Association of Accounting Technicians (AAT) response to the Treasury Select Committee inquiry into Tax Reliefs

1. Introduction

1.1. It is unclear if the current suite of tax reliefs represents good value for money because, as the National Audit Office highlighted in 2020, of the 1,000+ tax reliefs that exist, HM Treasury has assessed only 15 for value for money. This is particularly surprising considering at least 23 reliefs have a forecast cost of more than £1bn each.

1.2. Tax reliefs can secure policymakers key objectives – encouraging investment, creating jobs and ultimately leading to growth. That so little work is undertaken to establish the effectiveness of reliefs in achieving these benefits is extraordinary, even more so given the National Audit Office (NAO), Public Accounts Committee (PAC) and Office for Tax Simplification (OTS) have been highlighting their concerns in this area for many years.

1.3. As the NAO stated in 2020; *"Along with the Committee of Public Accounts, we have repeatedly raised concerns about the departments' management of tax reliefs. In our 2014 report, The effective management of tax reliefs, we found that neither department had frameworks or principles to guide their administration of tax reliefs. In 2016, we reported that while HMRC had developed internal guidelines for managing reliefs, staff did not understand they were compulsory. In 2018, the Committee of Public Accounts concluded that HMRC did not know whether a large number of tax reliefs were delivering value for money. HMRC and HM Treasury have responded to our recommendations by increasing their oversight of tax expenditures and actively considering their value for money. In 2019, HMRC informed the Committee that, whilst both HM Treasury and HMRC are responsible for advising ministers, the prime responsibility for advising ministers on the value for money of tax reliefs lies with HM Treasury. In July 2019, the Office for Budget Responsibility (OBR) identified the costs of tax reliefs as one of four new fiscal risks to the public finances. The OBR was concerned that: the government did not know the full cost of tax reliefs; that tax reliefs lacked transparency and scrutiny; and added complexity to the tax system."*[1]

2. Executive summary

2.1. **AAT agrees with the likes of the National Audit Office, Public Accounts Committee, Office for Tax Simplification and others that the system of tax reliefs in the UK is in need of urgent reform.** AAT notes that HMRC has committed to providing more public information on the costs of reliefs and that since 2019 new cost estimates have been published for around 120 reliefs which amounts to around 10% of all reliefs.

2.2. Problems with forecasting the cost of reliefs (both underestimating and overestimating) have a range of negative consequences for the effectiveness of reliefs and requires significantly more attention.

2.3. **AAT believes that there is some room for reform of the major tax relief expenditures.** For example, reviewing zero VAT ratings for water, new dwellings and books, magazines and newspapers amongst others.

2.4. **AAT repeats its long standing recommendation to halve the headline rate of Inheritance Tax from 40% to 20% and simultaneously end major Inheritance Tax Reliefs.** This is explained further at 3.77 and 3.78 below.

2.5. **AAT also repeats its long standing recommendation to reform Pension Tax Relief.** AAT supports the replacement of the existing 20%, 40%, 45% pension tax relief with a single flat rate alternative of 20%. This would represent a reduction for higher earners, protection for basic rate payers (as they will continue to receive the same level of relief as now) and a multi-billion pound annual dividend for the taxpayer.

2.6. **Anyone using a regulated agent i.e. a tax adviser or accountant who belongs to a relevant professional body, is likely to be made aware of any tax reliefs that they may be entitled to.** This is not always the case in respect of the third of agents who are unregulated i.e. those who do not belong to a professional body. Government should compel anyone providing paid-for accountancy and tax services to be a member of a professional body in the same way that over 200 other UK professions require professional body membership.

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[1] **The Management of Tax Expenditure, National Audit Office, 2020:**
https://www.nao.org.uk/wp-content/uploads/2020/02/The-management-of-tax-expenditure.pdf

3. **AAT response to the consultation**

3.1. **The largest tax relief expenditures**

3.2. According to the NAO, in 2018-2019 the 23 largest tax relief expenditures had a forecast cost of £143 billion, equating to 92% of the forecast cost of all tax relief expenditures[2].

3.3. It would therefore seem sensible to examine these reliefs first.

3.4. At first glance there may appear to be very little that could be cut here, given the political difficulty, perceived or real, in making changes to long standing, widely understood reliefs that millions enjoy.

3.5. However, when scratching the surface of what may at first appear to be unpalatable political decisions, AAT believes there is some room for manoeuvre providing the benefits of change are clearly communicated to those affected, well in advance of any such changes.

3.6. Private Residence Relief (PRR)

3.7. PRR was introduced in 1965 to encourage both home ownership and housing mobility.

3.8. There may be sound economic arguments for reforming or even ending the Capital Gains Tax relief for gains arising from the sale of someone's main residence but doing so is practically impossible given the political fallout such a change would create in seeking to end a widely understood, widely utilised and long standing relief.

