Treasury Committee – Call for Evidence: Tax Reliefs
Response from the Low Incomes Tax Reform Group (LITRG)

1. Executive Summary

1.1. Considering the appropriateness of granting certain tax reliefs is a matter for government and needs to take into account political and economic factors that fall outside of our remit. Our response to this call for evidence therefore focuses on some general principles relating to tax reliefs and practical challenges for unrepresented taxpayers.

1.2. Tax reliefs can have various objectives and can operate in different ways. For unrepresented taxpayers, where the relief is not automatic, there are several requirements to enable a successful claim. The first requirement is awareness of the relief. In general, much more needs to be done to raise awareness among taxpayers of various reliefs. More work is also required in relation to the other requirements, such as ensuring that processes for claiming reliefs are straightforward.

1.3. For the unrepresented taxpayer, optional reliefs can create complexities. This is particularly the case if they have to work out whether or not it is beneficial for them to claim a relief. One example of this is the choice between the cash basis and the accruals basis for the self-employed trader.

1.4. Unscrupulous businesses are able to take advantage of the availability of some reliefs to exploit unrepresented taxpayers. This is largely due to the low awareness levels of the general public of various reliefs, such as the marriage allowance, and the actual / perceived complexity of making a claim for tax relief by oneself.

1.5. The terminology used in relation to reliefs is inconsistent. The fact that the terms relief and allowance are used inconsistently, and for reliefs that operate in different manners, hinders understanding. Lack of consistency is also an issue for those on low incomes who claim welfare benefits too; the inconsistency can cause confusion and can create the risk of non-compliance when interacting with more than one government department.

1.6. While some allowances and reliefs are uprated regularly, some are fixed amounts. In order for the tax system to operate equitably, these fixed amounts should be reviewed (and uprated where appropriate) on an annual basis, by default.

2. About Us

2.1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those

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on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.

2.2. LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

2.3. The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3. Introduction

3.1. We welcome the opportunity to respond to the Treasury Committee Call for Evidence on Tax Reliefs. We published 'A better deal for the low-income taxpayer' in December 2020.[1] This paper sets out seven principles for the tax system. It also details practical steps that would make the tax and associated welfare systems work better for people on low incomes.

3.2. We support the points made by the Chartered Institute of Taxation in its submission. In particular, we agree with the comments made under the 'SMART' acronym in that response.

3.3. We do not repeat those points here, and instead focus on issues that arise for low income and unrepresented taxpayers. We also draw on insights from our December 2020 paper.

4. General comments about tax reliefs

4.1. As noted in the call for evidence, tax reliefs can be used to define the scope of a tax or they can be used to encourage particular activities or behaviours. As we will note below, some tax reliefs are intended to reduce complexity for certain taxpayers. Some reliefs apply automatically: for example, the personal allowance generally applies automatically, and is given either through the pay as you earn (PAYE) system or through Self Assessment. In some cases, the taxpayer has to apply for, or make a claim for, the relief if they are eligible. In other cases, the taxpayer has to decide whether it is worth them claiming a tax relief, for example, a self-employed individual may need to decide between claiming actual motoring expenses or using the approved mileage allowance payments (AMAPs) rates when claiming for business travel in a vehicle. Or they may need to decide whether to prepare their accounts on the cash basis or the accruals basis (which may not be immediately viewed as a form of 'tax relief', but by the very fact that preparing accounts on the different bases

[1] https://www.litrg.org.uk/latest-news/reports/201204-better-deal-low-income-taxpayer

can result in different tax liabilities, such less obvious rules like this would seem to fall within the scope of tax reliefs).

4.2. Where a relief is not automatic, in order for the taxpayer to apply for or make a claim for the relief, they must:

i. be aware of its existence;
ii. understand that they are eligible;
iii. in some cases, decide whether or not it is beneficial for them to claim the relief;
iv. understand that they need to apply for it;
v. understand how to apply for it;
vi. have the time, resources and capability to make the claim;
vii. have the wherewithal to check the claim has been made successfully.

This may sound fairly straightforward, but in reality, there is low public awareness of many tax reliefs. This can include tax reliefs that tax advisers might assume are well-known. And, as noted, awareness of a tax relief is just the first of several requirements that must be fulfilled to enable a taxpayer to obtain that relief successfully.

