LABOUR'S PLAN TO **CLOSE THE TAX GAP**

Labour

Contents

Summary

At £36bn[1], the tax gap in Britain – the gap between tax owed and tax paid – remains stubbornly high with no plan from the government to bring it down.

After 14 years in power, the government have lost any focus and energy in tackling tax compliance and avoidance, and they have weakened the deterrent effect of prosecutions and penalties, with falling numbers of criminal investigations for tax evasion.

And their plans to digitise the tax system for the modern age are floundering – they are behind schedule, and rapidly getting out of date.

The head of the National Audit Office says that there is £6bn annually that could be recovered through a concerted effort on tax compliance[2]. But the government only has plans to recover £1bn a year in outstanding tax debt[3].

At a time when the tax burden on working people is rising, Labour will relentlessly pursue the money that is owed, with a plan to make sure people pay the right tax in the first place, and that directly tackles tax avoidance and evasion.

Labour's plan would:

- Boost compliance activities in HMRC, recovering more tax revenues from those seeking to avoid it.
- Invest in technology transformation in the tax system to improve the customer experience and reduce the tax gap.
- Make legal changes to support this effort, restoring a genuine deterrent to tax evasion and making sure people pay their taxes in the first place.

These changes would raise £5bn a year by the end of the parliament.

As well as this package, we will be undertaking further detailed work to turn our tax system around through modernisation of HMRC.

This will further reduce the tax gap from error and avoidance, alongside improving the experience for individual taxpayers and driving productivity gains for businesses.

Background

Measuring the scale of the challenge

The 'tax gap' is a measure of the difference between the amount of tax that is owed and the amount that is collected. A falling tax gap indicates progress in collecting more of the tax that is owed.

'Compliance yield' measures how much HMRC estimate their work has generated in additional tax revenue. Falling compliance yield indicates less effective activity and/or less activity taking place.

Both measures are estimates, based on HMRC's assessment of how much tax is owed and the effectiveness of their compliance actions.

Tax debt measures the amount of unpaid tax that HMRC is aware of but has not yet been paid.

Progress in each of these areas, tax gap, compliance yield and tax debt, has either stalled or got worse in recent years:

- **Tax gap:** After falling by around a third between 2005/06 and 2016/17, there has been very little reduction in the level of the tax gap. In cash terms the tax gap stands at £36bn, £5bn more than the previous year and more than the UK's day-to-day defence budget[4].
- **Compliance yield:** HMRC's yield from compliance activity has fallen this parliament from 5.8% of total revenues to 4.2%[5]. That decline is worth £13bn in additional tax revenue not recovered.
- **Tax debt:** the total value of tax debt owed to HMRC is £43.9bn, compared to just £15.5bn in December 2019[6].

The parliamentary Public Accounts Committee recently raised concerns over HMRC performance in collecting revenues, managing compliance and customer service, arguing that, "the government is missing the opportunity to recover billions in lost revenue by not resourcing compliance."[7].

It's clear that significant revenue is at stake here:

- The head of the National Audit Office said in January that the Government could raise £6bn through cracking down on tax avoidance and evasion[8].
- In March, the Association of Revenue and Customs, the HMRC branch of the FDA representing managers and professionals within the department, published a report recommending a £910m investment into HMRC compliance and customer service for a cash return of £11.3bn, over the course of a parliament[9].
- Alongside the budget, the Office for Budget Responsibility have found that if the tax gap as a share of GDP fell by a further 0.3 per cent, half of the decrease seen in the four years between 2013-14 and 2017-18, that would increase receipts by £8.4bn a year[10].

Despite this, in the Budget the Government announced a policy targeted at collecting tax debt that is only expected to raise around £1bn a year once rolled out[11].

What has been going wrong?

HMRC resourcing:

While spending in some areas has increased in recent years, such as on customer compliance and on technology, a large part of that was to deal with covid-19. The Government plans to reduce the department's budget in 2024/25 by more than 20 per cent. In other areas, particularly customer service, spending has fallen sharply in real terms[12].

