

## Written evidence submitted by TaxWatch

### Summary

1. HMRC's latest published accounts cover an extraordinary period for the Department. The United Kingdom left the European Union at the end of January 2021, just as Covid-19 was beginning to spread around the world.
2. Brexit saw the UK leave the EU Customs Union, the Single Market, and the VAT area. This has required the creation of an entire new system of customs and border checks for the UK, costing at least £1bn and needing to be administered by HMRC.<sup>1</sup> In normal times this alone would have presented an enormous technical and administrative challenge for HMRC. That work continues with the UK Government phasing in border controls on imported goods over 2021 and 2022.
3. If that were not enough for HMRC to deal with, shortly after leaving the EU, in response to the pandemic, the UK entered a lockdown, with all but essential workers either furloughed or told to work from home. HMRC officers had to adapt to home work and the courts system was placed on a temporary hiatus, causing a significant backlog.
4. In order to support the economy at this difficult time, the government introduced several schemes to provide cash to people who could not work. This included the Coronavirus Job Retention Scheme, commonly known as furlough, and the Self Employment Income Support Scheme. Both administered by HMRC. This was an enormous piece of work for the department which necessarily diverted huge resources from other areas. In addition to that, other schemes such as VAT deferral scheme also impacted on HMRC's work.
5. 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. With this in mind there is no surprise that the performance data for HMRC seems relatively poor when compared to previous years.
6. However, the pandemic is far from over for HMRC. The need to divert resources during the pandemic has led to a significant backlog of cases. New schemes introduced by the government were themselves the subject of significant attack by fraudsters, which will need to be recovered.
7. HMRC's resources were significantly stretched before the pandemic, without significant additional investment it is likely that the department will struggle to recover for the next

<sup>1</sup> Spending Review 2020, HM Treasury, 15 December 2020, <https://www.gov.uk/government/publications/spending-review-2020-documents/spending-review-2020>

several years, risking long term damage to the performance of HMRC, as well as a deterioration in tax enforcement which will send completely the wrong message to the public.

8. TaxWatch invites the committee to explore the following questions with HMRC.
- ❑ **Should HMRC be required to produce an annual estimate of losses to tax fraud alongside its Tax Gap publication?**
  - ❑ **Is the balance of HMRC's criminal investigation policy appropriate, particularly in view of the very substantial amount of fraudulent claims on Covid related support schemes?**
  - ❑ **Why does HMRC management not collect data on the number of audits of tax returns completed by HMRC staff?**
  - ❑ **How can HMRC improve the number of civil and criminal fraud investigations in the near term**
  - ❑ **Is it reasonable for HMRC to only recover 50% of the amount of money stolen from or paid out in error from Covid related support schemes?**
  - ❑ **Should HMRC be decreasing the amount spent on compliance activity at this time?**



## About TaxWatch

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

## The “Tax Gap” and the amount of tax lost to fraud

12. HMRC’s “Tax Gap” analysis is a broad measure of tax losses though all types of taxpayer behaviour ranging from honest mistakes to criminal attacks. HMRC does not publish any estimate of the amount of tax lost to fraud.
13. Our analysis of the definitions underlying HMRC’s behaviours finds that several arise from from fraudulent behaviour, specifically “Criminal Attacks”, “Evasion”, “Hidden Economy” and “Avoidance”. Taken together, these behaviours accounted for £15.2bn in tax losses in 2019-20, 43% of the entire Tax Gap.
14. However, some tax losses which HMRC categorise as “legal interpretation” and “non-payment” will also be related to fraudulent conduct.
15. In addition, HMRC does not count tax losses arising from profit shifting by multinational corporations in its tax gap analysis, some of which will result from fraudulent conduct.
16. Furthermore, known issues such as fraudulent tax credit credit claims for reliefs such as creative industry tax relief or R&D tax relief are not specifically measured by HMRC’s tax gap methodology.
17. Taking all of this into account, it would seem likely that the Tax Gap lost to fraud was at least £20bn
18. This of course does not factor in Covid-related fraud.

