National Audit Office

Report
by the Comptroller
and Auditor General

HM Revenue & Customs

The effective management of tax reliefs

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Key facts

398	196	46
tax reliefs listed on HMRC's website	reliefs we identified that might support a particular group or activity towards economic or social objectives	'tax expenditures' that cost more than £50 million a year, according to HMRC

41%	reliefs we identified with possible social or economic objectives where HMRC has not estimated costs
14%	reliefs we identified with possible social or economic objectives where tax return data is collected but costs are not published
From £385 million to £1.2 billion	spike in value of losses for which share loss relief (before tax) was claimed in 2006-07, not identified by HMRC until 2013
£964 million	total value of share loss relief claims in 2006-07 that HMRC is currently investigating for suspected marketed avoidance
£2.9 billion	cost of entrepreneurs' relief in 2013-14, around three times more than HMRC original forecasts suggested

Summary

Introduction

1 In March 2014 we published a review of tax reliefs in the UK. We considered the opportunities and risks they present, and the way their design and implementation is managed by HM Treasury and HM Revenue & Customs (HMRC). Tax reliefs are diverse in nature, serving a variety of needs. Some are structural parts of the tax system, to improve progressivity or to ensure the correct calculation of profits. Other reliefs, sometimes described as 'tax expenditures', are designed to encourage a particular behaviour towards a social or economic policy objective.

2 The Committee of Public Accounts took evidence on our report and concluded there was a strong case for the exchequer departments – HM Treasury and HMRC – to monitor those reliefs which seek to influence taxpayers' behaviour to achieve social or economic objectives. It said the Departments should assess whether a relief is meeting its objectives, and report back to Parliament on the results. It encouraged the Departments to develop a clear framework to improve the management and accountability of tax reliefs.

3 Tax reliefs are an important part of public policy design, covering most aspects of government activity including welfare, housing, business, food, education, health and transport. They can also make the tax system more complex and less transparent, and pose risks to the exchequer because costs can rise unabated. Some have been the focus of tax avoidance. Decision makers and Parliament therefore need information about how tax reliefs are working and which reliefs require their attention. Making information available about the costs and uses of reliefs also provides transparency and accountability, thereby increasing confidence in the tax system.

4 For HMRC's management of tax reliefs to be effective, we consider its approach should vary depending on the nature of the relief and the risks it carries. We believe that effective administration of reliefs would require HMRC to:

- collect, analyse and report information about their costs and benefits;
- where relevant, review the extent to which they are achieving their objectives;
- identify and intervene to tackle risks to the exchequer, including evidence of abuse;
- have sufficient governance in place to manage its overall administration of tax reliefs, share knowledge and good practice, and achieve proportionality;
- be accountable as the custodian of the tax system for providing evidence to policy-makers and Parliament where tax reliefs are not working as intended.

Scope of this report

5 In this report we have focused on how HMRC manages those reliefs which seek to deliver economic or social objectives, either by influencing taxpayers' behaviour or providing targeted support to a particular group. HMRC does not distinguish between different types of tax relief or how they are managed. We therefore used a case study approach to look in detail at how HMRC administers 10 tax reliefs at different stages of maturity. We considered how well HMRC:

- collects and reports data on tax reliefs;
- assesses whether they are working as intended; and
- identifies and responds to evidence of abuse.

6 In light of our findings from the case studies, we have also looked at how HMRC could improve its administration of tax reliefs by reference to good practice HMRC exhibits for some reliefs and international comparisons. We have not sought in this report to assess whether tax reliefs themselves are working as intended or provide value for money.

7 HMRC has asked us to reflect in this report that it does not generally run its compliance regime by focusing on individual reliefs, but rather manages compliance risk through a three-dimensional approach: by customer group (eg large business or high net worth individuals), by customer behaviour (eg avoidance), and by tax product (eg patent box). HMRC provided us with material to support this shortly before we published this report, describing its entire compliance regime and its anti-avoidance approach. We have published this in Appendix Three (available online). It is certainly true that HMRC's compliance strategy is based on this approach, and we don't take issue with it. We will examine it in future reports. However, we do not think it prevents us from meaningfully examining the administration of tax reliefs for the following reasons:

a The taxpayer-centric approach alone does not address the risks to tax revenue, as is evidenced by our specific examples, until a considerable time after unexpected and possibly unintended use of a relief has occurred. This might arise from tax avoidance, or simply poor drafting giving rise to inadvertent opportunities for claimants not envisaged in the original legislation. Time is of the essence in picking up large increases in claiming and checking that the way reliefs are used supports Parliament's intention. A relief focused approach is likely to pick this up early if well administered.

