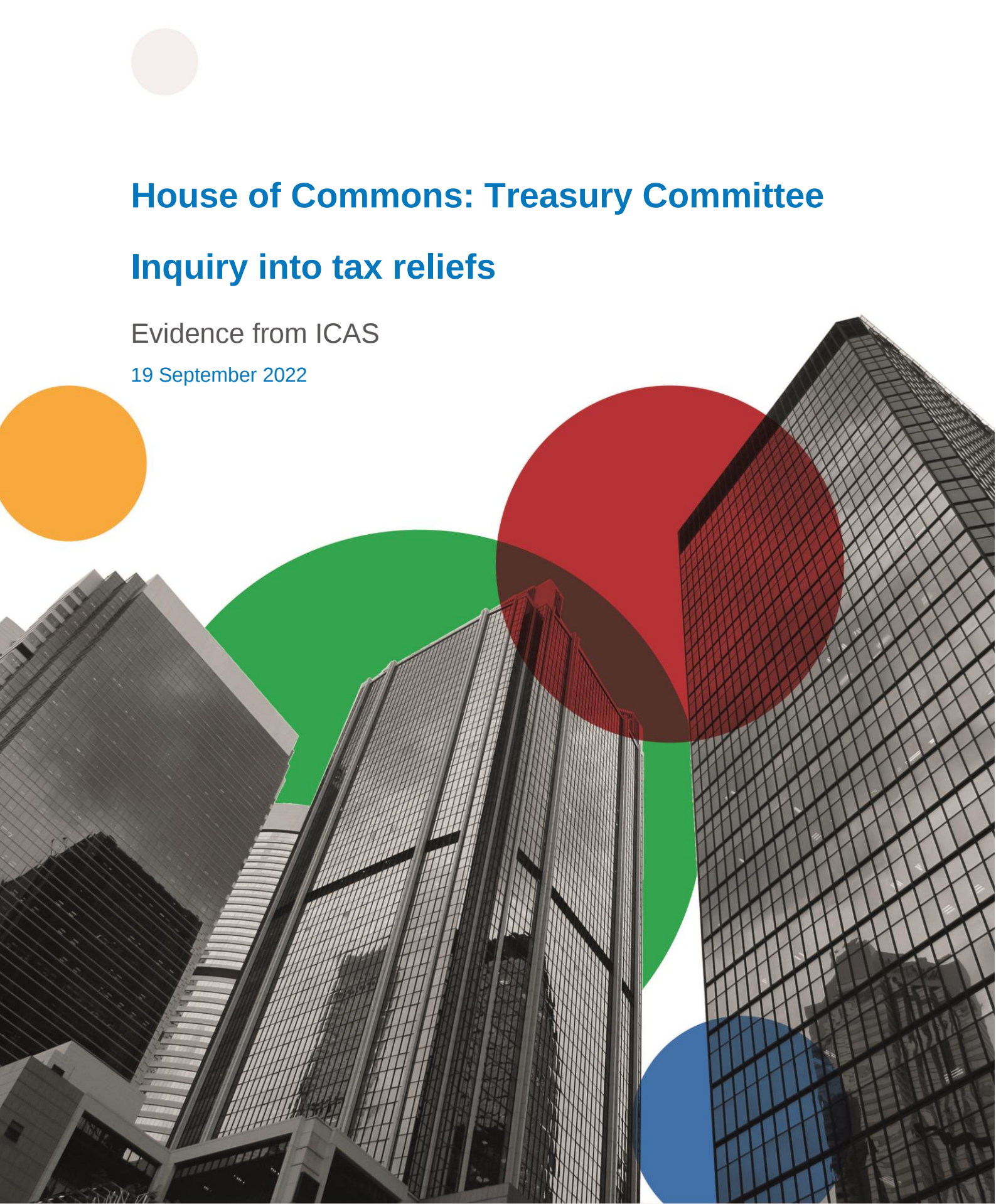




House of Commons: Treasury Committee

Inquiry into tax reliefs

Evidence from ICAS

19 September 2022

About ICAS

1. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants. We represent 23,000 members working across the UK and internationally. Our members work in the public and not for profit sectors, business and private practice. Approximately 10,000 of our members are based in Scotland and 10,000 in England.
2. The following submission has been prepared by the ICAS Tax Board. The Tax Board, with its five technical Committees, is responsible for putting forward the views of the ICAS tax community; it does this with the active input and support of over 60 committee members.
3. ICAS has a public interest remit, a duty to act not solely for its members but for the wider good. From a public interest perspective, our role is to share insights from ICAS members into the many complex issues and decisions involved in tax and regulatory system design, and to point out operational practicalities.

General comments: the need for tax simplification

4. The underlying complexity of the UK tax system causes considerable difficulties for taxpayers and HMRC. It increases costs for everyone engaging with the tax system. Complex tax law is reflected in complex tax administration systems which are difficult to use and do not facilitate compliance. HMRC and taxpayer resources are diverted into dealing with corrections, appeals and disputes. Increased digitalisation has the capacity to improve tax administration but without simplification of the underlying rules, the full benefits will not be realised. Tax reliefs and allowances contribute to this complexity, not least because there are so many of them.
5. The Office of Tax Simplification (OTS) produced its [final report](#) on tax reliefs in 2011. The OTS identified 1,042 reliefs, allowances and exemptions – and recommended that a number should be abolished or reviewed. Following the review, the Government did abolish over 40 reliefs (7 of which had expired) – this probably removed over 100 pages of legislation. However, in 2014 an [updated list of reliefs](#), produced by the OTS showed that there were 1,140 reliefs. There will be more now.
