

**TAXREP 18/00**

**The Grabiner Report: A riposte**

*Memorandum prepared by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to the issue of The Grabiner Report on the 'Informal Economy'.*

## **THE GRABINER REPORT - A RIPOSTE**

### **Introduction**

One of the most worrying aspects of Gordon Brown's Budget speech in March 2000 was the stark sentence; 'We will implement the Report of Lord Grabiner QC'. Why worrying? Well, the report is in many respect highly controversial; it has been based on very few hard facts; it reflects input from the tax authorities but not from those outside the Government machine and might, therefore, be expected to be a little one-sided. Below we set out why the Grabiner Report should be used with extreme caution.

### **Short timescale**

The following is not necessarily a criticism of Lord Grabiner. He was allowed a mere three months to produce his report on 'The Informal Economy', his new name for what the rest of us normally call 'The Black Economy'. The lack of research, the absence of consultation and an apparent indifference to the likely effect of some of his proposals is probably largely attributable to the ridiculously short timescale in which he was required to produce the report. Indeed, the Report itself states 'Given the time constraints ... and that there is a vast amount of relevant legislation and administration practice the report is necessarily something of a bird's eye view'.

Such a view is useful in highlighting the areas for discussion. It is not however a reasonable basis for legislation. We would have had no complaint if the Chancellor had said 'We have asked the Inland Revenue to consult with interested parties on the issues raised in the Report of Lord Grabiner' but he appears to have decided to accept it unquestioningly. The Government's professed concern for open Government and increased consultation does not, it appears, extend to proposals that will substantially undermine the freedom of the individual and which sit uneasily with the recent enactment of the Human Rights Act 1998.

### **Widespread debate**

It is important that there is a widespread debate about the Grabiner proposals. If the Chancellor is not prepared to initiate this debate we believe someone else should do so. The purpose of this paper is to highlight the issues raised by the Report that we believe should concern every citizen of this country in the hope that the public will make known their views.

### **No condoning fraud**

It should not need to be said, but we ought to state straight away that criticism of proposals aimed at combating fraud is not to condone such fraud. The Tax Faculty is totally opposed to tax evasion; it is totally opposed to Social Security fraud.

But as a society do we want to prevent such fraud at any cost? Should a citizen's right to a fair trial (Article 6 of the European Convention on Human Rights) be subjugated to a desire to make it easier to consign fraudsters to prison? Should a citizen's right to respect for his

privacy and family, his home and his correspondence, (Article 8 of the Convention) be abrogated by a perception that if the State were to have access to every detail of everyone's life they would be better able to counter fraud by the minority?

The Convention itself does permit such rights to be overridden where this is necessary in the interest of the national well being of the country or for the prevention of crime. In the year 2000 might it have become necessary for the State to create dossiers on everyone for such purposes? Should owner's of computers any longer be entitled to the peaceful enjoyment of the commercial information that they have amassed (Article 1 of the First Protocol to the Convention), or should the State be entitled to expropriate such information? Indeed, should a citizen be entitled to the peaceful enjoyment of his possessions where the State suspect that some may derive from tax evasion but under current law has difficulties in proving it?

We do not seek to provide answers to these questions. We believe that it should be for the country as a whole to do this. But we feel it important that they are asked. Whether the Grabiner Report should be enacted in its entirety, as Gordon Brown intends to do, and if not how much of it is acceptable to the populace at large, is a question that itself cannot be answered without first asking the bigger questions posed above.

Because, amongst other things, Lord Grabiner recommends that the Government should:

- \* consider ways to use information from private sector sources as a cross-check on the details people provide to Departments;
- \* give investigators the power to make routine 'reverse searches' of the telephone directory;
- \* impose better, i.e. tighter, more intrusive, controls on the issue of birth certificates and National Insurance numbers;
- \* establish a new statutory offence of fraudulently evading income tax which would be tried in a magistrates court; and
- \* consider the option of punishing persistent fraudsters (and, of course, also their families although Lord Grabiner does not spell that out) by removing, or heavily reducing, their right to benefit for a specified period.

### **Are there any benefits in these restrictions?**

Most of these things involve some restrictions of civil freedoms, not only for the fraudster but for the citizenry as a whole. Do the likely benefits justify this restriction? That may depend on the benefits. But no one, including Lord Grabiner, has yet attempted to quantify the likely benefits.

For a start no one can quantify the scale of the hidden economy (an expression Lord Grabiner uses interchangeably with 'the informal economy'). The Report states: 'For the purpose of this Report I have assumed that the hidden economy is a major problem, involving billions of pounds, and, in view of what I have learned in conducting this review, I am quite sure this assumption is a reasonable one'.

