Evidence submitted by Professor Richard Murphy (stb0026)

The VAT Tax Gap

A submission to the Treasury Committee of the House of Commons

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1. Background

1. The Treasury Committee has asked as part of its inquiry into the VAT tax gap the following questions, amongst others[1]:

   - ***What are the root causes of the UK VAT gap and how might they be addressed?***
   - ***Is government policy-making sufficiently responsive when a weakness in the UK VAT regime is identified?***
   - ***Are there ways in which HMRC's compliance strategy for VAT could be better targeted to close the VAT gap? Could its resources be deployed more effectively?***
   - ***Do developments such as the growth of on-line trading or changes in the labour market reflecting modern working practices require a new approach to VAT compliance?***
   - ***Is HMRC's approach to large, medium-sized and small businesses appropriate for the nature of the risk to the VAT element of the tax base that each sector poses?***
   - ***In what ways is the tax base in the UK vulnerable to exploitation by those determined to circumvent VAT rules, push boundaries or develop aggressive VAT planning arrangements? How might either the law or HMRC's processes and procedures be improved to reduce that vulnerability?***
   - ***What role do advisers play in encouraging or facilitating aggressive VAT planning arrangements? Do businesses, tax advisers and professional bodies have concerns about the nature of the advice given by some practitioners?***

2. This submission seeks to answer these questions. It has been made by Richard Murphy. He is Professor of Practice in International Political Economy, City, University of London[2] and Director of Tax Research UK[3]. He is a fellow of the Institute of Chartered Accountants in England and Wales and an honorary fellow of the

Association of International Accountants (AIA). He was a founder member of the Tax Justice Network and its research director for a number of years. He created the concept of country-by-country reporting in 2003[4]. This is now used internationally to tackle tax avoidance[5]. He is the author of a number of books on tax havens and related issues including 'Tax Havens: How Globalization Really Works', Cornell, 2010, jointly with Ronen Palan and Christian Chavagneux; 'The Courageous State', Searching Finance, 2011; 'Over here and under-taxed', Vintage, 2013; 'The Joy of Tax', Transworld, 2015 and 'Dirty Secrets: how tax havens destroy the economy', Verso, 2017. He blogs at http://www.taxresearch.org.uk/Blog/ .

2. The tax gap: a note on methodology

3. There is no one definition of the tax gap. HM Revenue & Customs defines the tax gap as "the difference between the amount of tax that should, in theory, be collected by HMRC, against what is actually collected." (HMRC, 2016, 3). The US's Internal Revenue Service ('IRS') adds a twist by defining the tax gap as "the difference between the tax that taxpayers should pay and what they actually pay on a timely basis" (IRS 2016). The language is similar to the one adopted by the HMRC with a slight but important difference: the IRS introduces the notion of 'timely payment' as a factor in the consideration of the tax gap. The International Monetary Fund's ('IMF') shares core aspects of the definitions above, but adds an important element to understanding[6]:

> *A commonly used definition of the tax gap is the difference between current and potential collections. Under this definition, the term "tax gap" tends to describe the difference between the actual tax collections and the tax collections a revenue administration should collect given the current policy framework (potential collections).*

4. In doing so the IMF suggest that there are two aspects to the tax gap requiring consideration. One is the effect of taxpayer-noncompliance on tax revenue, a notion that is captured in the definitions above. The other aspect is the impact that policy choices made by legislators and regulators might have had in reducing available tax revenues. These two different aspects of tax gap are labelled by the IMF as a) the 'compliance gap' caused by non-payment that results from noncompliance with tax rules, and b) the 'policy gap', which referred to tax laws granting exemptions, tax liability deferrals or preferential tax rates.

5. The European Commission Director General of Taxation (ECDGT) who commissions the annual study of the EU's VAT gap[7] explicitly embraces the IMF's concept of the 'tax policy gap', noting that:

> *[T]he Policy Gap captures the effects of applying multiple rates and exemptions on the theoretical revenue that could be levied in a given VAT system. In other words, the Policy Gap is an indicator of the additional VAT revenue that a Member State could theoretically, i.e. in case of perfect tax compliance, generate if it applied a uniform VAT rate on all goods and services.*

