The latest challenge: 21st century tax crime

General Features | Management of taxes



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What does tax crime and evasion look like in modern times? And what can we do to fight it?

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If you are looking for a job with security, one spent tackling tax evasion is a decent choice. Since tax, duties and tariffs first existed, people have found ways to evade paying them. Hiding transactions, wealth and assets have been the hallmarks of tax crime for centuries – as demonstrated by the regular use of anonymous numbered Swiss bank accounts as a plot device in so many novels and films...

The leaking of the Panama Papers in April 2016 did a lot to highlight these issues to the public. While the story wasn't all about tax, its global nature, the household names and the huge amounts of money involved exposed the industrial use of shell companies. It became clear that much of what was happening was being driven by unscrupulous professional advisors or facilitators.

The nature and scale of tax crime

In the UK, the latest estimate of the annual tax gap is around £46.8 billion. (In the US, it's around £700 billion.) Not all of that is evasion but a good proportion of those figures comes from deliberate behaviour of one sort or another. Evasion by its very nature is hidden and difficult to measure. In the UK, probably more than £15 billion a year, and possibly significantly more, arises from evasion or criminal behaviours.

The huge amounts of money involved, which could be otherwise be funding public services, is a crucial reason for tackling tax crime, but other reasons are important too. We all need to pay more tax to cover the amount not paid by the evaders and criminals. But there are more direct victims of tax crime. Some have lost state pension credits due to payroll fraud. Others think they have paid stamp duty only to find their solicitor has submitted false documents, underpaid duty and pocketed the difference. Shopkeepers may be threatened by an organised crime group to sell illicit, non-duty paid products or face the prospect of going out of business.

It is vital to maintain public confidence in the tax system. Diminishing trust in a tax system leads to lower levels of tax being paid voluntarily. Honest citizens and legitimate businesses must be reassured that the tax administration can effectively tackle those who break the rules.

We must also send a clear message of deterrence to certain individuals and sectors that their bad tax behaviour can mean life changing consequences for them.

Crime in the 21st century

What does tax crime or tax evasion look like in the 21st century? Here are some examples of how tax crime has developed:

- An ultra-high net worth individual controlling a multi-billion pound international business has evaded tax on hundreds of millions by putting that sum in an

offshore jurisdiction, disguised via a complex and opaque structure of companies trusts and investments.
- A crime group, specialising in money laundering, recycling millions of pounds through different criminal channels, including through off-record payrolls in construction sector supply chains.
- Quasi cyber-attacks on HMRC tax regimes are designed to generate entirely false tax repayments – at scale.
- Specialist, criminal facilitators orchestrate the abuse of specific tax reliefs, notably R&D in recent times.
- Smaller retail or hospitality businesses are using till software which automatically skims off 10% of receipts and balances the books.
- And, of course, international crime groups evade various duties, and make money to fund other criminal enterprises, by smuggling illicit tobacco.

Key trends and challenges

Almost everything that my HMRC Fraud Investigation team dealt with had an international element – and significantly more so than 20 or 30 years ago. Our investigations covered cross-border transactions; offshore banks, trusts and companies; and every variety of legal entity based in secrecy jurisdictions or tax havens. Some crime groups essentially operated as international businesses with all the logistics, inventory and financing that goes with that.

Most tax organisations are now predominantly digital or online, which makes them a huge target for fraudsters. And technology more generally is a significant factor in enabling tax crime:

- encrypted criminal communications hide activity from HMRC investigators;
- mass trading of stolen data enables identity-based tax fraud;
- the mass creation and liquidation of companies enable mini umbrella company frauds;
- millions of people can be reached through social media to promote fraudulent schemes;
- corrupt fintech firms can infiltrate the digital payments systems of unwitting banks to enable the laundering of criminal proceeds;
- quasi-cyber attacks are being used to steal tax repayments or relief payments; and

- artificial intelligence (AI) can be used to create false documents to support R&D claims.

We have seen a massive increase in financial complexity – blending traditional crimes involving cash, property and gold with crypto assets, alternative banking platforms and the ability to move money across multiple jurisdictions in hours. Deliberately long and opaque supply chains have become a key element in a growing number of tax crime types.

This all creates a huge headache for governments and tax administrations. Tackling such criminal activity requires being able to detect the crime in the first place, to work at the requisite pace, to develop or hire the necessary skills and talent, to ensure the ability to investigate across borders, to procure or develop the right technology and to ensure access to the intelligence needed to gain actionable insight into what's going on.

So what are the solutions?

There are a few specifics which I will address below. But first, here are a couple of examples from my own experience – one that didn't work and one that did.

Deterrent prosecutions

In 2011, the new coalition government wanted to do more to tackle evasion and avoidance. There was very significant investment in HMRC staff to tackle non-compliance with new teams, new legislation and new approaches.

One approach was what we called 'volume crime'. The theory was that by prosecuting 1,000 more people a year, we would create a deterrent effect and stop people evading tax. This proved hugely challenging for HMRC, the Crown Prosecution Service and the criminal justice system more generally.

