The Taxing Wealth Report 2024

Every politician's guide to "How to pay for it"[1]

Corporation tax reforms:

Reforming the administration of corporation tax

Brief Summary

This note proposes that:

- The administration of corporation tax by HM Revenue & Customs needs to be substantially reformed if the abuse of limited liability companies to illicitly accumulate untaxed wealth is to be prevented.
- The current lax regime for the requesting of a corporation tax return by HM Revenue & Customs should be replaced by a mandatory obligation that a company file such a return with attached accounts each year.
- That the directors and principal shareholders of a company should be required to prove their identities and current address to HM Revenue & Customs and Companies House annually.
- That the directors and principal shareholders of a company failing to supply a corporation tax return should be liable for the penalties due as a result of that failure. The latest available research on this issue suggests that 99 per cent of those penalties are unpaid at present.
- The directors and principal shareholders of a company should be liable for any tax of any sort owing by it if unpaid by the company itself unless they can

[1] This note forms a part of 'The Taxing Wealth Report 2024' published by Finance for the Future LLP, which is UK LLP number OC329502, registered at 33 Kingsley Walk, Ely, Cambridgeshire, CB6 3BZ. See https://www.financeforthefuture.com/taxing-wealth/. This note was written by Richard Murphy FAcSS FCA FAIA (Hon), Professor of Accounting Practice, Sheffield University Management School, who is a director of Finance for the Future LLP.

The Taxing Wealth Report 2024 is a joint project between:

Finance for the Future and Sheffield University Management School

demonstrate a clear commercial reason for which they were not responsible that explains the inability to pay. • Any banker, lawyer, accountant or other person in the financial services industry acting on behalf of a company who is required by law to prove the identity of that company's directors and principal shareholders shall be required by law to provide an annual declaration to HM Revenue & Customs and Companies House confirming those identities, or a statement as to why they are unable to do so. • Any bankers and accountants supplying services to or acting on behalf of any company in a year should be required by law to supply details of the total payments received in that company's bank accounts during each of its financial years within nine months of the end of that period so that in the absence of a corporation tax HM Revenue & Customs can raise an estimated assessment of those taxes that they think it might owe for which the directors and principal shareholders shall be liable unless they can disprove that claim. • That these proposals should considerably reduce the amount of tax evasion in the UK, which HM Revenue & Customs estimates to be £19 billion per annum, but which might be very much higher, most of which will be undertaken through limited liability companies. A revenue estimate of £6 billion is estimated to arise as a result of these changes. • These proposals might also considerably reduce the scale of fraud perpetrated on the government each year, which is estimated to be between £33 billion and £58 billion per annum excluding Covid related issues. No revenue estimate is made for the likely gain resulting. • The illicit accumulation of wealth in the UK that contributes significantly to inequality might be reduced as a consequence of these changes.

The proposal	To reform the administration and enforcement regimes of corporation tax in the UK when there is considerable evidence that these are insufficiently robust at present, resulting in the trading activities of many companies going undetected with significant loss of tax almost certainly arising as a result. This can lead to the untaxed accumulation of wealth which is deeply destructive of social and tax justice within the UK economy as a whole.
Reason for the proposal	1. Reduce the risk of the abuse of limited liability status to avoid taxation obligations. 2. Reduce tax gaps, and so increase tax paid by those with wealth in the UK who take most advantage the

	opportunities provided by the incorporation of companies within the UK. 3. Increase the effectiveness of resource usage by HM Revenue & Customs in the management of tax risk arising from the operation of limited liability companies. 4. Improve taxpayer accountability and compliance, most especially with regard to the use of limited liability entities. 5. Increase horizontal tax equity, which can be undermined by the abuse of limited liability companies. 6. Increase vertical tax equity, which can be increased by the use of limited liability companies by those with wealth. 7. To reduce the tax spillover effect that existing rates of capital gains tax create when compared to those charged under income tax rules. 8. To raise additional tax revenues.
Estimated tax that might be raised as a result of the recommendation made	The behavioural response to this recommendation cannot be known, although it is likely to be significant, which is why it is being made. The amount of tax abuse, including significant tax evasion, that is being undertaken through the medium of limited liability companies cannot be known, but is likely to be very significant for reasons noted below. Reducing the abuse of limited liability companies to prevent the accumulation of untaxed wealth must be a significant objective of any programme with regard to the taxation of wealth. Unlike almost all the other recommendations made in the

