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Management of tax reliefs

Twelfth Report of Session 2019–21

Report, together with formal minutes relating to the report

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The Committee of Public Accounts

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Summary

Tax reliefs have an enormous impact on tax revenue but it is far from clear whether they deliver the economic and social objectives many are supposed to support. The full cost of tax reliefs that support government's economic and social objectives is not known and could exceed £159 billion a year. We have long been concerned that tax reliefs are not sufficiently evaluated to ensure they are delivering what was intended when they were introduced. The impact of Covid-19 on public finances means that it is ever-more important that tax reliefs are demonstrably cost-effective. Despite our repeated examination of this topic since 2013, HM Treasury and HM Revenue & Customs (HMRC) have made unacceptably slow progress in improving their management of tax reliefs. It is staggering that they still have insufficient understanding of the cost and value for money of tax reliefs, as well as who benefits from them. Tax reliefs need rigorous challenge, as costs can be much higher than expected and their benefits are not always evident. HM Treasury and HMRC need to make a step change in their understanding and administration of reliefs. The current pressures on the public finances require an immediate and fast response. They must do more and focus on the largest and riskiest tax reliefs.

There is little incentive for the departments to investigate how tax reliefs are working unless they fall in an area of current policy development. This must change, and the departments should not need to wait for ministers' say-so to administer reliefs properly. HMRC and HM Treasury need to markedly improve their reporting on the cost, beneficiaries, and impact of tax reliefs in order to give Parliament the information it needs to scrutinise the value for money of these schemes. We look to HM Treasury and HMRC to provide this information quickly.

Introduction

Tax reliefs reduce the tax an individual or business owes. Many tax reliefs, such as the income tax personal allowance, are integral parts of the tax system and define the scope and structure of tax. The UK also had 362 tax reliefs at October 2019 where government opts not to collect taxes due in order to support social or economic objectives. Some of these tax reliefs reflect policy decisions to support a particular group or sector, such as the housing market. Others are designed to incentivise the behaviour of individuals or businesses by making a choice less costly, such as tax reliefs on pension contributions, or reliefs on research and development expenditure.

HMRC is responsible for estimating and reporting on the cost of tax reliefs. It has reported estimates for 158 reliefs with economic and social objectives. These estimates indicate that their aggregate cost could be £159 billion a year. The additional tax that would be collected if these reliefs were removed is likely to be less than £159 billion as some taxpayers would respond by changing their behaviour and there may be wider economic impacts. The cost of the remaining 204 reliefs with economic and social objectives is not known. HM Treasury and HMRC (the exchequer departments) work in partnership and oversee tax reliefs. HM Treasury leads on the design of tax reliefs and monitors their value for money and relevance. HMRC implements tax reliefs, monitors their use and cost, and evaluates them.

Conclusions and recommendations

1. **We are concerned that HMRC does not understand the impact of any of the largest tax reliefs, including reliefs on pensions which were forecast to cost £38 billion in 2018–19.** In March 2015, we reported that HMRC did not systematically evaluate the effectiveness of all tax reliefs intended to change behaviour. In the five years since then, HMRC has not evaluated any of the ten largest tax reliefs supporting government's economic and social objectives. These reliefs cost £117 billion a year, around 5% of the UK's gross domestic product. Those evaluations it has undertaken show mixed results, with only one of the four reliefs costing over £1 billion having a positive impact on behaviour. Despite the large cost of reliefs on pensions, HMRC has not evaluated what benefit these reliefs provide.

Recommendation: HMRC should:

- *within 3 months, establish and publish the criteria it will use to determine which reliefs to evaluate; and*
- *within 12 months, have evaluated the impact of pension tax reliefs.*

HMRC should report back to us to update on progress in these regards, within 3 months, and 12 months respectively.

2. **HMRC and HM Treasury are insufficiently curious about the impact of some key tax reliefs on different groups.** Data on who benefits from tax reliefs are crucial to understanding whether they are achieving their intended objectives and to informing decisions about which tax reliefs need amending. When he announced in the 2020 Budget that he was reforming entrepreneurs' relief, the Chancellor stated that the relief was unfair, with nearly three quarters of the £2 billion a year cost benefiting just 5,000 individuals. However, HMRC does not collect and report data on who benefits from all major tax reliefs. It does not, for example, distinguish between subsidising new luxury properties or affordable homes that are built as a result of the £15 billion VAT relief on the construction of new dwellings, and subsequently does not know who benefits from the tax relief. The data HMRC publishes on who receives pensions reliefs is limited and we are concerned that some groups are not benefiting from tax relief on their pension when they should. For example, around 1.75 million low-paid and part-time workers earning less than the personal allowance of whom around three quarters are women, will not be getting tax relief on their pension contributions after being auto-enrolled into employer pensions.

