Tax Justice and Jobs: The business case for investing in staff at HM Revenue & Customs

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Executive Summary

The UK has been in recession, and may well be in recession again soon. Through no fault of its own, the income of our government has collapsed whilst its obligations have increased. A gap between government income and expenditure of up to £175 billion a year has emerged as a result. This though is not a spending crisis: this is an income crisis.

This report argues that the scale of that income crisis is being increased as a result of policies being pursued by HMRC. Those policies were created before the onset of recession. They have two aims. The first is to cut over time the number of staff engaged by HMRC by 25,000 – 17,000 have already left. The second policy is to close many of the local tax offices from which HMRC used to undertake its work in local communities. Over 200 offices have either closed already, are about to close, or are under threat of closure. It is fair to say that all offices are under scrutiny. When the programme is complete some people in the UK will live more than 50 miles from their nearest tax office, making it impossible for many of them to turn to this natural source of help and advice when seeking to fulfil their obligation to pay tax. In addition, HMRC are about to press ahead with the closure or severe reduction of its drop-in enquiry centre facility, which has previously provided a local and immediate tax advice service for both members of the public and tax professionals.

As this report also notes, too many people do not pay the tax due by them in the UK. HMRC have estimated the 'tax gap' in the UK – the difference between the tax they think is owed and the tax they actually assess – to be about £40 billion a year. We argue that this dramatically underestimates the total tax gap, particularly with regard to tax evasion.
To data previously published by the TUC which estimated total UK tax avoidance at £25 billion we now add an estimate of £70 billion for tax evaded within the UK. We can provide detailed and precise workings for this sum and also outline why the estimates of this sum produced by HMRC and the National Fraud Authority inevitably understate this figure.

When the total outstanding debts now owing to HMRC are added to these two sums, which when last estimated was £28 billion, we suggest the total tax gap in the UK is now likely to exceed £120 billion.

It is very obvious that the UK cannot afford this tax gap. It is equally obvious that if investment were made in additional resources for HMRC then this tax gap could and would be substantially reduced.

In arguing this we make the following points:

Recommendation 1: The basis for estimating tax avoidance should be revised to use a definition widely recognised in society and which correctly reflects areas of continuing policy concern as well as those abuses making use solely of artificial arrangements.

Recommendation 2: HM Revenue & Customs should be required to prepare estimates of evasion of direct taxes on a "top down" basis, as they do for indirect taxes.

Recommendation 3: H M Revenue & Customs should recognise that their existing bottom up methodology for calculating the tax gap for direct taxes will inevitably seriously under-estimate the size of that estimate.

Recommendation 4: HM Revenue & Customs should recommence publication of the many statistics on taxation produced by the former Inland Revenue which have ceased to be available since its demise, the lack of which make objective appraisal of the performance of the tax system hard to achieve.

Recommendation 5: HM Revenue & Customs should engage more staff to tackle tax avoidance and tax evasion.

Recommendation 6: HM Revenue & Customs must on occasion select cases for investigation without consideration of potential tax yield, and make clear that this happens to protect revenues from those on lower levels of earnings.

Recommendation 7: More staff should be engaged to scrutinise tax repayments before they take place.

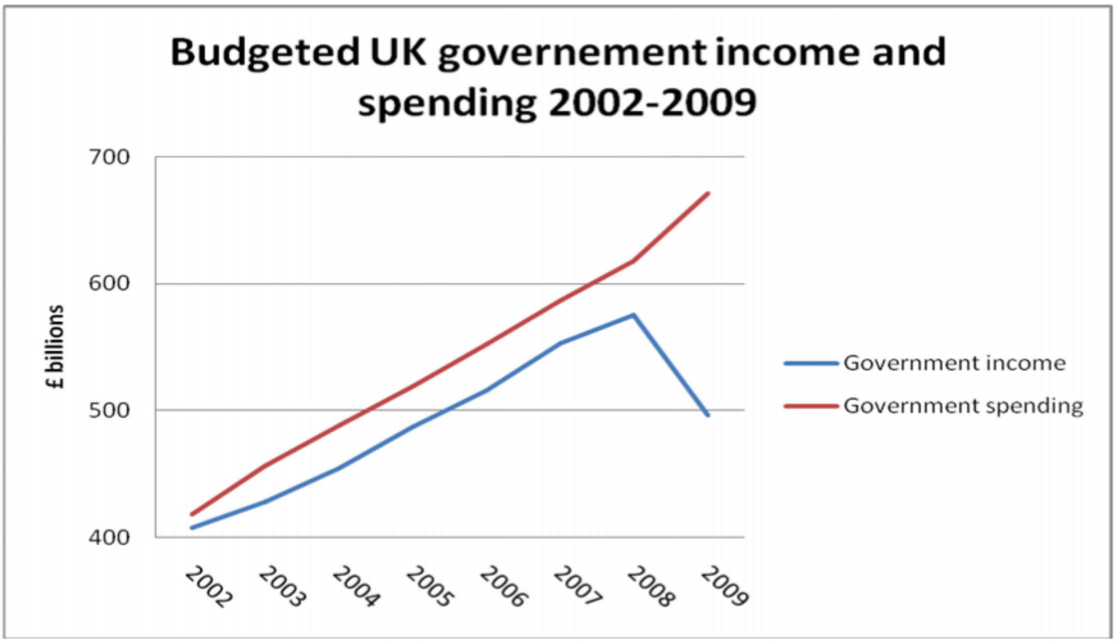
Recommendation 8: More staff should be engaged to recover tax debt owing, and limits on sums to be pursued for collection should be lowered considerably.

Recommendation 9: The local office closure programme being pursued by HM Revenue & Customs should not just be stopped, it should be reversed. Tax must be seen to be collected in the community.

It is our firm believe that adopting these policies would highlight the true extent of the UK Tax Gap, provide the data needed to appraise progress in tackling it, and be cost effective methods of achieving that goal for al the reasons this report outlines.

The cause of the current financial crisis

A lack of tax revenue did not cause the current financial crisis. The lack of tax revenue caused by the current financial crisis is, however, the problem facing any future government of the UK. This can easily be demonstrated. Budgeted UK government tax revenue and spending from 2002 to 2009 is shown in Figure 1.



Source: HM Treasury web sites for the budget for each year noted: http://www.hm-treasury.gov.uk/bud_bud09_index.htm

What is clear is that the current crisis in government financing is not a spending related issue: it is a revenue related issue. It is the collapse in income that has created the problems facing society. If we wish to continue to enjoy the benefits of government spending, the means has to be found to restore government income when a 'tax gap' of £175 billion has opened up in the UK.

The Tax Gap

That 'tax gap' has four major components:

1. Income lost as a result of a downturn in economic activity: this is not the concern of this paper;
2. Tax lost to tax avoidance, which is defined here as seeking to minimise a tax bill without deliberate deception (which would be tax evasion or fraud) but contrary to the spirit of the law;

3. Tax lost to tax evasion, which is the illegal non payment or under-payment of taxes, usually by making a false declaration or no declaration to tax authorities, resulting in legal penalties if the perpetrator is caught;
4. Non payment of tax declared to be due, i.e. bad debt suffered by HM Revenue & Customs.

The second to fourth items on this list are the issues considered here.