3.9. VAT on food

3.10. Ending the VAT exemption for food, especially during a cost of living crisis, would probably be politically unacceptable to any party although some tidying up around the edges could be achieved i.e. in relation to areas where there is dispute between what constitutes food and snacks.

3.11. Water

3.12. Water and sewerage services are zero-rated for VAT, costing £2.5bn in 2018-2019 and whilst it may initially appear difficult to justify price increases for something that is a necessity for all, not least given the current drought conditions the UK is experiencing, the argument against reform is weakened when taking into account the behaviour of water companies since privatisation in the 1990's. The 10 largest water companies have slashed investment in critical infrastructure, extracted over £70bn in payments to parent companies and dividends[3] and seen record amounts of raw sewage dumped in rivers and seas.

3.13. Increasing the amount the amount of tax revenue they contribute would therefore be welcome and given the size of profits there is no real reason for such an increase to be passed on to customers. Indeed, water regulator Ofwat could specifically preclude this.

3.14. New dwellings

3.15. The construction of new dwellings is zero-rated for VAT.

3.16. To raise revenue this could be brought into line with building renovation and building conversion costs which are subject to a 5% reduced rate of VAT.

3.17. Housebuilders will inevitably claim that anything that increases costs will reduce the amount of houses being built.

3.18. This is an argument housebuilders have successfully employed to prevent a wide variety of common sense reforms over the years, from policymakers attempts to ensure all new builds have solar panels to aborted plans to ensure all new builds have necessary infrastructure such as a broadband connection as standard.

3.19. The reality is that housebuilders do not like any extra costs because it eats into their excessive multi-billion pound profits which enable extraordinary executive payments such as the £110m annual bonus paid to the Chief Executive of Persimmon in 2018[4].

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[2] **Ibid**

[3] **Financial Times, December 2021:**
https://www.ft.com/content/86ac79f2-1169-4c2e-b28c-b18ff74aac10?shareType=nongift

[4] **Guardian, January 2018:**

3.20. Some have argued for the opposite i.e. that the zero rating not only be maintained for all new dwellings but that the zero rate be expanded to include building conversions and renovations who currently pay 5%. This would cost the taxpayer a further £3.75bn[5] and is therefore not something AAT recommends.

3.21. It is also worth highlighting that this relief is not targeted at specific new dwellings such as those that are environmentally friendly and have a good Energy Performance Certificate (EPC) or affordable homes etc. The relief is a blanket one and therefore benefits the developers of luxury apartments and houses.

3.22. Perhaps if the zero VAT rating was reserved for the types of dwellings that the country needs most, this would serve as more useful policy objective as well as a means of saving taxpayers money.

3.23. ISAs

3.24. Tax relief for Individual Savings Accounts (ISAs) comes with a cost of £3.3bn. This is not likely to be money that is well spent given the amount subscribed to an ISA increases with the income of the individual subscriber. As HMRC's commentary on ISA savings stated earlier this year;

3.25. *"15% of subscribers saved at the maximum in 2019 to 2020, rising to 39% of those with income of £100,000 to £149,999, and to 60% of those with income of £150,000 or more".*[6]

3.26. For ISA holders with incomes of £150,000 or more, the average value of their ISA savings is £74,928. That is £75,000 of savings upon which they are paying zero tax.[7]

3.27. ISA saving has been weakened by other policy decisions such as the introduction of a Personal Savings Allowance (PSA), allowing basic-rate taxpayers to receive £1,000 of cash interest, tax-free every year without the need of an ISA wrapper (£500 for higher rate taxpayers). Similarly historically low interest rates for more than a decade, they have been below 0.5% every year with the exception of 2018 (0.75%) until this year, has meant that most savers could achieve higher interest rate returns, even allowing for their tax free nature, on savings accounts other than Cash ISAs, fundamentally undermining their attractiveness. If the Committee wishes to explore this issue further, it was comprehensively covered in AAT's 2018 report, "Time for Change: A review of the Individual Savings Account (ISA) landscape"[8].

3.28. VAT threshold

3.29. Relief for small traders below the turnover limit for VAT registration (currently £85,000) costs an estimated £2.2bn in lost VAT. As AAT has highlighted before[9], irrespective of where the VAT registration threshold is set it creates a "cliff edge" that greatly impacts many small businesses' behaviour and productivity i.e. ceasing to work or reducing work when close to the threshold.

3.30. That's why AAT has previously suggested policymakers should consider scraping the VAT threshold[10]. Doing so would also eliminate competition challenges between VAT registered and non-registered businesses. Spain, Sweden and Italy already require all businesses to register for VAT/GST (Goods and Services Tax).