6. The ECDGT provides estimates of the policy gap with regard to value added tax ('VAT'). The ECDGT also extend their work to the compliance gap for that tax. These two international institutions apart it would appear that tax policy gaps are not measured: no national tax authority appears to appraise this issue in any effective way at present. The OECD when offering another succinct definition of the tax gap[8] as "the difference between tax due and tax collected" adds:

> *While the tax gap has intuitive attraction for both the public and political representatives, it is a difficult concept to define precisely. Estimation is also difficult as much of the tax gap is either deliberately concealed from view and/or data may be difficult to find. The measurement and publishing of tax gaps should therefore be navigated and communicated carefully. Limitations of tax gap estimates mean they are not a good basis for explicit performance targets.*

7. In so doing the OECD appear to endorse three opinions. The first is that tax gap appraisal is about the measurement of the efficiency of tax administrations. The second is that the 'bottom-up' approaches currently used by most tax authorities for this purpose are not especially suited to this task. The third is that tax gap methodology does not extend to policy gaps.

8. What is clear from this brief review is that whilst there is a relatively high degree of uniformity of opinion on what constitutes tax gaps, there is discrepancy with regards to the significance of time in their estimation and on the usefulness and significance of tax policy gaps.

9. That said, there seems to be agreement on there being two possible methods of estimation of the tax gap, one employing a 'bottom-up' approach, while the other is 'top-down'. For example, the IMF note that[9]:

   The HMRC [tax gap] program follows a pattern of employing 'bottom-up' based estimates for the direct tax gaps, and 'top-down' estimates for the indirect tax gaps. Both approaches are applied consistently with good international practices (IMF 2013, 9).

10. The OECD reflects the same view in 2017, suggesting:

    The use of tax gap measurements is becoming more common, especially for VAT, as jurisdictions increasingly see the benefits of having high level estimates of non-compliance within the tax system. Top-down methodologies that use national accounts data represent a relatively low-cost means of producing such estimates. These approaches are often associated, though, with a fairly high degree of uncertainty and therefore are of limited operational use. Bottom-up methodologies that include information from random audits, on the other hand, can provide a more accurate picture of lost revenue across segments and tax types. (OECD 2017, 62)

11. In doing so they succinctly express the difference between the two approaches as viewed from the perspective of the tax administration. HMRC's permanent secretary has explained the difference as follows[10]:

    HMRC use a mixture of "top-down" and "bottom-up" methods to measure the various constituent tax gaps, which make up the overall figure. We tend to use top-down methods – which compare consumption expenditure data with tax receipts – for indirect taxes, while using bottom-up procedures – building from departmental operational data and management information – for direct taxes.

12. A top-down approach as described here uses macroeconomic data to estimate the potential tax base within an economy. So, taking VAT as an example, the likely VAT due on each part of consumption within national income can be estimated. Allowance is then made for the items exempted from charge as a result of policy decisions as well as those allowances and reliefs granted either for reasons of tax administrative ease or to influence taxpayer behaviour to come to an actual tax base, from which a total theoretical VAT yield can be estimated. This is described as the VAT Total Tax Liability ('VTTL')[11].This is then compared with the actual yield to suggest a compliance tax gap in a 'top down' approach.

13. VAT gap analysis of this sort is dependent upon the existence of statistics of sufficient quality on the size of the tax base, derived from sources other than taxpayer records[12]. The IMF appears to be satisfied with the quality of statistics available in the UK but the fact that there have been concerns on this issue within the EU is apparent from the fact that the EC's VAT gap estimates excluded Cyprus until 2017 because of a lack of reliable national statistics.

14. In contrast a "bottom-up" approach uses an audit sample of submitted tax returns to estimate errors found within them and then extrapolates this error rate across the whole population of submitted returns. However the method leaves this approach vulnerable to estimates of tax not declared at all on tax returns not submitted by persons whose identity may not even be known, and it is also not good at capturing tax not paid by relatively small groups in society, such as the very wealthy. For this reason HMRC say in their note on 'bottom-up methodologies':

    Different methods and data sources are used, depending on best available, to estimate how much tax is lost within each area. HMRC uses internal data and operational knowledge to identify areas of potential tax loss [13].

