Labour's review of corporate tax reliefs

Labour

IT'S TIME FOR
REAL CHANGE

The next Labour government will conduct a review of corporate tax reliefs, as committed to in our manifesto. The review will assess the hundreds of corporate tax expenditures which make up some of the billions in revenue forgone through tax expenditures and structural reliefs by the UK every year.[1]

Structure

The review will be conducted by the Treasury. It will be informed by an expert panel which will include representatives of HMRC, the Office of Tax Simplification, the National Audit Office, and external stakeholders including trade union representatives, business organisations and taxation experts such as the CIOT, AAT and ICAEW.

Scope

The review will examine the body of corporate tax reliefs for its effectiveness against their stated aims and compared with alternative policy measures to achieve these aims. It will also seek to ensure stronger transparency and accountability concerning the creation and maintenance of corporate tax reliefs.

Timing

Full terms of the review will be published within a month of Labour entering office. The review will report after six months. Its findings will be operationalised quickly to inform subsequent fiscal events.

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[1] In contrast to this paper, HMRC distinguishes tax expenditures and structural reliefs. Tax expenditures are tax reductions which aim to encourage behaviours which will further economic or social policy goals. In effect, expenditures measure the cost of spending programmes run through the tax system (Burman, Geisler & Toder, 2008). Structural reliefs, by contrast, are those reliefs which are necessary for defining the scope of a tax. For example, the Personal Allowance is categorised by HMRC as a structural relief, as well as Double Taxation Relief for corporations. This paper uses the term 'tax relief' to cover those reductions in taxation intended to fulfil a particular policy objective. Stricto sensu, it therefore focuses on what HMRC defines as 'tax expenditures', but uses the term 'tax relief' to aid comprehension.

Introduction

Tax reliefs lower the final tax liabilities of some individuals and companies, effectively narrowing the tax base (Bauger, 2014). This paper follows common parlance in using the term ‘corporate tax reliefs’ to describe measures which reduce the tax payable by at least some companies and business people, in order to achieve a stated public policy aim. Despite the low levels of scrutiny they generally receive during the policy-making process, corporate tax reliefs are an increasingly expensive element of government activity.

It has been suggested that one of the reasons why their value has increased over time is due to the relative ease of enacting tax reliefs and the low level of scrutiny they subsequently receive (Howard, 2000). This point was made by the Office of Budgetary Responsibility, who address tax reliefs in the ‘Revenue Risks’ section of their Fiscal Risks 2019 report. The OBR point out that “in some instances, they are used as disguised and non-transparent alternatives to conventional public spending, getting far less scrutiny as a result.” (OBR, 2019) This is a problem in the UK, where a higher proportion of tax reliefs are opaque compared with many other countries (Minarik, 2009).

In response to these criticisms, Labour has committed to conducting a review of corporate tax reliefs. This paper sets out the context for such a review, including the costs of tax reliefs and their distributional impact, previous government reviews and international approaches, before moving on to a proposed structure and criteria for Labour’s own review.

The current costs of tax reliefs

In January 2019, HMRC published its 'estimated costs of tax reliefs' (HMRC, 2019a). This provides broad estimates as to the revenue foregone from the principal tax reliefs - those which they believe are worth over £50m. The sum of the 115 principal reliefs listed was over £400 billion in 2018-19, with a further £690m listed under 80 'minor reliefs'.[2]

Around half of the cost of principal reliefs comes from the personal tax threshold, National Insurance Contribution thresholds and VAT zero rating and exemptions, which **do not form part of our proposed review.** However, many of the remaining reliefs concern reductions in taxation for companies and business people to achieve differing public policy aims. Overall, the cost of tax reliefs is similar to a number of departmental budgets combined- a point which was highlighted by the Resolution Foundation (RF, 2018).

The same applies when it comes to HMRC's list of the reliefs for which no cost data is collected or available, of which there were 235 at last publication (HMRC, 2019b). It is very unusual for such a high number of policy measures to remain uncosted, often over a long period of time.

