Behavioural challenge

Management of taxes



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Helen Adams considers the findings of research commissioned by HMRC into tax evasion and the sharing economy and what more could be done to improve compliance

Key Points

What is the issue?

Research commissioned by HMRC into tax evasion and the sharing economy demonstrates that it is interested in understanding more about the causes of non-compliance.

What does it mean to me?

Evasion and sharing economy non-compliance occur for many reasons including ignorance of tax obligations, a belief HMRC will never find out and that, even if they do, the consequences are insignificant.

What can I take away?

HMRC may use the reports' findings to alter its working practices or introduce new legislation to deter and tackle tax evasion and non-compliance. HMRC will continue publicising its successes too.

There are numerous reasons why people make mistakes with their tax. HMRC is keen to understand them better so that it can identify affected people more easily, promote good compliance and deter the mistakes. Consequently, HMRC commissioned research into taxpayers' evasion and non-compliance. Ultimately this is all about collecting the 'right amount of tax'.

So what did the research tell HMRC?

The research focused on tax evasion by small & medium-sized businesses (evasion research) and non-compliance by people involved in the sharing economy (sharing economy research), i.e. internet businesses enabling people to share, sell or rent property, time, resources or skills. This focus is unsurprising as HMRC's statistics estimate that evasion and the hidden economy contribute £5.2bn and £3.5bn respectively to the 2015/16 tax gap.

Collectively these reports showed:

- Of those in the sharing economy contacted for the research, 54% thought their income is not taxable. However, 21% considered themselves to be employees and 12% saw themselves as self-employed in relation to their sharing economy earnings.

- 35% of those in the sharing economy had or planned to notify HMRC of that income whereas 46% considered they earned too little to report it. The reasons for not telling HMRC about their income included that it was sporadic/a hobby, taxes are too high, the government ‘does nothing for me’, a perception of not getting caught and not knowing that disclosure was necessary.
- 16% of those with a gross income from the sharing economy exceeding £70,000 thought they earned too little to tell HMRC about it. Those involved in the sharing economy for three or more years were least likely to have notified HMRC.
- Only 51% of those involved in the sharing economy considered they knew enough to fulfil their tax obligations and 17% kept no records of their income. They are more likely to get their information from HMRC although there was a general lack of awareness of HMRC’s digital services. The requirement to file tax returns deterred compliance as people viewed it as too difficult. Simpler, more regular online filing was preferred – so Making Tax Digital may be welcomed.
- Some people believe that intentionally making mistakes (e.g. not declaring stock used privately or including personal expenses in businesses’ accounts) is not an issue as ‘it’s my money’ or because they believe they pay too much tax or other businesses pay too little. For others evasion facilitates a lifestyle to which they consider they are entitled given the level of taxes paid.
- Others perceive that the likelihood of being caught is low as amounts are too small, they can think up an excuse which HMRC will believe or HMRC has too few resources to bother with their small business. ‘Systematic evaders’ tended to believe that they were not reliant on the state so they felt little sense of obligation to pay taxes.
- Both of the two previous points appear to be reinforced by media coverage of tax evasion and avoidance. The evasion research noted that news and social media commentary on high profile disputes appeared to reinforce that evasion risk for SMEs is low as HMRC’s focus is elsewhere. It also helped evaders self-justify their own evasion through the perception that others avoid and evade tax on a larger scale such that the evader believed they paid their fair share of tax.
- Some believe that the consequences of getting caught are so small that it is worth not getting their tax right. Mostly the potential impact on their business and their family was under-estimated.

- The 2008 financial crisis appeared to ‘normalise’ evasion behaviours for some businesses. Others perceived they needed to evade in order to offer competitive prices, survive cashflow crises and stay in business. Financial pressures also deterred people in the sharing economy from meeting their tax obligations.