15. The IMF noted[14] in 2013 that that there was room for improvement which would enhance HM Revenue & Customs' analysis of the tax gap, including the construction of bottom-up estimates for the VAT gap in order to compare results from top-down estimates. Further, the IMF warns that any tax gap estimates, and especially those based on bottom-up methods, should not be used as the sole basis for inference about taxpayer compliance behaviour. In so doing the IMF endorses the two methodologies but suggests they should be used simultaneously and reconciled when possible, and not be considered in isolation. What the IMF added was that 'bottom-up' approaches offer very limited explanation of tax policy gaps because the method cannot be extended to consider them. As they note:

    In general top-down models can be easily extended to estimate the policy gap.

16. With this being noted it is important to note that the IMF's advice appears to have been ignored: although the tax gap reporting by the UK's HMRC is the most comprehensive such exercise undertaken by any country in the world 'bottom-up' methods of estimation are still relied on for all taxes but VAT. In addition, the estimates of tax avoidance and evasion within personal income tax, national insurance contributions and capital gains tax are all described by HMRC in 2017 as being based on 'developing methodologies' whilst the estimates for the tax gaps for stamp duty reserve tax, inheritance tax, petroleum revenue tax, environmental taxes and insurance premium tax are described as 'illustrative indicators for gaps with no direct measure'. If HMRC stands at the forefront of tax gap methodology, their present lack of appropriate methodologies to estimate tax avoidance and evasion in key taxes suggests there is room for progress, whilst on tax policy, with the notable exception of the ECDGT's work on VAT tax policy gaps remain largely ignored. It is suggested that HMRC should adopt this approach to tax gap appraisal in future, for VAT and other purposes.

3. What are the root causes of the UK VAT gap and how might they be addressed?

17. HMRC's estimate of the UK VAT gap is the only one it undertakes on a 'top-down' basis, as described in the previous section of this submission. As such it is the only part of HMRC's tax gap estimate that is likely to be useful when considering macroeconomic taxation policy rather than micro economic assessment of HMRC's performance.

18. HMRC's latest tax gap estimate[15] suggests that the current UK VAT Is £12.1 billion, representing 9.8% expected VAT receipts. Of this sum just £0.1 billion relates to tax avoidance. Deliberate fraud is estimated to cost between £0.5 billion and £1 billion per annum. Bad debt (i.e. VAT liabilities declare but not paid as a result of taxpayer insolvency) amounted to £1.6 billion in the tax year 2015 – 16. This means that tax evasion (including deliberate fraud) amounted to approximately £10.4 billion in the year, representing 8.2% of VAT owing.

19. It should be noted that the European Commission also prepares VAT gap Estimates for the UK. In its latest publication on this issue[16] the total estimated VAT liability for 2015 was some £20 billion higher than that estimated by HMRC, at £148 billion. The VAT revenue that the European commission estimated arose during the course of the year was £132 billion, giving rise to a VAT gap of £16 million, or 11% of total revenues.

20. It should be noted that the EU estimate for VAT is for a calendar year and not for the UK tax year. It should also be noted that the EU figures for VAT would appear to include accounting for VAT on government income and expenditure, which in theory should be neutral. In 2015 – 18 this sum amounted to £14.1 billion. The remaining difference appears to relate to assumptions arising from interpretation of national income accounting. Over time the EU has persistently estimated the UK VAT gap at a percentage point or so higher than HMRC.

21. Using the EU estimate of the VAT gap the tax lost is slightly higher than HMRC suggest. So too is the percentage lost to tax evasion, which would be around 10% of revenues on this basis.

22. It should be noted that one of the most recent IMF published estimates of the size of the UK shadow economy [17], suggests that this averaged 11.08% between 1991 to 2015. The trend is believed to be downward. On that basis the VAT gap would appear to arise very largely as a consequence of activity in the UK shadow economy. The fundamental question to be asked in that case is how and why can a shadow economy of such size continue to exist in the UK?

4. Is government policy-making sufficiently responsive when a weakness in the UK VAT regime is identified? And are there ways in which HMRC's compliance strategy for VAT could be better targeted to close the VAT gap? Could its resources be deployed more effectively?

23. Noting the suggestion made in the previous section that the UK VAT gap almost certainly relates to tax evasion resulting from activity in the UK shadow economy, this section addresses why it is that HMRC appears unable or unwilling to address this issue.

24. As has been noted in another submission made by the author of this paper to the Treasury Committee, to its inquiry on tax avoidance and tax evasion, there are numerous systemic risks that still exist within the UK tax environment that facilitate the existence of widespread tax evasion. This section highlights some of them: a more comprehensive study is required.

