Public Accounts Committee
Call for evidence: Tackling the tax gap
Response from the Low Incomes Tax Reform Group (LITRG)

1 Introduction

1.1 *About Us*

1.1.1 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.

1.1.2 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.

1.1.3 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.

1.2 *Our interest in this call for evidence*

1.2.1 We are specialists in tax and related welfare benefits for people on low incomes. We provide online guidance[1] on these matters which, in 2019, received over 5.5 million unique visitors.

1.2.2 We are regularly contacted by members of the public via our websites with questions about their tax affairs. These contacts reflect how most unrepresented taxpayers try hard to get their tax affairs right, but sometimes fail because of confusion (so they inadvertently get things wrong) or lack of financial knowledge (such that they are drawn into tax avoidance schemes such as those targeted by the disguised remuneration loan charge). Both of these problems – compounded by sometimes inadequate or misleading guidance from HMRC – contribute to the tax gap. HMRC also have the ability to correct mistakes to help close the tax gap, for example through using information they already hold about taxpayers, but this is not always put to best use.

[1] Our main website for the public being www.litrg.org.uk

1.2.3 We give examples below of each of these three areas of concern.

2 Taxpayer confusion – compounded by inadequate, or misleading, terminology and guidance

2.1 A key point here is that it is far better to help people get things right up-front than to deal with issues further down the line. We discuss below (section 4) how HMRC could make better use of data to help achieve this. However, a big part of closing the tax gap is helping people to understand their tax affairs and supporting them to get them right.

2.2 *Terminology*

2.2.1 It is within policymakers' (rather than HMRC, as administrators of the tax system) control to help towards people's understanding of tax by using consistent terminology when making new law.

2.2.2 For example, it is confusing for people in the extreme that tax legislation uses the term 'allowance' to mean a number of different things, operated in different ways. The personal and blind person's allowances are deducted from taxable income, whereas the personal savings and dividend allowances are in fact nil rates of tax. With the latter, the income remains taxable, which means that a person can remain a taxpayer albeit at a nil rate. By assuming that all 'allowances' work in the same way, serious miscalculations of individuals' tax liabilities can arise – as illustrated by the case study below (based on an enquiry to our website). The differences also make the law very hard to explain by HMRC and others, such as ourselves, when seeking to support taxpayers.

> *Case study – dividend allowance*
> An individual incurred an unexpected tax liability of over £15,500 on his state pension lump sum,[1] having thought he was a non-taxpayer. In fact, he was a basic rate taxpayer, but his dividend income that fell within the basic rate band was taxed at a nil rate due to the dividend allowance. His (understandable) mistake was in thinking that the dividend allowance worked the same as the personal allowance – i.e. as a deduction from total taxable income.

2.2.3 It may be difficult to align existing definitions without a great deal of work and evaluation of winners and losers, but it is possible to:

- avoid introducing new or subtly different definitions of the same term, by including a formal step in policymaking to address this
- review how existing definitions might be aligned as and when other changes are made.

[1] Pre-6 April 2016 state pension lump sums are taxed in a unique way – applying the highest main rate of income tax applicable to other income. Sections 7 to 10 Finance (No 2) Act 2005. See also our article, November 2019: https://www.litrg.org.uk/latest-news/news/191114-claiming-state-pension-lump-sum-check-your-tax-you-act

2.3 ***HMRC pre-populating data***

2.3.1 While, as we explain below, HMRC making best use of data they already hold is welcome, it does present some practical problems. This is because the more HMRC reinforce taxpayers' perception that they already know everything about them by replaying data through digital, prepopulated systems, arguably the greater the risk of people simply taking the data as read (and therefore contributing to the tax gap by leaving errors uncorrected). It also means that people think they do not need to tell HMRC about changes.

2.3.2 Therefore, at the very least, HMRC need to be clear as to:

- the data they have and how it has been used;
- what taxpayers need to do to check and correct data; and
- what taxpayers need to do to notify any changes of personal circumstances (for example, a change of address).

2.3.3 However, there is a bigger question to be answered here, which is whether – given HMRC's increased data-matching ability, facilitated by digitalization – the balance of responsibility between HMRC and individuals is correct. Should the onus shift more onto HMRC to get individuals' tax right? A review of the balance of responsibility between HMRC and taxpayers is required. This is echoed in our comments under section 4 below where we give recent examples of HMRC's failure to make use of data available to them to help get individuals' tax affairs right (and hence close the tax gap).