b All reliefs have a dedicated product owner in place but there is considerable variation in the quality of the information they monitor and the speed of response where a relief is not behaving as expected.

c We think that our examples show that good administration of the tax system would be served by combining both approaches: a taxpayer-centric compliance strategy; and the conscious management and evaluation of tax reliefs as a class of policy instruments that share some common characteristics and risks.

8 Our audit approach and methodology are in Appendices One and Two. Appendix Four (available online) provides a detailed summary for each case study. Appendix Five (available online) contains a summary of international comparison work carried out by the Tax Administration Research Centre.

Review of 10 tax reliefs

9 To understand more about the way HMRC administers tax reliefs, we selected a group of 10 reliefs with social or economic objectives and carried out a comparative analysis (**Figure 1** overleaf). For each relief, we assessed the adequacy of the data HMRC collects and reports, how it assesses whether the relief is working as intended, how it identifies risks, and how it intervenes when it finds problems. We chose 10 tax reliefs to give us broad coverage across a range of factors including:

- type of tax;
- type of beneficiary;
- age of tax relief; and
- cost.

10 We included in our sample one relief where the cost is not known by HMRC (share loss relief) and one relief which HMRC nominated as an example of good practice in administration (R&D tax credits).

11 We chose our case studies to illustrate the issues HMRC faces and the action it takes, not to be representative of the way HMRC administers all tax reliefs. However, where there is wider relevance we consider the implications of our findings for the management of tax reliefs as a whole.

Key findings

Collecting and reporting data on tax reliefs

12 HMRC does not hold data on the cost of all tax reliefs. When deciding what data is necessary to administer the tax system, HMRC's primary considerations are what it needs to know about each tax to support the tax calculation and ensure compliance by taxpayers. It must also consider the administrative burden it places on taxpayers. Understanding the cost of a particular tax relief is normally a lower order priority. As a consequence, HMRC does not hold consistent or comprehensive data on the costs of reliefs (paragraphs 1.5 and 1.7).

Figure 1
Case study reliefs

We have looked at 10 case studies with social or economic objectives as part of our work

Description	Objective	Age	Cost (£m) 2013-14
The **patent box** gives companies a deduction equal to a 10% effective rate of corporation tax on profits from patented inventions.	Stimulate innovation	New reliefs (0–3 years)	350[1]
A **reduced rate of inheritance tax** of 36% applies if 10% of an estate is left to charity.	Increase charities' incomes		30[1]
Entrepreneurs' relief reduces capital gains tax to 10% for certain disposals, for instance all or part of a business.	Encourage enterprise	Recently introduced (3–10 years)	2,900[2]
Business premises renovation allowance provides 100% allowance for the renovation or conversion of unused business properties in disadvantaged areas.	Regenerate disadvantaged areas		40
Research and development (R&D) tax credits are an extra deduction from companies' taxable income for R&D expenditure. In some cases a payment is available to the company.	Support research and development activity	Established (11–40 years)	1,325[3]
Supplies of drugs on prescriptions are zero-rated for VAT.	Keep health costs low		2,950
Share loss relief allows a loss on disposal of shares in certain small unquoted trading companies to be set against income tax or corporation tax.	Reduce the financial risk of investment in smaller companies.		Unknown[4]
Construction of new dwellings. Supplies to build new homes are zero-rated for VAT.	Support housing construction	Long-standing (40+ years)	8,050
Business property relief grants 50% or 100% relief from inheritance tax on certain types of business assets including unlisted shares.	Support business continuity		415
Agricultural property relief grants relief from inheritance tax on agricultural property.	Support continuity of farming business		385

Notes

1 These figures are the forecast costs included in the tax impact and information notes (TIINs) for these tax reliefs.

2 HMRC's published cost of Entrepreneurs' relief is £3,200 million. HMRC has told us this figure is likely to be revised in its next publication of its 'tax expenditures, reliefs and ready reckoners statistics' to £2,900 million.