6. Some reliefs and allowances are useful, particularly those which remove the need for taxpayers to file returns to report small amounts of income and gains, where the administrative costs and burdens would almost certainly exceed any tax collected. It is very important for these reliefs to be periodically updated, to prevent their usefulness being eroded over time.
7. The Government may consider that other reliefs are essential to support its business policy objectives. For these reliefs it is important that businesses have a degree of certainty and stability. These reliefs need to be kept under review to ensure that they remain in line with Government policy.
8. Ongoing review of reliefs and allowances could also take into account whether some reliefs are particularly associated with abuse and avoidance schemes. This would help the Government and HMRC to identify actions to counter abuse quickly, without making the reliefs excessively difficult to access for legitimate purposes – or in some cases other forms of support could potentially be considered instead.
9. ICAS believes that an immediate decrease in the complexity of the UK tax system could be achieved by repealing outdated tax reliefs where the continuation of the relief cannot be justified on a cost/benefit analysis. All tax reliefs and allowances should be reviewed regularly to examine whether they continue to achieve their intended objectives – and whether the objectives remain valid. In some cases it might be helpful for new reliefs to include a 'sunset' clause so that action would need to be taken to retain them.
10. It would be useful for the OTS to be asked to revisit its work on tax reliefs – if the Government is prepared to consider removing additional reliefs, where they add to complexity without providing

significant benefits. ICAS believes that there is considerable scope for further simplification in this area.

