House of Commons
Committee of Public Accounts

Tax reliefs

Third Report of Session 2014–15

Report, together with formal minutes related to the report

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Committee of Public Accounts

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Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee's email address is pubaccom@parliament.uk.

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Summary

Tax reliefs are a substantial, complex and poorly managed element of the tax system. HM Treasury and HM Revenue & Customs (the Departments) are accountable to Parliament for providing timely feedback on what reliefs cost, and whether they deliver Parliament's intent. Complexity in the tax system is a longstanding issue, but the Departments appear not to have been able to cope with the growing demands of managing increasing numbers of tax reliefs. They are uncertain about the scale and value of different types of relief—including which reliefs should be treated as "tax expenditures" (reliefs to encourage behavioural change). The tax expenditures in the UK tax system are estimated to cost over £100 billion per annum. With the breadth, number and tax complexity of reliefs HMRC cannot be fully vigilant and knowledgeable about the cost and value of reliefs. The case of film tax relief highlights how a minor, but poorly designed, relief eventually cost the exchequer over £2 billion. The Departments were slow to respond and did not bring the surge in costs to the attention of Parliament. We look to the Departments to set out clear proposals on how to improve the management and accountability to Parliament of the cost and performance of tax reliefs.

Conclusions

1. At the end of 2013 there were 1,128 tax reliefs in the UK and the number continues to grow. Tax reliefs can range from fundamental components of the tax system, such as the level of personal allowance, to tax expenditures with more specific objectives to change behaviour, such as film tax relief. HM Revenue & Customs (HMRC) estimates there may be 150 tax expenditures overall, across its tax streams. Parliamentary approval through the Finance Bill is not a sufficiently robust way to provide assurance that tax reliefs are working as intended. Too often, tax reliefs provide opportunities for abuse, avoidance and evasion and there is a risk that costs might rise and remain above expectations, as Parliament is not kept adequately informed of changes in their costs. In this initial review of tax reliefs, we have identified the areas of concern. In future work, we plan to look at how the Departments have addressed the concerns we have highlighted in this report.

2. **There is a lack of transparency and accountability for tax reliefs and no adequate system of control, following their introduction.** HMRC and HM Treasury share responsibility for tax reliefs, but there is no accounting officer with responsibility for the stewardship of tax reliefs, as there would be for public spending. In 2010, HM Treasury committed to developing a framework for the introduction of new reliefs, recognising that it should consider new reliefs carefully, and that these should only be introduced when there is a strong and proven case. But it has not done so. Without a clear framework, or adequate definitions to distinguish between different types of reliefs, it is not possible to categorise reliefs effectively, and to understand how they should be managed.

3. **Tax expenditures are often alternatives to spending programmes, but are not managed or evaluated as closely.** Tax expenditures are reliefs introduced to support certain behaviours. They are, in effect, a form of public expenditure and should be treated as such. HMRC is not clear which reliefs fall within the category 'tax expenditure'. Unlike spending programmes, many tax expenditures are introduced without clear objectives, and are not evaluated as fully. The Departments do not carry out options appraisals for all reliefs, and evaluations are undertaken after risks emerge, rather than systemically. They have estimated the value of only 46 of the around 150 tax expenditures. Smaller reliefs, in particular, receive less evaluation. Spending programmes require departments to abide by the rules of *Managing Public Money*, but HMRC and HM Treasury are not subject to similar rules for their management of tax expenditures.

4. **The Departments do not keep Parliament adequately informed of changes in the costs of reliefs.** Parliament approves the introduction of new reliefs, and relies on accurate advice from the Departments for it to make informed decisions. HMRC publishes online annual estimates of the cost of only 180 tax reliefs. However, there is no feedback mechanism to alert Parliament, when the actual cost of tax reliefs varies from HM Treasury's original forecasts, on which Parliament based its enactment and amendment of reliefs.

