

CONFIDENTIAL

cc Press Office  
Mr Wolfson  
Mr Hoskyns

cc A. H. H. A

PRIME MINISTER



The Chancellor  
proposes to step up the  
anti - fraud effort  
in the Revenue. You might  
like to hear more about  
this when you see him?

Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

PRIME MINISTER

May I have a word

before any further action is  
taken. not

The Lord President has  
added a note (attached).

MS  
2/14

You will be aware of the widespread anxieties which have been expressed about evasion of tax and the black economy. It is important that, within the inevitable constraint of limited staff resources, we should take every possible step to counter tax fraud and evasion not simply because of the extra revenue which can be collected as a direct result of additional effort but also because of the indirect but undoubtedly valuable deterrent effect and impact on fiscal morality generally.

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2. I have accordingly agreed, following the review of the question within my Departments, that some redeployment of staff effort in this direction is fully justified and should now be made. In view of the likely Parliamentary and Press interest in the proposals - and I would expect the reaction to be generally favourable - I thought you would be interested to know the details before they are announced.

3. In the case of the Inland Revenue, it is proposed that some 400 staff overall should be redeployed on countering tax evasion and the black economy in the period up to 1984. None of these will, of course, represent an addition to the total staff of the Inland Revenue. They will be found from existing staff and will be more than offset by the much larger savings which that Department expects to make from efficiency improvements, eg by means of the Rayner scrutinies, in the period up to 1984. The build-up to the 400 will be

/gradual over this



gradual over this period with a smaller number for the first year than in the later years.

4. Although the likely return from this additional effort cannot in the nature of things be precisely quantified, I am satisfied that it is likely to be very cost effective on any basis of comparison. The Inland Revenue will monitor closely the effectiveness of all aspects of the redeployment, but the sort of thing they have in mind is:

- a. More audit of PAYE, which should be particularly useful in relation to casual and part-time employees or employed moonlighters, where the C&AG has recently drawn attention to serious abuses and potentially growing loss of tax;
- b. More action specifically against some of the other more widespread forms of moonlighting; and
- c. More effort on the detection of criminal default leading to prosecution.

5. I have also agreed in principle that Customs and Excise should also strengthen their anti-drug smuggling and fraud effort. I have not committed myself to any particular numbers, but the size of the redeployment is likely to be smaller than that in the Inland Revenue. Again there will be no net addition as the staff will be found from savings elsewhere.

/I shall be considering

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6. I shall be considering further with the two Departments the form and timing of any announcement. In the case of the Inland Revenue, a convenient occasion to make the decision public would be when the Chairman of the Board is examined by the PAC early in May.

7. I am copying this minute to Christopher Soames, Francis Pym, Patrick Jenkin and Jim Prior.

A handwritten signature in black ink, appearing to be "G.H.", written in a cursive style.

(G.H.)

21 April 1981



Civil Service Department  
 Whitehall London SW1A 2AZ  
 01-273 4400

24 April 1981

*(M. Rev)*  
*cc A. Walters*

Dear Chancellor,

Countering Tax Fraud and Evasion

In your minute to the Prime Minister of 21st April, with the purpose of which I quite agree, you made no mention of the staff target for your Department at the 1st April 1984. Would you confirm, before you are publically committed on numbers to be involved, that you will find the additional 400 staff of the Inland Revenue and the smaller number of the Customs and Excise from within the total figure of 102,600 which we agreed last autumn?

Copies of this letter go to the recipients of your minute.

*Yours sincerely,*

*Buckley*

*(Private Secretary)*

*Dictated by the hon. President and signed on his behalf.*

The Rt.Hon.Sir Geoffrey Howe, QC,MP.

24 APR 1981



ASSOCIATION OF HER MAJESTY'S INSPECTORS OF TAXES

Jb/LSW

17 NORTHUMBERLAND AVENUE

LONDON WC2N 5AP

TELEPHONE: 01-839 5585/6

cc Mr Green  
Mr Dalton  
Mr Boyd  
Mr Gracey ✓

Sir Lawrence Airey, KCB  
Chairman  
Board of Inland Revenue  
The Board Room  
Somerset House  
London WC2R 1LB

16 February 1951

*Des Lawrence 19/2*

I am enclosing as promised, a copy of the statement by the AIT and IRSF on "The Black Economy" that has been made on behalf of IRDC and sent to the Chancellor's Office.

*Yours ever*

*John*

cc Mr Adams  
Mr Moss  
Mr Byrnes ✓

JOHN BISHTON

865L

STATEMENT BY THE ASSOCIATION  
OF HER MAJESTY'S INSPECTORS OF  
TAXES AND THE INLAND REVENUE STAFF  
FEDERATION ON BEHALF OF THE TRADE  
UNION SIDE OF THE INLAND REVENUE  
DEPARTMENTAL WHITLEY COUNCIL

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THE BLACK ECONOMY

1. Whatever the exact size of the black economy, it is generally agreed that very substantial sums are at stake. The Chairman of the Board of Inland Revenue has suggested that a figure of 7½% of GDP is a plausible estimate (in evidence to the House of Commons Public Accounts Committee on 4th June 1980). This amounts to over £3 billion in tax, and, while not all of this vast sum could be recovered without massive increases in resources, there are undoubtedly substantial amounts which could realistically be within the reach of the Exchequer. The bulk of this statement is devoted to outlining potentially profitable areas of scrutiny which could recoup significant amounts of revenue.

