

The question the tax gap deniers must answer

Published: January 13, 2026, 12:54 am

The [latest report from the Bank of England](#) on the scale of cash usage in the UK economy has opened an intriguing question on UK tax gap.

The BoE has accepted the idea that the UK shadow economy might represent 10.3% of all UK economic activity. They have also noted that this is low by international standards.

The rate is unsurprising: [as I have noted the figure is consistent with the UK VAT gap](#) when averaged with the EU version for the same figure. The VAT gap is the one reasonably reliable macroeconomic element of the UK tax gap estimate from HMRC at present.

When I made enquiry of the Office for National Statistics a couple of years ago on the extent of the shadow economy included in UK official GDP I was advised it was at most 1%. This may have increased slightly since then because of the inclusion of prostitution and one or two other items in GDP but the implication of the Bank of England's position and this advice from the ONS is that at least 9% of gross UK economic activity is not reflected in GDP data.

UK [GDP in 2014](#) was £1,705 billion.

This implies unrecorded economic activity of at least £168 billion. Do, however, note that this is only the illicit element: that part relates to criminality is on top of this sum according to the BoE.

Total taxes [collected in 2014-15 were £603 billion](#). That is 35.4% of official GDP.

HMRC say that the tax gap is made up as follows:

Criminal attacks are in addition to the 10.3% the BoE describes as the shadow economy.

Bad debt is an unrelated issue as is avoidance and legal interpretation.

I would suggest that failure to take reasonable care and error also fall into the category of systems errors and not the shadow economy.

This leaves just £10 billion of tax lost to the shadow economy by this definition.

This is an effective tax rate in that case of £10 billion on £168 billion, or 6%.

If, generously, I add back in the systems errors but not the criminal attacks that tax rate on the shadow economy that the BoE recognise to exist increases to 10.2%.

I have argued that in practice the tax rate in the shadow economy may well be higher than in the mainstream economy because much of it is top sliced i.e. allowances and reliefs are already claimed. I will ignore that argument here, but I can see no reason at all why the overall rate of tax in the shadow economy as a part of GDP should be less than that for the economy as a whole. If it was, why would people evade?

So the tax due by the shadow economy should be at least £168 billion at 35.4%, or £59 billion.

On top of this there is then, I think, tax due as a result of error and not taking care of £7.1 billion. This does not come from the shadow economy, but is mistakes in the recorded economy.

And tax evasion on activity that does not make up part of GDP i.e. CGT and inheritance tax, [which I estimate at £10.4 billion](#) must then be added.

Then there are criminal attacks. Based on official fraud data I make this higher than HMRC at £6.5 billion.

And offshore is not, of course, in GDP so that £4.3 billion needs to be added in for that as well.

Now tax evasion amounts to £87.3 billion.

Then there may be £19 billion of avoidance.

However, I do recognise HMRC say debt may be down this year. Including write-offs internally it may not be much more than £13 billion at present. So we come back, as ever, to a tax gap of about £120 billion.

This is frequently denied. But there is a core question the tax gap deficit deniers do now

have to answer and that is given that the BoE now accepts that there is a shadow economy exceeding 10% in the UK, and that it is undertaken to evade tax obligations, how come the tax lost on that is, if HMRC are right, due at only 10.2% (at most, and maybe less) when the reality is that tax on GDP as a whole exceeds 35%?

The claim that tax evasion is as low as HMRC say it is only makes sense if:

- a) the shadow economy is only 3% of GDP - which is beyond the bounds of possibility in known macro data by some considerable way, or
- b) much of the activity in the shadow economy is exempt from tax - which would make not declaring it pointless.

Until anyone can explain this HMRC claim my own data on the tax gap looks right, whatever naysayers suggest. With the BoE on my side the doubters now have to prove their case, I suggest.