

Funding the Future

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Two regulatory agencies have responsibility for administering companies in the UK. One of course is Companies House. Companies House is an executive agency of the Department for Business, Innovation and Skills (BIS). I've already catalogued some of its failings in this area - allowing 500,000 companies a year to disappear, more than 325,000 at its behest and with no evidence available as to what those companies have done in the vast majority of cases.

The other agency that has this responsibility is H M Revenue & Customs.

Tax Research UK's new report, [500,000 missing people: £16 billion of lost tax](#) looks at the workings of both departments and finds weaknesses in both. Data from both departments, and parliamentary answers, suggest both departments have a 'blind eye' approach to regulation.

Concentrating on the tax year 2009/10, H M Revenue & Customs did, for example, request corporation tax returns from just under 70% of all companies. This is despite the fact that fewer than 19% were recorded as dormant at Companies House.

Worse, of those who received a request for a tax return only 65.9% had submitted those due during 2009/10, or late (meaning by November 2010). That means, given that only 69.3% were asked to submit returns, that just 45.7% of active companies left on the register at the end of the year submitted corporation tax returns. And of those, based on HMRC data, just 33.6% of companies in existence at the start of the year paid corporation tax - or just 915,000 out of some 2,723,000 companies existing in April 2009.

Of course, not all of the companies not paying tax should be. But it's very hard to believe that is true of all of them. Take the following table.

	2009-10 Thousands
Number of companies on Register at start of period	2,723
New companies incorporated	362
Dissolved	509
Restored	4
On register at end of period	2,590
Less 19% dormant companies, not trading and so with no tax bill	492
Net non-dormant potential trading companies	2,098
Less, allowance for new company that might never trade and which might never declare that fact (estimate, 50% of all incorporations)	181
Net likely trading companies	1,917
Number submitting a tax return for 2009 - 10	1,183
Number of likely trading companies not submitting a corporation tax return	734
Of which the likely proportion owing tax is 73%	536

This needs some explanation. The ratio of dormant companies is consistent over time at 19% (surprisingly).

It seems entirely reasonable to assume that a special case should be made for new companies incorporated which will be struck off before never recording that they are dormant, but which are struck off for that very reason. An allowance for fifty per cent of all new incorporations falling into this category has been made in the above estimate of the likely number of trading companies — i. e. it is assumed that half of all new companies formed are never used by their new owners for the economic activity that they intended for them and as a result never trade. This effectively inflates the ratio of dormant companies to allow for the fact that these entities never get as far as recording the fact that they have this status because they are struck off before ever having the chance to do so.

This still leaves a potential 1.9 million trading companies on the Register of which in the year ended March 2010 just under 1.2 million had filed tax returns. Of those that filed tax returns the Revenue reports that about 915,000 paid tax. This is a ratio of about 73% paying tax of those submitting returns. This has to be allowed for in estimating tax lost and it is assumed that none of these companies would have any tax liability in the estimates that follow — although not having a corporation tax liability does not, of course, mean that liability for other taxes does not arise, so this assumption is generously cautious.

The average corporation tax owed by the average small company that pays tax in the UK amounts to more than £10,000 a year, based on HMRC data. VAT, PAYE and other taxes due on activity undertaken to generate that profit would be several times that sum in all likelihood. As PricewaterhouseCoopers noted in March 2011:

Corporation tax is still the largest tax borne by these companies but the survey results show that for the year to 31 March 2010, for every pound paid in corporation tax, Hundred Group members paid £1.97 in other taxes borne and £6.79 in taxes collected.

There is no doubt at all that these ratios are lower for small companies: a ratio of one to almost nine with regard to corporation tax due to total tax liabilities settled is obviously unlikely for small businesses as some will not be VAT registered and the employment ratios of such entities is bound to be smaller than for larger companies. But profits do not arise without labour being expended in the vast majority of cases and VAT being due in many more. If corporation tax is not being paid it is highly likely that settlement of these obligations is also not occurring. A ratio of one to three, corporation tax to other taxes owing does seem conservative in that case given that corporation tax is due at relatively low rates after other costs have been settled for most small businesses. In that case it seems fair to assume that total taxes lost for each company trading fraudulently might amount to £30,000 a year on average.

If £30,000 a year is not paid on average in tax by each company (some 536,000 in all)

that seem to ignore their regulatory obligations to file accounts or annual returns or a corporation tax return then the tax lost would be £16 billion a year — almost 23% of the estimated tax evaded in the UK each year.

Of course that's an estimate. I accept that. But even the Oxford Centre for Business Taxation speculated in its recent report on corporation tax on why up to a million companies were not paying tax - without seeking to answer the question. I have sought to answer that question using official sources and data others like to quote as reliable - such as data from PWC.

I don't think all those companies should be paying tax. I allow for the fact that some will be loss making and some will never trade - having already allowed for the official dormant companies.

But it's absolutely impossible to think that the number of companies in the UK grew by a net million in little more than a decade without their being strong economic reason - and that reason implies trade.

Despite that more than 500,000 trading companies appear to not be accounting for their profits each year - and it's impossible to believe that the loss is not of extraordinary scale. I think it may be £16 billion. It may be a bit less. It could be more. That would be especially true if struck off companies carried on trading after being removed from the Register and so entirely slipped out of tax view - which seems entirely plausible in many cases.

However viewed then this is an issue that needs addressing. It costs just £4.4 billion a year to run HMRC and only £66 million to run Companies House. If only effort were put into ensuring they had the resources they really needed - and that's people in the main - to recover tax owing then the rate of return on employing those people to make sure accounts were filed, corporation tax returns submitted and tax paid would be phenomenal.

In the meantime if you want to know [why the tax gap is so big](#) - here's one of the reasons why.

And what is more - it is very obvious a great deal could be done about it.