HOUSE OF COMMONS

Public Accounts Committee

Oral evidence: Tackling the tax gap, HC 650

Monday 7 September 2020

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Watch the meeting

Members present: Meg Hillier (Chair); Gareth Bacon; Olivia Blake; Peter Grant; Mr Richard Holden; Craig Mackinlay; Sarah Olney; James Wild.

Gareth Davies, Comptroller and Auditor General, Andy Morrison, Director, National Audit Office, and David Fairbrother, Treasury Officer of Accounts, HM Treasury, were in attendance.

Questions 1-69

Witnesses

I: Jim Harra, First Permanent Secretary and Chief Executive, HMRC, Penny Ciniewicz, Director General, Customer Compliance Group, HMRC, and Beth Russell, Director General, Tax and Welfare, HM Treasury.

HOUSE OF COMMONS

Report by the Comptroller and Auditor General

Tackling the tax gap (HC 372)

Examination of witnesses

Witnesses: Jim Harra, Penny Ciniewicz and Beth Russell.

Q1 **Chair:** Welcome to the Public Accounts Committee on Monday 7 September 2020. We are here today to look at an issue that we look at every year: how the Government, and in particular HMRC, manages the tax gap, which is the gap between tax that is expected to be collected and that which is actually collected. The lack of compliance can sometimes be down to deliberate fraud, but is often down to mistake and error as well. We will be challenging HMRC on the numbers in front us, but obviously we are in the middle of a covid pandemic, so our witnesses will know that we will want to talk to them a bit about the impact of that on the tax take.

First, I will introduce our witnesses and highlight the National Audit Office's work on this issue. This is a Report called "Tackling the tax gap", which was published on 22 July 2020 and from which we are getting our figures. The Report has been agreed between the National Audit Office and HMRC, so the figures in it are agreed numbers.

I want to welcome Jim Harra, who is the first permanent secretary and chief executive of HMRC and a regular visitor to this Committee. Welcome to you, Mr Harra. We also have Penny Ciniewicz, who is the director general for customer compliance at HMRC, and Beth Russell, who is the director general for tax and welfare at the Treasury. A warm welcome to all three of you.

I want first to ask you, Mr Harra, before we get into the main session, what impact you think covid-19 will have on the size of the tax gap and compliance yield. Have you done any analysis of that at this early stage?

Jim Harra: We have started doing some work on that. Obviously, it will take time to understand what the impact will be, because of the level of uncertainty. It is clear that we can expect non-payment to be a significant issue for us. We have deferred collection of a lot of tax in the economy, and there are businesses that will find paying that challenging. A top priority for us is to understand how to manage that debt balance going forward and what the impact of that will be on the tax gap.

Beyond that, the impact of an economic downturn on compliance behaviours is not clear cut. There has been a bit of academic evidence in the past, I think from the IMF, that suggests it can have an upward effect on tax gaps— for example, in the hidden economy. But if you look at the trend in the tax gap, for example, after the last economic downturn following the financial crisis, it is not readily apparent that there is that much of an impact.

Q2 **Chair:** In terms of the deferred payments, presumably you have done some analysis about when you will expect those to come in and the likely compliance. Can you give us any gauge of the impact on day-to-day business and income for Government of those deferred payments?

Jim Harra: All VAT-registered businesses were given the option of deferring payment on VAT that fell due between 20 March and 30 June, and they do not have to pay that tax until 31 March next year. Additionally, income tax self-assessment payers were given the option of deferring their 31 July payment on account until 31 January next year. Obviously, we will not be taking any enforcement action ahead of those dates, so it will not be until after then that we know what the rate of payment will be.

On top of those general deferrals, any taxpayers who had difficulty in paying their tax during the pandemic are able to come to us and ask for time to pay; we work through those on a case-by-case basis. We have a very good track record of setting up time-to-pay arrangements; broadly speaking, compliance with them is around 90%. It will be some time before we know what the capacity of taxpayers is to pay those deferred taxes.

In the meantime, we have two priorities. One is to make sure that taxpayers restart payment, on an ongoing basis, of their liabilities as they arise, and in particular, in relation to VAT, that those taxpayers who cancelled their direct debits in order to give effect to the deferral restart direct debits for the end of June and start making their payments. In addition, we have started doing some analysis, based on data we hold, to try to identify those people who we think are likely to have been least affected by the pandemic and, where they are in debt, to inquire with them why they are in debt and what their capacity is to pay.

We are getting a positive response to that contact, which we have just started in recent weeks. For example, we have looked at whether we have had a job retention or furlough claim from employers to identify whether that is an indication of a reduction of activity in their business. We have also looked at VAT filings to see whether we can see evidence of a reduction in activity. In those cases where we don't a see significant reduction but where there is debt, we have been prioritising making contact with them and getting them back into a more regular payment position.

Q3 **Chair:** Thank you. It sounds like quite intense personal work for your staff to be in touch very directly with individual taxpayers, including businesses. Have you got the resources to do that, and have you had to take them away from any other of your activities, particularly any other of your compliance activities, in order to make sure that people's tax bills do not spiral out of control?

Jim Harra: We tend not to redeploy staff on to debt work, because it is relatively specialist work and requires quite a lot of training, so we tend to stick with our resources, although we do sometimes use debt collection agencies to supplement our resources if necessary. The main redeployment that we had was that during the pandemic, most of our debt staff were deployed on to helping people who needed time to pay, so there was very little work done during that period on chasing collection of tax; it was about actually supporting taxpayers who needed our help. As I say, we are now increasingly redeploying that resource on to making sure that people have restarted payment and also chasing debts in those cases where we cannot immediately see that there is good cause not to have paid. So we would expect to use the resources that we have on debt, plus, if we need to, we can turn to debt collection agencies to supplement that.

In terms of what that resource is doing, there is some one-to-one contact, particularly with large businesses, where we use our customer compliance managers and our debt staff to understand the payment profile for them; and then we have a letter-writing campaign, as I say, targeting those businesses that our risk assessment suggests should be able to pay.

Chair: Thank you very much. I am going to ask James Wild MP to come in now.

Q4 **James Wild:** Mr Harra, as you have outlined the focus is obviously on the response to covid-19. May I ask how many individuals you expect to be covered by the loan charge and how many settlements have been completed to date?

Jim Harra: I will let Penny Ciniewicz give you the details of that, but several thousand taxpayers do have until 30 September to reach a settlement with us, and if they do so, they will not be liable to the loan charge. Then there are several thousand taxpayers who are not subject to that settlement opportunity and who will have to pay the loan charge on 30 September. But I will let Penny give you the details.

Penny Ciniewicz: Of the originally estimated around 50,000 individuals affected by the loan charge, we currently estimate that around 11,000 were taken out of that by the December '19 changes following Sir Amyas Morse's Report, and around 1,000 employers were also removed. At the time of the review, we had around 12,000 customers who still had the opportunity to conclude a settlement with us, and most of those paused, understandably, while the review was under way. We have written to all those people to give them the opportunity to engage with us again and to settle so that they don't have to pay the loan charge, and around 2,000 of those have settled or no longer need to settle—for example, because their loans were taken out of the scope of the loan charge. We have around 6,000 customers who are actively in the process of conversation with us and may still settle with us. Another 3,700 or so customers remain out of that 12,000 balance of customers who are still able to settle, and a small number of those have asked us to pause, mainly due to covid-related issues. Around 3,000 of those customers who were able to settle originally have not responded to our letters or have missed deadlines, so it may be tricky for them to settle with us before 30 September.

Q5 **James Wild:** There were quite a lot of figures in there, but my rough calculation was that there are potentially about 9,000 people who are required to settle by the end of this month. Is that correct?

Penny Ciniewicz: That sounds about right; I have not done the maths in reverse, but that sounds about right.

Q6 **James Wild:** How credible is that, given there are only 18 working days left in this month?

Penny Ciniewicz: Sorry—if you are asking about the ones who could settle before the loan charge comes in, we think that we have around 6,000 of those who are still in active settlement conversations with us. And we believe that if they continue to converse with us and bring their evidence to us, and if we continue to work with them, we have enough resource to settle those customers if they continue to engage with us.

Q7 **James Wild:** How are you ensuring that people are treated fairly in this process, because 30 September is not very far away? I have had constituents who are having problems in getting access to physical copies of inquiry notice, for example, because staff are working from home and so they cannot get them? How are people being treated fairly?

Penny Ciniewicz: We work with customers very closely to understand what their particular issues are. Obviously, we have been communicating with customers for some time now, to help them to settle if they wanted to, right the way back from January. Clearly, some of those customers—well, all of the customers who are eligible to settle—had been in touch with us by April 2019 to say that that was the case.

We have a lot of staff available; we have around 1,000 staff in total who are working to help customers settle on the loan charge. We will work with customers, depending on their individual circumstances, to do whatever we can. That is our real focus at the moment—to help customers who want to settle to settle.

Q8 **James Wild:** Like many other MPs, I have had representations to extend this September deadline to January, to allow people to have more time during the covid situation as they are focusing on lots of other issues that might be affecting their business as well as HMRC. Does HMRC have the power to extend that deadline without further legislation?

Penny Ciniewicz: The legislation sets out that 30 September is the deadline and, no, we cannot adjust that deadline on our own behalf.

Q9 **Chair:** Is primary legislation required or would a statutory instrument be needed to change that? Does it have to be new primary legislation?

Penny Ciniewicz: I believe it would be a statutory instrument, but I am not the legislative expert on the loan charge—sorry.

James Wild: A final question. Can you assure the Committee that the resources and the capacity are there from the HMRC side to ensure that people are treated properly and fairly? It is not appropriate for me to raise individual cases in this Committee, but I have individuals whose cases I will bring to you to have a look at, because they are making representations to me that they have not been treated fairly during this process.

Chair: Okay—I am sure you can take that offline with Mr Harra or Ms Ciniewicz.

Q10 **Mr Holden:** This is a question for Mr Harra. I have had several constituents getting in touch, related to covid, about the furlough scheme. Their employers have told them that they are on it, they believe that their employers have received money, but it has not come through to them. As well as individual cases, which I hope you would be willing to take up with me when I contact you personally, what level of issues are you seeing at the moment regarding fraudulent activity with the furlough scheme and other schemes?