3.31. Books, newspapers and magazines

3.32. Ending zero VAT relief for books, newspapers and magazines seems highly unlikely, not least because of the general direction of travel that recently saw the Government grant digital versions equivalent zero VAT rating after a lengthy campaign.

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https://www.theguardian.com/business/2018/jan/09/persimmon-profits-chief-bonus-scheme
[5] **HM Treasury Questions, 10 May 2022:**
https://questions-statements.parliament.uk/written-questions/detail/2022-05-10/HL97
[6] **HMRC Official Statistics, Commentary for Annual savings statistics: June 2022:**
https://www.gov.uk/government/statistics/annual-savings-statistics-2022/commentary-for-annual-savings-statistics-june-2022
[7] **Ibid**
[8] **Time for Change: A review of the Individual Savings Account (ISA) landscape, March 2018:**
https://www.aat.org.uk/prod/s3fs-public/assets/AAT-ISA-Working-Group-Time-change-review-ISA-regime.pdf
[9] **Is it time to scrap the VAT threshold? AAT Comment, February 2021:**
https://www.aatcomment.org.uk/audience/members/scrap-the-vat-threshold/
[10] **Ibid**

3.33. In fact, Government plans to scrap VAT on e-books and e-newspapers were fast-tracked during the coronavirus outbreak and introduced 7 months ahead of schedule, primarily to aid consumers. At the time, Government stated that, *"On average publishers are reporting an increase of about a third in e-book consumption during the crisis, with some publishers reporting as much as a 50% increase. In the last seven days alone, subscriptions to TI media are up 200%, whilst Hearst's new subscribers were up more than 100% year-on-year across the second half of March."* [11]

3.34. It is also worth noting that no online e-newspapers reduced their prices for consumers following the VAT reduction and instead publishers retained the windfall. This was estimated to have earned billionaire Rupert Murdoch's Times empire at least £15m annually.

3.35. The above suggests a zero VAT rating for e-books and e-newspapers was wholly unnecessary and that should it be removed for books and magazines; the decision would not necessarily result in consumers being any worse off either – if publishers did not pass reductions on to consumers, it seems reasonable to ask why they should pass on increases?

3.36. There are many countries who do charge VAT on printed books without any obvious adverse effects. For example, Denmark charges 25% VAT. This is particularly interesting given Denmark boasts the highest literacy rate in the world (99%) and there is some academic evidence to suggest that young people in Denmark are now reading more than they did at the turn of the century.[12]

3.37. <u>Pension Tax Relief</u>

3.38. In 2018, RSA produced a report that stated basic rate tax payers, 75% of those claiming any relief, pay more into pensions (51%) but get only 32% of pension tax relief.

3.39. By contrast, higher rate payers get 53% of relief, despite contributing only 41%, while additional rate payers, make only 8% of contributions but get 15% of relief.

3.40. The report goes on to state that pensions relief costs the taxpayer £30.5bn, of which more than a third (£11.8bn) is spent on people earning more than £70,000.

3.41. The RSA recommended that a new 30% flat rate of pension relief would solve the problem as it would be, "*progressive, cost-neutral and leave three-quarters of earners better off.*"[13]

3.42. Like the RSA, the Pensions Policy Institute and various others, AAT supports the replacement of the existing 20%, 40%, 45% pension tax relief with a single flat rate alternative.

3.43. However, AAT does not support a flat rate of 30% as proposed by the RSA, 28% as proposed by the Resolution Foundation[14] or 25% as reportedly considered by HM Treasury on several occasions in the recent past[15].

3.44. Instead AAT recommends a 20% flat rate meaning a reduction for higher earners, protection for basic rate payers (as they will continue to receive the same level of relief as now) and a £13bn annual dividend for the taxpayer. There is no evidence that an increase in the 20% basic rate to 25%, 28% or even 30% will lead to increased saving amongst basic rate taxpayers and so investment in this area is unlikely to deliver a significant positive change.

3.45. Although this appears to be a simple, albeit potentially controversial, reform, in reality it involves considerable complexity.

3.46. This complexity includes dealing with the question as to what tax rate higher rate payers would pay when receiving their pensions in the future although this could be resolved by segregating funds i.e. stopping one regime and starting another.

3.47. Such a reform would also lead to a need to carefully review both salary sacrifice schemes and the pension cap and potentially end both.