Certainty and stability – business tax reliefs

11. ICAS believes that a predictable and sustainable tax regime is necessary to support long term economic performance. Businesses need to be able to plan for the future; stability and certainty are particularly important in the tax system – including tax reliefs. If reliefs change constantly, or may be withdrawn at short notice, it is difficult for businesses to plan a programme of investment over a number of years.
12. Capital allowances are intended to encourage business investment – but over the years the Annual Investment Allowance (AIA), a valuable relief, particularly useful for smaller businesses – has been subject to relatively frequent change. Whenever it changes there are issues for businesses whose accounting periods straddle the date of the change. Expenditure in the wrong part of the period can lead to businesses losing out on relief.
13. An AIA set at £500,000 per annum for the long term, with periodic uprating to prevent it losing value in real terms, would be welcomed by many businesses. For many SMEs it would mean that all capital expenditure on plant and machinery would be covered, simplifying administration, and removing the need to consider the timing of expenditure between accounting periods.
14. There has also been some support for the recent super deduction regime (the 130% first year capital allowance for qualifying plant and machinery/50% first year allowance for qualifying special rate assets) – but this is only available for a short time period (assuming it ends on 31 March 2023, as announced) so favoured companies with large cash reserves that could bring forward expenditure. It was less useful for companies unable to fund immediate expenditure – or for encouraging long term investment. Its impact may therefore have been limited – bringing forward expenditure rather than encouraging additional expenditure.
15. The timing of reliefs and the long-term availability of reliefs is important – it can have a fundamental impact on the profitability profile of some projects and could affect whether they go ahead or not. It is also important that reliefs take account of different stages of the business lifecycle – feedback to ICAS indicates that reliefs in the UK support the development of intellectual property, but not its exploitation. As a result some companies start up here to develop IP, but subsequently move to the USA.
16. ICAS frequently receives feedback that businesses would like to see the publication of a corporate tax strategy – similar to the strategy published in 2010 – to allow them to plan. Tax reliefs should play a part in this – but also wider non-tax incentives and the broader economic strategy of the Government.
17. From the perspective of indirect taxes, there are similar considerations around certainty and the interaction between VAT reliefs/VAT rates and other tax reliefs - and with non-tax policy objectives. For example, it is positive for customers with pensions and ISAs that these are both VAT exempt and benefit from various direct tax reliefs. This fits with the general government policy of encouraging savings.
18. There is scope for some modernisation of VAT to make it fit for the twenty-first century; post-Brexit some constraints on reform have been removed. Reliefs (including the availability of reduced and zero VAT rates) need to be fit for purpose and considered holistically. There is some ongoing work, following on from the OTS report on simplifying VAT; this could be combined with a post-Brexit review of the extensive options now available.

Reliefs/allowances – personal tax

19. There are a number of very useful personal tax allowances and reliefs that simplify administration for taxpayers. They remove the need for taxpayers to file returns to report small amounts of income and gains, where the administrative costs and burdens (for HMRC as well as taxpayers) would exceed the tax collected.

20. For income tax, the £1,000 property and trading allowances and the dividend and savings allowances are all useful. They do, however, need to be indexed or periodically updated, or their administrative usefulness will be eroded over time.
21. For capital gains tax, the Annual Exempt Amount (AEA) has a useful purpose and should be retained in its current form. It removes the necessity to report small gains in a simple, straightforward and understandable way. The administrative costs for HMRC and the taxpayer of reporting such small gains are unlikely to be justified by the tax collected.
22. The exemption for chattels/wasting assets should be retained and generally works well. Like the AEA this removes the need to report small gains – which would otherwise clog up the system and impose administrative burdens on both taxpayers and HMRC. It also, importantly, ensures that losses cannot be claimed on tangible moveable property within the definition. However, unlike the AEA, which has been regularly increased, the £6,000 figure has been in place for many years and needs to be revisited and increased.
23. Many inheritance tax reliefs have not been updated on a regular basis. This gives rise to problems – either burdensome reporting requirements producing little tax revenue, for those who are aware of the rules, or inadvertent non-compliance amongst those who are not. The OTS conducted a review of Inheritance Tax, to which ICAS contributed a number of suggestions:
- The annual exemption of £3,000 for lifetime gifts to individuals has not been increased since 1981. The small gifts exemption (£250 per year) and the exemptions for gifts in consideration of marriage or civil partnership (£5,000, £2,500 or £1,000, depending on the identity of the transferor) have similarly not been increased for many years. It would make sense for these exemption limits to be increased to a more realistic level and then indexed annually. Alternatively, they could be merged into one simple (but higher) exemption covering all gifts made in a year – either as a total figure for all gifts in the year or a total figure for gifts permitted to any one individual in a year. This amount should be indexed. This would be much easier for individuals to understand and would therefore make compliance more likely.
 - The requirement to keep records of small gifts imposes a disproportionate administrative burden. In practice it is highly unlikely that proper records, particularly of small gifts, are currently being kept by many individuals. Many people will be unaware of the rules but there will also be questions of interpretation and structure: for example, are parents paying costs for a wedding reception funding a social event, incurring expenditure out of income, or making a gift in consideration of a marriage – or a combination?
 - In many cases the interaction between some of the fixed exemptions, the exemption for normal expenditure out of income and the PET rules is likely to mean that even if a fixed exemption limit has been exceeded there may still be no IHT due – but disproportionate effort will have been expended to ascertain all the facts after death.
 - Putting in place realistic exemption limits or simplifying the rules by creating one simple annual exemption (set at a higher figure which would be indexed) is unlikely to result in a significant tax loss to the exchequer. Making the rules easier to understand and providing clarity would facilitate compliance and allow advisers and clients to concentrate on more significant lifetime gifts.
24. Some personal tax allowances and thresholds also appear to have been affected by the reluctance of governments in recent years to increase the main revenue-raising taxes, whilst still needing to raise revenues.
25. One of the less obvious ways of raising revenues employed by governments has been the freezing of various allowances, including the Personal Allowance (currently frozen until 2025/26), the threshold for the High Income Child Benefit Charge (which has remained at £50,000 ever since the introduction of the charge), the threshold for the reduction of the Personal Allowance (never increased from £100,000) and the Pension Lifetime Allowance (progressively reduced from

