

Tackling the hidden economy: Conditionality
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: conditionality’. We are pleased that HMRC are consulting at a very early stage in the development of the policy, as there are many complex issues to consider.
- 1.2 We have some serious concerns that conditionality as proposed in the consultation will not tackle certain groups within the hidden economy, such as those who are not only hidden for tax purposes, but for other official purposes too, and those who do not require a licence or trade registration in order to operate.
- 1.3 A system of conditionality would have to be structured very carefully to ensure that it does not drive taxpayers further into the hidden economy and inadvertently discourage disclosure which would be entirely counter-productive.
- 1.4 We think the principles for conditionality set out in the consultation document are reasonable, however additional principles of ‘achieving support or buy-in from those affected’ and ‘keeping it simple and easy to operate’ should also be followed. In order for conditionality to be successful, these would be crucial pre-requisites.

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 HMRC are looking at ways to improve compliance by design, such as the use of conditionality explored in this consultation document. As set out below, we have mixed views on these proposals, but we note that these proposals are at an early stage and hope that our comments will be useful in developing further policy and provide some further questions and ideas to consider.
- 3.2 While we acknowledge the benefits that a digital tax system can bring to many, we note that there is a risk of some taxpayers, who feel unable to engage digitally, entering the hidden economy by default. This means the impact of the speed with which it is being proposed to roll out the Making Tax Digital (MTD) strategy on risk in relation to the hidden economy needs to be considered carefully. Careful consideration must be given to what the appropriate approach is, not just for the taxpayer, but also for HMRC, to ensure future compliance.
- 3.3 HMRC's principle about promoting good compliance (and making it easier for people to get things right) is one that we agree with. We are concerned, however that there is a mismatch between this message and policies such as the trading allowance of £1,000 and the rental allowance of £1,000 announced in Budget 2016. We understand that there is confusion about the start date for these allowances;¹ the lack of detail currently available about how they will operate also means there is a risk that some individuals will not notify new sources of rental or trading income to HMRC, mistakenly believing that they do not have to. So, unless good communications and educational messages surround the launch of these

¹ The allowances are due to take effect from April 2017, but we understand that there is a wide held misconception that these were available from April 2016.

allowances, we think that there could be a risk of them leading to taxpayers falling into the hidden economy inadvertently.

- 3.4 We welcome the fact that HMRC are seeking to develop new ‘promote’ interventions, including guidance and tools for new businesses and those about the start-up, and also work with schools. We would encourage the use of such programmes as education is key to enabling people to comply with their responsibilities. Historically there has not been any tax education in the school curriculum; even now, tax education is patchy. Since the tax system is complicated and the Pay As You Earn (PAYE) system encountered by most individuals discourages engagement with the tax system, it cannot be assumed that the average member of the public understands the tax system or their responsibilities within it.
- 3.5 Just as the taxpayer has responsibilities, so too do HMRC. In particular, we think HMRC have a responsibility to advise and educate taxpayers. This will help to ensure that those who wish to comply, can, and that they do not receive the same treatment as those who are deliberately non-compliant. We also think HMRC can assist those whose failure to comply is a result of being unable to cope with the system – we think compliance teams should work with the NES service, to ensure taxpayers in this position are guided towards compliance in the most customer-friendly way possible.
- 3.6 We held a roundtable in February 2016,² at which Professor Colin Williams of the Sheffield University Management School gave a presentation. This referred to research conducted across the EU to examine the association between participation in the hidden economy and views on sanctions, risks of detection and ‘tax morality’. The results of the research suggest that views of sanctions do not necessarily correlate with propensity to participate in hidden economy; likewise, perceived risk of detection does not necessarily correlate with propensity to participate either. On the other hand, the results suggest that there is a strong correlation between propensity to participate in the hidden economy and tax morality. The conclusion to be drawn from the results is that the key to tackling the hidden economy is to improve tax morality.
- 3.7 Tax morality can be improved by changing societal attitudes through tax education. It can also be improved by changing rules to enhance support and advice available to taxpayers, and also by making it easier to comply.
- 3.8 We note that the existing Money Laundering Regulations 2007 are referred to in paragraph 4.6 of the consultation document. As set out in case study three, these require due diligence in terms of determining a customer’s identity. In addition, however, these regulations demand that those complying understand the source of funds for a transaction, such as buying a house.³ We wonder whether consideration has been given to strengthening or

² Can tax education tackle the hidden economy? – Low Incomes Tax Reform Group Roundtable (16 February 2016).