Reductions in government spending have not been accompanied by reductions in tax reliefs. Overall, despite the introduction of austerity, the cost of tax reliefs "rose from 5.5 per cent of GDP in 2010-11 to 6.0 per cent in 2014-15" (Corlett, 2015: 8) and it has continued to grow ever since. The OBR believe that the current cost is "large in absolute terms – approaching 8 per cent of GDP – and also by international standards." (OBR, 2019)

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[2] HMRC have since revised publication of their Estimated Costs of Tax Reliefs and are no longer publishing total cost estimates of principal and minor reliefs. The costs of individual reliefs are now estimated under 'structural' and 'non-structural' categories, with no overall estimates provided for these new categories. Our analysis found that total revenue forgone under 'Structural Reliefs' amounted to £280bn, while revenue forgone under 'Non-Structural' reliefs amounted to £160bn.

Distributional impacts

There is evidence that reliefs have negative effects on income and regional inequality. A lack of public accountability has meant that the distributional impacts of reliefs are largely ignored.

The OECD has argued for greater scrutiny of tax expenditures, given that they often benefit those which higher incomes, aside from measures such as tax credits which are specifically targeted at those on lower incomes (2012). In practical terms the OECD argue for the removal of reliefs including reduced taxation of capital gains from the sale of a principal or secondary residence, stock options and carried interest as an example of how to achieve a cut in marginal labour income tax rates and boost growth (2012:183). They state that “[c]utting back such tax expenditures is likely to be beneficial both for long-term GDP per capita, allowing a reduction in marginal tax rates, and for a more equitable distribution of income. Lowering tax expenditures would also reduce the complexity of the tax system, and thus tax compliance and collection costs” (2012: 197).

The system of corporate tax reliefs appears heavily skewed in terms of its regional impact, as well as its impact on the income distribution. For example, in 2012-3, London and the South East made up just over a third of total claims for Research and Development tax credits, but received over half of the value that was claimed. For every other region, excluding the East of England, the percentage of the amount claimed was lower than the percentage of claims overall (Fowkes, Sousa and March, 2015). As another example, October 2017 statistics on the Enterprise Investment Scheme indicate how a disproportionate number of claims made for this relief are in London. Finally, while London made only just over a tenth of the claims for Patent Box relief in 2014-5, it received over half of the total amount claimed in the whole of the UK (HMRC, 2018).

Public policy impacts

Helen Miller, Associate Director of the Institute for Fiscal Studies, recently highlighted that “[t]oo many reliefs have weak or poorly articulated policy aims” (IFS, 2018). This is particularly pertinent when it comes to many corporate tax reliefs, with the economist Diane Coyle (2016) stating that “the measures repeatedly tried by various governments so far, such as…tax credits for research and development, have not made enough of a difference to productivity.”

As the OBR point out “few of the reliefs have been evaluated, either in terms of cost or of effectiveness in meeting stated objectives.” (OBR, 2019)

Nor are different tax reliefs examined in relation to each other when it comes to their public policy impact. For example, the tax relief placed on red diesel costs more than all four principal measured tax expenditures included in the Climate Change Levy (the reduced rate for participants in Climate Change agreements, exemption of electricity generated from certain renewable resources, exemption of supplies (other than self-supplies) to CHP stations and exemptions for energy used in metallurgical and mineralogical processes).

Where tax reliefs may have been created with a strong policy rationale, this can drift over time. Indeed, Research and Development tax credit was used as an example within the Mirrlees Review to indicate how policy drift can affect the UK tax system. While industry did not lobby extensively for the R&D tax credit when it was first created, there is now a strong lobbying effort in favour of its continuation. As the Mirrlees authors concluded, this shows that “enacting tax policy can create interest groups…in favour of that policy” (Alt, Preston and Sibieta, 2010: 1205).

Previous reviews of tax reliefs

HMRC itself commissioned some 19 independent evaluations of tax reliefs which ran between 2003 and 2016 (NAO, 2014). These evaluations usually looked at the impact of reliefs rather than undertaking extensive research of the risk of tax avoidance or the costs of revenue foregone.

