National Audit Office

**Report**
by the Comptroller
and Auditor General

**HM Revenue & Customs**

# The effective management of tax reliefs

## Appendix Four

Our vision is to help the nation spend wisely.

Our public audit perspective helps Parliament hold government to account and improve public services.

The National Audit Office scrutinises public spending for Parliament and is independent of government. The Comptroller and Auditor General (C&AG), Sir Amyas Morse KCB, is an Officer of the House of Commons and leads the NAO, which employs some 820 employees. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether departments and the bodies they fund have used their resources efficiently, effectively, and with economy. Our studies evaluate the value for money of public spending, nationally and locally. Our recommendations and reports on good practice help government improve public services, and our work led to audited savings of £1.1 billion in 2013.

# Appendix Four

Detailed case studies

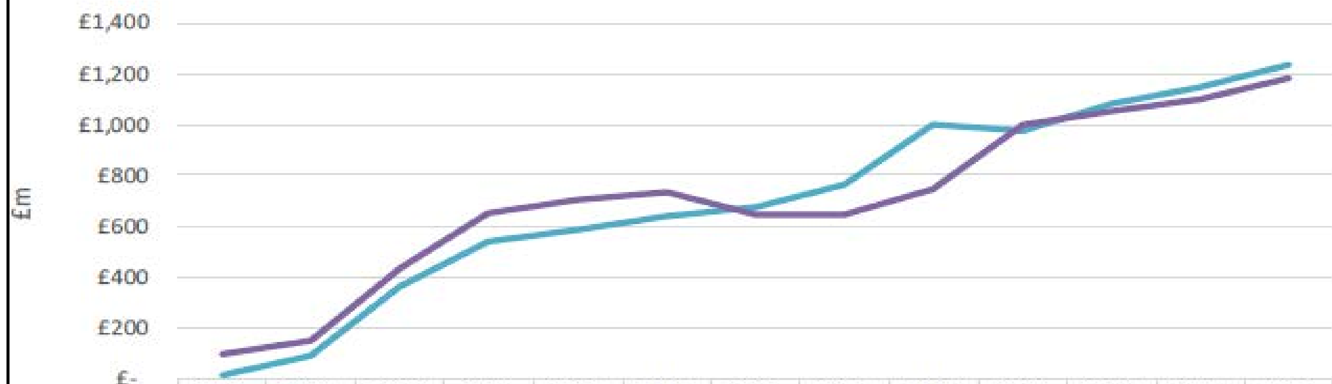
# Research and Development Relief

## BACKGROUND

**Current Value (2013-14):** £1,325 million

**Objective:** This relief supports the development of new technologies, innovations, inventions and R&D knowledge.

**How the relief works:** R&D relief reduces taxable profits for corporation tax. Qualifying R&D expenditure may be deducted at an enhanced rate from taxable profits. As at 2013-14, these rates stand at 225% for SMEs and 130% for large businesses. If a company reports a loss with R&D expenditure, tax credits may be paid by HMRC.




| | 2000-01 | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Outturn | £13 | £91 | £363 | £539 | £588 | £641 | £676 | £766 | £998 | £977 | £1,083 | £1,149 | £1,235 |
| Forecast | £94 | £150 | £433 | £655 | £704 | £733 | £647 | £644 | £746 | £1,002 | £1,056 | £1,100 | £1,185 |

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: **MEDIUM**

**Risks identified**

**1. Boundary pushing**, in particular in relation to:
- SME definition (i.e. do companies meet the EU definition of a genuine SMEs)
- Meaning of consumables

**2. Challenging expertise** - Whether HMRC have the knowledge to challenge definitions of R&D in technical areas, for example software development

**Extent to which this abuse has crystallised:** NO DATA RECORDED

**Example of response to avoidance:**

SME definition cases are few in number and are considered on an individual company basis. The issue is kept under constant review by CTIS.

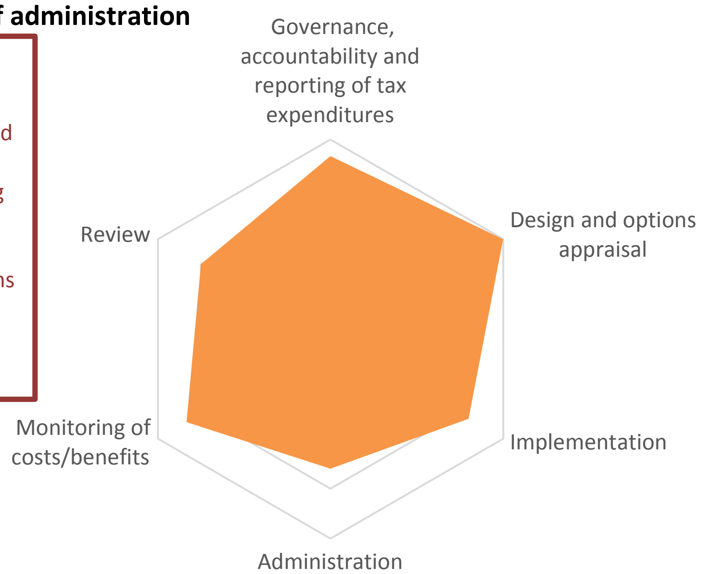
Monthly Specialist units and Unit Head meetings, which include product owner, review the national approach and emerging issues.

| Risk of abuse | | |
|---|---|---|
| The cost of abuse is estimated | The value of tax at risk is estimated | The success rate in investigations is known |
| ✗ | ✗ | ✗ |

## ADMINISTRATION

**NAO assessment of administration**

**Areas for improvement:**
- No abuse detected but risk of boundary pushing identified
- Limited expertise to challenge claims in some specialised areas.




**Examples of good practice:**
- Ongoing forecasting of costs
- Ongoing reviews and periodic evaluations
- Annual reports of performance
- Use of specialist unit to administer the relief , this includes monthly meetings to ensure a national approach to administration and that emerging issues or risks are highlighted early.
- Holds a consultative committee with companies and sector representatives

**HMRC's approach to administering the relief**

| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✓ | ✓ | ✓ |

## EVALUATION AND REVIEW

HMRC's objective is to increase take up of the relief. The figure shows that the amount of R&D activity on which relief is claimed has increased year-on-year. However, overall business expenditure on R&D has remained flat. HMRC studies have suggested that £1 of foregone tax revenue stimulates between £0.41 and £3.37 of R&D investment.

Growth in R&D activity and cost of R&D tax credits (indexed 2001-02 = 100)


| | 2001-02 | 2002-03 | 2003-04 | 2004-05 | 2005-06 | 2006-07 | 2007-08 | 2008-09 | 2009-10 | 2010-11 | 2011-12 |
|---|---|---|---|---|---|---|---|---|---|---|---|
| R&D activity on which R&D tax credits are claimed | 100 | 415 | 614 | 678 | 745 | 788 | 883 | 1043 | 922 | 997 | 1060 |
| Cost of R&D tax credits | 100 | 236 | 305 | 324 | 345 | 361 | 414 | 497 | 489 | 523 | 553 |
| Total business expenditure on R&D activity | 100 | 99 | 98 | 98 | 103 | 105 | 111 | 108 | 105 | 107 | 111 |