4.3. For example, the marriage allowance demonstrates low claim rates. It is thought that currently there are over two million couples benefitting from the marriage allowance,[2] but there could be just as many couples that have failed to claim.[3] This has been the case throughout its existence,[4] despite repeated publicity from HMRC and non-governmental organisations.[5] In addition, to make a claim couples need to share details of their income with their partner. With independent taxation, this sharing of information is not always a given and can be a significant barrier to making a claim. The eligibility criteria also exclude couples in some scenarios, for example, where one spouse has income below the personal allowance and the other has income just above the higher rate threshold. Moreover, in some scenarios, the couple may be eligible, but they would see no benefit or might even lose out from a claim, for example, where one spouse has income just below and the other spouse has income just above the personal allowance.[6]

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[2] See 7.12 of Tax relief statistics: https://www.gov.uk/government/statistics/minor-tax-expenditures-and-structural-reliefs/estimated-cost-of-tax-reliefs-statistics

[3] https://www.thisismoney.co.uk/money/news/article-10687693/How-families-miss-20bn-unclaimed-tax-perks-benefits.html

[4] https://www.rsmuk.com/ideas-and-insights/weekly-tax-brief-3-february-2016/low-take-up-of-the-marriage-allowance-highlights-policy-flaws

[5] HMRC press releases and articles include: https://www.gov.uk/government/news/all-you-need-is-marriage-allowance; https://www.gov.uk/government/news/18-million-couples-benefitting-from-extra-tax-relief; https://www.gov.uk/government/news/couples-urged-to-say-yes-to-marriage-allowance-proposal

[6] https://www.litrg.org.uk/tax-guides/tax-basics/what-tax-allowances-am-i-entitled#example-john

4.4. Using tax reliefs to incentivise certain behaviours can result in added complexity in the tax system. This can also create opportunities for different forms of non-compliant behaviour. This might manifest in spurious and/or potentially fraudulent claims for tax relief. This has been seen with the Enterprise Investment Scheme, for example. In these cases, it is sometimes an unscrupulous agent that encourages an unwitting taxpayer to obtain relief that is not due; the agent deducts their fee, leaving the taxpayer with a small proportion of the overall tax refund. Once HMRC investigate, the taxpayer is left facing a tax liability without the funds to pay it, because they did not receive the full refund in the first place. In some cases they do not receive any of the refund at all and may not in fact have been aware of the agent having amended their return to include the spurious claim for relief.

4.5. The creation of tax reliefs to incentivise different behaviours can also place unrepresented taxpayers at a disadvantage. They may be less likely to hear about or understand reliefs and therefore likely to miss out. Those with a tax adviser may receive information from their adviser and therefore be able to benefit.

4.6. Tax relief on pension contributions is intended to encourage taxpayers to save towards their retirement. Unfortunately, the current system of tax relief is complex, because there are different methods of obtaining tax relief, depending on the type of pension scheme and the taxpayer's own marginal rate of income tax. For taxpayers in Scotland, the existence of additional tax rate bands further adds to the complexity. Some taxpayers miss out on the tax relief that they should be receiving. While tax relief on pension contributions to net pay arrangements generally works well and ensures the correct tax relief for taxpayers across the UK, those on low incomes do not currently receive any tax relief if their income is below the personal allowance.[7] This means that pension saving is up to 25% more expensive for taxpayers earning below or just above the personal allowance, compared to individuals contributing under a relief at source arrangement. Conversely, while non-taxpayers receive tax relief on pension contributions made under relief at source arrangements, taxpayers that pay income tax at rates of 21%, 40%, 41% and above have to claim the additional tax relief (over the basic rate of 20% that is provided automatically) by contacting HMRC. Moreover, while all the tax relief under net pay arrangements goes into the pension fund of the individual, only the basic rate tax relief of 20% goes into the pension fund under relief at source arrangements. Not all taxpayers are aware of the need to make a claim for their extra tax relief under relief at source arrangements, particularly Scottish taxpayers with a marginal tax rate of 21%. This means that some taxpayers miss out on the tax relief through a lack of awareness and understanding. Disappointingly, even though the devolution of powers over rates and bands of income tax to Scotland offered an ideal opportunity for some promotion of the methods of obtaining tax relief by both HMRC and the Scottish government, this was not seized.

4.7. The UK government has consulted on methods of ensuring that workers on lower incomes in net pay arrangements receive tax relief on their pension contributions, and is to implement a solution in

[7] Page 25, https://www.litrg.org.uk/sites/default/files/files/LITRG-A-better-deal-for-the-low-income-taxpayer-2020.pdf

2025/26, with backdating to 2024/25.[8] Nevertheless the differences between net pay and relief at source arrangements will mean that complexity remains, particularly for those taxpayers who have to actively make a claim for all or part of their tax relief.

