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Summary

HM Revenue & Customs' (HMRC's) most recent estimate of the tax gap, the difference between tax owed and tax that is actually paid, was £31 billion in 2018–19.

Although HMRC recognises that there is significant uncertainty associated with its estimates of the tax gap, it continues to quote these figures in official reports and media releases in a way that suggests a much greater degree of precision. We therefore call on HMRC to publish the range of its estimate of the tax gap, rather than suggest there is a single figure. We also recognise the challenges for the taxpayer and HMRC during the COVID-19 pandemic with HMRC currently estimating up to 10% fraud or error in furlough claims. Compliance yield (the additional tax revenue directly attributable to HMRC's work) is down by about half in the first quarter of this year. HMRC is not yet able to assess fully the impact of the COVID-19 pandemic on its compliance approach. However, it is clear that HMRC now needs to think fundamentally about how it collects unpaid tax.

Early indications show compliance yield in the first quarter of 2020–21 is only half the amount HMRC reported in the same period last year. Understandably, HMRC has carried out fewer investigations since the lockdown began in March, as it had to prioritise the implementation of the COVID-19 support schemes and be responsive to the needs of taxpayers struggling with the impacts of the pandemic. The number of completed civil compliance checks fell from 62,000 in the first quarter of 2019–20 to 40,000 in the first quarter of 2020–21. HMRC may never catch up and it will inevitably have to change its approach to compliance because of COVID-19. For example, it has a large backlog of cases and there is significant fraud and error in the furlough scheme. It is very worrying that HMRC estimates up to £3.5 billion of furlough payments made by 16 August 2020 may have been fraudulent or paid in error.

HMRC publishes a detailed tax gap analysis but is unable to provide a detailed breakdown in some important areas, such as the tax gaps for the four nations of the UK. HMRC's analysis also fails to set out the relative size of the tax gap for different sectors of the economy and does not include legal but undesirable tax planning by the wealthy and large businesses.

The tax gap has a wide range of causes, ranging from deliberate evasion to accidental taxpayer error. Small businesses are responsible for more than 40% of the tax gap, followed by large business with 17%. Wealthy taxpayers, which HMRC classifies as people earning more than £200,000 a year, or holding assets of more than £2 million, account for 6% of the tax gap. HMRC claims success in tackling the tax gap but its estimates are simply not reliable enough to make such definitive claims. For example, in July 2020, HMRC made substantial revisions to its previous estimates of the tax gap as new and updated data became available. These large revisions reversed past trends reported by HMRC, highlighting the uncertainties associated with the tax gap estimates and the difficulty of using them to track performance.

We reported in July that, despite a pandemic being a top national risk for years, lack of thinking about its economic impacts had forced the government to design the support schemes from scratch. With at least some thinking about the economic risks

of a pandemic in advance, it may have been possible to build in stronger safeguards against fraud and error, while still providing much-needed support to businesses and their employees. HMRC relies heavily on taxpayers' ability and willingness to report and pay their taxes in line with the rules. This may have changed—in the short term and possibly for several years to come. More than ever, therefore, HMRC needs to consider the support customers need and the costs it imposes on taxpayers, particularly as it proceeds with plans to make tax digital, where there are indications that the costs imposed on taxpayers far exceed government estimates.

Introduction

HMRC is responsible for administering the UK's tax system. One of its three departmental objectives is to "collect revenues due and bear down on avoidance and evasion". HM Treasury leads on the design of the tax system. It agrees HMRC's revenue and efficiency targets, and levels of funding. HMRC reported record tax revenue of £627.9 billion in 2018–19, an increase of £22.1 billion (3.6%) on 2017–18. Tax administrations rely heavily on taxpayers reporting and paying their taxes in line with the rules. In 2018–19, HMRC received 90% of total tax owed this way. HMRC's most recent estimate of the tax gap, the difference between tax owed and tax that is actually paid, was £31 billion in 2018–19, equivalent to 4.7% of the total tax owed. HMRC estimated that its compliance activities increased tax revenue by £34.1 billion in 2018–19 against a target of £30 billion. The tax gap figures do not include the impact of COVID-19 and the full effects will take some time to become clear. Total compliance yield in the first quarter of 2020–21 (£7.5 billion) has already fallen by 51% compared to the same quarter in 2019–20 (£15.4 billion). HMRC estimates up to £3.5 billion of furlough payments made by 16 August 2020 may have been fraudulent or paid in error.

