

## Restricted - Budget



**HM Revenue  
& Customs**

...

(Anti-Avoidance Group)  
(Central Compliance)

**DATE: 13 February 2008**

**CHANCELLOR-**

**DIRECT TAX GAP: LARGE BUSINESS & AVOIDANCE**

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### **Background**

- 1. Broadly, the tax gap is the difference between the tax that should be paid and that which is actually paid. ...**
- 2. We have for some years published estimates of the main indirect tax gaps. The numbers here are large – c. £15bn a year. Although they have led to some criticism, most notably when MTIC fraud jumped in 2005/6, on the whole the reaction has been fairly muted, largely because of the balancing good news story that strategies to address these gaps has resulted in them falling.**
- 3. The position is different for direct tax. Although strategies for large business and on anti-avoidance have seen success they are harder to gauge by reference to the tax gap. Direct tax gaps are much more difficult to measure precisely because the taxes are more complex. But in 2004 HMRC did some preliminary work, which was heavily based on assumptions and experience in other countries, to provide a broad handle on the range in which the gap might fall. This work, which is the subject of the Fol, estimated the overall tax gap as lying in a range of £ 11-40bn p.a. (including £5bn-15bn being attributable to avoidance) – see attachment for details. The methodology was not robust and that is basically why we resisted the Fol request, but the overall figures at 4-16% of total tax yield were broadly consistent with the 8-13% that has been calculated in other countries. An assumption that the UK**

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tax gap was of this scale was stated in the O'Donnell report on the merger leading to the creation of HMRC.

4. Since then, work has continued to improve methodologies. At PBR the Govt published details of *some* direct tax losses, amounting to £5bn, but has yet to publish figures for tax losses attributable to large business or avoidance, which are widely (and rightly) assumed to be significant contributors to the overall direct tax gap.
5. HMRC now have estimates of the tax gap in these two additional areas ... This would show identified net losses of around [£5bn] p.a. from the use of avoidance schemes and a further [£2.5bn] p.a. losses arising from other issues identified operationally.
6. It is important to recognise that these figs do not give a current picture. Much of underlying data refers to 2004/05 and predates many legislative and operational developments. ...
7. The character of the tax gap is not constant. It arises because some businesses and individuals see tax as cost that they need to reduce and actively look for ways to do it. Some resort to evasion or fraud, but many of those who try to manage down their tax bills engage in active tax planning or in avoidance. For large businesses in particular, opportunities to manage down their tax bills may include international tax planning resulting in disputes with HMRC on transfer pricing. Globalisation means that complex international issues are

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**becoming increasing common. In an area as inherently complex as tax, there are also instances where genuine differences in opinion as to the meaning of the law can mean that HMRC does not collect as much tax as it and HMT would expect.**

- 8. The continued appetite for ways to save tax means that as one loophole is closed, some will seek to avoid tax via another loophole, but as UK Govt closes more loopholes more effectively, there are others who look to achieve tax saving by changing their own structures and ways of operating for example by offshoring parts of their operations. Such moves create fiscal risks which go beyond non-compliance, and which could be exacerbated by any perception of a heavy handed crack down on avoidance.**

**...**