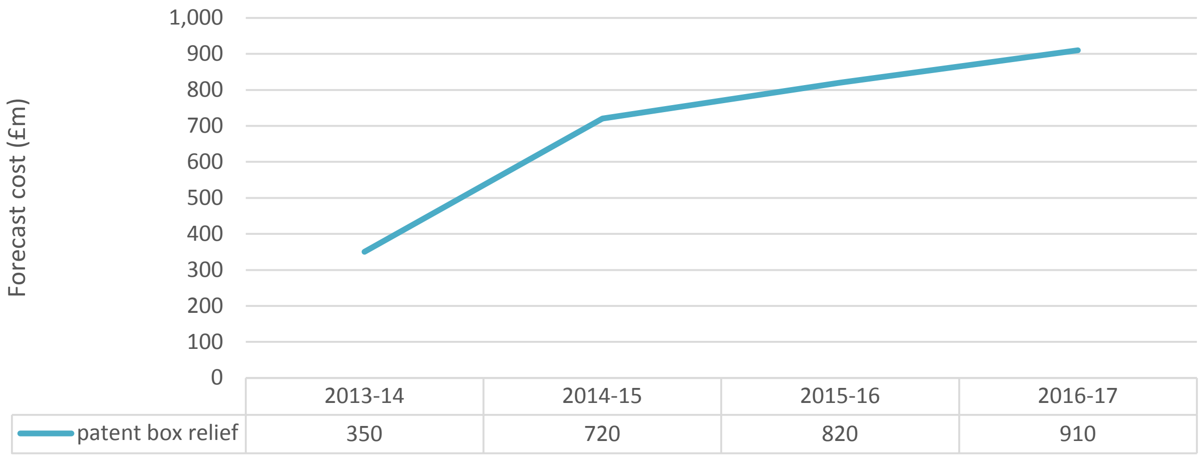
# Patent Box

## BACKGROUND

**HMRC Forecast Cost 2013-14:** £350 million

**Objective:** To provide an additional incentive to companies for retaining and to commercialise existing patents and to develop new innovative patented products. Encouraging companies to locate the high-value jobs associated with the development, manufacture and exploitation of patents in the UK.

**How the relief works:** The Patent Box allows companies to elect to apply a 10 % rate of Corporation Tax to all profits attributable to qualifying patents, whether paid separately as royalties or embedded in the sales price of products. The regime also applies to other qualifying intellectual property rights.




It was announced in the Pre-Budget Report that the regime will come in at more than anticipated cost, estimated at £500m in the first year

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: **HIGH**

**Risks identified:**

- Legislation contains areas of complexity and uncertainty open to interpretation
- Fragmentation of companies into multiple 'fields of use' could place more profits into Patent Box than intended, without the desired behavioural impact
- Reliance is placed on the premise that UK and European patents cannot be easily obtained
- Potential legal conflict - Patent boxes in numerous countries are being assessed by the OECD and the EU because they are potential breaches of rules limiting state aid. The formal investigation by the European Commission is not yet complete.

**Early intervention to prevent risk:**

- Anti avoidance measures have been built into legislation
- A risk taskforce is in place to monitor and assess all claims for risk along with the use of Patent Box specialists to investigate claims
- Engagement with stakeholders and collection of supplementary data to identify usage trends
- Discussions held with taxpayers prior to claim submission to get claims right first time

**Crystallisation of avoidance activity:**

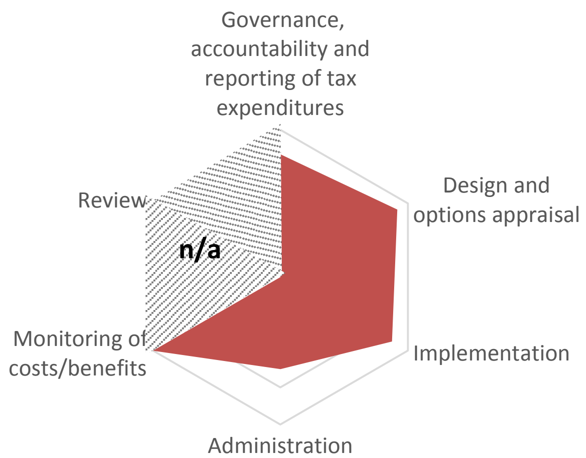
The Patent Box was introduced in April 2013, companies have two years from the end of their accounting period to make a Patent Box claim. HMRC will therefore not have a complete picture of the first year of the relief until 2016.

**Tax at risk:**

HMRC has yet to calculate the value of tax at risk.

## ADMINISTRATION

**NAO assessment of administration**




**Examples of good practice:**

- Consultation process showed good engagement with stakeholders and the team have attended roadshows to publicise the relief and how it works
- All claims are assessed for risk by a Risk Taskforce
- Collection of supplementary qualitative data via the Large Business Survey for example, to provide information on actual and anticipated impact on businesses.
- Plans exist to publish detailed statistics on cost and take-up
- A post implementation evaluation is planned 5 years after inception

**Areas for improvement:**

- Level of relief complexity: The Patent Box involves complex computations introducing potential for intentional avoidance and unintentional errors which will need to be monitored.
- Calculation of the tax at risk from misuse.

**HMRC's approach to administering the relief**

| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✓ | ✓ | ✓ |

## FORECASTING APPROACH AND PLANS FOR REVIEW

**Forecasting methodology**

HMRC has calculated the potential cost of the Patent Box from 2013 onwards by using companies and groups claiming R&D relief of more than £200,000 in 2006-07 as the raw data for its forecast.

The methodology has considered a number of behavioural effects:

- Increased number of patents where previously intellectual property would have been protected using other means
- Movement of income and expenditure within Corporate Groups
- Inward flow of overseas profits attracted by the Patent Box

**Tax yield arising from increased overseas investment due to the Patent Box (£ million)**

| 2013-14 | 2014-15 | 2015-16 | 2016-17 | 2017-18 | Steady State |
|---|---|---|---|---|---|
| 0 | 0 | 120 | 140 | 160 | 160 |

**Further analyses**

HMRC is still developing plans for evaluation of the Patent Box. These are likely to assess increased innovative activity, including through additional questions in the Large Business Survey and an interim review when a full year's cost data are available.

There will be a delay in conducting any analysis because companies have a long 2-year window in which to file Patent Box claims, delaying when HMRC has complete data.

# Agricultural and Business Property Reliefs

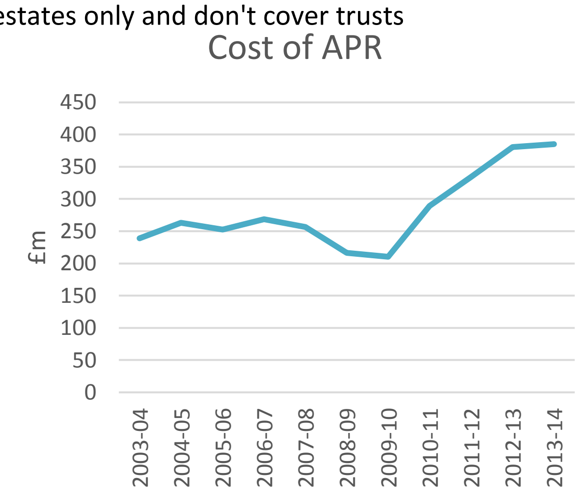
## BACKGROUND

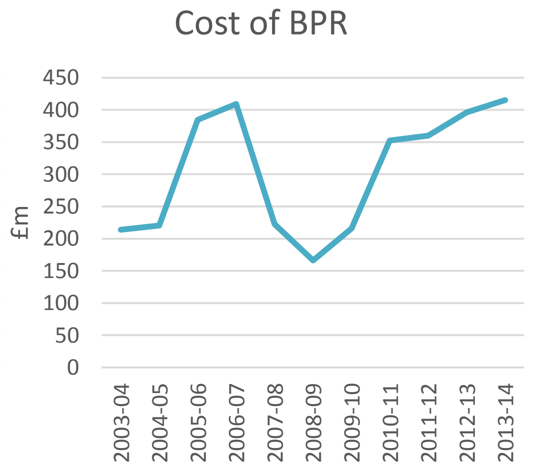
**Current Value (2013-14):** £385 million (APR) / £415 million (BPR)

**How APR relief works:** Agricultural property relief is available on the agricultural value of agricultural property. Either a 100% or a 50% relief from inheritance tax on the property is given. The rate depends on the type of property.

**How BPR relief works:** Individuals can claim business relief on transfers of certain types of business and of business assets if they qualify as relevant business property and the transferor has owned them for a minimum period. If an asset qualifies for BPR it is given either a 100% or 50% relief, depending on the type of asset.

