

**Tackling the hidden economy: public sector licensing
HM Revenue & Customs (HMRC) consultation document
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We welcome the opportunity to respond to the HMRC consultation document on ‘Tackling the hidden economy: public sector licensing’, which furthers the principles discussed in the original consultation document published in August 2016 on ‘Tackling the hidden economy: conditionality’.
- 1.2 We support the idea that tax conditionality in public sector licensing could align with HMRC’s compliance strategy on all three points: to promote good compliance, to prevent non-compliance and to respond to non-compliance. However, we continue to be concerned that some of the proposals may fall short of achieving the desired objectives in particular scenarios.
- 1.3 We would like to reiterate two key messages from our response to the original consultation: firstly, that there are significant groups of individuals for whom tax conditionality will not achieve the stated objectives (and in some cases, achieve the opposite of the intended effect), and secondly, that a greater focus on appropriate tax behaviour, education and support is required.
- 1.4 In particular, we stress that if people have a propensity to evade tax, then they will likely have a propensity to evade any other type of registration or licensing process. Making such registration or licensing conditional on being registered properly for tax is therefore unlikely to have any impact in such cases. Tax conditionality is more likely to be successful if the government simultaneously educates members of the public about the importance of using licensed or registered businesses in the first instance.

- 1.5 In other cases, if the government is able to structure tax conditionality in such a way which safeguards against the potential adverse impacts and combines it with a longer-term approach on appropriate tax behaviour, we feel that tax conditionality could be a success in helping tackle the hidden economy – although this will have limitations which need to be considered carefully.
- 1.6 These include the facts that:
- A taxpayer who is registered is not necessarily compliant;
 - Testing tax registration at licence renewal, which in some cases is once every five years, allows ample opportunity for hidden economy activity in the intervening period;
 - An individual or business which is tax-registered in respect of say, self-assessment, may not be properly registered for PAYE or other taxes.
- 1.7 We agree that initial licence applicants should be signposted to information regarding their tax obligations. However, HMRC then have a responsibility to make this information easy to use and apply, to help taxpayers get things right first time.
- 1.8 Rather than ask a renewal applicant to provide ‘evidence’ of their tax registration, we think the licensing body should be able to verify a person’s tax registration reference with HMRC as quickly and easily as possible to minimise disruption to the licensing process.
- 1.9 The government should also ensure that they consult with and learn any lessons from the Gangmasters and Labour Abuse Authority (GLAA) who have a tax compliance licensing standard for businesses supplying labour into the agricultural, horticultural, shellfish-gathering and associated processing and packing industries (which soon may be extended into other sectors).

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998 LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.

- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction and General Comments

- 3.1 We welcome the fact that the government is furthering the proposals discussed in the original consultation document regarding conditionality and is seeking further input on how these proposals might apply in specific sectors.
- 3.2 We strongly believe that tax education is the key approach in order to nurture a society in which as high a proportion as possible of its members understand and comply with their obligations in relation to tax compliance.
- 3.3 As a general comment on how these proposals apply in specific circumstances, we would like to see tax conditionality introduced on licences only where the licensee is accountable for income generated for the licensed activity, and where the licensee has the obligation for the tax registration to report that income. There can easily be a mismatch, for example, the responsibility for registering an employee (the licensee) for Pay As You Earn (PAYE) lies with the employer, and in companies or partnerships the person registered for tax and the person applying for the licence may not be the same.
- 3.4 It should also be clear which tax registration(s) should be checked and in what circumstances. This can be particularly complicated where an individual is providing services through a limited company (see paragraph 4.3).
- 3.5 We set out our answers below to the consultation questions.

