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The politics of tax breaks

How did we end up with such a complex system of tax reliefs?

If there's one thing accountants love, it's identifying obscure tax reliefs to which you may be entitled and using them to reduce your tax bills.

Tax reliefs, or tax breaks as they are sometimes called, aren't without controversy, however. There are too many of them, say critics, and they deny the public purse much-needed funds.

In January this year, think tank the Resolution Foundation published the results of its own annual review on the cost to the nation of tax reliefs and suggested the bill had grown to £164 billion in 2018/19, equivalent to £6,000 per UK household.

Attempts to tot up the number of individual reliefs in recent years consistently put the number well above 1,000.

How did we end up here?

For a long time, taxes were generally specific and temporary, such as that introduced by Charles II to pay for the rebuilding of London after the Great Fire of 1666.

By the 18th century, the majority of government funding in Britain was being raised through a national tax on land based on its rental value.

Income tax as we know it wasn't introduced until 1798, initially as a short-term measure to help pay for the Napoleonic Wars.

It is still, in legal terms, a temporary tax, but as you'll be only too aware, with only the odd pause during the early 19th century, it has been a fact of life ever since.

Almost as soon as there was income tax, there were income tax breaks. In 1799, a life assurance premium relief was introduced with the intention of encouraging people to provide for their dependents.

Over the years and decades, ever more tax reliefs were bolted on to the system as new taxes were introduced, with inheritance tax born in 1894, corporation tax in 1965, and so on.

They had various purposes, such as:

- preventing unnecessary bureaucracy in pursuing tiny amounts of tax, as in the case of the allowance on wear and tear for landlords.
- encouraging particular behaviours, such as entrepreneurism or personal saving.
- making tax progressive, so the better-off pay relatively more.
- putting common sense into legislation – air cabin crew obviously shouldn't be obliged to pay air passenger duty, for example.
- investing in economic and social policy indirectly, without being seen to spend public money.
- and, of course, winning over specific groups of voters.

Rabbits from the hat

A phrase you'll sometimes hear in relation to that last point is 'budget rabbits' – a reference to the desire of politically ambitious chancellors to make a splash on Budget day by whipping surprise announcements from the red briefcase.

They don't always take the form of tax reliefs, but often do. Chancellor Philip Hammond's announcement in Budget 2018 of a tax break for businesses providing public toilets is one crowd-pleasing example.

One of the problems with rabbits, though, is that you can't always be sure in which direction they will hop once they've been released.

A famous recent example of unintended consequences is around tax relief for UK film production introduced in 2006.

While this measure is credited with bringing high-profile franchises such as *Star Wars* to the UK, and with stimulating the production of many lower-budget films, it also provided a whole new avenue for complex tax avoidance schemes.

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In 2013, the producers of a thriller called *A Landscape of Lies* were prosecuted by HMRC after claiming it had a budget of £19.6 million and A-list stars, and claiming relief on that amount, while actually spending less than £100,000 on the entire production.

Slimming down

In recent years a consensus has developed: there are too many individual tax reliefs, and the system needs streamlining. But how?

In 2010, the incoming coalition government formed the Office of Tax Simplification (OTS), and almost its first job was to attempt to calculate the total number of tax reliefs and suggest ways to remove layers of bureaucracy.

It identified an astonishing 1,042 individual reliefs in operation as of November that year and picked 155 for further study, from the seafarers' earning deduction, to daily relief on the first 15p of any employer-provided luncheon voucher. The latter was introduced in 1946 during post-war rationing and its value was eroded by inflation over the course of decades.

"This relief was introduced in 1961", read the note against another especially obscure tax break, adding, dryly, "it is unclear what the original policy rationale was".

In its first pass, the OTS recommended abolishing 47 reliefs outright, and argued more generally for the consolidation and simplification of those that remained. Among the victims was the austerity-era luncheon voucher relief which was repealed in 2013.

But when the OTS revisited the issue in 2014, it didn't find fewer tax breaks, but more – 1,140 to be precise.

It seems to be a tough habit for politicians to kick.

The cost of reliefs

The National Audit Office (NAO), the government spending watchdog, carried out its own investigation in 2014, asking one blunt question: how much do tax reliefs cost government?

It took into account not only potential revenue lost through tax breaks themselves but also the cost of administering them, and the potential for error, tax avoidance and fraud created by each additional complexity in the tax system.

Neither HMRC or the Treasury much liked the results of this study, each formally disavowing one or more of its conclusions.

"As a proportion of GDP," the final report said, "the sum of all tax reliefs has increased from 16% to 21% since 2005/06, while tax revenues have decreased marginally".

It estimated that 'tax expenditures' – tax reliefs that aim to influence behaviour, and which are effectively a form of policy spend – cost £101bn in 2012/13.

Critics of this kind of analysis point out that they are based on an apparent assumption that every penny we earn is by default owed to the state, and that letting us keep some of it equates to a 'cost'. Many would, of course, disagree with that starting point.

It's also easy to identify outliers and apparently ridiculous examples when criticising tax reliefs, but the vast majority of the overall cost of tax relief actually goes on something relatively mundane and quite uncontroversial – the income tax personal allowance.

More serious, perhaps, is the suggestion that tax reliefs are open to abuse.

In a follow-up report from November 2014, the NAO also suggested that HMRC was failing to subject tax breaks to sufficient scrutiny leaving people free to exploit loopholes, or commit outright fraud.

Why, for example, did entrepreneurs' relief which was expected to cost £900,000 actually cost £2.9bn? HMRC wasn't able to provide the Public Accounts Committee with a convincing answer.

Here to stay

Realistically, despite pressure from government bodies, think tanks and other critics, the chance of the number of tax reliefs being greatly reduced seems slim.

Most have been introduced for concrete reasons, and in line with the priorities of the successive governments that introduced them.

What's more, removing tax reliefs once they've become embedded in the system is liable to aggravate those who have come to rely on them, or at least learned to live with them.

What we may well see is more of a reduction in the scope of certain reliefs as the Treasury seeks to find additional funding without actively increasing taxes.

In Budget 2018, for example, Chancellor Hammond shortened the final period exemption, which excuses people from capital gains tax on the last stretch of their ownership of a home, from 18 months to nine. This doesn't abolish the relief but chips away at it, substantially reducing the scope for tax savings.

Whatever happens, there's bound to be a key role for us as your accountants in helping you navigate this complex landscape and claim every relief to which you are entitled.

Talk to us about reducing your tax bill.