strategic Management vol. 13* (Greenwich, CT: JAI Press, 1996) 19-64; MJ Hatch and M Schultz, 'The dynamics of organizational identity' (2002) 55 *Human Relations* 989-1018). The concept of organisational identity was first developed by Albert and Whetten in S Albert and DA Whetten, 'Organizational identity' in LL Cummings and BM Staw (eds.), *Research in organizational behaviour vol. 7* (Greenwich, CT: JAI Press, 1985) 263-95. Subsequently the definition of the concept has become dynamic, in flux and often contested (DA Gioia, M Schultz and KG Corley, 'Organizational identity, image, and adaptive instability', (2000) 25 *Academy of Management Review* 63-81; SG Scott and VR Lane, 'A stakeholder approach to organizational identity' (2000) 25 *Academy of Management Review*, 43-62; and SG Scott and VR Lane, 'Fluid, fractured and distinctive? In search of a definition of organizational identity', (2000) 25 *Academy of Management Review*, 143-144.

However, the degree of institutional separation that is reported by our informants as existing prior to the merger is still surprising:

Just to come back to the reflections on how separate we were, which was by any stretch dysfunctional, so there were some connections but not many. The boards met once in a blue moon if ever, just extraordinary. Yes, the two perm secs would have known each other and seen each other on Wednesdays presumably like with the others; there was no structured engagement that I ever saw. (Interview #1)

Progress had been made, with a joint policy steering group set up in 1999/00 in order to ensure that the policies of the departments were co-ordinated.¹⁰¹ Yet it was widely appreciated that the difference between the departments involved not only the substantive tax treatments but also questions of approach. This can be seen clearly from divergent attitudes towards the conclusion of settlements with taxpayers. The following extract is from a former Customs official:

Because I wouldn't do the deals, because our view on the avoidance side was because if you did a deal even to an extent of saying, 'Okay, well we'll take 90% of the tax and we'll walk away from 10%,' it was still worth ... doing another deal, whereas if you said, 'We want the whole lot,' then they wouldn't do it. And VAT, the approach has always been on VAT, 'Well if it's due it's due and you pay, if it isn't due, well, fine it isn't due,' so that's quite simple. But the Revenue had this approach of 'Well, give us a bit of "go away money" even though alright, well, it might not be due.' (Interview #7)

The significance of VAT to the substance and style of the work done by HMCE was emphasised several times. The following extract is typical, although it does not quite explain why VAT in particular is associated with a 'can-do' attitude:

The other component is the VAT piece, which was the predominant tax of course in 1973, by far the most dominant and significant tax we managed ... the Excises [were] good little earners but they didn't have a lot of people even then doing them, so VAT was our big ticket thing, a strong sense of identity around that. So I think C&E saw themselves as quite can-do, doers, get-on and whatever, plain-speaking and all the other stuff – and there's almost a parody in this, it's classic – and then clearly parts of the Revenue would have seen them as gentlemen tax inspectors, more professional. (Interview #1)

In any case, this self-understanding fed into a fundamentally different attitude towards the role of a revenue department in applying the law:

[X from HMCE] was using the black letter law all the way down the line. Because that's the only thing you can rely on. And of course I've been brought up in IR, which absolutely didn't want to rely on the black letter law, because everybody tried to artificially get round it. (Interview #2)

The response of IR officials to the underlying assumptions of Customs people was one of mixed understanding and frustration:

... the footprint of Customs on the Inland Revenue was about, I think, 22%. Something like that. So you might say, "Why would you merge?" But having come to merge, and you look at that 22%, they are the same people, culturally, that we encountered when the Contributions

¹⁰¹ Inland Revenue, *One hundred and forty-second report of the Commissioners of Her Majesty's Inland Revenue for the year ending 31st March 2000* (Cm 5029, 2000-01), 25.

Agency merged. They are investigators. Which they ... so they're trained to be sceptical. And if you train people to be sceptical, to disbelieve, as they had to, and you train them to audit, and to challenge, you also create a culture which, I think, is resistant to change. And at its worst, you encounter people who don't even want change when they were in the Inland Revenue. (Interview #2)

To some extent, the portrayal of HMCE officials 'as a bunch of gangsters' and IR officials 'as a bunch of effete liberals'¹⁰² was a caricature, but many interviewees saw an element of truth to the exaggerations:

I think if you over characterise it, the Customs people saw the Inland Revenue people as rather soft. I mean, in our workshops we held with each other, we had to be honest to each other. In a polite way. For which we were trained. And I think the caricature was that ... we the big Inland Revenue, ... valued intellect. And digging down. But were not as cost effective as we might be, and were soft. We made compromises. We did deals. And ... I think there's elements of truth in that. (Interview #2)

Despite these differences, some interviewees had an optimistic attitude towards the ability of officials from different backgrounds to work together:

And these pleasantries were exchanged. But out of those caricatures, you began to see the good in each group. And you began to transform the group. And I think that's what Gordon Brown was probably trying to do. (Interview #2)

A second difference between the departments involved recruitment practices and career progression.