2.4 ***Support, and accessibility thereof***

2.4.1 One final point under this heading relates to the accessibility of HMRC services by the general public. For instance, HMRC's making tax digital programme might be welcomed by most in terms of modernising the tax system, however people who need 'human' support in dealing with their affairs must still have access to it. Without it, the efforts to help close the tax gap via digital improvements will be compromised – with those left behind potentially falling into non-compliance.

2.4.2 For instance, HMRC must continue to provide telephone numbers on correspondence. In addition, while HMRC's extra support service is welcome, it might be that HMRC could do more to proactively identify those who need help (for example, systems could flag where a previously compliant taxpayer falls into non-compliance). HMRC must also recognise that they have limited ability to provide extra support in cases of suspected non-compliance and taxpayers need to be signposted to independent support as appropriate, given that HMRC would have an inherent conflict of interest in supporting a taxpayer through an enquiry or dispute.

3 Lack of knowledge and being drawn into schemes

3.1 The tax system is complex and most people do not understand it.[1] Low-income, unrepresented workers may find that they are offered work on the basis they operate through a company structure (and, if they need the work, may have little choice but to accept). They can be drawn into arrangements they do not understand, such as umbrella companies and tax avoidance schemes such as those being targeted by the disguised remuneration loan charge.

3.2 We believe that HMRC could do more to tackle these types of arrangement, for example by:

- making it easier for people to raise employment status issues and report non-compliance by engagers;
- educating people about avoidance schemes through outreach initiatives (some effort is already made to do this, but in publications such as HMRC's Employer Bulletin, which is not likely to reach individuals who need the information);
- developing a clear action plan to identify exploitative schemes, and aiming to protect workers.[2]

3.3 Without a cohesive and comprehensive strategy to tackle employment arrangements, the impact of introducing certain measures, such as off-payroll working for public sector employers (to be extended to the private sector from April 2021), has apparently simply delivered a 'Medusa effect'. Where one head is cut off, another immediately grows back, with workers continuing to be caught in the middle.

4 HMRC's failure to use information available to them

4.1 Under section 9ZB of the Taxes Management Act 1970, HMRC have a time-limited power to correct obvious errors or omissions in personal or trustee tax returns, or anything else in the return which they have reason to believe is incorrect in the light of information available to them.

4.2 However, use of this power would seem to rely on one of two things:

a) HMRC's system being programmed to pick up obvious errors (which we understand does happen in relation to, for example, correcting amounts of state retirement pension which are returned inaccurately) – i.e. the computer comparing the figure returned to that held on file automatically; or

b) an HMRC officer looking at the return and identifying a mistake.

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[1] See 'The Tax Education Gap' report by Deloitte LLP, September 2019: https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/tax/deloitte-uk-tax-education-gap-explanatory-note.pdf

[2] See for example our comments on off-payroll working measures: https://www.litrg.org.uk/sites/default/files/190528-LITRG-response-off-payroll-FINAL.pdf

4.3 It should be noted that there is nothing obliging HMRC to use this power, however in some instances – two examples of which are given below – it might be argued that HMRC's failure to use it is tantamount to maladministration.

4.4 We understand that HMRC aim to do more pre-population of information, through their plans for building a trusted, modern tax administration system.[1] We hope that steps towards the objectives set out in this plan are made as soon as possible, given that there are clear examples of where HMRC failing to use data available to them has contributed to the tax gap (and to costly interventions attempting to close it).

4.5 Two specific examples of this spring to mind: Construction Industry Scheme earnings and the High Income Child Benefit Charge. We explain each in turn.

4.6 ***Construction Industry Scheme (CIS)***

4.6.1 Under CIS, the contractor deducts a flat rate of tax from payments made to the self-employed subcontractor. The subcontractor should then report their total earnings on the self-employment pages of their tax return each year, together with the total tax deducted.

4.6.2 This might sound straightforward enough, however, when it came to the government supporting the self-employed as a result of coronavirus, via the Self-Employment Income Support Scheme (SEISS), we received several reports of CIS workers being told that they are ineligible for SEISS grants. Upon closer inspection, this is because their income and CIS tax deductions have been reported on the Employment pages rather than Self-Employment pages of their tax return. Given that, for the purposes of SEISS, no amendments could be made to returns after 6pm on 26 March 2020,[2] these individuals could not correct their mistake and claim the grants even though they were in fact self-employed and within the category of people who the SEISS grant was intended to help.