While resourcing is not a silver bullet and far from the only issue affecting HMRC's performance, it is concerning that even as the numbers of taxpayers grow due to fiscal drag and population growth, HMRC's resources are being taken away.

Customer service:

Effective customer service is important to increasing tax compliance. This is because it makes it easier to pay the right amount of tax the first time, reducing errors that need to be corrected later.

Yet HMRC's performance on customer service is "at an all-time low"[13]. While the number of calls to HMRC is falling in line with growing adoption of other digital channels, the proportion of callers waiting more than ten minutes to speak to an advisor has increased from 14.6% in 2017-18 to 62.7% in 2022-23.

Part of the problem is failure to make improvements to HMRC's digital offer, alongside low awareness and adoption of HMRC's app. HMRC spokespeople have said that in the last tax year, HMRC received more than three million phone calls about "resetting an online password, getting your tax code, and getting your National Insurance number". These are all tasks that do not need to be dealt with via the phone for most people. The spokesperson went on to say that this volume meant 500 people working full time at great expense and when they could be focused on more complex cases and supporting vulnerable taxpayers[14].

The Chartered Institute of Taxation recently said "HMRC's service levels are having a significant detrimental impact, not just on tax matters, but on the wider economy, such as the ability and costs of doing business, and cash flow / finances. They are also having a negative impact on the tax system as a whole, such as attitudes to tax compliance and trust in the tax system."

HMRC case activity:

As well as supporting taxpayers to get it right the first time, HMRC is responsible for responding where people and businesses get tax wrong, either through carelessness and error, or avoidance and evasion.

HMRC follows a risk-based approach to this work, hoping to make the best use of resources by targeting activity where it is more likely to be needed.

Lower-level, high volume activities include letters, nudges and prompts targeted at groups of taxpayers where there are known to be issues.

HMRC will also carry out "compliance checks" into individual taxpayers, whilst bigger taxpayers such as large businesses and the very wealthy will have more direct approaches from their "client relationship manager" – a named member of HMRC staff.

In more serious cases, HMRC will undertake civil investigations to gather evidence, recover revenue and apply penalties.

The number of compliance cases being opened and closed by HMRC has fallen by 20% since 2019/20[15].

Some areas of HMRC's compliance work have been scaled back much further. For example the number of more serious civil cases taken up by HMRC's fraud investigation service fell by 28% between 2018/19 and 2022/23. Investigations by the offshore, corporate and wealthy unit fell by more than a half[16].

Prosecution:

As well as civil investigations, for the most serious cases HMRC can also commence criminal investigations with a view to prosecution, which provides HMRC with additional powers to investigate. The decision whether to prosecute rests with the Crown Prosecution Service in England and Wales and their counterparts in Scotland and Northern Ireland[17]. HMRC will also regularly work with other parts of government, the police and our international partners.

HMRC can carry out a criminal investigation in any case of tax fraud or evasion, but their policy is to target criminal investigations where they need to uncover more information, when it is particularly serious, and where they need to send a strong deterrent message[18].

This is because such investigations can be resource-intensive, lengthy and complex, so it is right that they are only used when necessary.

As Director of Public Prosecutions, Keir Starmer announced a crackdown on white collar tax evasion to boost this deterrent function[19].

The number of "positive charging decisions", an indication of the activity relating to criminal investigations that could result in a prosecution or a settlement to return tax owed, rose when this plan was put in place but this effort has subsequently collapsed after his tenure ended, with charging decisions halving between 2014 and 2019[20].

There was also an increase in the number of prosecutions and convictions after Keir Starmer's announcement. But these numbers fell dramatically during covid-19 and have remained low, with only small improvements since the pandemic ended.

Recent freedom of information requests revealed that in 2022 only 11 wealthy individuals were prosecuted following HMRC investigations, and HMRC have not charged a single company with new corporate offences introduced in 2017 of failing to prevent the facilitation of tax evasion[21].

We have heard from experts that this deterrent effect is viewed as particularly strong when there is a high-profile custodial sentence for more widespread forms of tax non-compliance in particular professions or industries. While the decline in volumes of prosecutions and convictions is cause for concern, it is also important that sentences provide this strong deterrent effect in long-standing and growing areas of tax non-compliance.