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[11] VAT scrapped on E-publications, April 2020:
https://www.gov.uk/government/news/vat-scrapped-on-e-publications
[12] The Local DK, November 2014:
https://www.thelocal.dk/20141124/remember-books-danish-school-kids-sure-do/
[13] RSA, Venturing to Retire, 18 April 2018:
https://www.thersa.org/about-us/media/2018/top-10-handed-40-of-pension-tax-relief-rsa-warns
[14] Resolution Foundation:
https://www.resolutionfoundation.org/app/uploads/2018/05/A-New-Generational-Contract-Full-PDF.pdf
[15] Chancellor considers introducing flat rate relief, 2016:
http://home.bt.com/lifestyle/money/investing-pensions/reports-chancellor-to-cut-pension-tax-relief-in-2016-budget-11364034471159

3.48. Some have suggested any such change should also be accompanied by increasing the annual £40,000 allowance to £50,000 or more as an incentive for people to save more. AAT does not agree with such a proposal because very few people save at the maximum allowance threshold. In fact, the average pension pot is £60,000 after a whole lifetime of saving. An increase to £50,000 or more would not only cost the taxpayer more money; it would also only help a small number of people, almost exclusively those with high incomes.

3.49. Think tanks and commentators often put forward suggestions as to how the money saved from reforming pensions tax relief could be better spent on alternative pension provision. Of course, it is not necessary for these savings to be reinvested in pensions policy. These billions of pounds could instead go to other priority areas such as the NHS, education or more generally plugging the increasing tax revenue hole generated by changing work, shopping, travelling and living arrangements; clearing the deficit or dealing with the cost of living crisis.

3.50. **Miscellaneous tax reliefs**

3.51. <u>Rent-a-room tax relief</u>

3.52. An obvious problem with the rent-a-room tax relief introduced 30 years ago, is that the £7,500 annual limit has not increased for more than six years (April 2016).

3.53. Had this relief simply increased in line with inflation it would today be worth £9,400.

3.54. To encourage greater numbers of room rentals, increasing the opportunities for employment mobility for tenants and additional income for landlords, especially important during the current cost of living crisis, AAT recommends that this relief be increased to £9,500 from April 2023 and that it increase in line with inflation (CPI) on an annual basis thereafter as a means of future proofing the relief, ensuring it remains fit for purpose and reducing the need for future HM Treasury review.

3.55. As a point of principle, once a tax relief has been evaluated as being effective, the default position should be for annual inflationary increases (or decreases) which would better future proof reliefs rather than relying on ad hoc reviews. It would also better help to ensure the original intended purpose of the relief continued to be met.

3.56. <u>R&D Tax Credits</u>

3.57. The Government has a commendable objective of ensuring R&D investment equates to 2.4% of GDP by 2027 but as stated before[16], AAT believes a more ambitious target should be set of ensuring the UK is in the top ten countries for R&D spend by 2027.

3.58. The 2.4% target is well below what leading countries are currently investing e.g. South Korea (4.3%) Japan (3.4%) Finland (3.2%) Switzerland (3.2%) Austria (3.1%) Sweden (3.1%) Denmark (2.9%) Germany (2.9%) USA (2.7%)[17] . Put another way, the Government hopes that in six years' time, the UK is investing the same percentage of GDP as Slovenia invests today. It is also worth noting that most of these countries have a stated objective to increase their R&D spend as share of GDP further still. For example, Finland has a 3.2% investment rate today but is intent on raising this to 4% by 2030.

3.59. When HMRC last consulted on this issue it observed that in some countries, such as the US, *"…a company can expect to be audited by the tax authorities on nearly any tax credit claim"*. There is no reason why the same could not be true in the UK. With regard to the responsibilities agents and the applicant company being better reflected in the claims process, AAT actively promotes member awareness and understanding of R&D Tax Reliefs[18] and has previously suggested Government consider imposing joint liability on agents and taxpayers alike[19].

3.60. Although the British tax system is designed so that accountability lies with the taxpayer, whether or not an adviser has been used, joint liability would probably be a more appropriate approach to take given this is likely to better reflect the reality of many tax advice situations. In Portugal the agent is liable for any fines and debts whilst the client is still responsible for ensuring the correct amount of tax is paid, ensuring no taxpayer unduly benefits from the mistakes or misdemeanours of their adviser.

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[16] AAT response to HMRC/HMT consultation on the scope of qualifying expenditures for R&D Tax Credits, 2020:
https://www.aat.org.uk/prod/s3fs-public/assets/aat-response-qualifiying-expenditures-r-and-d-tax-credits.pdf
[17] **UNESCO Institute for Statistics, 2020:**
http://uis.unesco.org/apps/visualisations/research-and-development-spending/
[18] See 2018 AAT member magazine article
[19] AAT response to HMRC Consultation, "Raising Standards in the Tax Advice Market" August 2020:
https://www.aat.org.uk/prod/s3fs-public/assets/aat-response-raising-standards-tax-advice.pdf

3.61. AAT also notes the plethora of unqualified, unregulated agents providing advice to businesses in relation to R&D Tax Credits. In 2019, unregulated agents were estimated to have encouraged businesses to overclaim R&D Tax Credits by over £600m[20].

