

£119.4bn

The tax gap

Tax evasion in 2014 – and what can be done about it

A report by Richard Murphy FCA of Tax Research UK
for the Public and Commercial Services Union
Executive summary



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Introduction

The government claims there is no alternative to the austerity agenda. Jobs and pay are being cut, benefits slashed and public services closed. A simple part of the alternative is to close the tax gap, which involves two things: making those most able pay their fair share of taxes and beating tax cheats.

Campaigning by PCS, UK Uncut and others about the high profile tax avoidance activities of companies such as Google, Starbucks and Amazon along with celebrities like Jimmy Carr, Chris Moyles and Gary Barlow, have pushed the issue into the media spotlight.

In 2010 PCS published the most comprehensive calculation of the UK tax gap undertaken at the time. The report by Tax Research UK estimated the tax gap at £120 billion. This was made up of £70 billion in evaded tax, £25 billion in avoided tax and £25 billion in tax paid late.

At the time the government criticised this figure as being far too high and instead estimated a tax gap of £35 billion in 2011/12.

This pamphlet is a summary of a new report 'Tax Evasion in 2014 – and what can be done about it' written for PCS, by Richard Murphy of Tax Research UK. It makes a new estimate of the tax gap, which continues to be significantly higher than the HMRC estimate. This estimate, which is £119.4bn for financial year 2013/14, includes reductions in the estimates of tax avoidance and tax debt, but a significant increase in the estimated tax loss from evasion.

It includes significant new data and a much more comprehensive analysis of tax evasion. It shows that tax evasion is higher than previously estimated. It concludes that the government should tighten up legislation and reverse the counterproductive cuts in HM Revenue and Customs staffing.



Mark Serwotka
General Secretary



Janice Godrich
President

Defining the tax gap

The tax gap is made up of three parts.

- **Tax debt** – non-collection; tax that is not paid by a person or a company who knows that they owe it, but who doesn't pay, or delays payment.
- **Tax avoidance** – tax that is lost when a person claims to arrange their affairs to minimise tax within the law in the UK, or in other countries.
- **Tax evasion** – tax lost when a person or company deliberately and unlawfully fails to declare income that they know is taxable or claims expenses that are not allowed.

Tax debt

The amount of debt outstanding has fallen in recent years, but the amount of debt written off as irrecoverable or discharged by HMRC during each year is growing. In 2013/14 the estimate of tax debt is £18.2bn.

This figure is down on the £25bn of tax debt that was estimated in 2008. This largely reflects a difference in the method of calculation we have now used that makes the figure directly comparable with the data for tax avoidance and tax evasion, which was not previously the case.

Tax avoidance

Total tax avoidance is estimated to be at least £19.1bn for 2013/14. The figure is lower than the £25bn estimated in 2008, which reflects declining corporation tax rates (which means the amount avoided also declines, automatically), declining capital gains tax rates, and a likely decline in non-domicile activity as a result of legislative changes as well as caution being made in other estimates.

Tax evasion

The main area considered by the report is tax evasion. This work draws on data to examine areas which the HMRC estimate of the tax gap does not address. The report indicates that tax evasion is by far the largest of the three tax gaps.

This report estimates that tax evasion cost

the UK £73.4bn in 2011/12 (see table 1) rising to £82.1bn in 2013/14 (see table 2).

There is more than one type of tax evasion. The following types of evasion are considered in this report but are themselves not exclusive or complete. They are, however, likely to cover the more common causes of the UK's tax gap resulting from tax evasion:

- Tax evasion in the shadow economy. The shadow economy represents economic activities that are not recorded or declared to avoid government regulation or taxation.
- Tax lost as a result of other criminal or fraudulent activity in the UK economy.
- Capital Gains Tax and Inheritance Tax and offshore tax evasion.
- Tax evasion on investment and rental income.

Each of these issues is considered in turn in this report. Table 1 below identifies the Tax Research UK 2011/12 estimate. HMRC's estimate £22.3bn¹ is also included and the difference.

Tax evasion in the shadow economy

The report refers to detailed earlier work that estimates that up to 10% of all net sales income in the UK economy may not be recorded for tax purposes. In 2011/12 this was likely to have represented £100bn of unrecorded sales income. Based on this estimate, £40.3bn of unrecorded tax has gone unpaid in 2011/12.

The estimate of unrecorded income in the UK economy made in the report by Tax Research UK was based on VAT gap data published by both HMRC in successive tax gap reports² and by the European Union³. The estimate specifically excluded data on criminal attacks on the tax system and bad debt. The resulting estimates of VAT lost and turnover of almost exactly 10% of the likely sums owing, correlate with some authoritative estimates of the size of the UK shadow economy⁴.

