

MEASURING TAX GAPS 2011

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Introduction

This statistical release presents estimates of tax gaps for 2009-10 in HMRC administered taxes and follows the publication of estimates for 2008-09 in 'Measuring Tax Gaps 2010' last year.

Estimating the scale of, and trends in, tax gaps is difficult and a relatively untested area of work for governments in the EU and around the world. HMRC has developed estimates for tax gaps for the main direct and indirect taxes that it administers that it believes are the best possible, based on all the information presently available. However, uncertainty in the estimates means that HMRC continues to review the methodologies in the light of new information and data. For this reason, the estimates are subject to periodic change, as improved understanding and new methods become available.

A summary of the methodology for each tax gap estimate is outlined in the document, with more detail on data sources and methods in the separate document 'Methodological Annex for Measuring Tax Gaps 2011'. Of particular note is the fact that the estimates presented are potentially subject to both random and systematic errors.

HMRC welcomes feedback on this paper from businesses, academic experts, and other interested parties, with a view to discussing and, where possible, improving these methodologies further. To comment on the report or methodologies presented, please use the contact details below.

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Tax gap overview

- 1.1 This section discusses the tax gap across HMRC-administered taxes¹. The tax gap is defined as the difference between tax collected and the tax that should be collected (the theoretical liability). The theoretical tax liability represents the tax that would be paid if all individuals and companies complied with both the letter of the law and HMRC's interpretation of the intention of Parliament in setting law (referred to as the spirit of the law). The tax gap estimate is net of the Department's compliance activities. An equivalent way of defining the tax gap is the tax that is lost through non-payment, use of avoidance schemes, interpretation of tax effect of complex transactions, error, failure to take reasonable care, evasion, the hidden economy and organised criminal attack.

Estimate of the overall tax gap

- 1.2 Overall the total tax gap is estimated to be £35 billion in 2009-10. This equates to around 8 per cent of the estimated total tax liability² for 2009-10. Table 1.1 shows estimates for the tax gap for 2008-09 (revised) and 2009-10 across HMRC administered taxes. The estimates show a decrease in the tax gap of £4 billion from 2008-09 to 2009-10. This decrease is mainly due to reduction in the VAT gap since 2008-09 following the reduction in the standard rate of VAT from 17.5 per cent to 15 per cent between 1st December 2008 and 31st December 2009.
- 1.3 All of the tax gap estimates shown are subject to error. The main sources of error are random errors due to sampling and systematic errors due to assumptions used to derive the estimates. Where possible the range within which the true estimates would be expected to lie has been estimated. However for some taxes and components it has not been possible to provide a robust estimate of the error margin.
- 1.4 The estimates shown in Table 1.1 differ in terms of the robustness of the estimate and the frequency with which they are updated. This is indicated using a colour coding system. All methodologies are subject to review which could result in revisions to the published estimates.
- 1.5 The format of Table 1.1 has been revised since the previous publication to present detailed tax gaps estimates for both the latest year, 2009-10, and updated estimates for the previous year, 2008-09. Ranges around the estimates are now shown in the relevant chapters.
- 1.6 The estimates of the excise tax gaps shown in Table 1.1 are for excise duty only and show duty loss as a percentage of revenue due. They differ from the excise tax gap estimates in Chapters 3 to 5 which include VAT and show the illicit market share.

¹ This report does not include Council Tax and Business Rates as these are administered by local authorities.

² Total tax liability is defined as the tax gap plus the amount of tax actually received.

Table 1.1: Tax Gaps for HMRC administered taxes – 2008-09 and 2009-10 (£ billion)

Tax	Component	Point estimates (£ billion) ^{1,2,4}		Percentage tax gap ³	
		2008-09	2009-10	2008-09	2009-10
Indirect taxes⁵					
Value Added Tax (VAT)		14.6	11.4	15.5%	13.8%
Spirits duty		0.1	0.1	2%	3.4%
Beer duty		0.4	0.6	10%	14%
Cigarette duty		1.4	1.1	13%	10%
Hand rolling tobacco duty		0.6	0.6	50%	46%
Great Britain diesel duty		0.7	0.5	5%	4%
Great Britain petrol duty ⁶		0.0	0.0	0%	0%
Northern Ireland diesel duty ⁷		0.1	0.1	27%	12%
Northern Ireland petrol duty ^{6,7}		0.0	-	16%	-
Other indirect taxes ⁸		1.0	0.8	7%	6.0%
Total indirect taxes		18.9	15.1	12.7%	10.9%
Direct taxes					
	Inaccurate self assessment returns from individuals (excluding large partnerships ⁹)	5.6	5.8		
	<i>Business taxpayers</i>	5.0	5.1		
	<i>Non-business taxpayers</i>	0.6	0.8		
	Inaccurate self assessment returns from large partnerships ⁹	0.8	0.9		
Income Tax, National Insurance Contributions, Capital Gains Tax	Inaccurate returns from small and medium-sized employers (PAYE) ¹⁰	0.6	0.9		
	Inaccurate returns from large employers (PAYE)	2.0	2.0		
	Avoidance	1.4	1.5		
	Non-declaration of income and capital gains by individuals who do not receive returns	0.3	0.3		
	Ghosts ¹¹	1.3	1.3		
	Moonlighters ¹²	1.8	1.8		
	Total	13.9	14.5	5.2%	5.8%
Corporation Tax	Businesses managed by the Large Business Service	1.3	1.2		
	<i>Avoidance</i>	1.1	1.0		
	<i>Technical issues</i>	0.2	0.2		
	Large and complex businesses	0.9	0.9		
	Small and medium-sized businesses	2.7	2.7		
	Total	5.0	4.8	10.3%	11.7%
Other direct taxes	Inheritance Tax	0.1	0.05		
	Stamp Duties ¹³	0.8	0.5		
	<i>Stamp Duty Land Tax</i>	N/A	0.2		
	<i>Shares Stamp Duty</i>	N/A	0.3		
	Petroleum Revenue Tax	0.05	0.02		
	Total	0.9	0.6	6.5%	4.9%
Total direct taxes		19.8	19.8	6.0%	6.5%
Total tax gap		39	35	8.1%	7.9%

	Established methodology, estimate updated annually
	Developing methodology, estimate updated annually
	Experimental methodology, not updated annually and illustrative indicators for gaps with no direct measure

¹ The overall tax gap is rounded to the nearest £1 billion. Other estimates are rounded to the nearest £100 million or the nearest £50 million if they are less than £100 million.

² As in 'Measuring Tax Gaps 2010' the estimates cover all sources of revenue loss including non-payment.

³ Tax gap as a proportion of theoretical liability which is defined as the tax gap plus the amount of tax actually received.

⁴ The tobacco methodology produces a range within which the true value is expected to lie. The point estimate shown is the mid-point of this range. The beer methodology produces an upper estimate only, shown in the table above as the point estimate. The point estimate shown for the other tax gaps is the estimate produced directly by applying the methodology.

⁵ The excise tax gap estimates are for excise duty only and show duty loss as a percentage of revenue due. They therefore differ from estimates in Chapter 3 which include VAT and show the illicit market share.

⁶ Estimates for Great Britain petrol duty are considered to be zero. Estimate of NI petrol duty was not possible for 2009-10. See Chapter 5 for details.

⁷ Estimates for Northern Ireland diesel and petrol duty are estimates for the non-UK duty paid share which includes legitimate cross-border shopping. They are therefore not true estimates of the tax gap which will be substantially smaller.

⁸ Other excise duties, customs duties, environmental taxes, Insurance Premium Tax.

⁹ Large partnerships are defined as those with five or more partners.

¹⁰ Small and medium-sized employers are defined as businesses with 500 or fewer employees that are not part of a complex group.

¹¹ 'Ghosts' are defined as individuals who have earnings from employment or self-employment and fail to declare any of this income - see Chapter 8 for more details.

¹² 'Moonlighters' are defined as individuals who pay tax on their main job through PAYE but have a second job or additional income from self-employment - see Chapter 8 for more details.

¹³ Estimates for the components of the stamp duties gap are not available prior to 2009-10 as a new methodology was introduced to estimate the gap for Stamp Duty Land Tax from 2009-10.

Historical time series of the tax gap

- 1.7 Table 1.2 shows the overall tax gap and the tax gaps by head of duty as a percentage of total tax liability. There were small annual decreases in the overall tax gap proportion between 2004-05 and 2007-08, resulting in an overall reduction from 8.5 per cent to 7.4 per cent. There was then a rise in 2008-09, up to 8.1 per cent, followed by a fall in 2009-10 to 7.9 per cent.
- 1.8 For VAT, the proportion increased from 11.7 per cent to 15.2 per cent between 2004-05 and 2005-06. This was followed by falls in the next two years and then a subsequent rise from 2007-08 of 3.1 percentage points in 2008-09, before a fall in 2009-10 to 13.8 per cent. The tax gaps for excise duties fell from 8.6 per cent in 2004-05 to 7.8 per cent in 2005-06, rose in the next year, before falling again and remaining constant, until a further fall in 2009-10, down to 6.5 per cent in 2009-10. The combined tax gap for income tax, national insurance contributions and capital gains tax fell from 6.2 per cent of total tax liability in 2004-05 to 5.4 per cent in 2005-06 and then remained around this level before a rise of 0.6 percentage points in 2009-10, up to 5.8 per cent. For corporation tax, the proportion fell from 14.7 per cent in 2004-05 to 9.3 per cent in 2007-08, before rising again in the next two years, up to 11.7 per cent in 2009-10.
- 1.9 A historical time series of the tax gap from 2004-05 to 2009-10 is shown in Table 1.3. This shows that over the period the tax gap has remained fairly stable in monetary terms, at between £35 billion and £39 billion. There was a rise in the tax gap of £3 billion between 2007-08 and 2008-09, which was followed by a subsequent £4 billion fall, down to £35 billion.

1.10 There is a break in the tax gap time series after 2006-07 as up to that point estimates for direct tax gaps are all based on actual data for those years. For subsequent years illustrative estimates have been produced for some components where actual data is not available for the years required. These estimates are produced by up-rating the latest available data using an appropriate GDP series. Details of the up-rating are provided in subsequent chapters. The trend in the GDP series used may vary to that of the receipts for the head of duty.

Table 1.2: Tax Gaps for HMRC administered taxes - 2004-05 to 2009-10 (percentage tax gap)^{1,2}

Tax	Percentage tax gaps					
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Value Added Tax (VAT)	11.7%	15.2%	13.5%	12.4%	15.5%	13.8%
Excise duties and other indirect taxes	8.6%	7.8%	8.6%	7.7%	7.7%	6.5%
Income Tax, National Insurance Contributions, Capital Gains Tax	6.2%	5.4%	5.4%	5.2%	5.2%	5.8%
Corporation Tax	14.7%	11.1%	10.6%	9.3%	10.3%	11.7%
Other direct taxes	8.4%	7.2%	7.5%	7.5%	6.5%	4.9%
Total tax gap	8.5%	8.3%	8.0%	7.4%	8.1%	7.9%

¹ Percentage tax gaps show the tax gap as a proportion of theoretical liability which is defined as the tax gap plus the amount of tax actually received. Estimates have been rounded to the nearest 0.1 per cent.

² Actual estimates are shown for direct tax gaps for the period 2004-05 to 2006-07. For subsequent years illustrative estimates have been produced by up-rating the latest estimate using an appropriate GDP series.

Table 1.3: Tax Gaps for HMRC administered taxes – 2004-05 to 2009-10 (£ billion)^{1,2}

Tax	Point estimates (£ billion)					
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Value Added Tax (VAT)	9.7	13.1	12.1	11.6	14.6	11.4
Excise duties and other indirect taxes	4.5	4.1	4.6	4.3	4.3	3.8
Income Tax, National Insurance Contributions, Capital Gains Tax	13.5	12.4	13.3	13.9	13.9	14.5
Corporation Tax	5.8	5.2	5.3	4.7	5.0	4.8
Other direct taxes	1.2	1.3	1.6	1.6	0.9	0.6
Total tax gap	35	36	37	36	39	35

¹ The overall tax gap is rounded to the nearest £1 billion. All other estimates are rounded to the nearest £100 million.

² Actual estimates are shown for direct tax gaps for the period 2004-05 to 2006-07. For subsequent years illustrative estimates have been produced for some or all the components by up-rating the latest estimate using an appropriate GDP series.

Revisions

1.11 Estimates for many of the tax gap components have been revised since those published in 'Measuring Tax Gaps 2010'. Table 1.4 describes the revisions and the reasons for them.

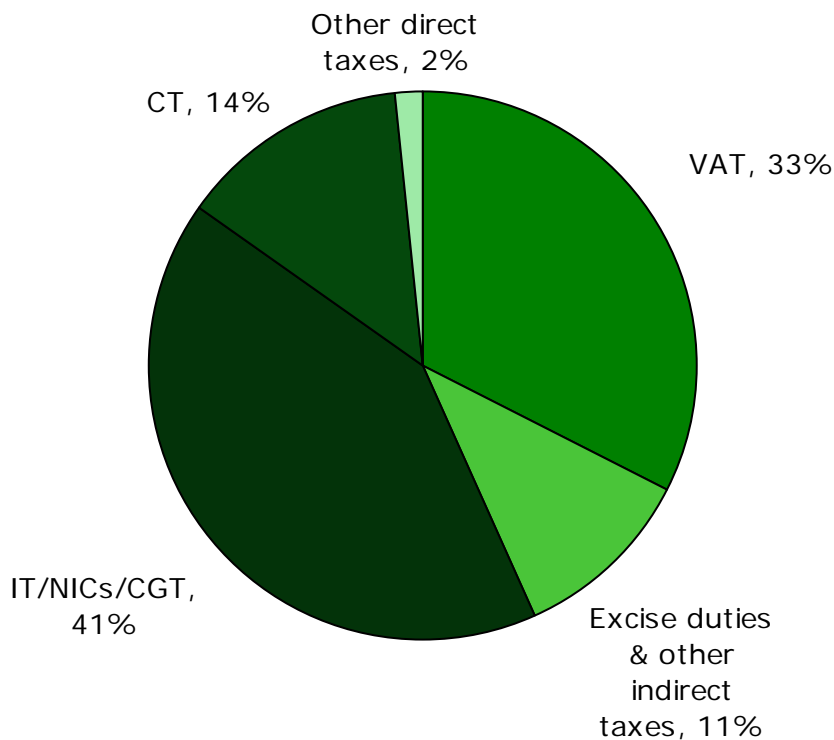
Table 1.4: Revisions to tax gap estimates

Tax gap component	Revisions
Value Added Tax (VAT)	The methodology is the same. The VAT gap estimates from 2008-09 to 2009-10 have been updated since 'Measuring Tax Gaps 2010' following improved modelling of the impact of the temporary VAT rate reduction from 17.5 per cent to 15 per cent on 1st December 2008 and from its reversion to 17.5 per cent on 1st January 2010 and routine updates to data sources used to construct the VAT Theoretical Tax Liability. The historical estimates will be revised when the model incorporates the latest Blue Book data in November 2011.
Excise duties and other indirect taxes	
Alcohol	The methodology is the same. 2008-09 estimates have been revised for both spirits and beer as the Living Costs and Food survey data were not available at the time of publishing 'Measuring Tax Gaps 2010'. Estimates for revenue loss in beer have also been updated for all years.
Tobacco	The methodology is the same. 2008 GLF survey results are updated which changed the 2008-09 tax gap for both cigarettes and HRT.
Oils	Estimates have been revised for all years. This is due to revised input data for both fuel efficiency and vehicle stocks, and a change in methodology. The new methodology assumes that the petrol illicit market is negligible in Great Britain and uses this assumption to inform the split between distance travelled by diesel vehicles and distance travelled by petrol vehicles.
Income Tax, National Insurance Contributions, Capital Gains Tax	
Self Assessment	2003-04 to 2006-07 revised due to settlement of more enquiries. 2007-08 revised due to using actual data rather than up-rating from the 2006-07 estimate. 2008-09 revised due to being up-rated from more recent 2007-08 estimate rather than being uprated from 2006-07 estimate.
Employer compliance	2004-05 to 2007-08 revised due to settlement of more reviews. 2008-09 revised due to using actual data rather than up-rating from the 2007-08 estimate.
Avoidance	No revisions to previously published estimates.
Hidden economy	No revisions to previously published estimates.
Corporation Tax	
Businesses managed by the Large Business Service	2004-05 to 2006-07 revised due to the closure of more risks, better estimates of tax under consideration on LBS' case management system and incorporation of further quality assurance checks into the methodology. 2007-08 revised as now estimated from case management data rather than up-rated from 2006-07. 2008-09 revised as now up-rated from actual 2007-08 estimate rather than the previous actual 2006-07 estimate.
Large and Complex businesses	2008-09 revised as estimated from updated tax under consideration estimate for 2007-08 for businesses managed by the Large Business Service.
Small and medium-sized businesses	2004 to 2006 revised due to settlement of more enquiries. 2007-08 and 2008-09 revised as now up-rated from updated 2006 figures.
Other direct taxes	
Inheritance Tax	No revisions to previously published estimates.
Stamp Duties	No revisions to previously published estimates.
Petroleum Revenue Tax	2008-09 revised due to change in methodology used to produce illustrative estimate.