3.62. As AAT has highlighted on numerous occasions, this issue could be easily resolved by requiring anyone giving paid for tax or accountancy services to be obliged to be a member of a recognised professional body in the same way that over 200 other professions require membership or relevant professional bodies. Regrettably, in sharp contrast to the increasingly tight regulation of auditors, there does not appear to be any political desire to address the issue of unregulated high street agents, whether operating in the R&D space or any other areas of the economy. The fact that HMRC has confirmed two thirds of complaints it receives about agents relate to the third of agents who are unregulated should be a sufficient warning to policymakers that action is necessary, to say nothing of the risks around money laundering, tax evasion and avoidance and so on.

3.63. Another area that the UK could examine in order to improve the effectiveness of R&D Tax Reliefs, would be to vary the rates of R&D support by sector and activity as is already the case in the US, Spain and Portugal. Indeed, those with the highest levels of R&D investment vary the rates of support e.g. South Korea, Japan and Finland. In light of both the UK's "net zero" and "build back better" ambitions, it would seem both consistent and desirable to encourage greater additionality in the sphere of environmental R&D and this is therefore something that AAT would support. Perhaps a genuine "super deduction" like the 150% provided for in Finland from January 2021 until 2025 would be sufficiently game changing to deliver a step change in R&D.

3.64. <u>Business Owners Asset Disposal Relief</u>

3.65. AAT had long been critical of Entrepreneurs Relief which did no more than reward business owners for selling up and whilst this has been scaled back and reformed, AAT continues to believe it should be scrapped and the money saved utilised for start-up and scale-up activity.

3.66. Last month the Secretary of State for Defence, said;

3.67. *"When Rishi was Chancellor, he cut entrepreneurs' relief. He cut the relief that we give to our entrepreneurs who have invested in this country, invested in businesses. And that's not a way to create either wealth or indeed growth."*[21]

3.68. This again demonstrates the very poor understanding that policymakers have of some reliefs.

3.69. This particular relief has been widely misunderstood given its objective is to encourage entrepreneurialism when it very clearly does no such thing.

3.70. As AAT has stated before; *"Focus groups with AAT licensed accountants have consistently found that these accountants' clients are unaware of the relief until the time comes to consider a sale - when their accountant or adviser tells them about it. This demonstrates that it does nothing to initially encourage entrepreneurialism (its stated objective) but instead unnecessarily rewards those who would have sold their businesses anyway*[22]*.*

3.71. <u>Properly address the second homes loophole</u>

3.72. Thanks in large part to a successful AAT campaign, this loophole which sees both Council Tax and Business Rates avoided due to the availability of reliefs, will reduce from April 2023 with a new requirement to make a property available to let for at least 140 days and actually let for a minimum of 70 days coming into force.

3.73. However, AAT does not believe this change goes far enough and there should instead be a requirement for a property to be made available for a minimum of 210 days a year and for it to be actually let for 105 days in order to qualify for relief. This would bring it into line with various tax reliefs and allowances that are already available for Furnished Holiday Lettings.

3.74. This serves as another example of an opportunity to reduce complexity, reduce the cost of tax relief and increase effectiveness that has been needlessly missed.

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[20] Accountancy Daily, "HMRC hunting £612m in R&D tax relief repayments" November 2019:
https://www.accountancydaily.co/hmrc-hunting-ps612m-rd-tax-relief-repayments
[21] National News, July 2022:
https://www.thenationalnews.com/world/uk-news/2022/07/29/ben-wallace-backs-liz-truss-and-takes-a-swipe-at-rishi-sunak/
[22] AAT submission to the OTS, September 2020:
https://www.aat.org.uk/prod/s3fs-public/assets/aat-response-office-tax-simplification-capital-gains-tax-review.pdf

3.75. Inheritance tax reliefs

3.76. Although only 4% of estates are liable for IHT, more than 50% of the electorate are concerned about this tax, perhaps contributing to its label as "the most hated tax"[23] amongst the general public.

3.77. AAT has long recommended that the headline rate of IHT be reduced from 40% to 20% whilst simultaneously ending the vast majority of IHT reliefs, especially the two main reliefs, Agricultural Property Relief and Business Property Relief, which combined cost around £1bn a year and which do not appear to be closely aligned to the intended purpose of granting the relief in the first place.

3.78. Employee share schemes

3.79. The employee share ownership industry makes much of the benefits of employee share schemes from increased productivity to reduced staff turnover, which combine to lead to better company performance overall.

3.80. However, robust evidence of these claims is very difficult to find. HMRC's own research in this area, undertaken by Oxera in 2007[24], was less than convincing.