4.8. An obvious point is that non-taxpayers are unable to obtain tax relief. In general, this seems appropriate. However, in certain circumstances, we think options should be explored for giving an equivalent relief to non-taxpayers. For example, there is an argument for ensuring that non-taxpayers should be able to obtain some form of relief for their employee travel expenses, where their employer does not reimburse them.[9] In general, an employee can deduct travel costs from their taxable income, if they are incurred necessarily in performing their job, are not ordinary commuting costs and the employer does not reimburse them. Employees receive tax relief at their marginal tax rate, for example, 20% of the costs if they are a basic rate taxpayer. A non-taxpayer cannot obtain this tax relief, because their income is already below the personal allowance.[10] Many care workers find themselves in this position, and they often have relatively high travel costs. We have previously suggested options such as allowing affected employees to carry forward or carry back tax relief claims.[11]

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

5.1. Where someone has a tax adviser, they may be able to plan to mitigate the effects of cliff edges to some extent. Unrepresented taxpayers are less likely to be able to do so, and therefore suffer the consequences of the cliff edge, for example, high marginal rates of tax.

5.2. See also our comments under heading 6 below relating to the trading and property allowances in respect of cliff edges.

6. What problems do tax reliefs cause?

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[8] https://www.litrg.org.uk/latest-news/news/220720-press-release-further-%E2%80%93-slow-%E2%80%93-step-towards-resolving-pensions-injustice-low

[9] Page 28, https://www.litrg.org.uk/sites/default/files/files/LITRG-A-better-deal-for-the-low-income-taxpayer-2020.pdf

[10] If an individual is claiming means-tested benefits, such as universal credit, they might be able to deduct the expenses in calculating their income, and therefore receive ‘relief’ in the form of an increased award.

[11] https://www.litrg.org.uk/latest-news/reports/180502-care-workers-%E2%80%93-challenges-tax-and-benefits-system and page 20 ff. https://www.litrg.org.uk/sites/default/files/180502-Carers-report-May2018.pdf

6.1. A major concern for us surrounds the explosion in the use of high volume repayment agents.[12] A number of these tax refund companies target taxpayers in relation to tax reliefs, often using aggressive marketing strategies. Over the past several years, we have seen taxpayers targeted in relation to marriage allowance, employee travel and subsistence costs and working from home allowances. We have raised various issues in relation to certain high volume repayment agents,[13] however, in the context of tax reliefs we would make the following points. It appears that tax refund companies are able to take advantage of:

- a lack of awareness of the existence of these reliefs among many taxpayers;
- the complexity (or perceived complexity) of claiming a tax relief for unrepresented taxpayers – this is particularly the case since there are different processes depending on the relief being claimed;
- advertising that suggests a large tax refund may be available and they can make it easy to obtain;
- labelling themselves as an "HMRC-approved agent", simply because they are registered with HMRC for Anti-Money Laundering purposes or as an agent for the purposes of acting on behalf of taxpayers.

6.2. While there will always be taxpayers who would prefer to use an agent to make a claim for tax relief, more could be done to make it easier for taxpayers to self-serve. In particular, HMRC need to themselves draw attention to the tax reliefs available, and to streamline some of their processes to make it simpler for taxpayers to make a claim without using an agent.

6.3. The trading and property allowances (each of which are £1,000) aim to reduce complexity for individuals earning lower amounts of trading, miscellaneous or property income. The trading allowance exempts trading and/or miscellaneous income of up to £1,000 from income tax and National Insurance contributions. It is not an automatic allowance, which means the taxpayer has to actively claim it in certain circumstances. Full relief is available if the taxpayer has gross trading or miscellaneous income of £1,000 or less. In this instance, it is not necessary to make a formal claim for the trading allowance or register as self-employed and complete a Self Assessment tax return (provided there is no other reason to do so). If the taxpayer completes a Self Assessment tax return for some other reason, then because the income is exempt, they do not need to include the trading and/or miscellaneous income and claim the trading allowance. Partial relief is available if the taxpayer has gross trading or miscellaneous income of more than £1,000. In this case the taxpayer can choose to deduct the trading allowance from trading income instead of deducting their actual

[12] https://www.litrg.org.uk/tax-guides/tax-basics/how-do-i-claim-tax-back/should-i-use-tax-refund-company

[13] https://www.litrg.org.uk/latest-news/reports/131015-tax-repayment-system-and-tax-refund-organisations-call-action, https://www.litrg.org.uk/latest-news/news/200707-tax-refund-company-deed-assignment-warning, https://www.litrg.org.uk/latest-news/news/210625-press-release-litrg-concern-growing-complaints-about-tax-refund-companies, https://www.litrg.org.uk/latest-news/news/220127-press-release-campaigners-call-urgent-action-diversion-tax-refunds, https://www.litrg.org.uk/latest-news/news/220623-press-release-tax-refunds-%E2%80%93-taxpayers-need-better-protection

trading expenses. The taxpayer must register as self-employed, complete a Self Assessment tax return and claim the trading allowance. The property allowance operates in a similar manner.