Tax gap by head of duty

1.12 As shown in Figure 1.1, the two largest components of the overall tax gap in 2009-10 were the combined tax gap from Income Tax, National Insurance Contributions and Capital Gains Tax at 41 per cent of the total and the VAT gap at 33 per cent.

Figure 1.1: Tax gap for 2009-10 by head of duty

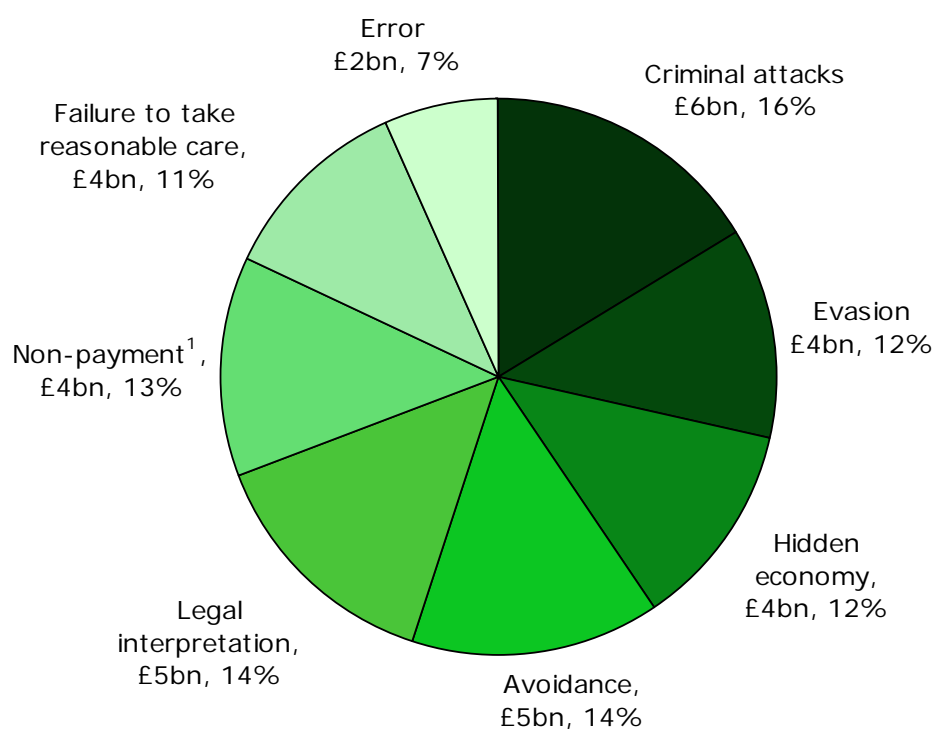


Tax gap by taxpayer behaviour

1.13 'Measuring Tax Gaps 2010' contained an illustrative breakdown of the 2007-08 tax gap of £40 billion as published in 2009 by taxpayer behaviour based on management assumptions and judgement. Although, work has been undertaken to improve the underlying assumptions concerning the taxpayer behaviours driving the various components of the tax gap, the behaviour breakdown for 2009-10 still involves some judgement and can only be used to give a broad indication of the behaviours driving the tax gap. It is important not to draw too many conclusions from comparing the latest behaviour breakdown for 2009-10 with that published for 2007-08. Figure 1.2 presents the results of this work for the estimated overall tax gap for 2009-10.

1.14 The estimates in Figure 1.2 imply that in general the contributions to the tax gap of the various taxpayer behaviours in 2009-10 were broadly similar, with the exception of error which was the smallest at approximately £2 billion (7 per cent).

Figure 1.2: Tax gap for 2009-10 by taxpayer behaviour



¹Non-payment will include tax losses as a result of insolvency.

Tax gap by customer group

1.15 It is estimated that around half of the 2009-10 tax gap can be attributed to SMEs, with around a quarter from Large Businesses. The remainder is split fairly equally between criminals (17 per cent) and individuals (11 per cent). A number of assumptions have been used, which may mean that the estimate for Large Businesses has been overstated and the estimate for SMEs understated.

VAT gap

1.16 There are two separate approaches for calculating the VAT gap: top down and bottom-up, these are detailed in full in Chapter 2.

Top Down

1.17 The top down approach uses national accounts data to calculate the theoretical total VAT liability in the UK economy, which is defined as the amount which would be collected in the absence of any fraud, avoidance, debt or other losses. The difference between actual cash receipts and this theoretical amount of VAT is the VAT gap.

- 1.18 The gross VAT Theoretical Tax Liability (VTTL) in the economy is built up from five expenditure components:
- Household consumption
 - Capital expenditure on housing
 - Government expenditure
 - Charities expenditure
 - Expenditure of partially exempt businesses
- 1.19 Certain amounts are deducted from this gross liability figure, such as VAT refunds to government departments, repayments in respect of litigation losses which relate to earlier liability years, and an adjustment for the activity of unregistered traders below the VAT threshold, to give a net liability figure.
- 1.20 The net theoretical liability for the calendar year is compared to cash receipts for the corresponding financial year (e.g. 2009 liability with 2009-10 financial year receipts), assuming a three month lag between economic activity and the payment to HMRC of the associated VAT.
- 1.21 The top down estimate for the VAT gap is £11.4 billion in 2009-10, which represents a VAT tax gap of 13.8 per cent as a proportion of VTTL.

Bottom-up

- 1.22 The bottom-up approach uses operational and intelligence data to reconcile the top-down approach and attribute losses to specific areas. It includes the following behaviours:
- General non compliance (under declaration of VAT liability due to error or failure to take reasonable care)
 - Evasion (deliberate under declaration of VAT liability)
 - Failure to register - hidden economy (VAT liability of traders that should be registered but are not)
 - Avoidance and legal interpretation
 - Debt contribution to the VAT gap
 - Criminal attacks – MTIC (missing trader intra-community fraud) and VAT losses due to excise fraud.
- 1.23 It is not possible to publish all of the components of the bottom-up approach, because the estimates are not reliable. However, robust estimates are available for MTIC fraud and debt. It is estimated that MTIC fraud contributes between £0.5 billion and £1.5 billion and debt contributes about £1.8 billion to the VAT gap in 2009-10. The remaining VAT gap can be attributed to general non compliance, evasion, failure to register, avoidance, legal interpretation and other criminal attacks.

Excise tax gaps

1.24 A top down approach is used to calculate the tax gap for the excise system. This includes revenue gaps for spirits, beer, cigarettes, hand rolling tobacco (HRT) and hydrocarbon oils (diesel and petrol). The excise tax gaps are estimated to be £3.8 billion of duty losses in 2009-10. The detailed results in Chapters 3 to 5 show estimates inclusive of VAT losses.

Direct tax gaps

1.25 It has not been possible to develop a top down approach for direct taxes. This is because independent data sources on income and assets are not sufficiently comprehensive or detailed to enable a robust estimate of tax liability to be calculated. This was confirmed in a recent research paper³ by HMRC analysts on the feasibility of a top down approach to direct tax gaps.

1.26 Direct tax gap estimates are produced using bottom-up methods. This means that components of the tax gap are estimated using departmental sources, such as surveys, administrative and operational data. The bottom-up approach for the direct tax gap includes the following types of taxpayer:

- Individuals in self assessment
- Individuals who do not complete a tax return
- Businesses
- Employers
- Hidden economy

1.27 Within each of the customer groups identified above, the estimates include tax losses as a result of the following behaviours:

- General non compliance (under declaration of liability due to error or failure to take reasonable care)
- Evasion (deliberate under declaration of liability)
- Hidden economy (tax loss as a result of ghosts, moonlighters and individuals with unearned income who are not in self assessment)
- Avoidance and legal interpretation
- Non payment (tax written off)

³ <http://www.hmrc.gov.uk/research/taxgap-workingpaper.pdf>

- 1.28 The bottom-up method is less comprehensive than the top-down method used for indirect tax gap estimates, because by its nature much of the gap arises from activities that are deliberately concealed. In addition bottom-up methods are based on compliance activity which, can in some cases, take years to complete. Therefore the underreporting elements of the direct tax gap estimates typically apply to earlier periods than those from the top-down methods. To produce an estimate of the overall tax gap these estimates have been up-rated to 2009-10, where necessary.
- 1.29 The tax gap for direct taxes is estimated to be £19.8 billion in 2009-10. This comprises £14.5 billion for income tax, national insurance contributions and capital gains tax, £4.8 billion for corporation tax and £0.6 billion for other direct taxes.

Chapter 2: Estimating the VAT Gap

VAT gap

2.1 This section discusses overall losses from the VAT system⁴.

Results

2.2 Table 2.1 shows the VTTL, net VAT receipts and estimated revenue losses for the years 2002-03 to 2009-10. Estimates between 2007-08 and 2009-10 have been updated since the last 'Measuring Tax Gaps 2010' publication in light of routine updates/revisions to data sources. The 2010-11 VAT gap estimates will be published in December 2011. This is because publication by the Office for National Statistics of Blue Book data, which is a key component of the estimate, has been delayed by several months. Incorporating the latest Blue Book data will also cause revisions to historical data series.

Table 2.1: VTTL, VAT receipts and revenue losses

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10 ²
Net VTTL (£bn)	75.5	78.6	82.5	86.1	89.7	93.6	94.4	82.8
Net VAT receipts (£bn)	63.7	69.1	72.8	73.0	77.6	82.0	79.8	71.4
Revenue loss (£bn)	11.8	9.5	9.7	13.1	12.1	11.6	14.6	11.4
VAT gap (per cent)	15.6%	12.0%	11.7%	15.2%	13.5%	12.4%	15.5%	13.8%

¹ Net VAT receipts are expressed net of payments and re-payments.

² A proportion of the VTTL estimate for the final year is based on projected rather than actual expenditure.

³ The totals may differ from the sum of the components because of rounding.

2.3 Growth in VTTL is determined mainly by growth in the total value of transactions liable to VAT and, to a lesser extent, any changes that are made to the tax regime. Overall VTTL grew between 2002-03 and 2008-09 but fell back in 2009-10 principally because of the cut in the standard rate of VAT on 1st December 2008, from 17.5 per cent to 15 per cent.

2.4 VAT receipts grew between 2002-03 and 2007-08 but then fell in 2008-09 and 2009-10.

2.5 The VAT gap results show a fall in the percentage VAT gap between 2002-03 and 2004-05, but then a rise in 2005-06 with subsequent falls in 2006-07 and 2007-08. There is a large rise in the gap between 2007-08 and 2008-09, when receipts fell despite an increase in VTTL. The gap has then fallen back to 13.8 per cent in 2009-10, which is equal to the average VAT gap for the last 10 years.

⁴ This includes losses through illicit activity in alcohol and tobacco goods. Prior to 2009 published estimates excluded such losses as they were covered in the excise duty section of the document.

2.6 Estimates of the contribution to the VTTL of each relevant expenditure component are given in Table 2.2.

Table 2.2: Expenditure components of VTTL (£ billion)

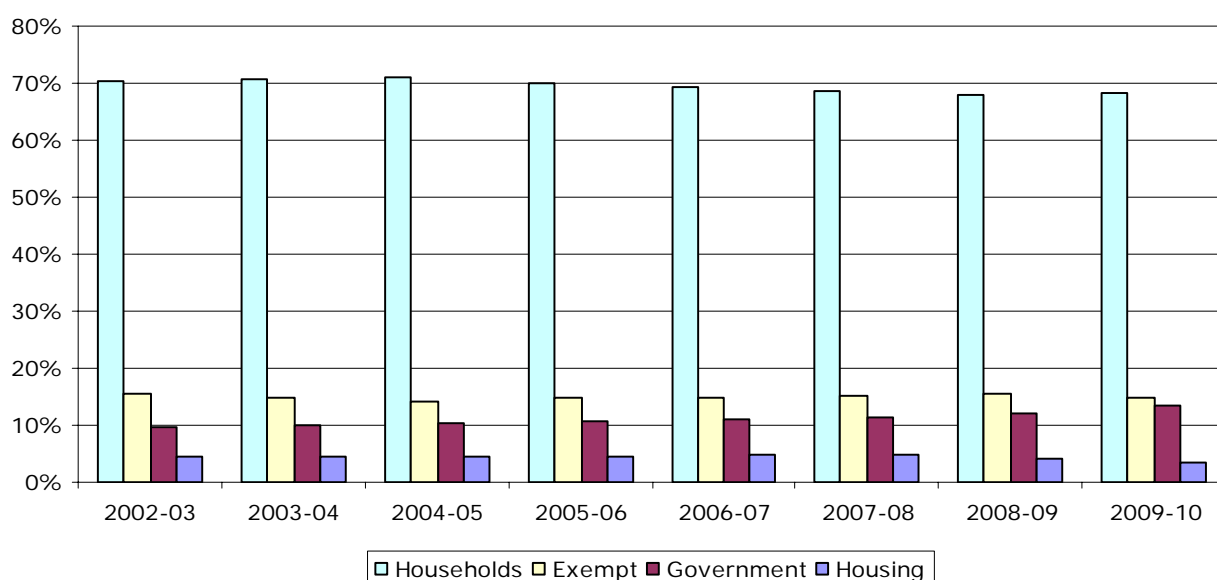
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Households ¹	57.1	59.8	63.1	65.3	67.4	69.8	70.3	61.2
Exempt	12.7	12.6	12.7	13.7	14.4	15.5	16.1	13.3
Government	7.8	8.5	9.2	10.1	10.8	11.5	12.4	11.9
Housing	3.6	3.8	4.0	4.1	4.6	4.9	4.5	3.1
Gross VTTL	81.0	84.7	89.0	93.2	97.2	101.7	103.3	89.5
Deductions	5.6	6.1	6.6	7.1	7.5	8.1	8.4	7.4
Net VTTL	75.5	78.6	82.5	86.1	89.7	93.6	94.9	82.2

¹ Households component also includes estimates of expenditure by non-profit institutions serving households.

Supplementary Results

2.7 Figure 2.1 shows that around two thirds of net VTTL is from household consumption and one third from the exempt, government and housing sector. The government share of VTTL has risen slightly in the last two years.

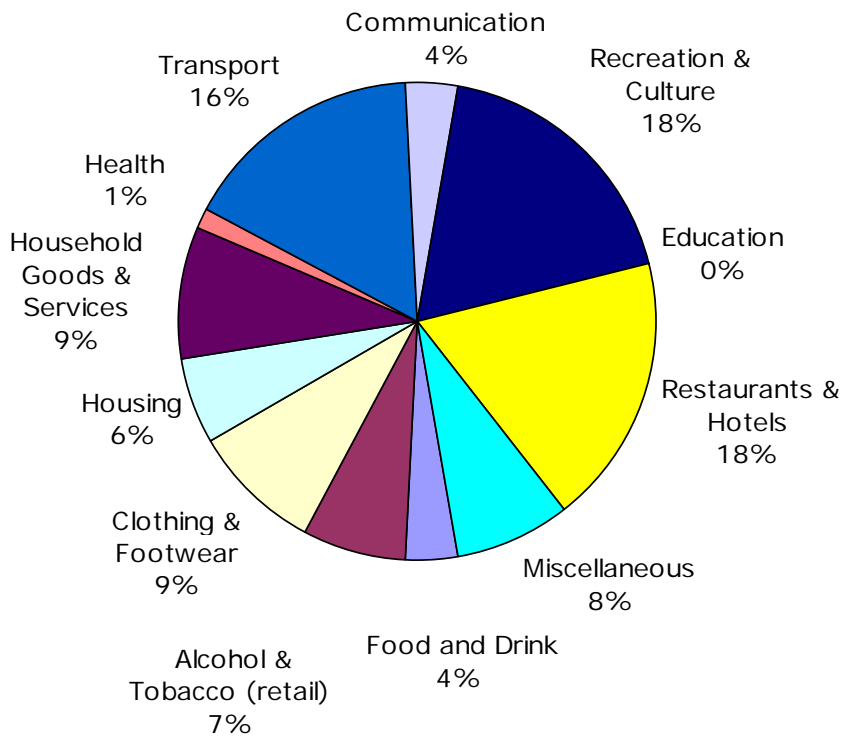
Figure 2.1: VTTL by sector



¹ Households component also includes estimates of expenditure by non-profit institutions serving households.