5. **The Departments are unable to cope with the demands of an increasingly complex tax system, including tax reliefs.** Tax revenues as a proportion of GDP remain stable over time but the tax code becomes more complex year on year. In March 2011, the Office of Tax Simplification reviewed 155 reliefs, and recommended that 47 should be abolished. While this led to the removal of 43 of these reliefs, a further 134 new reliefs have been introduced since 2011. Each new relief complicates the tax system, and increases the length and complexity of British tax law. It is unclear whether the impact of particular tax reliefs on tax revenue streams is properly considered, for instance the impact of agricultural property and business property reliefs on overall inheritance tax revenue. To accommodate new legislation, and anticipate the actions of avoiders, Finance Bills are four- to five-times longer than 50 years ago. HMRC has a considerable workload, with a huge backlog of cases outstanding in the tribunal, 43,000 of which will receive a notice to pay under new accelerated provisions. HMRC is looking to improve its systems, as these are not sufficiently adept at obtaining relevant information promptly from its customers.

6. **The Departments do not respond promptly to unexpected increases in the costs of tax reliefs.** Data on movements in the cost of reliefs is not available until tax returns are received, and HMRC takes time to react when it notices a cost increase, as it wants to ensure its response is appropriate. However, a longer elapsed time in reacting to an increase in the cost of a tax relief raises the total amount of public money at risk. In the case of film tax relief, it took ten years to resolve the problems and cost over £2 billion. We welcome the introduction of the Disclosure of Tax Avoidance Schemes (DOTAS) system which provides richer information on avoidance schemes, and allows HMRC to take more immediate action to close legal loopholes. We would question whether there are sufficient appropriate disincentives and sanctions in the system to inhibit advisers from promoting aggressive tax avoidance schemes. The National Audit Office identified 26 tax reliefs which had increased in cost by more than 50% in real-terms in the past ten years, and 30 that had increased in cost by more than 25% in real-terms in the past five years. HMRC told us some of the reliefs which the National Audit Office had identified were small, and it carried out less monitoring of these. However in terms of public spending programmes these figures are substantial.

Future work

7. In future work we plan to look at how the Departments have addressed the above concerns, in particular, what they have done to:

- Define and establish clear accountabilities, and deliver on commitments to develop and introduce a framework for effective assessment, management and reporting of tax reliefs.
- Provide proportionate feedback, and analysis to Parliament, on the costs of principal tax reliefs each year, including significant changes in costs.
- Define which reliefs are tax expenditures, and improve the management, evaluation and reporting on the performance of tax expenditures to Parliament.
- Report regularly to Parliament on the development of new tax avoidance products and the action being taken to mitigate their impact.
- Develop stronger checks and balances, to guard against the increasing complexity which is created by adding continually more reliefs.
- Dedicate sufficient resources to implement the policy, to simplify the tax system.
- Analyse and report clearly why the cost increases identified in paragraph 7 have occurred.

The annex to this report contains a set of good practice principles, which we believe a framework for the effective management of a well-designed tax relief, and system of reliefs, would include.

1 Accountability for tax reliefs

1. On the basis of a Report by the Comptroller and Auditor General, we took evidence from HM Revenue & Customs (HMRC) and HM Treasury (the Departments) on tax reliefs.[1] This is a wide-ranging topic and we see it is as our role to examine the effectiveness of tax expenditures—the tax reliefs that are most similar to spending programmes. In our role of considering value for money, it is for the Committee of Public Accounts to review the costs and impact of a relief against its policy intent, and to consider the cost of abuse.[2]

2. At the end of 2013 there were 1,128 tax reliefs in the UK. HMRC publishes data on around 400 each year. It has estimated the value of around 180 of these reliefs, 46 of which it has categorised as tax expenditures, in its published tables. HMRC does not categorise all the reliefs on which it publishes data, but has estimated that there may be around 150 tax expenditures, overall, across its tax streams.[3]