£1.8m to £1m, it should then have increased in line with the consumer price index but is currently frozen until 2026).

26. The practical consequences of freezing allowances in this way do not appear to have been considered. For example, there have been some (presumably) unintended consequences – disincentivising those affected from continuing to work or from working extra hours. Both the threshold for reducing the personal allowance and the Pension Lifetime Allowance have caused widely reported problems in the NHS (but also in other sectors) with staff declining extra hours, reducing hours, or taking early retirement, to avoid being penalised.

Tax Reliefs and net zero

27. In 2019 the Government put into legislation a requirement to bring UK greenhouse gas emissions to net zero by 2050. This is a very ambitious target. Tax can be highly effective at changing behaviour – and has already been used to discourage certain types of environmentally damaging behaviour (Landfill Tax) and to encourage investment in green plant and machinery. It can be a vital part of the package of measures needed to deliver net zero - as part of a wider mixture, including regulation, non-tax incentives (such as grants) and the development of the necessary infrastructure to support green technologies.
28. From the tax reliefs perspective, there are many existing reliefs which could be amended to support the move towards net zero. R&D reliefs, Patent Box, EIS and VCT could all be adjusted to favour the development and expansion of green technologies. Surprisingly, the recent HM Treasury review '[Potential Reforms to UK's Capital Allowance Regime](#)' made no link to the Government's net zero strategy, in spite of the fact that Capital Allowances have already been used to encourage green investment – for example, the enhanced capital allowances for energy and water saving plant and machinery (available until 2020) and enhanced allowances available for certain zero emission vehicles.
29. Consideration should be given to incentivising investment in renewables and wider green infrastructure with reliefs and allowances aligned to the wider energy strategy (ie development of more offshore/onshore wind power, nuclear power etc).
30. It is also important that the tax system, including tax reliefs and allowances, does not encourage environmentally unfriendly behaviour. The current VAT regime can disincentivise renovation and repair of existing buildings, even though re-use is environmentally preferable to demolition and replacement. In some limited circumstances the reduced 5% rate (effectively a tax relief) may be available (for example, residential properties empty for 2 years or some residential conversions) but there is clearly scope to incentivise more refurbishment and reuse of older buildings through extending the availability of the reduced and zero rates.
31. To some extent the Government clearly does recognise the potential for using zero-rating as an incentive to greener behaviour; the Spring Statement announced that for five years the zero rate would apply to the installation of energy saving materials, including insulation and low carbon heating. However, the investment allowance element of the recent Energy Profits Levy does not give relief for investment in renewables (only fossil fuels) – this does not sit very well with the commitment to net zero.
32. What is lacking is any overarching Government environmental tax roadmap or strategy (including setting out a coherent plan for green tax reliefs), to support the transition to net zero. ICAS has called for the publication of such a strategy that would help individuals and businesses to plan for the future and to invest in greener options. The lack of a strategy may also make it difficult for the Government to ensure that tax policy is closely aligned with the development of new green technologies and the necessary supporting infrastructure.