Jim Harra: Any employer who claims money under the job retention scheme is obliged to pay their employees at least 80% of their usual salary, up to the cap. In effect, they have to use that grant to fund their employees' wages. If they do not do so, they are not entitled to the grant. Since the end of July, when the Finance Act got Royal Assent, we have had the powers to claw back any grants that employers are not entitled to. Any employee who feels that their employer is not compliant with the scheme can report that to us confidentially. If they go to gov.uk and search for "report a fraud", there is the ability there for them to report that information to us. We always assess all of that information and we always act on it appropriately if we can. Although we cannot get involved in the relationship between the employee and the employer, we certainly can recover from an employer any grant that they are not entitled to, which would include grants that they have not passed on in wages to their employees.

We have had about 8,000 calls to that line, or online reports, so far. It is information that Penny's people will use to risk-assess employers for compliance action. In addition to that, we have our own risk assessment where we identify claims that look out of step with the information that we have. Whilst we had some pre-payment action, that was really designed to prevent any fraudulent payments to organised criminals. It was not designed to hold up payments to legitimate employers about whom we might have had concerns about the amount. We will do that post-payment. Currently, we have got about 27,000 high risk claims that we are inquiring into. The first step is to contact those employers to give them an opportunity to correct their claims, but, if they do not do so, we have the resources to look into that. Currently, Penny's people expect to check up about 10,000 of those 27,000 cases.

Q11 **Mr Holden:** How much overall do you reckon, realistically? I appreciate the Government had to act with immense speed to ensure that businesses survived and people kept their jobs, but what ballpark numbers are you looking at if you are looking at 8,000 reports and 10,000 high risk cases on top of that?

Jim Harra: We have made an assumption, for the purposes of our planning, that the error and fraud rate in the scheme could be between 5% and 10%. I know that there has recently been an academic study that suggests it might be higher. I know also that the National Audit Office have recently carried out a survey, which I am sure they will report on to the Committee next month, which will also give us a bit of information, and in due course we will do more work on it ourselves. That is the kind of ballpark that we are planning the assumption on at the moment.

Q12 **Mr Holden:** In actual cash numbers, what does 5% to 10% now look like in terms of the money that you have paid out?

Jim Harra: I believe that the last figures we put out said that we had paid £37 billion on this scheme. I think that is correct. So 5% to 10% of that figure would be the assumption on which we are basing it—sorry, £35.4 billion was the last amount that we said we had paid out on this scheme.

Q13 **Mr Holden:** We are talking about up to £3.5 billion potential fraud and error from the furlough scheme alone at this stage.

Jim Harra: Our planning assumption is somewhere between £1.75 billion and £3.5 billion, and is the basis on which we will be planning our risk assessment and our compliance activity. That will range from deliberate fraud through to error. We have said that in our risk assessment we are not going to set about trying to find employers who have made legitimate mistakes in compiling their claims, because this is something new that everybody had to get to grips with at a very difficult time. We will expect employers to check their claims and repay any excess amounts, but we will be focused on tackling abuse and fraud.

Q14 **Chair:** Thank you very much, Mr Holden. Before we move on to the main session, I want to come back to the issue of "Eat Out to Help Out", Mr Harra. You issued a letter of direction to the Chancellor asking him to direct you to allow this scheme to go ahead. Could you talk through your reasoning for that, and then explain whether you have done any work since "Eat Out to Help Out" to evaluate whether your assumptions in that letter were correct?

Jim Harra: This is one of a number of covid support schemes that were being developed at great speed, and it was time critical that we got them launched at the right time. Therefore, we simply did not have the time to do all of the analysis that you might normally wish to do before launching a policy of this scale—for example, to determine counterfactuals that would enable you to arrive at a value-for-money judgment.

I had to set that against the regular Treasury guidelines, called "Managing public money", which usually apply in much more normal circumstances than this, and I concluded that the advice that I had received, and that the Chancellor had received, meant that there was significant uncertainty as to whether the policy would give value for money. In the time available, it was not possible to do the further work and to arrive at the further evidence that would enable me to satisfy myself. Therefore, under those Treasury guidelines, I had to seek a direction. Other permanent secretary colleagues and other Departments have had to do similar things during covid-19.

I should say that it was entirely justifiable for the Chancellor to conclude that he would proceed with the scheme, as indeed he did. He gave me the direction that enabled me to implement it in accordance with Treasury guidelines. The Department obviously pulled out all the stops to ensure that we implemented it effectively.

Q15 **Chair:** Will you be doing any analysis? There are lots of ways of cutting this. Obviously, if you keep a business going you can get tax in from them, and if you keep the supply chains going you can get tax in. Will you be able to do an analysis of the cost versus the benefit, post hoc—the opposite of a ministerial direction; an analysis to see? In public policy terms, this is very interesting. In normal times, giving away in effect taxpayer cash in those quantities would be seen as quite extraordinary, but these are not normal times. I wonder whether you can tell us the timetable for that sort of work, so that Ministers and future Governments will have access to this sort of information.

Jim Harra: First, there is already clear evidence that the scheme achieved its objectives in terms of reassuring the public that it was safe to go out into restaurants and in helping restaurants to recover from the lockdown period. However, there is obviously much more work to do to evaluate the outcomes and the scheme's value for money. The Treasury and HMRC are in discussion about how we will carry out a post-implementation evaluation of that scheme, and indeed the other covid-19 schemes, to learn lessons from how they were implemented and to assess whether they achieved their objectives, what value for money they gave and, as we discussed previously, what the levels of error and fraud were, which we would want to know as quickly as possible to inform our compliance work. But we have not reached any decisions yet on how we will conduct those evaluations or when they will be available.

Q16 **Chair:** So there is no timetable on that at this point.

Jim Harra: Not at this stage.

Chair: We can understand that you are busy doing other things, but there is certainly an appetite to find out more. We know that the National Audit Office will hopefully be looking at this, but there is a lot for them to do as well. Thank you very much indeed for picking up on those points.

I now want to move into the main session, looking at the tax gap—an annual outing for you before the Public Accounts Committee, but obviously something that is of huge importance. In the light of covid, we will perhaps be having a different discussion when we look at this issue next year. We want to go into the detail of how you evaluate the tax gap and some of the issues around compliance. I will ask Craig Mackinlay MP to kick off.

Q17 **Craig Mackinlay:** I feel that we have Donald Rumsfeld in the room—we have known knowns, known unknowns and perhaps, after today, some unknown unknowns.

In my mind, we have three elements to the tax gap. I will keep this simple, because this is a good focus. First, we have mistakes by taxpayers, whether genuine mistakes or, to be slightly less generous, not mistakes, in fact. Another element is legislative interpretation and that, I think, is the elephant in the room, which I am not sure that we always discuss in enough detail. Is our tax law so complex that even a well-served taxpayer can fall into an interpretative mess? Thirdly, we have fraud—pure fraud, criminality and the hidden economy.

With those three elements in mind, a useful place to start is figure 14 on page 35 of the NAO Report. It helpfully categorises the different types of taxpayer: individuals who are lower and medium earning; wealthy individuals; small businesses; mid-sized businesses; and large businesses. Keeping in mind the three elements that I started with, each of those categories would have different emphasis. I am sure that for individuals there will be a fair bit of honest mistake going on; there might be a bit of legislative interpretation; there will be a hefty amount of fraud, criminality and underground activity. For the wealthy individual—usually well served by agents and professional help—the level of honest mistake is probably low; certainly, a fair bit of legislative interpretation is causing problems, and I would say that generally, the fraud and criminality might be on the lower scale.

For the small businesses, we are back to a similar situation as with individuals: there will be mistakes; not so much legislative interpretation because their affairs are generally fairly simple; but there is going to be a hefty amount of fraud and criminality. For mid-sized businesses, which are better served, there will a bit of honest mistake, a fair bit of legislative interpretation, and probably not so much fraud and criminality. For large businesses, I would say as a guess that the legislative interpretation is the biggest cause for concern.

With that in mind, as well as the figures that we have—the tax gap is at a fairly low level now, at 4.7%, or £31.7 billion—how much of the improved position of the tax gap, which is still a vast amount of money that would be very well served to the Treasury at this time were it recovered, is due to the good works of HMRC? Mr Harra is probably best placed to answer that.

Jim Harra: It is a very good question. We can measure some of our impact on the tax gap. For example, of the 95.3% of tax that we collected, roughly 5% comes in as a consequence of our direct compliance activity, which we measure as compliance yield. We believe that we also have an effect in promoting the voluntary compliance, because about 90% of taxes are collected through voluntary compliance by taxpayers. There is a whole range of factors that cause people to comply and HMRC cannot claim all the credit for that.

In addition to the direct effect of our interventions, which, as I say, is about 5.3%, we believe that we underpin that voluntary compliance through just engendering a sense of trust in the tax system, which will make people want to comply; through supporting people to help them to comply; and through the deterrent effect, so people know that if they do not comply, there is a risk that HMRC will be able to detect that and they will undergo investigation and financial sanctions for non-compliance. As the NAO Report acknowledges, that is much more difficult to measure. We are keen to do so, because it is important when it comes to deploying our resources that we understand our effect, so we are currently working on expanding our compliance performance measures to include more than the yield that we currently measure. Already, the yield that we measure is not simply the direct cash effect, we do measure the future effect that we have on the behaviour of the taxpayers whom we investigate, for example.

Q18 **Craig Mackinlay:** We will be investigating the whole compliance a regime a bit later on. The amount going into that has reduced year on year. Realistically, what can you do to reduce that tax gap further, bearing in mind what I think is the elephant in the room: the complication of legislation?

Jim Harra: I certainly believe that simplification can play a part. What we have done in recent years is bear down on the tax gap right across the piece, and we have seen all elements of it go downwards—with the exception of debt—and that is in response to our strategy to cover the whole piece. I am sure that there is scope for us to go further.

Two key areas are stubborn in their size. One is the small business tax gap, which accounts for about 43% of the total tax gap. That has remained fairly stable as a percentage for a number of years, and that is why a lot of the tax administration strategy that we have been implementing in recent years and on which we published an update on 21 July is focused on helping small businesses to get their tax right and make it harder for them to get it wrong.