Tax lost as a result of other criminal or fraudulent activity in the UK economy

The report goes on to use data from The National Fraud Authority's 'Annual Fraud Indicator Report for 2013'⁵ to estimate the

Table 1 Comparison between Tax Research UK and HMRC tax evasion figures for financial year 2011/12.

| Tax evasion | Item | Tax Research | HMRC | Difference |
|-------------------------------|---|--------------|-------------|-------------|
| Tax Research estimates | Trading in the shadow economy | 40.3 | 9.9 | 30.4 |
| | Untaxed proceeds of fraud and other crime | 6.5 | | 6.5 |
| | Capital gains tax | 3.8 | 0.1 | 3.7 |
| | Inheritance tax | 6.6 | 0.4 | 6.2 |
| | Offshore tax abuse | 4.3 | | 4.3 |
| | Total | | 61.5 | 10.4 |
| HMRC estimates | Criminal attacks on the tax system | 4.7 | 4.7 | 0 |
| | Error | 2.9 | 2.9 | 0 |
| | Failure to take care | 4.3 | 4.3 | 0 |
| | Total | | 11.9 | 11.9 |
| Total tax gap | | 73.4 | 22.3 | 51.1 |

¹ HMRC, Measuring Tax Gaps 2013, tax gap estimates 2011/12, Official Statistics Release, October 2013.

² <https://www.gov.uk/government/publications/measuring-tax-gaps>. Note: small rounding differences arise.

³ http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/vat-gap.pdf

tax loss. The estimate is careful to consider only those areas where it is likely that a tax liability should arise and to also exclude the possibility of double counting activity that might have already been considered as part of the shadow economy.

The National Fraud Authority (NFA) estimated that fraud against the public sector amounted to about £20.6bn in 2012. The total procurement and grant frauds have been excluded as they may be covered by estimates of tax lost to the shadow economy.

The estimate the NFA has made of fraud against the UK private sector is approximately £15.9bn per annum.

In the financial services sector the NFA used Department for Business, Innovation and Skills (BIS) data, which showed fraud at £5.4bn in 2012. The NFA also identified £9.1bn of fraud against individuals.

The report removes a number of elements to avoid double counting and identifies taxable income amounting to approximately £21.8bn in 2012. That

estimation would indicate that the tax loss arising in 2011/12 on this unrecorded income is £6.5bn.

Capital gains, inheritance and offshore tax evasion

The report considers these areas in detail. It recognises that estimating the tax gap in relation to capital gains, inheritance and off-shoring is difficult. However, an analysis of available data indicates that tax evasion is likely and significant. The report uses available data to make tentative estimates of the tax gap resulting from capital gains, inheritance and off-shoring.

The conclusion of a review of both share and property transactions is that the estimated tax loss from capital gains tax was £3.8bn in 2011/12. A review of inheritance tax indicates that £6.6 billion of additional inheritance tax might be due annually as a result. It is estimated that offshore tax evasion could cost the UK £4.3bn a year in lost tax revenue.

HMRC estimates

The HMRC official estimate⁶, records three

categories of tax loss which the report has included as tax evasion:

- Tax lost due to criminal attacks on the tax system, stated to amount to £4.7bn in 2011/12⁷
- £2.9bn lost to errors in that year
- £4.3bn lost to failure to take reasonable care.

Rental and investment income

Two further areas of income which the report indicates have the potential for significant levels of tax evasion are rental and investment income. While the report highlights the scale of potential for evasion, further work is necessary before an estimate of tax loss can be made, especially if the risk of double counting is to be avoided.

The tax gap over time

Table 2 below is an extrapolation of base data for each element on the basis of growth in GDP based on the 2014 budget and forecasts to the rise in VAT in the autumn statement 2013. The extrapolation shows that in 2013/14 the tax lost to evasion was £82.1bn.