Recommendation: HMRC should assess the groups and sectors benefiting from all significant reliefs and publicly report the results during 2021. For pension reliefs, HMRC should publish data showing who is benefiting, split by: income; groups with protected characteristics such as gender, age, ethnicity; people working in the public and private sectors; and people in defined contribution and defined benefit schemes.

3. **The exchequer departments are not transparent with Parliament on which tax reliefs need to change taxpayer behaviour for government objectives to be achieved.** Tax reliefs that are designed to change behaviour require more attention

than those which are intended to simply benefit a specific group because it is uncertain how taxpayers respond to tax incentives. The objectives of a tax relief are not always clear. It is difficult for Parliament to scrutinise a tax relief if the exchequer departments do not set out what they intend the relief to achieve. In 2019, HMRC completed a provisional assessment of which tax reliefs had behavioural objectives, but it has not finalised that assessment or published it. While this assessment would help parliamentarians, there is also a need for information on the specific objectives of each relief which aims to change behaviour. In its public reporting, HMRC describes reliefs but does not state their objectives.

Recommendation: *HMRC should, within three months, publish a list of all new and existing reliefs with objectives that include changing behaviour and specify the objectives of each.*

Recommendation: *For any new or amended tax reliefs HM Treasury should identify in the Budget's supporting documents whether they are intended to change taxpayer behaviour and how the government will measure whether that objective has been met.*

4. **HMRC cannot explain why the cost of some tax reliefs is considerably greater than government forecasts presented to Parliament.** Government forecasts of the cost of tax reliefs are prepared by HMRC and scrutinised by the Office for Budget Responsibility (OBR). The costs of some new tax reliefs are double the government's published forecasts. For example, the research and development scheme introduced in 2013 for large companies now costs over £2 billion a year, twice what HMRC expected when it was introduced. In July 2019 the OBR concluded that the cost of tax reliefs was poorly understood. HMRC does not compare the costs of reliefs to forecasts and is therefore not well-placed to investigate the reasons for cost variances or report differences to Parliament. HMRC has committed to publicly reporting variances between the forecast and actual cost of tax reliefs.

Recommendation: *HMRC should, as part of its next annual statistical publication on tax reliefs due in October 2020, identify all significant cost variances within tax reliefs, and report the reasons for those variances, explaining whether variations in cost are proportionate to the impact of the relief.*

5. **HMRC and HM Treasury do not publish sufficient information on the value for money of tax reliefs to enable Parliament to hold government to account.** In response to examinations by this Committee, HMRC now publishes a list of all tax reliefs which support government objectives, and now reports costs for 158 of these reliefs, up from 46 in 2014. However, since our last major report in 2015, HMRC has published evaluations of the impact of just 13 tax reliefs. Although it claims to undertake internal assessments of reliefs, HMRC cannot show which reliefs it has evaluated internally. In 2017, HM Treasury began to make assessments of the value for money of tax reliefs. When assessing value for money, HM Treasury considers factors such as how the cost of the tax relief compares to forecast, the extent of behaviour change and deadweight loss, and consideration of spending alternatives. HM Treasury does not publish its value for money assessments as it asserts they

are policy advice to ministers and do not represent the formal position of the department. Published information on factors covered by the assessments would help Parliament to hold government to account for their use of tax reliefs.

Recommendation:

- *HMRC should ensure that the results of internal, as well as external, evaluations are published, and are easily accessible to Parliament and the public*
- *HM Treasury should in 2021, prepare its first annual report setting out the results of its value for money assessments of tax reliefs.*

6. **HMRC and HM Treasury are far too slow in identifying and responding to some of the most serious problems identified with reliefs, including cases of abuse.** In June 2014, we found that the exchequer departments did not respond promptly to unexpected increases in the costs of tax reliefs. In March 2015, we questioned whether entrepreneurs' relief was value for money given that it was then costing £2 billion more than forecast. Despite our concerns, entrepreneurs' relief was not fully evaluated until 2017. This evaluation found that at the point they invested only 8% of claimants reported that their behaviour had been influenced by the relief, but this finding was not acted on until the 2020 Budget. Between April 2015 and March 2019, entrepreneurs' relief cost £11 billion. Companies with a minimal UK presence are abusing the £2 billion research and development relief for small- and medium-sized enterprises by exploiting a change to legislation made in 2012. Although HMRC identified the issue in early 2018, and is planning to introduce a new control that will restrict what companies with a limited UK presence can claim, the abuse is expected to continue to at least 2022–23, partly because of the time to identify and address the issue. HMRC estimates that the amount of money that is claimed through the relief but which would have been excluded by the latest proposed cap has risen from £70 million in 2016–17 to £130 million in 2020–21. This includes both claims that HMRC could challenge as abusive, and other claims where the exchequer was subsidising companies that were not doing research and development in the UK and which the cap would restrict. In 2019, HMRC forecast that introducing a new control on claims could save the Exchequer around £45 million a year. Officials must take the lead when problems with reliefs arise and, where necessary, quickly advise ministers about the action that could be taken.