3. Some reliefs are pure policy decisions. Other reliefs, known as tax expenditures, are intended to encourage behavioural change. HMRC told us it took a 'purist' view of tax expenditures, compared to other countries. It explained that this meant it tried to capture the widest possible range of reliefs, within its definition of tax expenditure. Therefore, it included zero-rate and reduced-rate VAT within this category. However, the Departments acknowledged there was no clear definition of tax expenditures. HM Treasury told us that the objectives of tax policies could be broad, and it was rare to have detailed objectives for reliefs. The lack of clarity in defining tax expenditures added to the difficulties in determining their objectives, and in examining their effectiveness. As the cumulative cost of tax reliefs is billions of pounds a year, the absence of examinations into their effectiveness, in achieving any detailed objectives, is of huge concern.[4]

4. In 2010 HM Treasury committed, in *Tax policy making: a new approach*, to developing a framework for new reliefs. This framework has still not been introduced. The framework was intended to ensure reliefs were considered carefully, and enacted only when there was a strong and proven case. HM Treasury told us it had put other measures in place, aimed at improving tax reliefs instead. It had increased the length of the consultation period for new legislation, and had introduced Tax Impact and Information Notes (TIINs). These were designed to consider a broader range of tax policy changes, than the previous impact assessment regime.[5]

5. Tax expenditures cost £101 billion in 2012–13. The Departments told us that each year they publish data on the costs of tax expenditures and structural reliefs. The Departments felt that this data gave people, and Parliament, the opportunity to make representations.[6]

1 C&AG's Report, *Tax reliefs*, Session 2013–14, HC 1256, 7 April 2014

2 Qq 1–2, 8–9, 136

3 Q 3; C&AG's Report, paragraphs 14, 24, 1.7

4 Qq 4–9

5 Q 57; C&AG's Report, paragraphs 23 & 2.10, Figure 16

6 Qq 2, 34

6. The data published by HMRC did not compare the actual costs of tax reliefs with forecast costs. When a revised form of film tax relief was introduced in 1997, officials had forecast it would cost £30 million in the first three years. However, its costs rose significantly, and reached nearly £700 million by 2005–06. It took ten years, at a total cost of over £2 billion, before HM Treasury and HMRC amended the relief to bring down the costs. A significant proportion of the costs incurred in film tax relief had not fulfilled the purpose of the relief, or the intention of Parliament. HMRC told us that it had taken a series of steps, from 1997 to 2007, in which it had put in place various restrictions for the relief, and that it had introduced each restriction after considering the policy perspective. However, it had not been Parliament's intention that the excessive cost of film tax relief should have been allowed to continue for so long. [7]

7. Such cost increases would not be tolerated in the same way if film tax relief had been provided as a grant programme. Other government departments are required to abide by the rules of *Managing Public Money* when administering a spending programme, but formal requirements do not exist for HM Treasury and HMRC in relation to tax reliefs.[8] The Departments are responsible for managing the tax system as a whole, and for implementing policy decisions, yet no individual accounting officer is assigned responsibility for managing tax expenditures, as would be the case for public spending. HM Treasury told us that no such an arrangement had been made before, because tax expenditures had always been regarded as different to spending programmes. HM Treasury acknowledged that, in principle, it could design a system where all reliefs were managed in the same way as public spending, with a dedicated accounting officer responsible for tax expenditures. HM Treasury said it is a decision for both Government and Parliament, whether or not to design such a system.[9]

7 Qq 12–13, 16–20

8 Qq 8, 16–17, 58–61

9 Qq 9, 16, 45–46, 59

2 Administering tax reliefs

8. While government policy has been for simpler taxes, the UK taxation system has become increasingly complex. Despite the fact that tax revenues as a proportion of GDP remain relatively stable over time, the tax code increases in length and complexity. The length of Finance Bills has increased from around 100 pages in the 1970s, to over 500 pages currently. The number of tax reliefs increased from 1,042 in March 2011, to 1,128 in December 2013. During this period, Parliament abolished 48 tax reliefs, but introduced a further 134.[10] Each new tax relief has made the tax system more complex, and provided an opportunity for avoidance and abuse, either individually or in conjunction with other reliefs. HMRC told us that it had put its best resources into designing tax reliefs to reduce the risk of abuse. However, rules which the Departments introduced to guard against potential abuse, could add further complexity to tax legislation.[11]