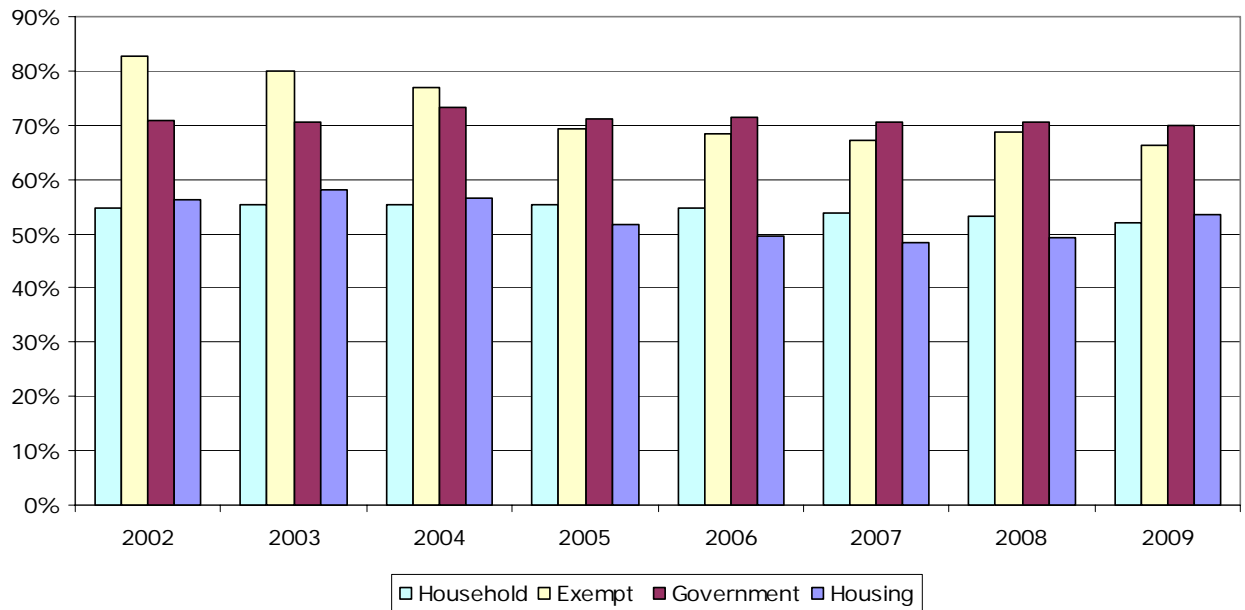
2.8 Figure 2.2 shows that within the household sector restaurants and hotels, recreation and culture and transport are the largest contributors to the VTTL.

Figure 2.2: VAT for the household sector



2.9 Figure 2.3 shows that the standard rated share of household sector expenditure has declined from 55 per cent to 52 per cent in 2009, while in the exempt sector there has been a fall from 80 per cent to 66 per cent in 2009. There has been little change in the government sector. The standard rated share in the housing sector has varied considerably, reflecting the fact that purchases of zero rated new build housing increased during the housing boom only to then fall substantially since the economic downturn.

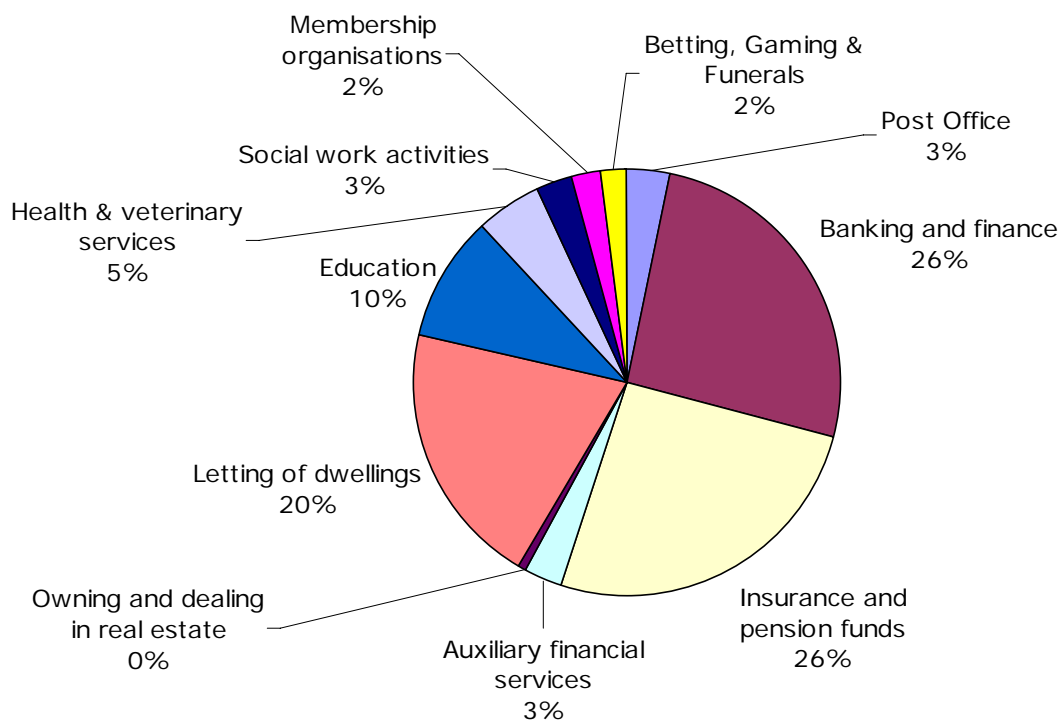
Figure 2.3: Standard rated share expenditure



¹ Households component also includes estimates of expenditure by non-profit institutions serving households.

2.10 Figure 2.4 shows that the banking and finance, insurance and pension funds and lettings of dwellings sectors account for over two-thirds of the VAT liability of exempt businesses.

Figure 2.4: Exempt sector standard rated VAT 2009



Methodology

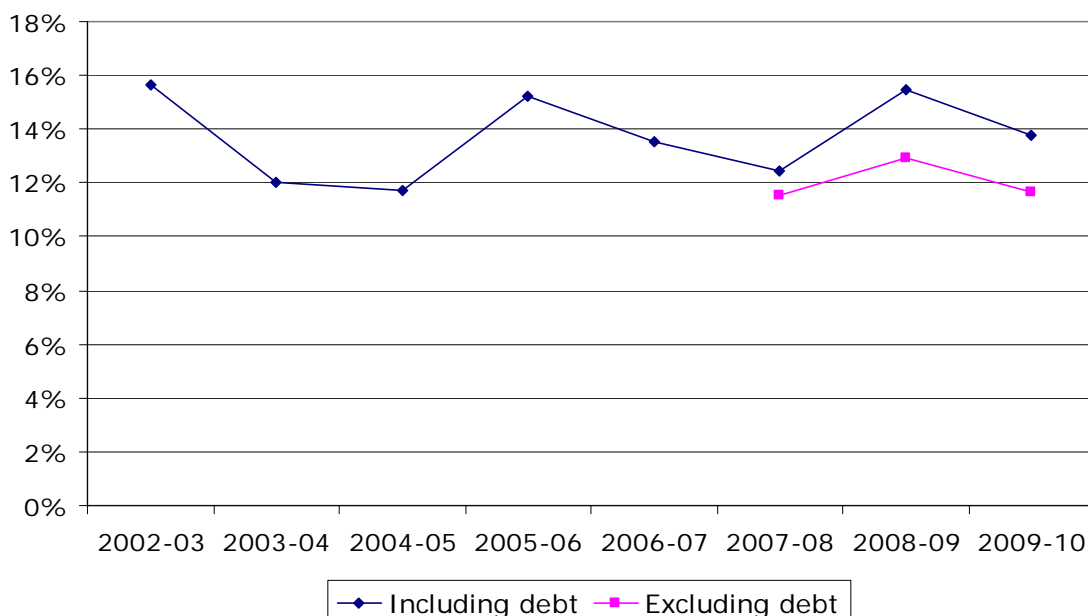
- 2.11 The methodology for calculating the VAT gap was first published in November 2002⁵.
- 2.12 The aim is to measure the total level of VAT losses by comparing the net theoretical tax yield with actual VAT receipts. The difference between these amounts is known as the VAT gap.
- 2.13 This 'top-down' approach involves:
- Gathering data mostly from the Office for National Statistics (ONS) detailing the total amount of expenditure in the economy that is subject to VAT;
 - Estimating the rate of tax on that expenditure based on commodity breakdowns of the expenditure data to derive the gross VAT theoretical tax liability (VTTL);
 - Subtracting any legitimate refunds (deductions), occurring through schemes and reliefs, to arrive at the net VTTL.
 - Subtracting actual VAT receipts from the net VTTL; and
 - Assuming that the residual element, the gap, is the total VAT Gap, including all losses for any cause.
- 2.14 More detail of the methodology for estimating the VAT gap is given in the separate methodological annex paper. As with any statistical estimate, the estimated level of the VAT Gap is subject to a margin of error.

Debt

- 2.15 One component of the VAT gap is VAT debt - the amount of VAT declared by businesses but not yet paid to HMRC; Figure 2.7 below shows the VAT gap estimates including and excluding debt.
- 2.16 The debt contribution to the VAT gap is measured as the difference between new debts arising and debt payments and uses statistics from the Departmental Trade Register (DTR). Adjustments have been made to exclude MTIC debt and to reflect the deferral of payments under the Time To Pay arrangements. As a consequence of data quality issues, the debt contribution can only be measured from 2007-08.
- 2.17 The downturn in the economy which began in 2008 has led to a significant increase in VAT debts, as insolvencies rise and businesses experience cash flow pressures. It is estimated that £1.5 billion of the £3.0 billion increase in the gap between 2007-08 and 2008-09 can be attributed to this increased debt. The impact of debt reduced in 2009-10, accounting for 0.4 percentage points of the 1.7 percentage point fall in the gap between these years, leaving the gap excluding debt in 2009-10 at a similar level to that seen in 2007-08.

⁵ 'Measuring Indirect Tax Losses' HM Customs and Excise, November 2002.

Figure 2.5 VAT gap estimates including and excluding debt



MTIC Fraud

2.18 This section discusses that part of the VAT gap that arises from Missing Trader Intra-Community (MTIC) fraud.

2.19 MTIC VAT fraud is an organised criminal attack on the EU VAT system in which fraudulent traders acquire goods VAT free from EU Member States; charge VAT on their onward sale and go “missing” to avoid paying the VAT charged to the relevant tax authorities. The most serious form of the fraud – known as carousel fraud – involves a series of contrived transactions within and beyond the EU, with the aim of creating large unpaid VAT liabilities and in some cases fraudulent VAT repayment claims.

Results

2.20 HMRC’s current assessment of losses is shown in Table 2.3⁶.

Table 2.3: Estimates of MTIC Fraud (£ billion)

	2005-06	2006-07	2007-08	2008-09	2009-10
Attempted Fraud					
Upper Bound	5	4	2	2	2
Lower Bound	4	3	0.5	1	1
Impact on VAT Receipts					
Upper Bound	3.5	2.5	2	2	1.5
Lower Bound	2.5	1.5	0.5	1	0.5

⁶ Estimates of MTIC fraud for 2000-01 to 2004-05 were published on a different basis in Measuring Indirect Tax Losses – 2005.

- 2.21 Levels of both attempted fraud and the impact on VAT receipts have substantially decreased since 2005-06 and levels remained broadly flat between 2007-08 and 2009-10 (unrounded levels show a small increase in 2008-09 and decrease in 2009-10). The estimates of attempted fraud and the impact on VAT receipts are not directly comparable. This is due to timing effects - for example the fact that some frauds only become measurable at the point they cause reductions in VAT receipts.
- 2.22 The apparent decrease of the 'Impact on VAT Receipts' estimate in 2009-10 is largely due to a rounding effect and does not reflect any substantial decrease of fraud.

Methodology

- 2.23 The method used to produce MTIC fraud estimates is predominantly a bottom-up approach, based on operational evidence. This method is used to produce estimates of attempted fraud and its impact on VAT receipts. It is not appropriate to reveal details of the methodology used to provide MTIC fraud estimates, as to do so may have a detrimental effect on compliance activity.
- 2.24 The method used to provide MTIC fraud estimates is continually under review. It is likely that this will lead to further improvements in the method and consequent revisions to these estimates.

Chapter 3: Estimating Excise Gaps – Alcohol

- 3.1 This section discusses tax gap estimates for Alcohol⁷. Estimates of the illicit market in alcoholic drinks are currently available for spirits and beer. Estimates are not included for other alcoholic drinks, though development is continuing with the aim of increasing the scope of published estimates.

Spirits

Results

- 3.2 Table 3.1 and Figure 3.1 show estimates of the illicit market in spirits. Estimates for 2009-10 are provisional because some elements of the total consumption calculation were not available at the time of publication and have therefore been forecast.
- 3.3 The illicit market share suggests a downward trend between the years 2005-06 and 2009-10, with an overall decrease of 3 percentage points in the central estimate between 2005-06 and 2009-10.
- 3.4 Supplementary tables are available in the accompanying Measuring Tax Gaps Methodological Annex document.

Table 3.1: Spirits: Illicit market share and associated revenue gap^{1,5}

	2005-06	2006-07	2007-08	2008-09	2009-10 ⁴
Illicit Market Shares					
Upper Estimate	11%	14%	14%	8%	11%
Midpoint Estimate	6%	9%	8%	2%	3%
Lower Estimate ²	-	3%	2%	-	-
Associated Revenue Losses (£million)³					
Upper Estimate	430	550	550	310	440
Midpoint Estimate	220	320	310	80	130
Lower Estimate ²	-	90	70	-	-

¹ Figures are independently rounded to the nearest £10m or 1%. - Indicates figures are negligible.

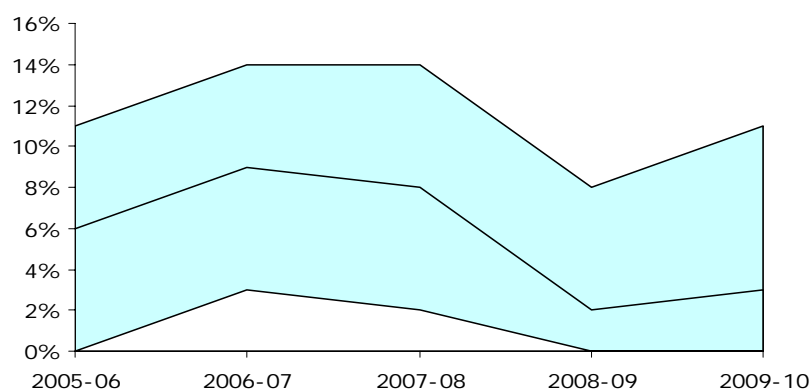
² Negative numbers have been truncated at zero.

³ Revenues include duty and VAT.

⁴ Figures for 2009-10 are provisional.

⁵ Figures for previous years have been revised due to new input data.

Figure 3.1: Spirits: Illicit market shares – central estimate and confidence intervals¹



¹ Negative numbers have been truncated at zero.

⁷ This includes losses in both duty and VAT.

Beer

3.5 The beer model is an upper bound model and the lower bound model is still under development.

Results

3.6 Table 3.5 and Figure 3.2 show the latest estimates of the illicit market in beer. The illicit market share shows no clear trend over the period; it decreased from 13% in 2006-07 to 10% in 2008-09, but then increased in 2009-10 to 14%, with an overall increase of 6 percentage points between 2005-06 and 2009-10.