4 Q1. Please provide comments or evidence on the suitability of the government's proposals to apply conditionality to one or more of the licensing schemes outlined above. In your answer, please comment on:

- **The extent to which checks on people's tax-registration status would address problems highlighted in the relevant sectors, or whether additional or alternative measures of compliance should be considered**
- **How effective conditionality would be in improving standards of tax compliance in the sectors concerned.**
- **Any positive or negative effects that conditionality would have upon the compliant majority who trade in the relevant sectors; please provide details of any additional one-off or ongoing costs that might be incurred.**

- 4.1 As an example of the point highlighted in paragraph 3.3, in the private security industry sector, it is individuals who are licensed by the Security Industry Authority (SIA). Where the

individuals are employees (whether or not their employer holds approved contractor status), their employer has the obligation to withhold income tax and National Insurance through PAYE. Therefore, to introduce conditionality for an individual licensee would be holding the employee accountable for the employer's obligations. If the employee is found not to be properly registered for PAYE at the point of renewal, the employer is at fault in the first instance and it would be unfair to penalise the employee by denying them their licence.

- 4.2 We suggest that a more sensible approach would be for conditionality to be introduced for the applications to the SIA for approved contractor status, to demonstrate they are PAYE-registered.
- 4.3 We are particularly concerned about the use of conditionality for licences issued to landlords. For houses in multiple occupation (HMO) licences, we note that the licences are only required to be renewed every five years. For an individual letting an HMO, if they are not required to provide evidence of tax registration on first application, then by the time they come to renew their licence any hidden economy activity is likely to be quite embedded.
- 4.4 In addition, where a licence is denied to a landlord who lets an HMO because of their lack of registration, the tenants renting that HMO may have their tenancies terminated and be forced to find alternative accommodation. This could also be the case if the landlord is unable to continue in business because the disclosure of his historic tax liabilities would cause him to be insolvent. Many individuals who rent an HMO will be those on low incomes (e.g. students) or otherwise may be vulnerable members of society for whom the disruption caused would have a disproportionate impact. Consideration should therefore be given to improving the interaction with existing legislation which protects tenants in the event that the landlord is denied their licence to operate.
- 4.5 Finally, the issue of the hidden economy resulting from undeclared rental receipts clearly affects the whole rental sector, not just those landlords who require licences under the Housing Act 2004. For this reason and those described above, an alternative approach may be more suitable and as such we question whether the sector is appropriate for introducing conditionality.

5 Q2. Please provide comments or evidence on the suitability of applying forms of conditionality – or similar approaches to promote tax compliance – in the construction sector?

- **Are there any other sectors that the government should consider for similar applications of conditionality?**

- 5.1 It is well known that domestic services are prone to hidden economy activity, in part through the use of cash transactions.¹ This is therefore certainly an area where more could be done to promote tax compliance. However, applying a form of conditionality here would not be a complete solution. This is because often the driving factor in choosing someone to take down a wall in your house, or to remove some rubbish, is not whether they hold a licence (indeed, we wonder how many people even ask to see a licence), but whether they are offering the cheapest price.
- 5.2 We would therefore re-iterate here the need to educate the public on the benefits of – not just proper tax compliance – but only using licensed operators in the first place.
- 5.3 As part of dealing with this sector, conditions could be introduced for the customers of the business in question to require documentation in respect of transactions which states the vendor's tax registration number, as is already the case in other countries (such as Brazil²), and in a similar way to the requirement of a business to state its VAT registration number on VAT receipts. This may be either for the individual to claim that expense for their own tax purposes (where they are in business), or more generally to impose (as formerly the case in Italy, for example³) joint and several responsibility on the customer and business to ensure that the necessary sales taxes have been paid. This would engender a culture where those operating in the hidden economy will simply be forced into compliance by commercial necessity, or driven out of business.
- 5.4 A contractor's personal tax affairs are not the only issue. There are substantial numbers of individuals who are stated to be self-employed in the growing gig economy, as well as in more established industry sectors. For example, a recent Freedom of Information request made by construction union Unite reveals that 47% of the workforce are being treated as self-employed.⁴ The actual status of many such workers has been and continues to be subject to question, given the benefit to engagers in particular with regard to employer's National Insurance Contributions (NIC) and other related obligations.
- 5.5 The Government have recently announced a consultation on 'status' for employment law and tax law – looking at how to make it easier for people to work out the correct status that