6.4. It will be noted that even in relation to these two allowances, there are different methods of operation depending on the level of income in question. This makes them rather complex for taxpayers to understand, which is ironic given they were introduced with the aim of making things simpler. It can also be very difficult for people to understand what gross income is in terms of gauging where they have breached the £1,000 trading allowance limit, given that some people receive income via platforms which is net of certain fees but might appear to them to constitute their gross income.[14]

6.5. This 'compliance' cliff edge of £1,000 in respect of each allowance can create issues for taxpayers – for example, the requirement to register for Self Assessment and as self-employed (in respect of trading income). Non-compliance may be a deliberate decision in some cases, but if someone starts trading informally and generates an income of less than £1,000, they may hear about the trading allowance. Since they are not brought into the Self Assessment system when they first start trading, it is perhaps more likely that they will overlook this at a later date should their trading income start to exceed £1,000 per annum. This can also lead to other problems for a business later on down the line, as HMRC will not have an official record of when the business commenced. For example, this might be problematic if someone in self-employment needs to prove they have been in business for at least a particular length of time, when raising finance, applying for a mortgage or claiming benefits.

6.6. The operation of the trading allowance may also be perceived as creating an unfairness between the employed and self-employed. An individual who is already self-employed and deducting trading expenses in excess of £1,000 against their main trade cannot obtain the benefit of the trading allowance against a second source of trading or miscellaneous income. An employee with a similar secondary source of income will be able to obtain the benefit of the trading allowance.

6.7. A final point on the trading allowance is that it exists for tax purposes (and in turn tax credits, for which the assessment of income generally follows the tax system), but not for means-tested benefits such as universal credit. Someone therefore earning small amounts of self-employment income who is claiming universal credit would need to report that income to the Department for Work and Pensions and have it taken into account with their claim, but might not need to report it for tax. This lack of joining up between the tax and benefits systems can therefore create additional confusion. In this example, it might risk non-compliance from a benefits perspective if the individual mistakenly believes that the same rules apply for tax and universal credit.

6.8. For small businesses, the Annual Investment Allowance has probably reduced complexity in relation to allowances on capital items. Most of the time the Annual Investment Allowance will cover a small business's capital expenditure and mean that the business is able to claim 100% relief for the year of expenditure. However, changes in thresholds can cause confusion for businesses with higher levels

[14] See our article of 2 December 2021 explaining this issue: https://www.litrg.org.uk/latest-news/news/211202-are-you-using-trading-allowance-correctly

of capital expenditure. In particular, if the threshold changes during an accounting period, it can be difficult to establish the full amount of Annual Investment Allowance available and when items should be purchased, due to the transitional rules.[15]

6.9. In relation to self-employment, most self-employed individuals are able to choose to calculate taxable profits on the accruals basis or on the cash basis. The introduction of the cash basis option was intended to simplify matters for smaller businesses, and also recognised that many small businesses had (albeit incorrectly) been calculating their taxable profits using a cash basis up to that point in any case. However, as with any choice, it is not necessarily a straightforward decision as to which option is most appropriate or beneficial. In addition, the decision to use the cash basis results in additional restrictions, such as which loss reliefs are available to the taxpayer. This makes the decision more complicated.

6.10. For capital gains tax, principal private residence (PPR) relief can cause problems and unrepresented taxpayers often have to deal with it when they dispose of a property. For unrepresented taxpayers it can be a difficult decision between trying to afford to pay for advice and muddling through without assistance. The continual stream of PPR cases appearing before the tax tribunals shows that the area has many complexities. This is now further exacerbated by the need to declare property disposals within 60 days. This short timescale may mean that errors are more likely.

7. Please outline potential reforms to the system of tax reliefs.

7.1. As we point out in our paper 'A better deal for the low-income taxpayer',[16] it is not easy for taxpayers to understand the tax system when terminology is used inconsistently.

7.2. This is a particular problem in the context of tax reliefs in relation to the use of the term "allowance". Tax legislation uses the term "allowance" for the personal allowance, blind person's allowance, transferable tax allowance for married couples and civil partners (or marriage allowance), personal savings allowance, dividend allowance, trading allowance, property allowance, as well as the lifetime and annual allowances for pensions.