Many economists have sought to devise rather more scientific methods of quantifying the black economy than 'I have guessed a figure and on what I have learned I am quite sure my guess is reasonable'. Most seem to come to the conclusion that it is probably between 6 and 10% of Gross Domestic Product (GDP). GDP for 1999/00 was £890 billion, so the black economy might be as high as £89 billion. But, of course, the cost of the black economy is far less. Total tax receipts for 1999/00 were £356 billion, or roughly 40% of GDP. But much tax evasion under the black economy is the evasion of tax at 23% or, frequently, less - indeed much of the black economy would probably not have attracted tax at all even if the money had been brought into the 'white' economy. Even adding social security fraud, it seems doubtful whether the cost to the Government of the black economy is more than around £12 billion per annum. Indeed, it could well be less as many participants in the black economy do not claim social security benefits to which they might well be entitled.

But £12 billion is still a lot of money. Will the Grabiner proposals garner in all of it? Common sense suggests that they cannot do so. Indeed, very few of the proposals claim to reduce its size. They are directed almost exclusively at helping the tax and social securities departments to combat the loss of tax and social security as a result of the black economy.

Does it matter if the Report's measures will not make significant inroads into the black economy? After all, a 10% reduction in a £12 billion loss is over a billion pounds. For the mathematically minded it should be pointed out that in Government accounting terms a billion is a thousand million, not the million million that the dictionary definition indicates. To put the cost into perspective, £1,200 million is roughly the amount that Gordon Brown proposes to forego by his proposed increase in the rate of Working Families' Tax Credit, or three times the extra £50 he has added to pensioner's winter fuel payments or three times the extra yield from his increase in tobacco duty, or four times the extra yield from the stamp duty increases.

Lord Barnett, Chief Financial Secretary to the Treasury in the Callaghan administration, when asked whether he thought tax evasion could be stopped responded, 'Where it lies makes it difficult to stop completely. It could be done if we have a Gestapo-type control over businesses, but I would not want to live in a society like that'. (The Black Economy, Professor Arnold Heertze, Margaret Allen and Harry Cohen 1982).

Which brings us back to that sort of society to that we want to live in. And is it the same society as that which Lord Grabiner and Gordon Brown appear to want. To discern the society that they seem to favour it is time to look at the proposals in more detail.

### **Incentives to go Legitimate**

Grabiner suggests a number of incentives to encourage individuals to come out of the black economy and become legitimate. Let's consider each in turn.

i) *The Government should advertise more widely the existing incentives for people to join the legitimate economy, such as the Working Families' Tax Credit.*

As Lord Grabiner did not have time to investigate why people resort to the black economy it is unclear how he can sensibly propose incentives for such people to go legitimate. It seems to us unlikely that, as Lord Grabiner apparently believes, many have joined the black economy because they did not realise that self-employed people can claim the Working Families' Tax Credit or that self-employed people with low profits need only pay £2 a week in NICs from April 2000, or that Business Links and the Government's new Small Business Service will be able to provide advice, finance and opportunities that 'are not available in the hidden economy'. If our perception is correct, advertising these benefits is accordingly unlikely to have much impact on the black economy.

*ii) More people would be attracted into legitimate jobs by setting up a confidential telephone line, which would offer advice on how to leave the hidden economy.*

This might be effective to a small extent if it were combined with a tax amnesty to wipe clean the slate for the past. But Lord Grabiner specifically rejects an amnesty on four grounds.

a) He envisages practical difficulties in defining an amnesty precisely enough to make it workable. As he does not expand on this it is unclear what problems he envisages. It would not be difficult to say that the Inland Revenue and Customs and Excise will not raise any questions about the past where a person admits to having underdeclared his income provided that he undertakes to declare everything fully for the future. We suspect that what Lord Grabiner actually means is not that it is difficult to define an amnesty but rather that an amnesty ought to cover only small amounts of tax and it is difficult to come up with a definition that will not risk waiving tax for people who have committed major frauds, when he only wants to let out those that have excluded small amounts of cash receipts from their returns.

b) He questions whether different kinds of hidden economy fraud should be treated in the same way. For example it may be thought that deliberately over-claiming a benefit is more serious than, perhaps negligently, failing to declare income for tax. Or he suggests that there can be no justification for allowing a business that has evaded VAT to retain tax it has collected from its customers.

These are interesting examples. Most would agree that fraud is more serious than negligence, but we suspect that many would also question whether it is right to regard tax lost through negligence as part of the informal economy at all. Indeed one of the problems of combating the hidden economy may be that the tax system often does not differentiate between fraud and negligence - and although most would see a large difference between negligently doing or omitting to do something and making a mistake in attempting to do or not to do, it many, if not most, tax officials seem to regard mistakes as what the Revenue makes and negligence as what taxpayers commit in identical circumstances.