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https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/654905/P11533_H_E_Final_report_MASTER_draft_v6_0_PC_FINAL.PDF - fig. 6.1, page 23

² <http://cglondres.itamaraty.gov.br/en-us/cpf.xml>

³ Article 11, paragraph 6, legislative decree n. 471/97

⁴ <http://www.constructionenquirer.com/2017/08/01/construction-self-employment-jumps-to-over-1m>

applies.¹ This is of course welcome, but there remains a problem – without tackling the underlying difference between the treatment of employees and the self-employed for tax (and NIC) purposes, there is always going to be the incentive for unscrupulous employers to foist self-employed status on vulnerable workers – whether it is correct or not. If those differences could be resolved, there would be greater scope to introduce changes to help tackle this issue and improve tax compliance in those sectors with high levels of reported self-employment.

5.6 In terms of the second part of the question, we think that all sectors where a licence is required should be subject to the same regime. We are uncomfortable with the idea that a scrap metal trader may be required to demonstrate some level of tax registration to obtain a licence, but a doctor, for example, is not required to demonstrate tax registration when revalidating their licence to practice or applying for a licence to prescribe certain drugs.²

5.7 It should also be remembered that there is a vast licensing regime already in operation by the GLAA and they have a licensing standard³ that covers tax:

‘A licence holder who employs workers under a contract of employment, contract of service, engages them under a contract for services or where the provisions of Chapter 7 of Part 2 of the Income Tax (Earnings and Pensions) Act 2003 apply must:

- *be registered with HMRC and have a valid PAYE number, and*
- *accurately calculate and deduct tax and National Insurance from all workers’ pay and pay the correct amount to HMRC in a timely manner.*
- *A licence holder who exceeds the VAT threshold must be registered with HMRC and charge and pay the correct amount of VAT in a timely manner.*

Please note

*Failure against this standard will lead to the licence being revoked without immediate effect’.*⁴

5.8 The Director of Labour Market Enforcement has recently suggested there might be a case for extending the GLAA’s licensing system into sectors such as social care, car-washing and construction.

¹ <https://www.gov.uk/government/publications/government-response-to-the-taylor-review-of-modern-working-practices>

² <https://www.gov.uk/guidance/controlled-drug-domestic-licences-for-doctors-how-to-apply>

³ <http://www.gla.gov.uk/media/2743/licensing-standards-may-2012-reprinted-july-2015.pdf>, page 13

⁴ This means that the labour provider can continue to operate until an appeal is heard. If the appeal results in a ruling in favour of the labour provider they will be able to keep their licence, otherwise they will lose their licence.

- 5.9 The Government therefore needs to be mindful of any administrative or operational overlap with their proposals and the work of GLAA.

6 Q3. Please describe how tax-registration or a similar standard of compliance could be introduced into existing terms and conditions of licences:

- **Would it be best to introduce tax conditionality as a new, standalone condition of licences, or would it be better included as a consideration with fit-and-proper person or similar checks?**
- **Would tax-registration be the best standard of compliance, or should a similar or broader standard of compliance be introduced – if so, what additional factors should be considered?**

- 6.1 We consider that if the objective is for tax registration to be checked upon each licence renewal in an easy and objective manner, it should be a delineated exercise so that it can be applied consistently and fairly, particularly as a licensing authority may, in addition, consider an applicant to fail a fit-and-proper assessment on the basis of not being properly registered for tax.

- 6.2 Clearly, providing evidence of tax registration is no proof that the applicant for a particular licence is fully tax compliant, but we acknowledge that a system which would require independent verification of an individual's tax position across all relevant taxes is unrealistic. Being obliged to provide evidence of tax registration would therefore appear to be the simplest approach to ensure that the individual has not entered the hidden economy simply because they were unaware they had to be registered in the first place.