25. The most obvious reason for the continued existence of significant tax evasion is that HMRC has not been been provided with the appropriate resources required to address the issue. If resources proportionate to the scale of the issue had been made available to HMRC to address tax evasion of similar proportionate scale to those provided to tackle Social Security abuse then significant inroads into addressing this problem would have been made, but this has not been the case. Details can be provided if the Committee would like them.

26. Whilst it is claimed by HMRC that its policy, particularly with regard to reducing the number of staff employed and with regard to their relocation to centralised offices, has not had an impact upon its effectiveness in tackling tax evasion, anecdotal reports supplied to the author of this submission from staff at HMRC suggest otherwise. Those staff suggest that substantial local knowledge of both accountants and taxpayers has been lost as a result of that policy, whilst the reduction in the number of staff dedicated to preventative measures, such as routine VAT and PAYE inspections, has had an impact on tax recovery of a scale that might, for comparisons sake, have been anticipated with regard to lung cancer rates if efforts to tackle smoking had been abandoned.

27. HMRC's own systems do not encourage tax compliance. Less than one in three income taxpayers are asked to complete a tax return each year. It is argued that in the vast majority of cases a return is not needed because information automatically supplied to HMRC allows the correct assessment of tax liabilities owing through the PAYE system. This claim does, however, clearly indicate the prevailing attitude among senior management at HMRC, which is that nondisclosure indicates the absence of a tax liability. This is a perverse approach. When by definition most tax evasion results from nondisclosure it is perverse that HMRC's assumption is that non-disclosure does not at least imply the possibility of tax evasion, especially when readily available evidence, including the loss of, on average over the last six reported years, more than 10% of expected VAT revenues per annum[18] (almost all of it due to tax evasion) suggests that tax evasion is commonplace. HMRC's policies are not designed to encourage compliance.

28. In many countries all taxpayers are expected to submit a return, which is a process now greatly assisted by the pre-population of those returns with data made available by third parties, including employers and savings institutions, prior to them being sent to the taxpayer for checking and approval. If this practice were to be adopted in the UK the excuse often offered by taxpayers that they were unaware that they had to declare a source of income because HMRC had not requested a tax return from them would disappear. Furthermore, the taxpayer would know that they had an obligation to make declaration because they would have had to at least approve a return. The obvious fact that it is a taxpayer's responsibility to ensure that complete disclosure has been made by them would be drawn to their attention, annually. Current practice does not do this: instead it treats most taxpayers as if they have no duty to the tax system at all. This has to change of taxpayer behaviour has any reasonable prospect of improving.

29. Although the principle loss arising from this policy of not sending everyone in the UK a tax return to complete each year might be presumed to be income tax, the loss of VAT revenues might also be significant. If HMRC were tasked, in cooperation and coordination with other agencies, with locating all taxpayers then the first problem in identifying those who might be partaking in the shadow economy would have been addressed.

30. In one particular area there is significant change required in HMRC procedure if there is to be any prospect of closing the tax gap. In answer to Parliamentary questions from Dame Margaret Hodge MP in February 2018 HMRC admitted that they do not request tax returns from all companies incorporated in the UK in a year. Previous research has suggested that this has been their practice for a considerable period of time: earlier research has suggested that approximately 30% of all companies were not sent to Corporation tax returns in the period from 2007 to 2012[19]. When challenged for their reasons for not doing so HMRC suggested that they had accepted assurances from the companies in question that they were not trading, but had also suggested that they did little work to verify this. This fact, coupled with the fact that during that same period only about 80% of companies requested to make a return actually did so[20] meant that in some years nearly 1 million companies did not submit corporation tax returns without HMRC having explanation as to cause. It is suggested that the opportunity that this laxness in systems provides may be the greatest contributory factor to the existence of the persistent and ongoing tax gap UK that is largely explained by tax evasion.

