Funding the Future

Reappraising the tax gap

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I learned yesterday that a book to which I contributed a chapter has been published. That book was the final output of the Combating Financial Fraud and Empowering Regulators (COFFERS) Horizon 2020 project to which I contributed from 2016 to 2019.

The book is available as a free download here, or you can buy it for £90. My chapter starts as follows:

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Reappraising the Tax Gap

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4.1 Introduction

The 'tax gap' is widely thought to be the difference between the amount of tax that a revenue authority should collect within its jurisdiction based upon the laws it has in operation in an annual accounting period and the actual amount of tax paid during that same period. It would seem logical that any government would want to know what their tax gap might be and to control it. Despite this, and the fundamental role tax has in any economy, whether viewed from the perspective of being government income; a tool for the delivery of a government's fiscal policy or as one of the largest likely overall components of spending for most people and organizations in that jurisdiction it is surprising how little attention is paid by many national governments to the tax gap. Recent surveys of the number of governments preparing tax gaps estimates (Murphy 2019) suggest, for example, that within the European Union only the United Kingdom prepares an annual tax gap estimate, which is a characteristic that also makes it unique in the world. In about half of all EU member states no local estimates of the tax gap are prepared, at all. In most others (Italy being the largest exception to this rule, bar the UK) the only tax gap usually considered is that for value added tax (VAT). This may be because the European Commission does itself consider this issue and publishes an annual report on the VAT gap, analysed by country for each EU member state (TAXUD 2018).

This chapter does, in light of this surprising situation, consider three issues. The first is a consideration of current methodologies for appraising tax gaps. This review suggests that the approaches used are very largely micro-economic. Second, it then considers whether this is the best approach to this type of analysis. The suggestion is made that any tax gap analysis should instead primarily be considered a tool for macro-economic management to suggest the scope for and effectiveness of fiscal economic management. Third, developing this idea the tax gap is reappraised within the context of national income accounting, assisted by tax spillover analysis (Baker and Murphy 2019). Using the resulting framework it is suggested that there are five potential levels, or tiers, at which the tax gap can be

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explored. The consequence may be improved tax gap measurement for tax administrations, but more importantly, it should result in a better understanding of the potential role for fiscal macro-economic policy at a time when it is likely