## Covid support schemes – losses to fraud and error

19. In total it is estimated that HMRC paid out around £5.8bn in claims for Covid related support as a result of fraud or error. This includes £5.3 on the furlough scheme, £500m on the Self-Employment Support Scheme and £71m on Eat Out to Help Out.
20. HMRC have provided no breakdown of how much of the overpayment arose from fraud and how much from error.

21. To some extent, the need to deliver cash into the hands of the public quickly meant that higher rates of fraud would be inevitable, however, the greater level of fraud will place an additional strain on HMRC's compliance department as they seek to recover those losses.

**22. We recommend that HMRC is required to produce an annual estimate of losses to tax fraud alongside its Tax Gap publication.**

## Compliance

### The tools at HMRC's disposal

23. Where there has been a loss to the exchequer through non-compliance, HMRC has discretion as to how it can recover the loss. HMRC can seek a settlement with the taxpayer, or amend the taxpayer's return, which can then be appealed to a tax tribunal.

24. Where HMRC suspects fraud, it can carry out a civil fraud investigation leading to a settlement with the taxpayer, alternatively, HMRC can initiate a criminal investigation with a view to prosecution.

25. It is HMRC's policy that they will not prosecute most cases of tax fraud as a criminal offence, instead having a preference to pursue civil claims.<sup>2</sup>

26. This policy has informed HMRC's approach to Furlough fraud. Janet Alexander, the Head of the new Taxpayer Protection Task Force set up to recover losses to covid-related schemes recently said in an interview with the BBC:

“In the UK, we use civil powers to recover the monies, we don't normally criminally prosecute – that is the way that we handle tax investigations in the UK. It doesn't mean it's not a fraud, it's just not the way that we deal with it.”<sup>3</sup>

**27. We would invite the Committee to consider whether the balance of HMRC's criminal investigation policy is appropriate, particularly in view of the very substantial amount of fraudulent claims on Covid related support schemes.**

### Audits and compliance checks

28. An audit involves a tax official undertaking a review of a tax return to ensure that the information that has been entered is in fact correct.

29. Audits are a key tool in detecting non-compliance, and a random audit programme is used to inform HMRC's Tax Gap estimates.

2 HMRC's criminal investigation policy, *HMRC*, 13 July 2021,

<https://www.gov.uk/government/publications/criminal-investigation/hmrc-criminal-investigation-policy>

3 Furlough Fraud, *BBC File on 4*, 09 November 2021, <https://www.bbc.co.uk/programmes/m0011cqy>

30. Research by Dr Arun Advani of the University of Warwick shows that while audits cost on average £2,500, a targeted audit brings in around £10,000-15,000 when changes in future behaviour are factored in. This is a return of between 4:1 and 6:1.<sup>4</sup>
31. We would expect audits to be a key tool in HMRC's armoury, with the number of audits completed being regularly reviewed by management. However, an FOI request by TaxWatch revealed that HMRC does not hold readily available data on how many audits the department completed last year.
- 32. HMRC should report to the committee how many audits it completes every year**

### Litigation and appeals

33. If a dispute over a tax liability cannot be settled between HMRC and the taxpayer by agreement, the taxpayer can appeal HMRC's assessment of the liability to an independent tax tribunal. The appeal is first heard at a First-tier Tribunal. If HMRC or the taxpayer disagrees with the decision of the FTT, a further appeal can be made at the Upper Tribunal, then the High Court, Court of Appeal, and finally the Supreme Court.
34. The pandemic has seen a huge drop in the amount of hearings at the First Tier Tribunal after they cancel face to face hearings.

	2019-20					2020-21				
	First-tier Tribunal	Upper Tribunal	High Court	Court of Appeal	Supreme Court	First-tier Tribunal	Upper Tribunal	High Court	Court of Appeal	Supreme Court
Total	1907	49	3	18	4	1052	53	3	17	5
Decision for HMRC	1465	34	1	9	2	855	42	3	11	1
Partial win	119	3	1	0	0	50	2	0	3	1
Decision for customer	323	12	1	9	2	147	9	0	3	3
HMRC Success rate	83%	76%	67%	50%	50%	86%	83%	100%	82%	40%

### Civil Fraud investigations

35. HMRC's Fraud Investigation Service carries out civil investigations into suspected fraud under two codes of practice, called Code of Practice 8 and Code of Practice 9. COP 8 is targeted at tax avoidance schemes, whereas COP 9 is reserved for what HMRC consider to be more serious cases of fraud.