Table 2 Estimating the tax gap 2012/13 to 2018/19

| The tax evasion gap | 2011–12 | 2012–13 | 2013–14 | 2014–15 | 2015–16 | 2016–17 | 2017–18 | 2018–19 |
|---|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| | £bn |
| GDP | 1,526 | 1,571 | 1,644 | 1,721 | 1,788 | 1,871 | 1,956 | 2,042 |
| Tax likely to be lost on unrecorded sales in the shadow economy | 40.3 | 45.6 | 46.4 | 47.7 | 49.5 | 51.8 | 54.2 | 56.6 |
| The HMRC tax gaps | | | | | | | | |
| Criminal attacks | 4.7 | 4.8 | 5.1 | 5.3 | 5.5 | 5.8 | 6.0 | 6.3 |
| Error | 2.9 | 3.0 | 3.1 | 3.3 | 3.4 | 3.6 | 3.7 | 3.9 |
| Failure to take care | 4.3 | 4.4 | 4.6 | 4.8 | 5.0 | 5.3 | 5.5 | 5.8 |
| Additional tax gaps calculated in this report | | | | | | | | |
| Tax due on fraud and other crime | 6.5 | 6.7 | 7.0 | 7.3 | 7.6 | 8.0 | 8.3 | 8.7 |
| Capital gains tax underdeclaration | 3.8 | 3.9 | 4.1 | 4.3 | 4.4 | 4.6 | 4.9 | 5.1 |
| Inheritance tax underdeclaration | 6.6 | 6.8 | 7.1 | 7.4 | 7.7 | 8.1 | 8.5 | 8.8 |
| Offshore tax evasion – income only | 4.3 | 4.4 | 4.6 | 4.8 | 5.0 | 5.3 | 5.5 | 5.8 |
| Total estimated tax evasion gap | 73.4 | 79.4 | 82.1 | 85.0 | 88.3 | 92.4 | 96.6 | 100.8 |

⁴ F Schneider and C Williams (2013) The Shadow Economy, Institute of Economic Affairs, London.

⁵ National Fraud Authority, annual fraud Indicator report 2013

⁶ HMRC, Measuring Tax Gaps 2013, tax gap estimates 2011/12, Official Statistics Release, October 2013.

⁷ <http://www.hmrc.gov.uk/statistics/tax-gaps/mtg-2013.pdf>

So what can be done about the tax gap?

There is a great deal that can be done to tackle both tax avoidance and tax evasion. The report suggests a number of measures that need to be taken:

- The introduction of a proper anti-avoidance rule into UK tax law.
- The introduction of country-by-country reporting for multinational corporations.
- Reform small business taxation to discourage avoidance and tackle tax evasion.
- Enforce proper regulation of companies in the UK to ensure that they file their accounts and tax returns and pay the taxes that they owe.
- Lastly, and most importantly, a reversal of the cuts to staff in HMRC and at Companies House, taking on more staff at both, to ensure that HMRC can collect the taxes the country so badly needs.

Staffing cuts in HMRC

The 2014 Tax Research UK report looks in detail at the impact of staffing cuts in HMRC on the tax gap. In 2005, HMRC had 92,000 staff. It has now less than 62,000 and by 2016 it is expected to have around 52,000 staff, a cut of almost 43% in just over a decade.

In June HMRC announced a further 23 local offices would be closed in an ill-conceived plan to cut 22,000 jobs. This comes after the government ignored the

majority of respondents to its consultation by announcing the closure of all 281 of its enquiry centres. This forces pensioners and those most in need to contact understaffed contact centres or use the internet to get help with their tax affairs.

These proposals signal the start of moves towards the new, highly centralised model that has been signposted in ministerial responses to debates on HMRC's plans for Scotland and Northern Ireland'.

HMRC's own customer service surveys show it is not meeting taxpayers' expectations. They are failing to collect tax from everyone who owes it resulting in an inability to create a level playing field in the UK economy.

Conclusion

While the government has argued that it is reducing the tax gap, the report shows that the tax gap is as large as it was in 2008. While the effect of the recession and a different method of calculating tax debt have reduced the estimates of tax avoidance and debt in the report, the estimate of tax evasion has significantly increased.

In any event the estimate of the tax gap in the Tax Research UK report remains over three times higher than the official HMRC estimate.

Further resource cuts are planned by the coalition government. The cuts planned if implemented will take public spending, as a proportion of GDP, back to levels seen in the immediate post war period, leading to further cuts in welfare and vital public services. Reducing tax avoidance, evasion and debt could significantly boost government income and so undermine the Government's argument that there is no alternative to austerity.

As we approach the general election it is clear that there is a real appetite for the issue of tax justice to be addressed. PCS has played a leading role in drawing the tax gap to the public's attention and has helped create an environment in which a growing number of organisations, NGOs, Trade Unions and groups like UK Uncut, have been able to highlight the injustice that the tax gap causes.

Tackling the tax gap is an important element in an alternative to a programme of austerity and cuts. We will never entirely close the tax gap but with the political will to take serious steps to address the issue, the economic outlook for the country could look very different indeed from that which we are told we face at present.

PCS

PCS is a trade union representing 240,000 members who work in the civil service, public and private sectors. PCS represents 50,000 members who work in HM Revenue and Customs.

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