3.7 The published figures for the tax gap are for the upper bound and not a mid-point estimate. This means the effect of an increase in the real mid-point tax gap will be magnified in the upper bound. For example if the lower bound is assumed to be zero per cent in all years then the mid point in 2008-09 and 2009-10 would have been 5 per cent and 7 per cent respectively. In this example, the increase of 4 per cent in upper bound is equivalent to a 2 per cent increase in the mid-point.

3.8 Supplementary tables are available in the accompanying Measuring Tax Gaps Methodological Annex document.

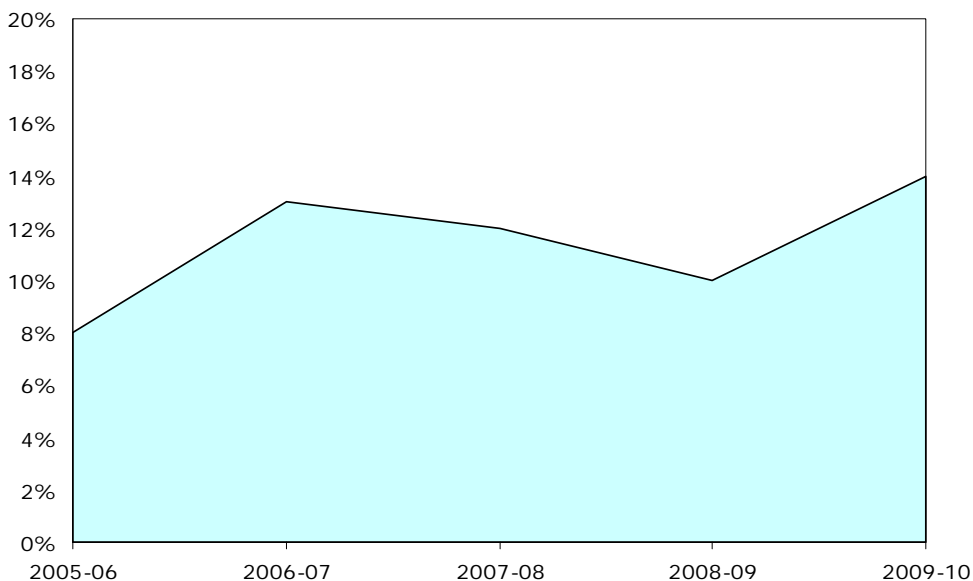
Table 3.5: Beer illicit market share and associated revenue losses^{1,2}

	2005-06	2006-07	2007-08	2008-09	2009-10
Illicit Market Shares					
Upper Estimate	8%	13%	12%	10%	14%
Associated Revenue Losses (£million)					
Upper Estimate	450	700	650	550	800

¹ Includes both duty and VAT.

² Figures are independently rounded to nearest £50m or 1%.

Figure 3.2: Beer illicit market share – upper bound



Methodology

- 3.9 The estimates of tax gaps for spirits and beer are produced using a top down methodology; i.e. total consumption is estimated first, and then legitimate consumption is subtracted, the residual being the illicit market.
- 3.10 Total consumption is estimated using the Living Costs & Food Survey (LCF). Legitimate consumption is based upon the returns to HMRC of the volumes of alcohol on which duty have been paid. The details of the methodology are presented in the separate methodological annex paper.
- 3.11 The LCF survey only becomes available around 18 months after the survey period. For this reason, estimates for 2010-11 are not yet available and some elements of the 2009-10 estimates have been produced using forecasts.
- 3.12 For spirits, the central estimate is best interpreted as an indicator of long term trends in the illicit market share rather than a precise estimate of the level. The confidence intervals indicate the potential size of chance fluctuations in the estimates due to sampling error. They do not take account of any systematic tendency to over or under-estimate the size of the tax gap that might arise from the modelling assumptions.
- 3.13 For beer, estimates should be interpreted as an indicator of long term trend rather than a precise estimate of the level or of year-to-year changes.

Chapter 4: Estimating Excise Gaps – Tobacco

4.1 This section discusses tax gap estimates for Tobacco⁸. This includes revenue gaps for Cigarettes and Hand Rolling Tobacco.

Cigarettes

Results

4.2 Table 4.1 and Figure 4.1 show the latest estimates of the illicit market share for the cigarette market, this is presented as lying within the range defined by the upper and lower estimates. The mid-point of the range is also shown. The mid-point shows a decline in the level of the illicit market between 2005-06 and 2009-10 from 16 per cent to 10 per cent.

4.3 Supplementary tables are available in the accompanying Measuring Tax Gaps Methodological Annex document.

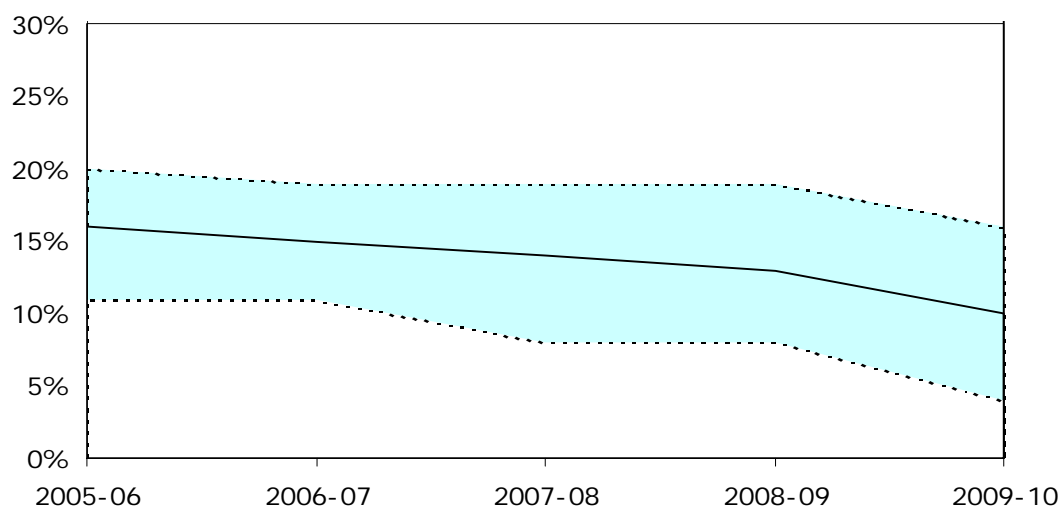
Table 4.1: Cigarettes: Illicit market and associated revenue losses ^{1,2}

	2005-06	2006-07	2007-08	2008-09	2009-10
Illicit Market Shares					
Upper Estimate	20%	19%	19%	19%	16%
Mid-point of range	16%	15%	14%	13%	10%
Lower Estimate	11%	11%	8%	8%	4%
Associated Revenue Losses (£million)					
Upper Estimate	2,700	2,400	2,400	2,500	2,200
Lower Estimate	1,300	1,300	1,000	900	500

¹ Includes duty and VAT.

² Figures are independently rounded to the nearest £100m or 1%.

Figure 4.1: Cigarettes: Illicit market shares – estimated range



4.4 The range provides an indication of the size of potential systematic errors due to under-reporting. However the consumption estimates are also subject to random fluctuations due to sampling error. Therefore, the mid-point estimate reported here, should be interpreted as an indicator of long term trends rather than a precise estimate of year-to-year changes.

⁸ This includes losses in both duty and VAT.

Hand rolling tobacco (HRT)

Results

- 4.5 Table 4.5 and Figure 4.2 show the latest estimates of the illicit HRT market. This is presented as lying within the range defined by the upper and lower estimates. The mid-point of the range is also shown. The trend in the mid-point suggests a downward trend since 2005-06 with the mid-point falling from 60 per cent in 2005-06 to 46 per cent in 2009-10.
- 4.6 Supplementary tables are available in the accompanying Measuring Tax Gaps Methodological Annex document.

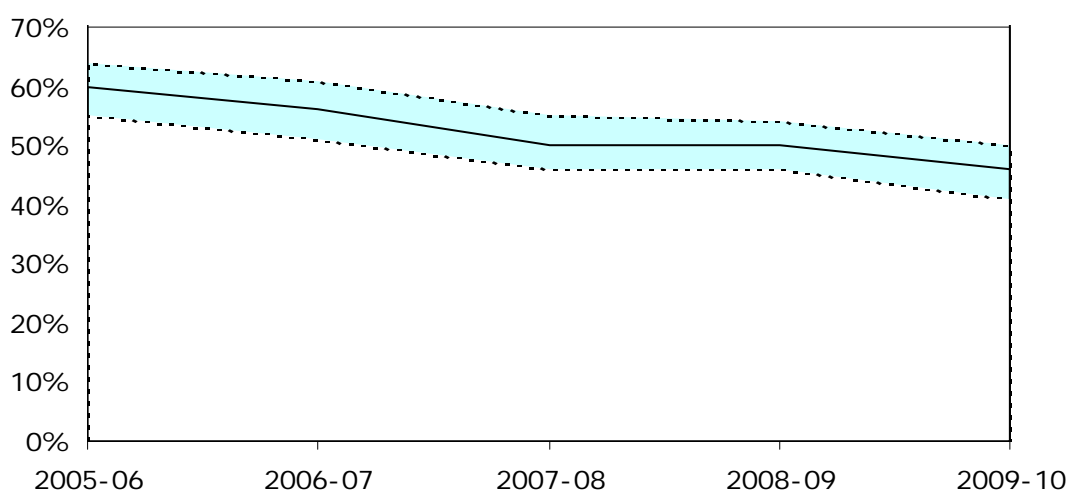
Table 4.5: HRT: Illicit market and associated revenue losses ^{1,2}

	2005-06	2006-07	2007-08	2008-09	2009-10
Illicit Market Shares:					
Upper Estimate	64%	61%	55%	54%	50%
Mid-point of range	60%	56%	50%	50%	46%
Lower Estimate	55%	51%	46%	46%	41%
Associated Revenue Losses (£million)					
Upper Estimate	960	920	820	940	880
Lower Estimate	690	650	570	700	620

¹ Includes duty and VAT.

² Figures are independently rounded to the nearest £10m or 1%.

Figure 4.2: HRT: Illicit market shares - estimated range



- 4.7 The range provides an indication of the size of potential systematic errors arising from the assumptions used to derive consumption and cross-border shopping estimates. However these estimates are also subject to random fluctuations due to sampling error. Therefore, the mid-point estimate reported here should be interpreted as an indicator of long term trends rather than a precise estimate of year-to-year changes.

Tobacco methodology

- 4.8 The estimates are produced using a top down methodology as described in Chapter 1; i.e. total consumption is estimated first, and then legitimate consumption is subtracted, the residual being the illicit market.
- 4.9 Estimates of the illicit market share for cigarettes and HRT rely on data from the General Lifestyle Survey (GLF), which only becomes available around 12 months after the survey period. For this reason, estimates for 2009-10 have been produced using a forecast for Q4.
- 4.10 There have been no changes made this year to the models used to estimate the tax gaps for cigarettes and HRT.

Chapter 5: Estimating Excise Gaps - Hydrocarbon Oils

- 5.1 This section discusses tax gap estimates for goods subject to hydrocarbon oil duty. Estimates of the illicit market are currently available for diesel and petrol in Great Britain (GB). Estimates of the Non-UK Duty Paid (NUKDP) market are currently available for diesel and petrol in Northern Ireland (NI).
- 5.2 The estimates for Northern Ireland relate to the non-UK duty paid market, rather than the illicit market. The non-UK duty paid market includes both the illicit market and legitimate cross border shopping consumed in Northern Ireland. They cannot currently be separated as we do not have an estimate of cross border shopping between Northern Ireland and the Republic of Ireland.

Great Britain diesel estimates

Results

- 5.3 Table 5.1 and Figure 5.1 show estimates of the illicit market share for diesel in Great Britain. Estimates for 2009-10 are provisional because some elements of the total consumption calculation were not available at the time of publication and have therefore been forecast.
- 5.4 The central estimate shown in Table 5.1 shows a level trend in the illicit market share between 2005-06 and 2009-10, at around 4 per cent.
- 5.5 Supplementary tables are available in the accompanying Measuring Tax Gaps Methodological Annex document.

Table 5.1: GB: Diesel: Illicit market share and associated revenue losses^{1,4}

	2005-06	2006-07	2007-08	2008-09	2009-10 ³
Illicit Market Shares:					
Upper Confidence Interval	6%	6%	6%	8%	7%
Central Estimate	4%	4%	4%	5%	4%
Lower Confidence Interval	2%	2%	1%	2%	1%
Associated Revenue Losses (£million)²:					
Upper Confidence Interval	900	1,000	1,000	1,400	1,150
Central Estimate	550	650	600	900	650
Lower Confidence Interval	200	350	200	400	150

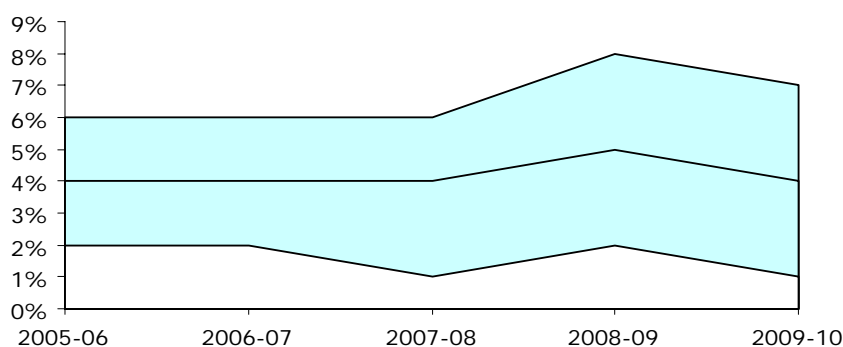
¹ Figures are independently rounded to the nearest £50m or 1%. - Indicates figures are negligible.

² Revenues include duty and VAT.

³ Figures for 2009-10 are provisional.

⁴ Figures for previous years have been revised due to new input data.

Figure 5.1: GB: Diesel: Illicit market shares – central estimate and confidence intervals



Great Britain petrol estimates

Results

- 5.6 Petrol is considered to be less vulnerable to illicit activity than diesel, because of the low demand from commercial sectors and the flammable nature of the product. In previous publications the illicit market has been consistently estimated around zero. In this publication we have assumed that the petrol illicit market is negligible and used this to inform the methodology for the GB diesel estimates.

Great Britain hydrocarbon oils estimates

Methodology

- 5.7 Estimates of GB diesel and petrol consumption are derived from a number of data sources including sample surveys, vehicle testing and administrative data. Details of the methodology are given in the separate methodological annex paper.
- 5.8 The central estimate is best interpreted as an indicator of long term trends in the illicit market share rather than a precise estimate of the level. The confidence intervals indicate the potential size of chance fluctuations in the estimates due to sampling error. They do not take account of any systematic tendency to over or under-estimate the size of the tax gap that might arise from the modelling assumptions.

Changes to the models

- 5.9 The estimates of vehicle fuel efficiency have been updated for the whole time series. The estimates of vehicle stocks in GB have been revised by the Department for Transport. This affects the estimates from 2005-06 onwards.
- 5.10 A new methodology has been introduced to split the distance data between diesel and petrol vehicles. This uses the assumption that the petrol illicit market is always negligible, and calculates a variable split for each year. More detail is available in the methodological annex paper.

Northern Ireland diesel estimates

Results

- 5.11 Table 5.5 shows estimates of the non-UK duty paid market share for diesel in Northern Ireland. The non-UK duty paid market includes both the illicit market and legitimate cross border shopping consumed in Northern Ireland.
- 5.12 Estimates for 2009-10 are provisional because some elements of the total consumption calculation were not available at the time of publication and have therefore been forecast.
- 5.13 The central estimate shows a downward trend in the NI diesel non-UK duty paid market share. The estimated non-UK duty paid market share has fallen from 39 per cent in 2005-06 to 12 per cent in 2009-10.

5.14 Analysis suggests that the low level of the non-UK duty paid market share in 2009-10 is mostly due to a reduction in the amount of cross border shopping done by Northern Ireland residents in the Republic of Ireland. This reduction is likely to be due to a smaller price differential between the two countries than in previous years, making it less cost effective for NI residents to cross border shop their fuel.