Conclusions and recommendations

1. **HMRC is not sufficiently clear about levels of uncertainty when publicising the tax gap.** It is misleading for HMRC to report the tax gap as a single figure. HMRC does not present the level of uncertainty associated with the tax gap estimate alongside the headline figure, such as in its Annual Report or tax gap press notice. HMRC highlights the uncertainties for around 42% of the tax gap using range estimates but it cannot do this for the remainder because of data limitations. Around 20% of the tax gap (by value) is estimated using experimental methods, which carry a greater degree of uncertainty than established methods. In July 2020, HMRC made substantial revisions to its previous estimates of the tax gap. For example, in 2019 it had reported that the tax gap increased by £5 billion between 2015–16 and 2017–18. Its most recent publication now estimates the tax gap reduced by £2 billion over the same period. HMRC also does not provide ranges of uncertainty for its reported compliance yield, despite this Committee's recommendation in 2015 to that effect. In May 2019, the Office for Statistics Regulation praised HMRC's tax gap statistics, in terms of coverage and usefulness, but said it should do more to reduce the level of uncertainty.

   Recommendation: ***HMRC should state more clearly (for example in its Annual Report or tax gap press notice) that its tax gap figures are highly uncertain and subject to revision. It should report the known range and scale of uncertainty alongside its headline estimates of the tax gap and compliance yield for 2019–20 onwards. Where that is not possible, HMRC should explain the elements where it is too difficult to give the range and scale of uncertainty.***

2. **HMRC does not know the relative size of tax gaps in the four nations of the UK or across different industries.** HMRC already publishes breakdowns of the tax gap by taxpayer group, tax type and behaviour. However, HMRC does not calculate or publish estimates of the tax gap for each of the four nations of the UK. We recognise the difficulties in doing so but HMRC ought to be able to produce reasonable estimates for the tax gaps in the four nations of the UK, particularly since the devolution of Income Tax powers to Scotland from 2016–17, and Wales from 2019–20. In addition, HMRC does not publish any tax gap analysis for different types of industry. For example, HMRC has not published an estimated tax gap for the construction industry despite introducing the construction industry scheme to deal with high levels of non-compliance.

   Recommendation: ***HMRC should include analysis of the tax gaps for each industrial sector in its future publications of the tax gap. In its Treasury Minute response to this report, HMRC should also set out what the benefits and challenges are of doing a similar analysis about the tax gaps in the four nations of the UK.***

3. **HMRC does not include sophisticated and undesirable tax planning by the wealthy and large businesses in its estimates of the tax gap.** HMRC's tax gap measures the uncollected revenue due to taxpayers' non-compliance with existing rules. HMRC does not assess the gap where taxpayers make lawful use of tax allowances and reliefs but which are not desirable from a policy perspective (sometimes referred to as the 'policy gap') although this is something that policy makers and Government often express concern about. We recognise that HMRC's

compliance team is focused on non-compliance with tax law and not the policy gap. But our Committee and its predecessors have long been concerned that the wealthy and large businesses can employ specialist tax advisers to engage in sophisticated tax planning arrangements which are not readily available to most taxpayers. These sophisticated practices are legal and HMRC can only challenge them through changes in tax law or multinational agreements. HMRC would need a separate calculation if it was to measure how much tax is not being paid as a result of tax planning that is effective and not illegal but that, from a policy point of view, might be undesirable, in addition to the compliance gap. This is something that Government may wish to assess and Government has changed the law to close this perceived policy gap in the past.