3 The forecast cost of the R&D relief includes the payable credit element and the research & development expenditure credit (RDEC) introduced in 2013-14.

4 HMRC cannot quantify the cost of share loss relief with certainty as the exact figure depends on whether the loss could alternatively have been set against gains in the same or future years.

5 The objectives summarised here are based on published material and discussions with officials. It is HMRC's view that the descriptions cannot always be defined narrowly and so may be partial.

Source: Tax Impact and Information Notes and HM Revenue & Customs

13 HMRC does not always hold complete data when the cost of the relief or risk to the exchequer is high. Looking beyond our sample, we found Lettings Relief (an exemption from capital gains tax for periods where a principal private residence is let) may cost at least £200 million a year but is reported as a 'cost not known' relief because HMRC is not confident it receives enough information to make a complete estimate. A tax return is only required on the sale of property when a tax payment is due. HMRC has concluded that its annual cost of processing tax returns from all taxpayers selling homes would be £3.6 million and is concerned that this would create a disproportionate burden. It has not assessed the benefits it would receive from collecting this data (paragraphs 1.8 and 1.9).

14 HMRC has an inconsistent approach to collecting, using and publishing data on tax reliefs. Government needs to know the costs of its policies to make sound decisions, and transparent reporting is important to provide accountability to Parliament and taxpayers. We identified 196 tax reliefs we thought might have social or economic objectives and found that HMRC published cost data on 115 of these. HMRC collects tax return data for 88 reliefs. In other cases, such as VAT reliefs, it uses national statistics to estimate the annual cost. We found 28 instances where data are collected through tax returns but are not published; and a further 53 cases where tax return data is not collected and a robust estimate of cost has not been made using data from other sources (paragraphs 1.6 and 1.10).

15 The data HMRC publishes on the costs of reliefs are estimates and are not sufficient to provide reliable information to Parliament or the public. HMRC publishes yearly data on the cost of reliefs in its 'tax expenditures, reliefs and ready reckoners statistics' to provide transparency and allow external monitoring of the cost of reliefs.[1] In most cases, these data are the only source of information on cost available to parliamentarians. These data are estimates, and in some cases HMRC adds the caveat that the estimates are 'particularly tentative and subject to a wide margin of error'. Data is first published as an end of year forecast 3 months before the completion of the tax year, and should be corrected with the actual cost of the relief when available. We found the published estimates for 4 of the reliefs we looked at (Entrepreneurs' relief, Seafarers' Earnings Deduction, Enterprise Management Incentives and Business Premises Renovation Allowance) were significantly different from the actual costs. The most significant difference was an understatement of the cost of Entrepreneurs' relief by £510 million in 2011-12. In no instances had the published statistics been restated, although HMRC had published amended cost data on Enterprise Management Incentives elsewhere. HMRC told us it publishes projections using the most recent data to provide timely information. In some cases the time lag in collecting and processing tax returns means that the year in question no longer features in its published table, so final costs are never published (paragraphs 2.8 to 2.10).

1 These can be found on the gov.uk website at: www.gov.uk/government/collections/tax-expenditures-and-ready-reckoners

Assessing whether reliefs are working as intended

16 **HMRC does not collect the data that would allow it to conclude on the effectiveness of tax reliefs.** HMRC does not routinely collect robust monitoring information that would allow it to assess the benefits of individual tax reliefs, the cost of abuse or the value of tax at risk. It does not identify differences in the way it administers tax reliefs, or the costs of that administrative effort. None of the 10 case studies we looked at regularly used or compared data in all of these areas. The teams responsible for the integrity of particular reliefs (known as product owners) are expected to work in partnership with the Department's risk and intelligence service to look at case data and consider avoidance risk for particular types of taxpayers; and with the Department's knowledge and analysis team to consider trends in the costs of reliefs and fiscal risks. In practice, we found the product owners of the reliefs we examined made little use of such analysis (paragraphs 1.12 and 1.13).

17 **We found little evidence that HMRC evaluates reliefs to see if their objectives are being met.** Of the 8 reliefs in our sample that had been in place for more than 3 years, HMRC had sought to evaluate the impact of the relief on taxpayers' behaviour only for R&D tax credits and Entrepreneurs' relief. Such evaluation can be both methodologically challenging and expensive, but without it, decision-makers lack the evidence to judge whether the costs of a relief to the exchequer are commensurate with the social or economic benefits it delivers (paragraphs 2.15, 2.21 and 2.22).