- 6.3 We note that paragraph 16 no longer lists VAT registration as a check which might be introduced under this consultation, but it did feature in the list of registrations for the original 'Tackling the hidden economy: conditionality' consultation. We acknowledge that it would appear to be easy for the licence applicant to circumvent the need to provide details of a VAT registration number by simply asserting that their turnover does not exceed the registration threshold. We agree that the licensing authority should not be burdened with assessing whether or not a business should be registered (as stated in paragraph 18) and in any case they would not be in a position to independently verify an assertion that it should not. Indeed, we suggest that HMRC are in a much better position to verify whether or not a business should be registered for VAT as the relevant turnover figures will be clear to HMRC from self-assessment (whether for corporation tax or income tax).

7 Q4. Please comment on the proposed process for introducing tax checks into new licences.

- **How effective would it be in promoting registration?**
- **How easily could the required changes be introduced into licensing processes?**

- **Please provide details of any additional one-off and ongoing costs that might be incurred.**

- 7.1 We agree that it would not be appropriate to expect or check for tax registration upon the initial licence application as there will be many instances in which an individual is legitimately not registered at the time. We also agree that the opportunity should be taken at this point to direct the initial licence applicant to information regarding their tax obligations (and of course, this information must be accurate, unambiguous and not open to misinterpretation). Indeed, it would seem appropriate to require a declaration from the applicant that they understand their obligations, that they will register for the relevant tax(es) by the time they are required to do so under law, and that they understand this registration will be checked upon renewal of the licence in question. This would also help to ensure that licensees understand the future expectations on them in respect of renewing a licence.
- 7.2 Clearly, there will need to be a robust process in place to ensure that a business does not take advantage of the fact that they are not required to provide tax registration details upon the initial application. This may inadvertently encourage phoenixism in the case of corporate entities, i.e. the dissolution of a limited company followed by the registration of another which carries on the same business with the same owners, directors, employees, premises, operations, clients, etc. Phoenixism could mean that a business never actually has to provide tax registration details in order to obtain a licence, as each licence application would essentially be an initial application.
- 7.3 Due regard should also be given to what would happen in the event that the licence is not a renewal but nor is it an initial application, for example, if an individual or business formerly held a licence for the particular activity which has since lapsed. In these cases, we do not consider it appropriate to allow the applicant to circumvent the need to show that they are registered for tax purposes.

8 Q5. Please provide evidence on the likely effectiveness on these proposals in motivating more applicants to register with HMRC.

Q6. Please provide further evidence on the suitability of the options described for verifying the tax-registration status of people applying for licences.

- **If evidence of an applicant's registration status is generated through personal or business tax accounts, how could applicants transfer this to a licensing authority in a secure and efficient way?**
- **If evidence is generated through use of documentation, how could applicants transfer this to a licensing authority in a secure and efficient way?**
- **Would an option be needed for those who do not engage digitally with HMRC?**

- 8.1 In the cases of self-employed individuals registering for self-assessment and companies registering for corporation tax, we agree that asking these businesses to confirm their

Unique Taxpayer Reference (UTR) would be a straightforward way to demonstrate that they are registered for tax purposes. We consider that it would discourage those who have not previously registered for self-assessment from entering the hidden economy from the outset, and once in self-assessment their reporting obligations should be more difficult to avoid, deliberately or otherwise.