The other area is, as you mentioned, legal interpretation, which is where taxpayers make a filing that is not on the basis of the law as we understand it. Obviously, taxpayers have a right to disagree with HMRC—we are not the arbiters of what tax law means—but we want, first, to promote a conservative approach by taxpayers as to whether they are going to challenge our legal interpretations and therefore to discourage them from taking strained interpretations, and, secondly, to encourage their transparency with us, so that we know when they are filing based on a contentious position. The Government have recently announced a measure to require large businesses to disclose to HMRC where they have made a filing based on a legal interpretation that they know HMRC would regard as contentious. That is best practice that is largely already followed, but it is now a practice that will be enforced across the large business population.

Q19 **Craig Mackinlay:** Ms Ciniewicz, we have the figures here, in figure 15 on page 39 of the NAO Report, for the tax gap versus the compliance yield. I think previous instances of these Committees have struggled to understand and get to the bottom of why the difference is. I can certainly understand that compliance yields can come in some years after, whereas your tax gap is on an annual basis, but for 2018-19, for the first time ever, the compliance yield exceeded the estimate of tax gap. First, what are the reasons for that, if you know them? I can certainly appreciate that, if it was like Ireland with its Apple case—although they did not win the case—and there was a huge yield in one year, it would dwarf everything else. Is that true in the UK? Were there a small number of very big business tax cases settled that led to a huge amount of yield coming in, or is there something else going on?

Penny Ciniewicz: You are absolutely right that we settle some large cases from time to time, and certainly some of that played into the yield in that year. As you say, it is incredibly difficult to create an equivalence between the tax gap and the current compliance yield, for the reasons you have described: cases we investigate may have yield going back over a number of years, sometimes a significant number of years, and we measure the compliance yield at the point we settle the case. That, as a simple starter for 10, makes the one-for-one resolution of tax gap and compliance yield very difficult to do. There are also other things that will be going on in the economy that will impact the size of the tax gap, and things such as the underlying size of the taxpaying population as well.

All those things mean that it is difficult to create an equivalence between those two things. We use the tax gap as an indicator of trend, as a way of thinking about, as you have described, certain behaviours and certain populations, and looking back over time to see where we think we are having an effect. We also have more operational tools that use a lot more insight and real-time information to help us to choose where to put our compliance effort on a day-to-day basis.

Q20 **Craig Mackinlay:** I want to go back to Mr Harra, because I think you mentioned yourself that small businesses seem to be the biggest perceived tax gap. Across all your compliance work, £1 spent seems to yield a very good amount. Some different taxpaying profiles receive more per £1; with big business, if you have done a bit of work, there is likely to be a huge amount of tax and a huge reward at the end of the day, if you win. But I have raised small business on many occasions, because I think it is on this end that you are finding the fraud. There is a bit of honest mistake—perhaps a bit of egregious mistake at times—but it is the out-and-out fraud and the underground economy that I feel are at work here. In days of old, HMRC might stake out a business and do an audit of how many people are going through the door, then check the till and all that sort of thing. In my experience, that is not going on anymore.

Let me give you a good example, from any high street, of probably any hand car wash in the country. Amounts of service are not being rung up in a till, so you have a corporation tax or an income tax deficiency. You have a VAT deficiency, of course, because that is not going through the till at all. You possibly have a payroll fraud because, if they are on the payroll at all, the workers might be on a minimal amount of hours. So, there are three frauds going on within that small business, but there is also a fourth one, which is probably not so much in your control or interest, in that those lower paid, so-called employees then qualify for tax credits or universal credit.

So, there are four potential frauds going on in probably every high street in the country, but I perceive very little work to uncover that. If we could put the fear of the Almighty into that business community, we might see greater compliance activity going on. What are you doing to try to encourage those smaller businesses, which I think are the riskiest, to comply? What are you actually doing within HMRC?

Jim Harra: There are two key reasons why we need to focus on the small business tax gap. One is, as you say, that it is the largest part of the tax gap by a customer group; it is about 43% of the tax gap. Furthermore, the small business population is growing all the time. It has grown by about 50% in the last 20 years and therefore, all being equal, that tax gap will get larger, so we need to tackle it.

In terms of the behaviours of small business, clearly, evasion is one element, but equally failure to take reasonable care or keep good records is another. Straightforward errors and mistakes are also important parts of that. We need to tackle all aspects of the small business tax gap and understand the behaviours that are behind it.

One big challenge for us is that a one-to-one approach to managing the compliance of all 5.7 million small businesses is just not a feasible way of managing that tax gap. Frankly, when I joined the Department 36 years ago, that was our approach. The only way to be effective with that approach would be to have one tax inspector for every small business and, as you say, park them by the till to watch what everyone is doing. That is not a role that, I think, anyone wants, so our strategy is to restrict the one-to-one engagement with small businesses to those real cases of evasion that we need to tackle, and to try to get more one-to-many solutions for all the other aspects of that gap.

Operationally, that means, for example, that Penny's people run campaigns where they have one-to-many operational impacts on small businesses. They will pick a particular small business sector and concentrate on that. They will contact large numbers of people if they think that their profiles look out of the ordinary, and invite them to revise their filings, with the backing that we will investigate a proportion of those who don't.

More recently, our more innovative approach has been Making Tax Digital. We and the Government announced an extension of that back in July, which will be carried through in 2022 and 2023. The particular aim of that is to drive down error and failure to take reasonable care in the small business sector, by requiring small businesses to use accounting software to keep good records and for that accounting software to produce the filing that goes into HMRC's system.

Chair: We are going to come back to Making Tax Digital later, if that is okay.

Q21 **Craig Mackinlay:** Yes, we are. Can I stop you there, Mr Harra? You have a menu that you are putting out to businesses that are already on the radar and already sort of compliant. They tend to do the right things and they want to do the right things, but perhaps they just want a bit more education and guidance.

I am talking about businesses that might not even be registered; they don't occur on anybody's radar. You and I probably use them on a weekly basis. I do not need to tell you what sort of businesses they are. You have so many frauds going on and I am hearing nothing about HMRC attacking them. There are cash businesses and people who are probably not recording PAYE who may have people who are then claiming benefits, or even worse, are almost in modern slavery, because HMRC are not looking at them, because there are 5.7 million of them, which is far too big a job, and the yield is not that great for the effort involved. Do you not think there is a better service to be had—a service to the community—by concentrating on the errant businesses on every high street and bearing down on them? You would find that the Facebook messages would go out: "My God, HMRC are on to us. Let's clean up our act."

Jim Harra: First, you characterise us as not doing anything in that area, but actually Penny has a directorate with about 8,000 people in it that concentrates on small business compliance, and we actively pursue the hidden economy. You are right, however, that the return on that work can be relatively low.

Our experience over a number of years is that, on the kind of deterrent effect that you mention, there is some, in particular for businesses that have been investigated, and for businesses who know that we receive data that might tell us that they are non-compliant. Nevertheless, a combination of the sheer number of them and the churn in them means that that approach, over a long time, has not made a significant dent in the size of the small business gap.

Strategically, the kind of steps that you could take that would significantly drive that down are first, much more third-party data for HMRC to enable us to identify incorrect filings, and secondly, potentially third-party withholding. On pay-as-you-earn, for example, we have a 1% tax gap. A key reason for that is that employers withhold income tax. There may be opportunities for that in relation to certain small businesses, but also for the approach that we are following, which is improving their record-keeping and having those records speak digitally to HMRC.

In relation to the hidden economy, as well as operational activity, there are some policy steps in train. Penny can give us more details, but the Government recently announced some conditionality attached to the licensing of, for example, taxi drivers, who, before they can be licensed to drive, have to be compliant and registered with the tax authority. We work right across the piece. For the scale of the population, a one-to-one approach is not going to bear fruit unless you very significantly increase the size of the tax authority, which I am not sure anyone wants.

Chair: As Mr Mackinlay said, sometimes the word gets round the sector. Just one last point, Mr Mackinlay, because we are coming back to some of this.

Q22 **Craig Mackinlay:** Just to throw in, I imagine that the outcome of covid, where we have seen less cash in the system and a desire for debit card use, so perhaps people are not carrying as much cash around, could be helpful. The rise of debit and credit card use in most businesses may act to the tax gap's advantage.

On the returns of your effort to the reward, the yield, in the NAO Report it said that you do a bit on everyone because the love needs to be shared, but I sometimes question—as you may know, I am still in practice as a chartered accountant, a chartered tax adviser; I have written to you in the past—why you make such effort for such small reward. What is the point of a query on a £100 cost? By the time you have had the professional advisers write and your officers writing backwards and forwards perhaps three times, one wonders whether your efforts would not be better served elsewhere getting the multi-thousand-pound returns.

Chair: Thank you, Mr Mackinlay.

Jim Harra: Obviously, the NAO Report sets out some of the rates of return that we get. We do aim for a positive rate of return. The highest is 44:1 in large businesses, but we get 7:1 across the board. We very much target our work to be effective at bringing in more revenues than we cost and underpinning the lowest possible tax gap. We will always look at whether we are deploying our resources in the most effective way. The better measures we can get of our impact on the tax gap, the better we can do that. We have a good track record of getting a good return on our deployment of resources, and of not unnecessarily deploying resources where there is little return, and therefore not bothering taxpayers, as well as not spending public money on something that does not give back very much.

Chair: We will come back to some of that a little later. I now ask Peter Grant MP to come in.

Q23 **Peter Grant:** Thank you, Chair. Good afternoon to all our witnesses. I will start with questions for Mr Harra. Jim, you quoted in your HMRC annual report that the tax gap for the last full financial year was £35 billion. How much confidence can we and the public place in the accuracy of that figure?

Jim Harra: The most recent figure tax gap figure for 2018-19 was £31 billion, which was 4.7% of the total liability that we believe we are due. That is an estimate. We published a very detailed description of the methodology that we used to arrive at that. That methodology has been sanctioned by both the IMF and more recently the Office for Statistics Regulation as meeting best practice. But it is an estimate, and there are confidence intervals in that. We are constantly refining the methodology and improving it, but it will always be an estimate.