Recommendation: ***Parliament needs to know when taxpayers do not follow the spirit of the rules, and how much tax revenue is lost as a result. In addition to the tax gap, HMRC should look at ways to measure and report the estimated scale of sophisticated tax planning that is legal but undesirable from a policy perspective by tax type and taxpayer group each year.***

4. **Although HMRC has yet to see the full effects of COVID-19 on taxpayer compliance, it is already estimating up to £3.5 billion of fraud and error in furlough payments and has seen a significant drop in compliance yield in the first quarter of 2020–21.**[1] HMRC's COVID-19 support schemes have led to a major reprioritisation of its resources and it has needed to reduce compliance activity while under lockdown. This has adversely affected HMRC's core compliance activities and led to a backlog of investigations. There has been a significant fall in HMRC's compliance yield in Quarter one of 2020–21 compared to Quarter one in 2019–20. Total compliance yield fell by 51%. HMRC assumes that most taxpayers will comply and can pay the tax they owe. COVID-19 means HMRC needs to reassess these assumptions. HMRC has already adapted its approach to compliance by reducing contact with taxpayers under financial pressure and it is initially contacting those it considers most able to pay.

Recommendation: ***HMRC should, alongside its Treasury Minute response, write to us separately explaining in detail how it will change its compliance approach in light of COVID-19.***

5. **It is not clear that Making Tax Digital will help reduce the tax gap or taxpayer costs at a time when individual taxpayers and small businesses are under considerable pressure.** HMRC's primary objective for the 'Making Tax Digital' programme is to help reduce the tax gap attributable to small businesses caused by error and failure to take reasonable care. The effectiveness of the programme is not yet known but HMRC is confident that it will achieve its aims: improving compliance rates, increasing productivity of businesses and allowing HMRC to realise savings. HMRC tells us that the Office for Budget Responsibility supports its view that the programme will help to close the tax gap, but we are not convinced that for all businesses there will be the benefits to them or tax collection that HMRC envisages. For example, the findings of a survey of businesses and agents, carried out

1 Since the Committee's evidence session HMRC is reported to have announced that companies and other bodies had voluntarily returned more than £215 million to the government in furlough scheme payments they did not need or took in error.

by the Chartered Institute of Taxation and the Association of Taxation Technicians during December 2019 and January 2020, raised doubts about the effectiveness of Making Tax Digital in reducing errors and increasing productivity as expected by the government. The survey findings also suggest costs to business of complying with the programme far exceed government estimates. The Making Tax Digital programme is a logical plan in a world where more and more activity is carried out digitally, but it will impose extra, and possibly unreasonable, costs on some individual taxpayers and small businesses, and may be disproportionate to the gain to HMRC. Some of these businesses may be less able to afford the changes since COVID-19.

Recommendation: ***HMRC should, as part of piloting future rounds of MTD, assess whether the administrative burden it is imposing on taxpayers is reasonable and affordable before proceeding with further national roll-outs.***

6. **HMRC's plans to tackle the part of the tax gap attributable to small businesses are made more difficult by the need to help those businesses survive the impact of the COVID-19 pandemic.** HMRC estimates that 43% of the tax gap in 2018–19 was attributable to small businesses (£13.4 billion). In response to COVID-19, HMRC paid out billions of pounds to support small businesses. In August 2020, HMRC published a document setting out how it will support taxpayers and the economy against the background of COVID-19. To support taxpayers, especially small businesses, and increase the efficiency of its compliance approach, HMRC is increasingly adopting a "one to many approach" in its compliance checks rather than the more traditional investigations of individual taxpayers. This may not provide the tailored support small businesses need through the pandemic and HMRC needs to adapt. The Committee is disappointed that, so long after the beginning of the pandemic, HMRC has still not made sufficient use of its data to identify small businesses which have been left out of previous support packages, and therefore maximise taxpayer eligibility for grant support.

Recommendation: ***HMRC should write to us within one month of this report explaining how it plans to balance its efforts to tackle the tax gap in small businesses with the support that those businesses will need to survive the impact of COVID-19.***

1 HM Revenue & Customs' tax gap estimates

1. On the basis of a Report by the Comptroller and Auditor General, we took evidence from HM Revenue & Customs (the Department) and HM Treasury on tackling the tax gap.[2]

2. HM Revenue & Customs (HMRC) is responsible for administering the UK's tax system. One of its three departmental objectives is to "collect revenues due and bear down on avoidance and evasion". HM Treasury leads on the design of the tax system. It agrees HMRC's revenue and efficiency targets, and levels of funding. HMRC reported record tax revenue of £627.9 billion in 2018–19, an increase of £22.1 billion (3.6%) on 2017–18. HMRC will report tax revenue for 2019–20 in its next Annual Report and Accounts, which are due in October 2020. Tax administrations rely heavily on taxpayers reporting and paying their taxes in line with the rules. In 2018–19 HMRC received 90% of total tax owed this way. Inevitably some taxpayers make mistakes, others choose not to comply, and some cannot pay because of insolvency. In other cases, taxpayers interpret tax rules differently from HMRC, or construct artificial arrangements to avoid tax.[3]