**Both reliefs** have an economic objective to encourage business continuation. They apply to assets held on death or in trust, or to transfers during a person's lifetime. Note the data presented in this slide relate to estates only and don't cover trusts




Note that the 2013-14 data is a forecast and may be revised by HMRC

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: **MEDIUM**

**Risk of avoidance**

In March 2014 the NAO reported that APR and BPR are regularly cited by tax planning firms as relatively easy ways to reduce inheritance tax liabilities. HMRC reviews all claims to APR and BPR using a range of tools and techniques and has a highly developed risk register to track risks to IHT. 7 out of the 29 risks identified on the IHT risk register relate to APR and BPR. Two of those are ranked as high impact and HMRC considers itself to be vulnerable to both . All of the risks on the IHT risk register are monitored and tackled through litigation if necessary.

**Example of response to avoidance:**

- The compliance officers determine which claims warrant further investigation. For example, if significant debt is deducted from an estate.
- Whether use of a relief is legitimate is decided on a case by case basis.
- For gifts, evidence must be provided to show that the money borrowed is spent (e.g. business accounts)
- HMRC Database Connect: checks values disclosed in planning applications.
- Where HMRC has concerns it investigates further and meets with the agents to address their behaviour or misunderstandings of the relief

**Management Information:**

HMRC monitors tax at stake for the individual cases that they intend to challenge. HMRC does not track the total tax at risk for similar types of cases or the total tax at risk figure relating to the APR or BPR.

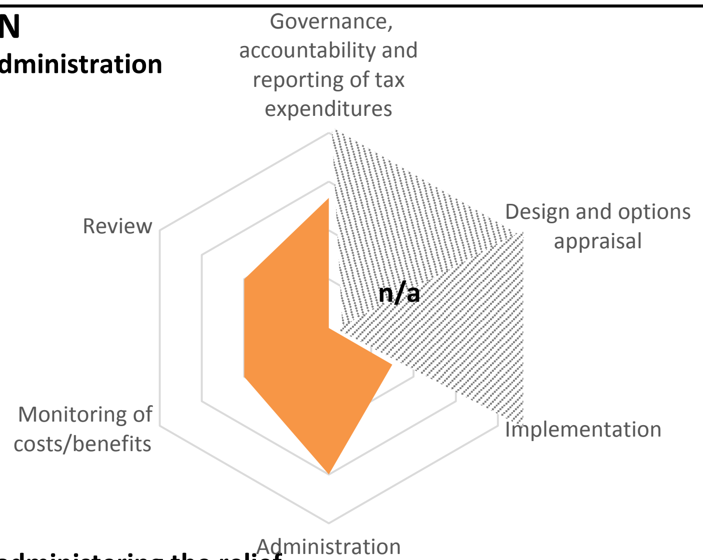
| Risk of abuse | | |
|---|---|---|
| The cost of abuse is estimated | The value of tax at risk is estimated | The success rate in investigations is known |
| ✗ | ✗ | ✓ |

## ADMINISTRATION

**NAO assessment of administration**

**Potential areas for improvement:**

- There is currently no analysis on awareness levels or take up
- Collate tax at risk data to identify which risks have the highest tax at stake




**Examples of good practice:**

- Identifying legislative changes to tackle misuse
- Highly developed risk register to track IHT risks. Particular agents who are regularly involved in abuse cases will also be flagged.
- Co-ordinating with specialist units including the Valuation Office Agency and Shares & Assets Valuation
- Operating on the basis of 'Promote, Prevent, Respond'

**HMRC's approach to administering the relief**

| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✗ | ✗ | ✓ |

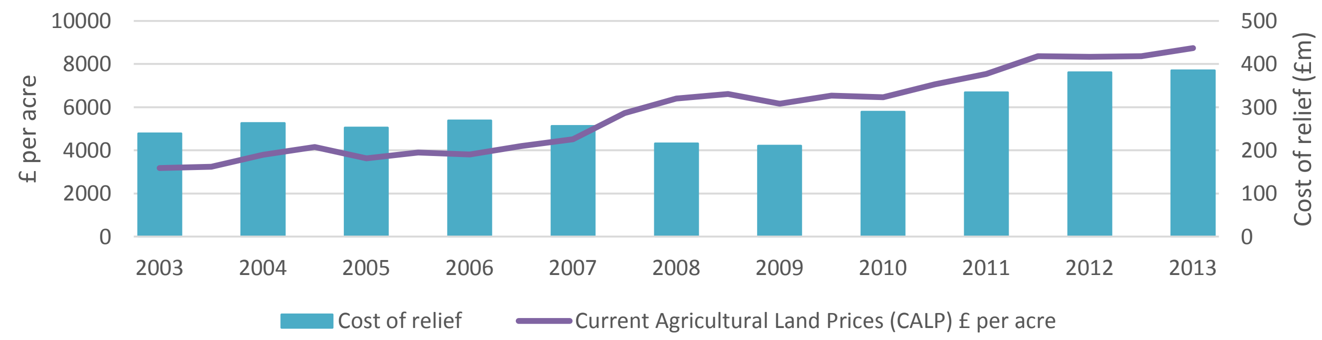
## EVALUATION AND REVIEW

**BENEFITS**

Evaluation of the benefits typically goes beyond HMRC's work to process a return. The department check that the business is still being used when there is a lifetime transfer. It does not look at whether a business remains a going concern following a claim for relief but there is nothing in the legislation to prevent heirs from selling the business afterwards.

**OTHER ANALYSIS**

HMRC does not routinely compare the value of the relief against the value of assets. The Department considers that the rising cost of APR is likely to be linked to the agricultural price of land. Our analysis below indicates there is a correlation.



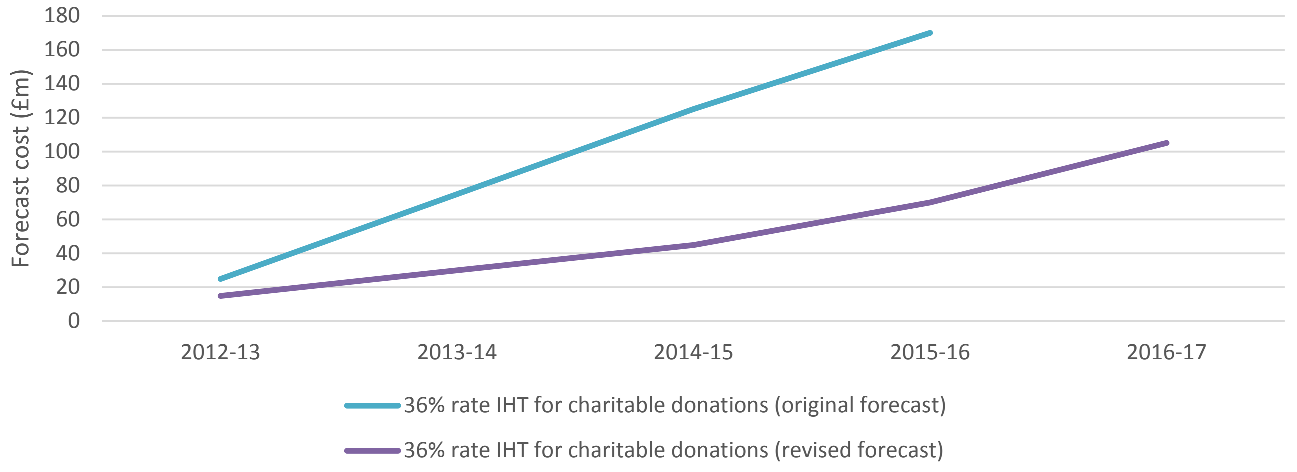
# 36% reduced rate IHT for leaving 10% of estate to charity

## BACKGROUND

**HMRC Forecast Cost 2013-14:** £30 million

**Objective:** This policy supports the Government's aim to encourage charitable giving, promote greater philanthropy, and links into the Government's objective of fairness in the tax system. The policy aims to act as an incentive for people to make charitable legacies, or to increase existing legacies, increasing the amount charities receive from estates.

