MFP0001

Written evidence submitted by TaxWatch

1. TaxWatch is a UK charity dedicated to compliance and sound administration of the law in the field of taxation. We conduct forensic research and analysis on tax avoidance, tax policy, and tax law, publishing our research to improve public understanding of tax issues. Through our work we seek to encourage high standards of tax conduct and civic responsibility.

Executive Summary

2. Her Majesty's Revenue and Customs carry out a vital role in administering and enforcing the tax system, and with limited resources. The aim of this submission is is to provide an independent analysis of certain aspects of tax compliance.
3. The timings of Brexit coupled with the pandemic has resulted in tax administration in the UK facing a difficult task without equal in modern times, highlighting how under-resourced HMRC is. The impact of the stress of the past few years could cause long term damage to the tax administration if government does not invest significantly more funds in tackling non-compliance.
4. In this report we highlight issues around the clarity of what is meant by tax simplification, a task made more difficult following the disbandment of the Office of Tax Simplification.
5. With returns on investment averaging 18:1, the government has serious questions to answer as to why more money isn't invested in HMRC. Adequate resourcing would not only allow for more staff to tackle the tax gap, but would allow for an increase in training to ensure that existing staff are more efficient.
6. Only 26% of compliance projects were evaluated in the three years to January 2022. An increase in resourcing would allow for further evaluation, ultimately culminating in increased effectiveness.
7. The relationship between HMRC and professional bodies is unclear. While HMRC does make disclosures to these bodies, the number is relatively small, and the effect is currently unknown.
8. The current course of action, including the naming and shaming of promoters of tax avoidance, is not having the desired effect. HMRC estimate 31,000 individuals used marketed tax avoidance schemes in 2020-2021. We believe criminal prosecutions would act as a serious deterrent for those who seek to promote these schemes.

Recommendations

9. The government should provide clarity about what it means when it says "simplifying the tax code" and define the steps to be taken by HMRC and the Treasury to achieve this.

10. Given the positive return on investment, planning and funding for HMRC should be long term. HMRC should be given an increase in funding for compliance activity and put in place long term resource planning to ensure appropriately skilled and trained staff are available to provide a robust compliance response.

11. HMRC should include a programme of evaluation as part of the introduction of all new legislation and compliance projects.

12. HMRC should work more closely with professional bodies, increase the amount of referrals, and publicise the results. HMRC should also consider what other action they can take against unregulated advisers who cause compliance problems.

13. An evaluation should be conducted as to the effect of 'naming and shaming' promoters. HMRC should consider the use of criminal powers to prosecute the promoters of tax avoidance schemes.

Introduction

14. Managing tax compliance by definition must be focused on tackling the tax gap, the difference between the tax due and the tax collected.

15. HMRC compliance is divided into two main streams – upstream which attempts to prevent non-compliance before it happens, and downstream which covers interventions to identify and rectify non-compliance after it has taken place.

16. HMRC has quite appropriately increased its focus on upstream compliance in recent years which is more efficient than traditional enquiry work.

17. This report focuses on different areas which will affect both of these aspects of compliance.

Simplification

18. Much has been written about the complexity of the tax system, both in legal and administrative terms. Though possibly not strictly tax compliance, simplification of both would result in fewer errors and opportunities for fraud thereby reducing the tax gap. However, the goal of a simplified tax system seems to be moving further away with the closure of the Office for Tax Simplification (OTS). The tax professions widely criticised this decision as a retrograde step even though the organisations more radical proposals were generally rejected by the government, as it still performed a vital function by consulting with professions and affected groups and simplifying processes and administration.[1]

19. The Growth Plan 2022 in which the closure was announced stated that the government was going to "set a mandate to the Treasury and HMRC to focus on simplifying the tax code."[2] It is

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[1] OTS abolition hugely disappointing, says CIOT, *CIOT*, 23 September 2022, https://www.tax.org.uk/ots_abolition_disappointing

[2] The Growth Plan, *HM Treasury*, September 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1105989/CCS207_C

not clear what this means in practice but it is important that these requirements are put in place and that there are sufficient skilled resources provided to HMRC and the Treasury in order for this to actioned.