3. HMRC's most recent estimate of the difference between the amount of tax theoretically owed and the amount collected, known as the tax gap, was £31 billion in 2018–19, equivalent to 4.7% of the total tax owed. HMRC estimated that its compliance activities, which range from educating taxpayers to fraud investigations, increased tax revenue by £34.1 billion in 2018–19 (5.2% of total tax owed) against a target of £30 billion. A wide range of factors affect the tax gap, some outside the control of tax administrators. For example, the state of the economy, demographic changes and the perceived fairness of tax policy can all affect how many voluntarily pay tax. HMRC considers the best way to tackle non-compliance is to: promote compliance by designing it into systems and processes; prevent non-compliance by, for example, using data to spot mistakes and preventing fraudulent claims; and respond to non-compliance by identifying and targeting the areas of greatest risk, and tackling those who deliberately try to cheat the system.[4]

4. The impact of COVID-19 on tax revenues and the tax gap is likely to be significant, with the UK government needing to prioritise support to businesses and taxpayers over tax collection. The pandemic may increase the risks of non-payment of taxes and more people may operate in the deliberately hidden part of the economy.[5]

Uncertainty in the tax gap measure

5. Measuring the true value of the tax gap is challenging because elements such as the hidden economy and evasion are inherently less visible, masking the extent of under-reporting. HMRC publishes its estimates of the size and composition of the tax gap annually.[6] It uses a combination of established and "experimental" methods to estimate the size of the tax gap. Experimental methods are less accurate than established methods.

2 C&AG's Report, *Tackling the tax gap*, Session 2019–21, HC 372, 22 July 2020
3 C&AG's Report, paras 1–2
4 C&AG's Report, paras 2–4
5 C&AG's Report, para 9
6 C&AG's Report, paras 7, 1.12

Around 20% of the tax gap, by value, is estimated using experimental methods.[7] We asked the Department about the reliability and accuracy of its tax gap estimates, particularly since HMRC does not publish the confidence intervals associated with its total tax gap estimates. HMRC told us that it publishes a detailed description of its methodology, which has been praised by the International Monetary Fund and the Office for Statistics Regulation (OSR) for "meeting best practice".[8] The OSR as well as praising HMRC's tax gap statistics, for example, for the appropriateness of data sources, also highlighted areas where HMRC can improve the transparency and trustworthiness of the published statistics.[9]

6. HMRC highlights the uncertainties in its estimates by producing separate range estimates for around 42% (£13.1 billion) of the tax gap's value but data limitations mean it cannot produce range estimates for the remainder. In 2018–19, the upper limit of the combined confidence intervals was £9.6 billion greater than the total reported tax gap for those elements. The lower limits were around £6.6 billion less.[10] HMRC also explained to us that there are two main reasons for its significant revisions of the tax gap estimates for previous years. First, HMRC needs to revise its estimates of some aspects of the tax gap, for example the VAT gap, to account for revisions to the statistics provided by the Office for National Statistics about the size of the economy. Second, following the settlement of long-running cases, HMRC has to revise its original forecasts.[11]

7. HMRC measures the additional amount it generates by tackling tax avoidance, evasion and non-compliance, known as compliance yield. In its 2018–19 Annual Report, HMRC reported £34.1 billion of compliance yield, compared with £30.3 billion in the previous year.[12] HMRC confirmed to us that it does not provide confidence intervals for its reported compliance yield.[13] We asked the Department about the relationship between its tax gap and compliance yield estimates. HMRC explained to us that there are a number of reasons why it is "incredibly difficult to create an equivalence between the tax gap and the current compliance yield". Cases that HMRC investigates can have yield going back over a number of years, whereas the tax gap estimates only relate to the year under consideration. There are also other factors that will impact the size of the tax gap, such as, economic conditions and the size of the taxpaying population.[14] We also asked the Department about the level of uncertainty associated with its reported costs of compliance activities. HMRC explained to us that it is unable to measure the indirect effect of many of its activities, such as customer services, in promoting voluntary compliance. It therefore only includes the direct costs associated with the compliance part of the Department in its reported cost figures.[15]