**How the relief works:** If 10% or more of net assets subject to inheritance tax are donated to charity, then the rate of inheritance tax is reduced to 36% (from 40%)




Note: Preliminary estimates of the costs were revised in Budget 2012 following consultation on the relief

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: LOW

### Risks identified

- **Risk of avoidance** through the manipulation of asset values
- **Lack of awareness** about the availability of the relief
- **Incorrect calculations and/or inappropriate claims**

### Example of measures to prevent and manage risk

- **Response to avoidance:** All returns where the 36% rate is claimed are risk assessed (tested)
- **Increase awareness:** Discussions with representative bodies, included as a standard option in the template for drafting wills
- **Review of guidance and tools on HMRC's website** to assist with claim calculations

### Tax at risk:

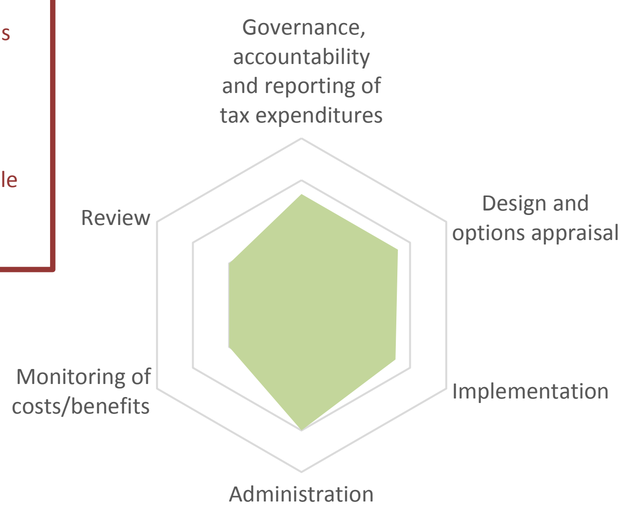
HMRC has yet to calculate the value of tax at risk as claims data is not available. This is due to the lag in getting data from IHT returns. Data from 2012/13 (the year the relief was introduced) will not be available until summer 2015.

## ADMINISTRATION

### NAO assessment of administration

**Areas for improvement:**

- There is currently no analysis on awareness levels or the administrative burden
- No specific performance targets have been set apart from an increase in charitable legacies




**Examples of good practice**

- The data used to review costs and benefits came from a sample of estates which were left on death in 2008-09 projected forward using the forecast determinants.
- The cost forecast included an estimate of deadweight loss
- Online calculator to help individual check if they qualify for relief
- Intelligence sharing between HMRC Charities team, Valuation Office and Shares and Assets Valuation
- HMRC plans to publish statistics on take-up and cost once data is available

| Administrative data | | |
|---|---|---|
| **Cost of administering the relief is known** | **The number of people involved in administration is known** | **The proportion of claims that is checked is known** |
| ✘ | ✘ | ✔ |

## EVALUATION AND REVIEW

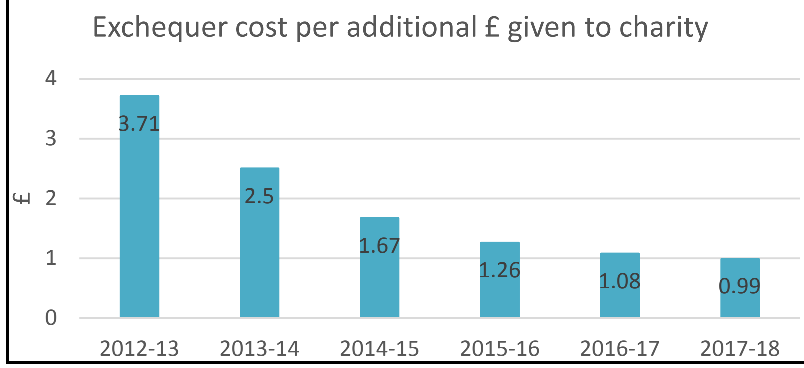
### BENEFITS

1) The additional revenue that this measure is expected to raise for charity up to 2016-17 is on average approximately £40 million per year.

2) Behavioural change assumptions:

- 30% of people who weren't giving anything to charity will now give 10-10.5% to qualify for the relief.
- 80% of people who were giving something will now give up to an additional 3% of their estate when necessary to qualify for the relief.
- 80% of people who were giving something will now give an extra 3-7.5% of their estate when necessary to qualify for the relief.
- 35% of people who were giving something will now give an extra 7.5-10% of their estate when necessary to qualify for the relief

**OTHER ANALYSIS:** during the design and options appraisal stage of the administrative cycle, HMRC considered the costs and benefits of this tax relief in detail.




Explanation:
The costs per additional £1 left to charity were expected to be high initially due to the delay as people: find out about the reduced rate; alter their will; die; and their legacies are distributed to charities.
This cost is forecast to decrease each year as people change their behaviour to leave more of their estate to charities.

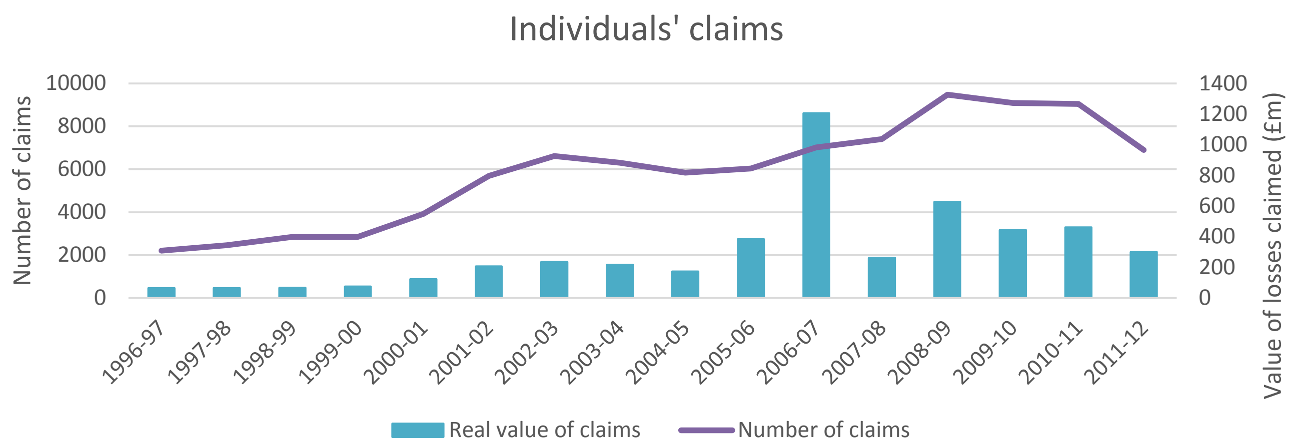
# SHARE LOSS RELIEF

## BACKGROUND

**Current Value (2013-14):** unknown

**Objective:** Alongside the venture capital schemes, this relief aims to support investment in smaller, higher risk, unquoted trading companies, that might otherwise have difficulties finding sources of finance due to risk of investment.

**How the relief works:** Share Loss Relief (SLR) is available to individuals and certain investment companies and allows them to offset capital losses on shares against income or profits rather than gains.




In 2006-07 the value of share losses claimed in individuals' income tax calculations rose in real terms from £385 million to £1,206 million. HMRC was aware of an increase in avoidance at the time but the scale of the increase in cost only came to light in 2013 as part of a one-off exercise. The increase in cost is due to two large and aggressive avoidance schemes already under investigation by HMRC.