In 2011 the Office of Tax Simplification (OTS) was asked by the then Chancellor to review tax reliefs. Of the 1,042 reliefs in operation at the time, the OTS chose 155 to examine in more detail. The government asked that any recommendations made by the OTS be revenue neutral.

The OTS applied the following review criteria to each relief they examined:

- Whether its policy rationale is still valid and remains the optimal method to achieve the stated policy objective, given other potential Government interventions
- The likely impact of changing or repealing the relief
- Evidence of taxpayer take-up and awareness of the relief
- Evidence of complexity, compliance costs and administrative burdens in claiming the relief
- Evidence of the impact of the relief on taxpayer behaviour.

Following their review, the OTS found that roughly a third of the 155 reliefs that they reviewed should be abolished, a third should be examined in more detail by the government, and a third should remain unchanged.

This report was followed up by the NAO, who reviewed tax reliefs again in 2014, and estimated that there were 1,128 reliefs in operation by that time. The NAO identified a series of issues with the current system of developing, implementing and administering reliefs including that:

- The number of tax reliefs is permanently growing, as different administrations add more reliefs than they abolish. The interaction of a growing number of reliefs creates complexity.
- As a result, the value of reliefs in relation to taxation or expenditure is increasing. The NAO estimated that, as a proportion of GDP, the sum of all tax reliefs had increased from 16% to 21% since 2005-06, while tax revenues had decreased marginally.
- HMRC does not hold cost data for many individual reliefs, making firm assessment of the total value of tax reliefs in the UK difficult, and analysis of the effectiveness of many specific reliefs impossible.
- HMRC did not systematically categorise reliefs based on the function they perform, thus reducing transparency.
- There is no regular assessment or evaluation of the effectiveness of each relief and no monitoring of changes to the cost of individual reliefs.
- The boundary between the legitimate use of tax reliefs and tax avoidance, evasion or fraud can be unclear, and requires significant resource to enforce. The precise level of revenue lost through abuse of tax reliefs is not known.

No other comprehensive review has been conducted by government or parliamentary bodies during recent years. Some examination of this topic has, however, been conducted by think tanks. Hence, the IPPR's Commission on Economic Justice argued for a renewed focus on corporate tax reliefs (2018), singling out the Patent Box for criticism, as well as advocating a minimum corporate tax; while the Resolution Foundation has examined the cost and impacts of Entrepreneurs' Relief (2018).

There has also been no consistent approach taken towards the design of tax reliefs. While some tax reliefs have included sunset clauses, for example (such as the Corporate Venture Scheme, which was discontinued after its review in 2010), their use appears ad hoc. Although the then government undertook, following the NAO's 2014 enquiry, to use sunset clauses more regularly in relation to tax reliefs, this has not occurred, and contrasts with the situation in Germany where sunset clauses are now the norm for newly introduced reliefs.

International approaches

A plethora of approaches are taken in different countries towards the creation, assessment and maintenance of corporate tax reliefs. The Indian and US approaches are particularly instructive in indicating how greater transparency and accountability can be implemented in this area.

India presents information on tax expenditures directly within its Union Budget, under the Receipt Budget category alongside information on tax revenues and the accompanying analysis. According to the Indian Government's Ministry of Finance, the first such statement in 2006-7 was "well received by all quarters and gave rise to a constructive debate on the entire gamut of issues concerning fiscal policy" (2018, p. 28).

The statement includes a list of types of incentive and the revenue foregone due to each. It explicitly differentiates between tax expenditures in the Corporate Sector and the Non-Corporate Sector, and Individual Taxes, and includes detailed information depicting the contribution of major commodity groups to revenue foregone (e.g. minerals, foodstuffs).