3.81. In fact that report concluded, *"These results indicate that the tax advantages of these share schemes are not sufficient on their own to increase company productivity."*

3.82. Yet hundreds of millions of pounds of tax relief are poured into Share Incentive Plans, Save As You Earn Schemes, Enterprise Management Schemes and Approved Company Share Option Plans every year.

3.83. That little or no evidence as to the effectiveness of most tax reliefs exists is unacceptable but where it does exist e.g. in relation to employee share schemes, it appears to be largely ignored when the findings are unfavourable, which should prompt much greater examination.

3.84. Video Games Tax Relief (VGTR)

3.85. HMRC forecast that VGTR would cost £35m a year but in the 12 months to March 2021 cost £180m.

3.86. TaxWatch have highlighted that 55 claims over £500,000 represent 87% of the total value of payments[25].

3.87. These claims are made by a small number of multinationals including Sony and Warner Brothers despite the intention being to help "culturally British" projects.

3.88. This relief does not appear to be going to the intended audience, does not appear to be meeting its intended objectives and has rocketed in cost to more than five times its original forecast and yet still no action has been taken to remove or reform it.

3.89. Social Investment Tax Relief (SITR)

3.90. Whereas VGTR has resulted in a far greater cost than was ever anticipated, SITR has resulted in a substantially lower cost than was ever anticipated

3.91. Initially, HM Treasury forecast an annual cost of up to £35m a year and yet it cost less than £2m in total not just per year but for the first three years of operation combined.

3.92. In its submission to the Treasury Select Committee inquiry into Tax Day (March 2021) AAT explained;

3.93. *"As AAT has already stated in its response to the Budget, and in response to the 2019 consultation on the subject, AAT alerted Government to the very poor levels of awareness of this relief, both among the intended user audience and the adviser community. AAT supports the extension of SITR to 2023 providing much more is done to promote awareness and understanding of this seriously underutilised relief."*

3.94. In the subsequent 18 months AAT is not aware of any action that has been taken to raise awareness of this relief and therefore very much suspects it will not be renewed again post 2023.

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[23] **Love Money, March 2016:**
https://www.lovemoney.com/news/51146/inheritance-tax-unfair-changes-family-allowance-estate-child-grandchild-copy
[24] **Oxera report for HMRC, Tax advantaged employee share schemes, August 2007:**
https://www.oxera.com/wp-content/uploads/2018/07/Tax-advantaged-employee-share-schemes—report-1.pdf.pdf
[25] **TaxWatch, VGTR Update 2021:**
https://www.taxwatchuk.org/video_games_tax_relief_2021/

3.95. This raises another question for the Committee to consider, if only a small proportion of an intended audience is aware of a relief designed to help them, should the relief be withdrawn or should government make greater efforts to increase awareness?

3.96. **New tax reliefs**

3.97. AAT has recommended the scrapping, reducing or reforming of various tax reliefs that it does not believe justify maintenance in their current format and generally does not favour the creation of new reliefs. That said, there are exceptions, AAT's proposed tax relief for self-funded work-related training being such an example.

3.98. A comprehensive rationale for introducing such a relief follows below.

3.99. <u>Tax Relief for work related training</u>

3.100. Under current legislation, the self-employed can deduct the costs of training incurred "wholly and exclusively" for their business where it maintains or updates existing skills but not when it introduces new skills – not much good when the country is facing an urgent need for workers to upskill and reskill.

3.101. Likewise, whilst many employers pay for their employees to undertake training, many more do not. Where their employer doesn't reimburse them, employees cannot receive tax relief other than in very limited circumstances when the training is an intrinsic contractual duty of their existing employment.

3.102. In 2018, the Government (HMRC & HM Treasury) consulted on proposals to allow tax relief for self-funded work related training but these plans were quietly dropped in the October 2018 Budget, with the 102-page Budget documentation containing a single paragraph confirming that "…following consultation responses indicating that tax relief is unlikely to be effective in addressing the barriers to learning or incentivising training."

3.103. This was a very disappointing but not wholly surprising decision given the highly skewed nature of the public consultation. It is also very misleading given the reason most respondents said tax relief would fail to incentivise training was because of the Government's insistence on capping the relief at such a low level.

3.104. Concerns about affordability and sustainability are reasonable but greater investment in workers is likely to lead to greater taxable incomes. In addition, the loss in tax revenue due to allowable training costs for individuals will become taxable trading income in the hands of thousands of training providers.

3.105. The Government decision taken in 2018 appeared short-sighted and self-defeating at the time but four years on it seems even more so given the state of the UK economy due to a global pandemic, Brexit related disruption and now a cost of living crisis, all of which have further enhanced the drastic need for increased reskilling and upskilling.

3.106. AAT would therefore very much like the Committee to recommend that Government revisit the idea of introducing tax relief for self-funded work related training.