- 8.2 We question whether it would be necessary to require individuals to submit evidence of their UTR in addition to simply stating what it is. The aim here will be to motivate businesses to register; those who are motivated to provide a bogus UTR will also be motivated to produce bogus evidence to substantiate it. However, if the issue is considered to be of high enough risk, we suggest instead introducing functionality for the licence authority to verify this information directly, quickly and easily with HMRC, such as for the CIS scheme.¹
- 8.3 If it remains the government's objective to use employee information to confirm the employer's tax registration, it should be sufficient for that individual to simply confirm their own National Insurance number. There should then be a mechanism for the licensing authority to verify that reference with HMRC who would be able to confirm the employee's status from the Full Payment Submission (FPS) data submitted to it by employers. It is wholly unnecessary for an employee to provide sensitive details regarding their pay (which would be shown on a payslip or P60) to a licensing authority, and while a PAYE coding notice would provide less detail on an employee's remuneration it still may contain detail such as that employee's tax bracket or benefits.
- 8.4 As regards the checking of the references provided above, besides the CIS scheme, another example of a successful platform for doing so is the VAT Information Exchange System (VIES) VAT number validation tool,² which allows anyone to verify the validity of a VAT registration number issued by any EU member state.
- 8.5 Despite HMRC's objective to maximise the use of digital tax accounts as a means of interaction with its customers, there will always continue to be a cohort of taxpayers who do not engage digitally and for this group we strongly consider that alternatives should be available. As we stated in our response to the original 'Tackling the hidden economy: conditionality' consultation, some taxpayers who are unable to engage digitally may enter the hidden economy by default. Therefore, if HMRC do not provide a central checking system, such that evidence is required of tax registration beyond the provision of the relevant reference, clear guidance should be issued as to what kind of evidence would be sufficient and how a taxpayer might obtain a copy of such evidence if one is not readily available. We agree with the propositions in the consultation document as to the documentation which might be provided as evidence.

¹ <https://www.gov.uk/what-you-must-do-as-a-cis-contractor/verify-subcontractors>

² http://ec.europa.eu/taxation_customs/vies/

8.6 Finally, while we recognise that a business may theoretically ‘deregister’ for tax under various circumstances, we wonder what value is added by checking tax registration on the second and subsequent renewals of a particular licence. Is it really proving anything to provide the same evidence of tax registration as in the previous renewal? It may be that requiring the necessary evidence of tax registration on the first renewal only would strike a more appropriate balance between tackling the hidden economy and increased burdens on the licence applicants and the licensing authorities.

9 Q7. How frequently would applications have a permissible reason for not being registered in the sectors outlined in chapter 2.

- **If applicants have a permissible reason for not being registered, how should they be able to demonstrate this in order to obtain the licence?**
- **How can HMRC ensure that any process is simple for applicants and licensing authorities to administer?**

9.1 Where an individual or business has a valid reason for not being registered with HMRC – however infrequently this situation might occur – we agree that the process should be as simple as possible for the applicant and the licensing authority to deal with. Notwithstanding the above, we do not consider that it will be common for applicants to apply to renew a licence under which they do not intend to generate any income.

9.2 We do not consider it possible to be exhaustive about the number of possible reasons why this might be the case, and by extension it is not possible to be prescriptive about the evidence which might be required. The cases will have to be considered individually, and the applicant should be required to explain in a free-form text box in the application why they feel it is applicable to them.

9.3 In order to prevent any undue burden being placed on the licensing authority to determine whether or not such a reason is valid,¹ as it may require a degree of tax expertise, the licensing authority should have a mechanism whereby it refers these cases to HMRC for them to audit as resources would allow. The applicant will therefore be required to give consent for this information to be shared with HMRC and agree for it to be subject to checks.

¹ This may be long and costly for the authority, as in *FS Commercial Limited v Gangmasters Licensing Authority* – see <http://www.gla.gov.uk/media/2064/98-f-s-commercial-limited.pdf>

10 Q8. Should licensing authorities refuse to process licences where no evidence is provided to verify an applicant's declaration that they are registered for tax?

- 10.1 We agree that, in order to achieve the stated objectives in this proposal, it will be necessary for a licensing authority to be obliged to refuse to renew a licence where the applicant is unable to demonstrate they are registered for tax, unless there is a valid reason (see Section 7). This should be subject to a suspension process such that an appeal may be heard before the license is withdrawn (see Section 16). However, we do feel that provision of the relevant reference numbers (see Section 8) which can be verified with HMRC by the licensing body, should be considered as evidence of registration of itself, so as not to create an undue burden on the applicant to provide, and the licensing authority to verify, additional third-party documentation which is external to the application itself.

11 Q9. Please comment on data powers that might be needed to support the tax-registration checks described in this chapter.