Limitations of HMRC's tax gap analysis

8. HMRC publishes a breakdown of the tax gap by taxpayer group, tax type and behaviour.[16] HMRC told us that it uses the outcomes of its tax gap analysis as indicators

7 Q 23; C&AG's Report, para 1.12
8 Qq 23–25
9 C&AG's Report, para 1.14
10 Q 23; C&AG's Report, para 1.13
11 Qq 23, 25; C&AG's Report, para 1.19
12 Q 26; C&AG's Report, Figure 11
13 Q 28
14 Q 19; C&AG's Report, paras 2.24–2.25
15 Qq 29–30; C&AG's Report, Figure 14
16 Q 24; C&AG's Report, para 1.5

of trends in its performance, which allow it to consider its track record in tackling non-compliance in relation to specific behaviour types and taxpayer groups. HMRC, however, confirmed to us that it does not measure the tax gap in each of the four nations of the UK. HMRC told us that it could attribute a proportion of the total tax gap to each of the four nations based on factors such as, the size of the economy and the number of small businesses in different parts of the UK, and assuming that taxpayer behaviours are broadly consistent across the different regions. But it had not undertaken such an analysis.[17] HMRC acknowledged that such an analysis could be beneficial, particularly in the context of the devolution of Income Tax powers to Scotland and Wales in 2016–17 and 2019–20 respectively. HMRC told us that the Scottish and Welsh Governments have an interest in how much combined yield it collects and its attribution to them. It said it has a formula to make sure that the yield compliance directorates recover for income tax is shared between Scotland, Wales and the rest of the UK.[18]

9. It also transpired, when we questioned the Department about the size of the tax gap in the construction industry, that HMRC does not assess and publish the relative size of the tax gap across different industries. The construction industry has traditionally had quite high levels of non-compliance. HMRC introduced the Construction Industry Scheme to tackle the risks in the construction sector but it has not assessed the tax gap in the sector since.[19] Notwithstanding the lack of a tax gap estimate for different industries, HMRC has intelligence on the levels of non-compliance in different sectors, such as in the case of buy-to-let landlords.[20] HMRC uses such intelligence to inform the targeting of its campaigns, where it contacts large numbers of taxpayers in a specific sector and invites them to revise their tax filings. A number of taxpayers that do not take action will then be subject to HMRC investigations.[21]

The completeness of the tax gap

10. HMRC's estimate of the tax gap includes both non-compliance with the letter of the law, such as tax evasion, and non-compliance with the spirit of the law, such as tax avoidance.[22] We asked the Department the extent to which the practice of 'base erosion and profit shifting' is captured in HMRC's estimates of the tax gap. These are arrangements by which multinational companies are able to, via financial transactions, shift their profits to countries where the tax rates are lower than the country where the profits were generated. HMRC explained that the tax gap is a measure of non-compliance with the UK tax law, and it therefore includes the costs to the Exchequer of multinationals shifting their profits in breach of the UK tax law. It acknowledged, however, that tackling this risk to ensure companies pay more of their fair share of tax to the right jurisdictions requires the reform of international rules. The Organisation for Economic Co-operation and Development is taking the lead in this area.[23]

11. HMRC's tax gap does not capture the 'policy gap', which HMRC characterised as the tax loss that is not due, but which might be due if the tax rules could be tightened up. HMRC confirmed to us that there is more "taxable capacity" in multinationals than the