Whilst it is clearly right for the Revenue to wish to collect all of the tax that is legitimately due, bracketing the honest taxpayer who makes a mistake with the person who deliberately commits fraud by hiding part of his income may itself be one of the things that draws people towards the black economy.

Where deliberate fraud is concerned it is difficult to see why there might be a justification for treating someone who falsely claims £1,000 of benefit more seriously than someone who fraudulently evades £1,000 of tax. The cost to the State is the same.

The concept that it may be acceptable to allow a person to evade his own tax but it would be wrong to allow him to retain tax that he has collected from customers is also an odd one (leaving aside that most VAT evasion actually involves not collecting the VAT from the customer, rather than charging it and not accounting for it, as collecting the VAT usually involves creating a paper trail which most tax avoiders seek to avoid as that creates an enhanced risk of exposure). If the State is to waive tax properly due as an acceptable price to buy future compliance, the sole question ought to be whether the expected benefit outweighs the cost. If evading tax collecting from third parties is felt to be particularly objectionable, ensuring future compliance in relation to such tax will be more beneficial than ensuring compliance with other tax obligations.

c) There is evidence from abroad that amnesties are not effective; they tend to create an expectation of future amnesties. A series of amnesties has the effect of undermining public confidence in the system and even encouraging honest taxpayers to become less compliant. As the report does not supply the evidence alluded to, these claims cannot be tested. It is dangerous to reject a concept because it did not work for someone else, without first analysing exactly how it was tried and why it proved unsuccessful.

d) The revenue generated by amnesties is usually exaggerated. The net return is often low as it is likely that much of the extra revenue attributed to amnesties would have been collected by enforcement alone. This begs the question of what enforcement powers are reasonable to introduce and what is their objective. If the objective is, as Lord Grabiner states, to provide an incentive to go legitimate it is hard to envisage how that might be achieved in a situation where going legitimate would automatically bring to light past liabilities which the taxpayer perhaps cannot meet.

It is not only that a telephone advice line without an amnesty seems unlikely to attract many callers. It is unclear how Lord Grabiner believes it should work. He envisages that in some circumstances the caller might be promised that no further action would be made to pursue past liabilities, which sounds like an amnesty to us. An amnesty that is given at the discretion of a third party surely brings with it all of Lord Grabiner's perceived disadvantages of a general amnesty but in addition is inherently unfair; it should be for parliament to determine who should and should not pay tax, not left to officials to make that decision on a case by case basis.

He also envisages that callers would not have to identify themselves. How then is the caller to claim the benefit of any promise not to pursue past liabilities? We suspect the reality is that he would be given no such assurance but would simply be told that in his circumstances there is a good chance that the Revenue would not pursue the tax. But if a person is to come clean he will surely want a concrete assurance before doing so.

Lord Grabiner also suggests that the advice line ‘should perhaps be run by an independent third party’. That compounds the difficulty. How can an independent third party give an assurance to an anonymous caller that the Inland Revenue will not collect tax properly due from him or that the DSS will not seek to recover past benefits that he fraudulently claimed?

iii) *The arrangements for people who leave means-tested benefits to take up full-time work should be improved.*

Whilst this might be a laudable aim and should encourage people to move from benefits into work it is hard to see what this has to do with the informal economy. Simply not seeking a job does not make a person part of that black economy as it is generally understood.

Lord Grabiner specifically rejects raising the level of ‘earnings disregards’ which allow people on benefits to do part-time jobs, as he believes that this would be expensive to the public purse and ‘would probably not give enough of an incentive for claimants to reveal that they were working’. That depends on how generous the increase is.

iv) *The Government should increase the assistance that it gives to the newly self-employed.*

Whilst this may help such taxpayers to calculate their liabilities properly, it seems unlikely to discourage them from joining the black economy. Substantially limiting the regulatory burdens on small businesses might well help if these are felt to be so burdensome that people choose to evade tax to avoid complying with the regulations. However there is no indication of any willingness by the Government to significantly reduce regulation.

Lord Grabiner indicates that there are plans to visit new VAT traders within the first year of registration (paragraph 3.33). This is intriguing. In November Martin Brown, Director of VAT Policy, told the Parliamentary Treasury Sub-Committee that Customs categorise new business on a risk basis and that a business in a low risk group ‘might not have a visit ever. That is one of the improvements we have made’ (Treasury Committee Report on HM Customs & Excise minutes of evidence). Customs used to visit all new traders but our understanding is that they stopped doing this some years ago as it was not felt to be cost-effective.