5.15 Supplementary tables are available in the accompanying Measuring Tax Gaps Methodological Annex document.

Table 5.5: NI: Diesel non-UK-duty paid market share and associated uncollected revenue^{1,4}

	2005-06	2006-07	2007-08	2008-09	2009-10 ³
Cross Border Shopping + Illicit Market Shares:					
Upper Confidence Interval	43%	43%	36%	32%	18%
Central Estimate	39%	39%	31%	27%	12%
Lower Confidence Interval	35%	36%	27%	23%	7%
Associated Uncollected Revenue (£million)²:					
Upper Confidence Interval	200	220	200	190	100
Central Estimate	180	190	170	150	70
Lower Confidence Interval	150	160	140	120	30

¹ Figures are rounded to the nearest £10m or 1%.

² Revenues include duty and VAT.

³ Figures for 2009-10 are provisional.

⁴ Figures for previous years have been revised due to new input data.

Northern Ireland petrol estimates

Results

5.16 Table 5.6 shows estimates of the non-UK duty paid market share for petrol in Northern Ireland. The non-UK duty paid market includes both the illicit market and legitimate cross border shopping consumed in Northern Ireland.

5.17 Estimates for 2009-10 are provisional because some elements of the total consumption calculation were not available at the time of publication and have therefore been forecast.

5.18 The non-UK duty paid market share could not be estimated in 2009-10 because there was a significant change in cross border shopping behaviour between Northern Ireland and the Republic of Ireland. Negative cross border shopping occurs when cross border shopping of Republic of Ireland residents is higher than that of Northern Ireland residents. To produce a NI non UK duty paid estimate, the cross border shopping of Republic of Ireland residents must be removed from the clearances to be consistent with the estimate of total consumption of petrol for NI residents. There is currently no way to remove this Republic of Ireland consumption from the estimate, which means that the non-UK duty paid market due to UK residents cannot be calculated.

5.19 The reason for this change in behaviour is thought to be that the price differential between the two countries was at a low level throughout 2009-10. This meant that there was very little incentive for Northern Ireland residents to buy their fuel in the Republic of Ireland, leading to lower than normal levels of cross border shopping. For some months petrol was less expensive in Northern Ireland than the Republic, which gave the residents of the Republic an incentive to buy their petrol in the North, leading to negative cross border shopping.

5.20 The central estimate shown in Table 5.6 shows no clear trend in the NI petrol non-UK duty paid market share between 2005-06 and 2008-09. Overall the level reduced from 19 per cent in 2005-06 to 16 per cent in 2008-09. Estimates of the total UK consumption and UK duty paid consumption in 2009-10 are available in the supplementary tables, which are available in the accompanying Measuring Tax Gaps Methodological Annex document.

Table 5.6: NI: Petrol non-UK-duty paid market share and associated uncollected revenue^{1,5}

	2005-06	2006-07	2007-08	2008-09	2009-10 ^{2,4,6}
Cross Border Shopping + Illicit Market Shares:					
Upper Confidence Interval	23%	20%	24%	21%	-
Central Estimate	19%	16%	20%	16%	-
Lower Confidence Interval	14%	12%	16%	12%	-
Associated Uncollected Revenue (£million)³:					
Upper Confidence Interval	80	70	90	80	-
Central Estimate	70	60	70	60	-
Lower Confidence Interval	50	40	50	40	-

¹ Figures are independently rounded to the nearest £10m or 1%. - Indicates figures are negligible.

² Negative numbers have been truncated at zero.

³ Revenues include duty and VAT.

⁴ Figures for 2009-10 are provisional.

⁵ Figures for previous years have been revised due to new input data.

⁶ The non-UK duty paid market share could not be estimated in 2009-10.

Northern Ireland hydrocarbon oils estimates

Methodology

- 5.21 Estimates of Northern Ireland diesel and petrol consumption are based on the average consumption per vehicle in Great Britain. Details of the methodology are given in the separate methodological annex paper.
- 5.22 The estimates for Northern Ireland relate to the non-UK duty paid market, rather than the illicit market. The non-UK duty paid market includes both the illicit market and legitimate cross border shopping consumed in Northern Ireland. The two markets cannot currently be separated as we do not have an estimate of cross border shopping between Northern Ireland and the Republic of Ireland.
- 5.23 The central estimate is best interpreted as an indicator of long term trends in the illicit market share rather than a precise estimate of the level. The confidence intervals indicate the potential size of chance fluctuations in the estimates due to sampling error. They do not take account of any systematic tendency to over or under-estimate the size of the tax gap that might arise from the modelling assumptions.

Changes to the model

- 5.24 The changes to the input data and methodology for the Great Britain models affect the average consumption in Great Britain, which is an input for the Northern Ireland models. Consequently the time series for Northern Ireland has been revised.

Chapter 6: Other indirect taxes

- 6.1 HMRC currently has no established methodologies for producing estimates of the tax gap for the following indirect taxes:
- Wine duties
 - Cider and Perry duties
 - Betting and gaming duties
 - Customs duties and levies
 - Air passenger duty
 - Insurance premium tax
 - Landfill tax
 - Climate change levy
 - Aggregates levy
 - Spirits-based ready-to-drink (RTD's)
 - Biofuels
- 6.2 A proxy indicator for the scale of revenue losses across these taxes has been produced based on the estimated percentage tax gaps for GB oils, Spirits duty, Beer duty and Cigarettes duty. Hand Rolling Tobacco and the Northern Ireland oils gaps have not been used to produce the proxy indicator. This is because:
- Northern Ireland estimates include losses from legitimate cross-border shopping and therefore overestimate the true tax gaps
 - It is clear from operational evidence that none of the unmeasured indirect taxes are subject to the high levels of fraud found in Hand Rolling Tobacco.
- 6.3 For alcohol duties, the average percentage loss from the measured alcohol tax gaps has been applied to the receipts of the unmeasured alcohol tax gaps. For other indirect taxes the indicator has been calculated by treating the unknown tax gaps as if they had the same simple average percentage loss as the selected measured excise gaps. By calculating the alcohol component separately, using known alcohol tax gaps, the calculation should be more representative.
- 6.4 The methodology for estimating the tax gap for indirect taxes is the same as was published in 'Measuring Tax Gaps 2010'. However, there have been a number of revisions to the oils, tobacco, beer and spirits estimates for previous years, which have led to revisions in the other indirect taxes estimate for previous years. In 2009-10, a revenue loss of 8 per cent was applied to alcohol and 6 per cent to other indirect taxes which results in an estimated tax gap of £0.8 billion. The comparable figure for 2008-09 is £1 billion.
- 6.5 The average percentage revenue losses should not be considered estimates of the true percentage loss across the taxes listed in paragraph 6.1 as this is unknown. Many of the indirect taxes listed are very different from one another in their nature, each being subject to different rules. The true percentage tax gaps are therefore likely to vary widely across the various taxes listed.

Overview

- 7.1 As described in Chapter 1, a “bottom-up” approach is used to produce estimates of the tax gap for direct taxes because independent data sources on income and assets are not sufficiently comprehensive or detailed to enable a robust estimate of tax liability to be calculated. This means that components of the tax gap are estimated using departmental sources, such as surveys, administrative and operational data. The bottom-up method is less comprehensive than the top-down method used for indirect tax gap estimates because by its nature much of the gap arises from activities that are deliberately concealed.
- 7.2 In addition because the bottom-up methods are based on compliance activity which can, in some cases, take years to complete the resulting tax gap estimates typically apply to earlier periods than those from the top-down methods. Thus, in general, the estimates for tax gaps for direct taxes lag behind those for indirect taxes. In order to produce an estimate of the overall tax gap for 2009-10, as reported in Table 1.1, where necessary an up-rating factor has been applied to the under-reporting element of the direct tax gap estimates to produce a notional value for this year. The up-rating factors are based on the appropriate Gross Domestic Product (GDP) series for each component. Details are provided in the relevant sections.
- 7.3 The main methods used to estimate tax gaps for direct taxes are random enquiries, risk registers and data matching. These are discussed in more detail below. In addition, where robust methodologies have not yet been developed, an illustrative estimate of the tax gap is given based on expert opinion or derived by selecting the nearest equivalent measured gap.
- 7.4 Methods used differ between taxes and according to the type of non-compliance and the type of taxpayer involved. Therefore, within one head of duty there can be multiple estimates covering the component parts which together form an estimate of the overall tax gap. These estimates are described in subsequent chapters.
- 7.5 The tax gap estimates for direct taxes are presented in the following chapters, together with a summary of the methodology used to derive them. More detail on methodology can be found in the separate methodological annex paper.

Random enquiries

- 7.6 Random enquiry programmes involve samples of taxpayers being selected at random and their returns being subjected to full enquiries by HMRC officers. HMRC has random enquiry programmes for individuals subject to Self Assessment, small and medium-sized businesses subject to Corporation Tax Self Assessment and small and medium-sized employers. The sizes of the samples for the three programmes are shown in Table 7.1 below.

Table 7.1: Sample sizes for the Self Assessment, Employer Compliance and Corporation Tax Self Assessment random enquiry programmes

Self Assessment		Employer Compliance		Corporation Tax Self Assessment	
Tax return year	Sample size	Year	Sample size	Accounting period ending in year	Sample size
2002-03	6,318	2003-04	1,649	2001	297
2003-04	6,419	2004-05	1,649	2002	315
2004-05	6,482	2005-06	1,649	2003	342
2005-06	5,834	2006-07	1,649	2004	400
2006-07	3,217	2007-08	1,649	2005	405
2007-08	3,219	2008-09	1,649	2006	455

- 7.7 The results of the random enquiry programmes show the proportion of taxpayers under-reporting their tax liabilities and the corresponding amount of additional tax due. These results can be used to produce an estimate for the amount of under-declared tax liability for the whole population because the enquiries are randomly selected and form a representative sample. A proportion of the under-declared liabilities will be recovered as a result of HMRC compliance activity. This is called compliance yield and is subtracted from the estimate of under-declared liabilities.
- 7.8 There are two main sources of error associated with the results of random enquiries which could result in the true values of the tax gaps differing from the estimates produced. These are:
- sampling variation in the data: the whole population is not subject to enquiry, so even though the sample is designed to be representative its characteristics may differ from the population purely by chance; and
 - systematic uncertainty where the sample results consistently tend to underreport the true values for the population, or where the sample does not include the full population, for example those participating in the hidden economy.
- 7.9 In addition, the random enquiry programmes will not identify all incorrect returns or the full scale of tax gaps, especially where independent information from third parties is not available to verify the data supplied by the taxpayer. This means that tax gap estimates produced through random enquiries underestimate the full extent of the tax gap. Furthermore, the proportion of the tax gap that is not identified may also vary over time due to changes in the enquiry regime or the nature of non-compliance.
- 7.10 The Internal Revenue Service (IRS) in the United States (US) has tackled this problem by using a range of 'multipliers' to make adjustments for non-detection⁹. These multipliers are generated through supplementary studies on particular tax return entries, together with econometric analysis of non-detection rates across IRS examiners.

⁹ James Andreoni, Brian Erard and Jonathan Feinstein (1998) 'Tax Compliance', Journal of Economic Literature, Vol. 36, No. 2. (Jun., 1998), pp. 818-860

- 7.11 The IRS is able to undertake this analysis of non-detection because their random enquiry samples cover upward of 50,000 cases – much higher than is feasible in the UK. In the absence of this data for the UK the US multipliers are used to account for non-detection. The size of the multipliers varies by the type of non-compliance found.
- 7.12 A further issue with using random enquiries to measure tax gaps is the delay between the relevant tax year and the availability of enquiry results. Particularly complex cases, which are often those involving large tax losses, can take a number of years to resolve. So it can be several years from the issue of a return before results are available for most of the sample.
- 7.13 To be able to produce provisional estimates, it is therefore necessary to forecast the aggregate results of enquiries yet to be settled. The forecasts for such enquiries are based on operational intelligence and the results of recently settled enquiries with similar durations. Once the open enquiries are settled the forecasts are replaced with the actual outcomes, which means the estimates for tax gaps reported in this document are subject to revision.

Risk registers

- 7.14 Risk registers are used to produce estimates of the tax gap for Corporation Tax within businesses managed by HMRC's Large Business Service and the avoidance tax gap for direct taxes. Risk registers encompass information on expert assessments of potential losses from identified risks.

Data matching

- 7.15 It is not necessary to issue most taxpayers with a Self Assessment return where all tax liabilities are withheld at source, for example employment income where tax is deducted under PAYE, or basic rate tax withheld from bank interest. However, there are risks within this population, for example due to taxpayers not informing HMRC about sources of income, such as rental income, capital gains or income from a secondary employment/self-employment.
- 7.16 HMRC cannot conduct random enquiries into the tax affairs of individuals who are not issued a return because the legal position requires a return to be issued for an enquiry to take place. An alternative method is therefore required for measurement of risks and estimating the associated tax gap.
- 7.17 The introduction of data matching tools has created opportunities for HMRC to measure the extent to which taxpayers do not declare sources of income. Income reported by third party data sources can be compared with HMRC's internal data to identify undeclared income, from which it is possible to estimate the tax due. This technique has been used to identify the scale of non-reporting of income by known individuals who do not receive tax returns, as detailed in Chapter 8.
- 7.18 Data matching cannot however be completely accurate and there will be instances where non-declaration of income is incorrectly inferred from a mismatch (and vice versa). Inference about the amount of non-compliance associated with a particular mismatch can be difficult.

Non-payment

- 7.19 The tax gap estimates include a measure of associated losses from non-payment of the tax by the relevant type of taxpayer where relevant. The estimates of non-payment for direct taxes come from HMRC's financial statements and represent amounts written off, i.e. debts that are not collectable. Direct tax debts that are later paid do not form part of the direct tax gap, although payment will be deferred. Due to timing effects the amounts written off during the year will not necessarily relate to liabilities arising during the year.
- 7.20 The top-down approach used to estimate the indirect tax gaps includes non-payment but this will not equate exactly to write-offs during the year due to timing effects. As mentioned in paragraphs 2.15 and 2.16, VAT debt is measured as the difference between new debts arising and debt payments, with adjustments made to exclude MTIC debt and to reflect the deferral of payments under the Time to Pay arrangements.

Chapter 8: Estimating the tax gap for Income Tax, National Insurance Contributions and Capital Gains Tax

Overall tax gap

- 8.1 The estimated total tax gap for Income Tax, National Insurance Contributions and Capital Gains Tax was £14.5 billion in 2009-10, equivalent to 41 per cent of the overall tax gap. The components of this are described below. These are presented for the latest year for which data are available, together with the resulting estimate for 2009-10 when up-rating has been applied.

Individuals subject to Self Assessment

- 8.2 The results of the Self Assessment random enquiry programme are used to produce an estimate of the tax gap for individuals subject to SA. In this context 'individuals' means individuals who are self-employed, and partnerships, as well as those who are employees or pensioners, or may only have investment income, who are all issued an SA return to file. Trusts also receive income tax returns and are included in the figures. The taxes covered are:
- Income tax
 - Capital gains tax, and
 - Class 4 National Insurance Contributions
- 8.3 The SA random enquiry programme covers all SA taxpayers with the exception of partnerships with 5 or more partners. An illustrative estimate of the tax gap for large partnerships has been produced – see paragraphs 8.14 and 8.15.
- 8.4 The taxpayers covered by the SA random enquiry programme have been segmented into 'business' and 'non-business' taxpayers. Business taxpayers consist of self-employed taxpayers and partnerships with up to 4 partners. Non-business taxpayers are individuals without business income who receive notices to file an SA return, including:
- company directors;
 - other employees and pensioners taxed under PAYE, who are liable to tax at higher rates or who have relatively complicated tax affairs; and
 - personal representatives or trustees.

Results

- 8.5 Table 8.1 shows estimated identified tax gaps for SA taxpayers (excluding large partnerships) for the tax years 2002-03 to 2007-08. The figures do not adjust for non-detection. Estimated identified tax gaps for SA taxpayers (excluding large partnerships) for the tax years 1999-00 to 2001-02 are not shown as these figures are no longer subject to revision; final estimates can be found in 'Measuring Tax Gaps 2010'.

Table 8.1: Identified tax gap for individuals in Self Assessment (£ billion)¹

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Under-declared liabilities due to incorrect returns²						
Point estimate	3.5	3.7	3.7	3.0	3.2	3.4
Lower estimate	3.1	3.2	3.1	2.6	2.7	3.0
Upper estimate	3.9	4.2	4.2	3.4	3.7	3.9
Compliance yield ³	0.5	0.5	0.5	0.6	0.6	0.9
Non-payment ⁴	0.1	0.1	0.1	0.4	0.4	0.4
Net total identified tax gap						
Point estimate	3.1	3.3	3.3	2.7	3.0	3.0
Lower estimate	2.7	2.8	2.8	2.2	2.5	2.6
Upper estimate	3.5	3.8	3.8	0.4	3.4	3.4
Total tax liabilities	20.6	22.2	23.1	24.0	26.4	29.4
Proportion of liabilities⁵	15%	15%	14%	11%	11%	10%

¹ Figures rounded to the nearest £0.1 billion. As a result components may not appear to sum.