	Report of which this note forms a part, the issue addressed here focuses on tax evasion and unpaid tax, which even in the estimate of HM Revenue & Customs might amount to at least £19 billion a year this is significant[2]. When they also estimate that 56 per cent of the tax gap relates to the activities of smaller business, most of which will be operated via limited liability companies, the scope for tax recovery amounts to many billions of pounds per annum[3], most especially when it is considered likely that the majority of tax abuse in the UK is undertaken through the medium of private limited companies. A target of at least £6 billion of additional revenue is proposed.
Ease of implementation	The changes proposed will take some time to implement and will require the expenditure of significant political capital by any government seeking to implement the proposed changes since opposition is likely to be significant.
Likely difficulties that might result from implementation	As noted above, there is likely to be significant opposition to these changes although they should be relatively easy to legislate and implement at a technical level.
Likely time required to implement the change	A process likely to take a number of years.
Consultation period required.	At least a year as opposition is likely and will have to be noted.

Background

[2] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1164246/Measuring_tax_gap_online_tables_2023.xlsx table 7.1 interpreted by author.

[3] Table 1.4 interpreted by author from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1164246/Measuring_tax_gap_online_tables_2023.xlsx

Corporation tax is charged on the profits and gains made by limited liability companies and some other entities in the UK.

Like most UK taxation liabilities, corporation tax is charged on the basis of self-assessment. In other words, a company that has a tax liability arising as a result of its trading activity has an obligation to report this fact to HM Revenue and Customs and to then compute its tax liability owing and to supply accounts to support that computation.

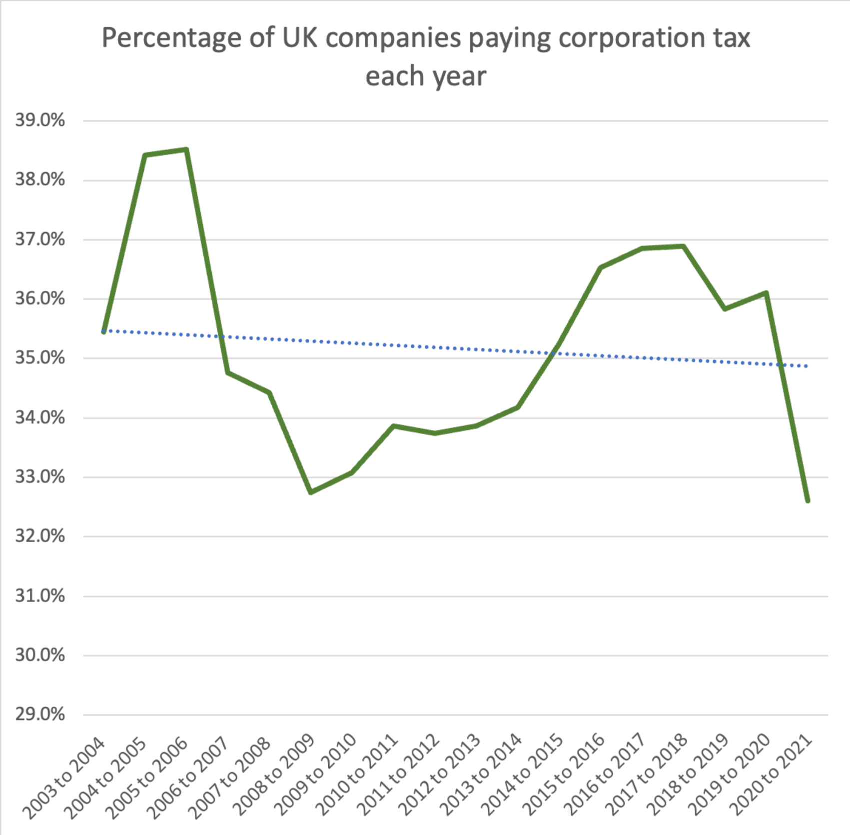
As data from HM Revenue and Customs shows[4], the number of companies making declaration of tax liabilities in the UK has arisen over time:

Number of companies making corporation tax payments

Financial Year	Corporation Taxpayers
2003 to 2004	715,000
2004 to 2005	830,000
2005 to 2006	895,000
2006 to 2007	885,000
2007 to 2008	925,000
2008 to 2009	890,000
2009 to 2010	870,000
2010 to 2011	910,000
2011 to 2012	965,000
2012 to 2013	1,031,000
2013 to 2014	1,111,000
2014 to 2015	1,221,000
2015 to 2016	1,344,000
2016 to 2017	1,436,000
2017 to 2018	1,488,000
2018 to 2019	1,506,000
2019 to 2020	1,571,000
2020 to 2021	1,538,000

As a proportion of the total number of companies in the UK each year, the number declaring a tax liability is, however, surprisingly small as this chart demonstrates:

[4] https://www.gov.uk/government/statistics/numbers-of-taxpayers-and-registered-traders



Sources, HMRC[5] and Companies House[6] and author's calculations

Whilst this data is slightly distorted by the steady increase in the number of companies in the UK over time, (this being a factor because companies do not pay corporation tax in the first year of their existence), this is insufficient by self to explain this very low proportion of the overall number of companies in existence that are not paying tax.

That increase in the number of companies not making corporation tax declarations in the UK is marked:

Number of companies not making a corporation tax declaration 2003 - 2021

Financial Year	Number of companies not paying tax
2003 to 2004	1,301,700
2004 to 2005	1,330,200

[5] https://www.gov.uk/government/statistics/numbers-of-taxpayers-and-registered-traders
[6] https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023

2005 to 2006	1,428,100
2006 to 2007	1,661,200
2007 to 2008	1,761,500
2008 to 2009	1,828,200
2009 to 2010	1,759,884
2010 to 2011	1,776,902
2011 to 2012	1,894,666
2012 to 2013	2,013,710
2013 to 2014	2,139,325
2014 to 2015	2,243,155
2015 to 2016	2,334,860
2016 to 2017	2,460,755
2017 to 2018	2,545,355
2018 to 2019	2,696,044
2019 to 2020	2,779,913
2020 to 2021	3,178,126

Sources: as previously noted

Whilst it is undoubtedly true that there are a significant number of companies in the UK that can be a technically described as 'dormant', meaning that the do not trade, it is also unlikely that there are sufficient such companies to explain the low number apparently making declaration of corporation tax liabilities.

Dormant companies include those companies incorporated to protect a trading name, or to protect an intellectual property right, or because liabilities that might arise as a result of their being dissolved cannot be reliably estimated, or because somebody simply had a bright idea which never happened, but the company formed to undertake it has yet to be dissolved.

All of these are entirely honest explanations for the existence of such companies, but given the ease with which companies can be both incorporated and dissolved in the UK, and in the absence of any effective form of regulation on their activities, (which issues are noted elsewhere in the series or notes making up the Taxing Wealth Report 2024, when considering the relationship between the activities of Companies House and HM Revenue & Customs) it is also very likely that a significant number of companies are incorporated in the UK each year for the purposes of undertaking fraudulent trades.

Discussion

The failure to detect this fraudulent trading is largely due to failings on the part of HM

Revenue & Customs. Research undertaken in 2014 (since when there have been no major changes in HMRC practice) suggested that[7]:

