Funding the Future

Even seasoned tax journalists are now beginning to doub...

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Andrew Goodall is a pretty seasoned tax journalist. He works for the Tax Journal. Like all good journalists he is not satisfied with first impressions, glib responses and being brow beaten. So it's interesting that Andrew's view on the tax gap seems to be changing. He's covered this issue for some time - talking to me about my work in the process, but yesterday on hios own blog he had this to say (and I reproduce at length with his permission):

There is a potentially very large amount of UK corporation tax, legally avoided by some of the biggest multinational companies, that does not figure at all in HMRC's £35bn estimate of the tax gap. As HMRC told MPs last week, that estimate is used to prioritise the department's response to the risk of revenue losses.

As I reported this week for Tax Journal, this avoidance is not the 'egregious' activity that the proposed general anti-abuse rule is meant to see off.

It is 'international' corporate tax avoidance of the kind featured in last week'sc Panorama programme, which some tax professionals regard as normal tax planning. This would not be caught by the new rule.

Last week's *Private Eye* said that while the schemes described in that programme were complex, they worked on a simple principle:

'paying tax-deductible expenses from the UK or other countries into Luxembourg companies that with some artful financial engineering pay less than 1% tax on the income'

The result? 'Multi-million pound tax savings all round.'

HMRC told the Treasury Committee that Richard Murphy's £120bn estimate of the tax gap — often quoted by trade unions, charities and campaign groups — was 'misleadingly high'.

By far the biggest component of the tax gap is illegal evasion. I'm focusing here on legal avoidance.

HMRC's estimate of tax lost due to avoidance is £5bn, while Murphy's is £25bn, including £12bn for corporate tax avoidance. That estimate is based on an 'expectation gap'.

Murphy argues that HMRC's 'bottom-up' approach for direct taxes does not take account of the tax saved by multinationals through arrangements such as those featured in Panorama.

Recent research for the *Mail on Sunday used a top-down, 'expectation gap' approach.*

But, using the bottom-up approach, HMRC may not identify any loss of UK tax, or 'avoidance risk', in a company's return.

Consider, for example, a deduction for interest paid to a Swiss subsidiary. UK law may well allow the deduction — and the tax saved by what may amount to profit shifting is not considered by HMRC to be part of the tax gap.

As ActionAid has demonstrated, it is the legal structure of multinational groups that enables them to shift profits from countries with high or 'normal' tax rates to those with lower tax rates, without breaching the OECD's transfer pricing guidelines.

John Christensen of the Tax Justice Network told MPs on the International Development Committee last month that the problem of corporate tax avoidance was systemic. The current regime for taxing multinationals was 'not fit for purpose', he said.

Now it seems that HMRC's assessment of the tax gap, in relation to corporate tax avoidance at least, may be misleadingly low.

HMRC declined to comment on the Tax Journal story, but in its report *Measuring Tax Gaps 2011* it did acknowledge (at 9.16) that for the largest businesses the main source of error in its estimates was that 'HMRC may not identify all risks'.

HMRC added: 'It is difficult to quantify the extent to which this source of error impacts upon the estimates.'

Andrew's right to highlight HMRC's doubts.

They're wrong to defend their claims so robustly.

The reality is that HMRC have got the tax gap wrong - and it's time they admitted it.