They had a different recruitment model. Whereas the Inspectorate in Inland Revenue were recruited as 2.1 undergraduates, 2.1s and firsts, with an expectation in the Civil Service Selection Board that they would get at least a Grade 6 and possibly to Grade 5 in those days, Customs recruited with the expectation that people would get to, I think, principal, grade 7.¹⁰³ (Interview #2).

The outcome was that:

... there was a sense of the professional status of the tax inspector as being plainly higher than a Customs officer ... (Interview #1)

However, this primarily concerned the more senior levels of the organisations. Both organisations employed a large number of clerical officials:

... when you look at the totality of the Revenue it had shed loads of administrative / clerical functions, unbelievable scale, even at merger, and still battle with rather a large [staff]. So it is funny that parts of the characteristics of the ... Revenue ... were heavily governed, at least as I saw it I suppose, by the very top of the shop, who were indeed almost all gentlemen. (Interview#1)

¹⁰² Interview #2

¹⁰³ As Civil Service grades decrease with seniority, this meant that Customs officials tended to be less well-recognised than their counterparts in the Inland Revenue, which would of course have been highlighted by the merger.

Especially on the Customs side, there was a sense of fatalism, in the sense that whilst the merger fundamentally changed the work and approach of tax officials, things were changing quickly anyway:

The culture of Customs was heavily conditioned up to point by the law enforcement component. Not that I ever worked in it – I worked all that time in Customs & Excise entirely in tax policy creation, and our law enforcement piece morphed and was different – but that was very powerful that sense of identity, the role we played, the enforcement role, the border-based role. Of course there was also SOCA's [Serious and Organised Crime Agency] creation at the same bloody time so there were all sorts of things which were migrating away from us anyway. (Interview #1)

The interviewee explains further

The creation of SOCA was approximately coincidental with some of this debate, so that was already leading to the export from C&E of some of our functions. So I think the broad sweep of the thing was there was a disaggregation of our law enforcement functions anyway and then more stuff went to, [who] knows what it was called in those days, Border Force. (Interview #1)

CONCLUSION: ORAL AND DOCUMENTED HISTORY

The content of this chapter has been directed not by contemporary documentary evidence of the merger, by existing academic or professional literature, or by our own preconceptions. Instead, we have been very much led by the issues highlighted by our informants by our detailed open coding of the transcripts of interviews. We make no claim that this is a superior method of understanding the merger to a review of published documents, or that the claims made by our informants are neutral and uncoloured by personal, professional, political or ideological considerations. Our claim is more modest, that the O'Donnell review and the ensuing processes of merger had an irreducible human element. They were carried out by leading characters within the government and civil service of the time, and were centrally concerned with the management of people. This being the case, it is enlightening to understand what some of these leading characters thought they were doing – or, to be more precise, what they now think they were doing in these important years leading up to the merger.

Matters get particularly interesting in those instances where the documented and recollections of events differ. These are relatively rare, and there were certainly aspects in which our informants mirrored the contents of the contemporaneous documentation, not least the O'Donnell Review itself. For example, there was a keen recollection amongst our interviewees of the perceived problems with the pre-existing allocation of functions, which for obvious reasons were brought to the fore in the O'Donnell Review but are also evident in the Treasury Committee report on the proposed merger that was published later in 2004.¹⁰⁴ An area in which there was a difference in emphasis was in the claim made at the time that costs would decrease, not only for HM Government in terms of greater efficiency and modestly reduced staffing levels, but also for taxpayers seeking to comply with their tax obligations. This claim can be found in the contemporaneous documentation but the idea that taxpayers would experience cost savings from a disruptive process that reduced the total number of revenue officials seems rather remote and speculative, although not altogether

¹⁰⁴ O'Donnell, above n 16, Ch 3; Treasury Committee, above n 70, 3 ff.

impossible. It was not emphasised by our interviewees, although in balance they were not prompted on this point.

An example of a theme brought out rather more strongly in our interviews than in the contemporary policy literature was the idea that the merger allowed HMT and the Chancellor to consolidate their control over tax policy. As we saw above, some interviewees linked this to the issue of how tax policy ought to be approached, with the post-O'Donnell arrangement being associated with a more big-picture and even economist-led approach, in contrast to the more detail-oriented and experience-based approach of policy-making within the legacy departments. These points were made with force and clarity by our informants but are in some respects shrouded in euphemism in the documentary evidence. The O'Donnell Review, for example, highlights the need for tax policy to be permeable to economic expertise, but discusses the question of control in terms such as the need for 'coherence' and the need to be responsive to government objectives.¹⁰⁵

Above all else, speaking to people about these events brings them to life, not only for our readers but for future researchers who may not have first-hand memory of the sense of importance, disruption and opportunity that surrounded the merger. Administrative reform can be a rather dry segment of history for those not directly involved, but to many of us who practised or studied tax at the time, the O'Donnell reforms involved something more meaningful than a simple shuffling of deckchairs. We have tried to capture something of this sense within the present chapter, which is also why we have preserved much of the conversational character of the interviews within the quoted extracts. We record our gratitude to our informants, without whose cooperation and enthusiasm this chapter would have been so much shorter and less colourful.

¹⁰⁵ O'Donnell, above n 16, Ch. 5.