Devolution and tax reliefs

33. The partial devolution of income tax has caused some additional complications as Scottish rates and bands for non-savings/non-dividend income have diverged from those in the rest of the UK, particularly because whilst rates and bands are devolved, related tax reliefs are reserved. Some of

the marginal rates that apply in Scotland as a result of different bands mean that the impact of tax reliefs is different. There is also some grit in the system, for example, around Marriage Allowance, Gift Aid and Pension Tax Relief. Some Scottish taxpayers will be losing out because they do not realise that as 21% taxpayers, they can claim the additional 1% relief on their pension contributions.

34. This is an inevitable consequence of devolving tax powers, but it would be helpful to see closer working between Westminster and devolved governments to try to minimise avoidable difficulties and additional complications. For example, it would be useful to have an agreed timeframe for UK and devolved Budgets; this could require a more formal process, designed to enable maximum collaboration. The starting point could be a UK Budget in early autumn to allow the devolved administrations adequate time to consider UK tax measures with an impact on the devolved tax regimes, when preparing their Budgets.

Abuse of reliefs

35. As set out above, ICAS believes that ongoing review of reliefs and allowances is essential to consider whether they continue to achieve their intended objectives – and whether the objectives remain valid. One aspect of regular review could examine whether some reliefs are particularly associated with abuse and avoidance schemes.
36. This would help the Government and HMRC to identify actions to counter abuse quickly, without making the reliefs excessively difficult to access for legitimate purposes – or in some cases other forms of support could potentially be considered instead.
37. In the past the film tax reliefs produced a raft of abusive schemes that HMRC spent years challenging through the courts. More recently, ICAS has received many reports from members about issues with R&D ‘specialists’ who generally do not belong to professional bodies and approach businesses aggressively selling their services. In many cases it is unlikely that genuine R&D eligible for the available tax reliefs is being undertaken at all, or the boundaries of the eligible R&D activities are significantly overstated. In others, the ‘specialists’ have overlooked, or ignored, the legislative requirements, such as taking account of subsidisation, contract R&D, eligible cost categories or SME status.
38. This has been a problem for some time, and many claims appear to have succeeded due to a lack of scrutiny (possibly because individually they were of low value). We are aware that recently, HMRC has been taking more action to tackle abusive R&D claims but a proper review process for reliefs might have prompted earlier action.
39. In addition to problems with some R&D advisers, the recent consultation [‘Raising standards in tax advice: protecting customers claiming tax repayments’](#), highlighted problems with some repayment agents (who claim tax reliefs and repayments on behalf of clients). These agents also generally do not belong to professional bodies.
40. A long term solution to tackling some of the issues arising from the behaviour of unregulated agents (affecting tax reliefs, but also the tax system generally), would be to introduce a requirement that everyone acting as a tax agent should be qualified, and should belong to one of the main professional bodies that subscribe to, and enforce, Professional Conduct in relation to Taxation (PCRT).
41. Implementing this requirement could take some time to implement in full – and might require a transitional period - but in the long term it should ensure that all tax agents comply with minimum standards of behaviour. In the meantime, ICAS supports HMRC’s plan to expand its ‘standard for agents’, so that it more closely matches the standards professional body members are already required to meet; it should also enforce the standard rigorously by imposing sanctions on those failing to comply.

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