20. **Recommendation**: The government should provide clarity about what it means when it says "simplifying the tax code" and define the steps to be taken by HMRC and the Treasury to achieve this.

Staffing

21. Successful upstream and downstream compliance activity both rely on HMRC having sufficient appropriately trained and experienced staff.

22. The December 2022 NAO report, Managing Tax Compliance Following The Pandemic, looks at numbers of compliance staff and the plans for recruitment and training. However, the report does not look at the grades and technical ability of staff involved in compliance. Tax legislation and investigation requirements are highly complex and require a broad range of tax technical knowledge alongside the ability to project manage, form professional relationships externally and understand governance rules.

23. The Institute for Government has recently identified from ONS statistics that between March 2016 and March 2022 there has been a reduction of 8,160 Full Time Equivalent (FTE) staff working within the tax profession in the civil service.[3] This change is even more stark when their analysis shows it to be the greatest reduction in numbers across any of the civil service professions with the majority of professions having increased their numbers since 2016. In particular policy professionals have increased by over 15,000.

24. It is known that the recent move to a small number of centralised hubs from a much greater distribution of smaller offices has resulted in a loss of experienced staff who were not within reasonable travelling time of one of the new offices.[4] The PCS union estimated that HMRC had lost 17,000 years of staff experience through staff departures due to the move to large hubs, which was before a further round of redundancies in 2020.[5] HMRC's Annual Report and Accounts for 2021-22 states that 4,200 FTE staff were recruited to compliance in that year, who are expected to complete their training in 2022-23, and even then it will be some years before they will accrue the experience of the staff that have been lost.

25. However, the short length of the training programme for these new recruits indicates that these are not fully trained tax professionals. The internal tax professional training programme has changed regularly over recent decades, with HMRC now having a degree level training

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[3]Civil Service Staff Numbers, *Institute for Government,* 15 December 2017, https://www.instituteforgovernment.org.uk/explainers/civil-service-staff-numbers

[4]HMRC launches redundancy scheme as remote-working review goes on, *Public Technology,* 25 June 2020, https://www.publictechnology.net/articles/news/hmrc-launches-redundancy-scheme-remote-working-review-goes

[5]HMRC launches redundancy scheme as remote-working review goes on, *Public Technology,* 25 June 2020, https://www.publictechnology.net/articles/news/hmrc-launches-redundancy-scheme-remote-working-review-goes

programme for its most senior tax professionals. However, only a proportion of compliance staff are trained to this level. It is difficult to identify how many fully trained tax professionals are involved in tax compliance within the department. The Annual Report and Accounts for 2020-21 said that 187 joined the tax professional programme and 137 successfully completed it, but the Report for 2021-22 does not provide these figures.

26. Lack of judgement and appropriate skills amongst some HMRC staff has been highlighted by a number of recent tribunal cases. The case of Sintra and Malde v HMRC involving £25m of assessments relating to alcohol fraud was lost on all points by HMRC.[6] While many officers were described as credible and helpful, a number of HMRC officers were criticised by the judge for their lack of knowledge and failure to assist the tribunal. HMRC officers appeared to not understand the difference between a corporate entity and its shareholders. The tribunal judge used the terms "evasive", "obstructive" and "misleading" to describe some of the HMRC witnesses. The judge also indicated that with a 'less myopic' approach to the case by HMRC, the tribunal may have reached a completely different decision, suggesting that the failure to be objective during the investigation may have ultimately resulted in a significant loss of tax.

27. In a recent VAT case (TC08660), the judge found that the approach to arriving at figures for assessment the officers had not considered all information, used flawed arithmetic, and relied on unrepresentative sampling. The officer also did not consider whether the alleged underdeclared income was credible in light of other information.

28. While complex investigations will almost certainly have some aspects that are not dealt with perfectly, the fact that cases such as these were so flawed raises questions about the skill level of some HMRC compliance officers. It also raises concerns about the processes involved in taking such a case to tribunal which should have identified those flaws prior to them being exposed before a judge.