If you take the VAT gap, that is a top-down estimate. We take statistics from the Office for National Statistics about the size of the economy. We calculate how much VAT that economy should produce. We compare that with how much we collected, and the difference is the VAT gap. For small business self-assessment, we do a bottom-up calculation. We take a random selection of small businesses, and we inquire into them and identify any under-declaration by them. We then extrapolate from that. Some of our tax gap figures are what we call experimental—that tends to be some of the smaller ones—because we do not have as accurate a methodology. But it is all set out very transparently. It has been audited and assessed as a good practice that we constantly improve.

Q24 **Peter Grant:** As part of that answer, you confirmed that these figures are estimates. It is not at all clear from the HMRC annual report—or certainly its one-page summary—that the figures have such a large margin of error associated with them. You mentioned the phrase "confidence intervals"; they have to apply to all these figures. Why is it so difficult for me or any member of the public to find out what the confidence intervals are for the figures in your publications?

Jim Harra: Obviously, we have a lot to report in our annual report, so we cannot put a lot of information in on the tax gap, but we do publish the tax gap in considerable detail. I can send you the link to that. That is a publication that the National Audit Office has audited. That includes a lot of detail about the methodology and how we arrive at the estimates, as well as the breakdown of the tax gap by customer group, behaviour and tax type. It is really detailed. It is the most comprehensive, frankly, in the world.

Q25 **Peter Grant:** To be fair, part of my issue is the amount of detail that it is broken down to. It possibly goes beyond what we can have confidence in, but we might come back to that later. Looking at the document you referred to—the 2020 edition of "Tackling the tax gap"—it is quite clear that almost every year there have to be quite significant revisions to the figures after they have been published. In five out of the past 10 years, the figures have had to be adjusted by 10% or more of the original figure. Why do you not include in your headline documents—the one or two-page summary that goes to the press about HMRC's annual report, for example—a health warning that these figures come with a much bigger margin of error than most official figures coming out from the Government or anyone else?

Jim Harra: The Office for Statistics Regulation has reviewed our publication and was satisfied with it. We can look at what you say, but we do meet the best standards of national statistics. You are right that in the 2020 statistics release, we set out some significant revisions of tax gap for previous years. There are two key reasons for that. First, the top-down measures that I mentioned use statistics provided by the Office for National Statistics about the economy. When those are revised, we must revise our tax gap. Those are not statistics that we are responsible for, but they are statistics that we use.

In the case of the bottom-up estimates, over a period of time, more and more of those cases get resolved. Sometimes, that then affects the measure for previous years, and we have to go back and restate that. Our practice is to always do those restatements, because it gives the most accurate figure, but it does mean that the tax gap figures in the most recent years are still subject to revision. Further back in the series, they are definitely much less likely to be revised in the future.

Q26 **Peter Grant:** Penny, one of the figures quoted in the annual report is the compliance yield, which is described as the additional amount generated by tackling avoidance, evasion and non-compliance. The latest figure I have is £34.1 billion, compared with £30.3 billion in the previous year. Again, how certain can you be that that amount of money has actually come from compliance activities, rather than anything else? What confidence interval would you attach to that £34.1 billion?

Penny Ciniewicz: We have a really well developed and continually tested methodology for the measurement of compliance yield. Obviously, it is part of the audits of the data we publish that take place in the organisation, but we also work really hard internally to make sure there is internal assurance around how we assess compliance yield and the methodologies we use. We have a strong commitment in our analytical community to testing that, and that is part of our ongoing work to make sure we are reporting the work we do accurately.

Q27 **Peter Grant:** But isn't it the case that if I put the correct figures on my tax return, you have no way of knowing whether I did that because I thought it was the right thing to do, or because I thought I might get into bother if I did not? Indeed, I might do it because I'd had a warning letter previously and thought, "I'd better not do it again." There is a very significant amount of uncertainty as to how much people tell you because they want to, and how much because they have to.

Penny Ciniewicz: We work with a whole range of colleagues across the department. Compliance is not all about compliance and what we call respond activity—in other words, investigations. We do a whole range of what we call promote and prevent work. Promote activity means promoting compliance—helping people to understand what they need to do to complete tax returns and give us the money that is due in the simplest possible way. We also do prevent activity—designing the tax system in a way that hopefully prevents non-compliance—and then we do what we call investigative or respond activity. All of those have a really important part to play in helping people pay the tax that is due.

Obviously, people's motivations vary hugely, and in a sense, what we are trying to do is interact with the customer as we find them. We use an awful lot of data to help us profile where to put our compliance efforts. We use a lot of data to produce profiles of the kinds of cases where we think there is non-compliance, so we can target our investigative resource and our respond resource as effectively as possible. As you say, there is a whole range of reasons why people will or will not respond positively to paying their tax, but we try to get under the skin of all those different elements and make sure we are thinking about taxpayers' behaviour in the round.

Q28 **Peter Grant:** I did not hear you mention the size of the confidence interval that applies to that £34.1 billion. Can you tell us what that confidence interval is?

Penny Ciniewicz: I am not aware that there is a confidence interval around that per se, but we can check that.

Q29 **Peter Grant:** If you can check that and let the Committee know, I would appreciate it.

I want to look at the quoted costs of compliance, because we have seen the figures that tell us every pound spent on compliance generates x pounds, depending on what client group you are looking at. The figures I have seen indicate that just under £1.5 billion is spent per year on compliance activities by HMRC. What is HMRC spending its other £43 billion per year on, if not compliance? That might be a question for Jim Harra, rather than Penny.

Jim Harra: We have to operate the tax system and collect all of that 90% of the tax that comes in voluntarily. We have IT systems that enable employers to file and pay their pay-as-you-earn. We have a service organisation to run, because we get millions of phone calls and pieces of post every year from people who need our help in order to comply with their obligations. We also have to deal with people's claims for reliefs and repayments. There is a whole range of activity involved in administering the tax system, over and above direct compliance action. Much of that activity will go to improving the tax gap, because it will go to making people feel trust in the way the tax system is administered. It therefore helps to support that 90% of voluntary compliance. But as I said at the outset, it is very difficult for us to measure that. We do not actually have a reliable measure of that, so instead we focus on: what is the direct cost going into the compliance part of the organisation, and what is the direct yield from that activity?

Q30 **Peter Grant:** Can I take from that that the figures that are quoted are the direct costs of compliance, but you don't really know how much compliance-related work has been done by people whose direct costs are maybe shown somewhere else? Doesn't that, again, cast significant uncertainty over the size of the cost of compliance, and the size of any other figures that are calculated based on that?

Jim Harra: We know all our costs, but we are unable to measure the indirect effect of many of our costs on propping up voluntary compliance. What we are able to measure confidently is the direct yield from our compliance activities, either through the cash that we collect or through the impact that we have on the future behaviour of the people whom we investigate.

Q31 **Peter Grant:** Thank you. I want to come back to part of the definition of the tax gap. You have made it clear in the publications that it does not include wealth and income from other jurisdictions that do not give rise to a UK tax liability. There is specific mention of what is known as base erosion and profit shifting. My understanding of that is that a company will generate all its profits in the United Kingdom, but will use financial arrangements to incur significant expenses in such a way that the profits are declared in a country with a much less rigorous tax regime. Given that the cost of that kind of tax avoidance is not included in the tax gap, do you have any indication of what the actual cost to the UK tax revenue is of the practice of base erosion and profit shifting?

Jim Harra: Yes. The tax gap is a measure of non-compliance with UK tax law, and it therefore includes multinationals that shift their profits, in breach of UK tax law. Similarly, the yield figures include the amount of yield that we collect from tackling that kind of behaviour. What it does not include is what you might call the "policy gap"—in other words, the tax that we are losing that is not due, but which might be due if you could tighten up the tax rules.

On multinationals and profit shifting, we know that the UK and other jurisdictions would like to see the international rules reformed so that such companies pay more of their fair share of tax to the right jurisdictions. The base erosion and profit shifting project going on in the OECD is trying to achieve that. That has already made some changes to, for example, transfer pricing, which is feeding through into additional revenues. If multinationals do not comply with the new rules on the tax gap, Penny's people will tackle that.

I do not have a figure, and the OECD has not published one, on how much additional tax Governments might raise through changing the rules, because that would depend on how you changed the rules, but there is a belief, both in the UK and in other countries, that there is more taxable capacity in multinationals than the current law ensures.

Q32 **Peter Grant:** I assume that the practices we have described—as you say, at the moment they are perfectly legal—tend to be open only to either wealthy individuals or very big companies. Is it then fair to say that by reporting on the tax gap as it has been defined, the public might be given an under-representation of the degree to which wealthy people and big multinational companies might be avoiding paying tax in the United Kingdom, because they are wealthy enough to do it in a way that does not count as part of the tax gap?

Jim Harra: Yes. Clearly, wealthy people and large businesses are the taxpayers who have the most capacity to engage in sophisticated tax planning. Where that tax planning is, in our view, not compliant, either because it is tax avoidance that we think does not work, or because it is a legal interpretation that we think is incorrect, it is recorded in the tax gap, but to the extent that it is sophisticated tax planning that succeeds in its objective, it is not. You are right that if you were to measure, in addition to the compliance gap, how much tax is not being paid as a result of tax planning that is effective but that, from a policy point of view, you might think is undesirable, that would be another figure.

Q33 **Peter Grant:** One final question. On the analysis you have provided about how much of the tax gap you think is attributable to different kinds of businesses and individuals, Craig Mackinlay has asked a lot of questions about the assessment of the tax gap caused by small businesses, but when you define something as a small business, what inquiries do you undertake to find out whether it shares ownership with a number of other small businesses, so it is actually a big business that, for tax-relevant purposes, has been artificially divided into several smaller and therefore legally distinct companies?

Jim Harra: I will let Penny answer about the kinds of data that we have that enable us to join up taxpayers' different interests.