18 **Significant increases in costs do not automatically trigger a response to rule out abuse.** Using the data published by HMRC, we found that of 46 high-value reliefs with social or economic objectives (described as 'tax expenditures' on HMRC's website), 11 had increased in real terms by more than 25% above 2007 levels. We looked at the 3 tax reliefs reporting the biggest percentage increases. HMRC could explain why the costs might have shifted. However, it tended to seek the most obvious explanation and did not try to definitively rule out abuse. In one case HMRC analysed cost increases each year. In another, a rise in Seafarers' Earnings Deduction led it to search further to rule out unexpected behaviour or abuse but not until the fifth year of reported cost increases. Corrected data provided to us in November 2014 showed that cost increases over this time were less significant than the published cost data had suggested. However, HMRC also told us it expects the annual reporting of the costs of the most significant tax reliefs to inform product owners' assessment of the operation of the reliefs. HMRC does not publish this data with analysis of variations or provide internal analysis to its product owners unless they commission it (paragraphs 2.3, 2.6 and 2.7).

19 HMRC detected large scale abuse of share loss relief in 2006-07 but did not monitor changes in the use of the relief until 2013. A disclosure of tax avoidance schemes (DOTAS) disclosure for 2006-07 and HMRC's risk assessment processes identified 2 large and aggressively marketed tax avoidance schemes using share loss relief. In 2006-07, the amount of individuals' claims against taxable income for share loss relief rose in real terms from £385 million to £1,206 million, but HMRC only identified the scale of this increase in 2013 as part of a one-off exercise. Avoidance schemes detected by HMRC accounted for almost all the increase, but HMRC did not check the total amount of claims in 2006-07 or subsequent years to check whether there were other unexplained surges. HMRC is investigating 80% of the 2006-07 claims by value (£964 million). Avoidance activity has continued and HMRC has detected 20 undisclosed schemes between 2005-06 and 2011-12. It has opened investigations into 60% of claims by value made by individuals. HMRC now plans to monitor trends in the amount of share loss relief claimed in future (paragraphs 1.16 to 1.18).

20 In only one of our case studies, did HMRC make regular forecasts of the cost and monitored whether the actual costs were as expected. It is normal practice for HM Treasury and HMRC to produce forecasts of cost only when a new tax relief is introduced or a change in a relief is considered. Comparison of the actual costs of reliefs with such forecasts is very difficult because HM Treasury and HMRC calculate these on different bases. Forecasting the costs of significant reliefs helps to predict broader trends in tax revenues, but HMRC must balance the usefulness of forecasting against its cost. We found HMRC carried out regular forecasting of the cost of R&D tax credits but not for any other of the reliefs in our sample. HMRC plans to introduce such regular forecasting for some other corporate tax reliefs, but the practice is not used for reliefs in other tax streams (paragraphs 2.17 to 2.19).

21 HMRC has carried out limited high level analysis to understand why the cost of entrepreneurs' relief has significantly outstripped its forecast. Entrepreneurs' relief has risen by over 500% since it was introduced in 2008-09. Costs have continually exceeded forecasts. Its estimated cost of £2.9 billion in 2013-14 is 3 times greater than published forecasts predicted. There have been several changes to the relief that might help to explain the increase, but HMRC has not quantified these changes robustly or reviewed the accuracy of its forecasts. It cites recent policy changes as the reason for this, including increases in the amount of relief available to individuals and increases in the capital gains tax rate. However, HMRC's most recent forecast took these factors into account. Our analysis indicates the total of all policy forecasts, adjusted for changes in the tax rate, would suggest an expected cost of around £900 million in 2013-14. Rising asset values may have contributed to increased levels of both capital gains receipts and the value of Entrepreneurs' relief. HM Treasury told us that with so many policy changes in a relatively short amount of time, it has been difficult to fully investigate whether the cost increase might be influenced by misuse of the relief but HMRC has carried out checks of individual claims it considers to be high risk. The departments consider that a more complete evaluation on the impact of different factors will not be possible until the policy reaches a more steady state. HMRC is undertaking research in this area and exploring ways to gather more evidence (paragraphs 2.11 to 2.16).