Recommendation: *HMRC and HM Treasury should, within 3 months, write to the Committee to explain how they will accelerate their response when reliefs are costing much more than expected, are subject to abuse, or are not achieving their objectives.*

1 Understanding the impact of tax reliefs

1. On the basis of a report by the Comptroller and Auditor General, we took evidence from HM Treasury and HM Revenue & Customs (HMRC).¹

2. Tax reliefs reduce the tax an individual or business owes. In October 2019, the UK had 1,190 tax reliefs. There are two broad categories of tax reliefs: structural tax reliefs that are largely integral parts of the tax system and define the scope and structure of tax (such as the income tax personal tax allowance); and non-structural tax reliefs where government opts not to collect tax to support social or economic objectives. The UK had 362 of these non-structural tax reliefs in October 2019. Some of these tax reliefs reflect policy decisions to support a particular group or sector, such as the housing market. Others are designed to incentivise the behaviour of individuals or businesses by making a choice less costly. These include tax reliefs on pension contributions and reliefs on research and development expenditure by business.²

3. Ministers propose the introduction or amendment of tax reliefs, and Parliament scrutinises proposals as part of the Budget process. Ministers depend on the exchequer departments—HM Treasury and HMRC—to work in partnership and oversee tax reliefs and provide advice. HM Treasury leads on the design of tax reliefs and monitors their value for money and relevance. HMRC implements tax reliefs, monitors their use and cost, and evaluates them.³

The cost of tax reliefs

4. HMRC is responsible for estimating and reporting on the cost of tax reliefs. In October 2019, HMRC reported the cost of 111 of the tax reliefs which are designed to support the government's economic and social objectives. These tax reliefs had a combined forecast cost of £155 billion in 2018–19.⁴ In May 2020, HMRC reported provisional costs for 47 more tax reliefs, which had a combined annual cost of £4 billion.⁵ Aggregating the cost of tax reliefs gives a sense of their scale, but it does not reflect the amount of tax that would be generated if they were removed as some taxpayers would respond by changing their behaviour and there may be wider economic impacts. In 2018–19, the ten largest tax reliefs had a combined forecast cost of £117 billion, which was around 5% of the UK's Gross Domestic Product. The ten largest included reliefs on employer and employee pension contributions. The cost of these two reliefs combined had a total forecast cost of £38 billion.⁶

1 C&AG's report, The management of tax expenditures, Session 2019–20, HC 46, 14 February 2020

2 C&AG's report, paras 1, 3 and Figure 1

3 C&AG's report, para 4

4 C&AG's report, paras 9–10, 1.5–1.6

5 HMRC, Non-structural tax reliefs –Additional cost estimates, 20th May 2020. Costs are not reported for the other 204 tax reliefs with economic and social objectives.

6 C&AG's report, para 3 and Figure 3; HM Treasury, [GDP deflators at market prices, and money GDP March 2020 \(Quarterly National Accounts\)](#), April 2020

Evaluating the impact of tax reliefs

5. In March 2015, we examined the management of tax reliefs by HMRC and HM Treasury. We concluded that HMRC did not systematically evaluate the effectiveness of all tax reliefs intended to change behaviour and found that some reliefs which had existed for many years had not been evaluated. We welcomed HMRC's acceptance that it should be accountable for assessing, monitoring and evaluating tax reliefs. We recommended that it should regularly evaluate and report on whether tax reliefs designed to influence behaviour were achieving the desired impact and were doing so in a cost effective manner.⁷ In its response, HMRC disagreed with the recommendation, contending at the time that it was not practical to evaluate all reliefs with behavioural objectives on a regular basis. Nevertheless, the Department also stated that it had a substantial number of analysts preparing evaluative work in-house to inform tax policy development.⁸

6. In the five years since March 2015, HMRC published evaluations of the behavioural impact of just 13 of the approximately 150 reliefs that aim to change behaviour. None of the ten largest tax expenditures were covered by these evaluations and only four of the tax reliefs costing over £1 billion a year were covered. Of these four, the evaluations found that the research and development relief for small- and medium-sized enterprises (annual cost £2 billion) had a positive impact on behaviour and gift aid (£1 billion) had some impact on behaviour. The other two reliefs—entrepreneurs' relief and employment allowance (both costing £2 billion)—had limited impact on behaviour.⁹