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: **MEDIUM TO HIGH**

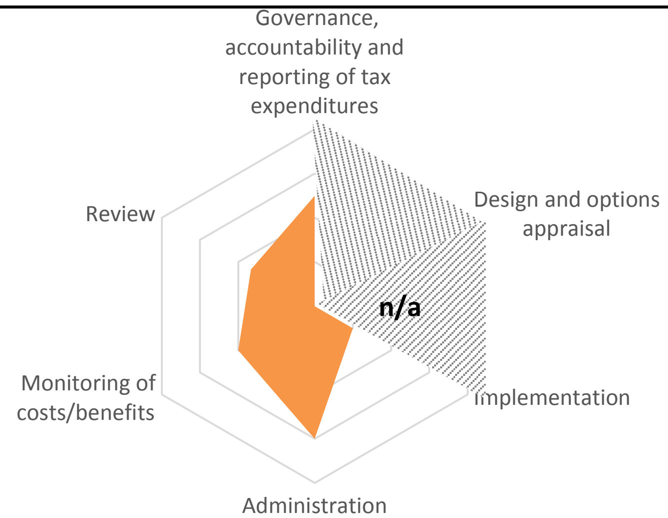
**Risks identified by HMRC:**
- mistaken claims that do not meet qualifying conditions for investment
- claims made to offset losses on quoted shares or other assets against income
- marketed avoidance

**Examples of response to avoidance:**
- HMRC considers that the medium-high risk to the relief is currently adequately controlled by its compliance action.
- HMRC is investigating 24 suspected avoidance schemes marketed between 2005 and 2012, believed to cost up to £780 million in tax (in nominal terms).
- All claims for share loss relief are screened to identify erroneous or invalid claims, as well as suspected avoidance.
- As well as investigating and challenging suspected avoidance, HMRC has attempted to deter taxpayers from using SLR avoidance schemes by publishing a Spotlight describing 'highly artificial tax schemes to create capital losses. HMRC warns that when one of these schemes is used, it will open an enquiry into the return and will not make any tax repayment claimed.

| Risk of abuse | | |
|---|---|---|
| The cost of abuse is estimated | The value of tax at risk is estimated | The success rate in investigations is known |
| ✓ | ✓ | ✓ |

## ADMINISTRATION

**Examples of good practice:**
- Partial awareness of the risks of the relief and levels of abuse
- Publication of spotlights to deter users from avoidance schemes
- HMRC identifies and challenges suspected avoidance




**Areas for improvement:**
- HMRC has not routinely monitored the cost of this relief, despite collecting data. In October 2014, HMRC decided it would monitor trends in the amount of share loss relief claimed in future.
- Extensive avoidance relating to this relief. HMRC has opened investigations into 60% of claims (by value) between 2005 and 2012 for suspected avoidance.
- Make better use of avoidance data to ensure actions are proportionate to the overall levels of avoidance

**HMRC's approach to administering the relief**

| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✗ | ✗ | ✓ |

Share Loss Relief is administered as part of Self-Assessment; there is no disaggregated information available about administration specific to SLR.

## EVALUATION AND REVIEW

**BENEFITS**

HMRC has not measured the benefits of Share Loss Relief and considers that doing so would be a poor use of resources.


**CAP ON INCOME TAX RELIEFS**

In 2013, share loss relief was included within a general cap on income tax reliefs. The cap is a wider measure to promote fairness amongst taxpayers and is not a specific reaction to limit risk for share loss relief. However, HMRC expects the cap will curb some avoidance but the effect will not prevent avoidance outright. HMRC will monitor the effect of the cap.

**DOTAS**

HMRC is currently challenging 24 marketed avoidance schemes involving share loss relief. 4 of those schemes are disclosed under DOTAS. HMRC believes that all schemes are disclosable and intends to challenge each failure to apply DOTAS.

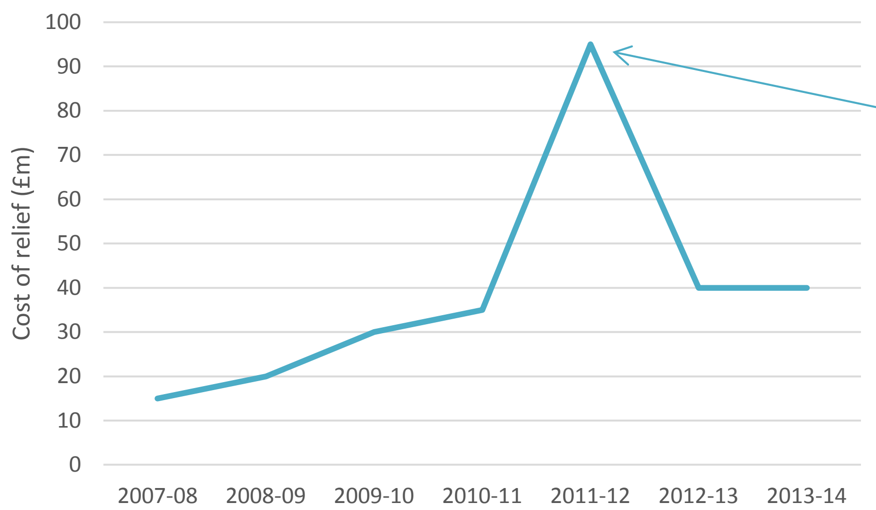
# Business Premises Renovation Allowance

## BACKGROUND

**Current Value (2013-14):** £40 million

**Objective:** The BPRA scheme is intended to foster physical, economic and social regeneration of disadvantaged areas.

**How the relief works:** BPRA provides a 100 per cent initial allowance for capital expenditure incurred on the renovation or conversion of business properties that have been unused for at least a year in disadvantaged areas of the UK.




£60 million (171%) increase in cost of the relief from 2010-11 to 2011-12 due to avoidance activity followed by prompt legislative change in response.

Note that the 2013-14 data is a forecast and may be revised by HMRC

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: LOW

**Risks identified:**

Boundary pushing in relation to:

- claims for costs other than the actual direct capital costs of renovation
- non-compliance with the requirement for buildings to have been unused for 1 year
- claims for costs contractually incurred when work does not take place for several years, if at all

The existence of a significant incentive for avoidance behaviour through the availability of sideways loss relief

**Extent to which abuse has occurred** -There are currently 39 avoidance schemes in operation for BPRA

| Risk of abuse | | |
|---|---|---|
| The cost of abuse is estimated | The value of tax at risk is estimated | The success rate in investigations is known |
| ✓ | ✓ | ✗ |

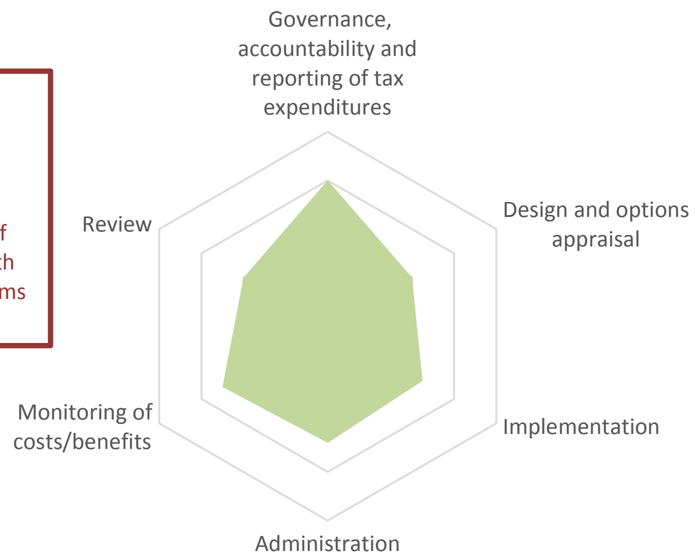
The success rate in investigations is not yet known as investigations are continuing.