Estimates of these tax gaps are rare, and subject to considerable dispute. Richard Murphy, writing for the UK TUC estimated that the UK tax avoidance gap was £25 billion in 2008[1]. He has since estimated that tax evasion is not less than £70 billion in the UK using data published by HM Revenue & Customs[2]. The UK's HM Revenue & Customs estimate these two gaps to be £40 billion in total, with the split between evasion and avoidance being unclear and using parameters for definition much tighter than those used by Murphy[3]. UK unpaid tax is currently estimated to be £28 billion[4]. The likely gap is therefore not less than £70 billion and might be as high as £120 billion. That sum is between 40% and 68% of the current annual tax deficit. Tackling this issue is, therefore, of paramount importance.

The policy opportunities – an outline

There are a range of policy initiatives any government can and should take to tackle the tax gap at this time. These initiatives split into two parts.

First, tax evasion and the non-payment of tax due must be addressed. As this report makes clear, this should be done by increasing the number of staff engaged by HM Revenue & Customs to tackle these issues. As the report argues, this makes particular sense during a period of high unemployment. This logical course of action is contrary to that adopted by the UK government at this time, which is pursuing a policy of closing a significant number of tax offices and making more than 25% of HM Revenue & Customs' staff redundant, leading to low morale amongst remaining staff, chaos in tax administration[5] and rising debt arrears. There is significant danger in this policy at a time when public services are under threat with consequent risk of public unrest. As the OECD said in January 2010[6]:

> *[T]axation is more than just about revenue mobilization. The way in which revenues are collected and spent defines the symbiotic relationship between the state and its citizens, strengthening the former and making it more accountable to the latter.*

[1] http://www.tuc.org.uk/touchstone/Missingbillions/1missingbillions.pdf; 1-2-2010.
[2] http://www.taxresearch.org.uk/Blog/2010/01/17/why-wont-hm-revenue-customs-admit-the-scale-of-tax-evasion/; 1-2-2010.
[3] http://www.hmrc.gov.uk/stats/measuring-tax-gaps.pdf; 1-2-2010.
[4] http://www.publications.parliament.uk/pa/cm200910/cmselect/cmpubacc/97/97.pdf; 1-2-2010.
[5] 43% of all calls to HM Revenue & Customs went unanswered in 2008/09 according to the UK's National Audit Office http://www.channel4.com/news/articles/business_money/taxman%20ignored%2044%20million%20calls/3502357; 1-2-2010.
[6] http://www.oecd.org/dataoecd/7/36/44493096.pdf; 1-2-2010.

Failure to collect tax due undermines that relationship at a time when it will already be under stress. Investment in tax collection and tackling tax evasion is vital at this time.

Secondly, challenging tax avoidance is vital. This activity, largely unrecorded by the government and therefore not reflected in its statistics mainly because by definition it is legal, shifts the burden of tax payment in society, most especially from capital (and the large companies that utilise it) onto labour and from the wealthy and self employed onto employed labour. The resulting perceptions of injustice are politically significant at this time.

This report addresses both these issues in detail.

Why HM Revenue & Customs underestimate the tax gap

Given that this report is making a business case for investing in staff to be employed by HM Revenue & Customs it is important that the scale of potential benefits that might flow from doing so are as fairly stated as possible.

As noted above, HMRC think that the tax gap is made up of£40 billion of tax evaded and avoided and £28 billion of unpaid tax. The latter figure has undoubtedly increased since then as a result of HMRC's 'Time to Pay' scheme, introduced to deal with the impact of the recession[7]. This figure is rising by the day as more and more businesses defer payments. It has now been estimated that at least £4.8 billion of tax payments have been deferred under this scheme with 160,000 businesses employing 1.2 million people deferring payments. Insolvency practitioners have warned that many of these debts may prove irrecoverable in due course, adding to the bad debt crisis faced by HM Revenue & Customs and the overall tax gap[8]. For that reason the tax gap may already be bigger than HM Revenue & Customs recognise, although it is also important to note that HM Revenue & Customs suggest that £3 billion of the sums they have agreed to defer have already been repaid.

This figure for unpaid tax is, however, the smallest part of the tax gap. The much bigger element is that relating to tax avoidance and tax evasion.

The tax avoidance issue is only touched on in HM Revenue & Customs' summary of tax losses, which is summarised here:

[7] http://www.hmrc.gov.uk/MANUALS/dmbmanual/DMBM800040.htm 7-2-2010
[8] http://www.independent.co.uk/news/business/news/tidal-wave-of-business-failure-feared--as-tax-help-scheme-ends-1892249.html 7-2-2010

Table 1.1: Tax Gaps for HMRC administered taxes – revenue losses 2007-08 (£bn)

Tax	Component[1]	Estimates (£ billion) Point[2]	Lower	Upper	% Tax gap
Indirect taxes[3]					
Value Added Tax (VAT)		11.5	N/A	N/A	12%
Spirits duty		0.1	0.0	0.2	5%
Cigarette duty		1.0	0.4	1.6	11%
Hand rolled tobacco duty		0.5	0.4	0.6	53%
Great Britain Diesel duty		0.5	0.0	0.9	4%
Great Britain Petrol duty[4]		0.0	0.0	0.0	0%
Northern Ireland Diesel duty[5]		0.1	0.1	0.2	34%
Northern Ireland Petrol duty[4]		0.0	0.0	0.0	15%
Other (Illustrative indicator)[6]		0.9	N/A	N/A	
Total indirect taxes		15	N/A	N/A	10%
Direct Taxes					
Income tax, National Insurance Contributions (NICS), Capital Gains Tax	Inaccurate self-assessment returns from individuals	7.2	3.3	13.4	
	Non-declaration of unearned[7] income and capital gains by individuals who do not receive returns	0.3	N/A	N/A	
	Hidden economy (income from un-declared employment and self-employment)[8]	2.8	1.3	6.9	
	Inaccurate returns from small and medium sized employers (PAYE)[8,9]	0.4	0.2	0.5	
	Avoidance[10]	1.1	0.8	1.6	
	Non-payment	1.4	1.4	1.4	
	Other (Illustrative indicator)[11]	2.7	N/A	N/A	
	Total Income Tax, NICS, Capital Gains Tax	15.8	N/A	N/A	6%
Corporation Tax	Inaccurate returns from Small and Medium sized businesses[12]	3.6	1.2	8.1	
	Avoidance by Very Large businesses[13]	3.1	N/A	N/A	
	Other tax gap for Very Large businesses[13]	0.2	N/A	N/A	
	Avoidance by Large and SME businesses[10,12]	0.3	0.2	0.4	
	Non-payment	0.4	0.4	0.4	
	Other (Illustrative indicator)[14]	1.3	N/A	N/A	
	Total Corporation Tax	8.9	N/A	N/A	16%
Cross-tax avoidance	Cross tax and stamp duty land tax avoidance[10]	0.2	0.1	0.3	
Other (Illustrative indicator)[15]		1.6	N/A	N/A	
Total direct taxes		25	N/A	N/A	8%
Total HMRC Tax Gap		40	N/A	N/A	8%

Avoidance apparently amounts to a total of just £4.7 billion, of which £3.1 billion is by large business. A tiny part is supposedly undertaken by individuals.