17 Qq 19, 35
18 Q 36; National Audit Office, *HM Revenue & Customs: Departmental Overview 2019*, slide 6
19 Qq 37–38
20 Q 68
21 Q 20
22 Q 31; C&AG's Report, Figure 1
23 Q 31

current law ensures.[24] We questioned the Department about the extent to which its tax gap estimates underestimate the true scale of non-compliance, particularly in relation to the wealthy individuals and multinational companies, who tend to have the most capacity to arrange their financial affairs to avoid paying their taxes in a way that does not fall into the scope of HMRC's tax gap estimate. HMRC confirmed that the wealthy individuals and large businesses are the taxpayer groups with the most capacity to partake in "sophisticated tax planning". HMRC records such tax planning arrangements in its estimate of the tax gap *where they are, in its view, non-compliant* because they are deemed to be a form of tax avoidance or because HMRC deems them to be incorrect interpretations of the tax laws. But any sophisticated tax planning that is effective in legally achieving its objectives, will not be part of the tax gap no matter how undesirable it is from a policy point of view. If HMRC measured, in addition to the compliance gap, how much tax is not paid as a result of effective, legal tax planning, that however from a policy point of view is undesirable, it would produce another figure.[25]

24 Q 31
25 Q 32

2 HMRC's plans to tackle the tax gap

The impact of COVID-19 on taxpayers' compliance

12. The COVID-19 pandemic may increase the risks of non-payment of taxes and more people may operate in the deliberately hidden part of the economy.[26] We asked HMRC about its assessment of the impact of the pandemic on the size of the tax gap and compliance yield. The Department told us that because of the level of uncertainty, it will take some time for the full impact of the pandemic to become apparent.[27] Some outcomes of the pandemic, such as, the rise of digital transactions in most businesses and the move away from cash, may have a positive impact on the size of the tax gap.[28] However, HMRC expects non-payment of taxes to be a significant issue, particularly because HMRC deferred the collection of a lot of the taxes due in order to support taxpayers. For example, HMRC offered all VAT-registered businesses the option to defer their payments of VAT that were due between 20 March and 30 June 2020 until 31 March next year. It confirmed to us that managing its debt balance in the future and the impact that will have on the tax gap will be one of its top priorities. HMRC has begun to prioritise contacting those taxpayers whose business affairs do not appear to have been significantly reduced due to the pandemic but nevertheless owe taxes to HMRC.[29]

13. During the pandemic, HMRC told us that it had to redeploy its resources from frontline activities, such as collection of tax, to work supporting taxpayers through the COVID support schemes. HMRC expects a reduction on compliance yield in 2020–21 compared with previous years.[30] HMRC's compliance yield dropped by 51% in the first quarter of 2020–21 compared to the same period in 2019–20 as it opened fewer inquiries and was more responsive to taxpayers' needs. HMRC told us that it does not expect to make up for the loss of six months of normal activity by increasing the number of its investigations in the coming year.[31] We asked the Department about the level of fraud and error in the COVID-19 support schemes, such as the furlough scheme. HMRC told us that to date it had received 8,000 notifications from employees highlighting potential non-compliance of employers with the terms of the Job Retention Scheme. HMRC is reviewing 27,000 "high-risk claims" and, after providing employers with the opportunity to correct their claims, it expects to investigate 10,000 of those 27,000 cases. Since the end of July, HMRC has had the powers to reclaim any grants that employers are not entitled to keep. HMRC told us that the error and fraud rate in the Job Retention Scheme claims could be between 5% and 10%. HMRC estimates up to £3.5 billion of furlough payments made by 16 August 2020 (£35.4 billion in total) may have been fraudulent or paid in error.[32]

14. HMRC explained to us that its overall approach to ensuring taxpayers' compliance with the tax laws is predicated on promoting voluntary compliance through promoting trust in the tax system and supporting taxpayers that want to comply. It aims to deter those that may not want to comply by highlighting the risk of their detection and subjecting them

26 C&AG's Report, para 9
27 Q 1
28 Qq 22, 61
29 Qq 1–2
30 Qq 3, 47, 51
31 Qq 52–53; HMRC quarterly performance report: April to June 2020, available at: www.gov.uk/government/publications/hmrc-quarterly-performance-report-april-to-june-2020
32 Qq 10–13

to investigations and financial sanctions for non-compliance.[33] The COVID-19 pandemic, by increasing fragility across the economy and in the financial affairs of taxpayers, has compelled HMRC to reconsider its processes for administering the tax system. HMRC told us that the assumptions that underpin its one-size-fits-all processes, namely that the vast majority of taxpayers can comply with their obligations and have the capability to do that, with a few exceptions that will need to be pursued for their non-compliance, may no longer hold true. For example, it has recently started issuing some penalties for people not filing tax returns because there has been a drop in the number filed by the taxpayers.[34]