Penny Ciniewicz: Thanks. We have a really quite robust way of approaching this problem, because when we are risking, we use risk profiles that incorporate all the identifiable risks we can find relating to directors and shareholders and all their identifiable interests. We are looking at those individuals as a whole and trying to ensure that we target the highest-risk individuals, regardless of how their affairs are split. We also target individuals who fail entirely to submit tax returns and look at a full review of their business interests as well. Our approach is holistic in that area.

Q34 **Peter Grant:** I find that quite interesting, because the kind of analysis you have described is exactly the same as the analysis that we were told would be too difficult and time-consuming to carry out in order to identify small business owners who probably should have got more covid support. Company directors who were also shareholders and paid themselves through dividends were told that it would be too difficult to separate them out from people who were paid dividends for companies in which they took virtually no active interest. If you can do that, quite rightly, to identify who should be paying more tax on the total of the companies they are involved in, why can't it be done in reverse to identify who genuinely is a small businessperson whose only source of income is the profit from a company?

Jim Harra: They are two different things. We have a pretty sophisticated data and data analytics system called Connect, which enables us to join up the activities of taxpayers across different legal entities and therefore, for the purposes of compliance risk profiling, identify instances where they materialise in the tax system, which may touch on the risks that they pose. That tends to involve our analysts doing a lot of work to identify that. It tends to be downstream, after the event, when we have obtained data, and it is not reliable in the sense that you can simply make an automated decision based on it. It forms the basis of a risk assessment for someone who then decides what risks to inquire into. That is very different from an ability, at scale and at speed, to operate the payment of grants to people based on linking different entities together.

On the coronavirus support schemes, as you know, Mr Grant, we concluded that it simply was not possible for us to calculate for the purpose of the job retention scheme how much, for example, a company director was forgoing in salary by taking dividends. That just was not feasible and was quite a different operation from the one that Penny described.

Q35 **Olivia Blake:** My questions are for Mr Harra. First, are there any plans for HMRC to measure the tax gap in each of the UK nations?

Jim Harra: That is a very good question. Not that I am aware of. Obviously, you can make some attributions, in the sense that we have data about the scale of the economy in different parts of the UK and how many small businesses there are, so if you assume that all other things are equal in terms of taxpayer behaviour, you might be able to make some attributions, but I am not aware that it is work that we have done, or that we have any plans to do.

Q36 **Olivia Blake:** Do you think it would be useful to?

Jim Harra: In relation to Scottish and Welsh income tax, where the Scottish and Welsh Governments have an interest in how much combined yield we collect and its attribution to them, we have a formula to make sure that, for example, the yield that Penny's people recover on income tax is shared between Scotland, Wales and the rest of the UK.

Q37 **Olivia Blake:** My second question is about something completely different. Given that HMRC has a number of dedicated teams looking at non-compliance in the construction industry scheme, has HMRC made any assessment of the tax gap in this area? I am struggling to find information on that.

Jim Harra: We have not made a specific measurement on non-compliance in relation to the construction industry scheme. It was introduced a number of years ago specifically to address the risk of non-compliance in a sector that has traditionally had quite a high level of non-compliance, although it does in itself generate its own risks. I do not know whether Penny can add anything on the activity that we undertake to monitor that scheme.

Penny Ciniewicz: It is part of our regular compliance work to look into the construction industry scheme. Indeed, there has been some new legislation recently introduced in relation to it. It remains part of the risks that we take a particular interest in. Making sure that that scheme is run in compliance with the law is a significant part of our compliance activity in those business areas.

Q38 **Olivia Blake:** Just to confirm: you don't take into account the tax gap in that area.

Penny Ciniewicz: We don't have a specific tax gap for that individual area, as Jim said.

Olivia Blake: All right. Thank you.

Q39 **Sarah Olney:** Good afternoon. I want to ask a few questions about how you are resourcing your compliance activities in HMRC. My first question is to Jim Harra. In the Report, paragraph 2.8, the NAO found that the "compliance activities are led principally by" a "Customer Compliance Group". In that group they get "an average rate of return of 15:1… compared with an average of 8:1 from across HMRC", and yet they have also found in paragraph 2.19 that in that particular group the staffing has "remained…constant at around 23,000" over the last five years, which begs the question: if that particular group is getting such increased returns compared with HMRC as a whole, why would you not increase your resources?

Jim Harra: There are two possible ways in which you could do that. One would be to redeploy resources from elsewhere in HMRC. The other would be to increase our resources overall. Obviously, it depends on your relative priorities, but people working elsewhere in HMRC who are not working in customer compliance are delivering services to our customers. If I redeployed them into doing investigations and they were not answering phone calls or answering post, I suspect I would be appearing before the Committee to answer for that. We have to balance our resources and get across the whole of the job of administering tax, including compliance interventions.

We were funded to maintain our level of yield and to protect tax revenues in the last spending review, after efficiencies. Over time, that would have resulted in a reduction in the size of this group, as it achieved its efficiencies.

However, in intervening Budgets we have been given additional funding to bring in additional tax revenues, which is why the size of the group has remained pretty constant, but its performance has increased over that time. For example, as the yield table shows, we have brought in more and more yield with the same amount of resource. When you look at some of the areas of our work—for example, on small business compliance—you can see that what we have done is quite successfully achieve efficiencies so that we are getting more yield per case, if you like, and we are increasingly good at targeting our activities so that we are not wasting resources, from our own point of view, or unnecessarily bothering businesses, from their point of view, by investigating cases where in fact nothing is wrong. It is about achieving efficiencies, as well as the overall amount of resource.

In practice, we make the case to Treasury for when we believe that we can bring in additional tax revenues with additional funding. My experience is that Treasury is always interested in getting additional revenues. You can see a track record of that over time, where again and again we get funding in return for promising additional tax revenues, and we deliver on those promises.

Chair: I am sure Ms Olney will bring the Treasury in now.

Q40 **Sarah Olney:** You have anticipated me. I was just going to say to Beth Russell, just picking up on the first point of what Jim Harra was saying, that if we want to make real progress on the tax gap, we would need to increase resources overall. How might you respond to that?

Beth Russell: As the Treasury, we have two objectives here. One is that, like any operational Department, we want to put in place the right incentives for HMRC to make efficiencies and to become more productive. Also, as you say, we want to invest—where it is sensible and there is a good case to do so—in additional compliance activity. As Jim said, if you look over the fiscal events of the last few years, we have done exactly that. We have invested over £1 billion over the period since the spending review in 2015 and at various fiscal events for new measures where HMRC has made a robust and persuasive case for us to do that.

Q41 **Sarah Olney:** I want to go back to Mr Harra. Figure 13 is quite a striking graph, "Trend in HM Revenue & Customs' enquiry and audit-based enforcement interventions". We can see that the number of compliance interventions has fallen while yield has remained stable. Do you have a comment about that?

Jim Harra: I should let Penny take some of the credit. That indicates what I said before: we are becoming much more effective at targeting our compliance interventions. Therefore, the yield per intervention has gone up and the proportion of interventions that, for example, use up our resource and the time of taxpayers only to bring in a nil or small yield has gone down. Penny can elaborate on that.

Penny Ciniewicz: In our individuals and small business compliance directorate, that is absolutely true. We have improved productivity since the 2015-16 baseline, I think, by about 13%, and we have done that through an increased focus, as Jim said, on the quality of our risking, so that we make sure that we select the right cases and that we focus our investigations where they can add most value. That has the effect, as Jim said, both of not investigating individuals and small businesses where there is actually less to look at and of increasing yield. We have also been using different techniques. Jim mentioned earlier that one of our areas of investment over the last few years has been in work where we use what we call one-to-many techniques. Initially, we write to taxpayers to prompt them to be compliant, and then we follow up with one-to-one investigations when we do not get a satisfactory response. That has also proved to be a very cost-effective way of helping people who want to be compliant to be compliant and of identifying cases where we need to do more detailed work.

Q42 **Sarah Olney:** Is the implication of this graph perhaps that if you had maintained the number of your traditional compliance inquiries, we might have seen an increase in your compliance yield, given what you have just said about a lot of your interventions becoming more efficient and so on?

Penny Ciniewicz: One of the things that we are doing is looking constantly and, as Beth and Jim have indicated, we look for areas where we can seek investment and where we think we could bring a decent return back to the Exchequer. Obviously, the marginal rate of return on activities tends to fall away. We try to be efficient, so in any case we try to invest our resources in the most efficient aspects of our delivery. Inevitably, there is therefore less return from the additional work that we seek to do, but as Beth said, we do put in proposals to the Treasury and they are funded regularly for that additional work.

Chair: I am going to bring in Craig Mackinlay at this point and I will come back to you in a moment, Ms Olney.

Q43 **Craig Mackinlay:** If someone was running a business and had the chance—at the worst end—to get a seven times return on an investment, I think everybody would take that all day long. To go back to figure 13, which is an interesting one—Ms Olney has highlighted some of the issues with it—are we saying that just two years ago, in 2016-17, 200,000 of the compliance interventions that you undertook, whether low-level aspect inquiries or full-on audit and criminal, were a total and utter waste of time, or is it rather that the more you do, the more you get, even though you get a lower return, as Ms Olney was saying; that if you had kept the number at 581,000, as you had two or three years ago, you would actually have received a proportionately higher level of compliance yield than where we are now? Or are we chasing things that you think are not worth our while?

Penny Ciniewicz: Certainly, there are cases where we close an inquiry without raising any revenue—what we call closing cases for nil—and we want to reduce the number of cases that we close for nil for obvious reasons: it is not a good use of our resource and it is not helpful for taxpayers. But we also recognise that in that period, we have been changing the way that we investigate. As I have talked about, the one-to-many activity is a very different model for intervention. As I say, there are a lot of factors that go into how we decide the number of investigations that we will deliver and we try to maximise the impact that we have by deploying resource to the most effective ways of ensuring compliance across a wide different range of taxes, customer groups and different behaviours.

It is a complex beast; we are constantly evolving new ways of targeting our interventions to be more effective. As I have said, we seek additional investment from the Treasury and we have received it, which indicates that there is an attractive rate of return, but we are not infinitely expandable as an organisation. Even in the context of the tax gap, there must be a level at which it is also sensible to invest in other kinds of compliance-related investments that help us to get the outcome that we all want, which is people paying their tax at the right amount and on time. That is where investments in a whole range of other things, such as

Making Tax Digital, help us to make sure that we are providing the right interventions to help people pay tax at the right time.