29. More broadly, the statutory review process for dealing with disputes provides for an objective review of an HMRC officer's decision by a technical specialist not involved in the original case. This is an efficient way of resolving disputes without going to tribunal but in 2021-22 almost a quarter of original decisions (23%) were varied or cancelled, which again suggests a skills problem amongst HMRC officers.

30. In addition, the Tax Settlement Assurance Programme has existed since 2013 to review a sample of settled enquiry cases to check that they comply with quality standards which includes following adherence to internal guidance and governance of decisions. The percentage of cases that fully complied with standards fell from 36% to 29% between 2020-21 and 2021-22, ie. 71% of cases failed to comply with at least one standard.[7] 37% of those cases that fell short

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[6] Sintra Global Inc and Parul Malde vs HMRC, *First-Tier Tribunal,* 05 October 2022, https://www.lincolnhousechambers.com/wp-content/uploads/2022/10/Decision-TC-2015-04972-Others-Sintra-Global-Parul-Malde-05.10.22.pdf

[7] HMRC Annual Report and Accounts 2021 to 2022, *HMRC*, July 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1125182/HMRC_Annual_Report_and_Accounts_2021_to_2022_Print.pdf P118

only failed on one standard, which may not have a significant impact, but if extrapolated to the total number of enquiry cases it suggests a very large number of cases do not comply with the department's full quality standards. This points to a lack of knowledge/training/experience among compliance staff, but also a lack of case supervision by more senior offices who should be monitoring and correcting problems during ongoing enquiry cases.

31. In recent years, performance and promotion within HMRC (as across the whole civil service) has been competence-based. This has been identified as favouring generalist rather than specialist staff, taking the focus away from professional qualifications, skills and experience and potentially resulting in some of the problems identified above.[8] It is good to know that there has been relatively recent recognition of a lack of confidence in this approach and a new system introduced, which also considers track record and technical ability, but it is vital that this new system really recognises and supports those people who are skilled in conducting complex tax compliance.[9]

32. Recent announcements for funding tax compliance have fallen well short of amounts invested in DWP for benefits compliance.[10] The return on investment from tax compliance activity is significantly greater than from benefit fraud but in recent years DWP have received greater funding pots.

33. Consistent long term funding and resource planning, focusing on appropriate tax professional skills, is required to ensure a robust compliance resource is available. Evidence from various reviews, e.g. Covid scheme compliance[11], has identified the problems with one off funding pots for compliance which fail to take into account recruitment and training requirements for staff to carry out such work. When the return on investment in tax compliance is always reported to be positive (varying across customer sector but ranging from 6.3:1 for individuals to 60:1 for large business in 2021/22)[12] it is counter productive to rely on short term funding which impedes planning for necessary recruitment and training to produce a reliable compliance resource. Consistent investment would also put the department in a better position to deal with another shock such as the pandemic or the UK's exit from the European Union.

34. **Recommendation:** Given the positive return on investment, planning and funding for HMRC should be long term. HMRC should be given an increase in funding for compliance activity and put in place long term resource planning to ensure appropriately skilled and trained staff are available to provide a robust compliance response.

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[8]Name-blind recruitment – a commitment to diversity, *Civil Service,* 05 November 2015, https://civilservice.blog.gov.uk/2015/11/05/name-blind-recruitment-a-commitment-to-diversity/

[9]Launching the 10th annual Civil Service People Survey, *Civil Service,* 01 October 2018, https://civilservice.blog.gov.uk/2018/10/01/launching-the-10th-annual-civil-service-people-survey/

[10]Opportunities missed – Autumn Statement 2022, *TaxWatch*, 17 November 2022, https://www.taxwatchuk.org/autumn_statement_2022/

[11]Funding of Taxpayer Protection Taskforce raises serious issues, *TaxWatch*, 14 November 2022, https://www.taxwatchuk.org/taxpayer_protection/

[12]HMRC Annual Report and Accounts 2021 to 2022, *HMRC*, July 2022, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1125182/HMRC_Annual_Report_and_Accounts_2021_to_2022_Print.pdf

Evaluation

35. Regular evaluation of aspects of tax administration and compliance would assist with both upstream and downstream activity.