4 Arun Advani, *The dynamic effects of tax audits*, IFS Working Paper W17/24

36. A Freedom of Information request from an accountancy firm<sup>5</sup> has revealed that the number of investigations carried out by HMRC under COP 9 has steadily decreased over the last five years, although the number of COP 8 inquiries increased in 2021.

CoP8	2016-17	2017-18	2018-19	2019-20	2020-21
Cases opened	297	369	258	271	352
Cases closed	218	249	380	328	240
Yield recorded	£70,063,729.00	£73,691,338.00	£118,473,279.00	£115,179,253.00	£56,011,160.00

CoP9	2016-17	2017-18	2018-19	2019-20	2020-21
Cases opened	549	486	438	425	363
Cases closed	340	375	512	528	540
Yield recorded	£161,101,906.00	£91,132,829.00	£95,829,887.00	£121,282,884.00	£99,031,451.00

### Criminal Investigations

37. According to the latest annual accounts, the number of criminal investigations declined steeply as a result of the pandemic, with HMRC concluding 437 criminal investigations in 2020-21, a 49% reduction on 2019-20 when the department concluded 864 investigations.

38. Between COP8, COP9, and criminal investigation, HMRC's Fraud Investigations Service completed 1,217 investigations for tax fraud in 2020-21, down from 1,720 the previous year.

### Offences Charged And Reaching A First Hearing At Magistrates' Courts

39. TaxWatch sent an FOI to the Crown Prosecution Service (CPS) seeking to discover how many offences they had charged relating to specific revenue offences related to tax fraud. The figures we received are reproduced below.

40. The figures show a clear decline in prosecutions for almost all forms of tax fraud over the last five years, with the number of prosecutions being reduced substantially in 2021.

	2016-2017	2017-2018	2018-2019	2019-2020	2020-2021
Common Law (Cheating the Public Revenue)	144	113	127	79	19
Criminal Law Act 1977 { 1(1) } (Conspiracy to Cheat the Public Revenue)	9	13	49	27	1
Taxes Management Act 1970 { 106A }	173	127	62	69	21
Value Added Tax Act 1994 { 72(1) }	228	184	161	170	48

5 Lancaster Knox, HMRC Serious Tax Investigations, 2021 update, <https://lancasterknox.com/hmrc-serious-tax-investigations-2021-update/>

}					
Value Added Tax Act 1994 { 72(3)(a) }	100	65	69	33	18
Value Added Tax Act 1994 { 72(3)(b) }	17	1	0	1	0
Value Added Tax Act 1994 { 72(8) } }	1	3	2	1	0
Value Added Tax Act 1994 { 72(11) of and paragraph 4(2) of Schedule 11 }	119	196	96	137	23

### Positive Charging Decisions against the target of 100 prosecutions for serious and complex tax crime

41. In 2015, HMRC stated their aim to increase the number of prosecutions into serious and complex tax crime, focusing particularly on wealthy individuals and corporates. The stated aim was to increase prosecutions in this area to 100 by 2020-21.

	2017-18	2018-19	2019-20
Positive Charging Decisions	33	42	46

42. In February of 2020, HMRC told us that they were on track to meet the commitment by the end of 2019-20, however, the pandemic will have affected this work. HMRC used to publish this target in their annual report, however, it is missing from the 2020-21 edition. It is assessed as likely that HMRC will have missed the target this year.

**43. TaxWatch invites the committee to consider how HMRC should increase levels of compliance activity of all kinds.**

### Compliance interventions with covid support schemes - and the impact on other areas of compliance

44. In the March 2021 Budget Chancellor Rishi Sunak confirmed the creation of a £100m “Taxpayer Protection Taskforce”, to be staffed by 1,265 “HMRC operatives”, seeking to recoup money wrongly claimed from pandemic support schemes. With HMRC stating on multiple occasions that it was not intending on hiring new staff to deal with fraud and error in Coronavirus support schemes,<sup>6</sup> it is thought that these 1,265 staff are likely to have been moved from other departments.