This argument is hard to sustain in the light of evidence published by HM Revenue & Customs themselves[9]. In their own data on tackling non-compliance in 2008-09 they claim total revenue raised of £12,075 billion. Of this £3.7 billion related to corporation tax from large businesses: in 2007-08, the year to which the above data refers the collection including interest was apparently £3.9 billion from those same companies and yet the above table refers to an error rate of just £3.1 billion. Interest may explain the difference between these two numbers but in that case the above table does in this case suggest that HM Revenue & Customs found and recovered one hundred percent of errors in this tax paying community. That is logically very unlikely.

[9] http://www.hmrc.gov.uk/about/autumn-report-2009.pdf page 40.

It is also disappointing to note that the recovery by HM Revenue & Customs from the hidden economy in 2007-08 was just £76.1 million, emphasising as it does the weakness in approach by HM Revenue & Customs in concentrating its efforts on errors made by those who do deliver tax returns and ignoring the significant element in society who evade the system altogether.

Deloittes, the international accountants, reporting[10] as part of the Foot Report on the British Crown Dependencies, denied even the level of tax avoidance noted above by HM Revenue & Customs, declaring that tax avoidance by large corporations amounted to no more than £2.2 billion a year, and maybe less even though HM Revenue & Customs data noted above shows substantially more than this was recovered from them on investigation. However, they defined tax avoidance only as activity in conflict with tax policy. They claimed that only prior year adjustments with regard to tax in the accounts of major companies, which they thought might indicate the existence of tax claims of relatively doubtful validity which had, none the less, passed scrutiny under the review of HM Revenue & Customs (not that, although they did not note it, most of them would not have been drawn to their attention) met this criteria. All other reductions in tax liabilities reducing tax payments below the anticipated rate due by a tax payer represented, in Deloittes opinion, intended tax policy on the part of HM Revenue & Customs and as such could not be considered tax avoidance.

This is a strange assertion for a number of reasons, as is that of HM Revenue & Customs, where they use the term tax avoidance only in relation to what they call artificial avoidance schemes[11]. This is quite obviously not what the tax profession considers to be tax avoidance. A large range of mechanisms commonly considered to be tax avoidance, such as income splitting between married persons and within civil partnerships; the creation of artificial self employments through limited companies where dividends are paid instead of salaries to avoid National Insurance Contributions and to divert income to non-working persons who pay lower rates of income tax; mechanisms that convert income into capital gains; the use of offshore arrangements by large corporations, and more besides have all been subject to discussion and /or consultation in past budgets and have been described as tax avoidance and yet none appear to fall into that category using the definitions offered by Deloittes or HM Revenue & Customs when calculating loss to this activity. This does not mean that these are not tax avoidance just because at present they may remain legal. They are tax avoidance none the less: they have just not as yet been declared artificial. In addition, many such arrangements whilst ostensibly legal tread a very fine line between legality and tax evasion by using minimal disclosure. Much of the £2.2 billion of tax avoidance Deloittes refer to may fit in to this category since not every submission by every company is, of course, examined in detail.

The estimate of tax lost to avoidance by Richard Murphy for the TUC uses a broader definition of tax avoidance and accords with the commonly understood use of the term and as such is more likely to reflect the real scale of the activity. It is, however, accepted that this activity does to some degree remain unmeasurable whilst too limited resources are dedicated to identifying those undertaking tax avoidance and to checking whether their arrangements are tax compliant or not.

[10] http://www.hm-treasury.gov.uk/d/foot_review_deloitte.pdf 7-2-2010
[11] http://www.hmrc.gov.uk/stats/measuring-tax-gaps.pdf page 5 7-2-10.

Recommendation 1: The basis for estimating tax avoidance should be revised to use a definition widely recognised in society and which correctly reflects areas of continuing policy concern as well as those abuses making use solely of artificial arrangements

Tax evasion is another problematic issue. By definition those tax evading do not willingly tell HMRC of their activities. This means there are, broadly speaking, two ways of identifying the amount evaded. Oddly HMRC use both, but incompatibly. The first method is the one they use to estimate losses in indirect taxes. Indirect tax losses to tax evasion are primarily estimated using a "top down" approach. This means the tax gap for each tax is estimated by subtracting tax paid from an estimate of total tax due. Total tax due is estimated using data sources on consumption that are independent of HMRC, most coming from the Office of National Statistics household and business surveys. So, and for example, with regards to VAT (which makes up by far the largest part of indirect tax losses) the loss is estimated by comparing the net theoretical tax yield with actual VAT receipts. The difference between these amounts is known as the VAT gap.

This 'top-down' approach employs a gap analysis, which involves:
• assessing the total amount of expenditure in the economy that is theoretically liable for VAT
• estimating the tax liability on that expenditure based on commodity breakdowns of the expenditure data
• estimating the value of tax on the VAT-able expenditure, to derive the gross VAT theoretical tax liability (VTTL)
• subtracting any legitimate refunds (deductions), occurring through schemes and reliefs, to arrive at the net VTTL
• subtracting actual VAT receipts from the net VTTL and
• assuming that the residual element, the gap, is the total VAT Gap, including all losses, for any cause.

This approach is rational because it seeks to establish the likely total tax due independent of any data submitted to HMRC and then compares this with the data HMRC hold. The residual is a good estimate of the likely tax gap.

The same is not true of the basis used for estimating tax evasion with regard to direct taxes. As HMRC note[12]:

> *At present tax gap estimates are available for the main sources of revenue loss in Income Tax, National Insurance Contributions, Capital Gains Tax and Corporation Tax.*
>
> *Direct tax gap estimates are produced using "bottom-up" methods. This means that components of the tax gap are estimated using departmental sources, such as surveys, administrative and operational data. The bottom-up method is less comprehensive than the top-down method used for indirect tax gap estimates because by its nature much of the gap arises from activities that are deliberately concealed. In addition because the bottom-up methods are based on compliance activity which can, in some cases, take years to complete*

[12] Ibid, page 22 7-2-2010

the resulting tax gap estimates typically apply to earlier periods than those from the top-down methods.

Unfortunately the Revenue's own admission of the incompleteness of their methodology is itself seriously incomplete. The method relies on data available to the department. It is readily apparent that a great deal of tax evasion will never result in data being available to the department: the evasion is completely outside the tax system and entirely undetected by it. As a consequence the method used by HMRC must seriously under-estimate the loss of direct taxes compared to any method using a top down approach of the type used to calculate indirect tax losses.

Recommendation 2: HM Revenue & Customs should be required to prepare estimates of evasion of direct taxes on a "top down" basis.

Fortunately a good estimate of the direct tax loss that a top down calculation might suggest likely can be computed on the basis of available top down loss estimates for VAT, excluding missing trader fraud. HMRC's 2009 estimate of the VAT gap includes the following time series data:

Table 2.1: VTTL, VAT receipts and revenue losses

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09[2]
Net VTTL (£bn)	75.5	78.7	82.5	86.2	89.5	93.5	94.2
Net VAT receipts (£bn)[1]	63.7	69.1	72.8	73	77.6	81.9	79.8
Revenue loss (£bn)	11.9	9.5	9.8	13.3	11.9	11.5	14.4
VAT gap (per cent)	**15.7%**	**12.1%**	**11.8%**	**15.4%**	**13.3%**	**12.3%**	**15.3%**

[1] Net VAT receipts are expressed net of payments and re-payments.
[2] A proportion of the VTTL estimate for the final year is based on a forecast.