7.3. Despite the fact that these are all known as allowances, they do not all work in the same way. The personal and blind person's allowances reduce a taxpayer's taxable income. The personal savings and dividend allowances are actually nil rate bands of tax – the income remains taxable, and uses up the tax bands, even though the tax is due at a nil rate. The trading and property allowances reduce taxable income, but the taxpayer chooses whether or not to use them, depending on their particular circumstances. Moreover, rent-a-room relief works in the same way as the trading and property allowances, but is called a 'relief' rather than an allowance.

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[15] https://www.taxadvisermagazine.com/article/annual-investment-allowance-reverting-standard-limit

[16] Page 13, https://www.litrg.org.uk/sites/default/files/files/LITRG-A-better-deal-for-the-low-income-taxpayer-2020.pdf

7.4. Miscalculations can occur if taxpayers assume that all "allowances" work in the same way as the personal allowance. It is difficult to explain the differences to taxpayers, who generally have a limited understanding of the tax system.[17]

7.5. We appreciate that it is difficult to make the use of terms consistent in relation to allowances that are already in existence. However, moving forward, we think that it is possible to avoid introducing new or subtly different definitions of the same term. So, going forwards, the term "allowance" should only be used consistently – possibly in line with its use for the personal allowance and blind person's allowance. It should be possible to introduce a formal step in the policymaking process to address this. In addition, a review could be carried out to consider how it might be possible to align existing definitions.

7.6. Many tax reliefs are amounts that are fixed in legislation. In order for the tax system to be equitable, such amounts should be reviewed and uprated annually by default. Otherwise, the tax reliefs diminish in value, and may fail to provide the benefit intended at the outset. There is a benefit, in relation to taxpayer awareness and understanding, of retaining such amounts at fixed levels. However, there needs to be a balance between this and compensating for fiscal drag. Examples of tax reliefs where this applies include the trading and property allowances, which remain at £1,000, which is the level at which they were introduced in 2017/18. For other examples, see our paper, 'A better deal for the low-income taxpayer'.[18]

7.7. One tax relief that tends to be uprated regularly is the personal allowance for income tax. Although this has now been frozen at its 2021/22 level up to and including 2025/26,[19] it has been a policy of successive governments in the recent past to increase it significantly. Taxpayers with income that exceeds £100,000 face a tapering away of their personal allowance such that those with income exceeding £125,140 do not benefit from the personal allowance at all. However, most taxpayers benefit from increases to the personal allowance. It provides less benefit however to those on the lowest incomes. The lowest earners, those already earning under the personal allowance, gain nothing from it increasing. Those earning above the personal allowance who are also in receipt of means-tested benefits, such as universal credit, find that much of the benefit is clawed back by government, because a reduced tax liability means a higher net income, which is assessed for those benefits. We explain in more detail in our paper, 'A better deal for the low-income taxpayer'.[20] A reform here would be to recognise that while uprating of the personal allowance can be an

[17] https://www2.deloitte.com/uk/en/pages/tax/articles/tax-education-gap.html

[18] Page 27, https://www.litrg.org.uk/sites/default/files/files/LITRG-A-better-deal-for-the-low-income-taxpayer-2020.pdf

[19] https://www.gov.uk/government/publications/income-tax-personal-allowance-and-the-basic-rate-limit-from-6-april-2022-to-5-april-2026/income-tax-personal-allowance-and-the-basic-rate-limit-from-6-april-2022-to-5-april-2026

[20] See pages 27ff., https://www.litrg.org.uk/sites/default/files/files/LITRG-A-better-deal-for-the-low-income-taxpayer-2020.pdf

appropriate policy, if the intention is to help those on very low incomes, increasing work allowances in universal credit would be more beneficial than increasing the personal allowance for income tax.

7.8. Finally, when considering reforms to tax reliefs, it is necessary to take into account equality issues and how impacts of the tax system can be relieved by providing exceptions for some people. For example, disabled people benefit from certain reliefs in the tax system, such as the blind person's allowance and zero-rating of certain goods and services that would otherwise be subject to VAT. There are arguments on both sides as to whether or not the tax system provides reliefs in this way or whether it is more appropriate to provide support through via welfare benefits. While there have been piecemeal changes since LITRG first examined these areas,[21] it remains arguable that policymakers need to keep equality issues in mind when designing coherent tax and benefits systems.

LITRG
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[21] See *Disability in Tax and Related Benefits: The Case for a Modern and Coherent Approach*, LITRG, 2003 https://www.litrg.org.uk/latest-news/reports/040115-disability-tax-and-related-benefits-case-modern-and-coherent-approach and *VAT and disabled people – the case for removing the barriers*, LITRG, 2007 https://www.litrg.org.uk/latest-news/reports/070130-vat-and-disabled-people-case-removing-barriers