² Ranges for under-declared liabilities are 95% confidence intervals.

³ By period of settlement of enquiry.

⁴ Estimates of write-offs of tax in 2002-03 to 2004-05 are converted to financial year figures from periods ending in October each year. From 2005-06 estimates for write-offs of tax are available on a financial year basis.

⁵ Point estimate.

8.6 Estimated identified tax gaps for SA individuals decreased from 15 per cent of liabilities in 2002-03 to 11 per cent in 2005-06 and then remained constant before falling slightly to 10 per cent in 2007-08.

8.7 Table 8.2 shows estimated identified tax gaps for SA taxpayers (excluding large partnerships) for the tax years 2002-03 to 2007-08 for business and non-business taxpayers.

Table 8.2: Identified tax gap for individuals in Self Assessment by type of taxpayer (£ billion)¹

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Net identified tax gap						
Total	3.1	3.3	3.3	2.7	3.0	3.0
Business taxpayers	2.6	2.8	2.8	2.2	2.6	2.6
Non-business taxpayers	0.5	0.6	0.5	0.5	0.3	0.4

¹ Figures rounded to the nearest £0.1 billion. As a result components may not appear to sum.

8.8 The tax gap from business taxpayers contributes the majority of the net total identified tax gap. Between 83 per cent and 85 per cent of the net total identified tax gap was from business taxpayers between 2002-03 and 2007-08, except for 2006-07 when the level increased to 88 per cent.

8.9 As the latest available estimate, the 2007-08 figures for under-declared liabilities due to incorrect returns in Table 8.1 have been used to produce a measure for the tax gap for 2008-09 and 2009-10 for inclusion in the estimation of the overall tax gap for those years.

- Based on US research (as detailed in Chapter 7), non-detection is accounted for by applying a multiplier to the figures for under-declared liabilities due to incorrect returns. A multiplier of 1.9 is used for business SA taxpayers and 1.3 for non-business taxpayers.
- An up-rating factor based on the trend in the GDP income series, is applied to the business and non-business estimates for the 2007-08 tax year. A multiplier of 1.01 to produce estimates for 2008-09 and 1.02 to produce estimates for 2009-10.
- Compliance yield for each year is then subtracted to give the estimate of the tax gap arising from underreporting. Losses from non-payment for each year are added to produce estimates of the net total identified tax gaps for business and non-business.
- These estimates are then summed to produce the estimates of the tax gap for inaccurate reporting from individuals in SA for 2008-09 (£5.6 billion) and 2009-10 (£5.8 billion) shown in Table 1.1.

8.10 The methodology described above is used to calculate ranges around the estimates of the 2008-09 and 2009-10 tax gaps for individuals in SA. The lower and upper estimates for under-declared liabilities due to incorrect returns for 2007-08, as shown in Table 8.1, are used for this, together with a range of multipliers (1.0 and 3.1 for business taxpayers and 1.0 and 1.9 for non-business taxpayers). This produces a range of £2.6 billion to £10.4 billion for the tax gap from inaccurate reporting from individuals in SA for 2008-09 and a range of £2.8 billion to £10.7 billion for 2009-10.

Supplementary Results

8.11 The results of the random enquiry programme can also be used to estimate the proportion of SA returns which are incorrect leading to under-declaration of liabilities. Table 8.3 shows that this proportion remained fairly constant at around a third from 2002-03 to 2004-05, before falling to around 30 per cent in 2005-06 and remaining constant. The proportion of returns where the annualised under-declared liability was between £501 and £1,000 was around 5 per cent to 7 per cent over the period, whilst a further 9 per cent to 14 per cent had annualised under-declared liabilities exceeding £1,000.

Table 8.3: Incorrect SA returns with under-declared tax liability (per cent)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Proportion	34%	32%	34%	29%	29%	30%
<i>of which, under-declared liability per annum</i>						
£1 to £500	18%	16%	16%	14%	14%	12%
£501 to £1,000	7%	6%	7%	5%	5%	5%
over £1,000	10%	10%	11%	9%	10%	14%

8.12 Table 8.4 shows that about half of the returns submitted by business taxpayers under-declared the true tax liability. The proportion of returns where the annualised under-declared liability was under £500 was between 15 per cent and 25 per cent, whilst a further 17 per cent to 24 per cent had annualised understated liabilities over £1,000.

Table 8.4: Business taxpayers: Incorrect SA returns with under-declared tax liability (per cent)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Proportion	56%	55%	53%	49%	44%	46%
<i>of which, under-declared liability per annum</i>						
£1 to £500	25%	22%	22%	21%	19%	15%
£501 to £1,000	12%	13%	12%	10%	8%	8%
over £1,000	19%	20%	19%	18%	17%	24%

8.13 Table 8.5 shows that for non-business taxpayers, the levels of under-declaration are much lower, at between 14 per cent and 17 per cent overall and between 2 per cent and 5 per cent where the annualised under-declared liability was more than £1,000. The majority of income tax paid by these individuals is deducted at source under PAYE, leading to the low levels of incorrect SA returns with under-declared tax liability compared with individuals with business income with under-declared tax liabilities.

Table 8.5: Non-business taxpayers: Incorrect SA returns with under-declared tax liability (per cent)

	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Proportion	17%	16%	15%	14%	15%	17%
<i>of which, under-declared liability per annum</i>						
£1 to £500	12%	11%	10%	10%	10%	10%
£501 to £1,000	2%	2%	3%	2%	3%	2%
over £1,000	3%	3%	3%	2%	3%	5%

8.14 Partnerships with 5 or more partners are not covered by the SA random enquiry programme and therefore an alternative methodology is required to estimate the associated tax gap. An illustrative estimate can be produced by assuming that the tax at risk will represent a similar proportion of liabilities to all other SA taxpayers, as shown by the results of the random programme. Applying this assumption produces an estimate of the tax at risk for large partnerships for 2007-08.

8.15 As with the estimate for under-declared liabilities due to incorrect returns for all other SA taxpayers, an up-rating factor, based on the trend in the GDP income series, is then applied to the tax at risk estimate (a factor of 1.01 to produce estimates for 2008-09 and 1.02 for 2009-10). Compliance yield for each year is then subtracted and losses from non-payment added. This produces an illustrative estimate of the tax gap for large partnerships of £0.8 billion for 2008-09 (within a range of £0.7 billion and £0.9 billion) and £0.9 billion for 2009-10 (within a range of £0.8 billion and £1.0 billion). These point estimates for 2008-09 and 2009-10 are presented in Table 1.1.

Methodology

- 8.16 The SA random enquiry programme allows HMRC to estimate the extent of under-declaration of liabilities arising from the submission of incorrect returns. The random sample used for the programme is selected from SA taxpayers issued with a notice to file a return.
- 8.17 Enquiries are taken up into the sampled returns. The results of the enquiries are then extrapolated to the population to produce estimates of the compliance of SA taxpayers.
- 8.18 As enquiries can take a number of years to settle, it is necessary to make assumptions about any enquiries that are still open at the time of analysis. Therefore figures are subject to revision until all enquiries are settled.
- 8.19 The most recent results available from the SA random enquiry programme are for 2007-08. The figures for earlier years have been revised since those previously published to include additional data on enquiries which have since settled. The figures in Tables 8.1 and 8.2 do not adjust for non-detection of non-compliance.

Employer compliance

- 8.20 Estimates of the tax gap for employers with up to 500 employees (except where the employer is part of a complex group) come from the employer compliance random enquiry programme and data on compliance yield and non-payment. The figures relate solely to income tax and NICs collected through PAYE due on earnings and other income from employment. The scope of these figures also includes tax due on occupational pensions taxed through PAYE.
- 8.21 An illustrative estimate of the tax gap for larger employers has been produced – see paragraphs 8.25 and 8.26.

Results

- 8.22 Table 8.6 shows that identified tax gaps for income tax and NICs for small and medium-sized employers remained fairly stable from 2003-04 to 2007-08 at between 1.3 per cent and 1.4 per cent of liabilities. In 2008-09 the level fell by 0.6 percentage points to 0.7 per cent. This reduction in 2008-09 was due to a decrease in the proportion of employers failing to meet their obligations in respect of operating a PAYE scheme (from 30 per cent in 2007-08 to 24 per cent in 2008-09; see Table 8.7).

Table 8.6: Identified tax gap for small and medium-sized employers (£billion)¹

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Under-declared liabilities due to incorrect returns²						
Point estimate	0.7	0.7	0.7	0.9	1.0	0.5
Lower estimate	0.6	0.7	0.7	0.8	0.9	0.4
Upper estimate	0.7	0.8	0.8	0.9	1.0	0.5
Compliance yield ³	0.2	0.3	0.3	0.4	0.3	0.3
Non-payment ⁴	0.4	0.6	0.5	0.5	0.5	0.4
Net total identified tax gap						
Point estimate	0.8	1.1	0.9	1.0	1.1	0.6
Lower estimate	0.8	1.0	0.9	0.9	1.0	0.5
Upper estimate	0.9	1.1	1.0	1.1	1.2	0.6
Total tax liabilities	68.2	78.9	76.8	82.4	91.0	86.8
Proportion of liabilities⁵	1.3%	1.4%	1.3%	1.3%	1.3%	0.7%

¹ Figures rounded to the nearest £0.1billion. As a result components may not appear to sum.

² Ranges for under-declared liabilities are 95% confidence intervals.

³ By period of settlement of enquiry.

⁴ Estimates of write-offs of tax in 2002-03 to 2004-05 are converted to financial year figures from periods ending in October each year. From 2005-06 estimates for write-offs of tax are available on a financial year basis.

⁵ Point estimate.

8.23 As the latest available estimate, the 2008-09 figures for under-declared liabilities due to incorrect returns in Table 8.6 have been used to produce an estimate and range for the tax gap for 2009-10. These figures are produced using a similar method to that described in paragraph 8.9 for individuals subject to self assessment (an up-rating factor of 1.01 is used to produce estimates for 2009-10). No multiplier is applied to adjust for non-detection, as it is not deemed necessary for small and medium sized employers. This results in an estimate of the tax gap for small and medium-sized employers of £0.9 billion for 2009-10, as shown in Table 1.1, with a range of £0.89 billion to £0.93 billion.

Supplementary Results

8.24 The results of the random enquiry programme can also be used to estimate the proportion of employers failing to meet their obligations in respect of operating a PAYE scheme. Table 8.7 shows that between 2003-04 and 2006-07 this proportion declined from 37 per cent to 27 per cent. There was a subsequent rise to 30 per cent in 2007-08, before a fall of 6 percentage points in 2008-09, down to 24 per cent. For between 11 per cent and 14 per cent of employers over the period this resulted in an annualised under-declared liability of more than £1,000.

Table 8.7: Small and medium-sized employers: Employers found to be failing to meet PAYE scheme obligations (per cent)

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
Proportion	37%	32%	30%	27%	30%	24%
<i>of which, under-declared liability per annum</i>						
£1 to £1,000	23%	17%	18%	15%	17%	13%
over £1,000	14%	14%	12%	12%	13%	11%

- 8.25 Larger employers, including those dealt with by the Large Business Service and employers which are part of a complex group, are not covered by the random enquiry programme and therefore an alternative methodology is required to produce an indicator of the associated tax gap.
- 8.26 It is possible to produce an illustrative estimate using an assumption of the size of the tax gap in proportion to receipts. Table 8.6 shows that the estimated tax gap for small and medium-sized employers represents approximately 1 per cent of liabilities for this group on average. Using the assumption that the ratio for larger employers will be similar, in the range of 1 per cent to 2 per cent, and applying this to the receipts for larger employers gives an illustrative tax gap estimate of £2.0 billion (within a range of £1.4 billion and £2.7 billion) for 2008-09 and £2.0 billion (within a range of £1.3 billion to £2.6 billion) for 2009-10.

Methodology

- 8.27 The employer compliance random enquiry programme allows HMRC to estimate the extent of under-declaration of liabilities arising from the submission of incorrect returns. The random sample used for the programme is selected from small and medium-sized employers operating PAYE schemes.
- 8.28 Reviews are taken up into the sampled employers. The results of the reviews are then extrapolated to the population to produce estimates of the compliance of small and medium-sized employers.
- 8.29 As reviews can take a number of years to complete, it is necessary to make assumptions about any reviews that are still open at the time of analysis. Therefore figures are subject to revision until all reviews are completed.
- 8.30 The most recent results available from the employer compliance random enquiry programme are for the 2008-09 tax year. Estimates for earlier years have been revised since previously published as a result of the inclusion of additional data from reviews that have since been completed. In addition, revisions have been made to the figures for earlier years due to improvements in the method used to extrapolate the results of the random enquiry programme to the population.

Avoidance

Results

- 8.31 HMRC's rolling record of the use of avoidance schemes gives an estimate for the total amount of tax that is considered to be at risk whilst avoidance schemes are in operation.
- 8.32 The estimate of tax under consideration for Income Tax, National Insurance Contributions and Capital Gains Tax avoidance for all taxpayers excluding businesses managed by the Large Business Service is £3.5 billion, based on a snapshot of information taken at the end of March 2011. The estimated expected compliance yield is £1.9 billion, leaving a £1.5 billion tax gap. The yield will reflect the legal framework in place at the time and not include any subsequent changes to the tax law to prevent further use of avoidance schemes.

- 8.33 The tax gap estimate is a lower bound as not all avoidance schemes will be identified. It is possible to produce a range around the estimate of £1.1 billion to £2.3 billion by varying the assumption concerning the average number of years that the schemes operate.
- 8.34 The estimate of tax under consideration for Income Tax, National Insurance Contributions and Capital Gains Tax avoidance has increased from £2.9 billion last year to £3.5 billion this year. However, the estimated expected compliance yield has also increased and therefore the result is that the tax gap is only slightly higher than last year, £1.5 billion compared with £1.4 billion.

Methodology

- 8.35 The avoidance tax gap estimate in this section comes from information that HMRC holds on avoidance schemes. This includes avoidance schemes for individuals, trusts, partnerships and employers.
- 8.36 The information represents a stock of avoidance schemes. Annual estimates are derived from this by dividing the total tax under consideration by the average number of years that the schemes operate.
- 8.37 The estimate includes only those avoidance schemes which have been identified, and reflects only the instances in which use of the schemes has been disclosed or otherwise detected. As a result the amount of avoidance, and therefore the avoidance tax gap, is likely to be underestimated.
- 8.38 The methodology has been developed since the previous publication to increase the depth and quality of the information available. As a result there has been an improvement in the underlying assumptions concerning the nature of the avoidance schemes.

Hidden economy

Non-declaration of income and capital gains by individuals who do not receive returns

Results

- 8.39 By matching data supplied by third parties to HMRC records, it has been possible to produce an estimate of the tax gap relating to income and capital gains of individuals taxed through PAYE but who do not receive SA returns. The income covered would not have been earned from employment and therefore the associated tax liability was not recovered under the PAYE system. As these individuals did not receive SA returns, the income and gains were also not reported through this means and thus additional liability was due.
- 8.40 This initial analysis produced an estimate of income tax and CGT losses of £0.3 billion relating to tax year 2004-05 for individuals who are taxed through PAYE but not declaring income through SA. However the limitations associated with this methodology suggest that this may be a lower limit for the true scale of the tax gap for this group of taxpayers. An up-rating factor of 1.1 is applied to the estimate to produce measures for 2008-09 and 2009-10 of £0.3 billion for both years for Table 1.1.

8.41 Table 8.8 shows the sources of income and gains contributing to the estimated tax gap for these taxpayers. Half of the estimated tax gap results from undeclared lettings income with the majority of the remainder from undeclared bank and building society interest or undeclared capital gains on land and property.

