

What use the tax gap? A defence of a key element in #Co...

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Jolyon Maugham [wrote a blog with the first part of the above title yesterday afternoon](#). It was quite explicitly an attack on Jeremy Corbyn's use of [my tax gap data](#) to support what now seems to be called [Corbynomics](#), although Jolyon (who I know well, call a friend and with whom I have discussed his article) chose not to name me. Well friendship or not, I have to say that on this one Jolyon has let his politics get well ahead of him. That may be his right as he is a member of the Labour party, and no doubt has his own preferences for leader, but I am not a member and will not be voting so let me offer what I hope is a reasoned response to Jolyon's claims.

First, to summarise those claims they are:

- 1) The Coalition did a good job in closing the tax gap
- 2) HMRC is doing a good job in measuring it
- 3) My estimate of the tax gap is too big to be credible
- 4) There is no conspiracy to underestimate the tax gap
- 5) The tax gap will be extremely difficult to close
- 6) My estimate includes tax that would be due if the law was changed by creating new taxes e.g a window tax
- 7) In summary, the tax gap is just, according to Jolyon:

a sophisticated performance metric for HMRC. It measures how well they're doing and where they should target their resources.

The Tax Gap is not a serious tool for making broader economic policy. It is no magical pot of gold that will obviate the need for close engagement with the choices inherent in being in government. And it's not a basis upon which you can pitch to a sentient electorate. It just isn't.

I have to admit I am struggling to comprehend how someone as bright as Jolyon can be quite so wrong in so many ways. To show why let me work it through in the easy bite size chunks Jolyon tried to use, using the order of points Jolyon has raised.

First, as has so often been the case, the Coalition did not tackle this issue. They continually redefined the way that the tax gap was measured during their time in office. As anyone reading the annual reports on the issue from year to year will have noted, a continuing theme has been that changes in definition have provided a constant downward trend in its measurement. That is how the tax gap improved over the last five years.

Whether this is appropriate or not is hard to say. As the [National Audit Office has said](#):

Around two-thirds of the tax gap is estimated using established methodologies, with the remainder estimated using developing and experimental methodologies.

And:

HMRC is not able to estimate the scale of uncertainty around its best estimate of the tax gap. For around 60% of the value of the tax gap, it has not made any estimate of the scale of uncertainty.

All of which provides ample room for mis-statement if management has been set, or has set itself the number one task of reducing the tax gap, [which it has](#).

Second, I very strongly dispute that HMRC is doing a good job in measuring the tax gap. There are several reasons for saying so of which the most obvious is that the NAO and IMF agree with me. I [have already noted](#) the NAO reiterating recommendation from the IMF so I guess they endorse it:

The IMF recommended that HMRC improve its measurement and reporting of the tax gap, such as by combining 'bottom-up' and 'top-down' approaches for those taxes where this is possible, including direct taxes.

I have long said the same. The NAO also add:

It also recommended that HMRC improve its estimates of undetected non-compliance by replacing uplift factors derived from US evidence with those produced from UK data.

In other words, HMRC should try to use reliable data. I do not think those are ringing endorsements. As [the NAO also says](#):

Other commentators have published estimates of the tax gap in the UK which rely on macroeconomic data to make 'top-down' estimates. Without access to the range of data held by HMRC, it is necessary to infer relationships from aggregated data in order

to produce such estimates. They also define the tax gap differently, such as by using a much broader definition of tax avoidance than that employed by HMRC. Such approaches typically lead to much higher estimates. HMRC argues that top-down approaches are not possible for direct taxes. Instead it uses the data it has from sources such as random enquiries, risk registers and data matching, to produce 'bottom-up' estimates for direct taxes.

Let's be clear: the other commentator is me (there is no one else it can be) and if the NAO or IMF believed what HMRC had to say on the impossibility of top down approaches they would not have recommended HMRC try using them. The fact is they did suggest that they should: I take that as endorsement that HMRC have not tried as well as they might to calculate the tax gap.