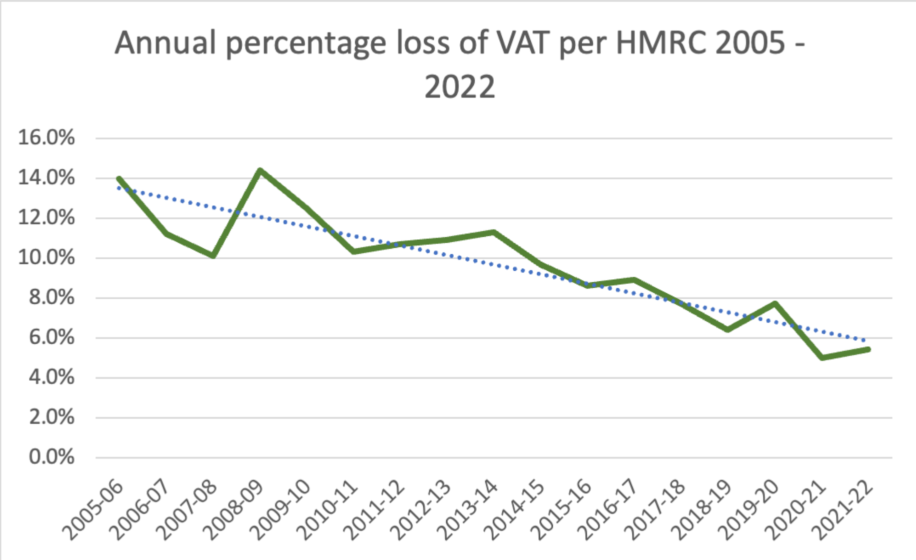
- HMRC did not requested corporation tax declarations from approximately 25 per cent of all companies because those companies had stated at some time in the previous five years that they did not trade.
- HMRC accepted that claim at face value in almost every case.
- HMRC also appears to accept the claim made by the 19 per cent of all companies that submitted a corporation tax return who said that they had not traded in a period at face value in almost every case.
- On average 25 per cent of all corporation tax returns requested by HM Revenue & Customs were not submitted without them making any further inquiry.
- More than 99 per cent of the penalties imposed by HM Revenue & Customs for failing to submit corporation tax returns were not paid, suggesting that the companies not doing so had, in effect, been abandoned by their directors who had no further intention of complying with their legal obligations.

In essence, submitting a corporation tax return had as a consequence all the appearance of being a voluntary activity on the part of those doing so.

The number of companies that might be abusing this situation cannot be known for certain. However, when it is known that in the year to March 2023 there were 585,807 companies dissolved in the UK[8] and that of these 557,096 were 'struck off' the register of companies i.e. they were dissolved either because the company applied for this to happen, suggesting in the process that they had no liabilities owing (to secure which striking off they pay a fee of £8), or they were removed by Companies House because of the company's failure to file either an annual confirmation statement or annual accounts, the risk that a significant number of the companies that are dissolved without any form of inquiry as to their activities prior to dissolution being made might have been engaged in illicit activity is likely to be high.

This is a concern reinforced by the scale of VAT loss in the UK as evidenced by the UK tax gap:

[7] http://www.taxresearch.org.uk/Documents/Intheshade.pdf
[8] https://www.gov.uk/government/statistics/companies-register-activities-statistical-release-2022-to-2023/companies-register-activities-2022-to-2023



Source: HM Revenue & Customs[9]

As the data shows, over the period for which UK tax gap data is available, the total likely VAT lost through what is recognised by HM Revenue & Customs to be very largely fraudulent or criminal activity has exceeded ten per cent per annum on average at a total cost of £180 billion, which is a sum in excess of £10 billion per annum.

The latest fall in losses is claimed to be due to better detection and changes in methodology, although whether this is true is open to some doubt given that (as noted elsewhere in the Taxing Wealth Report 2024) HM Revenue & Customs has now almost entirely ceased on-site reviews of VAT registered person's books and records and relies almost entirely on digital audits. The apparent improvement in the tax gap might simply be due to the fact that this methodology does not identify the rate of error that tax inspectors sitting in company premises once did.

It is important to note that even if the current VAT gap is correct and just £7.6 billion of VAT is currently lost per annum per annum for this reason, this inevitably means that the gross income that would generate this loss, which amounts to at least £38 billion per annum, would also give rise to other tax losses. Assuming that this £38bn should have had income tax and national insurance paid on its transfer to the persons who benefit from that illicit sum then an amount likely to be not less than 45 per cent of this gross value might also be lost for tax purposes, meaning that a further £17 billion of tax might be unpaid. HM Revenue & Customs do not make this obvious extrapolation in their estimates of VAT gaps, which is one of the reasons why their accuracy is open to doubt.

[9] https://www.gov.uk/government/statistics/measuring-tax-gaps-tables

Given that it highly likely that most of this fraudulent activity will take place through limited liability companies it is clearly worth investing more in the administration of the UK's corporation tax system, and the related activities of Companies House with whom these companies are registered.