7. We were dissatisfied at the fact that none of the ten largest tax reliefs had been properly externally reviewed by HMRC.¹⁰ We asked HMRC why it had not evaluated any of these reliefs, such as pension reliefs. HMRC explained that cost was only one factor it took into account in selecting which reliefs to evaluate. It told us that some large reliefs, such as VAT relief on food, were difficult to evaluate because they are in a sense structural reliefs. It explained that it also took into account how likely a tax relief was to achieve its intended impact. This was particularly the case for those reliefs which were designed to achieve a specific behavioural economic change, which HMRC considered were easier to evaluate because their effects could be more marginal.¹¹ HMRC also told us that it needed to consider which tax reliefs “politicians might be interested in reforming” as there was little point in spending money on evaluating a tax relief in an area where there was no appetite to reform. HMRC told us that it was keen to move towards an increasingly systematic approach for deciding which tax reliefs to evaluate, prioritising the largest reliefs that seek to incentivise behaviours. It explained that it would also apply other criteria to this, including strategic fit, priority and urgency, and the likely impact of the research.¹²

8. The need for greater monitoring of the impact of tax reliefs was also raised with us by key stakeholders in the sector. We heard from the Chartered Institute of Taxation, which raised concerns about “the almost total lack of attention, at least so far as is visible to the outside world, as to how effective those measures prove over time.” It also contended

7 Committee of Public Accounts, *The effective management of tax reliefs*, Forty-ninth Report of Session 2014–15, HC 892, March 2015

8 HM Treasury, *Treasury Minutes Government responses on the Thirtieth, the Thirty Fifth, the Thirty Seventh, and the Forty First to the Fifty Third reports from the Committee of Public Accounts: Session 2014–15*, July 2015

9 C&AG's report, paras 1.5, 3.3, 3.6, Figure 14

10 Q 52

11 Qq 46–47

12 Qq 40, 63

that a key part of HMRC’s policy maintenance responsibility should be making sure that tax reliefs are achieving their objectives at reasonable cost. The Institute argued that this should be undertaken as part of a programme of regular reviews which monitors their take up, the cost of the relief, and whether it is having the desired impact on behaviours.¹³

9. Evaluations typically cost between £50,000 and £250,000. The NAO estimated that HMRC had spent around £2 million on evaluating tax reliefs since 2015. HMRC has an annual central research budget of £2 million per year to fund evaluations of tax reliefs and other research to inform its wider business and HM Treasury priorities.¹⁴ We asked HMRC why it spent so little on evaluations compared to the value of taxes. It explained that its £2 million budget was for external research only and that it also undertook internal evaluations and analysis. However, it had no central record of the research it had conducted internally.¹⁵ HMRC was also unable to tell us how much it had spent on internal research, and in written evidence submitted after the hearing stated that it did not record activity spent on reviewing reliefs internally.¹⁶ HMRC accepted that it was important for it to focus on bringing together its internal analysis and publishing whatever information it could.¹⁷

10. Tax reliefs on pensions contributions, designed to encourage people to save for their own personal pensions, are among the largest tax reliefs. HMRC forecast that the gross cost of these reliefs totalled £38 billion in 2018–19.¹⁸ We were concerned by claims that the tax relief was not being taken up and was also potentially not encouraging savings in real terms. HM Treasury asserted that take-up of pension tax relief had “grown over time” and that there was some evidence that “amongst some people it is quite a popular product,” but did not provide details on this.¹⁹

11. We asked how the exchequer departments could be sure of the impact that pension tax reliefs were having if they had not evaluated them. HMRC asserted that pension reliefs had been subject to extensive evaluative attention, with “virtually no stone left unturned” as part of work to strengthen the incentive to save in 2015. However, it also accepted that it had not commissioned an external evaluation of the relief. HM Treasury added that it had undertaken substantial open consultation and research, including with focus groups, as part of its 2015 review, and that the Government had decided not to change the relief as a result. We encouraged HMRC and HM Treasury to commission a full external evaluation of the relief and to publish the information it held on the relief in order to encourage and support debate on this issue.²⁰

Identifying who benefits from tax reliefs

12. HMRC collects and reports data on who benefits from some tax reliefs. For example, HMRC reports annually on the number of people gaining from entrepreneurs’ relief

13 Written Evidence MTE0002 – Mr Richard Wild, Chartered Institute of Taxation, published 10 June 2020

14 C&AG’s report, paras 3.4 and 3.5

15 Qq 40, 63 C&AG’s report, para 3.3, footnote 39

16 Q 41; Letter from Jim Harra, Chief Executive and First Permanent Secretary, HMRC, 26th June 2020

17 Q 63

18 Qq 32, 47; Written Evidence MTE0003 – Management of tax reliefs, Ruari Grant (Senior Public Affairs Associate, Standard life Aberdeen), and C&AG’s Report, para 9 and Figure 3

19 Qq 33, 47–48

20 Qq 47–48, 51

and how much they gain.²¹ In March 2020, as part of the 2020 Budget the Chancellor announced that he was reforming entrepreneurs' relief on the basis that the relief was expensive, ineffective and unfair. The relief cost over £2 billion a year and nearly three quarters of the cost benefited just 5,000 individuals.²²

13. We asked HMRC what assessment it had made to determine who benefited from another large tax relief, the VAT relief on the construction of new dwellings. HMRC forecast that the relief cost £15 billion in 2018–19. We asked whether the relief would distinguish between the benefit of someone spending large sums of money to build a single house, compared to another spending the same amount of money to build many more houses for low-paid families. HMRC told us that this tax relief was intended to incentivise the construction of new dwellings and encourage housebuilding. It explained that it considered the test of whether this was a success to be based on whether the relief reached the intended target part of the economy rather than who benefited.