31. This laxness is replicated in the procedures of Companies House, Research, as yet unpublished by the author of this submission, shows that over the last decade an average of just over 350,000 companies a year have been removed from the UK register of companies, and that approximately half of these have been removed at the behest of the Registrar of Companies because the companies in question have failed to comply with their legal obligations to file documentation. Rather than pursue the reasons for non-filing, the Registrar does instead simply resort to having the company struck from the Register. It is suggested that tax fraudsters awareness of this possibility, coupled with their awareness that HMRC appear to take no effective action when a company fails to file a corporation tax return, means that in combination the actions of these two agencies provide the perfect

opportunity for fraudulent trading to take place without any trace being provided of those who are really responsible. Since new obligations on this registration of the beneficial ownership of companies can be completely avoided buy making a simple declaration that no one controls the company, and because no checks are undertaken on the identity of those persons who are declared to be the directors of a company, it is at present almost impossible to verify who might own, control, and benefit from the operation of the UK limited company that is created for, and trades with, fraudulent purpose.

32. Legislation to tackle this issue was proposed by the late Michael Meacher MP[21]. In the interests of full disclosure it should be noted that the author of this submission assisted with the drafting of that propose legislation. Meacher's Bill included the following clauses:

4 Disclosure of beneficial ownership of companies

(1) In section 113 of the Companies Act 2006, after subsection (2) insert—

"(2A) The company shall undertake those actions required by Regulation 5 of the Money Laundering Regulations 2007 (S.I. 2007, No. 2157) to positively identify those persons who are beneficial owners of the shares that it issues and if it does become aware as a result that the person who is recorded as the owner of a share is not the same as the person who has beneficial ownership of that share as defined by those Regulations then it shall in addition to recording the name of the recorded owner of the share also record the name, date of birth and nationality of the beneficial owner that it has identified and the means by which that beneficial owner exercises their control of the share including the identity of any intermediate companies, trusts or other arrangements that act as agents, nominees or alternates on the beneficial owners behalf and under their instruction, whether direct or implicit."

(2) Regulation 6 of the Money Laundering Regulations 2007 shall be amended so that on each occasion when 25% is referred to 10% shall be substituted in its place.

(3) In section 856A of the Companies Act 2006—

(a) after subsection (2) insert—

"(2A) The return must state where the person named as the owner of share recorded in subsection (2) differs from that of the person named as the beneficial owner of that share as identified pursuant to the requirements of section 113(2A) of the Companies Act 2006 and must where such statement is made also name that person who is the beneficial owner of the share in question and state their date of birth and nationality and how that beneficial owner exercises their control of the share in question as recorded by the company pursuant to its obligations under section 113(2A) of the Companies Act 2006."

(b) after paragraph (b) of subsection (4) add—

"(c) The information to be supplied under the provisions of this section shall be delivered in machine readable electronic format."

(4) In section 856B of the Companies Act 2006—

(a) after subsection (3) insert—

"(3A) The return must state where the person named as the owner of share recorded in section (3) differs from that of the person named as the beneficial owner of that share as identified pursuant to the requirements of section 113(2A) of the Companies Act 2006 and must where such statement is made also name that person who is the beneficial owner of the share in question and state their date of birth and nationality and how that beneficial owner exercises their control of the share in question as recorded by the company pursuant to its obligations under section 113 (2A) of the Companies Act 2006."

(b) after paragraph (b) of subsection (4) add—

"(c) The information to be supplied under the provisions of this section shall be delivered in machine readable electronic format."

(5) The Secretary of State must lay regulations to give effect to these requirements within 6 months of the passing of this Act, including those penalties that shall apply for failure to notify. The regulations must be in the form of a statutory instrument and may not be made unless a draft of the statutory instrument has been laid before, and approved by a resolution of, each House of Parliament.

5 **Duty of United Kingdom financial institutions to report**

(1) United Kingdom financial institutions must notify Her Majesty's Revenue and Customs and Companies House that they have opened or closed an account in the United Kingdom for a company within thirty days of that account being opened or closed stating—

(a) the name and registered number of the company;

(b) the address at which they correspond with that company;

(c) the names and full addresses, dates of birth and nationalities of those persons who they have accepted as having authority to take action with regard to the account;

(d) the names and addresses, dates of birth and nationalities of those persons who they have identified as the beneficial owners of the company in question as required by Regulation 5 of the Money Laundering Regulations 2007;

(e) the number of the account that they have opened; and

(f) the numbers of any other accounts that they maintain for the company.

(2) If a United Kingdom financial institution shall become aware that any of the matters referred to in subsection (1) shall have changed then they shall notify HM Revenue & Customs and Companies House within 30 days of their having become aware of such change.