- 11.1 We have discussed in our answers to the above questions where we feel it would be necessary for information to be shared between licensing authorities and HMRC in order to achieve the proposed objectives.

12 Q10. Please comment on the circumstances in which HMRC could disclose relevant information back to a licensing authority.

- **What action would licensing authorities wish to take in these cases?**
- **Are there circumstances in which licensing authorities would wish to be informed about a licence holder engaging in tax non-compliance, beyond a failure to register for tax? Please describe what these would be.**

In our view, the licensing authorities should not be viewed as extensions of HMRC and the information which HMRC disclose to a licensing authority should be limited to that which is required for the licensing authority to verify an individual's tax registration status. In other words, the additional burden required of a licensing authority should be minimised in order to mitigate the cost impact – on the compliant as well as the non-compliant – of any new regime. Where HMRC believe a taxpayer to be operating in the hidden economy, working with a licensing authority to rescind that individual's licence (for example) would not be aligned with the principles of tax conditionality, which currently relates purely to tax registration for the purpose of obtaining a licence and not tax compliance more generally.

13 Q11. What one-off and ongoing costs and administrative burdens do you think will arise as a result of this proposal? Please provide evidence on the extent to which these proposals would minimise additional administrative burdens for licensing bodies?

Q12. Are there any extra steps or safeguards that should be considered, particularly for customer groups who may find it difficult to provide proof that they are registered for tax?

13.1 The key to minimising the costs and administrative burdens of these proposals will lie in ensuring the evidence which is required to be submitted is simple and readily available. We believe that the use of tax references will fulfil these requirements and that the submission of accompanying documentary evidence for these references to be checked manually would be clunky and burdensome. A faster and more reliable system would involve a mechanism whereby the licensing authority can cross-reference the references provided with HMRC on a digital platform, as discussed in Section 8.

14 Q13. Do you agree that the proposals set out in chapter 3 strike an appropriate balance between the need to safeguard customer privacy and to address risks posed by the hidden economy? Are there any different or additional safeguards that the government should consider?

14.1 We believe that implementing tax conditionality in a way which minimises the transfer of sensitive financial information between the licence applicant and the licensing authority should achieve the stated objectives while minimising the risk to customer privacy.

15 Q14. Please provide evidence on the extent to which these proposals would minimise administrative burdens for licensing authorities. What factors should be considered to ensure that changes do not alter the regulatory effectiveness of existing regimes and processes? Are there any extra steps or safeguards that should be considered?

15.1 The principal purpose of a license should remain as certification of compliance with the relevant legislation in order to operate. The introduction of tax conditionality to the licence application process should therefore be a distinct add-on which aligns as much as possible with the process but does not divert the resources of a licensing body away from ensuring sector-specific regulatory compliance. To do so would address one problem by allowing another to manifest.

- 16 Q15. Please describe appeal mechanisms that would, or should, apply in relation to the proposals detailed in chapter 3. Please describe any additional one-off and on-going costs or any administrative burdens associated with these proposals, and how these could be kept to a minimum.**
- 16.1 Where a licence is denied to an individual (or business) on account of their failing the tests relating to tax registration, this could have potentially devastating effects on that individual's ability to trade and earn a living to support themselves or their families, those they employ and those who engage that individual's services. In other words, the impact could extend to innocent parties. Where the renewal is denied on account of failing tax registration checks, an appropriate suspension process should be triggered, meaning that the licence would not be withdrawn immediately.
- 16.2 Similarly, if a licence is granted subject to conditions which may be unreasonable or impracticable (for example, where the applicant is required to demonstrate tax registration within an unreasonable timescale or where an applicant who is digitally excluded is asked to provide information electronically), the licensee should be allowed to appeal if he feels these conditions are unfair.
- 16.3 It is critical that a proper appeals process be in place to allow a fair opportunity for an applicant to appeal the suspension (or unfair conditions). The individual (or business) should only lose their licence after the appeal process has been completed. This would ensure business continuity until a final decision has been reached, protecting all parties potentially impacted.

LITRG
2 March 2018