By 2008-09 at most £1bn of this sum was estimated to arise from missing trader fraud. Given the scale of the numbers involved this is considered immaterial to the exercise being undertaken here because it will have little impact on the broader tax related issues that the above suggests likely.

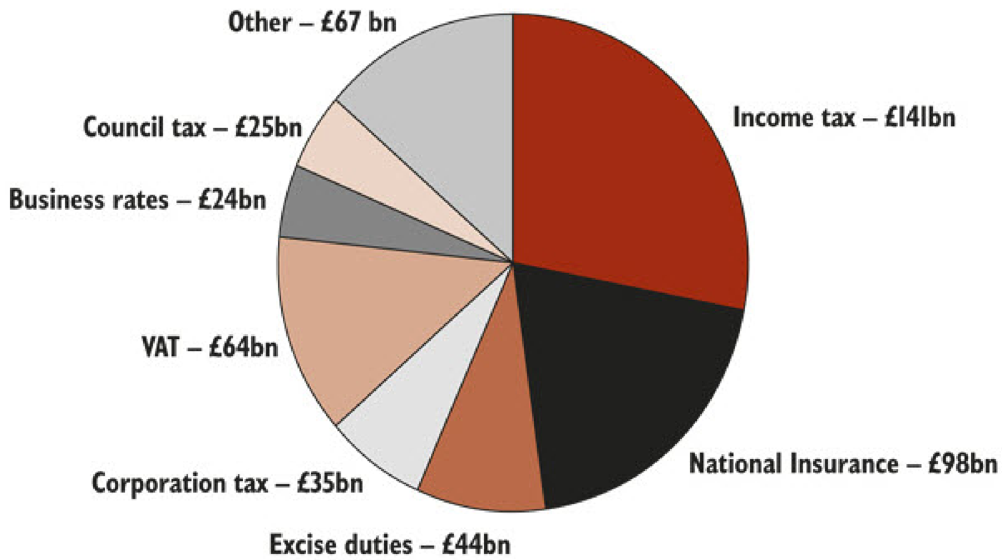
The average VAT loss (and trend data analysis suggests no upward or downward trend in this average over time, rather curiously) suggests the average loss is 13.7%, which is below the current rate of loss having allowed for any missing trader fraud and is the data therefore used here for extrapolation purposes.

The extrapolation assumes that if 13.7% of VAT revenues are lost then it is likely that 13.7% of all direct taxes are lost as well. For this purpose it is important to note that the current breakdown of anticipated tax receipts is as follows[13]:

[13] Source, Pre-Budget Report December 2009

Chart 1.2: Government receipts

Total receipts: £496 billion



Presented in table format the data on taxes collected is as follows over the last decade (2009/10 is an estimate)[14]:

Year	2001-02 £bn	2002-03 £bn	2003-04 £bn	2004-05 £bn	2005-06 £bn	2006-07 £bn	2007-08 £bn	2008-09 £bn	2009-10* £bn
Income tax	108.0	109.5	114.0	122.9	130.5	143.3	147.3	147.9	134.4
National Insurance Contributions	63.2	64.6	72.5	78.1	85.5	87.3	100.4	96.9	94.9
Capital gains tax	3.0	1.6	2.2	2.3	3.0	3.8	5.3	7.9	2.5
VAT	61.0	63.5	69.1	73.0	72.9	77.4	80.6	78.4	67.2
Corporation tax	32.0	29.3	28.1	33.6	41.8	44.3	46.4	43.1	33.3
Petroleum revenue tax	1.3	1.0	1.2	1.3	2.0	2.2	1.7	2.6	1.2
Fuel duties	21.9	22.1	22.8	23.3	23.4	23.6	24.9	24.6	26.4
Tobacco duties	7.8	8.1	8.1	8.1	8.0	8.1	8.1	8.2	8.8
Spirit duty	1.9	2.3	2.4	2.4	2.3	2.3	2.4	2.4	2.6
Beer duties	2.9	2.9	3.0	3.1	3.1	3.1	3.1	3.1	3.2
Wine duties	2.0	1.9	2.0	2.2	2.3	2.4	2.6	2.7	2.9
Cider & perry duties	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.3

[14] Source http://www.hmrc.gov.uk/stats/tax_receipts/table1-2.xls 11-2-10

Stamp duties	7.0	7.5	7.5	9.0	10.9	13.4	14.1	8.0	7.5
Betting & gaming duties	1.4	1.3	1.3	1.4	1.4	1.4	1.5	1.5	1.4
Customs duties & levies	2.0	1.9	1.9	2.2	2.3	2.3	2.5	2.7	2.6
Air passenger duty	0.8	0.8	0.8	0.9	0.9	1.0	2.0	1.9	1.9
Insurance premium tax	1.9	2.1	2.3	2.4	2.3	2.3	2.3	2.3	2.2
Landfill tax	0.5	0.5	0.6	0.7	0.7	0.8	0.9	1.0	0.9
Climate change levy	0.6	0.8	0.8	0.8	0.7	0.7	0.7	0.7	0.7
Aggregates levy	-	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Inheritance tax	2.4	2.4	2.5	2.9	3.3	3.6	3.8	2.9	2.3
Misc	-	-	-	-	0.0	0.0	-	-	-
	321.8	324.5	343.6	371.0	397.9	423.7	451.1	439.1	397.4

The critical point to be noted is that a limited number of taxes, and especially income tax and the closely related national insurance contributions together with corporation tax, dominate the total direct tax take. Taxes such as capital gains tax and inheritance are relatively immaterial in comparison. The calculation noted here assumes that this is the case.

It also assumes that if VAT is not collected then it follows that direct taxes will not be as well: the two are not independent of each other. This must be the case for a number of reasons. Firstly, VAT is only paid by VAT registered traders. These can be individuals, partnerships, limited companies and other entities, although these three dominate. If they do not pay VAT when it is due there are two possible reasons. The first is they have failed to record the sales on which VAT may be payable to H M Revenue & Customs. Alternatively, they have entirely failed to register for this tax when required to do so. All entities making supplies potentially chargeable to VAT are required to register for the tax when the value of those supplies made by them has exceeded £68,000 (2009/10) in any twelve month period. It is of course possible for a mistake to be made on the timing of VAT registration as a consequence, but it is much more likely that sales are not recorded to ensure that the business is apparently below the VAT registration threshold, and so entirely outside the VAT system.

Any such suppression of sales income will, however, have consequent effects. The first is that profits will be understated, meaning that either income tax is underpaid by the self employed or corporation tax is underpaid by corporations, or alternatively tax on wages paid is not recorded, because they are in turn paid out of unrecorded income. Of course cash might also be paid to suppliers as well, creating a cycle of trade within the shadow economy. This is inevitable: it is simply not possible to suppress sales data for tax purposes and not then also understate taxes on income; one leads to the other.