## ADMINISTRATION

**NAO assessment of administration**

**Areas for improvement:**

- Collection of additional data to enable monitoring of BPRA interaction with grants and other forms of relief




**Examples of good practice:**

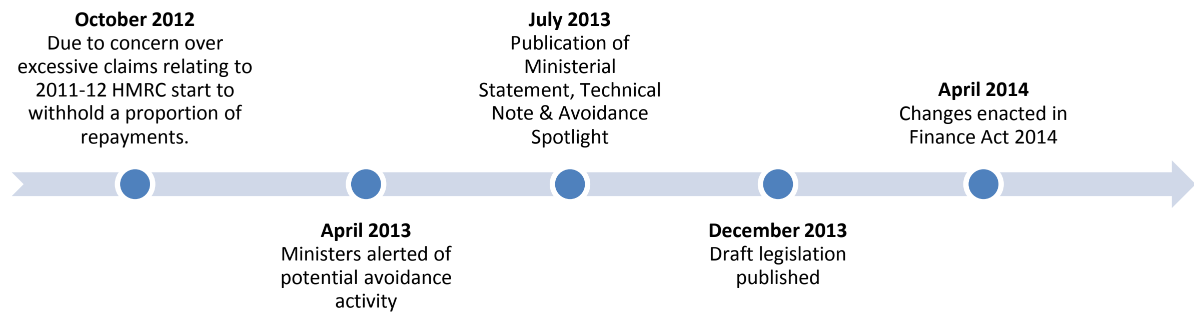
- Prompt legislative response following avoidance identification
- Close monitoring of DOTAS declarations to identify indicators of abuse
- Dedicated avoidance team for BPRA

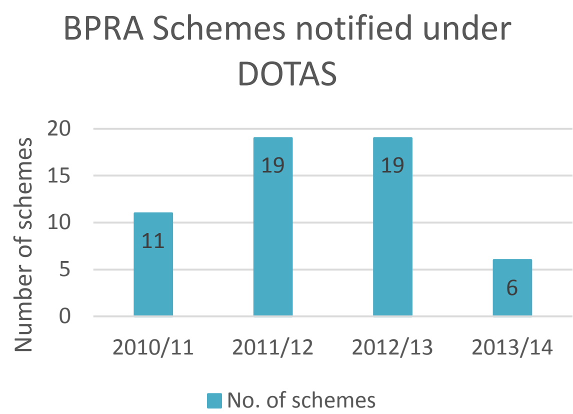
**HMRC's approach to administering the relief**

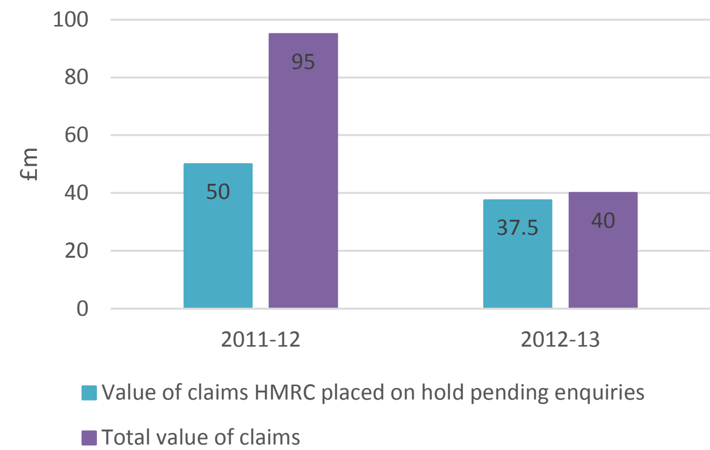
| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✗ | ✗ | ✗ |

BPRA is administered as part of Self-Assessment; there is no disaggregated information available about administration specific to BPRA.

## HMRC RESPONSE TO AVOIDANCE




Only partial data is available for 2013-14

# Entrepreneurs' Relief

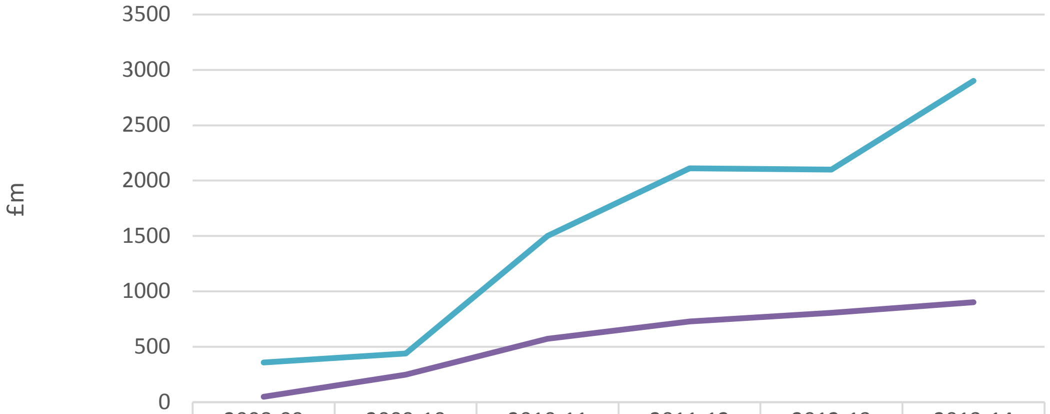
## BACKGROUND

**Current Value (2013-14):** £2.9 billion

**Objective:** This relief was introduced to encourage entrepreneurship, contributing to making the UK a more attractive location for business.

**How the relief works:** Entrepreneurs' relief gives qualifying individuals a reduced rate of capital gains tax on disposal of qualifying business assets. The rate is reduced to 10% from either 18% or 28% and applies up to a lifetime limit of £10m of gains.

Note that the 2013-14 'actual cost' data is a forecast and may be revised by HMRC




| | 2008-09 | 2009-10 | 2010-11 | 2011-12 | 2012-13 | 2013-14 |
|---|---|---|---|---|---|---|
| Actual cost | 360 | 440 | 1500 | 2110 | 2100 | 2900 |
| Cumulative exchequer impact of policy changes approved by Parliament | 50 | 250 | 573.75 | 728.75 | 807.5 | 901.25 |

The cost of the relief has risen significantly above HMRC's forecasts. HMRC told us that increases in the asset values and disposals might explain the increases but that it is not able to attribute increases in cost to any factor until it has more evidence. It expects to wait until the policy background has reached a steady state before conducting more detailed quantitative analysis.

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: **MEDIUM**

**Risks identified**

- **Boundary pushing**, specifically manipulation of eligibility rules to make additional people qualify for the relief.
- **Avoidance schemes** for which HMRC have no legislative recourse.
- **Claims made In excess of lifetime limit.**

HMRC has no overarching method which measures levels of risks to the relief.

**Examples of response to risks:**

Two avoidance schemes were disclosed in 2010. One has no known uses and for the other here are 5 known corporate users and 9 usages (3 users in each of 2010/11, 2011/12 and 2012/13). HMRC and HM Treasury reviewed the new scheme to consider the scale of risk and to inform policy development. No changes have been made or announced. HMRC has not monitored the scale of use of these arrangements or the amount of tax that is at risk because of these arrangements.

The overall impact on the cost of the relief is hard to estimate. Although HMRC and HMT monitor the number of scheme users, the amounts individuals claim vary and Entrepreneurs' relief is only obtained on disposal of shares (which could be many years after the disclosure of the scheme).