### **Prevention: Cutting of the Supply**

Grabiner makes some interesting suggestions about preventing people staying in the black economy. We consider each in turn.

i) *Businesses should be required to register with the Inland Revenue as soon as they are set up rather than after up to 18 months.*

This will undoubtedly collect a lot of extra penalties. Whether it will have any effect on the black economy is questionable. At present a business must notify the Inland Revenue that it is chargeable to tax within six months after the end of the tax year in which it commences if the proprietor is an individual or partnership or within 12 months after the end of its first accounting year if it is a company. If it has made a loss in the first year there is actually no

obligation to notify until 6 or 12 months after the year in which it first makes a profit. If it has employees it must obviously notify its existence earlier because it needs to set up a PAYE scheme.

A requirement to notify the Revenue when a business is set up creates huge practical problems. It is often not easy to decide when a business commences. For example suppose a person buys a property that he intends to let out as rooms to students. Does the business commence when he buys the property, when he has split it into self-contained rooms, when he first advertises the rooms or when he makes the first letting? It is probably when he first advertises the rooms, but the average person cannot be expected to know that. And what if he fails to attract students so he sells the property? He probably never set up a business at all. If he notified the Revenue when he placed the adverts he will now have to withdraw that notification. Because he cannot let the building he decides to sell it. When he makes that decision he may be commencing a new business of property dealing, so he now needs to notify the Revenue again because this is a different business to that initially envisaged.

Or what about the stamp collector who sells a few duplicates to friends. He wants a perfect example of a particular stamp so is continually buying and selling that stamp. He realises he has become an expert in that particular stamp so buys examples of it specifically to sell as they are not of the quality that he wants. He has become a stamp dealer. But when did that business start? Probably when he began to buy stamps that he knew were not suitable for his collection; before that he was merely engaging in a hobby. But it is possible that dealing started earlier, perhaps when the volume of purchases increased significantly. It is utterly unrealistic to expect the stamp collector to be able to identify at the time when his hobby became a trade; this only becomes practicable with the benefit of hindsight.

Or what about the person who sells some personal possessions through an Internet auction. This gives him the idea of buying a few items from friends specifically to auction them. In time he begins to buy items commercially in order to auction them. The examples are endless. The reality is that in many cases the taxpayer goes into business almost by accident. It is very difficult to recognise that a trade has started.

Lord Grabiner says nothing to suggest that the current system either creates or exacerbates a tendency towards the black economy. The impression that we have is that in practice the current system works well. Most people realise that they need accounts if they are in business and that these have to be prepared at the end of the first year. By that stage it is normally clear that they have in fact created a business - and often clearer than at day one what the nature of that business is and when it began.

The recommendation seems to be based on a vague belief that a person may be inclined to hide the existence of his business when he knows it is making money but would be less likely to do so when the business is set up. We doubt the validity of such an assumption. Lord Grabiner also sees as a spin off that it would enable the Revenue to offer advice and guidance to a business at an early stage. We would question whether the Revenue is actually the ideal agency to help a new business, but in any event any such benefit has little to do with the black economy.



What we think is beyond doubt is that the additional bureaucracy of having to get involved with the Inland Revenue at an early stage when the proprietor's main concern may be to get his business off the ground would be very burdensome in many cases. It would also in practice serve little or no purpose if, as sometimes happens, the entrepreneur is unable to make a go of his business and it never generates profits.

Indeed as many businesses would inevitably not notify the commencement timeously, either out of ignorance of the need to notify or because of the difficulty in identifying the time of commencement, there is a risk that the obligation could have the opposite effect of that assumed by Lord Grabiner. A person who is already in trouble with the tax authorities for not having notified the creation of a new business might well be more inclined to run that business as part of the black economy in the hope that the failure to notify may not then come to light.

ii) *Lord Grabiner suggests that it may be possible to apply elements of the building industry sub-contractors scheme in other areas relating to the hidden economy, although he does acknowledge that 'it is hard to find other sectors where the regulatory burden on firm's of a scheme requiring the deduction of tax at source would not outweigh the tax compliance benefit'.*

Apart from Lord Grabiner and the staff of the Inland Revenue we suspect that few people with experience of the sub-contractors scheme, particularly over the last few months, would be in favour of using it as a model for anything. It is in effect illegal to work as a self-employed person in the building industry without the permission of the Inland Revenue, small businesses must suffer deduction of tax at source on a large part of their income unless the Revenue decide to exempt an individual business from this requirement, and the administrative requirements are in many cases extremely burdensome.