It is interesting to note that the HM Revenue & Customs Autumn Report for 2009[15] suggests that as a proportion of liabilities owing the tax gap for individuals in the period 1999-00 to 2004-05 (where after it seems not to have been calculated) averaged 13.5%, and if the first year was excluded averaged 14.6%. This appears to corroborate the logic used in this report, as does the fact that the same source noted that the tax gap for small and medium sized entities reached 18% in 2002 and averaged 14.25% over the years before data disclosure on this issue ceased, also in 2004.

It is therefore important to quantify the likely consequence of this. It is stressed that the resulting figure of tax lost is, of course, an estimate, but that is true of all data with regard to tax evasion. Those partaking in this activity do not willingly make data available for the purposes of statistical accuracy. The logic used is simple, but flows inevitably, and it is suggested certainly from the observations made in the previous paragraph. If VAT is understated by 13.7% of the gross sum due then it is likely that, having allowed for the cycles of trade within the shadow economy, that direct taxes will be underestimated by the same amount.

Indeed, this is almost certainly an underestimate because the estimate of VAT due used to calculate the VAT gap takes into account the facts that less than 1,961,000 of all known self employments and trading companies in the UK are VAT registered[16] (there are 2.6 million companies incorporated in the UK in January 2010[17] but only 940,000 companies are taxpayers[18] whilst there were in 2007-08 4,890,000 self employed people, the vast majority of whom earned less than £15,000 a year according to their tax returns[19]). The possibility must therefore be recognised that sales suppression resulting in lost direct tax revenue is more prevalent amongst non VAT registered traders precisely because VAT registered traders are more likely to be audited by HMRC inspectors than are the non-VAT registered, so making compliance more likely in the VAT registered group – who by definition are also at least partly compliant by having registered in the first place. The ratio of 13.7% is therefore likely to understate the likely direct tax loss, but is the best available for current purposes.

In the current tax year direct tax revenues are £274 billion. This, however is the sum after the loss arises i.e. this figure is 86.3% of the gross expected revenue. That total expected revenue is, therefore approximately £318 billion, giving a direct tax gap of £44 billion. If the reported VAT tax gap ratio for 2008-09 of 15.3% is used, it almost certainly being higher than average because this ratio is likely to rise in a recession when there are more registered unemployed people, that gap is close to £50 billion.

To this must be added not the £11.5 billion of VAT evasion noted by HMRC in their summary table reproduced above but the higher specific figure of £14.4 billion for VAT noted in the same source report plus the £4 billion of evaded excise duties, i.e. £18.4 billion since these seem more reliable estimates.

[15] http://www.hmrc.gov.uk/about/autumn-report-2009.pdf page 38
[16] http://www.hmrc.gov.uk/stats/tax_receipts/table1-4.pdf 2008/09 data
[17] http://www.companieshouse.gov.uk/about/busRegArchive/businessRegisterStatisticsJanuary2010.pdf
[18] http://www.hmrc.gov.uk/stats/tax_receipts/table1-4.pdf data not updated by HMRC since 2007/08, and on the basis of trend data may exceed 1 million now
[19] http://www.hmrc.gov.uk/stats/income_distribution/3-10table-jan2010.pdf

Consideration then has to be given to evasion of other taxes and revenues, totalling £116 billion as it is inconceivable that there is no loss in these areas. Whilst losses in these areas may well not run at the rate seen in the taxes already noted some evasion must occur. Assuming any loss on these income sources it is quite reasonable to presume that the total losses to tax evasion at this time amount to at least £70 billion.

This then leaves a total tax gap, as noted previously, of not less than £123 billion (and rising) made up of £70 billion of tax evasion, £25 billion of tax avoidance and £28 billion (and rising) unpaid tax.

Recommendation 3: H M Revenue & Customs should recognise that their existing bottom up methodology for calculating the tax gap for direct taxes will inevitably seriously under-estimate the size of that estimate.

Recommendation 4: HM Revenue & Customs should recommence publication of the many statistics on taxation produced by the former Inland Revenue which have cased to be available since its demise, the lack of which make objective appraisal of the performance of the tax system hard to achieve.

It should be noted that the above findings differ from those of the National Fraud Authority who said in January 2010 that total tax fraud in the UK amounted to £15.2 billion a year, amounting to about 3% of total tax liabilities. It is hard to reconcile this data with, for example, HM Revenue & Customs' estimate of the current VAT gap (noted above) – which can only relate to fraud – being, by itself £14.4 billion per annum and no attempt to do so has been undertaken as a result.

HM Revenue & Customs – its cost and revenues

The taxes collected by HM Revenue & Customs do not come in entirely voluntarily. There is a cost to collecting these taxes. The latest accounts of HMRC are available on line and cover the year 2008-09[20]. For the purposes of the current analysis the activity under consideration at HMRC is what they term 'Request for Resources 1', which is described as:

> *Administering the tax and customs control systems fairly and efficiently and making it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credit and other entitlements.*

This activity in 2008-09 had to following costs and benefits, with the previous year shown for comparison.

Year	2008-09	2007-08
	£m	£m
Staff costs	2740.7	2787.6
Admin costs	1943.1	1835.1
Income generated	(742.1)	(661.6)
Net cost	3941.7	3961.1

[20] http://www.hmrc.gov.uk/about/hmrc-accs-0809.pdf 12-2-10

Salary costs for this activity are overstated as no salary costs are allocated to HM Revenue & Customs' other activities, which is unrealistic resource accounting and weakness in the reporting of HMRC.

The salary costs were broken down as follows:

Year	2008-09	2007-08
	£m	£m
Wages	2179.1	2215.0
Social security	156.0	161.2
Pensions	406.2	412.6
Total	2741.3	2788.8

The reason for the minor discrepancies between figures in the two tables is not readily apparent from the accounts.

The total staff numbers at HMRC were as follows in each of the following years:

Year	2008-09	2007-08	2006-07[21]	2005-06	2004-05[22]
Tax related	80,532	84,245	89,746	92,455	97,489
Others	5,314	5,620	6,055	6,854	6,642
Total	85,846	89,865	95,801	99,309	104,131
% of staff tax related	93.8%	93.7%	93.7%	93.1%	93.6%

Data is not available before 2004-05 as the Inland Revenue and HM Customs & Excise were independent entities before that time.

The fall in the number employed in a year will be noted. This is consistent with the department's plans, which were announced as follows:

Department	Sep-05	Sep-09	Difference	Difference
Criminal Investigations	2,356	2,197	-159	-6.7%
Central Compliance	348	253	-95	-27.3%
Compliance and Enforcement	0	320	320	100.0%
Debt Management and Banking	10,254	7,922	-2,332	-22.7%
Detection (UK Benefits Agency)	4,343	4,485	142	3.3%
Local Compliance	21,758	14,661	-7,097	-32.6%
Risk & Intelligence	1,493	2,877	1,384	92.7%
Specialist Investigations	352	1,661	1,309	371.9%
Anti-Avoidance	116	107	-9	-7.8%

[21] http://www.hmrc.gov.uk/about/hmrc-06-07-acc.pdf

[22] http://customs.hmrc.gov.uk/channelsPortalWebApp/downloadFile?contentID=HMCE_PROD1_025710

Corporation Tax & VAT	324	307	-17	-5.2%
Excise & Stamps	389	322	-67	-17.2%
Large Business Services	1,950	1,549	-401	-20.6%
Total	**43,683**	**36,661**	**-7,022**	**-16.07%**

It will be noted that the planned number of job losses has fallen: the numbers remain substantial none the less.