Identifying and responding to evidence of abuse

22 **HMRC's approach to compliance risk is based on looking at the complete tax position of higher-risk taxpayers, rather than seeking to understand the specific risks attached to tax reliefs.** HMRC is developing a long-term strategy for compliance work to tackle behaviours leading to non-compliance. This strategy is based on customer segmentation, recognising that the majority of taxpayers are compliant, and focusing on those who carry higher risks. HMRC uses data from tax returns and other sources to understand how these taxpayers use all the tax rules taken together, allowing it to connect different taxpayers who organise their affairs in similar ways. The overall costs of particular reliefs are not considered by HMRC's risk and intelligence service. We found different levels of understanding and awareness of compliance risks among the product owners we interviewed, and in most cases we found little or no monitoring of particular tax reliefs to understand the potential scale of abuse (paragraphs 3.2 and 3.3).

23 **HMRC has not taken a systematic approach to managing the risks of tax reliefs, but has identified risks specific to each of those we examined.** HMRC does not assign risk ratings to tax reliefs, nor does it have an overall system for comparing tax reliefs or determining the resources required to manage them according to the level of risk. Nonetheless, the teams responsible for administering the tax reliefs we looked at had identified the main risks they perceived. We found 3 examples (patent box, agricultural property relief and business property relief) where HMRC managed known and emerging risks through the use of a risk register (paragraphs 3.2 to 3.7).

24 **In 6 of the 8 case study reliefs in place for three years or more, HMRC had not estimated the value of tax at risk.** HMRC held data on the value of tax at risk for 2 tax reliefs we looked at: share loss relief and business premises renovation allowance. HMRC requires risks with an impact of more than £250 million to be included in HMRC's top-level view of compliance risk so these can inform Senior Management decisions about whether compliance action or policy responses are needed. This includes consideration of measures from the tax gap, which incorporates the overall tax at risk from reliefs, although they are not separately identified. Without data on the level of tax at risk it is hard to determine where and whether further action is needed. Of the reliefs in our sample with known costs, 3 tax reliefs (Entrepreneurs' relief, zero-rated VAT on new dwellings, and zero-rated VAT on drugs and supplies on prescription) varied in cost by more than £250 million from one year to the next. Cost movements are not necessarily caused by abuse but the reasons for these cost increases had not been explored fully or included in HMRC's top-level view of compliance risk. HMRC considers the two VAT reliefs to be low/medium risk (paragraphs 3.11 to 3.15).

25 **HMRC has responded in different ways to evidence of abuse in respect of 3 of the tax reliefs we examined.** We looked at how HMRC had responded and the speed of response in 3 case examples where HMRC had evidence of avoidance activity. HMRC's response for each example was as follows:

- HMRC responded rapidly to high numbers of disclosure of tax avoidance schemes (DOTAS) declarations on business premises renovation allowance. It sought immediate changes to tax rules and published a warning to taxpayers within a year.

- HMRC published a warning to taxpayers in respect of marketed avoidance schemes using share loss relief in November 2012 after a period of in-depth investigation. It has identified and challenged 20 undisclosed avoidance schemes operating between 2005-06 and 2011-12. In total HMRC is investigating 60% of the value of relief claimed by individuals for suspected avoidance – equivalent to £780 million in tax. It has not proposed any changes to the mechanics of the relief because it considers that existing share loss rules and the targeted anti-avoidance rule will be effective in defeating these schemes. However, it expects new limits on income tax reliefs will reduce levels of avoidance. It has not estimated the cost of its activity to detect, investigate and challenge avoidance.
- Entrepreneurs' relief has seen the most significant rise in costs over its lifetime. HMRC received two DOTAS disclosures in 2010, and is monitoring use of the schemes. So far use has been limited. HMRC and HM Treasury reviewed the new schemes to consider the scale of risk and to inform policy development. No changes have been made or announced. However, HMRC is not able to estimate the amount of tax at risk because the tax advantage accrues when the individual shareholders dispose of their shares, which could be many years later (paragraphs 3.16 to 3.23).