Recommendations

There are a number of very obvious solutions to this problem of failing to properly identify those companies that have traded in the UK and that might as a result have an undeclared liability to pay a range of UK taxes, including VAT, PAYE (encompassing both income tax, and national insurance) and corporation tax. All of the following are recommended:

1. Requiring that no company be registered in the UK without its directors and controlling shareholders having first proved their identities to the UK's Companies House for money laundering purposes, with that proof of identity being required to be renewed annually.

2. That every company in the UK be required to submit a corporation tax return annually with the directors and principal shareholders[10] having joint and several liability for penalties owing if the company does not fulfil this obligation.

3. Making the directors and principal shareholders of a company jointly and severally liable for any tax, interest and penalties owing by it unless those persons can demonstrate that:

    a. The failure arose for reasons beyond their control such as a commercial failure of the business that could not have been anticipated, or
    b. The company has made payment.

    HM Revenue & Customs shall be required to use best endeavours to recover such sums owing, including on those occasions when the company shall fail to make returns when the information referred to in the following paragraphs might be used to raise estimated assessments of such liabilities owing, which estimates sums the directors and principal shareholders shall have the legal obligation to disprove if they wish to reduce the sum due by them.

4. Requiring that any bank or professional accountant or bookkeeper in private practice who might be engaged to deal with the affairs of a company shall each

[10] It is suggested that anyone with a holding of more than 10 per cent be a principal shareholder.

year, within nine months of the accounting reference date of that company, file a return with HMRC, with regard to its affairs declaring at least one of:

   a. Its turnover for accounting purposes, as reconciled with its bank records.
   b. The sum deposited by the company in each of the accounts that it might maintain with the bank in question.
   c. A statement that this return cannot be made, with reasons given.

5. Requiring that any bank, accountant, bookkeeper, lawyer, or registered financial advisor, who is required to prove the identity of their clients for the purposes of money laundering regulations shall file annually with both HM Revenue & Customs and Companies House a statement of those persons whose identities they have verified as a consequence of them being directors or principal shareholders of every entity that they have advised during the course of a year, or they shall provide a statement saying why they are unable to do so, with detailed reasons being given.

Supporting notes

It is likely that many company directors, banks, accountants, bookkeepers and other financial advisors will object to the demands made of them by these proposed regulations. It would be inappropriate for them to do so for two reasons.

Firstly, limited liability was never granted as a right to an individual. It was, and remains, a privilege that affords a company considerable advantages if used honestly, which will remain the case despite these proposals. Preventing the abuse of limited liability by those who use it with fraudulent intent is to the benefit of all honest traders by reducing the risk to them from competition from dishonest traders. The benefit of that protection is worth the costs imposed by these suggested regulations.

Secondly, the proposed data to be supplied by those in the financial services industry in the UK imposes an obligation no more onerous than that now imposed by international automatic information exchange regimes. These require that those in the financial services sector in tax havens and other places supply extensive data to the domestic tax authorities of those persons to whom they provide services, whether directly or as a result of their association as directors, principal shareholders or indirect beneficiaries with the operations of limited companies registered in such places. If this data can be required from tax havens there is no reason why it cannot be required domestically to tackle what is, almost certainly a much bigger loss of taxation arising within the domestic UK economy.

Potential tax saving

It is aways hard to estimate the tax benefit that might arise from measures designed to prevent tax evasion. However, assuming that the total losses from tax abuse of the type identified is not less than £25 billion per annum (approximately £8 billion of VAT and £17 billion of other taxes) then it is quite reasonable to target a yield of at least 25 per cent of this sum, or at least £6 billion) given the scope of the proposed regulations to improve the administration of corporation tax, although not all of this will be corporation tax.

More might be achievable given time, whilst a secondary benefit will arise from a reduction in fraud, which the National Audit Office[11] has estimated costs the government between £33.2 billion and £58.8 a year in lost government spending and income. Almost all of that fraud will be undertaken by limited companies that might not be declaring their incomes at present. No estimated gain is attributed to this potential benefit at present. However its importance in the context of the Taxing Wealth Report 2024 cannot be overstated since it will reduce the illicit accumulation of untaxed income in the UK which makes a significant contribution to inequality in this country.

[11] https://www.nao.org.uk/press-releases/tackling-fraud-and-corruption-against-government/