Using this data in combination produces the following table:

Year	2008-09	2007-08	2006-07	2005-06	2004-05
Tax related staff	80,532	84,245	89,746	92,455	97,489
Tax revenue	439.1	451.1	423.7	397.9	371.0
Tax raised per staff member	5,452,491	5,354,620	4,721,102	4,303,715	3,805,558
GDP inflator*	111.30%	115.80%	109.80%	104.00%	98.50%
Adjusted revenue using 2004-05 as base point	388.6	383.7	380.1	376.9	371.0
Revised tax raised per staff member	4,825,430	4,554,664	4,235,232	4,076,115	3,805,558

* http://www.statistics.gov.uk/statbase/TSDSeries1.asp

GDP current prices seasonally adjusted

On raw data tax revenues appear to have increased as staff numbers have fallen. However, adjusted for GDP and inflation it is shown that the rise in revenue is in fact quite modest at £17 billion in real terms over five years. Much of this does not relate to staffing either: changes in tax rates and allowances can explain much of this. The apparent yield increases are not as big as might appear to be the case when raw data is used, but it is unavoidably true that apparent productivity has increased whilst leaving the tax gap firmly intact.
This has then to be set in the context of current job cutting plans which have been published as follows (and which were substantially delivered for 2008-09):

Year	Total Staff	Operational Staff
2008-2009	5280	4500
2009-2010	5016	4275
2010-2011	4765	4061
2011-	4527	3858

Another 12,000 jobs are meant to be cut. The question that obviously arises are three fold:

1. When does the apparent increase in efficiency HM Revenue & Customs might claim has occurred tip into inefficiency? This must happen: it must be true that at some point a staff reduction will precipitate such a loss of efficiency and such a loss of perception of threat by those taxpayers who want to abuse the system that net revenues will fall even if revenue per employee were rising. As is clear, having allowed for inflation and GDP net revenues are hardly rising now.

2. When does long term damage to credibility arise as a result of staff cuts that mean that knowledge transfer to new generations of staff cannot take place?

3. When, if ever, does that tax gap begin to close?

It is these questions that this paper now addresses.

The efficiency issue

HMRC may appear to be raising more tax per employee over the last few years, but the signs are that this cannot continue. Tax yields grew slightly in comparison to GDP during the period reviewed – but this is unsurprising, since even into 2008 – 09 the legacy of growth was fuelling the receipts, many of which are received some time after the profits to which they relate are earned. This cannot continue.

It will not continue for other, very good reasons. HMRC has, as part of its cost saving drive, set financial limits below which action is not required by its officers. These suggest that the level of tax HM Revenue & Customs will collect in the future will fall and that the tax gap will rise.

For example, to achieve a year on year percentage efficiency increase to maintain yield per person HMRC management are using new interrogation databases. These interrogate a taxpayer's data against set parameters or a national data set on a particular matter of tax. Those results are then further refined by the application of a database which links to all known interactions between the particular taxpayer and HMRC and other agencies. This is then used to suggest the likely yield from any investigation. Yield forecast must be over a certain limit for interventions to take place. These limits are:

Type of investigation	Required yield
Full corporation tax investigation	£20,000
Partial corporation tax investigation	£10,000
Full income tax investigation	£15,000
Partial income tax investigation	£5,000
Employer Compliance (PAYE) £12	£12,000
VAT	£10,000

Of course it is appropriate to target resources: there is little or no point in investigating cases where there is no reasonable expectation of an additional payment of tax. All that happens is that taxpayer resentment is caused. Setting investigation levels at these levels is, however, seriously detrimental to effectiveness within the tax system. To put these limits in context:

1. An individual does not pay £15,000 of income tax until they have income of at least £62,000 or more in 2009 – 10 tax year. Well over 27 million of the 30 million taxpayers in the UK do not have this level of income, meaning that these limits suggest 90% of all income taxpayers are now likely to be exempted from full tax investigations[23].

2. To have a £20,000 corporation tax error at the small companies' rate of corporation tax requires profit misstatement of almost £100,000, and yet the vast majority of small companies do not register for VAT and as such have sales of less than this sum. As a result most companies will now be outside the scope of tax investigation.

3. A £10,000 VAT error requires sales misstatement of £57,000. To make such an error requires a business to first be VAT registered, requiring a sales level of £68,000 a year, and to then not record the first £57,000 of sales requiring total real sales of £125,000 before there is risk of VAT enquiry arising. The vast majority of the UK's small businesses make nothing like this sum meaning most never face risk of VAT inspection.

In effect this level of tolerance implies that for more than 90% of the total tax paying population tax compliance is now almost entirely voluntary with their being very little risk that their affairs will ever be investigated. In the case of income tax those now unlikely to be investigated pay more than 70% of all income tax[24].

Tax payment is also voluntary on the basis of standards set by HM Revenue & Customs for chasing tax debt. Almost one quarter of all tax is paid late[25]. Low value debt is not chased. The result is that its value has increased. At least £11.2 billion of bad debt arose in 2008-09 tax year[26]. The rate of tax recovery has slowed over a number of years.

Anecdotal evidence says that in many tax offices sums of less than £3,000 are not proactively chased for recovery: reports suggest in some offices it is higher still. This would mean that the tax bills of almost 20 million people, and the vast majority of the self employed, would be considered too small to chase for recovery purposes. The rise in tax debt owing to HM Revenue & Customs can only logically be explained if this is true.

There is a management flaw in the work of HM Revenue & Customs that exacerbates the risk of bad debt. All self assessment returns submitted to it are dealt with on a 'process now, check later' basis. In other words, if a tax return is submitted making a claim for repayment of tax that repayment is made without being checked. It is only after the event that the claim is checked. By then if it is shown that the repayment was made in error the person to whom it has been made is a debtor of HMRC, and one unlikely to pay. The risk that this exposes HMRC to is hard to assess, but corporation tax refunds alone amounted to £9.7 billion in 2008-09 (a figure up from £4.7 billion in 2005-06)[27] so

[23] http://www.hmrc.gov.uk/stats/income_tax/table2-5.xls 16-2-10
[24] ibid
[25] http://www.publications.parliament.uk/pa/cm200910/cmselect/cmpubacc/97/97.pdf 16-2-10
[26] All ibid
[27] Both from HMRC accounts for 2008 – 09, page R24

it is clear that the volume of such refunds is considerable and might, by themselves, make significant contribution to the bad debt suffered by HM Revenue & Customs.

It is important to note two things in this context, however. Firstly, HM Revenue & Customs recognise this problem exists. Secondly, they are improving their IT systems to handle their debt. This is clearly overdue. Thirdly, the Chancellor of the Exchequer has recognised this problem exists and has demanded action to solve it[28]. In this sense he is recognising the need for the sort of target setting that this report is suggesting is appropriate. It is not yet clear whether HM Revenue & Customs will meet the targets set by him and although recent reports suggest it has cleared £1 billion of the overdue corporation tax debt that still means there is still considerable cause for concern .