(3) The Secretary of State must lay regulations to give effect to this requirement within 6 months of the passing of this Act, including those penalties that shall apply for failure to notify. The regulations must be in the form of a statutory instrument and may not be made unless a draft of the statutory instrument has been laid before, and approved by a resolution of, each House of Parliament.

6 **Duty of Companies House relating to beneficial ownership information**

(1) Companies House must publish for each company that information required to be supplied under section 5(1)(a), (b), (c) and (d) of this Act by a United Kingdom financial institution.

(2) If Companies House cannot secure information that they are entitled to receive for any reason from any company within ninety days of that information being due for submission then they may request the information in question from any person named under section (5)(1)(c) and (d) of this Act.

(3) If information requested using the provisions of section 6(2) of this Act has not been supplied to Companies House within 30 days of any request having been made then Companies House shall advise the directors and beneficial owners of the company that they have become personally liable for the debts of the company until such information is supplied in the form requested and shall place notice to this effect on public record.

7 **Duty of Companies House not to dissolve companies**

Companies House must not dissolve any company on the Register of Companies under either section 1000 or section 1003 of the Companies Act 2006 if that company has—

(a) an account with a United Kingdom financial institution that the financial institution in question has not notified has been closed;

(b) closed all its accounts with United Kingdom financial institutions but failed to deliver accounts to Companies House covering any period when such accounts were open;

(c) not supplied information required by Companies House in respect of which a notice under section 6(2) of this Act has been issued.

8 **Duties of HM Revenue & Customs to request tax returns**

(1) Her Majesty's Revenue and Customs must issue a request for a tax return to any company that it has been advised has maintained an account with a United Kingdom financial institution during the course of any period of account notified by that company or, in the absence of such notification, for any year ending on 5 April.

(2) If Her Majesty's Revenue and Customs cannot secure information that they are entitled to receive for any reason from any company within ninety days of that information being due for submission then they may request the information in question from any person named under section 5(1)(c) and (d) of this Act.

(3) If information requested by HM Revenue & Customs under subsection (2) has not been received within 30 days of any such request having been made then—

(a) HM Revenue & Customs may request copies of the all the banking records of the company for any periods they consider appropriate from the United Kingdom financial institution that has advised that it has maintained an account on its behalf;

(b) HM Revenue & Customs shall be entitled to use the information obtained under paragraph (a) to raise such assessments to taxation of any type they consider might be due with such sums owing being the joint and several personal liability of the persons identified under section 5(1)(c) and (d) of this Act.

(4) The Secretary of State must lay regulations to give effect to this requirement within 6 months of the passing of this Act, including those penalties that shall apply for failure to notify. The regulations must be in the form of a statutory instrument and may not be made unless a draft of the statutory instrument has been laid before, and approved by a resolution of, each House of Parliament.

33. It is suggested that adoption of these clauses would greatly assist three objectives. The first would be the proper disclosure of the beneficial ownership of UK limited companies. The second would be the proper management of those companies. The third would be an increased probability of the settlement of the tax obligations that they might have owing, including at the time that they ceased to trade. This would, then, reduce the tax gap, firstly by properly identifying those companies that are trading in the UK at present, which HMRC is unable to do at present, and by increasing the chance of tax recovery from them.

34. It is suggested that nothing that might be done now to tackle tax evasion in the UK could be more effective than these measures, barring increasing the resources of HMRC. It is stressed that this disclosure would not place a new, or in any way significant, cost or obligation upon UK financial institutions, who must already have procedures in place to identify the beneficial owners of all companies to whom they provide services and who must supply this information in some situations to relevant authorities for the purposes of tax information exchange. For that same reason this should create no increase in the burden on, or cost to HMRC in creating systems to ensure that this transfer of data can take place: those arrangements should already be in place. All that is being proposed is the replication within the UK, and for solely domestic purposes, of the standard of information exchange now required internationally. The object is to reproduce within the UK the standard of data that should be available to it from tax havens. It is inexplicable but this has not been replicated to date.

35. If the legislation noted above was to be introduced the biggest consequence would-be behavioural: those with responsibility for limited companies would know that they had to fulfill their obligations as laid down in law or face personal risk of penalty.

36. Behavioural change has to be sought in other areas as well. As a consequence it is essential that HMRC have the authority to seek information on those trading on common internet platforms, and that those undertaking such trades are aware of the fact that the information on their affairs may be supplied to HMRC so that HMRC can determine whether, or not, there is a likelihood that trade is taking place. Awareness of this information exchange is likely to induce greater degrees of compliance than any other step that HMRC can presently take to address fraudulent trading by individuals in their own names in the UK.