The evasion research noted that most advisers moderated evasion behaviour (e.g. by preventing personal expenses being recognised as business costs) if they were aware of it. However, typically taxpayers didn’t tell advisers of their evasion activities. The sharing economy research found that agents are a good source of advice and made reporting easier but some people cannot afford to engage them.

Arguably the reports’ findings suggest that more work is needed by HMRC to change the perception that it has insufficient resources to tackle non-compliance and that tax evasion ‘pays’ as the consequences are so unlikely and too small to outweigh the benefits. One of the five principles against which HMRC assesses penalty regimes is whether they are a credible threat. This research suggests that, at least amongst those interviewed, the current tax-geared penalty regimes are not perceived threatening.

How does HMRC identify and investigate evaders?

HMRC already has considerable powers to obtain information from third parties to enable it to identify who is yet to declare their income from these sources. HMRC also collates accounts and tax returns data. All of this information is fed into HMRC’s CONNECT computer system which identifies discrepancies between tax returns (or the lack thereof) and the information it holds, such as which businesses look like they are making too little profit compared to the average for their business type or which individuals are receiving undeclared income.

Discrepancies flagged by CONNECT are then investigated further usually by HMRC’s Risk & Intelligence Service or individual officers before the taxpayer is aware of HMRC’s interest in them. They may, for example, look at the property and other assets the taxpayer owns, their debts, lifestyle costs etc to see whether their outgoings are so large that it’s unclear how the person affords their lifestyle. A deficit may indicate that the person is not declaring all their income and gains. HMRC will then open an enquiry, civil fraud investigation or criminal investigation with a view to prosecution.

What if few records exist?

Parminder Kaur v Commissioners for HMRC [2017] UKFTT 815 (TC06210) considered a penalty on an eBay trader for failing to register for VAT (FA 2008, Sch 41). The judgement outlines HMRC's investigation, noting that Ms Kaur said she was unaware that she needed to keep records or accounts and did not do so. She failed to comply with information notices (FA 2008, Sch 36) and said she could not provide details of PayPal account transactions. HMRC analysed a sample of feedback postings on her eBay account which stated the value of each transaction before extrapolating the total value of transactions on all feedback postings. This was used as the basis for calculating the undeclared VAT on which the penalty was imposed. This methodology was favourable to her as it did not take into account transactions on which no feedback was given but it also omitted VAT on goods purchased for her business as she did not provide any evidence about this.

Clearly in such situations income tax, CGT or corporation tax may be undeclared in addition to national insurance, VAT and Customs Duties. Overall HMRC can use a combination of methods to calculate undeclared tax to the best of their judgement, including:

Reviewing bank statements to identify the source of funds deposited;

- Identifying business expenses documented in bank and credit card statements;
- Obtaining information from customers or suppliers on transactions (amounts, dates etc);
- Referring to data held by HMRC on the level and margins of profits for a typical business of the type under investigation;
- Using data for a limited period as a basis from which to extrapolate profits for earlier years during which the business operated but for which no information exists;
- Building a picture of the taxpayer's assets, liabilities and lifestyle using a combination of this data plus information from other sources such as the land registry, local councils (planning applications), investment records etc. This is then used to extrapolate living costs and compare them to declared income in a means review, particularly where cash takings may be spent rather than banked.

Consequences of evasion

HMRC’s aim is to ensure all tax was correctly declared and paid. If errors are found or if the person incorrectly did not file returns then HMRC can use its discovery (e.g. TMA 1970, s29) and determination (e.g. TMA 1970, s28C) powers to assess up to 20 years’ tax, impose late payment interest and charge penalties of up to 100% of the tax (more if income or gains are from certain offshore countries).

In cases where mistakes were deliberate and the tax arising exceeds £25,000 HMRC may also publish the taxpayer’s name, address and other details for a year (FA 2009, s94). Clearly this may cause reputational damage. Deliberate defaulters may also be placed in HMRC’s Managing Serious Defaulters’ (MSD) regime. This enables HMRC to use its existing enquiry and information powers to closely monitor the taxpayer for at least two years until it is satisfied of full compliance with tax obligations.