Craig Mackinlay: That is fine. We will shortly discuss in great detail my views on Making Tax Digital.

Chair: Saving the best till last? Back to you, Ms Olney.

Q44 **Sarah Olney:** On figure 13, given the downward trend in your number of compliance audits, I wonder whether you have figures for how many cases you closed for a nil return in each of those years? If that information were available, would it show a decreasing trend of cases closed for nil?

Penny Ciniewicz: I am not sure that we have it available in a format that is easy pulled together for this conversation—I certainly do not have it here today—but we can go away and have a look. We have a lot of different management information systems across the organisation, and it is not necessarily true that something that is measured in one management information system can necessarily be compared with another, so it might be quite a lot of work to pull that together, but we can take that away and have a look, certainly.

Q45 **Sarah Olney:** I would really appreciate that, thank you. I want to talk quickly about figure 14 as well. A bit earlier in the inquiry, we touched on small businesses and the particular issues around small businesses and the tax gap. We can see not only that they make up the largest component of the tax gap, but that that has been the case, and at the same proportion of the tax gap, for a long time.

I am interested to know why you have reduced the costs of compliance activities from £525 million to £490 million from 2017-18 to 2018-19. Why have you reduced resources to pursue small businesses for their unpaid taxes?

Penny Ciniewicz: The number of staff overall in the ISBC, which is our individuals and small business compliance directorate, has remained broadly stable from the start of 2015 to 2019. In terms of our approach to tackling non-compliance in small businesses, as I say, we are doing much more one-to-many activity, which reaches more businesses with fewer people, in effect, in the short term.

We also obviously have an eye to the Making Tax Digital benefits that we expect to flow from people being able to give us digital records, which will reduce the failure to take reasonable care and the error rate, which are a big part of the tax gap for small businesses. It is a constant and dynamic shift that we make using a lot of different information to work out what the tax risks are that we most need to tackle each year and where we think we can get the most effective interventions from an investigative or response space, as opposed to a promote and prevent space.

Q46 **Sarah Olney:** You are implying that some of that reduction is due to increasing digitisation, and you have talked about Making Tax Digital, but I do not think Making Tax Digital was required for small businesses in those periods, was it?

Penny Ciniewicz: No. I suppose, in investing the resource we have in compliance in the most effective way, there will be a lot of different factors at work in how we consider where the resources are spent across the organisation. As I say, probably the most important piece in that jigsaw puzzle from the point of view of risk and compliance resources has been, over the last couple of years, that shift into the one-to-many activity, as well as thinking about our longer-term returns from Making Tax Digital.

Q47 **Sarah Olney:** I would like to ask Mr Harra a question, because I am concerned about the implications of a one-to-many approach to small businesses in the current environment. Obviously everyone has had a turbulent time, and I think all of us MPs are concerned about small businesses in our constituencies and how they are going to come through the recent shutdown and the challenges that are still to come. I am concerned about the idea of a—perhaps I am characterising it wrongly—one-size-fits-all approach to small businesses in terms of recovering their unpaid taxes, because so many will be grappling with new and unprecedented challenges.

Some, no doubt, are taking advantage of the situation to undergo fraudulent activity, as Mr Mackinlay was talking about earlier, but many will be making honest errors in an environment that is new to everybody. I wondered what your approach might be in the next few months to small businesses to make sure that we are providing the right support to those businesses that are desperate to get this right, want to continue trading and are doing everything they can to stay in business. How can HMRC ease the burden on them?

Jim Harra: I will describe how we are approaching that, but first, if I could just elaborate on what a one-to-many approach means. In the past, we might have identified 500 risky cases and taken each of them up for investigation. Our approach now would be to contact those 500 people or businesses and say, "We have identified risks in relation to you and we could well take you up for investigation, but first you have an opportunity to review your filings and step forward if you think you've got them wrong." If 400 of them step forward and change their filing, that leaves 100 for us to investigate. We potentially get yield from all 500, but we do not have to investigate each one individually, so that is quite a crude description of what a one-to-many approach means.

In relation to the impact of covid-19, there is no doubt that it has increased fragility across the economy and in each our businesses. It is a concern of mine, right across tax administration, that many of our processes are a one-size-fits-all process and they are based on an assumption that the vast majority of people can comply with their obligations and have the capability to do that—with a few exceptions that will fall out and that we will need to handle. We need to look carefully at whether that is really going to hold true in the coming months.

In relation to Penny's area and small businesses in particular, what we have done on covid-19 is steered clear of taking up new investigations in relation to businesses who we believe will be struggling just to keep their heads above water and keep things going. We have also, where we have opened inquiries, for several months said that we won't pursue those inquiries unless they have the capacity to do so and we will only take action if we are up against, say, statutory deadlines, which we simply cannot let pass. But otherwise, if you tell us you need a six-month break from pursuing your investigation, then *that's what we're* doing. We will keep reviewing that over time, but it has been pretty effective in the last six months in backing up our overall task, which has been to support the economy, frankly. But it will mean a reduction in compliance yield in 2020-21 compared with previous years. That is very much the approach that we have followed.

More broadly, we have more work to do to make sure that we do not make the wrong assumptions about one-size-fits-all processes and that we do not, for example, just issue thousands and thousands of penalties to people who have not filed a return if in fact they have all got real difficulty filing those returns and it is not in our interest then to get lots of reasonable-excuse appeals from that. So what we have really been doing in terms of our restart strategy, which we published on gov.uk a few weeks ago, is inching across the ice and seeing what works and what does not work. For example, we have recently started issuing some non-filing penalties, because we have seen a fall-off in the filing of returns and, even though we are happy to defer the payment of tax if people can't afford it, we really do need those returns so that we know what it is that we are deferring—so we have been working on that.

As I mentioned earlier, on debt, as we have restarted debt recovery action, we have been testing whether we can use risk assessment to identify those debtors who we think probably have the most capacity to pay. We are stepping quite carefully through that and building our own confidence in the capability of our customers as we do that.

Chair: Thank you very much, Ms Olney. We now go back to Craig Mackinlay MP.

Q48 **Craig Mackinlay:** I just want to clear something up, and this question might be yours, Mr Harra. You have two types of companies. Obviously, at the current time, there is a lot of strain within businesses. Let's say that they have put in their returns at the right time, they have put their VAT return in, they have taken advantage of the deferral, they have come to an agreement on time to pay across PAYE, corporation tax and whatever else they might have to pay—it might be landfill taxes; whatever multitude of them you like. Then, for whatever reason, they go bankrupt a bit further down the road. That is one type of business: the honest business trying to do the right thing, but it has all gone horribly wrong because of the current environment.

You also have the other businesses; and funnily enough, they have been flushed out a little bit—in the fast fashion industry, for instance, in Leicestershire. There has been a lot of this going on where companies are intentionally set up—again, they might be compliant and put all the returns in, but at the end of the day there was always the intention to declare bankruptcy, with every intention of never paying HMRC despite its preferential treatment in the hierarchy of creditors.

Are those two amounts treated the same? Are they treated as irrecoverable or are they treated as tax gap figures? Can you just clear that up for me? Are they tax gap figures or something else?

Chair: Mr Harra, a brief answer, please.

Jim Harra: All non-payment of taxes that were due is counted in the tax gap, as part of the tax gap. Obviously, in the case of people who are deliberately taking steps to use insolvency to evade paying their tax, there is a range of powers that we have—for example, to disqualify directors and tackle phoenixism. If you want, Penny can describe in more detail what we would do. It is all ultimately captured in the non-payment element of the tax gap.

Q49 **Craig Mackinlay:** Okay; that is very interesting. Can you tell me how hard you pursue what you perceive to be those very errant directors, because you then get into the realms of the Companies Act, BEIS and all the rest of it, which have responsibilities? You have got a bit of cross-responsibility going on here, because I think it would be a decision for the Secretary of State for BEIS as to whether these things are pursued, which is away from your Department. Are they linked up enough so that the real errant people who intentionally go bankrupt without paying what is due are pursued, so that they cannot be directors again—not that that seems to be a barrier, because they seem to get friends and family just to take up their positions in the future?

Penny Ciniewicz: I can reassure you that they certainly are pursued. We have specialist teams—insolvency specialists—in our business, who work with all sizes of businesses. We make sure that we do pursue phoenixism and insolvency risks. Recently we have had some new powers, as part of the Finance Bill, which help us considerably, because they recognise the need to tackle not just the penalties that we would seek to recover through joint and several liability but the tax itself.

A couple of years ago, we set up a new targeted enforcement and recovery unit, and that team is all about pursuing assessments from individual directors in the event that a business enters insolvency for inappropriate reasons. Already we have got £3 million in cash from those kinds of individuals, including from hidden funds, and we continue to pursue those kinds of debts vigorously.

We also work really closely with the Insolvency Service. You referred recently to Leicester. We have worked to help to provide the information that enables the Insolvency Service to disqualify directors. Obviously, if we see evidence that disqualified directors are behaving in ways that do not align with the conditions of their disqualification, we equally go back to the Insolvency Service to support it to take further action.

We are absolutely focused on that issue and we certainly will continue to be focused on it going forwards.

Q50 **Craig Mackinlay:** I have a final question on that issue. You have increasing powers to recover, say, PAYE from directors. How often are those powers used, or is there more that you should be doing or could be doing? I ask that question because my perception is that those powers are there, but they are not used very often.

Penny Ciniewicz: The powers to recover taxes through the joint and several liability of company directors are very new; they came in through the Finance Act. We are really pushing them onwards, but we continually pursue those debts. As I said, I think that the setting up of the targeted enforcement and recovery unit is a statement of our intent in this area to make sure that we are deterring people from taking that route, and so they do not think that they will get away with it.

Q51 **Craig Mackinlay:** Thank you. Mr Harra, in terms of getting back to work, from my experience, we have some aspect inquiries ongoing and we are not getting a response for six months. I know you say, "Well, we've had a lot of our staff involved with furlough and getting the money out the door," and all the rest of it, but I would think that those skills are not terribly transferrable. How many of your staff are back in the office? I do find the delays a little bit strange, given that everything is scanned and online, and all of your staff have—

Chair: So, the question is: how many are back in the office?