14. We also asked who benefited from pension tax reliefs, and the split between different types of pensions. HMRC told us that its aim was to be fully transparent with all the information that it held, and referred to the work that had been undertaken to support the government's 2015 review of pension tax reliefs.²³ In September 2019, HMRC published data on the cost of different pension tax reliefs between 2012–13 and 2017–18. HMRC's data did not show which groups or sectors benefited from these reliefs, or how the reliefs were used by those working in the public and private sectors, or by those with defined contribution or defined benefit schemes.²⁴

15. We were concerned that the lack of available information on some large reliefs had meant that it was not possible for HMRC and HM Treasury to know whether all of those who were expected to benefit had been able to do so and whether a relief is working. We heard from Standard Life Aberdeen, who told us that lower-paid workers in specific groups, who most needed tax relief on their pensions contributions, were at most risk of missing out on this tax relief.²⁵ The financial services company Royal London estimated that around 1.75 million low-paid and part-time workers, auto-enrolled into employer pensions, were missing out on tax relief on their pension contributions.²⁶ Around three quarters of these workers are women.

16. We asked the exchequer departments when they would take action on the issue of workers not receiving pension tax relief.²⁷ HM Treasury said the Government recognises the different impacts of the two systems of paying pension tax relief on pension contributions for workers earning below the personal allowance. It referred to the Government's announcement in Budget 2020 that a call for evidence would be published in spring 2020 on this subject. The call was due to ask for views on how to address the different pension outcomes for lower earners, depending on whether their employer's pension scheme used the net pay or relief at source method of tax relief on their pension

21 HMRC, [Capital Gains Tax statistical tables](#), August 2019, Table 4

22 Budget Speech 2020, available at <https://www.gov.uk/government/speeches/budget-speech-2020>

23 Q51

24 HMRC, [Personal pensions: contribution and tax relief statistics](#), October 2019

25 Written Evidence MTE0003 – Management of tax reliefs, Ruari Grant (Senior Public Affairs Associate, Standard life Aberdeen) published 10 June 2020

26 Royal London, [New FOI reveals far more low-paid workers missing out on pension tax relief than previously thought](#), April 2019

27 Q49

contributions.²⁸ HM Treasury told us that in the light of COVID-19 the Government was considering the publication of this and other Government documents on a case by case basis. It planned to provide more information on the timeframe for publication of this call for evidence in due course.²⁹

28 Net pay is where the employer takes pension contributions from an individual's pay before it is taxed. Relief at source is where the employer takes pension contributions after tax and National Insurance has been taken from an individual's pay.

29 Q 49, Letter from Beth Russell, Director General, Tax and Welfare, HM Treasury, 26th June 2020 and HMRC, [Guidance – Pension schemes newsletter 118](#), March 2020; and HMG [Workplace pensions](#)

2 Transparency and reporting on tax reliefs to Parliament

Clarity of objectives for tax reliefs

17. When we examined tax reliefs in June 2014, we found that many tax reliefs were introduced without clear objectives. As part of our evidence session in 2014, HM Treasury told us that it was rare to have detailed objectives for reliefs, which we noted was a cause for huge concern.³⁰ In February 2020, the NAO reported that HMRC considers some tax reliefs to be difficult to evaluate because they have multiple or unclear objectives. For the new and revised tax reliefs NAO examined, HM Treasury had set objectives in general terms but did not provide baselines against which benefits could be measured. In its public reporting, HMRC describes reliefs but does not explain the objectives they are designed to achieve.³¹

18. Some tax reliefs incentivise behaviour, while others represent a choice by government to reduce the tax burden on particular groups or sectors. In 2019, HMRC completed an assessment of reliefs with economic and social objectives, resulting in them being grouped into three broad categories reflecting the broad type of outcome they were designed to achieve. Around 40% are designed to incentivise a specific behaviour, 40% to benefit a specific group, and 20% to serve a social purpose. This internal assessment was provisional. HMRC told us that the exchequer departments want to focus attention with their evaluations on those reliefs that are designed to achieve behaviour change. The NAO found that while HMRC's categorisation was useful in understanding the broad objectives of tax reliefs, it was not sufficiently detailed to be able to identify tax reliefs targeted at similar sectors or with similar objectives.³²