Similarly in the US, the Congressional Budget Act of 1974 requires that tax expenditures be included within the budget, which covers their costs (as with the Indian system) but also some discussion of performance measures in relation to purported policy goals. Tax reliefs are differentiated according to whether they apply to companies or individuals, and are also ranked by magnitude. US budgets explicitly include cumulative consideration of tax reliefs, with President Obama for example setting out policies in 2017 which limited the rate at which upper-income individuals could reduce their tax liability through tax reliefs. In addition to this, Congress' expert Joint Committee on Taxation has, since 1975, annually published a report on tax reliefs (e.g. JCT, 2017). These reports contain extensive information on tax reliefs, both the general concept and the methodology used to analyse them, information on new reliefs which have been introduced, and estimates of costs and details on the distributional effects of individual tax reliefs by income groups. The reports also identify tax reliefs which are due to expire within the year. The purpose is to provide policymakers with adequate information in order to evaluate the trade-offs amongst the use of tax reliefs and competing policy goals and priorities.

Labour’s review

Labour’s review of corporate tax reliefs will be conducted by the Treasury. Within a month of taking office, the Treasury shall publish the full terms of Labour’s review of tax reliefs. The review shall report to Treasury ministers after six months.

Labour’s review will be informed by an expert panel which will include representatives of HMRC, the Office of Tax Simplification and National Audit Office, and external stakeholders including the trade union representatives, business representatives and tax experts. The expert panel will meet on a monthly basis and offer findings after six months. These will include proposals for reliefs which no longer meet the criteria for foregone revenue under a Labour government, as well as wider proposals on policy and practice relating to the management of tax reliefs by a Labour government.

Meetings will also be held with think tanks and policy groups that have produced work on tax reliefs such as the Institute for Fiscal Studies, the Resolution Foundation and others.

The review will examine existing corporate tax reliefs in relation to the following questions:

- Does the relief meet its stated policy objectives, and in a cost-effective way in comparison with alternative means of achieving these objectives?
- Is this objective already achieved by another policy or relief?
- Who does the relief target and what impact does it have on them, both individually and cumulatively in interaction with other reliefs?
- Does the relief simplify the tax system e.g. by avoiding double taxation?
- Is there evidence of misuse of the relief, including for the purpose of tax avoidance?

Labour’s Treasury team will consider the recommendations of the expert panel and bring forward proposals for policy change based on this evidence. The above criteria will inform recommendations for the elimination, redesign or retention of different corporate tax reliefs.

We will set the review a target to achieve efficiencies of 1% of total tax relief expenditure through reductions in corporate tax reliefs by the final fiscal year of the Parliament, estimated to be around £4.3 billion.

In relation to how policy and the practical management of corporate tax reliefs can be reformed the review will also consider:

- What is the best means of guaranteeing regular assessment of corporate tax reliefs to ensure that they remain fit for purpose?
- How can more transparency and accountability be provided for corporate tax reliefs, including by providing improved data on tax reliefs in budgetary statistics, and/or the conducting and publication of analysis of the distributional impact of corporate tax reliefs (e.g. according to income, gender and/or region)?
- Which, if any, bodies should have a defined role in relation to assessing tax reliefs, out of the OTS, OBR and/or NAO?
- Should the OTS' constraint of revenue neutrality be maintained when it comes to the assessment of tax reliefs?
- Should a more systematic approach be applied to all (new, or existing) corporate tax reliefs, such as the automatic use of sunset clauses?

Recommendations will be considered by the Treasury team and will feed into subsequent budgets. Ongoing policy recommendations relating to the oversight and management of tax reliefs will be implemented as soon as possible, through primary or secondary legislation as appropriate.

Under the Conservative Government, tax reliefs have been used as a mechanism to provide state assistance to certain individuals or organisations without proper scrutiny, and with poor ongoing management and oversight. As the international examples mentioned above demonstrate, the UK has fallen behind it its transparency and accountability over this crucial area of Treasury policy.

Labour's review will return the UK to international standards over the management of tax reliefs, ensuring that all reliefs in operation are subject to ongoing scrutiny and found to be effective means of meeting the Labour government's policy aims.

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