³ In particular Regulations 8 and 14. In addition, see the guidance from the Law Society, which states, “In many ways, client identification and verification is secondary in anti-money laundering compliance

widening these requirements, or simply ensuring that they are properly understood and implemented.

3.9 It may also be possible to draw lessons from the Tell Us Once scheme, which operates in the case of bereavements, allowing an individual to report a death to most government departments in one go.⁴

3.10 We set out below answers to selected questions. We have not included the questions for which we have no comments.

4 Q1. Do the examples set out at paragraph 1.15 provide a good starting point to define ‘tax registration’ when thinking about conditionality? Are there any other requirements which should be included in this definition?

4.1 If the approach is adopted that tax registration is the responsibility of the individual or the business, then we agree that the examples set out at paragraph 1.15 provide a good starting point.

4.2 An alternative approach might be to adopt a system whereby HMRC register everyone for a tax account / provides everyone with a tax reference, in a comparable manner to the issue of National Insurance numbers by the Department for Work and Pensions (DWP). This reference would have to be displayed on bills and quotes provided in the course of a business, in a similar way to VAT registration numbers, giving the recipient of goods or services the opportunity to check whether or not the tax reference was genuine and the ability to refer any concerns to HMRC.

5 Q2. What is your view on HMRC’s assessment of how conditionality could tackle the hidden economy?

Q3. Do you agree that conditionality could promote a cultural norm of tax registration?

5.1 We have mixed views on whether or not and how conditionality could tackle the hidden economy. At the February 2016 roundtable,⁵ there were differing opinions on not only why people do not declare their income (whether some or all) to HMRC, but also on how to tackle the issue.

to understanding the source of funds”, <https://www.lawsociety.org.uk/support-services/advice/articles/source-of-funds-clean-or-consistent-risk/>.

⁴ <https://www.gov.uk/after-a-death/organisations-you-need-to-contact-and-tell-us-once>.

⁵ Can tax education tackle the hidden economy? – Low Incomes Tax Reform Group Roundtable (16 February 2016).

- 5.2 Taxpayers that present to the tax charities often indicate a desire to put their tax affairs right, for example, when retiring, but they simply do not know where to start in order to do so. In some cases, the end result is that the taxpayer is owed more by the state (for example in unclaimed welfare benefits and tax credits) than he/she is due to pay in tax. Equally, there will be others who have simply fallen into the hidden economy (despite wanting to do the right thing) because they did not understand their responsibilities fully, how to deal with them or where and how to get assistance. Often, a single issue or oversight quickly grows out of control. In cases such as these, an educational and supportive approach might be more effective – enhancing understanding of what taxes are used for and improving tax morality, for example.
- 5.3 We have some concerns that conditionality as proposed in the consultation will not tackle certain groups within the hidden economy, as set out below. Here, we deal with those who have taken a conscious decision to operate in the hidden economy, unlike those discussed in paragraph 5.2 above.
- 5.3.1 Some traders operating in the hidden economy may be ‘hidden’ not just for tax purposes, but for other purposes too. Such traders are unlikely to be registered with any professional or trade body, or licensed for the purpose of whatever trading activity they pursue.⁶ Making such registration or licensing conditional on being registered properly for tax is unlikely, therefore, to have any impact in such cases.
- 5.3.2 Some traders operating in the hidden economy will not require any professional or trade registrations or licences.⁷ The conditionality proposals in the consultation will not affect such cases.
- 5.3.3 There are other businesses, perhaps larger and more established, that will also not be affected by the proposals in the consultation. This is because they are properly registered for tax, and indeed pay tax. However, they under-declare their income. Some businesses may do this to ensure their declared turnover stays under the VAT threshold, thus avoiding the compliance burden of accounting for VAT, and ensuring they do not have to charge VAT (which could cause them to lose customers). Since they are registered, conditionality would not affect their ability to obtain requisite trade licences.
- 5.4 If, in order to obtain a full disclosure – which will result in penalties and a bill for back-taxes – HMRC cause a trader’s license or registration to be denied them, there is a risk that it could have one of two effects: either the trader will dig themselves still deeper underground and operate without registration or licensing; or they will lose their livelihood and with it the