19. We asked the exchequer departments why new reliefs were being introduced with unclear objectives. HMRC responded that some tax reliefs were expected to apply to a certain group and reflected a political choice about who or what to tax. It gave the example of marriage allowance, which recognises marriage in the tax system. HMRC explained that it could demonstrate the extent to which those who were entitled to it were receiving it, but questioned what objective this would demonstrate and whether the success of this relief could be assessed by the numbers getting married or the length of marriages.³³ We also asked HM Treasury whether it was guilty of not giving Parliament sufficient clarity about the purposes of tax reliefs. It similarly explained that in some cases it was clear that a tax relief was intended to have a particular objective but in others it was a decision by Government to not levy tax on something. It asserted that in these cases, such as the decision not to charge VAT on food, the objective was simply to not tax a particular activity or group of people and the fact that the relief existed meant that the objective had been met.³⁴

30 Committee of Public Accounts, Tax Reliefs, Third Report of Session 2014–15, HC 282, June 2014

31 C&AG's report, paras 2.5, 3.5, 3.19 and Figure 9

32 Q 46, C&AG's report, paras 1.4, 1.20–1.21 and Figure 7

33 Q 42

34 Q43

Reporting on the cost and value for money of tax reliefs

20. When we examined tax reliefs in 2014 we found that HMRC published estimates of only 46 reliefs which had economic and social objectives.³⁵ Since then HMRC has responded to our recommendations that it be more transparent. In October 2019, it published for the first time a list of all 362 tax reliefs with economic and social objectives.³⁶ It has now reported costs for 158 of these reliefs and plans to reports costs for more reliefs over the next two years.³⁷ However, in its public reporting HMRC does not compare the cost of tax reliefs to published forecasts.³⁸

21. Government's published estimates of the costs of tax reliefs are prepared by HMRC and scrutinised by the Office for Budget Responsibility (OBR) in its role as the government's official forecaster. Higher costs can indicate that a tax relief is working well or that it is not being used as intended.³⁹ In 2014, we concluded that departments did not keep Parliament adequately informed of changes to the costs of tax reliefs. We also found that there was no feedback mechanism to alert Parliament if the actual cost of tax reliefs varied from HM Treasury's forecasts, on which Parliament had based its approval of the relief. We said that in the future we would look at what the exchequer departments had done to provide proportionate feedback and analysis to Parliament each year on the costs of principal tax reliefs (those costing more than £50 million annually), including significant changes in costs.⁴⁰ In their response, the exchequer departments said that the government was transparent about both the costs of existing reliefs and the costs and likely impacts of new reliefs with, for example, HMRC annually publishing information on the Exchequer cost of existing tax reliefs.⁴¹

22. HMRC has not compared the costs of tax reliefs to government's original published forecasts. The NAO examined the costs of ten tax reliefs introduced since 2013. Of these, the costs of four tax reliefs were at least double government's original forecasts. For example, the research and development scheme for large companies cost £2 billion in 2017–18 against a forecast of £1 billion when it was introduced. In July 2019, OBR reported that the cost of tax reliefs was poorly understood. It found that HMRC could not offer explanations for large changes in the cost of the research and development reliefs or entrepreneurs' relief.⁴²

23. We asked the exchequer departments whether reliefs costing double what HMRC had forecast meant that they were out of control. They asserted that they could not anticipate everything when they made their forecasts. They outlined factors that could affect costs including shifts in science and technology, reliefs driving changes in behaviours and changes in the economic determinants which underpin forecasts, such as the level of investment. They also stated that variances between forecasts and actual costs can occur because of changes in the underlying tax rates.⁴³

35 Committee of Public Accounts, Tax Reliefs, Third Report of Session 2014–15, HC 282, June 2014

36 HMRC, [Estimated Costs of Tax Reliefs](#), October 2019

37 HMRC, [Non-structural tax reliefs – Additional cost estimates](#), May 2020

38 C&AG's report, paras 3.18 and 3.19

39 C&AG's report, paras 2.16–2.17

40 Committee of Public Accounts, Tax Reliefs, Third Report of Session 2014–15, HC 282, June 2014

41 HM Treasury, Government responses on the Sixty First report (Session 2013–14) and the First to the Seventh reports from the Committee of Public Accounts: Session 2014–15

42 C&AG's report, paras 2.17, 2.24, Figures 10 and 11 (2017–18 is latest year for which data are available)

43 Qq 28, 36, 39

24. We asked HMRC and HM Treasury what action they took to follow up on cost forecasts and understand the actual costs of new tax reliefs. HM Treasury told us that there was a variety of reasons why the cost of a tax relief might be different to what was expected and that it kept the cost of reliefs under review. HMRC similarly asserted that it based its forecasts on modelling using the best evidence it had available but that unexpected changes, such as in exchange rates, could occur that could result in significant variances. HMRC confirmed that it was committed to increasing the transparency of the information it made available on costs and in its autumn 2020 statistical bulletin it would start including explanations for how costs compare to original forecasts.⁴⁴