Table 8.8: Estimated tax gap for employees and pensioners taxed through PAYE but outside Self Assessment, by income source, 2004-05

Source of income	Estimated tax gap (£ millions)
Lettings	142
Bank and building society interest	67
Capital gains on land and property	55
Secondary income ¹	4
Irregular ISAs ²	3
Chargeable events ³	3
Offshore bank interest	3
Total	277

¹ Secondary income from employment is included in the estimate for 'Moonlighters' and therefore excluded from the estimate for 'Non-declaration of income and capital gains from individuals who do not receive returns' in Table 1.1.

² Irregular ISAs: Individuals are allowed to open or subscribe to just one ISA of any particular type within a given tax year. If another ISA of the same type is opened or subscribed to, then it is not entitled to tax-free status.

³ Chargeable Events: Chargeable events are most commonly payment of money from a life insurance policy, though other types of event such as the sale of an investment bond can also give rise to chargeable event gain that should then be treated as income for income tax purposes.

Methodology

8.42 The estimate of the tax gap for individuals who do not receive tax returns relates to employees and pensioners who are taxed through PAYE but are outside SA. The taxes covered are income tax and capital gains tax.

8.43 The estimate was produced by matching data supplied by third parties with a sample of tax records for these taxpayers. Income recorded in the third party data was compared against income shown on HMRC records as being taxed through PAYE. Several sources of income were investigated, such as income from lettings, bank and building society interest and capital gains. Where a difference was found between income in the third party data and the tax records, the tax that should have been paid on this income, if any, was then calculated and identified as the tax gap. The results from the sample were then grossed to produce an estimate of the overall tax gap for all employees and pensioners taxed through PAYE who are outside SA.

8.44 The limitations associated with the results of this exercise relate to the coverage of the third party data used to establish evidence of additional undeclared income. Not all potential sources of income could be investigated due to availability of data and the investigation of some sources was limited by the completeness of the information. The resulting estimate should therefore be interpreted broadly as a lower limit for the true scale of the tax gap relating to this group of taxpayers.

Ghosts

Results

- 8.45 Some individuals who receive income from employment or self-employment are not known to HMRC because they and/or their employers fail to declare their earnings. This may happen, for instance, if the individual is fraudulently claiming out of work benefits and either colludes with their employer to evade PAYE income tax or fails to declare that they are self-employed. Individuals who have earnings from employment or self-employment and fail to declare any of this income are known as “ghosts”.
- 8.46 Ghosts are not accurately recorded by any government agency or survey and therefore any estimate as to their number or the consequential loss of duty is approximate. A series of assumptions has been used to inform thinking about the potential scale of tax losses. The resulting estimate of the tax gap for ghosts is £1.3 billion for 2009-10. Due to the extent of the assumptions used to produce this estimate and the inherent uncertainties in the methodologies, this estimate has a large margin of error and should be treated with due caution.

Methodology

- 8.47 An estimate for the tax gap for ghosts has been produced by applying a set of assumptions to information on Jobseeker's Allowance claimants, the reported income from individuals who are known to HMRC, and estimates of the flows of illegal immigrants.
- 8.48 The tax gap estimate has been updated since 'Measuring Tax Gaps 2010' to take account of more up to date source data and as a result an estimate for 2009-10 has now been produced. The methodology has remained the same.

Moonlighters

Results

- 8.49 Individuals who pay tax on their main job through PAYE but have a second job or additional income from self-employment are known as “moonlighters”. Using a series of assumptions, it has been possible to produce an indicative estimate of the tax gap from moonlighters of £1.8 billion for 2009-10, within a range of £1.2 billion to £3.5 billion. Due to the extent of the assumptions used to produce this estimate and the inherent uncertainties in the methodologies, this estimate has a large margin of error and should be treated with due caution.

Methodology

- 8.50 UK survey data reported in *The Shadow Economy in Germany, Great Britain and Scandinavia: A measurement based on questionnaire surveys*¹⁰, has been used to estimate the proportion of employees who moonlight, the average number of hours spent moonlighting and the income generated through this. It is possible to then calculate a ratio of informal to formal income which can then be applied to employment income data. Applying marginal tax rates to these figures then produces an estimate of the tax due.

¹⁰ Soren Pedersen (2003) *The Shadow Economy in Germany, Great Britain and Scandinavia: A measurement based on questionnaire surveys*, Statistics Denmark.

8.51 The tax gap estimate has been updated since 'Measuring Tax Gaps 2010' to take account of more up to date source data and as a result an estimate for 2009-10 has now been produced. The methodology has remained the same.

Chapter 9: Estimating the tax gap for Corporation Tax

Overall tax gap

- 9.1 The estimated total tax gap for Corporation Tax was £4.8 billion in 2009-10, equivalent to 14 per cent of the overall tax gap. The components of this are described below. These are presented for the latest year for which data are available, together with the resulting estimate for 2009-10 when up-rating has been applied.
- 9.2 The tax gap for Corporation Tax is estimated separately for small and medium enterprises (SMEs) and large businesses. The large business estimates are subdivided into two categories; 'Large Business Service' (LBS) and 'Large and Complex' (L&C). These are the two divisions of HMRC that manage the relationship with these businesses. The LBS handles the largest businesses, approximately 800 groups, and L&C oversees a much larger number of comparatively smaller businesses, approximately 8,500 groups.

Businesses managed by the Large Business Service

Results

- 9.3 Table 9.1 shows estimates of the corporation tax gap for LBS groups as a proportion of total liabilities for accounting periods ending in 2004–05 to 2007-08 as at April 2011. The risks identified by LBS fall into two categories (described in more detail in the methodology section);
 - avoidance risks and technical risks subject to litigation
 - technical risks not subject to litigation

Table 9.1: Estimated tax gap for LBS groups: accounting periods ending in 2004–05 to 2007-08 (£ billion)

	2004-05	2005-06	2006-07	2007-08	2008-09 ⁶	2009-10 ⁶
Total number of risks ^{1,2}	3,478	1,937	1,402	1,090		
Number of technical risks not subject to litigation	2,831	1,418	998	787		
Number of avoidance risks and technical risks subject to litigation	647	519	404	303		
Total Tax under Consideration (TuC) ³	8.8	6.3	7.0	6.2		
TuC from technical risks not subject to litigation	3.9	2.5	3.1	3.5		
TuC from avoidance risks and technical risks subject to litigation	4.8	3.9	3.9	2.7		
Compliance yield ⁴	2.5	1.7	1.8	1.4		
Tax Gap ⁵	2.3	2.2	2.2	1.3	1.3	1.2
Total liabilities	25.7	30.8	29.4	27.2		
Tax Gap as a proportion of liabilities⁷	9%	7%	7%	5%		

¹ Risks may span more than one accounting period.

² Estimates will include both risks that are being worked (open) and risks that have been settled (closed) – see Table 9.4.

³ Tax under Consideration is defined in the glossary.

⁴ Compliance yield = the total yield from closed avoidance or litigated technical risks plus the estimated compliance yield from open avoidance risks and technical risks in litigation.

⁵ Tax gap = TuC on avoidance risks and technical risks subject to litigation minus compliance yield.

⁶ Estimates for 2008-09 and 2009-10 are derived using up-rating factors of 1.02 and 0.92 respectively – see paragraph 9.6.

⁷ Total liabilities = the estimated corporation tax liabilities from LBS groups plus the TuC on avoidance risks and technical risks not subject to litigation.

9.4 The tax gap estimates, in terms of value, remained relatively stable between 2004-05 and 2006-07 before decreasing by £0.9 billion to £1.3 billion in 2007-08. Estimates are subject to change over time as more risks are resolved (see revisions section).

9.5 As a proportion of total tax liabilities the tax gap was 9 per cent in 2004-05, 7 per cent for 2005-06 and 2006-07 and 5 per cent in 2007-08. The reduction in the tax gap between 2006-07 and 2007-08 can be explained by a number of factors.

- The overall number of risks identified fell from 1,402 to 1,090 (22 per cent).
- The proportion of total TuC relating to avoidance risks and technical risks subject to litigation fell from 56 per cent to 43 per cent.
- In addition, the average TuC from avoidance risks and technical risks subject to litigation decreased from £9.7 million to £8.8 million from 2006-07 to 2007-08 (see Table 9.2).

These factors resulted in the TuC from avoidance risks and technical risks subject to litigation decreasing 32 per cent (from £3.9 billion in 2006-07 to £2.7 billion in 2007-08). Over the same period the compliance yield from these types of risks fell less sharply (from £1.8 billion to £1.4 billion or 22 per cent) i.e. the conversion ratio¹¹ increased. The combination of these factors led to a reduced tax gap.

9.6 Since these estimates are for accounting periods ending in tax years up to 2007-08 an up-rating factor, based on the trend in the UK's Gross Operating Surplus as published by the Office for National Statistics, is applied to the latest year's estimate (2007-08). A factor of 1.02 is therefore applied to produce an estimate of £1.3 billion for 2008-09 and a factor of 0.92 is applied to produce an estimate of £1.2 billion for 2009-10, as shown in Table 1.1.

Table 9.2: Average value of risks for LBS groups: accounting periods ending in 2004–05 to 2007-08 (£ million)

	2004-05	2005-06	2006-07	2007-08
Average TuC from technical risks not subject to litigation	1.4	1.7	3.1	4.5
Average TuC from avoidance risks and technical risks subject to litigation	7.5	7.4	9.7	8.8
Average TuC from all risks	2.5	3.3	5.0	5.7

9.7 As shown in Table 9.3, the tax gap can be split according to the type of risk identified; into the gap due to avoidance risks and the gap due to technical risks subject to litigation.

¹¹ The conversion ratio is calculated by dividing the compliance yield by the tax under consideration for avoidance risks and technical risks subject to litigation that are closed on the case management system.

Table 9.3: Estimated tax gap for LBS groups: by type of risk and accounting period (£ billion)¹

	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Tax gap for avoidance risks	2.1	1.9	1.6	1.1	1.1	1.0
Tax gap for technical risks subject to litigation	0.2	0.3	0.5	0.2	0.2	0.2
Total tax gap	2.3	2.2	2.2	1.3	1.3	1.2

¹ Figures may not appear to sum due to rounding.

9.8 Avoidance risks contribute the majority of the tax gap (ranging from 76 per cent in 2006-07 to 90 per cent in 2004-05) and the overall level has declined over the period 2004-05 to 2007-08 (falling from £2.1 billion in 2004-05 to an estimated £1.1 billion in 2007-08). The tax gap due to technical risks subject to litigation has generally been in the range of £0.2 billion to £0.3 billion with the exception of 2006-07 where the estimate was £0.5 billion. The up-rating factors of 1.02 and 0.92 are applied to the 2007-08 estimates to provide illustrative estimates for 2008-09 and 2009-10 of £1.1 billion and £1.0 billion respectively for avoidance and £0.2 billion for both years for technical risks subject to litigation, as shown in Table 1.1.

Revisions

9.9 Tax gap estimates for the period 2004-05 to 2006-07 have been revised since last year. This is primarily the result of efforts made by the LBS to record better estimates of TuC on the case management system. In addition, further quality assurance processes have been built into the methodology.

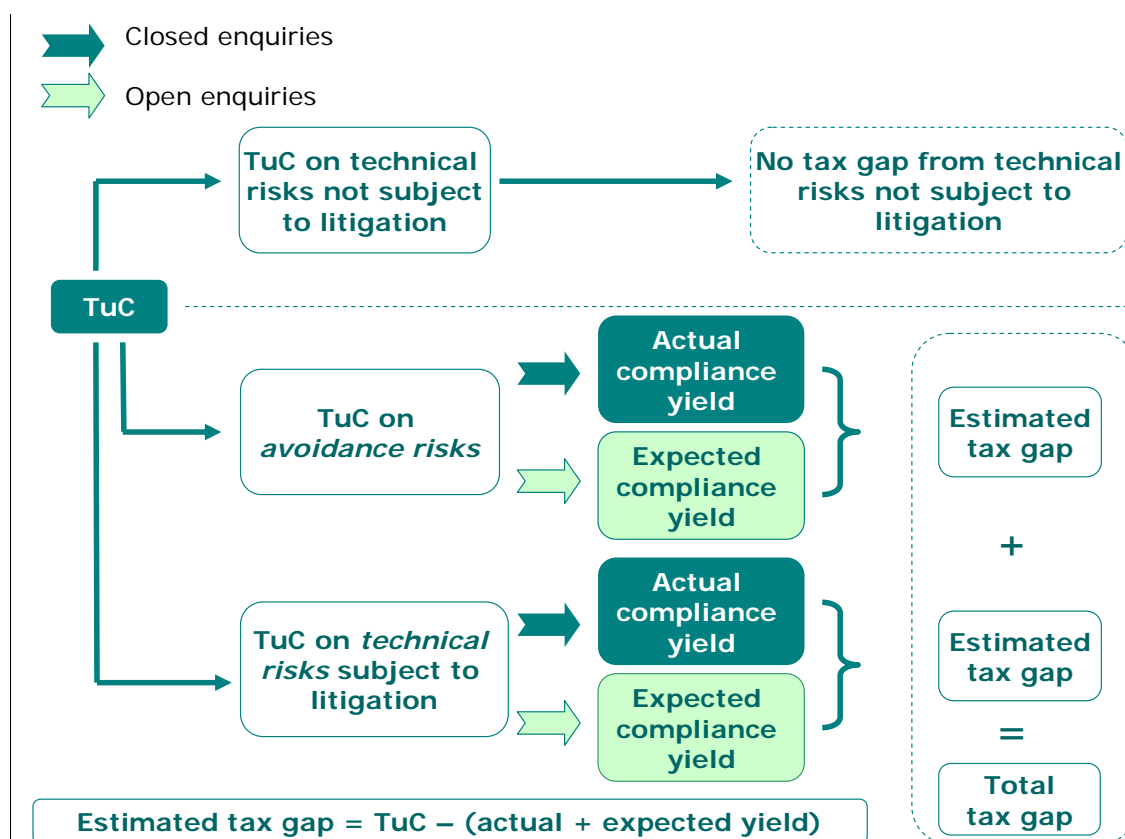
9.10 Other minor changes result because a more recent snapshot of the data was used. In last year's publication, the data used was from April 2010 whereas the estimates are now based on data from April 2011. Where time has elapsed between data snapshots, differences between the initial and latest tax gap estimates are expected, for the following reasons.

- More risks may be found, leading to additional TuC in any category;
- A larger proportion of the tax gap estimate will be based on actual yield numbers, replacing the values previously forecast;
- The forecast values may change as the conversion ratio calculation is based on a larger sample of closed cases;
- HMRC's judgement on the TuC of a risk or its classification as avoidance or technical may change where better information has emerged.

Methodology

- 9.11 Estimates of the corporation tax gap for businesses managed by the LBS come from information captured on HMRC's LBS case management system. Where HMRC tax specialists identify risks for further consideration, the initial estimate of the tax associated with these risks is recorded on the system as the TuC. TuC is not tax owed or unpaid - it is a tool which helps LBS managers to better direct resources in order to produce the best results. It is, however, the closest approximation to the tax that should be collected that can be used for the purpose of estimating the tax gap.
- 9.12 The LBS case management system allows the classification of risks into two broad categories; avoidance and technical risks. The avoidance category relates to the use of disclosed avoidance schemes or other suspected avoidance identified by HMRC tax specialists. Technical risks cover a wide range of risks; from cases where there is genuine uncertainty about the correct tax treatment, through mistakes to culpable errors in, or omissions from, the company tax return.
- 9.13 The risks will be worked until resolution in line with HMRC's Litigation and Settlement Strategy. Where the risk relates to avoidance or is resolved after litigation, tax gap may result. (Risks proceeding to litigation are identified on the case management system). There is assumed to be no tax gap on technical risks settled by agreement. The flowchart at Figure 9.1 shows the process for arriving at the tax gap estimate.
- 9.14 The tax gap estimates are calculated;
- for avoidance risks, as the total TuC minus the total actual and expected compliance yield and,
 - for technical risks, where it has not been possible to reach agreement, as the total TuC minus the total actual and expected compliance yield.

Figure 9.1: The process for estimating the tax gap for LBS groups by category



Actual compliance yield refers to closed risks only

Expected compliance yield refers to forecast yield from open risks

9.15 Identified risks can take a number of years to be resolved. Table 9.4 shows the proportion of risks that have closed from accounting periods ending in 2004-05 to 2007-08. While all these risks will be closed over time, in the interim it is necessary to estimate the yield that will result from open enquiries (see Annex A.18 for further detail). Differences between the estimated yield and the actual yield will lead to revisions to the tax gap estimates when calculated for subsequent publications. As the proportion of risks closed is lower for later years, and hence more estimation of yield is required, the tax gap estimates for these years are more likely to be subject to revision.