Craig Mackinlay: How many are back to work, because they are all getting paid 100% of their salary, no doubt?

Jim Harra: First of all, everyone has been at work throughout, whether they have been in the office or at home. As you say, we scan our post, so, generally speaking, our officers do not have to rely on getting their hands on the physical pieces of post. There are some exceptions to that, but broadly speaking they are able to do their work from home on the screen. No one should be experiencing six-month delays in inquiries. If you let me know about the cases, I will certainly look into them.

Our staff have all been working throughout, although, as you say, a significant number of them have been redeployed from business-as-usual tax work to supporting the covid support schemes. That includes some of Penny's compliance workers, who have been moved on to service roles, to service the job retention scheme and the self-employed income support scheme, because an understanding of PAYE or self-assessment has been important to those schemes.

In terms of returning to the office, between 4,000 and 5,000 colleagues were coming into the office every day throughout the lockdown. We have been increasing that more recently, and on the current plans we will use the full covid-secure capacity of our offices in the coming weeks. Having said that, our covid-secure offices do not have the capacity that they once did, and therefore many colleagues will continue having to work at home for some or all of the time while those distancing measures are in place for our team.

Q52 **Craig Mackinlay:** Finally, this one is for Ms Ciniewicz. From my experience in practice, I have small inquiries—aspect inquiries and responses—taking six months. Practices across this country and taxpayers generally have been sending in their returns as normal over the past six months. I do not recall myself or any practitioner I know having had a new inquiry raised in the past six months, so is this going to significantly impact your compliance yield? It is like trying to catch up with the MOTs—heaven knows how the DVLA is going to do that.

In this last year, are you going to miss out on compliance audit activity? Will you write it off as, "Well, we'll never get through that lot that we should be looking at," and start afresh as you go forward? In the figures we have been given, your compliance audit reward yield is about £30 billion a year, so given the past six months' unusual lack of activity across the nation, are we likely to lose half of that—£15 billion of compliance yield—for the six months just gone?

Penny Ciniewicz: We certainly saw a drop in compliance yield in the first quarter, and that was due to a number of effects. As Jim described, we were trying to make sure we were responsive to customers' needs in the way we handled inquiries, certainly when lockdown started and people were coping with all kinds of difficult challenges in relation to their personal or business affairs. We were giving people the opportunity to continue with inquiries with us where they were able to and wanted to, because we recognise that having an open inquiry can be stressful, and I am very sorry to hear about those aspect inquiries. As Jim said, if you want to give us the details of those, we will certainly look into them, because those delays should not be happening. Our response has been to try to check those inquiries—

Craig Mackinlay: I do not intend to mix business with pleasure, Ms Ciniewicz. They were just examples.

Penny Ciniewicz: No, I recognise that is not—*[inaudible].* I think our responsibility is to try and make sure we progress inquiries where people have wanted to, but also recognise that there are many reasons why people may be unable to progress inquiries, and to do that in a sensitive way, depending on the circumstances.

We have obviously continued to pursue our criminal and serious investigations, as you would expect us to, and we continue to do all we can to tackle promoters and to protect people from getting involved in avoidance. In that period, we have certainly seen fewer inquiries opened, and a number of factors are at play. Sometimes, it is the customer experience; equally, as Jim said, we have deployed a lot of people at various peak points on to helping with the covid support schemes, and I would just say that people have been working incredibly hard to—

Craig Mackinlay: I realise that, Ms Ciniewicz.

Chair: We need to move along fairly swiftly, because of time. Last very quick one, Mr Mackinlay.

Q53 **Craig Mackinlay:** The question is this. We have tax returns going in on a daily basis. You have lost six months of normal working activity in HMRC, because people have been allocated elsewhere, doing covid things and all that good stuff. Are you realistically going to be re-examining all of those returns that have been coming in over the past six months? Instead of having your normal compliance audits—we are now up to 380,000 compliance audits of one description or another—are you ever going to get that 380,000 for the year ahead, plus the six months that you haven't really been able to focus on in the normal way? That is the real issue I am trying to put forward, and I do not think you have quite explained that.

Penny Ciniewicz: Sorry. I think the answer is, "No, we will not do that many audits in the coming year." We will focus on where we think we can add most value, both in terms of the interaction with the tax system and making sure we are protecting our rights of inquiry, if we need to, but also making sure we are focusing our compliance efforts where we can make a difference. We will not open that many inquiries in the coming year. That would not be realistic, and probably not helpful from the point of view of the customers who continue to struggle with the impacts.

Craig Mackinlay: Again, that's probably not very helpful on the public record.

Q54 **Chair:** I will come back to Mr Mackinlay in a moment. I want to ask some quick-fire questions to you, Mr Harra, on the issue of offices and attendance in offices. What percentage of staff do you think will be physically in the office by the end of this month and the end of October? Do you have a target?

Jim Harra: Last week, all Departments received a letter from the Cabinet Office setting out an aim.

Chair: They had that. Where will you be in relation to that?

Jim Harra: On our current plans, before we received that letter, we would not be having 80% of our colleagues in the office by the end of September. We will review those plans and go back to the Cabinet Office this week with what we can achieve. We currently have capacity for about 20,300 to be in every day.

Q55 **Chair:** What is that as a percentage, roughly?

Jim Harra: That is roughly a third—actually, it is less than a third. It is about 30% of our normal capacity. We prioritise who comes in based on those who need to because they cannot work from home, either because they do not have the facilities or they need to be in the office for welfare reasons, or because of effectiveness. Those are our priorities. We will look, in the context of those priorities, at what progress we can make.

Q56 **Chair:** That comes to the point about productivity. A lot of organisations have been surprised at how productive staff can be at home. Have you seen any positive or negative impact on productivity as a result of home working? Obviously, it is challenging when people are home schooling and working, but presumably you can take account of that.

Jim Harra: Yes, it is an atypical period to measure productivity. As you say, people have been home schooling and doing childcare in combination. However, we have been both tracking performance and surveying our colleagues on what they think about their own productivity. Most of our colleagues believe that they can be productive at home.

We have one-to-one conversations with those who have not, to understand what we need to do to improve their productivity. For example, we have provided over 23,000 pieces of kit to people at home, to help them become more productive. In some cases, we have said, "For parts of your job, you need to be in the office to be productive."

To give one example, one area that we have struggled with a bit in recent months is some of our helplines. That is because once we had the technology sorted to send calls homes, we have colleagues who simply cannot take confidential customer calls at home, because they do not have a confidential space in their home where they can take those calls. Up until recently, we allowed those colleagues to be at home all the time; now we say, "You need to come to the office on the days when you are scheduled to be on the helpline."

Q57 **Chair:** Given that you only have capacity for around 30% and you had this huge programme of closing small offices and opening huge big ones, does this put a question mark over that programme, which is almost fully delivered?

Jim Harra: I don't believe it does. We remain committed to our programme of having large regional centres. However, it does call into question some of the policies we have had towards flexible working. In the recent voluntary redundancy scheme we have operated as we close some offices, which applied to about 3,300 staff, we have offered greater flexibility to those who wish to stay on in the organisation than we previously would. For example, we recently agreed in principle that currently around 600 colleagues can have flexibility ranging right up to permanent home working as an alternative to them taking redundancy, because they are unable to reach the regional centre. We are also doing some work, to complete by February, on our longer-term strategy for how we can combine regional centres with more flexible working, learning the lessons from the past few months and leveraging the technology investments we have made recently.

Chair: Perhaps you could write to us with what you are doing to ensure that no staff are disadvantaged because of their health or family needs. There is some evidence that suggests that there could be quite a big equalities issue as people who are carers, for example, are at home caring and working, because it is easier in one way, but it could inhibit their professional development. Rather than get into that now, which is a bit off the subject of this debate, perhaps you could write to us to tell us how you are supporting staff so that we do not see inequality built in as a co-product of this way of working. If you agree to that—I think that is a nod—I will move on to Richard Holden MP, who has some quick-fire questions, and then back to Mr Mackinlay.

Q58 **Mr Holden:** Moving quickly into the final section about your future approach to tackling the tax gap, I know Mr Mackinlay and Ms Olney have been pushing you on this with their questions, but your strategy now seems to be very much along the lines of promoting compliance and preventing non-compliance, rather than going after people. Is that going to be an increasing thing because of the lack of staff in the office that do that work, given covid? Do you think it is going to be the right approach when we are seeing, across the board, such huge amounts of public money going out of the door at the moment?

Jim Harra: Our strategy for managing compliance is promote, prevent and respond. In other words, upstream activity encourages people to get it right or prevents them from getting it wrong, and downstream activity tackles those who have got it wrong. What you are seeing is an emphasis on promote and prevent, because traditionally we have been an organisation that has poured a lot of resources into respond, and therefore there needs to be a rebalancing of that.

Downstream investigation will always, I believe, be a part of the business. We want that to be targeted at fraud and abuse, and end activity that needs "respond" when people get it wrong because they have made a mistake. Increasingly, we want to design our systems to prevent mistakes happening in the first place. All three aspects are part of the future, but increasingly we will be investing in the upstream element, which we have done less on in the past.

Q59 **Mr Holden:** To press you a touch further before I start moving on to some of my quick questions, you have obviously shifted resources substantially and covid is making that something that now, with only a third of your staff in, is—*[Inaudible.]*

Chair: Mr Holden, your sound is poor. I think we knew that at the beginning, but if you could speak a little slower, we will hear you more clearly.

Mr Holden: Sorry about that. Given your shift away from your traditional role, which is the respond element, to what extent do you think that will adversely affect the tax gap now, or do you think that it is all upside?

Jim Harra: I will be extremely disappointed if it does adversely affect the tax gap because our whole aim is to keep driving the tax gap down. As I mentioned earlier in relation to small businesses, which make up 43% of that tax gap, a respond approach, which has been our approach for probably a century, has limited impact. We want to have more impact, so our whole strategy is about not having an adverse effect on the tax gap, but about having a better effect. We will, of course, test that that is what we are achieving, but it is not just a UK tax authority approach but what we are seeing leading tax authorities doing internationally.