4.6.3 The question is then: why would CIS workers make such a mistake, and why did HMRC not act before to correct it?

4.6.4 In answer to the former, the tax system does not help CIS workers to understand their status. For example, CIS workers must be given a payment and deduction statement[3] ('payslip') each month which – confusingly – includes a box for the "employer's" tax reference, thus giving the impression that the CIS worker is in fact an employee. As regards the latter part of the question,

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[1] HMRC / HM Treasury corporate report, 21 July 2020: https://www.gov.uk/government/publications/tax-administration-strategy/building-a-trusted-modern-tax-administration-system

[2] SEISS first direction, para 10: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/882593/SEISS_Direction_Final_-_SIGNED.pdf

[3] https://www.gov.uk/government/publications/construction-industry-scheme-payment-and-deduction-certificate

it seems extremely odd to us that HMRC did not routinely use their powers to correct tax returns where CIS income was reported on the employment pages (or, if not, otherwise enquire into/compliance check these returns). HMRC's system should have been 'expecting' those earnings to be reported as CIS income and would not have been 'expecting' any employment income given the absence of PAYE real-time information data. This seems like an 'obvious error' which HMRC's systems should have flagged up.

4.6.5 Affected individuals are now not only unable to access the SEISS grants, but have to put right their earlier mistakes. There might be unpaid classes 2 and 4 National Insurance contributions to rectify, even if the income tax position is correct. Such cases have therefore directly contributed to the tax gap, even though identifying and correcting them early would seem to have been relatively straightforward for HMRC to have done.

4.7 ***High Income Child benefit Charge (HICBC)***

4.7.1 The HICBC is levied where the child benefit claimant or their partner has adjusted net income of £50,000 or more a year. We are now seeing a raft of cases coming to tribunal where HMRC are seeking to collect this charge for earlier years and whether or not HMRC's 'discovery' powers[1] can be applied.

4.7.2 In such cases, it is easy to see how the taxpayer is flabbergasted at HMRC asserting they have 'discovered' a tax liability – given that HMRC administer child benefit and, by virtue of PAYE, would have known that the claimant's income was over the threshold for paying the charge. It was therefore within HMRC's gift to marry the two sets of data together and rectify the position much sooner – and even forewarn the taxpayer of the need to consider their liability to the charge.

4.8 ***A caveat – inaccurate data***

4.8.1 As above, we encourage HMRC to make better use of data they already hold in an effort to help close the tax gap. In addition to our comments under para 2.3 above about being able to check data, there is a further caveat to highlight here. This is that people need to be able to correct inaccurate information held about them and there needs to be an easy mechanism for them to do this.

4.8.2 One such problem area is the use of PAYE data from employers. The employee is asked to take up mistakes with their employer. The employee is then placed in the difficult position of

[1] S29 TMA 1970. In *Wilkes v HMRC* [2020] UKFTT 256 (TC), the taxpayer successfully argued that the discovery assessment was not valid, on the basis that there was no income which ought to have been assessed that was not assessed (as neither the charge nor the child benefit is taxable income). However, the decision is not binding on HMRC or on other judgments at the first-tier tribunal (for example, see *Haslam v HMRC* [2020] UKFTT 304 (TC) in which the judge decided that a "rectifying interpretation" of the legislation was justified such that a discovery assessment could be used to assess the charge).

approaching the employer to suggest they may have sent incorrect data to HMRC. The following query to our website illustrates how frustrating this is for taxpayers.

> "I was made redundant and left work on 31/03/2018 - the 2017 to 2018 tax year. My redundancy payment was made on 28/04/2018 - the 2018 to 2019 tax year. I have spoken to HMRC regarding getting a refund on the tax I paid on my redundancy payment. They said they had no record of the payment - I have a wage slip and bank statement with the payment.
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> "Eventually they found the details but it is not reporting in the 2018-2019 tax year. They maintain that it is my ex-employer's issue as they have sent the wrong data through. I have spoken to my ex-employer and they said that everything is correct and that the tax office is wrong and I should speak to someone else as would probably get a different answer. I have done this and got the same answer, i.e. the data sent through by the employer is wrong…
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> "I feel stuck in the middle and going around in circles. I do not have the knowledge to speak to my employer and they keep fobbing me off. I suffer from depression and anxiety as well as caring for my disabled wife. I feel very overwhelmed with this and get upset just thinking about it. I just do not feel able to cope with it."

4.8.3 This problem is compounded further when the HMRC data is then used for other purposes. For example, HMRC might use tax data to finalise a tax credits award, or pass it to DWP for universal credit to be calculated. It is therefore vital that queries can be resolved without delay – not only to reduce the tax gap, but also so that there is not a further loss to the Exchequer downstream through overpaid benefits.

LITRG
21 August 2020