The target was met but, in my view, that was at quite a cost in terms of other important and probably more impactful things that we could have done with that resource. Ultimately, it made very little difference in terms of the overall scale and value of tax evasion.

A multi-faceted approach

More encouraging, I think, was the response to missing trader or carousel fraud. This is a complex VAT fraud involving goods or intangibles going round in circles via lengthy supply chains – before part of that chain going missing and taking the VAT with it. It was perpetrated by organised crime groups and, at its height, was costing more than £4 billion a year – money that was usually going straight overseas into property, gold and other offshore investments.

HMRC did begin by trying to investigate and prosecute its way through this threat, which almost crippled its enforcement activities and was making negligible difference to the overall volume of the fraud. So we developed a multi-faceted approach, including hardening the department's repayment processes, tightening up VAT registration, introducing sophisticated, real time risk rules, and seeking derogation from EU law to make it impossible to commit the fraud using the criminals' favourite commodities.

Specialist teams were developed to monitor suspicious traders and to educate businesses in high-risk sectors. In parallel, parts of the illicit supply chains that were enabling the illegitimate trading were targeted using civil investigation powers, resulting in large fines and disqualification of directors. And the criminal justice interventions – criminal investigation and covert intelligence collection – were reserved for the guiding minds behind the frauds. Overall, this whole system approach reduced the threat from that fraud by over £3 billion annually.

Criminal investigations

Clear strategic intent is essential – being clear why you are taking the actions you are, how you can make maximum impact on the scale of tax crime, and then using all elements of the system to achieve that intent.

Investigating single instances of evasion is unlikely to get you what you want. But criminal investigations do play a vital part in the overall strategy to tackle tax crime and are crucial in driving behavioural change. They can alter the risk/reward ratio for wealthy individuals or corporates who might decide not to cross the line if they perceive the risk of jail time as too high. They can also impact sectors that have widespread tax evasion.

Sometimes only a criminal investigation will enable you to gain insight into those perpetrating fraud and their modus operandi in order to find out what is really going

on.

You can also focus on the enablers or facilitators who have a disproportionate impact on the amount of evasion. I think tax administrations could do more to act quickly and aggressively to take the most harmful actors out of the game before they create the inevitable victims of failed schemes.

Data and intelligence

HMRC already has significant data and intelligence capabilities. Indeed, the department is one of the biggest holders of data in the UK, dealing with citizens from cradle to grave – from child benefit to inheritance tax.

Much of that data ends up in Connect, which is HMRC's mammoth data matching system. This includes all the data provided by millions of individual taxpayers and businesses, as well as details of property ownership, credit and debit card totals for all UK businesses, data from online platforms, banking information from over a hundred countries, cross-references to previous data leaks – and more.

HMRC also has significant investigatory and covert powers to carry out surveillance, to use informants and to intercept phone calls or emails. I think tax administrations could act more aggressively, using every tool in their armoury, to target key facilitators, corrupt professional advisors and professional money launderers.

Building partnerships

However, even more data and intelligence can be useful in tackling modern day tax fraud. Some of that requires ambitious partnering with the private sector to take advantage of an increasingly transparent world – whether that's working with banks to understand and prevent financial crime; accessing specialist crypto and blockchain investigation capabilities; or using private sector aggregators of data, like worldwide ultimate beneficial owners of corporate entities or property.

The government can't do this all itself and a new culture that welcomes this sort of partnership is essential.

International collaboration

International collaboration is required too – going beyond the policy initiatives of bodies like the OECD to ensuring more direct and timely operational cooperation between tax administrations and law enforcement.

A little-known fact is that HMRC has officers based in 40 embassies or high commissions in key jurisdictions around the world – officers who coordinate action and gather intelligence from international partners.

There is also the J5 – something I helped to create – where the UK, US, Dutch, Australian and Canadian tax enforcement teams share intelligence, coordinate international investigations and help develop each other's capability. As tax crime becomes more and more international, it is critical to continue to invest in this type of collaboration or tax enforcement will get left behind by sophisticated and internationally mobile criminals.

In conclusion

Tax administrations like HMRC need the right resources and skills. I know from my time there that HMRC could achieve more if it had more resources. But the compliance part of HMRC already has around 28,000 staff and that's a big number by any comparison. So it's also important that ministers challenge the department to have the right focus, strategic intent and technology to ensure maximum efficiency.

Staff skills are as important as numbers, though, whether that's the need to significantly improve and modernise internal training or to buy in the necessary skills. This is possibly the most critical issue in my opinion.

It's a tough job to tackle tax crime, and in my experience, HMRC does a lot very well. But the challenge continues to become more and more difficult. Ministers and senior tax administration officials – in the UK and across the globe – need a laser focus on this, the most deliberate type of non-compliance. It needs resourcing properly and to be an increasingly active and creative partner with organisations in both public and private sectors.

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