Optimising the administration of tax reliefs

26 We found examples of good practice but also inconsistency and fragmentation in the way HMRC administers tax reliefs. Tax reliefs differ in design, method of delivery, target population, maturity and risks, so we would expect a differentiated approach in how they are administered; but the absence of a framework to govern the management of reliefs presents risks. For example, evidence that a relief is not achieving its objectives or is being misused by taxpayers, sometimes at considerable cost to the exchequer, may not be detected. We also see common characteristics among reliefs with social or economic objectives and suggest there would be synergies in considering them as a group and identifying how different types of relief should be administered in a structured way. Such a framework could help HMRC to be more methodical in how it deploys its resources to optimise its administrative effort (paragraphs 4.2 to 4.4 and 4.13 to 4.16).

27 We found no shared understanding within HMRC about how tax reliefs should be administered and insufficient information sharing about their costs, risks and benefits. Tax reliefs are administered by product owners who are accountable for ensuring that the tax products they manage deliver HMRC's objectives. The risks to tax collection are assessed separately within the enforcement and compliance division, and analysis of the usage and costs of reliefs is undertaken by the knowledge, analysis and intelligence directorate. We found little recognition among product owners of the analysis and data that were available on either cost or risk, and a lack of clarity about the extent to which their role required them to evaluate whether the reliefs they manage were working as intended. In most cases, when we asked for an assessment of the costs and risks of the reliefs they managed, the product owners were unable to provide us with relevant, up-to-date information (paragraphs 1.13, 3.6, 3.14 and 3.15).

28 HM Treasury and HMRC do not assess or report to Parliament on whether tax reliefs are achieving their objectives. In responding to the Committee of Public Accounts' report on tax reliefs in September 2014, HM Treasury and HMRC rejected the proposition that any tax relief should be subject to similar management and accountability arrangements as public spending. They argue that the design of tax policy, including tax reliefs, is subject to Parliamentary scrutiny by the Treasury Select Committee, while Parliament as a whole has an annual opportunity, through Finance Bills, to debate the design of tax reliefs and propose amendments, and must approve all tax reliefs before they can commence. While we recognise the distinction between tax and spending, we consider that this does not absolve the departments of responsibility to evaluate tax reliefs rigorously or to report to Parliament on whether their objectives, where these are measurable, are being achieved. The Committee of Public Accounts has said it is looking to the departments "to set out clear proposals on how to improve the management and accountability to Parliament of the cost and performance of tax reliefs". The departments have not proposed any alternative framework by which they should administer this form of policy instrument; nor have they described what features the effective management of tax reliefs should exhibit. As a consequence, neither HM Treasury nor HMRC:

- identify which tax reliefs are designed to deliver specific policy objectives by influencing taxpayers' behaviour;
- provide guidance to their teams on how tax reliefs should be monitored or evaluated;
- estimate the tax at risk should a tax relief be used in ways not intended by Parliament; and
- provide meaningful feedback to Parliament on whether tax reliefs are working effectively and at what cost (paragraphs 4.3 and 4.4).

29 HMRC has identified a number of different categories of tax reliefs by objective but has not identified which tax reliefs require the most monitoring. The departments do not categorise reliefs in any way (for example by objectives, level of risk, or parliamentary interest) to help prioritise administrative effort. HMRC has identified different categories of tax relief, including a class of relief it describes as *"Reliefs to provide incentives for behaviour that may be conducive to economic or social objectives"*. It has not sought to identify which reliefs meet this description because it considers this group has no administrative implications. We found examples where HMRC had commissioned research to test how effective a tax relief is in influencing behaviour change, but no system or guidance to require such analysis for all those reliefs that are intended to achieve a specific policy goal (paragraphs 4.5 and 4.6).

30 Other countries have developed a specific approach to monitoring certain types of tax reliefs. International practice varies considerably in how far tax authorities monitor tax reliefs and publish information about them. HMRC is one of only a handful of fiscal authorities we found that reports the costs of more than 100 tax reliefs and uses caps on the use of particular tax reliefs. Some other countries focus particularly on those reliefs with social or economic objectives and monitor and report on them more extensively than in the UK (paragraphs 4.17 to 4.21).