⁶ For example, a trader that carries out garden clearances and takes away rubbish should obtain a waste carriers licence. If they are in the hidden economy for tax, they may also not have the correct licence, and may discard the waste by fly-tipping.

⁷ By way of example, a window cleaner only needs a few items of equipment in order to trade, such as a ladder, cloth, spray, bucket, etc.

means to pay the penalties and back-taxes that will follow upon full disclosure, thereby taking away any incentive to leave the hidden economy. Thus the use of conditionality could result in more people not engaging in the system (tax and other official bodies). This could in turn result in lower incomes and family poverty. To ensure this is not the consequence of conditionality, it would have to be structured carefully.

5.5 We note that the intention is to ensure tax registration through conditionality. Although this might improve compliance in terms of registration and notification, ensuring tax registration will not, in itself, tackle the tax gap. Traders may register for tax purposes, to ensure they are able to obtain licences, etc., but then they may under-declare profits. The point being that those intent on finding a way around the rules will find one.

5.6 HMRC would also need to educate the general public and business customers to ensure they use traders and providers of services who operate fully within the formal economy. Unless this happens, those operating in the hidden economy will continue to find customers. In addition, even if they are required to show some sort of credentials, this is not helpful unless the customer is aware of what licences a particular business should hold or enabled to identify whether or not the credentials are valid.

6 Q4. Do you agree with the principles set out at paragraph 3.2? Are there any additional or alternative principles which should apply?

6.1 If conditionality were applied to licences or services, we think additional principles should be 'achieving support or buy-in from those affected' and 'keeping it simple and easy to operate'. We think that in order for conditionality to be successful, these would be pre-requisites.

6.2 We recognise that conditionality could bring benefits for customers and compliant traders, who suffer unfair competition from the non-compliant. In order for it to be successful though, we think it would have to be simple and inexpensive for all parties (and we think HMRC would need to carefully consider how they can assist in ensuring this is the case). In addition, we think there would need to be a clearly publicised link to benefits for compliant traders and the public (customers) – and this would need to be properly communicated, so that the public and compliant traders support it.

7 Q5. What are your views of the merits or drawbacks of applying tax-registration conditions to public sector licences, such as those described in this chapter?

7.1 Requiring licensing authorities to put in place additional checks to ensure that applicants' tax affairs are up to date as a condition of granting the licence is likely to cost the licensing authorities more, and the additional cost will be passed on to licence fee payers – i.e. the compliant ones as well as the non-compliant.

- 7.2 The key to success would therefore be to make it simple, and make the benefits for the general public and compliant businesses plain to see.
- 7.3 For sole trade businesses the taxpayer should be the same as the person applying for a public sector licence or registration. For larger businesses however, whether companies or partnerships, there may be a mismatch between the person registered for tax and the person applying for a licence. It would be necessary for any system of conditionality to be able to cope with any such mismatches, such that compliant businesses are not incorrectly rejected when applying for licences.
- 7.4 We would also like clarification of where this proposed strategy sits in relation to HMRC's CONNECT system? In particular, it would be helpful to have confirmation that HMRC will continue to use that system as another approach to tackling the hidden economy.

LITRG
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