A number of tax experts have expressed concern about the lack of an effective deterrent at present:

- King's College London's senior lecturer in corporate law Stephen Daly: "If you don't enforce the rules, then you create a culture in which people don't have to worry about the tax returns later being checked."[22]
- Price Bailey partner, Andrew Park, said: "The drop off in compliance activity is undermining the deterrent effect of HMRC's work."[23]
- Philip Fisher, BDO: "It doesn't take a mathematical genius to work out that if the number of civil inquiries has halved, the number of investigations reduced by two-thirds and no company has been charged in the seven years since a law was enacted to clamp down on corporate tax evasion, the tax service has a serious problem and so does the country."[24]

Some of these issues predate covid-19, and experts have pointed to a number of issues with HMRC's legal framework that makes investigations harder, longer and more expensive, and means it is more difficult to prosecute people who are avoiding tax.

HMRC digital slowdown:

HMRC's two main digitisation programmes are 'Making Tax Digital' (MTD), focused on businesses' tax affairs, and the 'single customer account' (SCA), focused on wider taxpayers.

In practical terms, these programmes involve changes to HMRC's ways of operating, such as: digitisation of existing paper-based systems; increasing real-time reporting and payment; and improving and integrating different systems.

Digitisation is important in reducing the tax gap, especially from carelessness and errors. The two largest components of the tax gap are 'failure to take reasonable care' (£10.7bn – 30% of total) and 'error' (£5.4bn – 15% of total).[25]

As well as improving compliance, digitisation will improving productivity, freeing up businesses' resources by reducing complexity, minimising data requirements, and improving record-keeping.[26]

And it will help improve customer service, where long-term improvement needs a much better digital offer.

In June 2023, the NAO found that MTD has delivered some benefits, but there have been very substantial delays, costs have increased, and HMRC has not demonstrated value for money[27].

The Public Accounts Committee (PAC) has been very critical of HMRC's delivery of MTD, in terms of timetable and budget, and their poor engagement with stakeholders, including tax experts and software developers[28].

The PAC has also attributed the decline in customer service in part to digitisation programmes not reducing demand for contact nearly as much as anticipated[29].

The Infrastructure and Projects Authority rated SCA delivery 'red' and 'amber' in the last two years[30].

The UK compares unfavourably with other G20 countries in terms of the scope of digitisation, e.g. HMRC is much less ambitious in terms of filing of objections or dealing with correspondence digitally, or making full use of pre-filled data[31].

Offshore tax issues:

The HMRC estimate of the tax gap does not include amounts lost on assets held offshore by UK taxpayers[32]. In 2022, the Government committed to publishing an estimate of the offshore tax gap for the first time, but they have delayed publication and there is no sign that it will be released this year[33]. This means the tax gap may be even larger: we have no way of knowing how much might be being lost offshore.

Andrew Park, Tax Investigations Partner at Andersen in the UK, said "In professing to have no current estimate of the scale of the offshore tax gap HMRC is effectively loudly proclaiming that it no longer has the necessary human resource to open sufficient investigations into offshore related matters to know what it still has to deal with. That cannot be in the general public interest."[34].

A major issue with offshore tax is non-resident trusts. Although there are legitimate reasons to set up a trust structure – it can make probate much easier for assets spread across jurisdictions, and in many cases this is perfectly legal, a report commissioned by the government found protecting assets from tax was one of the main reasons people use an offshore trust[35].

Policy

Boosting tax compliance

Labour will set a target to raise up to £5bn per year by the end of the next Parliament from action on tax compliance. This would be additional to the current compliance yield target for HMRC which is £40.5bn in 2023-24.

The Chief Executive of HMRC has said that for every marginal £1 that HMRC spends on compliance activity, there is a return of £9 in additional tax revenue[36].

This means we will need to invest £555m per year in additional HMRC resources to achieve £5bn in revenue by the end of the parliament. This would represent a 12% increase on the planned £4.7bn current budget HMRC has been set in 2024/25.