Table 9.4: Proportion of risks closed by the number and value of the risk and accounting period for LBS groups

	2004-05	2005-06	2006-07	2007-08
Percentage of risks closed	91%	85%	77%	63%
Percentage of Tax under Consideration closed	81%	72%	61%	60%

Limitations

9.16 The main source of error in these estimates is that HMRC may not identify all risks - which will lead to an underestimation of the tax gap. It is difficult to quantify the extent to which this source of error impacts upon the estimates.

9.17 Compliance yield will reflect the legal framework in place at the time of intervention and does not include changes to the tax law to address the issues.

9.18 As it can take many years to close every risk identified in a particular year, the yield expected from open cases must be forecast to be able to produce estimates of the overall tax gap. Differences between forecast yield and actual yield may lead to some degree of error, and as such, estimates are provisional until every risk is closed.

Large and Complex businesses

9.19 Businesses dealt with by Large and Complex fall out of scope of the Corporation Tax Self Assessment (CTSA) random enquiry programme which is used to derive estimates of the tax gap for small and medium-sized businesses (see next section). They are also not covered by the case management system used by LBS (as detailed above). Hence neither of the methodologies used to derive estimates for those businesses can be directly applied to produce an estimate of the tax gap for the Large and Complex businesses.

9.20 An illustrative estimate of the Corporation Tax gap for Large and Complex businesses can be produced by assuming that the tax at risk will represent a similar proportion of liabilities to businesses managed by the LBS. Applying this assumption produces an estimate of the tax at risk for Large and Complex businesses for 2007-08. As with the estimate for LBS businesses, up-rating factors of 1.02 and 0.92, based on the trend in the Gross Operating Surplus series, are then applied to the tax at risk estimate for the latest year. This produces illustrative estimates of under-declared liabilities for 2008-09 and 2009-10, respectively, from which yield from compliance checks is then subtracted and an estimate of losses from non-payment is added. This produces illustrative estimates of the tax gap for Large and Complex businesses of £0.9 billion for both 2008-09 and 2009-10.

9.21 Using information that HMRC holds on avoidance schemes, it is possible to produce an estimate of the corporation tax gap from avoidance by Large and Complex businesses. The same methodology used to produce an estimate of the IT/NIC/CGT tax gap due to avoidance (as outlined in Chapter 8) can be applied. Using this methodology it is estimated that within the overall Large and Complex tax gap of £0.9 billion for 2009-10, approximately £0.2 billion is due to avoidance of CT. This is an indicative estimate only. The corresponding estimate of CT avoidance for 2008-09 is £0.4 billion. This has been revised from the estimate of £0.7 billion published last year following improvements in the quality and detail of the supporting information.

Small and medium-sized businesses

9.22 Estimates of tax gaps from incorrect returns in this section come from the Corporation Tax Self Assessment random enquiry programme and data on compliance yield and non-payment. The programme covers 'small and medium-sized businesses', which in this context means those businesses not managed by the LBS and also excludes the largest and most complex businesses dealt with outside the LBS.

Results

9.23 Table 9.5 shows estimated tax gaps for businesses with accounting periods ending in calendar years 2001 to 2006. Data for 2007 was not of a sufficient quality to be able to use for analysis and therefore 2006 remains the latest year for which information is available. The figures do not adjust for non-detection.

Table 9.5: Identified tax gap for small and medium-sized businesses (£billion)¹

	2001	2002	2003	2004	2005	2006
Under-declared liabilities due to incorrect returns²						
Point estimate	2.5	1.7	3.2	2.2	1.9	1.8
Lower estimate	1.5	0.9	1.9	1.1	1.0	1.1
Upper estimate	3.6	2.7	4.8	3.6	3.1	2.8
Compliance yield ³	0.4	0.4	0.4	0.4	0.5	0.5
Non-payment ⁴	0.1	0.1	0.1	0.2	0.2	0.2
Net total identified tax gap						
Point estimate	2.2	1.4	3.0	2.0	1.5	1.4
Lower estimate	1.2	0.7	1.6	0.9	0.7	0.7
Upper estimate	3.3	2.4	4.5	3.4	2.7	2.4
Total tax liabilities	12.1	12.0	14.1	14.8	13.7	14.9
Proportion of liabilities⁵	18%	12%	21%	13%	11%	10%

¹ Figures rounded to the nearest £0.1billion. As a result components may not appear to sum.

² Ranges for under-declared liabilities are 95% confidence intervals.

³ By period of settlement of enquiry.

⁴ Estimates of write-offs of tax for periods of approximately a year ending in October each year, converted to calendar year figures.

⁵ Point estimate.

9.24 The estimates for the identified tax gap as a proportion of the total relevant tax liabilities were similar between 2004 and 2006, at around 10 per cent, and were comparable with 2002. For 2001 and 2003, by contrast, the proportions were higher, at 18 per cent and 21 per cent respectively. However, due to a substantial margin of sampling error in these figures it is not possible to determine with certainty whether or not this variation represents changes in the underlying level of under-declaration of liabilities. Allowing for confidence intervals the trend in these figures is broadly stable.

9.25 As the latest available estimate, the 2006 figure for under-declared liabilities due to incorrect returns in Table 9.5 has been used to produce a measure for the tax gap for 2009-10 for inclusion in the estimation of the overall tax gap for that year. Based on the US research a multiplier of 1.4 is applied to this estimate to account for non-detected non-compliance. An up-rating factor of 1.02, based on the trend in the UK's Gross Operating Surplus is then applied. This produces an illustrative estimate of under-declared liabilities for 2009-10, from which compliance yield for that year is then subtracted and losses from non-payment added. This results in an estimate of the tax gap for small and medium-sized businesses of £2.7 billion for 2008-09 and also £2.7 billion for 2009-10, as shown in Table 1.1.

- 9.26 The methodology described above is used to calculate ranges around the estimates of the 2008-09 and 2009-10 tax gaps for small and medium-sized businesses reporting CTSA. The lower and upper estimates for under-declared liabilities due to incorrect returns for 2006, as shown in Table 9.5, are used for this. This produces a range of £1.2 billion to £5.6 billion for the tax gap for 2008-09 and a range of £1.2 billion to £5.3 billion for 2009-10.
- 9.27 Due to the improvement in the detail and quality of the data on avoidance schemes this year (as described in Chapter 8) it is possible to produce an estimate of the corporation tax gap from avoidance by small and medium-sized businesses. This indicative estimate is £0.1 billion for 2009-10.

Supplementary Results

- 9.28 Table 9.6 shows that for the years 2001 to 2006, the proportion of small and medium-sized businesses submitting an incorrect return leading to a loss of tax was in the range 35 to 42 per cent. This should be considered to be relatively constant in the context of the margin of error of these figures. The annualised additional liability over £1,000 was initially 28% in 2001 after which it has been fairly consistently around 20%.

Table 9.6: Small and medium-sized businesses: Incorrect CTSA returns where additional tax liability established (per cent)

	2001	2002	2003	2004	2005	2006
Proportion	42%	37%	38%	40%	40%	35%
<i>of which, under-declared liability per annum</i>						
£1 to £1,000	15%	16%	17%	20%	20%	16%
over £1,000	28%	21%	21%	20%	20%	19%

Methodology

- 9.29 The CTSA random enquiry programme allows HMRC to estimate the extent of under-declaration of liabilities arising from the submission of incorrect returns. The random sample used for the programme is selected from small and medium-sized businesses issued with a notice to file a CTSA return.
- 9.30 Enquiries are taken up into the sampled returns. The results of the enquiries are then extrapolated to the population to produce estimates of the compliance of small and medium-sized businesses.
- 9.31 As enquiries can take a number of years to settle, it is necessary to make assumptions about any enquiries that are still open at the time of analysis. Therefore figures are subject to revision until all enquiries are settled.
- 9.32 Estimates have been revised since the previous publication to include information on the outcomes of enquiries which have since settled.
- 9.33 The estimate for avoidance of corporation tax by small and medium-sized business has been produced using information that HMRC holds on avoidance schemes and applying the same methodology as is used to estimate the IT/NIC/CGT tax gap due to avoidance (as outlined in Chapter 8).

Chapter 10: Estimating the tax gaps for other direct taxes

10.1 This section contains illustrative estimates of tax gaps for direct taxes where HMRC has no accepted direct measure of loss. The methodologies used to produce the estimates are heavily assumption-based. They should therefore be interpreted with caution and used for illustrative purposes only as they are not direct measures of losses for the individual taxes themselves. They are subject to change as methodologies are developed.

Inheritance Tax

10.2 To produce an indication of the size of the inheritance tax gap, the assumption has been made that the tax at risk is approximately 10 per cent of receipts. If compliance yield is then subtracted and losses from non-payment of inheritance tax are included, an indicative tax gap of £0.05 billion is produced for 2009-10. Varying the tax at risk assumption between 5 per cent and 20 per cent of receipts gives a range for the tax gap of negligible to £0.3 billion. These estimates, however, are based purely on judgment and should be treated with due caution.

Stamp Duties

Stamp Duty Land Tax

Results

10.3 The estimated total tax gap for Stamp Duty Land Tax (SDLT) was £250 million in 2009-10. The estimate is a lower bound of the SDLT tax gap. It covers both commercial and residential transactions.

10.4 SDLT tax gap is estimated using a bottom-up methodology. This is an improvement in the method of estimation used in previous publications as it uses departmental and third party information to estimate the gap. The estimate covers a single year only as we do not have sufficient historical information to estimate the figures for previous years. The general methodology is described below with the detail being presented in the methodological annex.

Methodology

10.5 The tax gap is calculated from the total of three components: Avoidance, General Non-Compliance and Evasion; and then subtracted yield from enquiries.

10.6 The avoidance tax gap estimate comes from information that HMRC holds on avoidance schemes. The estimate includes only those avoidance schemes which have been identified, and reflects only the instances in which use of the schemes has been disclosed or otherwise detected. As a result the amount of avoidance, and therefore the tax gap, is likely to be underestimated.

10.7 The evasion component of the tax gap is estimated by assessing the amount of threshold manipulation.

10.8 The general non-compliance component is estimated from information on valuation issues, reliefs claimed and other open enquiries.

Shares Stamp Duty

10.9 An illustrative estimate of the tax gap for Shares Stamp Duty has been produced using the same approach as was used in the previous publication for estimating the overall Stamp Duties tax gap. The assumption is made that the tax at risk is approximately 10 per cent of receipts, from which compliance yield is subtracted and losses from non-payment of stamp duties are added. This results in an estimate of the tax gap for Shares Stamp Duty of £0.3 billion for 2009-10. Varying the tax at risk assumption between 5 per cent and 20 per cent produces a range for the tax gap of £0.1 billion to £0.6 billion. These estimates are based purely on judgement and should be treated with due caution.

Petroleum Revenue Tax

10.10 The methodology used to produce an illustrative indicator of the tax gap from Petroleum Revenue Tax (PRT) has been reviewed since the last publication. Previously, the tax gap was assumed to be equal to 6 per cent of PRT receipts based on the average percentage tax gap from excise duties. Further discussions with PRT specialists have suggested that the proportion of receipts may be too high given the narrowly defined extent of the tax (limited to oil producing fields developed before April 1993), the small number of businesses involved and HMRC's compliance approach of six-monthly reviews. Consequently, a range of between 1 per cent and 3 per cent of receipts has now been used which produces an estimate of between £30 million and £80 million for 2008-09 and between £10 million and £30 million in 2009-10. The mid-point of 2 per cent is used to produce the PRT estimates shown in Table 1.1 of £50 million in 2008-09 (compared to £200 million published previously) and £20 million in 2009-10. PRT receipts fell between 2008-09 and 2009-10 and hence the estimated tax gap for 2009-10 is lower.

Glossary of technical terms

Accounting period: The period for which a business prepares its accounts and in respect of which a corporation tax assessment is raised. It cannot be more than 12 months in length, although it can be shorter.

Central Estimate: The most likely estimate of the true value.

Clearances data: Administrative data source certifying that duty has been paid; used to measure the level of legal consumption.

Compliance: State of being in accordance with established legislation.

Compliance activity: An intervention by HMRC, such as a direct tax enquiry, employer compliance review or VAT assurance visit, design to ensure that the correct amount of tax is being accounted for and paid.

Compliance yield: Additional tax charged, resulting from compliance activity.

Confidence interval: A range of values that has a specified probability of containing the true value of interest.

Cross-border shopping: Legal importation of goods for personal use.

Estimates: Approximate results calculated from approximate or incomplete data.

EU-Duty paid: Duty paid legally within the European Union.

EU Large: EU definition of a large business, which has either 250 or more employees or both a turnover of more than €50 million and a balance sheet total more than €43 million.

Evasion: The deliberate omission, concealment or misrepresentation of information, or the false or deceptive presentation of circumstances, to fraudulently obtain a fiscal advantage, whether temporarily or permanently.

Fraud: Deliberate, dishonest evasion of tax.

Gross Domestic Product (GDP): GDP is the market value of all final goods and services made within a country in a year.

Gross Operating Surplus (GOS): the surplus due to owners of incorporated businesses. Often called profits, although only a subset of total costs are subtracted from gross output to calculate the GOS.

Illicit market: The part of the market on which due taxes and duties have not been paid.

Legitimate consumption: Consumption of goods for which the correct duty has been paid.

Litigation: A lawsuit seeking a legal remedy to a question or dispute.

Lower bound: The value below which the true value will not lie.

Margins of errors: Measures of how reliable the estimated value is.

Mid-point: Average of the upper and lower bounds.

Non-payment: Tax debts that are identified but never paid off. Eventually this debt will be written off by HMRC as uncollectable.

Non-UK-Duty paid: Any product that has not had UK duty paid on it.

Official Statistics: All statistics produced by the Office for National Statistics, government departments, the devolved Administrations and other Crown bodies, are automatically deemed to be Official Statistics.

PAYE scheme: Each employer operating PAYE registers a PAYE scheme with HMRC, which allows for the issue and monitoring of returns.

Risk Register: A list of identified tax risks, together with information such as estimated value, nature and status. Registers are used to track and monitor the risks they cover.

Sampling weights: In order to make the results from the sample more representative of the population, respondents' answers are "weighted" (multiplied by a coefficient) to rebalance the survey answers to the population profile.

Self Assessment (SA): A system for reporting income and capital gains to, and claiming tax allowances from, HMRC.

Settlement: Closure of a direct tax enquiry, resulting in the agreement of any additional tax liability.

Small or Medium Enterprise (SME): Any business that does not fall within the EU Large definition

Smuggling: In this document this covers all activity that results in goods entering the UK market without the correct duty being paid.

Targeted Education, Enabling and Leverage (TEEL): HMRC Business area that aims to improve customer compliance in a range of ways, without using enquiries or assurance visits.

Tax under Consideration (TuC): The value of an issue is the amount of TuC. The TuC in an enquiry is an estimate before any consideration of the specific facts has taken place and before any reliefs or allowances are applied. It does not represent the tax owed or unpaid. The TuC for a given risk is updated when the Department's view on the possible outcome of the enquiry changes, for example, because new facts are established or legal advice is obtained.

Upper bound: The value above which the true value will not lie.

Write offs: Debts that are considered to be irrecoverable.

Abbreviations

CGT:	Capital Gains Tax
CT:	Corporation Tax
CTSA:	Corporation Tax Self Assessment
EU:	European Union
GB:	Great Britain
GDP:	Gross Domestic Product
GLF:	General Lifestyle Survey
HMRC:	Her Majesty's Revenue & Customs
HRT:	Hand Rolling Tobacco
IRS:	Internal Revenue Service (United States)
IT:	Income Tax
L&C:	Large and Complex (businesses)
LBS:	Large Business Service
LCF:	Living Cost and Food Survey
MTIC:	Missing Trader Intra-Community fraud
NI:	Northern Ireland
NICs:	National Insurance Contributions
NUKDP:	Non-UK-Duty Paid
ONS:	Office for National Statistics
PAYE:	Pay As You Earn
PRT:	Petroleum Revenue Tax
SA:	Self Assessment
SDLT:	Stamp Duty Land Tax
SME:	Small or Medium Enterprise
UK:	United Kingdom
VAT:	Value Added Tax
VTTL:	VAT Theoretical Tax Liability