Tackling the hidden economy – consultations on sanctions and conditionality

General Features **Management of taxes**

01 December 2016

LITRG has responded to the HMRC consultation documents, 'Tackling the hidden economy: sanctions' and 'Tackling the hidden economy: conditionality'.

LITRG has submitted comments to HMRC on two consultations on different approaches to tackling the hidden economy – one on sanctions and the other on conditionality. The fact that both consultations are taking place at an early stage in the development of policy is welcome.

LITRG made some general comments noting that certain proposals may increase the risk of some taxpayers entering the hidden economy by default or inadvertently. By way of example, the speed with which it is being proposed to roll out the Making Tax Digital strategy may create a higher risk of this happening to those who feel unable to engage digitally.

Sanctions

LITRG previously responded to HMRC's 2015 discussion document on penalties, and notes that the penalty system should differentiate between those who deliberately and persistently fail to comply and those who occasionally fail to comply.

LITRG acknowledges the important role that sanctions play in tackling the hidden economy, but points HMRC towards research that suggests a strong link between tax morality and compliance. We therefore strongly encourage the use of educational activity and taxpayer support by HMRC, alongside publicity demonstrating the effectiveness of compliance activity.

We think the consultation should draw more of a distinction between different taxpayer behaviours within the hidden economy. In particular, LITRG suggests that consideration should be given to harsher sanctions for employers who do not operate Pay As You Earn on the earnings of their employees. In addition, there needs to be recognition that some businesses operating in the hidden economy wish to come forward, but simply do not know how.

LITRG agrees with the principles set out by HMRC for penalties, but cautions that in respect of penalty escalation, the design must take into account a variety of situations, such as occasions when what appears to be a repeat failure is not. In addition, we recommend the adoption of safeguards by HMRC, for example in respect of vulnerable taxpayers and also suggest the use of suspended penalties to encourage those who wish to be compliant to come forward.

Conditionality

LITRG is pleased that HMRC are considering methods of improving compliance by design, but has some serious concerns that conditionality as proposed in the consultation will not tackle certain groups within the hidden economy. In particular, we do not think it would tackle those who are not only hidden for tax purposes, but for other official purposes too, or those who do not require a licence or registration in order to conduct their business.

We note that a system of conditionality would have to be structured very carefully, to avoid driving taxpayers further into the hidden economy. In addition, we think that achieving support from all stakeholders affected by a system of conditionality (not just those within the hidden economy) and keeping the system of conditionality simple and easy to operate will be crucial pre-requisites for success.

The LITRG responses are available on the LITRG website.