37. At the same time, measures must be taken to ensure that those companies the trade into the UK are correctly identified. It is most particularly the case that is Brexit is to take place then all companies that propose to trade into the UK must be required to, firstly, register that intent with HMRC before doing so; secondly, to register for the purposes of distance selling for VAT purposes and, thirdly, to register their details with the Registrar of Companies so that details of their beneficial ownership can be determined. Trading in this context should include the management of any property or the receiving of rental income within the United Kingdom. These measures could, if properly managed be used to address significant tax evasion on trading into the United Kingdom.

38. It should be noted that the additional costs of these registrations should not impose a significant burden upon the taxpayer in general. Since most abuse is likely to be undertaken by limited companies it is they that should bear the burden of any additional costs. Since, however, the annual filing fee for a company is currently £13 per annum even a tenfold increase in cost, which would dramatically transform the number of personnel available to

check for fraudulent trading within the UK economy, would still only result in an annual registration fee of £130 per company per annum, which is a modest fee to pay for the assurance that will be provided that all companies could then trade on a level playing field without fear of being cheated by those companies that failed to meet their obligation to pay tax. It is stressed that this is a move intended to reinforce fair competition and the existence of open, competitive markets and which is not designed in any way undermine the effectiveness of market competition in the United Kingdom.

39. As a result of the weaknesses noted it is suggested that government policy-making is insufficiently responsive when a weakness in the UK VAT regime is identified and that there are there ways in which HMRC's compliance strategy for VAT could be better targeted to close the VAT gap. The information that could be secured using the methods noted could result in significantly improved targeting of HMRC resources.

5. Do developments such as the growth of on-line trading or changes in the labour market reflecting modern working practices require a new approach to VAT compliance?

40. I have had the pleasure of working with Richard Allen of RAVAS over a number of years. I would endorse the approach that he and his organisation take with regard to methods of tackling abuse in online trading and have nothing further to add on that issue.

41. By far the largest change that has taken place in the labour market to reflect modern working practices that has impact upon VAT is the widespread use of limited companies for 'self-employed' contracting purposes. The failings of both HMRC and Companies House with regard to the effective monitoring of the activities of such companies are noted in the previous section and are not repeated here.

6. Is HMRC's approach to large, medium-sized and small businesses appropriate for the nature of the risk to the VAT element of the tax base that each sector poses?

42. There are a relatively small number of large businesses in the United Kingdom, but between them they contribute a significant proportion of VAT revenues. They do, of course, pose VAT risk to HMRC, but since most seek to be tax compliant with regard to this tax, since doing otherwise would be too costly for them to countenance, and most have customer relationship managers appointed to them by HMRC. Since they can deal with issues arising in real-time, including referring matters to internal HMRC experts, HMRC's approach to the management of these taxpayers with regard to VAT is likely to be adequate. As such large companies are unlikely to contribute a significant part of the VAT gap as a consequence since little, if any, of their activity takes place within the shadow economy where the greatest degree of risk with regard to this issue arises, as noted previously in this submission.

43. Medium-size enterprises within the UK economy do not enjoy the benefit of having customer relationship managers within HMRC even though many of them will make a significant contribution towards net VAT collection in this country. The majority of medium-sized enterprises are likely to be broadly VAT compliant by choice. Since the penalties for VAT non-compliance are substantial, and can prejudice the very existence of a company that makes a serious VAT error, and since the owners of most medium-sized entities are profoundly risk averse with regard to VAT as a consequence because mistakes with regard to it threaten those owner's financial well-being, it is likely that most of the contribution that these companies make to the VAT gap result from genuine error rather than from deliberate non-compliance. These companies have, as a consequence, suffered from a decline in the number of routine VAT compliance visits undertaken by HMRC during which they received the advice and reassurance that they required that the systems that they were operating were compliant with HMRC's requirements. These businesses require greater access to HMRC with regard to VAT to ensure that their risk of failing to comply with VAT requirements is minimised. This would ensure that the compliant VAT yield would be maximised with minimum risk a penalty occurring. HMRC are not meeting this sector's expectations at present.

44. HMRC's compliance approach to the management of the VAT liabilities of small businesses has fallen short of what might be considered desirable since the merger of HM Customs & Exercise and The Inland Revenue. This is for three reasons.