9. In March 2011, the Office of Tax Simplification (OTS) reviewed 155 tax reliefs and recommended that 47 should be abolished, either: because they had expired; there was no longer a policy rationale for them; the value of the relief was negligible; or the administrative burden outweighed the benefit. Forty three of these 47 tax reliefs were abolished, and the exceptions were: land remediation relief; capital gains compensation for mis-sold pensions; late-night taxies; and, national insurance contribution exemption for awards for the assistance with lost credit cards. The Departments told us they supported the work of the OTS, and HMRC agreed with OTS's view that there was a great deal of work to be done, to make tax simpler. However, OTS had only around six people working for it, and HM Treasury acknowledged that the role of OTS could be increased.[12]

10. HMRC told us its compliance work aimed to examine whether the conditions of a tax relief were being met. It pursued cases as tax avoidance, if it had determined that contrived and artificial arrangements were in place. We were pleased to note that HMRC was taking more cases of tax avoidance to tribunals. However the backlog is enormous and HMRC told us there are around 43,000 cases where it expected to receive payment for outstanding tax, and that as many as 17,000 of these related to film tax relief.[13]

11. The tax avoidance industry makes profits from devising and selling avoidance schemes. Some high-risk promoters, in particular, make money from their fees, rather than from any success of their avoidance schemes. It is questionable whether there are sufficient disincentives and sanctions in the system to prevent advisers from promoting aggressive tax avoidance schemes. HMRC was shifting to collecting the tax at the point where it had made inquiries, both to reduce the cost of administration in pursuing disputed tax, and to incentivise people who were participating in avoidance schemes, to reach an agreement.[14]

10 Qq 54–55, C&AG's report, paragraphs 14, Figure 3

11 Qq 14, 25, 54, 62–63, 66–67, 129

12 Qq 54–56; C&AG's report, paragraphs 14, 1.11

13 Qq 21–24, 134–135

14 Qq 64–65

12. HMRC told us it was looking to improve its systems, so that it could gain better information on how its customers were using reliefs. It hoped to design new services that provided tailored prompts for information to help with compliance. For example, higher risk companies might have to provide more information on how they calculated their tax.[15]

13. Good management information and feedback are essential to ensure problems with cost increases are addressed quickly, and the effectiveness of tax expenditure policies is constantly monitored. Escalating costs indicate that a relief needs further investigation, to ascertain whether it is being used appropriately.[16]

14. To get data on possible upsurges in the costs of reliefs, HMRC has to wait for it to come through on tax returns. This can be as long as two years after the relief has been used. HMRC explained that it was not always an increase in costs that would lead to questioning whether a relief is working as expected; other factors may also have an impact. It believed it was a case-by-case judgement, and changes should not necessarily be made just because costs had increased. HMRC wanted to avoid overreacting, so it might decide to wait to determine what was taking place before it made changes to a relief, particularly for tax expenditures that sought to bring about a behavioural change.[17]

15. Delays by HMRC in responding to abuse might increase the amount of public money at risk. In the case of film tax relief, it had taken ten years to resolve the problems and cost over £2 billion, after initial assessments by HMRC and the Treasury had predicted the tax relief would cost £30 million a year. The Departments acknowledged that even reliefs that cost relatively small sums of money were important, as they would add up to significant amounts over time.[18]