31 We estimate that about half of all tax reliefs have economic or social objectives targeted at certain activities or aimed at particular groups. HMRC has identified 46 tax reliefs on its website which it describes as ‘tax expenditures’. We identified 196 reliefs that may have economic or social objectives from 398 tax reliefs listed on HMRC’s website. Further analysis indicates many of these may have behavioural objectives, but this judgement is difficult because HMRC does not record the objectives of reliefs. The reliefs we have identified include 43 tax expenditures which appear to provide clear behavioural incentives; a further 70 which may be intended to influence taxpayers’ behaviour; and 78 whose aim is to reduce the tax paid by particular sectors or groups. We found that costs were more often known for reliefs providing subsidies (83%) than for behavioural reliefs (63%), indicating HMRC could improve its understanding of the cost and impact of behavioural tax reliefs (paragraphs 4.8, 4.11 and 4.12).

Conclusion on value for money

32 Neither HM Treasury nor HMRC have established a framework or principles to guide the administration of tax reliefs. This reflects their view that tax reliefs do not have administrative implications that differentiate them from other parts of the tax system. It is our view that the defence of this principle, coupled with the desire not to be more directly accountable for reliefs, is costing the exchequer money. The departments have not identified which tax reliefs are intended to change behaviour in order to deliver policy objectives; and do not monitor or report their costs and benefits in a way that would allow government, Parliament or the public to know if such reliefs are working as intended. Not all reliefs lend themselves to such analysis, but some do. We believe this creates a significant gap in accountability to Parliament for administrating public finances effectively.

33 We found some examples where HMRC proactively monitors and evaluates tax reliefs, but in general it does not test whether tax reliefs are achieving their aims. This creates significant risks that may go undetected: that tax reliefs cost more than expected; that they are used in ways not intended by Parliament; or that they do not bring about intended behaviour change. Without monitoring the use or impact of tax reliefs, or acting promptly to analyse increases in their costs, HMRC’s administration of tax reliefs cannot be value for money.

Recommendations

34 Our recommendations are designed to support the development of a systematic approach to administrating tax reliefs. Tax reliefs represent policy choices about what groups and activities government wishes to support, but they always have a cost to the exchequer. We would therefore expect to see clear feedback from HMRC to policymakers about whether they are working as intended and at what cost. HMRC considers its holistic approach to managing compliance risks is sufficient to detect and address the systemic abuse of a tax relief. But we observed a lack of clarity among product owners about the extent of their responsibility for evaluating the reliefs they manage, which demonstrates the analysis that would enable meaningful feedback is lacking.

35 Some tax reliefs will need a greater level of administration than others. HMRC should therefore develop a methodology for identifying groups of similar reliefs and determine what level of administration is appropriate for each type, taking into account factors such as objective, beneficiaries, cost, complexity and risk. We recommend HMRC, in partnership with HM Treasury, develops its approach in 5 key areas:

a **Drawing on good practice internally and internationally to develop principles and guidance for administrating and reporting on tax reliefs.** This should take into account the materiality of particular tax reliefs as well as issues of proportionality and the cost of collecting data.

b **Publishing data on the cost and effectiveness of significant tax reliefs.** HMRC should review tax returns so data collected are proportionate to cost and risk. It should consider how it can collect better data on reliefs as part of its digital strategy. It should publish the actual cost of tax reliefs and present these alongside any other published statistics on tax reliefs to aid comparison.

c **Tracking actual costs against forecasts.** For the most material tax reliefs, HMRC and HM Treasury should systematically track actual costs over time against mid-year projections and the forecasts made for policy changes, wherever data can be collected cost-effectively from tax returns or other sources. Mid-year cost projections should be updated with actual cost data when available, and explanations sought for significant changes.

d **Reporting to Parliament each year on the cost and impact of the tax reliefs posing the greatest risks.** HMRC should systematically assess the risks of tax reliefs. It should propose what form of reporting would be most effective to provide assurance to Parliament that tax reliefs, particularly those where the risks are greatest, are working as intended. Reports could include the cost and value to beneficiaries but also wider effects that could affect the value to society (such as evasion, interaction with other parts of the tax system, distributional effects with positive value to society and economic distortions).

e **Carrying out a pilot exercise to analyse behavioural reliefs systematically and identify and explore patterns and risks.** The exchequer departments could establish a small, dedicated team to examine areas such as assessing risk, monitoring costs and benefits and developing good practice. They should consider whether to commission expert advice from an independent source on how such a function could be framed and executed.