Funding the Future

Even the House of Lords thinks HMRC makes numbers up

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The House of Lords Economic Affairs Finance Bill committee has now published its report on Making Tax Digital (MTD). I submitted written and oral evidence to the committee earlier this year. There is much to commend in the report, but I want to focus on its finding on the tax gap. As their Lordships note:

HMRC's case [for MTD] appears to rest on three propositions:

(1)that a substantial proportion of the 'tax gap'–the difference between the amount of tax that should, in theory, be collected by HMRC, and what is actually collected–stems from taxpayer errors, or a failure to take due care, when completing tax returns;

(2)that a disproportionate amount of such errors are committed by smaller businesses; and

(3)that requiring such businesses to keep digital records, on a timely basis, proven by making quarterly updates, will improve the quality of the information submitted to HMRC, thus reducing the annual loss of tax due to error and a failure to take due care.

According to HMRC's latest estimates, the total tax gap amounts to £36 billion or 6.5 per cent of total direct and indirect tax liabilities. Professor Richard Murphy challenged HMRC's methodology, arguing that the figure is an underestimate. For the purposes of this report we use HMRC's estimates of the overall gap.

They also noted:

Most of the evidence submitted to the inquiry challenged HMRC's analysis of the behavioural effects of the measures arguing that the estimated tax gap reductions would either never materialise in full or might even go the other way.

Some argued that, to the extent that record-keeping would improve, the result would not necessarily be in the Exchequer's favour.

The Chartered Institute of Taxation (CIOT) commented that they were not convinced *that MTD would help close the tax gap because "businesses will make mistakes, both during the transition, and thereafter."*

Professor Murphy was particularly critical about the impact of the quarterly update requirement considering it would "increase the error rate". He pointed out:

"People who are forced to prepare accounts in a short period of time tend to make a lot more errors than people who have a little more time to get the thing right … there will be an inclination … for people simply to dump in estimates to meet a deadline for submission when there is a penalty attached to it."

And they conclude:

We do not share the confidence of HM Treasury and HMRC in their estimates of the tax gap reductions from the introduction of MTD from April 2018. On the evidence presented to us, those estimates appear very fragile and little more than guess work. They rely heavily on the untested proposition that sufficient numbers of taxpayers currently making errors will provide HMRC with correct information as a result of adopting digital record-keeping and quarterly reporting and that on balance changes would be in HMRC's favour. At this stage we regard those estimated tax gap reductions, the main drivers for the mandating the new obligations, as not yet proven.

That's pretty damning. And I think it is right.

But I also make another point. Earlier this week I pointed out that HMRC estimates may be critical to debate on Scotland's future. I was told by many unionists in Scotland that it was wholly inappropriate for me to question the objectivity of HMRC. Respectfully, the evidence is that HMRC is not too good at objectivity but is instead rather good at making politically motivated estimates to appease its political masters. Their Lordships agree. They should on the tax gap as well.