Nevertheless if that is the type of society that most people want, there is no doubt that significant inroads could be made into the black economy if there were a requirement to deduct tax at source from all payments to the self-employed and it were to be illegal for anyone to set up in a business of any kind without first obtaining permission from the Inland Revenue.

iii) *The procedures for issuing National Insurance numbers should be tightened.*

At the moment the only way to obtain a National Insurance number is to apply in person at a National Insurance office with proof of identity. Many people, particularly foreign businesses sending staff to set up a business in the UK, find this a burdensome and time consuming procedure. They are used to leaving their lawyer, accountant or office manager to deal with such administrative formalities. Indeed it is likely that many do not get round to finding the time to obtain a National Insurance number so the current system may well actually delays the application of National Insurance in many cases.

Lord Grabiner believes that even attending in person at a National Insurance Office with proof of identity is insufficient. He wants the Revenue to use 'specially trained staff to interview applicants, with the expertise and equipment to detect forged documents'.

Again it is a question of balance. In 1998/99, 276,000 people, mostly from abroad, applied as adults for National Insurance numbers. By using such specially trained staff in one office 162 fraudulent applications were detected whereas ordinary staff detected far fewer. If such specially trained staff had been used elsewhere it is likely that 1000 - 1200 cases of fraud would have been detected. But Lord Grabiner estimates that the specially trained staff take twice as long to process an application as their less trained colleagues.

There is therefore no doubt that better interrogation of applicants and cross-checking of their documents to counter increasingly sophisticated forgery would reduce the number of National Insurance numbers that are issued on the basis of forged documents and which are subsequently used to claim benefits. There is equally no doubt that the vast majority of applicants do not produce forged documents, do not claim social security benefits, and are not illegal immigrants with no entitlement either to work or to claim benefit.

In these circumstances is it desirable to inconvenience the honest even more than at present in the hope of detecting a tiny number of fraudulent applications for benefit? As a country we expect the USA or France to recognise our passports. Is it right that we should officially approach a US or French passport on the basis that it may be a forgery and is therefore not necessarily a reliable proof of identity? Might it be better to relax the rules, e.g. to allow qualified professionals such as accountants and solicitors to apply for National Insurance numbers on behalf of clients provided that the professional has inspected the client's passport (which in many cases he already does to comply with the money laundering regulations) so that people who should pay National Insurance are brought into the National Insurance net as early as possible? After all the problem is not people paying tax; it is people falsely claiming benefits. The specially trained staff might be more effectively used to carry out checks when a person first claims benefits rather than treating the holding of a National Insurance number as automatic proof of entitlement to benefit. This would involve a far fewer number of cases needing in-depth checking and thus inconvenience far fewer people.

*iv) There should be tighter control over the issue of birth certificates.*

Lord Grabiner points out that in the novel 'The Day of the Jackal' the Jackal built a false identity by finding the name of a person born around the same time as himself who had died in childhood. He tells us that sophisticated and well-organised frauds using the same procedure are regularly discovered.

Lord Grabiner does not know whether the solution is stricter control over the issue of birth certificates or tighter checks on their use as proof of identity. A birth certificate is a vital identification document. A person cannot obtain many important documents such as a passport or a driving licence, or open a bank account, or sometimes even purchase a train season ticket, without this document. Making it difficult to obtain a copy when the original is lost or destroyed would cause serious inconvenience. Is such inconvenience to a large number

of people a reasonable trade off to seek to prevent a small number of very sophisticated frauds?

### **Detection: Intelligence Gathering**

The Report offers some suggestions to improve on current intelligence gathering methods.

i) *The Government should examine how to make use of information held by the private sector. This is a valuable source of data which has not yet been tapped.*

The only legitimate way to enable the Government to use such information is to legislate to forcibly over-ride both any commercial duty of confidentiality and the inconvenience of the Data Protection Act which prevents information being used in this way.

There is little doubt that if the Government were to have access to information held by banks, credit reference agencies, suppliers, customers etc, and they were to be given the resources to cross-check this information it would be better able to detect fraud. Lord Grabiner does not mention the extra resources - which would almost certainly need to be very extensive and costly - but, as the US Internal Revenue Service discovered many years ago, having access to a lot of information is fairly pointless without the resources to actually cross-check it.

The big question here is where does the balance of public interest lie. There is clearly a public interest in combating tax fraud and benefit evasion. There is equally clearly a public interest in the protection of confidential information and the citizen's right to privacy. There is a public interest in maintaining a distinction between the rights of the individual and the power of the State.