Making Tax Digital

15. HMRC is implementing an ambitious initiative, Making Tax Digital, to help tackle error and failure to take reasonable care, particularly in the small business population. Small businesses accounted for the largest share of the tax gap (£13.4 billion; 43%) in 2018–19.[35] They will be required to use accounting software to keep accurate and up-to-date records, and the software will produce filings that will feed into HMRC's systems.[36] HMRC has introduced Making Tax Digital for VAT.[37] In July, the government announced an extension of the programme, throughout 2022 and 2023, to other taxpayers and tax types. The government plans to extend the programme, from April 2022, to all VAT payers and then from April 2023 to businesses and landlords with income over £10,000 per annum which are liable for Income Tax.[38]

16. We questioned the Department about the effectiveness of Making Tax Digital in closing the tax gap, particularly in tackling tax evasion. HMRC explained that the programme is not designed to tackle tax evasion by small businesses. Other solutions are required to address the risk of tax evasion. The aim of Making Tax Digital is to reduce the level of error and failure to take reasonable care, including failure to keep good records. HMRC told us that the Office for Budget Responsibility, which is independent of HMRC, has validated its estimates for the extent to which Making Tax Digital for VAT will reduce the VAT tax gap.[39]

17. We also received written evidence from the Chartered Institute of Taxation, which highlighted the findings of a survey of businesses and agents with an interest in the programme that they had carried out jointly with the Association of Taxation Technicians during December 2019 and January 2020.[40] The findings of the survey suggested that the costs of Making Tax Digital compliance had far exceeded government estimates. While HMRC had estimated the average transition costs to be £109 per VAT-registered business, less than 10% of respondents estimated their or their clients' costs at or below that amount, with 45% estimating costs between £109 and £500, and some 12% estimating costs over £5,000.[41]

33 Q 17
34 Q 47
35 Qq 20, 45; C&AG's Report, Appendix Four
36 Qq 20–21, 69
37 C&AG's Report, paras 1.11, 3.4
38 Qq 20, 67; HM Revenue & Customs and HM Treasury, *Building a trusted, modern tax administration system*, 21 July 2020
39 Qq 66–67
40 TTG003 - Chartered Institute of Taxation para 4.21
41 Findings of the survey available at: www.tax.org.uk/media-centre/press-releases/press-release-survey-results-contradict-government-claims-realising

Small businesses

18. Small businesses accounted for the largest share of the tax gap in 2018–19.[42] The tax gap attributable to small businesses was 43% (£13.4 billion) of the total tax gap in 2018–19 and has remained fairly stable as a percentage of the total tax gap for a number of years. Furthermore, the small business population is constantly growing. HMRC told us that it had grown by about 50% in the last 20 years, and therefore the tax gap is likely to get larger.[43] HMRC explained to us that this is why increasingly its strategy is to focus on helping small businesses to get their tax right and make it harder for them to get it wrong. The Department told us that a 'one-to-one' approach to ensuring the compliance of all 5.7 million small business is not feasible. It needs to restrict its one-to-one interactions with small businesses to cases of tax evasion, and use more 'one-to-many' solutions, such as campaigns targeting specific sectors, for the other aspects of the tax gap.[44] We asked HMRC why it had reduced resources allocated to pursuing small businesses for taxes unpaid when small businesses make up the largest share of the tax gap. It told us that its one-to-many activities allow it to reach more businesses with fewer of its staff.[45]

19. We asked HMRC whether it is doing enough to tackle small businesses that operate in the hidden economy and deliberately evade their responsibilities. HMRC told us that about 8,000 of its staff concentrate on ensuring compliance in the small business sector, including those businesses active in the hidden economy. It explained that the large number of small businesses and the fast changes in the make-up of the sector compromise the effectiveness of HMRC's one-to-one enforcement actions in deterring small businesses from non-compliance. The Department told us that, from a strategic point of view, to reduce the tax gap HMRC has to consider making more use of third-party data to enable it to identify incorrect filings, and introduce more third-party withholding, as in the case of pay-as-you-earn income tax.[46]