45. Diverting resources from other areas of compliance will have a detrimental impact on HMRC’s ability to recoup tax from other areas. The March 2021 budget estimated that

<sup>6</sup> It was reported in City Wire in March of 2020 that HMRC wasn’t planning on increasing its recruitment despite the new workload that had arisen out of the pandemic. In October 2020, HMRC stated that it does not believe it can recruit additional staff to deal with furlough fraud and error due to the 18-month time-lag between starting recruitment and getting staff fully trained.

increases on spending on compliance would end up yielding less in tax for the next three years due to the “impacts on compliance yield reflecting reprioritisation (including to respond to COVID19).”<sup>7</sup>

	Head <sup>2</sup>	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
36 VAT: powers to tackle Electronic Sales Suppression (ESS)	Tax	*	+5	+20	+20	+20	+20
37 OECD Mandatory Disclosure Rules	Tax	0	0	*	+5	+5	+5
38 HMRC: investment in compliance <sup>7</sup>	Tax	-55	-500	-460	+110	+750	+1,310
39 HMRC: investment in digital infrastructure	Spend	0	-30	-25	-15	-5	*
40 DWP: investment in compliance	Spend	0	-10	+190	+235	+250	+250

Figure 1 – HMRC: Investment in Compliance, taken from March 2021 Budget

46. As of August 2021, HMRC had received 30,000 reports of potential furlough fraud, however only 20 criminal investigations had been opened.<sup>8</sup>
47. At the end of June 2021, HMRC had conducted 7,632 compliance interventions relating to fraud and error with CJRS.<sup>9</sup> The vast majority of these interventions do not lead to penalties being levied. HMRC informed us on 13 August 2021 that “Since the start of the CJRS scheme, we have issued 50 penalties with a total value of £276,591.”
48. Turning to the self employed scheme, by the end of June 2021, HMRC had conducted 6,351 compliance interventions into SEISS.<sup>10</sup> No arrests have yet been made in relation to the SEISS scheme.
49. At the end of June 2021, HMRC had launched 584 compliance interventions into Eat Out to Help Out, and that there had been five arrests.<sup>11</sup> HMRC had previously announced in

7 Budget 2021, *HM Treasury*, March 2021, [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/966868/BUDGET\\_2021\\_-\\_web.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/966868/BUDGET_2021_-_web.pdf)

8 No prosecutions for furlough fraud, despite 30,000 allegations, *Open Democracy*, 05 October 2021, <https://www.opendemocracy.net/en/opendemocracyuk/no-prosecutions-for-furlough-fraud-despite-30000-allegations/>

9 Thousands more self-employed under investigation for coronavirus fraud: HMRC data reveals 27% jump in investigations in 3 monthss, *BLM law*, 28 16 November 2021, <https://bestofboth.blmlaw.com/insights/news/thousands-more-self-employed-under-investigation-for-coronavirus-fraud-hmrc-data-reveals-27-jump-in-investigations-in-3-months/>

10 Thousands more self-employed under investigation for coronavirus fraud: HMRC data reveals 27% jump in investigations in 3 monthss, *BLM law*, 28 16 November 2021, <https://bestofboth.blmlaw.com/insights/news/thousands-more-self-employed-under-investigation-for-coronavirus-fraud-hmrc-data-reveals-27-jump-in-investigations-in-3-months/>

11 Thousands more self-employed under investigation for coronavirus fraud: HMRC data reveals 27% jump in investigations in 3 monthss, *BLM law*, 28 16 November 2021, <https://bestofboth.blmlaw.com/insights/news/thousands-more-self-employed-under-investigation-for-coronavirus-fraud-hmrc-data-reveals-27-jump-in-investigations-in-3-months/>

November 2020 that they were to contact around 4,000 hospitality businesses asking them to double check their Eat Out to Help Out claims.