25. In March 2015, we concluded that there was inadequate assessment of the value for money of tax reliefs.⁴⁵ In 2017, HM Treasury began to make assessments of the value for money of tax reliefs and by 2019 had assessed the value for money of 63 tax reliefs.⁴⁶ We asked HM Treasury how it assessed value for money. It explained that in considering a proposal for a tax relief it first tried to establish the ultimate objective and consider alternative ways of achieving that objective, such as through spending or regulation. It said it then looked at the relief's cost, likely impact including on behaviour, possible levels of deadweight loss⁴⁷ and the potential for fraud and abuse. It also explained it looked at how the relief would interact with the wider tax system, and then it made an overall assessment of the likely consequences of the new relief.⁴⁸ HM Treasury's value for money assessments of tax reliefs also often compare actual costs to the forecast cost of tax reliefs. HM Treasury's assessments of the value for money of tax reliefs contain information which could help Parliamentary scrutiny of tax reliefs. However, HM Treasury does not publish its value for money assessments as it asserts these to be policy advice to ministers which do not represent the formal position of the department.⁴⁹

44 Qq 28–29, 36

45 Committee of Public Accounts, *The effective management of tax reliefs*, Forty-ninth Report of Session 2014–15, March 2015

46 C&AG's report, paras 2.13, 3.8

47 The amount of relief going to taxpayers' whose behaviour is unchanged.

48 Q64

49 C&AG's report, paras 19, 3.13, Figure 15

3 Responding to problems with tax reliefs

26. In our June 2014 report on tax reliefs we concluded that the exchequer departments did not respond promptly to unexpected increases in the costs of reliefs. We found that HMRC took time to react when it noticed a cost increase as it wanted to ensure that its response was appropriate, but that this increased the amount of public money at risk.⁵⁰ In March 2015 we questioned whether entrepreneurs' relief was value for money given it was costing £2 billion more than forecast. HMRC told us that the cost variation was due in large part to changes in the scope of the relief. It told us that it had no evidence to suggest that there was systematic abuse of entrepreneurs' relief and no evidence to suggest that Parliament's intentions were not being achieved.⁵¹

27. In 2015, HMRC published a qualitative evaluation of entrepreneurs' relief but it only interviewed 17 claimants as part of the evaluation.⁵² In 2017, HMRC published a larger quantitative evaluation of entrepreneurs' relief which included interviews with 625 claimants. The 2017 evaluation found that at the point they invested, only 8% of claimants had been influenced by the relief.⁵³ The Chancellor referred to the results of this evaluation when he announced a major reform of entrepreneurs' relief in the 2020 Budget.⁵⁴ Over the period April 2015 to March 2019 entrepreneurs' relief cost £11 billion.⁵⁵ We asked the exchequer departments why it had taken them so long to conclude on the value for money of entrepreneurs' relief. HMRC responded that it had published information on the cost of entrepreneurs' relief which had informed the public debate and that it was a matter for ministers to decide which tax reliefs to amend. HM Treasury said that it required careful preparation to change a tax relief. It also told us that the rules covering entrepreneurs' relief had been changed following a review in 2017.⁵⁶

28. Research and development tax relief for small- and medium-sized enterprise is designed to support companies that work on innovative projects in science and technology.⁵⁷ The cost of the research and development relief for small- and medium-sized enterprises increased from £0.8 billion in 2014–15 to £2.2 billion in 2017–18. This increase was faster than any published forecasts suggested. The NAO found that the higher costs of the research and development relief for small- and medium-sized enterprises was in part due to abuse and poor-quality claims. The relief has suffered from abuse by companies with a minimal UK presence. This abuse started after a control was lifted in 2012 which had sought to ensure that companies claiming payments through the research and development scheme had not been arranged solely for this purpose. HMRC identified that companies were exploiting the removal of the control in early 2018, and the government is now planning

50 Committee of Public Accounts, Tax reliefs, Third Report of Session 2014–15 Report, together with formal minutes related to the report, HC 282, June 2014

51 Committee of Public Accounts, The effective management of tax reliefs, Forty-ninth Report of Session 2014–15, HC 892, March 2015

52 IFF Research, [Capital Gains Tax Relief – Research on Entrepreneurs' Relief and Business Asset Rollover Relief](#), February 2015

53 IFF Research, [Capital Gains Tax Entrepreneurs' Relief: Behaviours and Motivations – HMRC Research Report 456](#), May 2017

54 Budget Speech 2020, available at <https://www.gov.uk/government/speeches/budget-speech-2020>

55 C&AG's report, Figure 12

56 Q 63

57 HMRC, [Claiming Research and Development tax reliefs](#), March 2020

a further change in legislation to address this. It has proposed introducing a new control capping the payments a company can receive in a year. The cap will be linked to the amount a company pays in PAYE and National Insurance Contributions.⁵⁸