20. We were interested to hear about how HMRC will support the small businesses as they have to deal with new and unprecedented challenges posed by the COVID-19 pandemic. HMRC recognised the impact of COVID-19 in increasing the fragility of businesses, particularly small businesses.[47] It set up and administered a number of schemes, such as the job retention scheme, the self-employed income support scheme and "Eat Out to Help Out", to support the economy and taxpayers. We asked HMRC why it had not used its data and sophisticated data analytics systems to identify all of the taxpayers, including small business owners whose only source of income is the profit from their companies, that were entitled to support from the COVID-19 support schemes. HMRC told us that its data analytics system, called CONNECT, which enables it to join up the activities of taxpayers across different legal entities is only used to identify risks of non-compliance, usually after the event, when HMRC has obtained enough data. The system could not be used, "at scale and at speed", to operate the payments of grants to people based on linking different entities together.[48] HMRC also told us that to support taxpayers it has avoided investigations into businesses that it believes are struggling as a going concern. In the case of already opened inquiries, it only takes action when statutory deadlines for reclaiming

42 C&AG's Report, para 1.5
43 Qq 18, 20, 45; C&AG's Report, Figure 3
44 Qq 18, 20, 41, 47
45 Q 45
46 Q 21
47 Qq 3, 10, 14, 47
48 Qq 33–34, 51

taxes unpaid are about to expire or the business has the capacity to engage with HMRC.[49] HMRC has also deferred tax payments, for example, for VAT and self-assessment income tax, and offered taxpayers who have had difficulty in paying their taxes during the pandemic time to pay.[50] In August 2020, HMRC published a policy paper that set out how it plans to continue to support taxpayers and the economy.<?>

49 Qq 47, 52
50 Q 2

Formal minutes

Monday 12 October 2020

Virtual meeting

Members present:

Meg Hillier, in the Chair

Olivia Blake	Shabana Mahmood
Sir Geoffrey Clifton-Brown	Sarah Olney
Barry Gardiner	James Wild
Peter Grant	

Draft Report (*Tackling the tax gap*), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 20 read and agreed to.

Summary agreed to.

Introduction agreed to.

Conclusions and recommendations agreed to.

Resolved, That the Report be the Twentieth of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Thursday 15 October at 9:15am

Witnesses

The following witnesses gave evidence. Transcripts can be viewed on the inquiry publications page of the Committee's website.

Monday 07 September 2020

Jim Harra, First Permanent Secretary and Chief Executive, HMRC; **Penny Ciniewicz**, Director General for Customer Compliance Group, HMRC; **Beth Russell**, Director General, Tax and Welfare, HM Treasury Q1–69

Published written evidence

The following written evidence was received and can be viewed on the inquiry publications page of the Committee's website.

TTG numbers are generated by the evidence processing system and so may not be complete.

1 The Chartered Institute of Taxation (TTG0003)

2 Low Incomes Tax Reform Group of the Chartered Institute of Taxation (TTG0002)

List of Reports from the Committee during the current Parliament

All publications from the Committee are available on the publications page of the Committee's website. The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2019–21

First Report	Support for children with special educational needs and disabilities	HC 85
Second Report	Defence Nuclear Infrastructure	HC 86
Third Report	High Speed 2: Spring 2020 Update	HC 84
Fourth Report	EU Exit: Get ready for Brexit Campaign	HC 131
Fifth Report	University Technical Colleges	HC 87
Sixth Report	Excess votes 2018–19	HC 243
Seventh Report	Gambling regulation: problem gambling and protecting vulnerable people	HC 134
Eighth Report	NHS expenditure and financial management	HC 344
Ninth Report	Water supply and demand	HC 378
Tenth Report	Defence Capability and the Equipment Plan	HC 247
Eleventh Report	Local authority investment in commercial property	HC 312
Twelfth Report	Management of tax reliefs	HC 379
Thirteenth Report	Whole of Government Response to Covid-19	HC 404
Fourteenth Report	Readying the NHS and social care for the COVID-19 peak	HC 405
Fifteenth Report	Improving the prison estate	HC 244
Sixteenth Report	Progress in remediating dangerous cladding	HC 506
Seventeenth Report	Immigration enforcement	HC 407
Eighteenth Report	NHS nursing workforce	HC 408
Nineteenth Report	Restoration and renewal of the Palace of Westminster	HC 549