Funding the Future

The tax gap - the Treasury Select Committee misses the ...

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The Treasury Select Committee is issuing a report in the morning on the tax gap. I gave evidence at the hearings that resulted in this report. I'll add a link when I can find one - I'm writing this when it is still under embargo.

The report is a confused mess. It's called 'Closing the Tax Gap: HMRC's record at ensuring tax compliance' but I really don't think the committee got their heads round the issues on the tax gap, let alone the broader management issues they address. I'll stick to the tax gap here.

They define the tax gap using the HMRC definition, as:

the difference between tax collected and the tax that should be collected (the theoretical liability). The theoretical tax liability represents the tax that would be paid if all individuals and companies complied with both the letter of the law and HMRC's interpretation of the intention of Parliament in setting law (referred to as the spirit of the law).

Now I ahppen to agree with that - except they should add in tax paid late. It's clearly part of the gap. Sometimes HMRC say it is; other times they ignore it. That confusion is a feature of this subject.

As the committee note, in 2010, HMRC estimated the tax gap to be £35 billion or 8% of the total tax liability. The 8% is wrong by the way: you add the gap onto the tax paid before calculating the percentage gap. The real number is 7.2% on that basis - and as I have shown, that is implausibly small. The UK shadow economy is likely to be at least 12.5% - and that's the gap for evasion alone.

As the committee also say:

HMRC officials told us HMRC "invest[s] a lot" in producing the estimate. Dave Hartnett CB, Permanent Secretary, Tax, HMRC, told us that "The tax gap is quite an important tool ... in promoting understanding of all the causes of non-compliance and helping us to focus on ways of reducing them ... it is a bit like a long-term health check for us."

I have to take quiet pleasure from that. Until I produced my report The Missing Billions for the TUC HMRC took no interest in this issue. It's been well documented that they only did so in response to that report (see archived old treasury web site). In that case though it's worrying to note that the Committee thinks:
HMRC acknowledges that “the [tax gap figure] … is not accurate; it is our best shot”. As noted in our previous report, the size of the tax gap is disputed, and many widely-varying estimates have been made.

It's a pity HMRC have not been as honest before. And it's welcome that the Committee notes that the basis for HMRC's preparation is inconsistent. They say (I admit largely quoting me, but favourably):

HMRC combines two approaches in order to calculate different elements of the tax gap, referred to as “top-down” and “bottom-up”. To calculate the tax gap using the top-down approach, HMRC “Gather[s] data mostly from the Office for National Statistics (ONS) detailing the total amount of expenditure in the economy that is subject to [tax]”. It then uses this to estimate the tax it should be collecting and compares this to what it does collect. In the bottom-up approach, “components of the tax gap are estimated using departmental sources, such as surveys, administrative and operational data”. HMRC use this data to estimate how accurate the returns they receive are, and calculate the tax gap by applying this to the amount declared in returns they receive. Richard Murphy, Tax Research UK, argues that this approach fails to acknowledge that “large numbers of people who are tax evading will never be in the system and will never send in a tax return”. Giving a figure which uses different methods to calculate different components does not allow for the fact that each method may measure something slightly different or omit particular parts of the population.

Quite so: I've always said this. The indirect tax gap calculated by HMRC is fine. It's completely consistent with my estimates of the shadow economy. It supports my estimate of tax evasion of £70 billion pa and agrees with World Bank data I have used elsewhere. It's the HMRC direct tax estimate that is ludicrously wrong. The committee got that fact, and I welcome it. That's why, in essence, they say they're not sure as it stands the tax gap is a good tool for HMRC management - which has to be true if it's wrong as they currently calculate it- as it is! They concluded on the tax gap:
1. The tax gap can be a useful concept for assessing trends in the amount of possible unpaid tax. We are not, however, convinced that the process of calculating, publishing and publicising an aggregate figure for the tax gap is a sensible use of HMRC’s limited resources. The aggregate tax gap figure is misleading and risks focusing HMRC on the wrong task as it only provides an order of magnitude.

I disagree: but the gap has to be broken down as I do in my work between evasion, avoidance and tax paid late. That then makes it a management decision making tool. At present the Revenue disguise these figures by tax, for example. That is ludicrous. They also fail to address likely causation and so indicate they have no idea how to address issues. I have sought to move on to this stage, for example, here. This is an essential next step HMRC have not tried.

They continue:

2. We recognise that it is useful for HMRC’s employees to have some idea of the difference between what HMRC should be collecting and what is collected, particularly in the case of criminal activity. However, in other areas it would be more useful for it to identify ambiguities in tax law rather than employ resources in calculating how much tax would be collected if everyone shared its interpretation of the law. Separate reports on how much tax was lost through criminal activity and areas where HMRC had encountered different interpretations of tax law would be a better use of resources.

I agree.

3. We would welcome further submissions from HMRC and tax experts both on how the tax gap calculation can be improved, and on whether it serves any useful purpose in HMRC’s work.

Give me a call, I say. As indeed, I'd add, the agency working on this issue for HMRC right now have done. But ponder this: why have HMRC engaged a marketing agency to estimate the total of tax evasion in the economy - and why is that agency planning an interview base for their work? Imagine the chance they'll have of getting an accurate answer when they approach someone and say "Excuse me, we're working for HMRC and just want to ask you, do you evade tax?". 100% of answers will be no! But that's what HMRC is having an agency ask right now. That's either incompetence or a stitch up. The Committee need to hold them to account for that too. The tax gap is real, a critical issue to address in our economy, and hopelessly mis-estimated and mismanaged by HMRC. The Treasury Select Committee hints at that, but we've a long way to go yet. And the first stage will be when HMRC recognise by just how much they've got this wrong.