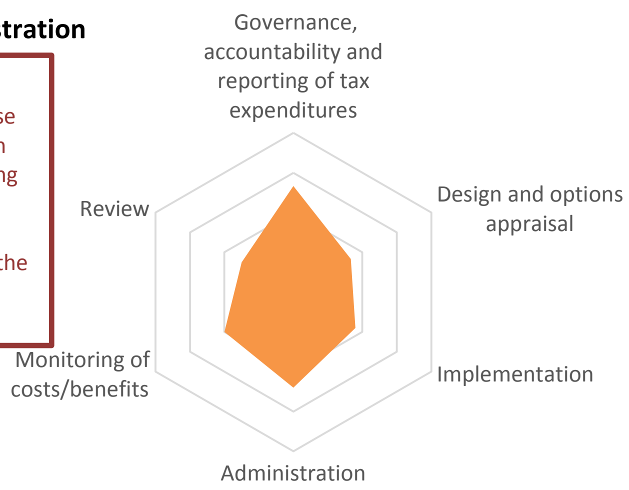
| Risk of abuse | | |
|---|---|---|
| **The cost of abuse is estimated** | **The value of tax at risk is estimated** | **The success rate in investigations is known** |
| ✘ | ✘ | ✘ |

## ADMINISTRATION

**NAO assessment of administration**

**Areas for improvement:**

- Limited awareness of misuse
- Comparison of actuals with forecasts and understanding variances
- Assessment of the benefits and behavioural effects of the relief




**Examples of good practice:**

- Risks for the relief are built into the risking process of returns
- Forecast of costs up to 2015-16 is published
- Publishes national statistics relating to the number and size of claims annually
- Commissioning of reviews to investigate take-up issues

**HMRC's approach to administering the relief**

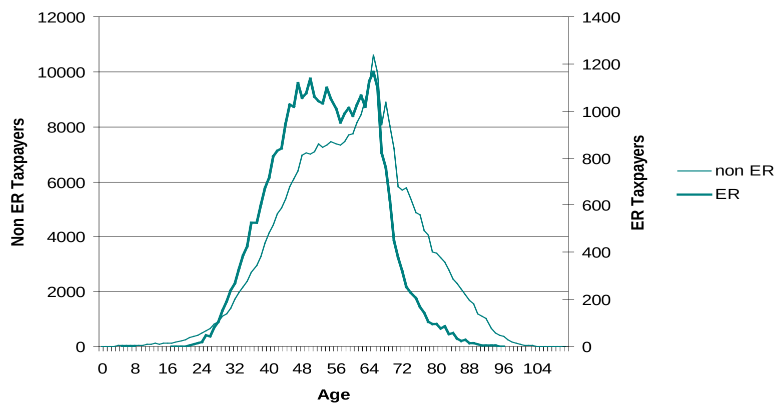
| Administrative data | | |
|---|---|---|
| **Cost of administering the relief is known** | **The number of people involved in administration is known** | **The proportion of claims that is checked is known** |
| ✘ | ✘ | ✘ |

Entrepreneur's Relief is administered as part of Self-Assessment; there is no disaggregated information available about administration specific to ER.

## EVALUATION AND REVIEW

**Post Implementation Review**

HMRC undertook some internal preliminary post implementation analysis for Entrepreneurs' relief in 2012. This review went some way to try to understand if Entrepreneur's Relief was fulfilling its policy goals, however the scope, depth and accuracy of this review was limited. Note that this is not part of HMRC's ongoing monitoring of the relief, but was a one-off piece of customer insight work.




The review looked at various pieces of evidence. For example, this graph shows the different age distributions of those who claim Entrepreneurs' relief from those who do not. The average age of those who claim the relief is 53; the average age of those who do not is 59.

Based on this evidence, the preliminary analysis suggests *"that ER may form a genuine incentive for entrepreneurs."*

HMRC is exploring ways to do more detailed analysis such as external research on motivations for claiming the relief. In May 2014 HMRC commissioned a qualitative study of 50 people to find out why they claimed the relief.

# VAT - Construction of new dwellings (including DIY)

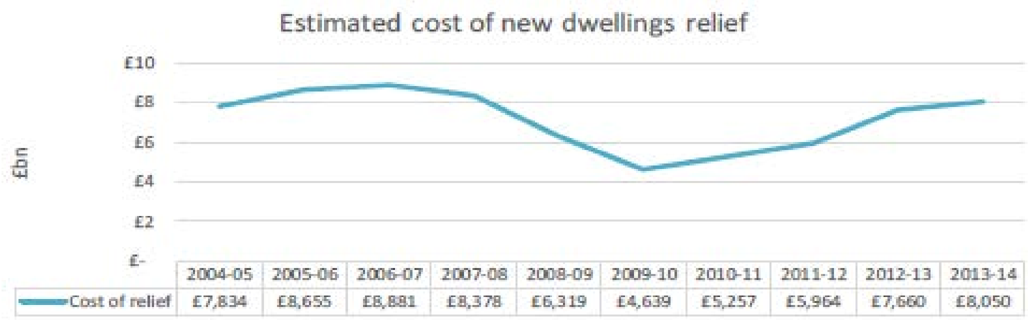
## BACKGROUND

**Current Value (2013-14):** £8,050m

**Objective:** to encourage construction of new dwellings, increasing housing supply and improving living standards

**New Dwellings Relief** zero-rates supplies for the construction industry and sales of new homes, reducing the cost of construction and of purchasing a new home.

**DIY Builders' VAT Refund Scheme** provides parity between self-build and other new build. It has been part of VAT since 1974. HMRC receives claims directly from individual DIY builders and uses these as accurate data for the VAT cost of the relief for self-built homes.




The steep decrease in total actual cost 2007-2010 cannot be explained by any policy changes, but the financial crisis will have reduced the level of construction taking place. The increase in total cost after 2010 is due to the increase in the VAT rate back to 17.5% and then to 20%.

Note that the 2013-14 data is a forecast and may be revised by HMRC.

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: **Low to Medium**

**Risk identified:**

- **Claimants to disguise items for which input VAT is blocked** (e.g. non-integral furniture) by buying packages from suppliers where such items are included but not separately listed on the invoice.
- **DIY builders selling houses originally intended for own use**. The DIY builder could complete the house, live there to claim the VAT refund, sell it and move on to another project. VAT refunds for the subsequent project could be claimed in another name.

**Extent to which abuse has crystallised:**

There are two known avoidance schemes – one is VAT avoidance in the construction of holiday homes. The other has been attempted only twice and is available to a very small group of people: those who have owned certain types of accommodation since 1973 and who are now hoping to refurbish and sell.

There is no data available on the value of tax at risk . However, for risks surrounding zero-rates in general, 10 of the 80 risks on the February 2014 VAT Risk Register deal with zero-rates - of which one is specifically relevant to construction relief.

**Examples of response to avoidance and risks**

The avoidance schemes HMRC has identified have been around for approximately 7-8 years but have so far been considered small. The risks HMRC has identified are tackled as part of HMRC's overall compliance programme for VAT. All VAT returns go through the VAT compliance risk process to identify businesses where further investigation is required. HMRC considers its own internal controls highly effective, reducing the residual risk probability level to low.

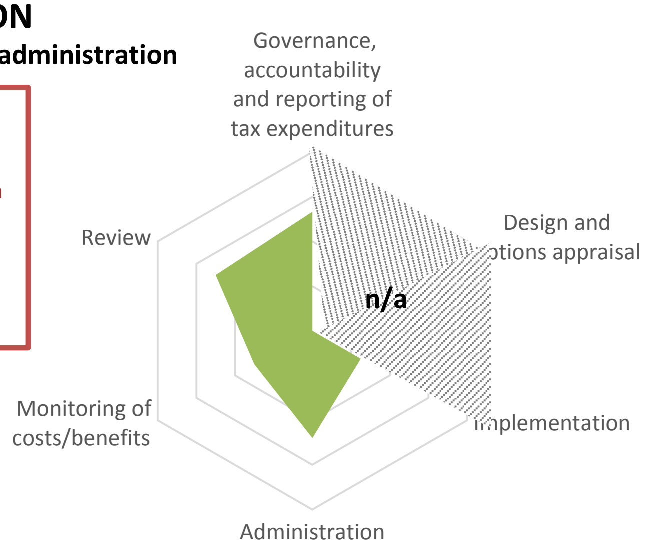
| Risk of abuse | | |
|---|---|---|
| The cost of abuse is estimated | The value of tax at risk is estimated | The success rate in investigations is known |
| ✘ | ✘ | ✘ |

## ADMINISTRATION

**NAO Assessment of administration**

**Areas for improvement:**

- HMRC relies on an outdated prediction of house building for its forecasts




**Examples of good practice**

- Several anti-avoidance measures have been introduced over the years (10 years ago, there was lots of avoidance in the Land and Property area, now most of this has been combatted by HMRC)
- DIY unit in Birmingham produce quarterly statistics on the number, value and success of claims. They also carry out risk analysis to identify which claims to target with checks

**HMRC's approach to administering the relief**

| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✘ | ✘ | ✘ |

## EVALUATION/REVIEW

**BENEFITS**

HMRC has not carried out any significant review of the use of this tax relief (e.g. no cost-benefit analysis has been conducted) and as a result of this lack of review, no changes have been made to its administration (at least in the past 10 years). The costs of administering these reliefs are not known, as HMRC considers it impossible to separate these costs from the administration of the overall VAT regime.