Q60 **Mr Holden:** That takes me on to the next question about the comprehensive taxpayer strategy, which has been informed by lots of international work. Where are we on those comprehensive taxpayer strategies that were due in autumn 2020, Ms Ciniewicz?

Penny Ciniewicz: The taxpayer strategies are published by the strategy unit and not by the customer compliance group, but work is ongoing on a number of them. Obviously, we have had a large business strategy for around 10 years, so that is a strategy that we are refreshing. The plan, I believe, is still to publish those this autumn.

Q61 **Mr Holden:** I have two further quick questions, the first of which relates to cash. Due to covid, there has obviously been a shift in cash use in the economy. What changes do you think this will make to your compliance levels? Will it help? Will it hinder? What about the impact on some of the small businesses?

Jim Harra: Traditionally, cash-based businesses have been among the highest-risk businesses, for obvious reasons. As a tax administrator, the move away from cash towards more secure payment should help us. However, we understand that cash is important for wider societal reasons, and therefore we are always going to need to work with it. It remains to be seen whether, post-covid, people go back, or whether the sort of practices that we now have become embedded, but both in terms of receiving data about how money moves—whatever it is—a move away from cash can help us to manage the tax gap. Certainly, large handling of cash can often be a really suspicious thing from the tax point of view.

Q62 **Mr Holden:** Obviously, the other big thing which is happening at the moment is Brexit. What impacts are you expecting to see in terms of tax gap—particularly around duties—regarding when we do leave the EU and the transition period, early next year?

Jim Harra: Well, EU exit will bring in some new accountabilities that people will need to comply with. As you mention, there could be duties payable on goods imported to the UK from the EU, where previously there wouldn't be. There will also be new ways of administering and accounting for VAT, and we will need to understand the extent to which those create new or different risks that we need to manage. The duty gap will depend on what UK tariff policy is and what kind of free trade agreement we might have with the EU; and obviously we wait to see what that is.

I think initially our focus will be on helping people to get ready to comply with the new obligations, rather than worrying about a new tax gap, but over time that's something that we will need to track. I don't think the impact is very substantial. I think much of the tax system will be as it currently is, and the risks will be very similar to what they currently are.

One area where we are able to make progress when we leave the EU is in relation to VAT on online sales, where our policy in tackling that has been constrained to some extent in the past by EU VAT law. The Government has already announced that after the transition period ends the UK will move fast, and certainly faster than the EU, to introduce new, more secure, rules for preventing VAT evasion on online sales.

Q63 **Mr Holden:** Just on that specific thing, Mr Harra, what upside in terms of revenues are you hoping to see from those changes in VAT?

Jim Harra: I can't remember precisely what it is. I am pretty sure that we will have published a figure for the additional yield that we expect to get from that, so I will write to you if I may.

Mr Holden: Thank you very much.

Chair: Thank you very much, Mr Holden. And thank you to anyone bearing with us on the sound. That is a technical problem we have been struggling with this afternoon. Over to Craig Mackinlay now, on his pet topic, and ours—Making Tax Digital. Over to you, Mr Mackinlay, but keep it to questions, please, because of the time. I know you have got a lot to say about this.

Q64 **Craig Mackinlay:** Let's lead this to a conclusion. First, I think to Ms Ciniewicz, and also to Ms Russell, who has been waiting ever so patiently—I hope to get you in on this one. The big elephant in the room, as I said at the start, was legal uncertainty. We have addressed all sorts of things—how we are going to nudge people in the right way, and all those good things; but we are not really addressing the complication of tax law. Now, we love having tables of figures and statistics when we go through these papers. Let's just go through one that particularly was in my mind over the last year or so. It is the Silver case on the single premium investment bonds, where Parliament came up with this legislation—well, it didn't, obviously; the Treasury came up with it and we meekly and compliantly nodded it through. Where does that change in interpretation hit your figures? Does it become a negative in this year on compliance yield, or does it become a restatement of prior years' tax gap? Where do things like that hit these figures? The figures are really important when we are looking at trends of your performance.

Penny Ciniewicz: Compliance yield would register when a case was settled. So if the case has yet to be settled it will not have been included in our compliance yield figures. In terms of tax gap, if a case is settled in a particular way and it is of a really significant size, clearly it can affect the tax gap, depending on the scale of it; but obviously it would have to be quite significant.

Q65 **Craig Mackinlay:** What I am asking is when you lose does it make a negative on your tax yield for the year in question?

Penny Ciniewicz: We would not have counted that yield unless we had settled the case. We would not have settled the case at that point, so it is not a minus because it is not in the compliance yield at that point.

Craig Mackinlay: It never appears.

Penny Ciniewicz: Yes.

Q66 **Craig Mackinlay:** Let’s go to what everyone seems to be hanging their hat on as the panacea for the future: Making Tax Digital. It has already been implemented for VAT, which has probably helped computational errors when people are transposing from their manual or computer systems on to the HMRC screens in order to give their VAT return over to you. Beyond that, I am really struggling to think how this will help. I am afraid I must give you an example. You have a jobbing builder, who turns up at his accountant’s once a year with his bag full of bits and pieces. He has probably lost half of them out of his window over the course of the year, so what he is presenting to his accountant is not enough expenses. Forcing him into that digital world, where he might take the photocopy of his bill as he goes to the plumbers, could actually be detrimental. I can see no gain whatsoever. If he is tempted to do cash jobs because he is near the VAT threshold and does not want to go over it and enter that world of VAT, Making Tax Digital will make no difference whatsoever. What are your comments on that?

Jim Harra: First, I would agree that these phases of Making Tax Digital are not aimed at tackling evasion by small businesses; they are aimed at tackling about a third of the small business tax gap, which is attributable to straightforward error and failure to take reasonable care, including failure to keep good records. Different solutions are required for the direct evasion of the kind you describe. On the other hand, if Making Tax Digital results in people keeping better records of their allowable expenses, which results in their paying less tax, that is a positive thing from our point of view. It is actually taken into account in the scoring of the Making Tax Digital figures. The Office for Budget Responsibility, which is independent of HMRC, has validated our estimates for the extent to which making tax digital for VAT will reduce the error and failure to take reasonable care gap in VAT.

We also published a document on 21 July that describes what other steps you might take in a tax administration strategy to tackle areas of the tax gap. You can in the future build on Making Tax Digital to tackle other parts of the tax gap—for example, by building risking and nudges and prompts into the software, where you believe people are doing things that they ought not to do. That is clearly not in the initial phase; the initial phase is to roll it out to everyone and to get those early benefits. But those early benefits are focused on error and failure to take reasonable care, not on cash in the back pocket.

Q67 **Craig Mackinlay:** Let’s carry on with this, because the idea is to roll this out in time to a lot of taxpayers—nearly all of them. You have, say, the retired taxpayer. He is in receipt of a pension and has a rental property. He will probably have a professional adviser, or he might just be able to cope with doing it himself online. I do not understand how Making Tax Digital will get him to pay the right amount of tax or pay any more. I fail to see the link between Making Tax Digital, more receipts and getting rid of the tax gap for a lot of taxpayers, but we are rolling it out everywhere.

Jim Harra: What the Government has announced is that it will extend Making Tax Digital to all VAT payers and then to self-assessment taxpayers in small businesses and to landlords with income over £10,000. I don't know whether that would catch your example of the pensioner.

Q68 **Craig Mackinlay:** It would.

Jim Harra: The fact is that we see significant non-compliance in that sector by buy-to-let landlords. Penny and her people deploy quite a lot of resource on chasing that. Making Tax Digital will require people to keep records that automatically generate a filing to HMRC and will reduce the opportunity for them to make a mistake that underreports their income to us.

Q69 **Craig Mackinlay:** It would seem to me, with the diminishing amount of hands-on proper audit—deploying people out to the field to do PAYE investigations as in the good old days as they were—you are going to be very much algorithm driven. It has been in chrysalis, in real or imagined form, for a very long time, where for a taxpayer in a particular industry it will come up with the golden figure or range of, "You are expecting this amount of profit and this amount of expenses." Is that really what we are aiming towards in this whole new world, where hopefully the computer says ping and these 100 people are worth looking at this year, thank you very much?

Jim Harra: What we are aiming for in Making Tax Digital is improved record keeping and improved accuracy of filing, and hopefully other benefits for businesses as well as for HMRC. That will reduce the need for us to deploy resources on tackling that part of the tax gap and free those resources up to do more on the abusive end of the tax gap, on deliberate evasion and avoidance. We use very sophisticated data analytics to zone in on who those people are and to risk assess them. We do not necessarily use algorithms and ping—there is a lot of it—but Penny has a whole directorate of people whose job it is to run analytics on all the data that we have and to identify those cases that require intervention. In the future, I want less of that resource to be deployed downstream, fixing simple errors and carelessness, and more of it deployed on tackling serious evasion and avoidance.

Craig Mackinlay: I would just finalise my opening remarks; I honestly believe that, because we are into the Donald Rumsfeld "unknown unknowns", the underground economy is significantly higher than you anticipate. I would hugely recommend, given the rewards of at least £7 back for every £1 spent, if not more, that you make a plea—I will back that plea up on your behalf—that you need more staff to get rid of the underground economy and all the foulness that goes with it. I think that would be money well spent and I would recommend that you put that application to the Treasury.

Chair: There you go. I think Beth Russell from the Treasury has heard that point, so you have a champion in Mr Mackinlay and the Public Accounts Committee to help to tackle the tax gap.

Thank you very much indeed, all of you, for your time. We look forward to receiving information particularly about how staff are supported. You are a very big organisation, one of the last command and control organisations in Whitehall, with the DWP, in that you employ nearly everybody who works for you directly, so you are quite a good case study for how home working is working for people, and the negative as well as positive impacts. We hear a lot about the positive and we hear a lot about the negative impacts on city centres, but we do not hear about some of the more nuanced issues, so it will be very interesting to see what you are doing on that. I think Whitehall will be looking to you, Mr Harra, and how you are dealing with that.

Thank you to our members, our witnesses and the National Audit Office. The report on this will come out in the next few weeks.