45. Firstly, VAT compliance visits by HMRC officers to this sector have almost ceased to take place in recent years. This means that this sector have almost no access to advice and help from HMRC on a regular basis with regard

to their VAT obligations. The risk of error has, therefore, increase significantly, at significant potential cost to this sector, because such errors are heavily penalised.

46. Secondly, some of the schemes that make compliance by this sector relatively more straightforward such as flat rate schemes are now being withdrawn.

47. Thirdly, HMRC's proposal that all VAT registered businesses should be included, automatically, in the Making Tax Digital (MTD) arrangements imposes substantial, and wholly inappropriate, burden upon these businesses that will impose quite disproportionate cost and risk upon them solely for the purpose of saving marginal costs at HMRC in pursuit of the policy of government austerity.

48. The public good is not being served by this new system of tax declaration. When it is tax compliant the small business sector provides vibrancy to the UK economy and a great many job opportunities, particularly for the young, which would otherwise not be available. Whilst the settlement of tax liabilities is, of course, important, and reasonable accuracy is to be expected, the new MTD requirements that impose an obligation upon a small business to submit a tax return at least six times a year, with accuracy required on each and every occasion, with penalty being attached for error on each such occasion that it arises in due course, is an excessive burden that will alienate many in this sector, reduce the viability of others, and most certainly increase rates of tax non-compliance. This well be because some small businesses will decide that the obligation to disclose is simply not worth the stress, work, and risk of a penalty that is imposed as a consequence, with the likelihood that excessive tax rates when such factors are taken into account will be suffered in proportion to the earnings that they make.

49. All these points could be elaborated, but the conclusion would always remain the same: HMRC's current policy towards the collection of VAT from small sized enterprises in the UK lacks any rigour with regard to the identification of those who might have liability to pay whilst being excessively burdensome for those who do make declaration of liability owing. There is, therefore, a disproportionate incentive for non-compliance amongst the small business community, and HMRC have to overhaul, and reappraise their entire approach this sector to address this issue or significant rates of non-compliance in VAT payment by small enterprises will continue unabated.

7. In what ways is the tax base in the UK vulnerable to exploitation by those determined to circumvent VAT rules, push boundaries or develop aggressive VAT planning arrangements? How might either the law or HMRC's processes and procedures be improved to reduce that vulnerability?

50. As noted previously in this submission, HMRC estimate that the cost of VAT avoidance amounts to no more than £0.1 billion per annum.

51. When noting this it should be understood that there are significant problems with the way in which HMRC identifies any form of tax avoidance. In their opinion tax avoidance only exists if it takes place under an arrangement that has to be notified to them under the Disclosure Of Tax Avoidance Schemes regulations of 2004 and subsequently. This is a wholly outdated, inappropriate, and exceptionally narrow definition that means that most tax avoidance arrangements in most taxes fall entirely outside the scope of their identification mechanism, meaning that HMRC persistently understate the tax gap with regard to all avoidance. This is likely to be the case with regard to VAT as a result.

52. This point having been noted, however, there does not appear to have ever been a significant, or large-scale, VAT avoidance sector within the UK tax profession. Whilst it is likely that VAT avoidance is a little larger then the sum estimated by HMRC this is inconsequential with regard to the appraisal of overall VAT lost. This is because the VAT gap is estimated on a 'top-down' basis, using the terminology noted previously in the submission, and as a consequence the overall loss is likely to be broadly correctly stated.

53. There can be no doubt there have been some organised attempts to undermine VAT collection during the past decade as a result of developments in internet and distance selling arrangements, and the rise of e-commerce. These were not specific to the UK. Overall it would appear that the European Union has taken appropriate steps to address these issues, and the UK has adopted appropriate measures to tackle them. Our vulnerability to such attack will increase when we leave the European Union.

8. What role do advisers play in encouraging or facilitating aggressive VAT planning arrangements? Do businesses, tax advisers and professional bodies have concerns about the nature of the advice given by some practitioners?

54. For the reasons noted in the previous section risk in this area is relatively limited. There are real issues of concern with regard to the continuing role of the tax profession in tax avoidance relating to other taxes, but focus should be given to them because the risk with regard to VAT is, in proportion to the activities of these firms in other part of the tax system, relatively minor.

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