36. From an upstream perspective, evaluation of the outcomes of new, significant pieces of tax legislation, at an appropriate point after introduction, would allow lessons to be learned about design of legislation, guidance and administration along with other more innate compliance risks within different types of legislation. One obvious area being any types of reliefs which results in repayments, which are clearly targets for abuse by both organised crime groups and lower level high volume advisers who seek to push or exceed the boundaries of legislation promoting reliefs to a large number of potential clients. This has particularly been seen in the area of R&D reliefs.

37. Evaluation is also appropriate for downstream compliance. The NAO report, Managing Tax Compliance Following The Pandemic, identified that only 26% of compliance projects were evaluated in the three years to January 2022. While the report suggests HMRC were aware that this activity had reduced during the pandemic and are intending to design evaluation into future projects, this would seem to be a fundamental requirement for understanding the success and value for money of specific compliance activity. For example, TaxWatch analysis of statistics for recovery of amounts incorrectly paid out under the Covid protection schemes shows that the staff moved to work on the Taxpayer Protection Taskforce actually produced lower compliance yield than if they had stayed in their original teams.[13]

38. In addition, HMRC often receives funding in one-off pots to deal with particular identified compliance challenges with a fixed investment anticipated to produce a given compliance yield. These are often described as 'spend to raise' projects. A failure to fully evaluate the progress and outcome of these means that lessons are not being learned about different approaches to compliance and results in there being little evidence to support future funding.

39. **Recommendation:** HMRC should include a programme of evaluation as part of the introduction of all new legislation and compliance projects.

Tax Advisers

40. The activity of tax advisors can have a significant impact on tax compliance both upstream and downstream.

41. HMRC estimates that only 63% of tax agents – financial agents who personally deal with HMRC on behalf of clients – are members of professional bodies[14] but research indicates that

[13] Funding of Taxpayer Protection Taskforce raises serious issues, *TaxWatch*, 14 November 2022, https://www.taxwatchuk.org/taxpayer_protection/

[14] Individuals, Small Business and Agents – Customer Survey 2019, *HMRC*, November 2020, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/933105/HMRC_research_report_585_ISBA_customer_survey_2019.pdf

more than 80% of unregulated advisors have no tax professional qualification[15]. However, most taxpayers assume, incorrectly, that the tax advice market is regulated[16] and years later some face unexpected tax demands and penalties, but have little recourse against those who gave the bad advice. This is likely to continue given HMRC estimate[17] approximately 31,000 individuals used a tax avoidance scheme in 2020-21.

42. In general, unregulated and unqualified advisors risk more errors in returns or worse deliberately incorrect submissions which require greater scrutiny by HMRC and result in more difficult compliance enquiries. The fact there are significant number of unqualified and unregulated advisors operating in the field has given rise to a number of concerning situations in recent years.

43. For example, recent reviews of research and development tax reliefs have identified poor practice among agents specialising in making claims for these reliefs . Concerns derive from tax claim 'specialists' who; advertise 100% success rate on claims, cold call businesses to persuade them to make claims, and propose firms make claims for expenditure that clearly does not comply with the definition of R&D. One result is the cost of this tax allowance to the government has far exceeded the original forecasts. Most of these 'specialists' are not members of professional bodies and do not appear to have been systematically tackled by HMRC. Changes to R&D legislation and information requirements will result in HMRC receiving more information about such advisers in the future but not for around another two years. More recently, HMRC opened a consultation[18] on 'high volume repayment advisers' i.e. those who make claims for relatively small refunds in relation to certain expenses on behalf of taxpayers. The initial concern stems from reports that a large proportion of the taxpayer's refund is going to the agent in fees, often directly and without the client's knowledge.[19] An example given in the consultation is 'work from home' repayment claims that multiplied during the pandemic.