In addition, the National Audit Office have estimated using HMRC figures that investments in technology can achieve a return of £2 for every £1 of investment within a parliament[37].

HMRC's capital budget is facing a reduction of almost 40%, or £300m, in 2024/25. Our plan would reverse that reduction, with £300m made available to HMRC each year for an expected return of £3bn over the parliament. Unlike compliance staffing there is not a profile through the parliament available for capital spending but it would be expected that more of the revenue benefit would be back-loaded in later years.

EXAMPLE – Internal Revenue Service, USA

The US Inland Revenue Service (IRS) received a significant investment of $80bn over 10 years as part of the Inflation Reduction Act. Following the Act, the IRS announced a strategic operating plan covering the 10 years in which that investment takes place[38].

The plan covered five areas: improving services to help taxpayers meet their obligations, resolving taxpayer issues quickly when they arise, expanding enforcement activity focused on complex tax filers and high-value non-compliance, delivering cutting-edge technology and improving the IRS workforce.

The IRS have estimated the impact this investment will have on revenue.

This includes the effect from increased enforcement staffing, as well as wider measures that boost tax compliance, including better services that make compliance easier, as well as technology and analytic improvements in the IRS that will boost productivity. They have also included the impact of the deterrent effect that tax compliance activities have.

The IRS now estimate that a total return of $851bn could be reached between 2024 and 2034, if the IRA investment were to be extended to that year, with $497bn from enforcement and $354bn from technological and analytic improvements[39].

As well as the USA, other international examples show similar interventions generating a sizable return.

The 2022 Canadian budget highlighted "$2.2 billion in resources provided to the CRA since Budget 2016 which has yielded a return of five dollars to each dollar invested"[40].

The Australian Parliamentary Budget Office, modelling the tax plans of the then opposition Labour party, forecast revenue reaching 4.5 times the multiple of any increase in departmental spending on the Australian Tax Office[41].

How the additional resource will be deployed:

Labour will work with the Treasury and with HMRC to allocate the additional resource where it will be most effective in raising compliance yield and reducing the tax gap.

We expect our compliance plan to include:

- **Increasing staffing on compliance:** each FTE compliance officer accounts for £1.1m in additional tax revenue. Reaching £5bn will therefore require an additional 5,000 staff to be recruited and trained to work within HMRC. This would represent a less than 10% increase in HMRC staffing[42].
- **Focusing additional resource on segments with the greatest complexity and return**: some groups including larger businesses are rightly more likely to have a compliance check. This is because their tax affairs are more complex meaning the scope for error is higher, combined with the scale of any error being larger making it a sensible way to focus resources. Among other groups including smaller businesses, upstream compliance activity is a better use of resources to improve compliance yields[43].
- **A focus on offshore tax compliance:** informed by the findings of the first offshore tax gap estimate, due to be published in Summer 2024, Labour would assess what dedicated capacity for offshore tax compliance HMRC needs. Understanding and responding to offshore tax non-compliance is more complex than other segments due to difficulties accessing information held in other jurisdictions, and the complexity of internationally mobile high net wealth individual's tax affairs.
- **Improved quality control of compliance checks:** a recent Public Accounts Committee Report set out how every year HMRC samples 400 compliance cases to check if their numbers are right, and that in 80 cases the compliance yield recorded was wrong, and in seven cases the taxpayer had been overcharged. Overcharging means higher costs for HMRC in repayments and debt interest.
- **Drawing on external resource where effective to raise revenue in the short-term:** HMRC has been drawing more on external commissioned support to collect tax debt. We would explore whether more external resource could be deployed to raise tax compliance in the short-term as HMRC staff are trained.
- **Restoring a deterrent:** a part of this pot would ring-fence a portion of so-called "blockbuster" funding to be used on strategically important criminal cases, as determined by HMRC working with other departments and agencies, to ensure we bring back a strong deterrent where it is needed.
- **Improving customer service:** HMRC's customer service record is dire at present. This means that more and more taxpayers risk making errors in their tax returns. Alongside getting a grip on the rollout of digital solutions, Labour would seek to improve the core customer service offer.