29. The cap was due to be introduced in April 2020, which would have given companies until 2022–23 to make claims under existing rules. HMRC estimated that the proposed changes would have saved the Exchequer around £45 million a year. However, at the 2020 Budget the government announced that it would change the design of its proposed cap to minimise the impact on legitimate business. It also announced that introduction of the cap would be delayed to April 2021.⁵⁹ We asked HMRC how much tax will have been lost to abuse before the new arrangements kick in.⁶⁰ HMRC estimated that the amount of money claimed through the relief which would have been excluded by the latest proposed cap was £70 million in 2016–17 and £130 million (forecast) in 2020–21. It explained that the estimate covered both claims that HMRC could challenge as abusive, and other claims where the exchequer was subsidising companies not doing research and development in the UK and which the cap would restrict. It also explained that its estimate did not represent the impact on the exchequer as it did not take account of how companies' behaviour would have changed in response to the cap. HMRC did not provide a separate estimate of the amount of tax lost.⁶¹

30. The main cause of lost tax on the research and development scheme for small- and medium-sized enterprises is from poor quality claims, which has been an issue since the scheme was introduced. We raised the issue with HMRC of the higher than expected number of claims for the relief and the role of agents in making these claims. HMRC said it was a relief that it had to police quite carefully. It explained it faced two issues. First, some businesses tested the boundary of the relief by arguing that their expenditure was within the scope of the relief. Second, agents produced some claims, but these were not to the standard that HMRC would have liked. HMRC told us that it had confidence in how it administered the relief, and that it placed a great deal of resource and attention into making sure that claims were right.⁶² HMRC set out the actions it had taken which included:

- allocating funding in 2020–21 for an additional 100 staff to be deployed predominantly on compliance activities, such as investigative work and risking claims;
- reorganising teams processing claims so that they were better able to manage peaks of work;
- from April 2019, requiring companies to provide more information to support claims; and
- working with agents and tax advisers to improve the standard of claims.⁶³

58 C&AG's report, paras 2.20–2.27 ad Figure 12; and HM Treasury, Open consultation – Preventing abuse of the R&D tax relief for SMEs: second consultation, March 2020

59 C&AG's report, para 2.27; HM Treasury, [Budget 2020 – Delivering on our promises to the British people](#)

60 Q 44

61 Letter from Jim Harra, Chief Executive and First Permanent Secretary, HMRC, 26th June 2020

62 Q 34, C&AG's report, para 2.27

63 Letter from Jim Harra, Chief Executive and First Permanent Secretary, HMRC, 26th June 2020

Formal minutes

Monday 13 July 2020

Virtual meeting

Members present:

Meg Hillier, in the Chair

Gareth Bacon	Shabana Mahmood
Sir Geoffrey Clifton-Brown	Mr Gagan Mohindra
Dame Cheryl Gillan	Nick Smith
Peter Grant	James Wild

Draft Report (*Management of 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 30 read and agreed to.

Summary agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Resolved, That the Report be the Twelfth 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 Thursday 16 July at 10:30am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the [inquiry publications page](#) of the Committee's website.

Wednesday 10 June 2020

Sir Tom Scholar, Permanent Secretary, HM Treasury; **Beth Russell**, Director General, Tax and Welfare, HM Treasury; **Jim Harra**, Permanent Secretary, HM Revenue and Customs; **Ruth Stanier**, Director General, Customer strategy and tax design, HM Revenue and Customs

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Published written evidence

The following written evidence was received and can be viewed on the [inquiry publications page](#) of the Committee's website.

MTE numbers are generated by the evidence processing system and so may not be complete.

- 1 Al Kaddour, Doctor Hosam ([MTE0001](#))
- 2 The BioIndustry Association ([MTE0008](#))
- 3 Charity Tax Group (CTG, Secretariat) ([MTE0007](#))
- 4 Chartered Institute of Taxation (Mr Richard Wild, Head of Tax Technical Team) ([MTE0002](#))
- 5 Institute for Family Business (Joe Cooper, External comms support) ([MTE0006](#))
- 6 Ntim, Professor Collins ([MTE0001](#))
- 7 Standard Life Aberdeen (Ruari Grant, Senior Public Affairs Associate) ([MTE0003](#))

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the [publications page](#) of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2019–21

First Report	Support for children with special educational needs and disabilities	HC 85
Second Report	Defence Nuclear Infrastructure	HC 86
Third Report	High Speed 2: Spring 2020 Update	HC 84
Fourth Report	EU Exit: Get ready for Brexit Campaign	HC 131
Fifth Report	University Technical Colleges	HC 87
Sixth Report	Excess votes 2018–19	HC 243
Seventh Report	Gambling regulation: problem gambling and protecting vulnerable people	HC 134
Eighth Report	NHS capital expenditure and financial management	HC 344
Ninth Report	Water supply and demand management	HC 378
Tenth Report	Defence capability and Equipment Plan	HC 247
Eleventh Report	Local authority investment in commercial property	HC 312