That said, action on the issues noted here could help close the tax gap. It could be closed by:

1. more staff being engaged to tackle tax avoidance and tax evasion

2. more staff being engaged to check repayment claims before they are settled

3. more staff being engaged to recover debt.

When the alternative to such staff being engaged is the destruction of public services it is hard to comprehend the refusal to engage with these activities.

Recommendation 5: HM Revenue & Customs should engage more staff to tackle tax avoidance and tax evasion

Recommendation 6: HM Revenue & Customs must on occasion select cases for investigation without consideration of potential tax yield, and make clear that this happens to protect revenues from those on lower levels of earnings.

Recommendation 7: More staff should be engaged to scrutinise tax repayments before they take place

Recommendation 8: More staff should be engaged to recover tax debt owing, and limits on sums to be pursued for collection should be lowered considerably

The cost of employing additional staff at HM Revenue & Customs

This last point is important: in a time of unemployment the cost to the government of employing additional staff at HM Revenue & Customs is very low. The average pay of a member of staff at HMRC was in 2008-09 tax year just over £27,000. The following case study use tax data for the 2009 / 10 tax year and assumes the new HMRC employee is paid £25,000 a year, which is below average for HMRC but that would be expected for new staff. The case study also assumes that the new staff member would otherwise be unemployed (and well over 2 million people are in the UK at present),

[28] http://www.hmrc.gov.uk/about/alistair-darling-letter.pdf

is a single parent with a child of school age, paying £500 a month in rent and £700 a year in council tax. The assumptions are slightly simplifying: benefits are harder to calculate in more complicated households. The total tax paid and benefits received by this person look like this:

Income			£25,000
Income tax paid			-3,705
National insurance paid			-2,120
Net pay			19,175
Council tax paid			-700
Income after council tax			18,475
Add:	Child benefit	1,040	
	Child tax credit	1,110	
			2,150
Disposable income pre rent			20,625
Rent paid			-6,000
Disposable income after rent			14,625
Tax (VAT, petrol duty, car tax, TV licence, alcohol duty, etc.) paid out of disposable income (approximately 15%)			2,300
Income tax paid (as above)			3,705
Council Tax			700
National insurance paid (as above)			2,120
Total tax paid			8,825
Add, National insurance paid by employer			2,465
Total tax paid as a result			11,290
Less, benefits received (as above)			2,150
Net contribution to government			£9,140

Assuming the same person was unemployed they would get the following benefits:

Job seeker's allowance	£3,353
Child tax credits	2,785
Child allowance	1,040
Housing benefit	6,082
Council tax benefit	700
Total income	13,960
Tax paid: council tax	-700
Net income after tax	13,260
Rent paid	-6,000
Net income after rent	7,260
Tax (VAT, petrol duty, car tax, TV licence, alcohol duty, etc.) paid out of disposable income (approximately 15%)	1,100
Add, council tax paid, as above	700
Total tax paid	1,800
Net cost to government	
Total benefits paid	13,960
Less: tax paid	-1,800
Net cost to government	£12,160

The total cost to the government of employing this person is, therefore, the difference between the payment made to them less the net tax paid on it which goes straight back into the government's coffers (£25,000 less £9,140 or £15,860 in all) less the saving from them (or another equivalent person) no longer being paid benefits i.e. £15,860 less £12,160, or a total net cost of employing this person of just £3,700 a year.

Any other calculation is misleading during a period of unemployment. That is not the case during times of full employment, but we do not enjoy those at present.

Therefore the cost to the government of employing a person is the net cost after tax less benefits saved, as noted here. The fact that the new employee may have been previously employed does not change this: it is reasonable to assume in that case that somewhere someone else will be offered a job and leave unemployment as a result of the new job created by the government with HM Revenue & Customs and therefore the logic used applies even if the new employee and the person coming off benefits are not the same.

This establishes a reasonable benchmark for now establishing the marginal cost of employing a new HMRC employee: they may cost no more than £3,700 a year. Of course in some cases it will be higher; it could be lower. The point is that the cost of employing staff at HM Revenue & Customs at this time to HM Government is significantly less than the total additional apparent payment in salary and related cost noted in the accounts of HM Revenue & Customs.

Recommendation 9: The cost of additional staffing to HM Revenue & Customs shall until such time as unemployment falls below 1 million be based on the marginal likely cost to the government as a whole of engaging them

The benefit of employing a new person at HM Revenue & Customs

The benefit of employing a new member of staff at HMRC will not, of course, be an increase in the tax yield that is consistent with the average tax yield per head noted in tables above. The marginal tax revenue generated by additional members of staff will be lower than that because the relatively easily collected tax will have already been recovered. Any potential revenue must, therefore, assume tax will be collected out of the 'tax gap' noted above. That tax gap may exceed £120 billion a year: the potential revenues remain high.

The two obvious sources for attention are collection of tax already identified as due but not yet paid and tax evasion. The first is the easiest target: the second requires a longer time period to train staff and so is not considered here, although it is stressed that this is just for the sake of example, not because the activity is not considered important.

According to the Credit Services Association in the UK their members handle 20 million debt collection cases a year, recovering more than £15 billion a year in debt as a result for their clients. That is an average recovery of £750[29]. HM Revenue & Customs has more debt than this, and yet is not seeking to recover debts of less than £3,000 a year (or maybe more). Data from the USA suggests that in the case of domestic debt of less than $20,000 (approximately £12,500) average debt collection recoveries by agencies are about 45.5%[30]. Costs of recovery are calculated as a proportion of sums recovered: this rate of recovery is, by definition economic for all parties as a result.

US data may not of course translate to the UK directly, but the rate suggests significant tax recovery opportunities exist in HM Revenue & Customs when outstanding debt is now likely to exceed £30 billion. Applying significant additional staff to this exercise is bound to yield significant additional revenue, but an estimate will give this perspective. Assuming no debt to be recovered exceeds £3,000 and that a person employed can deal with no more than one case a day on average (which would be the time it would take to write two letters and make two calls I suggest before referring the case for legal proceedings) and they work for 42 weeks a year after allowing for holidays, bank holidays, training and reasonable sickness absence and that they only succeed in recovering 40% of the debt they chase then the average recovery rate of an employee engaged on this activity would be £252,000.

This rate of recovery is, incidentally, a rate higher than that assumed for HMRC staff on about the suggested pay rate at present. The estimate does therefore seem not unreasonable.

This gain is available, using the logic noted above at an average real cost to the government of employing a person to undertake this work of maybe little more than £3,700 a year in real terms. The potential yield from engaging staff to undertake this work is, therefore, substantial. But it is stressed that to recover just 40% of HM Revenue & Customs debt on this basis, which would amount

[29] http://www.csa-uk.com/media/editor/file/Manifesto.pdf 24-2-10
[30] http://www.credit-to-cash-advisor.com/Home/Articles/Collections/EvaluatingYourCollectionAgency 24-2-10

to a sum of some £12 billion, would generate employment for 48,000 people. That's the scale of the problem being faced by HM Revenue & Customs if the tax debt is to be cut, which is the exercise the country so clearly requires to be undertaken if the national debt is to be reduced.

