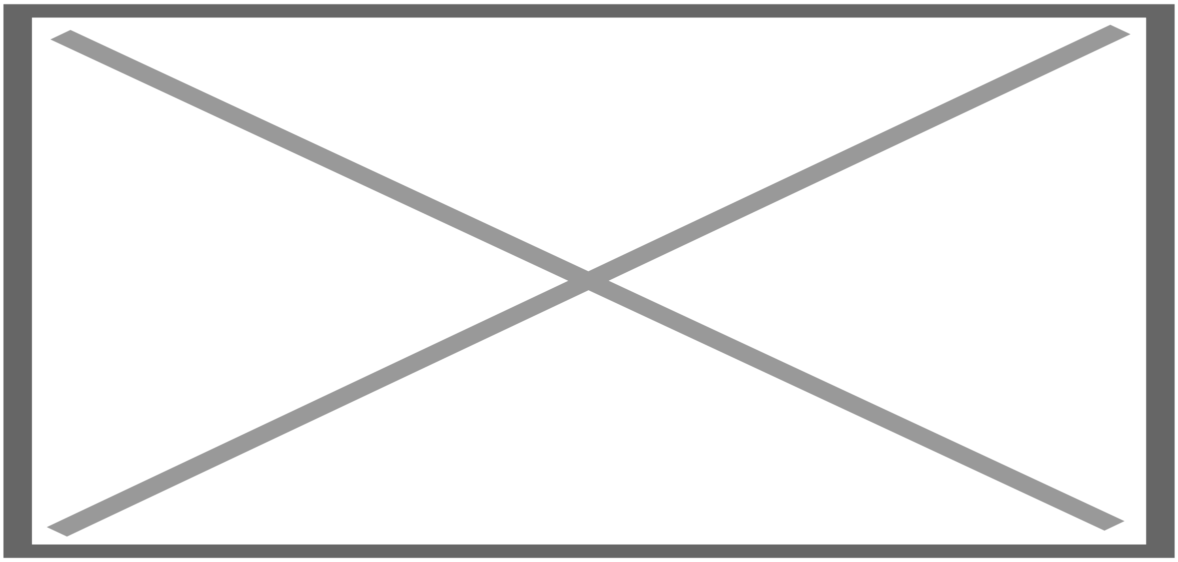
Working it out

Large Corporate | OMB | Personal tax



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Bill Dodwell considers the options regarding tax reliefs

The very first project undertaken by the Office of Tax Simplification looked at tax reliefs. The OTS concluded in 2011 that there were ‘1,042 reliefs, allowances and exemptions’ within the tax system. It examined 155 reliefs and concluded that 54 should remain unchanged, 17 simplified, and 47 abolished. More work was needed on the others.

The National Audit Office has looked at reliefs in two reports. In 2013, it was estimated that there were now 1,128 reliefs which ‘cost’ £334 billion. The biggest reliefs are the income tax personal allowance (£68.5 billion), the thresholds for national insurance contributions (£44 billion) and VAT zero-rating on food (£15 billion). Loss relief for individuals and companies is important, as are capital allowances (£21 billion) and interest expense. Exempt amounts for inheritance tax (£18 billion) and capital gains tax (the £10 billion principal private residence exemption) also cost a great deal. In all cases the costings assume that extra tax would be paid if they were abolished, ignoring behavioural effects and indeed the ability to pay.

The total cost of reliefs categorised by the NAO as having similar objectives to spending programs was £101 billion. The largest amount here was tax relief on pension contributions (£23 billion). R&D tax credits are a small part of the total (just £1.2 billion then, although £2 billion now), as is the film tax credit and the other creative industries schemes (in total just under £1 billion). EIS and VCT reliefs cost £565 million. Gift Aid costs £1.5 billion.

One of the criticisms levied at HMRC is that the Department does not monitor tax reliefs to assess their cost and whether they achieve the policy impact intended. For example, the NAO highlighted the big increase in entrepreneur’s relief which cost £2.9 billion in 2013/14 – three times more than originally expected. There was no easy explanation for the increase, leading the NAO to wonder whether there was undetected avoidance. The

NAO also highlighted a major increase in claims for income tax relief on share losses, which turned out to be due to marketed avoidance schemes, not detected sufficiently swiftly (although HMRC are now winning cases before the Tribunal).

HMRC has recently produced data on the creative industries' schemes. Film tax relief was introduced in 2007. There were 175 films completed in the UK in 2016/17 which claimed £415 million of tax relief, with UK expenditure of almost £1 billion. Since the relief was introduced in 2007, 2,070 films have made claims, accounting for £8.9 billion of UK expenditure.

A total of £2.3 billion has been paid out since January 2007, of which over £1.6 billion were tax credit claims paid to large-budget films and over £630 million to limited-budget films.

High end TV relief was introduced in 2013. 45 television programmes were completed in the UK in 2016/17, with UK expenditure of £480 million and tax relief of £163 million. Since 2013, 205 programmes have made claims, supporting £1.5 billion of UK expenditure. £374 million has been paid out on 360 claims since 2013.

The reliefs only support culturally British films and TV mini-series – a requirement for EU state aid approval. Ministers have highlighted the UK expenditure in making these films and programmes and consider that without the tax subsidy less money would be spent in the UK. Other countries also offer support for film-making – so it is quite possible that less activity would take place in the UK without the reliefs. Given that the UK has a strong presence in creative industries the money is argued to support and grow the sector.

The challenge for tax policy making is that this topic has excited political focus on all forms of relief. Many of the reliefs are simply a UK way of giving tax relief for business costs (e.g. capital allowances instead of accounting depreciation). Loss relief, including within groups, simply leaves tax levied on the economic profit of the business over a period of years. Other reliefs are simply part of the structure of a particular tax. For example, a tax might be designed by specifying narrow circumstances when it applied. Alternatively, it could be designed with a broad ambit, subject to a range of reliefs. The latter approach makes the tax less susceptible to avoidance – but does produce more 'reliefs'.

Pension tax relief is unusual, in that for the most part it is simply a tax deferral. The true incentive element is the 25% tax-free lump sum where no tax at all is levied. Offering initial tax relief is aimed at encouraging individuals and their employers to invest in pensions now. The pay-out is taxed eventually, although some will benefit from tax relief at higher rates than they end up paying on the income. Capping the relief available to additional rate taxpayers has solved one perceived inequity; it remains possible that higher rate relief could be limited in future

The open question is what the economic consequence might be of abolishing those reliefs intended to encourage investment or support other social objectives. More data from HMRC would help the analysis but economics alone is unlikely to decide future tax policy.