50. These figures have led Jim Harra, the head of HMRC, to state in an interview with the FT that the organisation will struggle to recover more than half of the estimated £5.8bn paid out in fraud and error to Coronavirus support schemes, and plans to recoup the money lost may not go beyond 2022-23.<sup>12</sup>

**51. Is recovering only half of the money stolen, or paid in error from covid support schemes a reasonable target for HMRC?**

### **Resourcing – personnel**

52. HMRC was created in 2005 by the merger of the Inland Revenue and Her Majesty's Customs and Excise, bringing together most, though not all, of the functions of both organisations.

53. In 2003–04, prior to the merger, there were some 77,300 staff in the Inland Revenue and some 22,400 in Customs and Excise,<sup>13</sup> for a combined total of 99,700 full time equivalent staff.

54. What we have seen since the merger is just under a 40% deduction in staff numbers. In 2020-21, the headcount stands at 57,727 for the 'core department', and 61,867 for total staff – a number smaller than 2019-20, despite the extra burdens placed on HMRC as a result of both Britain's exit from the European Union, and the Covid-19 pandemic.

55. HMRC is seeing an increase in staff leaving. The previous year, 2020-21 saw 2,118 members of staff leave the organisation, an increase on the 1,298 of 2019-20, which was again an increase on the 1,037 of 2018-19. This is a 104% increase in departures over a three year period.

56. The 2020 Civil Service People Survey saw an 'Engagement Index' of 57% at HMRC, notably lower than the 66% Civil Service Median Benchmark, with only 23% happy with pay and benefits, and 49% with 'leadership and managing change'.<sup>14</sup>

57. Staff dissatisfaction can increase staff turnover, and with it the accompanying recruitment and training costs, but it can also reduce performance amongst the unmotivated workforce that remains.

12 HMRC expects to recover less than half £5.8bn lost in Covid fraud and errors, *Financial Times*, 21 November 2021, <https://www.ft.com/content/3991505c-8311-401e-aece-55342f2b07df>

13 The Merger of Customs & Excise and the Inland Revenue, *House of Commons Treasury Committee*, November 2004, <https://publications.parliament.uk/pa/cm200304/cmselect/cmtreasy/556/556.pdf>

14 There is no single definition of employee engagement or standard set of questions; for the Civil Service it was decided to use five questions measuring pride, advocacy, attachment, inspiration, and motivation.

## Resourcing – budget

58. In the Autumn 2020 Budget, Chancellor Rishi Sunak stated that HMRC is set to see a “£0.9 billion cash increase over the Parliament to £5.2 billion in 2024-25”.
59. Spending Review 2020 revealed that £1bn would be going to HMRC “to reform and enhance the UK customs system after the end of the transition period, including investment in vital physical and IT infrastructure and additional support for UK traders”.<sup>15</sup> So while the £0.9bn cash increase sounds impressive, it’s worth bearing in mind that the vast majority (if not all) of this will be put towards dealing with the additional complexities surrounding the UK’s departure from the European Union.
60. In fact, HMRC’s annual report 2020-21 shows a slight decrease in compliance related expenditure, from £1,255,000,000 in 2019-20 to £1,255,000 last year.
61. **Should HMRC be decreasing the amount spent on compliance activity at this time?**

## Concluding remarks

62. HMRC rightly won plaudits for the speed and efficiency with which it implemented the covid support schemes that were put in place to help people in need during a time of national crisis.
63. However, the legacy of those schemes risks being damaged if more is not done to recover the billions of pounds stolen from them.
64. The data clearly shows that HMRC does not have the resources to properly enforce the law and ensure that criminals that seek to exploit the tax system are brought to justice.
65. When the UK’s exit from the EU required a new customs system to be built £1bn in additional funding was made available.
66. A substantial investment in tax compliance is now required to ensure that public confidence in the tax system is maintained and enhanced as we recover from the covid crisis.
67. The head of HMRC, Jim Harra, has recently stated that he could “always do with more” staff.<sup>16</sup> We agree.

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15 Spending Review 2020, HM Treasury, 15 December 2020, <https://www.gov.uk/government/publications/spending-review-2020-documents/spending-review-2020>

16 HMRC expects to recover less than half £5.8bn lost in Covid fraud and errors, *Financial Times*, 21 November 2021, <https://www.ft.com/content/3991505c-8311-401e-aece-55342f2b07df>