That scale of new employment is clearly unlikely: the need for HM Revenue & Customs to improve its debt collection systems at the same time as employing extra staff to ensure that those systems are made fully operational is readily apparent. To however assume one option is possible without the other is not realistic. HM Revenue & Customs already send statements and reminders to taxpayers, it is very obvious that the additional pressure that only individual targeted attention can deliver is necessary if the issue of tax debt is to be resolved.

This can be done: the marginal cost of employing even 48,000 staff at the rate of true possible additional cost noted above might be less than £200 million a year, a price vastly less than the interest paid on the debt recovered even at current low rates.

The unquantifiable benefit of more staff

Cash collected, whether outstanding debt or from tax evaders is not, however, the only benefit from engaging more staff, even if it is the easiest to measure. An article on HM Revenue & Customs own intranet recognised this point recently. The author of that article noted:

"The quickest and easiest way to collect tax is via the PAYE system. It's essential therefore that the public doesn't lose confidence in the fairness of this system, and they are in danger of doing so."

They suggested there were four reasons for this:

1. HMRC is not checking that each individual's tax deducted is correct at the end of each year - a promise which the Government made to taxpayers when PAYE was introduced
2. Changes to notices of coding are not being made when taxpayers advise of a change in their circumstances due to lack of staff to record those changes;
3. Tax return processing is inefficient and because of the way in which enquiries are conducted under the self assessment tax system glaringly obvious errors are not being questioned when the returns are processed because an enquiry about a return can only be raised once. In many cases those errors go uncorrected altogether as a result.
4. Insufficient help is being given to the public who need it to prepare their tax returns correctly.

These are vital issues: if confidence in the tax system and the democratic government it funds is to be maintained then it is vital that more be invested in, and more staff be engaged on these issues or we risk a crisis of confidence in government itself in the future.

The importance of staff being local

People cannot, of course, be helped with their tax returns unless HM Revenue & Customs staff are nearby to help them. Telephone and internet communication with taxpayers will never be enough if he tax system is to operate to best effect: only local tax offices can represent the essential role taxation has in our society in the local communities around the country where we are all asked to pay the tax we owe. The symbolism is not just for show though: tax is the consideration in the contract between the government and the people of this country. If people cannot see the important role of tax in their lives, thorough the benefits it provides and understand the human nature of the processes involved in collecting it by knowing those who undertake the important task of collecting that tax live and work in their own communities then they will be alienated from that process. The consequences for democracy are serious if that relationship is lost.

There are also more pragmatic reasons why HM Revenue & Customs staff must work locally alongside the communities in which taxpayers live and work. Local revenue staff in local tax offices know the communities in which they live and many of the businesses that exist in their area. When they review they accounts of a local enterprise they will very often have a view of that company. They might well be a customer of it. Or they might know where the owner lives, what car they drive, which school their children go to and other vital knowledge that lets them form an almost instant opinion of the plausibility of the data on the tax return with which they have been presented. No one can put a value on that knowledge. Anyone can appreciate that value though: the contribution it can make to the efficiency and effectiveness of HM Revenue & Customs' working processes is enormous.

The close of local tax offices destroys that knowledge base. It is quite impossible to be as effective a tax investigator when located two hundred or more miles away from the place for which you have responsibility as it is possible to be if located near its town centre. The loss from this destruction of local knowledge may be hard to calculate: ignoring it is very unwise.

Doesn't employing people incur an overhead cost though?

The calculation noted assumes the Treasury, the paymaster of HM Revenue & Customs, lets that agency take the credit for the reduction in benefits paid and tax generated in a time of unemployment when determining the true cost of its debt recovery policy.

Employing people does, however, incur overhead costs. Those of staff supervision etc. are allowed for in the low overall rate of recovery per employee noted in the above example. These need not therefore be considered again and it is the costs of providing staff with places to work and the equipment and services they need to complete their duties that need concern us now.

As has been noted above, the accounts of HM Revenue & Customs suggest that for every pound of payroll cost they incur they incurred 70.9p of overhead in 2008 / 09. The same ratio was just 65.8p in 2007/ / 08 and in 2004 / 05 it was 66.2p. The ratio appears to have risen over time as staff numbers have fallen.

There is good reason for this. By definition overhead costs do not vary directly with the number of employees an organisation has. In the case of HM Revenue & Customs there is believed to be even better reason for this being the case. Under the terms of its PFI contracts HMRC has remarkably little flexibility in many cases for making savings on the use of premises – one of its biggest overhead costs and the one which seems to be driving its desire to close local offices. As a report by the House of Commons Treasury Committee noted in 2007[31]:

[31] http://www.publications.parliament.uk/pa/cm200607/cmselect/cmtreasy/483/483i.pdf 25-2-10

Thus, the terms of the PFI covering HMRC offices indicate that, in the case of 71% of its estate, HMRC could not secure direct savings from the closure of office space. According to HMRC's 2007 Spring Departmental Report, any savings would "be achieved principally by fully utilising flexibility provisions within the STEPS PFI contract and through subletting surplus accommodation to other Government departments".

This situation is unlikely to have changed: the chance of subletting at this moment is very low given the state of the property market. As such it is very likely that accommodation for a great many staff (albeit, not 48,000, but this report is not suggesting the engagement of so many people) would be available to HM Revenue & Customs at little cost bar marginal spending like heat, light, telephones and IT. Of course these cost money. For this purpose it's assumed these costs might be one third of all overheads of HM Revenue & Customs, meaning a cost of, being generous and rounding upwards, of 25p on such spend for each £1 of gross spend (i.e. on the nominal wage paid) of each additional member of staff at HM Revenue & Customs.

Translating this into real spending, and also rounding up the marginal salary cost of each new member of staff to £5,000, and assuming 20,000 staff are re-engaged then the extra marginal employment cost would be £100 million and the additional overhead £125 million or about £225 million in all, albeit that notional wages paid would amount to some £500 million.

If those 20,000 staff could reduce HMRC debt by £12 billion, assisted by the new IT systems HMRC is introducing, the impact on national debt would be twofold. First there would be a reduced demand for government borrowing, which should help stabilise financial markets. Secondly at 3.75% interest rate – the current approximate cost of government borrowing – the saving in interest on reducing that debt would be £450 million a year, twice the cost of employing the staff to collect the tax due.

If, alternatively, the staff were used to reduce tax evasion then the yields might be greater still, although they may take longer to realise.

Conclusions

It is accepted that the logic used in the analyses noted here is simpler than that which a fully developed business plan would require. The importance of the arguments made are, however, threefold.

First, this report argues that employment costs at HM Revenue & Customs should be considered at their net cost to the economy as a whole in a time of unemployment. Failure to do so will result in sub-optimal decision making and the employment of too few staff at HM Revenue & Customs when to engage them will improve government finances and unemployment statistics for the net well being of the country as a whole.

Second, it is argued that only limited additional overhead costs need be incurred if a significant number of new staff were engaged by HM Revenue & Customs because it would appear that many of its overhead costs are contractually fixed.

Third, it is argued that logically a significant rate of return for the government can be demonstrated from the employment of new staff by HM Revenue & Customs, more than economically justifying the case for their engagement. Such is the significance of the benefit over cost the margin for error in favour of engaging staff is substantial, and this at the very least justifies a demand that HM Revenue & Customs consider this proposal and justify why at this time such a policy is not being adopted.