HMRC should have calculated, and be calculating, any behavioural effect of this scheme as part of its monitoring of the effectiveness of reliefs. However, HMRC treats the relief and refund scheme as simply a different rate of tax.

**OTHER ANALYSIS**

HMRC does not routinely collect detailed information on the businesses that are subject to this zero rate, and so no analysis has been conducted on awareness levels, take-up, administrative burden, distribution of take-up or usage by non-target groups.

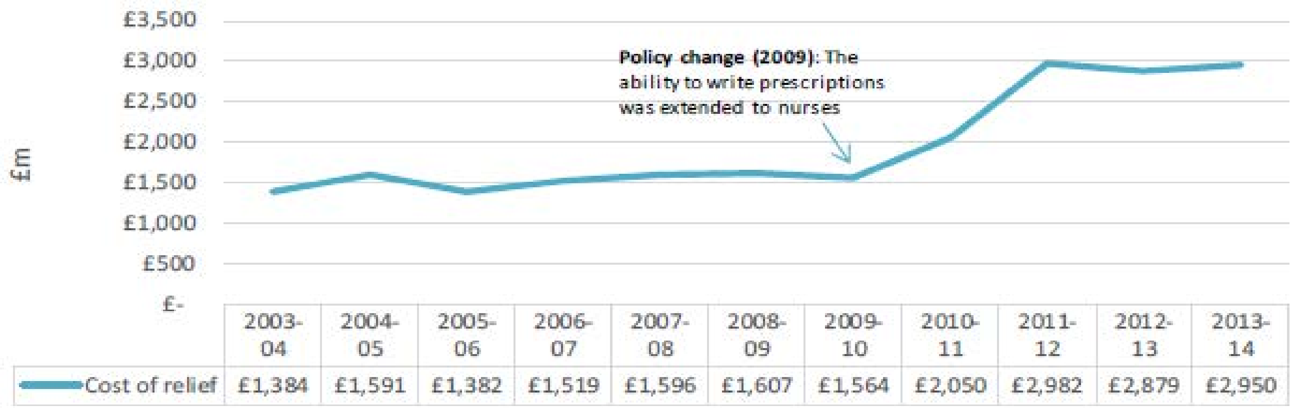
# VAT - Supplies of drugs on prescription

## BACKGROUND

**Current Value (2013-14):** £2,950m

**Objective:** In line with the zero-rating of other "essential supplies", the aim is to reduce the impact of regressive nature of VAT on lower income groups.

**How the relief works:** The supply of drugs, medicines and other items for personal use of patients can be zero-rated if the certain conditions are met. The zero-rate has been applied to goods dispensed on prescription since the inception of VAT in 1973. VAT is not charged on the supply of goods - however, as the supply is zero-rated, input VAT can be reclaimed via the practitioners VAT return.




Costs increased sharply in 2010-11 and 2011-12. This may be due to the increasing cost of drugs and increase in the VAT rate in 2009-10 and 2011-12. It may also be explained by the policy change in 2009. In 2013 the rules were once again changed so that prescriptions written by physiotherapists and podiatrists are zero-rated. The constant increase of the UK population, and therefore in NHS patients is consistent with the overall rise in costs of the relief over the 10 year period.

Note that the 2013-14 data is a forecast and may be revised by HMRC.

## IDENTIFYING AND MANAGING RISKS

HMRC assessment of risk level: Low

**Risks identified**

- Standard rated drugs or other medicinal products will be incorrectly, either intentionally or by error, treated as zero rated.

**Examples of response to risk**

HMRC do not believe this is a high risk area for VAT. The only valid claimants are healthcare professionals. Drugs are also more tightly controlled than other goods and there are very few borderline cases - since all prescriptions are zero-rated. There are no known avoidance schemes for this relief, but there is a risk that standard rated drugs or other medicinal products will be incorrectly, either intentionally or by error, treated as zero rated.

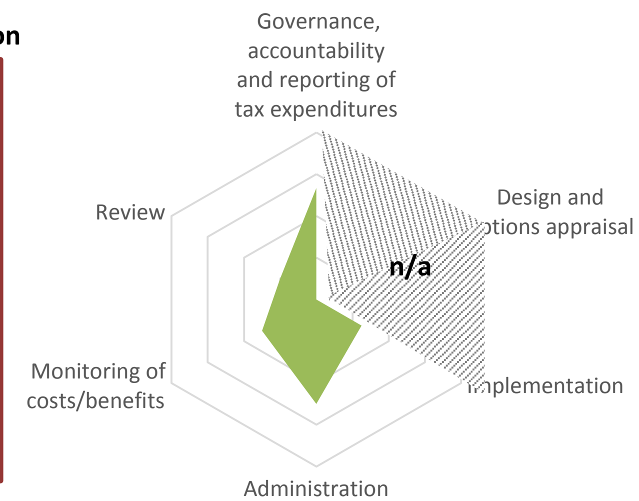
There is no information available on the value of tax at risk. However, in relation to risks surrounding zero-rates in general, 10 of the 80 risks on the February 2014 VAT Risk Register relate to zero-rates - of which one is specifically relevant to prescription relief (health providers entering into artificial arrangements to achieve VAT savings). Inherent probability and impact are scored as medium and high respectively. HMRC considers that its own internal controls are moderately effective, reducing the residual risk probability and impact levels to medium and overall RAG rating to amber.

| Risk of abuse | | |
|---|---|---|
| The cost of abuse is estimated | The value of tax at risk is estimated | The success rate in investigations is known |
| ✘ | ✘ | ✘ |

## ADMINISTRATION

**NAO Assessment of adminstration**

**Areas for improvement:**
- There is no specific administration nor calculation carried out for this relief.
- Limited analysis of take up and other issues is undertaken
- The data KAI collect on this relief as part of the zero rate is not used internally (except for the annual publication of the cost of tax expenditures)




**Examples of good practice:**
- This relief is well-costed. HMRC obtains good data from the ONS and NHS that it can use to calculate reliably estimates of the cost of this relief, despite the lack of information available on tax returns.

**HMRC's approach to administering the relief**

| Administrative data | | |
|---|---|---|
| Cost of administering the relief is known | The number of people involved in administration is known | The proportion of claims that is checked is known |
| ✘ | ✘ | ✘ |

## EVALUATION/REVIEW

**BENEFITS**

As for construction relief, HMRC regards the zero-rate of VAT on supplies of prescription drugs as an integral part of the VAT system - and simply a different rate of tax.

NO ANALYSIS UNDERTAKEN

**OTHER ANALYSIS**

HMRC does not routinely collect detailed information on the businesses that are subject to this zero rate, and so no analysis has been conducted of awareness levels, take-up, administrative burden or usage by non-target groups.

All VAT returns go through the VAT compliance risk process to identify businesses where further investigation is required. As well as this, HMRC considers awareness within society (i.e. customers complaining if charged VAT on a their prescriptions) another way that the relief is monitored.

NAO

National Audit Office

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