Treasury Committee

Tax Reliefs

Written evidence from Dr. Mohamed Hosam Al Kaddour, Senior Academic and Tax Expert, Head of Department of Accounting, Professor Ven Tauringana and Professor Collins Ntim, Professor of Accounting, Department of Accounting, Southampton Business School, University of Southampton, UK. We are academics, who have extensive experience and expertise in accounting, corporate finance and governance, public policy, and taxation. We have focused our answers on areas of our specific research and teaching experience that are directly relevant to this consultation. We are happy to provide further information/insights in these areas if required.

According to our evaluation for National Audit Office's report (June 2022) that indicate that tax expenditures represent a large and growing cost to the Exchequer. In March 2022, the Office for Budget Responsibility has reported that the known cost of tax expenditures had risen in the past decade more than 6%. The Government is committed to reduce tax burden and increase the growth in the UK economy. Based on our extensive research/teaching experience and expertise, we provide evidence in response to the following questions asked by the Committee:

1- Does the current suite of tax reliefs represent good value for money?

2- Are tax reliefs being used in a way that Parliament or Government intended?

3- Do "cliff edges" in the structure of tax reliefs lead to problems for taxpayers, businesses or for the wider economy?

4- What problems do tax reliefs cause, whether in relation to the tax system including tax evasion or avoidance, or the wider economy?

Citation: Al Kaddour, M., Tauringana, V., Ntim, C., Tax Reliefs (2022) A response to the Treasury Committee's inquiry into Tax Reliefs.

DOI: 10.5258/SOTON/PP0019

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Does the current suite of tax reliefs represent good value for money?

Are tax reliefs being used in a way that Parliament or Government intended?

These reliefs must maintain the equity of the UK tax system (vertically and horizontally), the structural tax reliefs should be kept as core part of the effective fair tax system while non-structural tax reliefs can be managed (operated) in better way that really achieve intended social and economic objectives.

- Pension contributions relief (annual allowance & lifetime allowance), as the largest tax expenditure, is operated in satisfying ways that maintain good life standards for our pensioners (during current life cost crises) at reasonable Government tax expenditure.

- The R&D tax relief is quite important, especially for SMEs. Wise and Miles (2013), for example, provide evidence that the US R&D tax credits enhance the economic viability of innovative activities with positive financial implications of this type of tax credit for SME owners and managers in particular. Additionally, extra tax relief is provided when the R&D activities are contracted out to a tax-exempt charity. In the UK, Cowling (2016) has used the National Systems of Entrepreneurship to investigate whether the UK-SMEs take-up of tax credits has led to an increase in product, service, or process innovations. His results suggest that the SMEs' engagement with the policy is randomly distributed across the sectors. Further, he found evidence that suggests that additional product–service innovation occurs that justifies the expenditure in foregone taxes given within the current distribution of R&D tax credits. The literature e.g., Foreman-Peck (2013) assessed the UK innovation policy effects on a large sample of SMEs. His results indicate that SMEs receiving UK state support for innovation were more likely to innovate than unsupported comparable enterprises. The ability to innovate is significantly linked with fast growth. Thus, the UK SME innovation policy has overall been efficient, as well as effective. There is also evidence that SME tax credits were expensive compared with earlier support instruments.

- We understand the Government's desire to increase the growth in the UK economy and reduce unemployment levels through tax cut for businesses but this mission would be better achieved if the Government increases the Annual Investment Allowance (AIA) from £200,000 into £500,000, especially after the inflation that makes capital investments more expensive. The long-term benefits of this increase will outweigh the tax shield of corporations' taxable profits (tax liabilities) and will not be considered an aggressive tax avoidance.

- Structural reliefs: The government proposal to cancel the Health and Social Care Levy (the increase in National Insurance contributions NICs) will be useful particularly for businesses which will have more money to invest (with good R&D relief and maintain the proposed increase in Employment Allowance), getting better revenue, employ more staff or pay higher wages and enhance the growth of the UK economy.

- The Government proposal to cancel the additional band rate of 45% will NOT be useful as it will send the wrong signal to low earners, will not increase the incentive to work and will reduce the Government revenue. Instead, The Government should instead increase the personal allowance to £15,000 or increase the basic band limit to £45,000 or £50,000 instead of £37,700.

Overall, the majority of tax reliefs have been used in a way that Parliament or Government intended. Although HMRC seeks improvements to address value-for-money concerns, we suggest setting up a formal office that governs the operation of tax expenditures with clear guidance about HMRC's accountabilities for tax expenditures to enable greater transparency. Other responsibilities for this office include measuring and analysing any variation between the actual and forecast cost for tax expenditures.

Do "cliff edges" in the structure of tax reliefs lead to problems for taxpayers, businesses or for the wider economy?

In principle, using cliff edges in the structure of tax reliefs is good especially in child benefits for household income more than £50k and Personal allowance for income more than £100k and even in Stamp Duty Land Tax where sometimes the difference between residential property and mixed-use property is significant. For the Property Development Sector, claims to Multiple Dwellings Relief can often achieve tax reductions from the commercial rate of 5% to as little as 1% if multiple dwellings are available that's an 80% fall! The UK commercial Real Estate industry has significant economic contributions for example 2.5 million jobs directly and indirectly; £40 bn per annum as employment-related taxes, business rates and other taxes including property transaction taxes.

Even VAT has its own such cliff edges when the business turnover is around the registration threshold (£84K) in a certain quarter. This significant step would encourage the business to undertake tax evasion or an aggressive tax avoidance scheme.

What problems do tax reliefs cause, whether in relation to the tax system including tax evasion or avoidance, or the wider economy?

Tax literature states that tax reliefs have negative effects on income and regional inequality (distributional impacts) and these effects will be more severe with a lack of public accountability. The Government should scrutinise its tax expenditures to avoid inequality between higher and lower incomes and introduce specific tax credits for lower incomes. The OECD argue for the removal of reliefs like low CGT for the sale of a principal or secondary residence and stock options to achieve a cut in marginal labour income tax rates and boost growth (OECD, 2012). Reducing the tax expenditures is beneficial both for long-term GDP per capita; for a more equitable distribution of income; reduce the tax system's complexity and tax compliance and collection costs. Fowkes, Sousa and March (2015) indicate that the UK corporate tax reliefs appear skewed in terms of their regional impact and income distribution. For

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example, over a third of total claims for R&D tax credits have been made by London and the South East, and received over 50% of the claimed value.

Helen Miller (2018) stated that many reliefs have weak or poorly articulated policy aims, especially corporate tax reliefs. OBR (2019) indicates that only few reliefs have been evaluated, either in terms of cost or effectiveness in meeting stated objectives. Moreover, the relationship between various tax reliefs hasn't been examined 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.

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