Our technology investments will include:

- **Investing in digitisation to improve compliance and customer service:** the UK is falling behind other countries in terms of the range of data that is automatically provided within tax returns through pre-population, and our lack of email correspondence routes for taxpayers to speak to HMRC.
- **Longer-term investments to update technology in the department:** HMRC relies on legacy systems that are holding back the work of the department. As part of our work on HMRC modernisation (see below) Labour would look to put in place a plan to replace HMRC's legacy IT systems over time.

Alongside resourcing, there are legislative and regulatory changes that could help to tackle tax non-compliance. For example, HMRC themselves say they need legislative changes to maintain their current performance on upstream tax compliance[44]. Some legislative and regulatory options are:

- Taking forward the outcome of the current view on regulating the tax advice market.
- Requiring a wider range of tax schemes to be reported to HMRC, under the disclosure of tax avoidance schemes (DOTAS) rules. Currently many schemes are constructed to avoid the requirement to register. We will look to widen the scope of DOTAS and will consider whether to require all tax schemes to be disclosed.
- Strengthening HMRC's powers to enforce payment of tax in an investigation case. Currently these rules make it hard for HMRC to get the money it is owed, contributing to the tripling of tax debt since 2019.
- Quarterly reporting on volumes and nature of criminal powers deployed to the relevant ministers in HM Treasury and Attorney General's Office, to provide more oversight of HMRC's investigations teams. This reporting would not be public.
- Explore whether the tax gap could be further reduced if Deferred Prosecution Agreements, currently only used for corporate bodies, could be applied to individuals for tax evasion. DPAs are used at present to avoid a lengthy trial as the corporate can make full reparation without a conviction, under the supervision of a judge, with full transparency. And financial penalties. In the USA, where DPAs originate, they were initially used in targeting individuals before being broadened to also target corporates.

Accelerating modernisation and digitisation

An effective digital tax system will improve the experience for individual taxpayers, reduce the tax gap, and drive productivity gains for businesses.

Digitisation would also free up HMRC resources to focus on improving the experience of the tax system for taxpayers, dealing with more complex cases and supporting the digitally excluded.

HMRC's progress in digitisation has delivered some benefits, but according to the National Audit Office, there have been very substantial delays, costs have increased, and HMRC has not demonstrated value for money.

Labour will work with businesses, the tax profession and digital service providers to bring a new focus to HMRC's modernisation, including greater use of AI – learning from industry and best practice overseas to make sure its scope is ambitious, whilst having new, achievable timescales for delivery.

Appendix: Costings

We have reviewed Treasury and OBR costings of previous tax compliance investments, as well as examples from the USA, Canada and Australia.

The table below shows how the return on tax compliance will grow to £5bn over a parliament, based on the average profile of HMRC investments made this parliament that have been scored by the Treasury and verified by the Office for Budget Responsibility.

On technology, while no existing profile is available, the costing assumes the return from annual investment of £0.3bn is backloaded into the last three years of the parliament, based on the National Audit Office conclusion that technology investment will return £2 for every £1 of investment over a parliament.

	2025/26	2026/27	2027/28	2028/29	2029/30
Return on tax compliance additional resources	**£1.6bn**	**£3.3bn**	**£3.6bn**	**£3.8bn**	**£5bn**
Return from technology investment	**£0**	**£0**	**£1bn**	**£1bn**	**£1bn**
HMRC additional resource – maximum staffing budget*	**-£0.6bn**	**-£0.6bn**	**-£0.6bn**	**-£0.6bn**	**-£0.6bn**
HMRC additional technology investment	**-£0.3bn**	**-£0.3bn**	**-£0.3bn**	**-£0.3bn**	**-£0.3bn**
Total	**£0.7bn**	**£2.4bn**	**£3.7bn**	**£3.9bn**	**£5.1bn**

* This line represents the maximum staffing budget, which is expected to be used by 2029/30 to employ around 5,000 extra staff. As we scale up to this level, earlier years may see resources spent on external support, or an underspend.

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