3.107. There are lessons to be learned from previous experience in the UK and current experience overseas, but AAT believes many of these obvious lessons appear to have been ignored.

3.108. For example, the 2018 consultation document acknowledges that, *"…more than a quarter of the £36 million tax relief given in 1997 to 1998 related to claims for flying and diving. Horse riding and cookery courses were also popular, with the relief criticised for funding expensive hobbies."* Despite this, the consultation document goes on to state that, *"…the government is not seeking views on whether to target any changes at a particular industry or set of skills."*

3.109. Likewise, in relation to international lessons, we remain in a minority of OECD nations not allowing training to be deducted from taxable income and yet the Government had proposed that a cap be imposed, despite two thirds of OECD nations who permit deductions having no cap.

3.110. AAT agrees that any tax changes will need to be closely defined to achieve the desired intention. However, it should be noted that a very small number of businesses will always seek to exploit the tax system regardless of how well the tax legislation is defined.

3.111. There would be challenges with trying to restrict the relief so that it is not available for ‘recreational activities’ because of the subjectivity in this distinction. For example, diving may be recreational for some people or necessary for people whose work involves inspecting the hull of a ship. Similarly, there may be issues with trying to restrict the relief so that it is not available for ‘personal purposes’ where it is difficult to distinguish between a person’s occupation and their hobbies.

3.112. AAT therefore recommends that any new legislation to define allowable ‘training’ relies on an objective test (as set out below).

3.113. AAT understands the rationale for restricting the applicability of tax deductions to those needing to upskill or retrain, particularly for those who want or need to change career, to progress in the work place and improve their earnings. That said, it should be acknowledged that there are numerous other areas which although not considered to be directly, “work-related” are likely to lead to increased chances of employment. These include enabling the third of UK workers who experience mental health issues to receive non-work-related training that may help their recovery and enable them to continue working or return to work and including Health and Safety training, which strictly speaking may not be considered “work-related” but is likely to produce significant benefits in the workplace.

3.114. There is likely to be increased earnings from those who receive relevant high-quality training which in turn increases tax receipts. There will also be reduced state benefit payments to those who were at risk of redundancy or at risk of losing their own business etc. as increased skills may lead them to secure alternative employment.

3.115. AAT acknowledges that there is a wide spectrum of training available from a wide range of learning providers in the UK but that value for money and tangible benefits to individuals and the UK economy should be a key criterion in deciding eligibility. Rather than re-inventing the wheel, AAT suggests focusing on support for training provided by providers who have already been approved to offer formal qualifications i.e. those that appear on the Register of Regulated Qualifications, providing the government additionally allows tax relief for formal qualifications offered by professional organisations approved by HMRC for the purposes of tax deductions related to fees and subscriptions (the HMRC “Approved professional organisations and learned societies” list).

3.116. It will be very difficult to minimise the scope for misuse related to ‘recreational activities’ as the rules should not require HMRC to establish ‘intent’. A person’s intention may change over time, for example if the intention was to gain skills in a particular area but on embarking upon the training they subsequently find they have little aptitude for the subject. Similarly, the learner may have multiple intentions for the same course e.g. some may be personally/socially interested in a course where the subject also relates directly to the industry within which they work. Currently, there are several NVQ courses that could potentially be used for ‘recreational activities’ such as NVQ Courses in Crafts, Creative Arts and Design; Sport, Leisure and Recreation; Languages, Literature and Culture. Education, training and recreational activities are not necessarily mutually exclusive so HMRC are likely to face considerable challenges in establishing intent here.

3.117. As a result, AAT recommends that any new legislation, introduced to define allowable ‘training’, relies on an objective test. For example, if the course is an NVQ and is recognised by the government for funding then it would be an allowable training cost that is deductible against income tax and National Insurance.

3.118. It is questionable whether a cap is needed. Two thirds of OECD nations who provide tax relief, do not impose a cap (14 of 21 nations).

3.119. Whilst concerns about affordability and sustainability are reasonable, this ignores the fact that, as already stated above, greater investment is likely to lead to greater taxable incomes and the loss in tax revenue due to allowable training costs to individuals and the self-employed will become taxable trading income in the hands of thousands of training providers.

3.120. If affordability and sustainability are of such importance then limiting the types of training eligible for the tax deduction, rather than imposing a cap, is likely to be a better way of ensuring sustainability and affordability for public funds whilst simultaneously enabling the greatest likely return for the taxpayer.

3.121. Whilst AAT does not believe a cap is necessary, should the government insist on imposing one, then it must be considerably higher than the derisory £500 suggested by Government in 2018.

3.122. A cap of £500 would provide a basic rate taxpayer with income tax relief of just £100. AAT contends that a deduction at this level would be insignificant, fail to significantly change behaviour and be unlikely to incentivise most to apply for any tax deduction.