Carried to extremes, this proposal would enable the Government, through the tax authorities, to maintain detailed dossiers on each of us. This is probably not what Lord Grabiner intends but it is not clear where he would stop. And once the right to privacy is breached, that breach is likely to become the thin edge of an increasingly long and intrusive wedge. George Orwell in his horrific vision of the future, '1984', envisaged the State having very intrusive powers over the private lives of members of 'the Party' but even he could not conceive a nightmare of such control extending to the entire populace.

ii) *There should be greater data sharing within Government.*

This probably makes a great deal of sense but a fraudster would have to be fairly naïve to believe that information he provides to the Government for one purpose will not also be used by the Government for other purposes. In fact as Lord Grabiner points out, power already exists for the sharing of information between Customs, the Inland Revenue and the DSS. The question is whether there should be greater information sharing powers with other departments. It is easy to agree that makes sense. But it may depend on why someone gives the information. For example in *R v R*, which was a divorce case, the judge held that there was a greater public interest in people honestly declaring their assets to the divorce courts than that in detecting tax evasion. We believe that this is not an exceptional case and that the

divorce courts fairly regularly turn a blind eye to tax evasion. Perhaps the public interest in honestly providing information to the Child Support Agency should fall into the same category. People might be more inclined to be open with the CSA if they know that the information they give will not be passed to the Inland Revenue. Perhaps people applying for Naturalisation would be less honest if they thought that possibly used to challenge their domicile status. The answer is not as straightforward as it may appear at first glance.

iii) *The Inland Revenue should be empowered to conduct reverse searches of the telephone directory.*

Reverse searching, i.e. finding an address through a telephone number, is not permitted by Data Protection law. The police and Customs do however have power to make such searches. A check is automatically made on all 999 calls. Customs and Excise use such searches although their usage is fairly tightly controlled.

Giving such a power to the Inland Revenue would enable them to trace traders who advertise or issue leaflets showing their telephone number but no address. If it is valid to assume that such people must be part of the black economy this would be a useful power. How useful is questionable. It may not help if the number is ex-directory - and the existence of such a power might result in most such numbers becoming ex directory. The number might be that of a message taking service. Accordingly it is hard to guess how useful such a power might be, particularly if it is not combined with extra resources.

Lord Grabiner in any event feels that if the Revenue is given this power it would be desirable for it to be accompanied by suitable guidelines in the form of a code of practice.

iv) *Departments should agree common guidelines for staff about what data sharing is legally permissible and how it should be carried out in practice.*

We doubt that anyone will find this recommendation controversial.

### **Detection: Investigation**

The Report also offers suggests on investigations.

i) *To detect people in the informal economy it is more efficient to focus on the employer than to pursue individual employees who are claiming benefit while working.*

This depends on what part of the informal economy one is looking at. If an employer is engaging a number of illegal immigrants and not accounting for tax and National Insurance, investigating the employer is on the face of it more effective than investigating the 20 or 30 employees. On the other hand investigating the employees creates 20 or 30 chances of finding the rogue employer, so again the answer is far from self-evident. Investigating employers will however not trace those who are self-employed in the black economy, apart from the likelihood that the employer himself will probably be part of that economy.

Lord Grabiner would like to see closer working between the DSS, the Inland Revenue and Customs. He believes that joint working between Customs and the Inland Revenue has been confined to a few, fairly small pilots and recommends, that this should become the norm. This belief conflicts with Customs' evidence to the Treasury Select Committee.

Joint working can actually be very burdensome for small businesses. This ought not to be a consideration if the business is being carried on fraudulently. Clearly where one department has knowledge of tax evasion it should share that knowledge with the other. But what where it has no such knowledge? Perhaps where it receives an anonymous tip off from a disgruntled ex-employee? In such a case should the need to combat possible tax evasion override the inconvenience and worry that would be imposed by a joint investigation on what could well be an honest businessman trying to build up his business and create employment opportunities for the good of the country.

*ii) There should be a specific Government function or line of work accountable for investigating businesses in the informal economy. This would be specifically funded for, and capable of taking action against the range of tax and benefit offences associated with the informal economy.*

On the face of it that sounds like common sense. But the more one thinks of it the less clear it becomes how it might work in practice. Is it envisaged that, for example, if the Inland Revenue want to investigate an informal economy case they should not do so but hand it over to the informal economy department? Or is it envisaged that both should investigate it, which would be very burdensome on what might turn out to be an honest business and would be wasteful of resources? How will the informal economy department build up expertise in investigation, and keep it up to date? After all they would want to keep abreast of all changes in tax and other laws to be able to identify evasion. How would the department's efficiency be judged? Will it be expected to identify many cases itself or to rely on other departments to identify potential targets?

Is such a department needed at all if there is greater emphasis on closer working between departments? The justification for the recommendation is that 'there is a risk that insufficient attention will be given to investigating the informal economy ... This is because informal economy businesses exist at a level where the potential tax yield is lowest'.

In other words as the Inland Revenue and Customs do not feel it cost effective to investigate small businesses, a new department should be set up and funded which should not need to worry about cost effectiveness. Why? Is there an overriding public interest in clamping down on the informal economy whatever the cost? If not, why should the Government not be as concerned about getting value for money in collecting taxes as in say the NHS. Many people would prefer resources to go into hospitals or schools than in investigating micro-businesses for the sake of it even though the cost of doing so exceeds the additional tax yield.