44. HMRC does some work to tackle problems arising with advisers. Its *Standard for Agents* clarifies what is expected of advisors, particularly those who are not members of professional bodies.[20] It has an Agent Compliance Team that attempts to engage with agents where there are

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[15] Understanding the characteristics of unaffiliated tax agents, *HMRC*, November 2021, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1037031/Understanding_the_characteristics_of_unaffiliated_tax_agents.pdf

[16] Raising standards in the tax advice market, *HMRC,* November 2020, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/934614/Raising_standards_in_the_tax_advice_market_-_summary_of_responses_and_next_steps.pdf

[17] Use of markets tax avoidance schemss in the UK (2020 to 2021), *HMRC*, 30 November 2022, https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2020-to-2021

[18] Raising standards in tax advice: protecting customers claiming tax repayments, *HMRC*, 11 January 2023, https://www.gov.uk/government/consultations/raising-standards-in-tax-advice-protecting-customers-claiming-tax-repayments/raising-standards-in-tax-advice-protecting-customers-claiming-tax-repayments

[19] High Volume Repayment Agents, *Low Income Tax Reform Group,* 14 September 2022, https://www.litrg.org.uk/latest-news/submissions/220914-high-volume-repayment-agents

[20] HMRC standard for agents, *HMRC,* 11 January 2023, https://www.gov.uk/government/publications/hmrc-the-standard-

concerns about their practices. The government has also allowed HMRC to ‘name and shame’ promoters of tax avoidance schemes after certain criteria have been met.

45. Two-out of-three tax advisors are also bound by the rules of a professional body and the Professional Conduct in Relation to Taxation (PCRT). HMRC endorses this code and discloses cases of suspected regulated agent misconduct and bad practice to professional bodies for their consideration. The scale of public interest disclosures to professional bodies in recent years is revealed in the following table:[21]

46. Number of Disclosures:

Year	Accounting	Tax Advisers
2018-19	11	4
2019-20	9	7
2020-21	10	12
2021-22	15	7

47. While it is good to see that HMRC have taken action in some cases, the numbers appear relatively small and it is not known what the outcome of such referrals have been.

48. Despite these approaches, it is clear from the examples above that some advisers are still responsible for a number of compliance problems. Greater efforts by HMRC to tackle them, and possibly the granting of stronger powers to HMRC to do so, could improve both upstream and downstream compliance results.

49. **Recommendation:** HMRC should work more closely with professional bodies, increase the amount of referrals, and publicise the results. HMRC should also consider what other action they can take against unregulated advisers who cause compliance problems.

Deterrent Effect

50. Alongside any upstream improvement in design and processes which result in reductions in errors, it is important that compliance activity by HMRC also provides sufficient deterrent against knowingly taking part in avoidance and fraud.

51. While HMRC has made some attempts to increase the deterrent effect in relation to taking part in tax avoidance or evasion, such as publishing names of avoidance scheme promoters and deliberate defaulters there is little evidence that this has much of an impact. It is highly unlikely that ordinary members of the public will be aware of these lists so they are generally only of use within the profession and are unlikely to have a significant impact on reputation or business. In addition, there still appear to be a consistent number of businesses promoting disguised remuneration (DR) avoidance schemes despite many being ‘named and shamed’, so this does not appear to have had the required deterrent effect. HMRC estimate approximately 31,000 individuals used a tax avoidance scheme in 2020-21. While the former figure is

for-agents/hmrc-the-standard-for-agents

[21]HMRC’s reply to Freedom of Information request (FOI2022/72035) dated 5/12/22

significantly less than the 44,000 individuals estimated to have used such schemes in 2017-18, it is more than the 28,000 involved in 2016-17 [22], and the number of organisations involved in the marketing of disguised remuneration schemes has not fallen in the last few years. In each of its three annual reports on the use of marketed tax avoidance schemes, HMRC suggested about 20-30 promoter organisations were behind most of the tax avoidance schemes marketed to the UK public, and while some of them leave or significantly reduce their activity, new promoters have not been deterred from joining the tax avoidance market[23].