16. The introduction of the Disclosure of Tax Avoidance Schemes (DOTAS) system had allowed HMRC to react more quickly to avoidance schemes. It was now able to make changes to legislation within days of having a disclosure through DOTAS. HMRC gave us the example of the quick changes it had made to the Seed Enterprise Investment Scheme to limit the relief and to stop an unintended connection between it, and a relief for renewable energy.[19]

17. The National Audit Office identified 26 tax reliefs which had increased in cost by more than 50% in real-terms in the past ten years, and 30 that had increased in cost by more than 25% in real-terms in the past five years. A large proportion of the increase for two of the reliefs related to changes in the rate of VAT. For these reliefs, HMRC told us that it would not evaluate the change in cost, because it already knew the reason for the increase. HMRC told us some of the other reliefs identified by the National Audit Office were relatively small. HMRC considered that while small reliefs were worth monitoring, it might not be worth spending much time or money to evaluate them.[20]

15 Qq 107–108

16 Qq 20, 26, 137

17 Qq 31–33, C&AG's report, paragraph 3.24

18 Qq 12–13, 132

19 Qq 31–33

20 Qq 35, 42– 44

18. The main focus of HM Treasury was to monitor major changes in the value of tax receipts. It depended upon HMRC for this information. Between 1999–2000 and 2012–13, the value of agricultural property relief and business property relief had increased by 160% and 200% respectively, but Inheritance Tax revenue had risen by only 10% over this period. HM Treasury said that while such an increase would be reported to Ministers, the total annual costs of agricultural property relief and business relief were relatively small (currently, £370 million and £385 million respectively).[21]

19. HMRC told us that it undertook a great deal of monitoring of reliefs, and that this could be through both published evaluations, and the work it carried out internally. Smaller reliefs received a different level of monitoring to larger reliefs. HMRC did not provide full details of its monitoring approaches for different types of reliefs. However, it said those reliefs with negligible cost (which it defined as costing £2.5 million or less a year) were ones on which it did not do a great deal of work.[22]

20. The Departments told us they did not carry out options appraisals for all reliefs and did not always undertake a full evaluation, because they reviewed risks as they emerged. In particular, they considered that they had improved the design of reliefs to reduce the risk of abuse, and the need for evaluation.[23]

21 Q 29; C&AG's report, paragraph 24

22 Qq 4, 34–35, 37–39

23 Qq 8, 58–61

Annex 1

Good practice principles for the effective management of tax reliefs

We believe a framework for a well-designed tax relief, and system of reliefs, would include:

- **A clear definition of tax expenditures,** so it is easy to understand the number and value of these types of reliefs and they can be monitored appropriately;
- **Assessing the effectiveness of tax expenditures,** using the same basic principles as for spending programmes;
- **Establishing the policy objectives** of a relief, so it is possible to evaluate the relief ;
- **Understanding the costs and benefits,** including the costs of abuse;
- **Measuring behavioural change** as a result of the relief's introduction, to assess whether it has resulted in the intended behaviour change;
- **Setting clear parameters** for monitoring the cost and impact of reliefs, such as establishing what changes in costs will trigger feedback to policy makers;
- **A responsible attitude to promoting take-up,** to ensure target groups can use the relief.

Formal Minutes

Monday 9 June 2014

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon
Guto Bebb
Chris Heaton-Harris
Meg Hillier
Mr Stewart Jackson
Mrs Ann McGuire
Austin Mitchell
Nick Smith
Justin Tomlinson

Draft Report (Tax reliefs), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 20 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Annex agreed to.

Resolved, That the Report be the Third Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Monday 16 June at 3.00 pm

Witnesses

Monday 17 April 2014 *Page*

Sir Nicholas Macpherson, Permanent Secretary, HM Treasury and **Lin Homer**, Permanent Secretary and Chief Executive, HM Revenue and Customs Q1-137

List of printed written evidence

1 HM Revenue And Customs (REL0001)

2 HM Treasury (REL0002)

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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Second Report	Help to Buy equity loans	HC 281