*iii) The rules and procedures for staff that work on joint investigations should be standardised if joint working is to be effective.*

The Inland Revenue has a policy of not making unannounced visits to businesses whereas Customs have no compunction against doing so. This prevents the Revenue from joining in such visits. Lord Grabiner acknowledges that the Inland Revenue policy is a deliberate one in order to improve customer service. As there is nothing to prevent Customs giving advance warning of joint visits, the assumption is presumably that Lord Grabiner believes that the public interest in detecting fraud overrides the public interest in the tax authorities maintaining a good relationship with taxpayers, although he does not specifically say so. Is that a valid assumption? Both VAT and income and corporation tax are now assessed taxes. Some may feel that fostering customer service relationships with the vast majority of compliant taxpayers will generate a greater tax yield than sacrificing such relationships to attempt to thwart a small number of non-compliant businesses. By and large taxpayers in this country are far more compliant than in many other countries. This may or may not result from the approach of the Revenue. It could be dangerous to simply assume that it does not without at least some research.

### **Sanctions: Dealing with Offenders**

The Report provides examples of the sanctions it believes should be imposed.

*i) There should be a statutory offence of fraudulently evading income tax, which would be tried in the magistrates' court.*

This is probably the most controversial of Lord Grabiner's recommendation. As he points out the Inland Revenue tend whenever possible to make settlements or use civil proceedings against offenders, rather than initiate criminal prosecution. This is not wholly correct. There are some categories of fraud, such as in the building industry sub-contractors scheme, collusive fraud, or fraud by tax professionals where they invariably prosecute.

Nevertheless Lord Grabiner points out that 'because of the relative inefficiency of criminal investigation and prosecution as a method of recovering sums owed in an individual case' they only take 50 to 100 cases a year. In fact so do Customs, even though there is already a statutory criminal offence of fraudulent evasion of VAT. So how would a new offence of fraudulent evasion of income tax help? Lord Grabiner does not say. Where the Revenue currently prosecute they generally charge the taxpayer with cheating the public revenue, or false accounting. Is there any evidence that the need to allege such common law offences makes prosecution difficult? Not that we are aware.

The reasons that the Revenue prefers to make a financial settlement and collect civil penalties rather than prosecute tax evaders are largely pragmatic.

a) It is often very difficult for the Revenue to prove fraud.

b) Proving fraud is extremely resource intensive; a financial settlement uses far less resources as it presupposes an admission of 'guilt' by the taxpayer and co-operation by the taxpayer in establishing the tax lost, neither of which would be likely in a criminal investigation.

c) With a financial settlement even if agreement cannot be reached on the figures the Revenue need only show that tax has been lost on a balance of probabilities - and in many cases they do not even have to show that; the taxpayer has to show that on the balance of probabilities the Revenue's assessment is wrong (which means that if the appeal Commissioners are not convinced either way they must uphold the Revenue's assessment). With a criminal prosecution the Revenue have to prove fraud beyond reasonable doubt; and if they fail to do so they are in practice likely to find it more difficult to win a subsequent action for recovery of the tax they claim has been evaded.

d) The duty of the Revenue is 'the collection and management of Inland Revenue' (Inland Revenue Regulation Act 1890, s 1). The prosecution of tax evasion will contribute to achieving that objective only to the extent that it is likely to make the general body of taxpayers more compliant or is likely to make the individual concerned more compliant in the future. In general financial settlements achieve both of these objectives at far less cost.

How will Lord Grabiner's proposed new offence help the Revenue? He acknowledges that 'for tax evasion, the current system seems to work well'. There is a saying that 'If it ain't broke don't fix it', i.e. if something works well it is best to leave it alone lest the improvement works less well.

However he believes, we think wrongly, that one reason the Revenue does not prosecute many offenders is that 'the sanctions process is expensive'. In the Crown Court cases 'tend to be slower and are certainly more expensive' than in the magistrates court. That may well be right, but a large part of the cost of a criminal prosecution, we suspect the major part, is the cost of investigating and establishing the offence to the required standard of proof not the actual cost of the Court hearing.

This cost would not be saved by a prosecution in the magistrates Court. Or at least we hope that it would not. We hope that there is not an intended implication behind the suggestion that it is likely to be easier to convince a magistrate, who is not a trained lawyer, that a taxpayer is guilty than it is to convince either a High Court judge or a jury with the benefit of guidance on the law from a High Court judge.

Indeed there is a growing feeling amongst lawyers that fraud is often so complex that it is difficult for juries to follow, and perhaps such cases ought to be heard by a High Court judge sitting alone as his legal training provides him with the ability to understand complex transactions and to assess the relevance of often contradictory evidence from each side's experts. Why should tax fraud be so different that it should go the other way; that the most appropriate person to understand the complexities should be a lay magistrate?