52. Similarly, official figures suggests the number of non-compliant umbrella companies involved in the operation of disguised remuneration avoidance schemes has not decreased. HMRC estimate[24] 70-80 existed in 2020-21, a range that shows no improvement on the 60-80 non-compliant umbrella companies it estimated operated in the previous year.

53. A recent large penalty case (Hyrax) may well have caused concern to some promoters but it will depend how much they have made in fees and how well that has been publicised in the market.

54. There is increasing evidence that HMRC needs to take a more robust approach to tax fraud.

55. As a matter of law, HMRC has complete discretion to deal with tax fraud by criminal prosecution or by civil litigation or contract settlement; and in civil litigation it is up to HMRC to decide whether to plead fraud at all, regardless of the facts of the case.

56. We believe that this means that HMRC does not pursue cases as tax fraud, even when the facts of the case clearly suggest fraud has taken place.

57. HMRC rarely brings cases of complex tax avoidance by large corporates to court. It has never brought criminal charges against companies or their advisers for dishonest implementation of complex tax avoidance schemes.

58. Evidence emerging from the loan charge scandal suggests an abundance of dishonest behaviour on the part of tax advisors marketing tax avoidance schemes.

59. Many other countries are far less reticent to tackle tax avoidance as a matter of fraud than the UK.

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[22] Use of marketed tax avoidance schemes in the UK (2020 to 2021), *HMRC*, 30 November 2022, https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2020-to-2021

[23] Use of marketed tax avoidance schemes in the UK (2018 to 2019), *HMRC*, 30 November 2022, https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk , Use of marketed tax avoidance schemes in the UK (2019 to 2020), *HMRC*, 30 November 2022, https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2019-to-2020 , Use of marketed tax avoidance schemes in the UK (2020 to 2021), *HMRC*, 30 November 2022, https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2020-to-2021

[24] Use of marketed tax avoidance schemes in the UK (2020 to 2021), *HMRC*, 30 November 2022 https://www.gov.uk/government/publications/use-of-marketed-tax-avoidance-schemes-in-the-uk/use-of-marketed-tax-avoidance-schemes-in-the-uk-2020-to-2021

60. In the US, the IRS has brought criminal charges against major accountancy firms for devising and marketing tax avoidance schemes.[25]

61. We believe that there is scope for HMRC to pursue a much more robust approach to the detection and prosecution of tax fraud, which would reap dividends in terms of promoting levels of compliance.

62. A recent report compiled by TaxWatch and the APPG on Anti-Corruption and Responsible Tax makes a case for prosecution of promoters of avoidance to act as a deterrent and to reasonably punish the people who are often more culpable than the individual participants.[26] While scheme participants might be expected to be wary of arrangements that sound too good to be true, they are generally told by scheme promoters that the arrangements produce the required tax outcome and are often supported by QC (or now KC) advice. However, that advice is usually generic, based on an ideal series of transactions, which are often not enacted in the prescribed way. In addition, the paper transactions are often intended to create an economic fiction, e.g. an indefinite loan from a trust receiving contributions from the employer is not employment income. It seems likely that these representations would be found to be dishonest by a jury.

63. Overall, greater consideration of actions that will increase the deterrent effect would go some way to reducing the tax gap.

64. **Recommendation:** An evaluation should be conducted as to the effect of 'naming and shaming' promoters. HMRC should consider the use of criminal powers to prosecute the promoters of tax avoidance schemes.

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[25]See for example the US Justice Department's criminal prosecution of KPMG for marketing tax avoidance schemes, Department of Justice, KPMG to Pay $456 Million for Criminal Violations in Relation to Largest-Ever Tax Shelter Fraud Case, https://www.justice.gov/archive/opa/pr/2005/August/05_ag_433.html

[26]Cross-party MPs call time on feeble approach to tax avoidance and urge HMRC to prosecute tax fraudsters, *TaxWatch*, 27 October 2022, https://www.taxwatchuk.org/tax_fraud_event_appg/