Third, let's get down to basics on my estimate of the tax gap. I go back to an argument I have long used, which relies upon the one top down part of the tax gap that HMRC estimate, which is that for VAT. It's important to note that the EU does not think the UK has estimated this correctly. The HMRC estimate for this gap was, for example, 10.4% in 2011-12 but the EU thought it 13% in the same year in their authoritative study (page 20, [here](#)). That being noted, and averaging the EU and HMRC estimates, and discounting VAT lost to criminal attacks, a loss rate of about 10% of total VAT due is likely for this tax, almost all of which, HMRC admit, is due to evasion. This implies 10% of the UK trading economy is unrecorded. The ONS confirmed to me some time ago that no more than 1% of the GDP estimate relates to the shadow economy so at least 9% of GDP is unrecorded on this basis. Recorded GDP is currently [about £1.7 trillion](#). This is then about 91% of the true figure, implying £168 billion is unrecorded. I have assumed a tax rate of 40% applies to this: higher than the overall rate of tax due as tax evaded is the top part of people's incomes. I explain this here ([page 21](#)). That suggests £67 billion is lost to the shadow economy. I then add to that tax lost in transactions that do not contribute to GDP, such as CGT and Inheritance Tax fraud as well as criminal attacks as recorded by HMRC, and come to total over £80 billion. Jolyon Maughan says this is not plausible. I would like to know why not? In particular I would like to know why if someone evades VAT they do declare the income for all other taxes as HMRC assume, which is utterly implausible? I believe my figures remain well and truly in the right area.

Fourth, is there a conspiracy to underestimate the tax gap? Yes of course there is! HMRC have stated closing the tax gap to be their number one objective so they are desperate to say they have succeeded. And as I have shown, the NAO do not think that they have tried hard enough to prove their case. I rest my own case until they rise to the challenge of doing top down calculations.

Fifth, closing the tax gap as defined by HMRC may be hard, largely because they use such narrow definitions of what tax avoidance (by excluding the behaviour of Google, Amazon and Starbucks, for example) and tax evasion (where they come to their conclusions on the basis of a tiny number of tax enquiries for which they have decided

they do not need additional resources to do more) might be that of course closing the tax gap that they identify will be hard given their desire to request no real new resources to do so (the latest announced new funds simply represent the cancellation of cuts). But, if you really want to close the tax gap Jeremy Corbyn's programme, largely inspired by my work (as he said on Channel 4 News last night) is a good place to start. And I outline a great deal more that could be done [here](#) and [here](#) (the latter being the de facto semi-official estimate of the EU tax gap). This claim by Jolyon is just nonsense and is typical of the chosen blind eye that many tax practitioners and politicians use when looking at this issue.

Sixth, Jolyon's claim is disingenuous in the kindest interpretation that I can offer of it, but worse than that, it simply implies that Jolyon has not bothered to read my work. I have to say, friend or not, I would have expected better of him than suggest I just made things up without even bothering to check his facts first. The claim is emphatically untrue.

So let's come to point 7. The first thing to say is that HMRC flatly contradict Jolyon here: they say that closing the tax gap is their highest priority. It's odd that Jolyon ignores that fact.

Second, if macro-economic data, which is what the tax gap data I have prepared is, does not constitute the basis for broader economic policy I do wonder what Jolyon thinks might be?

Third, if 9% or more of GDP being untaxed does not represent a pot of gold I wonder, again, what Jolyon thinks such a thing might be?

Fourth, whilst I do accept that tackling the tax gap is not an alternative to other decision making (because that is obviously true) to deny it is an issue to the electorate is to suggest that we simply accept that it is acceptable that at least 9% of GDP goes unrecorded, and rather more of the tax take, with all the resulting distortions that flow from that fact. That is, I think, a completely inappropriate act for any government to take.

Or, to put it another way, I would suggest that Jolyon's view on this issue is as irresponsible and reckless in its negligence as the approach to the issue adopted by Chris Leslie. And I welcome Jeremy Corbyn's willingness to embrace it as a key issue to be addressed by any future government that believes in social justice, the creation of a level playing field for business, balancing the books and building the economy we need.