If the Revenue will still have the obligation to prove fraud and to prove it beyond reasonable doubt, to interview suspects in accordance with the Judge's Rules of Evidence and to piece together precisely what transactions have occurred without in many cases much assistance from the taxpayer, it is hard to see any reason why they might be more likely to prosecute

cases than at present merely because they could be prosecuted in the magistrates court rather than in the Crown Court.

*ii) In suitable cases where there is a well-founded suspicion of illegal behaviour, more use should be made of a procedure for directly confronting employers with the allegations, coupled with a plain warning to the effect that if they do not clean up their act, they will find themselves exposed to in-depth investigation and possible prosecution.*

Apparently the DSS sometimes does this. We find it unsatisfactory in a tax context. If there is a 'well-founded suspicion of illegal behaviour' we would expect both the Inland Revenue and Customs & Excise to raise the appropriate assessments and if agreement cannot be reached with the taxpayer to pursue his appeal against those assessments before the appeal Commissioners and the VAT Tribunals respectively, as a 'well-founded suspicion' must surely imply at least evidence sufficient to justify a balance of probability of the alleged illegal behaviour.

If it does not, the procedure smacks of the 'when did you stop beating your wife?' type of question. We find it repugnant that the Revenue should in effect say to what may well be an honest taxpayer 'We think you are a crook. We have no proof. But we don't need to prove anything. Unless you stop defrauding your taxes we are going to put you to the huge expense of a detailed investigation and if we find anything we will prosecute you. We are not interested in your protestations of innocence. Unless you declare higher profits next year you are a marked man'.

The cards are already stacked against the taxpayer in a civil action as he has to disprove the Revenue's assessment. To allow the Revenue to threaten taxpayers on the basis of mere suspicion seems to us unreasonable. Is this the sort of society that the majority of people want to be part of?

*iii) Job-centres should have a policy of inviting claimants in at short notice at variable and unpredictable times for additional appointments if they are suspected of working, in order to disrupt their everyday work.*

The idea is that this would make it harder for people to carry out a normal job by disrupting their routine. It might of course also make it harder for the genuine unemployed to find work by disrupting arrangements for interviews, but Lord Grabiner does not mention that. He does mention that it might be seen as an obviously punitive measure which could detract from the agency's core business of helping people into work. We suspect that the fraudster would call in sick to his employer when he has to attend the Job-centre, so are sceptical whether it would achieve anything.

*iv) Consideration should be given to denying benefit altogether for persistent social security offenders.*

Lord Grabiner does say that 'of course, any measure of this kind must have safeguards to protect the innocent and the vulnerable'. However he does not suggest how this might be



done. If the State does not provide financial assistance to the unemployed they and their families will surely need to resort to either begging or crime - or indeed to trying to become a part of the informal economy - in order to live. Lord Grabiner does accept that this sanction should be infrequently used and restricted to a hard core of convicted cheats.

v) *Research should be carried out on the sentences imposed for benefit fraud.*

Lord Grabiner believes that magistrates are often too soft on persistent offenders. He thinks that a policy of 'two strikes and you are out' (or rather in, in prison that is) would be justified for benefit fraud. Does most of the populace share this view?

### **Deterrence: Publicity**

Finally, the Report considers the issue of publicity as a means of deterrence.

i) *Greater effort should be put into publicising both the incentives available for people to join the legitimate economy and the risks of staying in the informal economy.*

Lord Grabiner is unclear 'whether lack of information is generally a factor in hidden economy fraud'. For example would people agree to accept cash in hand if they realised this might reduce their pension? We would be very surprised if this is a factor. We would question the logic of putting resources into advertising without more research into this area.

ii) *The use of advertising as a tool for changing public attitudes should be tested, insofar as many people currently regard the hidden economy as socially acceptable.*

This comes back to the fundamental question of what sort of society we want to live in. If the majority of people are happy to buy services in cash at a reduced price, while suspecting that the reason for the reduction is that the supplier intends to evade tax, or are willing to turn a blind eye to the rogue down the street who does a few hours' work cash-in-hand to supplement his social security which they believe he is unlikely to declare to the DSS, should it be a role of the State to seek to change such attitudes? If something is illegal but socially acceptable perhaps it is more legitimate to legalise it to reflect what society wants than to seek to change society.

### **Conclusion**

The above highlights the reasons why we believe the Grabiner Report should not be simply accepted, with no questioning of its recommendations. It raises many important points but equally it is not a full solution to a difficult problem and it brings with it many other problems that should not be accepted without full and frank public debate.