3.123. The Government suggested in their 2018 consultation that this low cap, *"…could then be modified in the future once the government has been able to assess the operation of the relief in practice."* This provides no reassurance as the most likely outcome is that a low cap will prove a substantial barrier, ensuring low take-up and then providing justification for government to state that having reviewed its operation it has now decided to completely withdraw the relief based on poor results. This has been the case with several tax reliefs that are either poorly designed or poorly promoted and then withdrawn due to low take-up (see reference to Social Investment Tax Relief above).

3.124. When considering where to set a cap, it is worth bearing in mind that training to become qualified in many manual construction industry jobs cost at least £5,000 e.g. becoming a plumber/gas engineer.

3.125. Most academic routes cost more still.

3.126. By way of background, AAT has thousands of students who are reskilling and upskilling to either change careers or progress with their existing employer – exactly the type of activity such a deduction is designed to encourage – including over 3,000 students aged over 50. AAT's Accounting Qualification, delivered through training providers (e.g. Further Education colleges, Kaplan, BPP etc.) costs between £4,000 and £10,000.

3.127. The difference in fees charged by training providers is dependent on the type of training (distance learning or classroom based) and the level of tutor support etc.

3.128. Finally, if insistent on imposing a cap, concerns about wealthier earners benefitting from the tax system must be considered. However, these must also be weighed against the likely increased lifetime earnings of the individual and the increased tax revenues for the state that are consequently derived. As already indicated, the greater the investment, the greater the potential return.

3.129. If there is a genuine intention to encourage greater levels of high quality training then the offer must be attractive i.e. no cap or a reasonable cap of at least £5,000 per annum so as not to eliminate most relevant upskilling and reskilling opportunities.

3.130. Introducing this new tax relief would help the Government meet its 2019 General Election manifesto commitment to deliver, *"…a dramatic rebooting of our training system – to support public services, existing businesses and the businesses of the future. But above all, … ensure that Britain's workers have the skills they need to flourish – and that every citizen of this country has the opportunity to express their talents to the fullest.[26]"*

3.131. **Claiming Tax Reliefs**

3.132. Anyone using a regulated agent i.e. a tax adviser or accountant who belongs to a relevant professional body, is likely to be made aware of any tax reliefs that they may be entitled to, encouraged to claim them direct from HMRC or would have the relief claimed on their behalf by their tax adviser/accountant where suitable.

3.133. This is not always the case in respect of the third of agents who are unregulated i.e. they do not belong to a professional body.

3.134. As HMRC's own research shows, 82% of these are completely unqualified[27] so the chances of receiving bad, inaccurate or misleading advice in relation to tax reliefs (and much else) is very high. A point that is further proven by the fact that two thirds of agent related complaints to HMRC relate to the one third of agents who are unregulated.

3.135. These problems are compounded by the fact most unregulated advisers do not undertake any form of CPD and that most are uninsured.

3.136. As HMRC and Government know, this could very easily be solved by requiring anyone who gives paid-for tax or accountancy services to be a member of a relevant professional body, in the same way that is required of over 200 other professions in the UK.

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[26] Conservative Party manifesto 2019:
https://www.conservatives.com/our-plan/conservative-party-manifesto-2019
[27] Understanding the characteristics of unaffiliated tax agents, November 2021:
https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037031/Understanding_the_characteristics_of_unaffiliated_tax_agents.pdf

3.137. This would drastically enhance consumer protection; reduce the number of problems encountered with repayment agents along with numerous other issues (tax avoidance, money laundering, false claims etc.) as AAT has repeatedly set out over the past decade, perhaps most notably in our April 2021 response to HMRC.[28]

3.138. Of course this does leave a third cohort, those who are unrepresented either by regulated or unregulated agents. These individuals can make a claim direct to HMRC themselves and doing so is relatively straightforward. The challenge is ensuring that these taxpayers know that they can both make such a claim and be aware that it is relatively straightforward.

1. AAT

1.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are more than 6,000 licensed accountants who provide accountancy and taxation services to over 600,000 individuals and small/medium sized British businesses.

1.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

2. Further information

2.1. If you have any queries, require any further information or would like to discuss any of the above points in more detail, please contact Phil Hall, AAT Head of Public Affairs & Public Policy:

2.2. E-mail: phil.hall@aat.org.uk Telephone: 07392 310264 Twitter: @PhilHall2021

2.3. AAT (Association of Accounting Technicians), 30 Churchill Place, London, E14 5RE

Phil Hall, 1 September 2022

[28] **AAT response to HMRC consultation, Raising Standards in the Tax Advice Market, April 2021:** **https://www.aat.org.uk/prod/s3fs-public/assets/AAT-response-HMRC-consultation-raising-standards-tax-advice-market.pdf**