What could HMRC do differently?

The research on understanding SME evasion identified that evasion may be deterred by:

- Actions that persuade evaders that there is a real likelihood that HMRC will identify and investigate them, i.e. publicising that HMRC has the capability to identify evaders, the resources to investigate them and is achieving results, such as successful prosecutions and publishing deliberate defaulters’ details (PDDD);
- Improving evaders’ understanding of the potential consequences of evasion, e.g. criminal sentences, the size of civil financial penalties, PDDD & MSD;
- Highlighting the other ramifications, such as the possible implications for evaders’ families, their business/employees and their reputation.

Interestingly it suggests that the approach taken in some HMRC ‘nudge’ letters of highlighting the impact of tax evasion on the funding for the NHS and other government services appears to have limited impact. The sharing economy research identified a desire for more support and information from HMRC and digital platforms about tax and reporting obligations too.

Communication therefore seems to be the key. The challenge is how to ensure the messages reach the target audience in an era of information overload and multiple channels through which people receive news. The research suggests that HMRC’s

current messages such as the publication of deliberate defaulters' details simply do not reach evaders so more blogs or press releases appear unlikely to have the desired effect.

Statistics on the number of deliberate behaviour penalties are not routinely published by HMRC. Local publication of these statistics and details of those sanctioned via PDDD (i.e. in the area in which the sanctioned person lives and runs their business) through traditional journalistic and social media outlets may have a greater deterrent effect as it may alter the perceived

- low likelihood of being caught, and
- lack of consequences of getting caught as it would mean that others would appreciate that customers and suppliers are more likely to become aware of their behaviour, which may result in a loss of business and the consequential impact on their staff and family.

The client notification regulations (SI 2016/899) obliged advisers to send HMRC branded documents to clients suggesting they review their UK tax affairs relating to offshore income and activities before making a disclosure via the Worldwide Disclosure Facility. It is too early to know whether this increased disclosures or whether a similar exercise targeted at SME evasion may bear fruit. However, a similar exercise targeted at sharing economy participants appears less likely to succeed as fewer people have advisers. However, if digital platforms were to routinely provide information on tax obligations then this may well improve users' compliance. HMRC may be hoping that risk assessments and the creation of reasonable prevention procedures in order to protect businesses against the Corporate Criminal Offences of failing to prevent the criminal facilitation of tax evasion (Criminal Finances Act 2017, Part 3) may improve compliance too.

HMRC is taking other steps to tackle the online marketplaces aspect of the sharing economy. Finance (No 2) Bill 2017, Clause 38 will extend HMRC's powers to hold online marketplaces jointly and severally liable for unpaid VAT of:

- UK traders, in addition to overseas traders for which legislation already exists in VATA 1994, s77B;
- non-UK businesses selling goods on their platforms, where the business was not UK VAT registered and the online marketplace knew or should have known that the business should be UK VAT registered.

The government plans to call for evidence in Spring 2018 on what more digital platforms could do to prevent non-compliance amongst their users. The Autumn Budget 2017 also announced further investment in HMRC, part of which is to ‘transform their approach to tackling the hidden economy through new technology’.

So, what now?

Lower penalties are charged for voluntary disclosures. Consequently, anyone who made mistakes in the past or who is yet to submit tax returns should bring their tax affairs up to date before HMRC starts investigating regardless of whether the proceeds of non-compliance are in the UK or offshore. The Requirement to Correct’s Failure to Correct sanctions (Finance (No 2) Act 2017, s67 & Sch 18) will affect the latter if disclosures are not made by 30 September 2018.

Overall, HMRC’s recent announcements are a significant step towards tackling VAT irregularities. It will be interesting to see how HMRC uses its resources, alters legislation and publicises successes in future and the extent to which this influences taxpayers’ behaviour.