2. The profitability of such added scrutiny must be of interest to an administration interested in cost effectiveness - a criterion embodied in the work of Sir Derek Rayner. Employing extra staff to curb the black economy will not only bring in many times their cost to the Exchequer, it will help in keeping the Public Sector Borrowing Requirement within bounds without resort to higher taxation. Nor should this return be evaluated purely in terms of tangible revenue accrued directly as a result of the added effort. Each £ so saved can be multiplied many times over by the £££ voluntarily paid in by those discouraged by the fate of those selected for attention. The converse is also true: the failure to tackle the growing black economy (recognised by the PAC and others) can only lead to an escalation in its size and in the PSBR.

3. It is becoming fashionable to imply in some circles that the black economy represents a dynamic and innovative sector of the economy as a whole. Robbing the public purse is no more a wealth-creating exercise when done by tax evasion than by fraudulent claims for farming subsidies or price-fixing for contracts. On the contrary the black economy is actually an obstacle to the creation of wealth through individual enterprise - a point forcibly made by representatives of small business and the self-employed. The honest trader who pays his fair share of tax finds himself undercut by unfair competition forced to join the dishonest sector or go under. The uncertainty which this creates is not conducive to building a business which gives employment to others; it also detracts from the stable business climate so necessary for enterprise to flourish. Nor is the consumer necessarily the benefactor of such unfair competition: the fly-by-night contractor is more likely to do a shoddy job, be harder to track down for recompense and may be beyond legal reach if (as is likely) no receipt is given. The black economy may be growing - but it is only at the expense of the rest of us.

4. It is sometimes said that the problem of tax evasion would be ameliorated by lower rates of tax. There is no evidence that this has happened.

5. To some extent the Government has already recognised the problem: one extra Special Office has been opened (and another brought up to strength); and 200 extra Inspectors are to be appointed over four years. But the drive to reduce the size of the Civil Service is more than outweighing these extra resources. Staffing restrictions restrain the development of the Inspectorate and positive cuts, approaching 10,000 in number, have been made at clerical and executive levels.

#### INVESTIGATION OF BUSINESS ACCOUNTS

6. Since 1977 instead of giving every business account some consideration each year Inspectors of Taxes have been selecting a few accounts for detailed investigation and passing the vast majority for assessment without any detailed examination. The aim at the start of the scheme was for approximately 5% of non-company accounts to be given detailed investigation each year but this figure has never been achieved and the coverage in the last year for which figures are available, the year to 31 October 1979, was only 2.5%. For company accounts the coverage was a mere 0.25%.

7. In those cases selected 82% of the businesses concerned were found to have understated their profits. The additional tax recovered from those cases selected for detailed examination where it was not appropriate to seek interest and penalties was £14.1 million in the year ended 31.10.1979. The yield from cases where interest and penalties have been sought has also increased considerably: the total charge raised (including interest and penalties) has risen from £14 million in the year ended 31.10.1976 to £40 million in the year ended 31.10.1979.

8. These figures do not include those of Enquiry Branch where the yield has increased by 60 per cent in the last two years as the investigation of cases in Districts yields a greater flow of appropriate cases.

9. The Department is presently engaged in further re-deploying resources to release more of the most highly trained Inspectors on to the detailed investigation of company accounts. This exercise will at best achieve only a 1% coverage of companies - yet may reduce the coverage of non-company investigations to 2.3%, levels which are not considered adequate by either the Department or the Public Accounts Committee. Essentially it is additional resources that are required both of Inspectors who can investigate non-



company accounts and of fully trained Inspectors to work in the company field and at Enquiry Branch.

#### OPERATION OF PAY-AS-YOU-EARN

10. For the employee and director, tax is largely gathered through PAYE, a system which greatly depends on employers to deduct tax correctly and forward it to the Collector, and to supply information needed for the assessment of the individual taxpayer. On the Revenue's part, this generates the type of work traditionally carried out by the clerical and executive grades: coding, assessment and repayments, filing and linking information from different sources, explaining methods of operation to employers, liaising with other tax offices and collection offices, making further written enquiries, and so on. It is arguable whether enough resources have ever been devoted to these important tasks, but is undeniable that attention to them is declining as staff cuts work their way through to offices.

11. For example, employers are supposed to make a yearly return of the fringe benefits and expense allowances given to any employee liable for tax on them (broadly, those earning at a rate in excess of £8,500 a year). In practice, a high proportion of these forms P11D are never sent back, and the Department lacks resources to get them in. Those which are sent back are all too rarely verified though they are often incorrectly completed. A common omission is amounts reimbursed by the employer for private motoring expenses such as petrol. Even when there is a figure for petrol, it is unlikely to be checked by the tax office. The yield from taxing company cars and other benefits could be greatly increased if there were enough staff to ensure that P11Ds were sent back and completed correctly.

12. Another example of PAYE abuse arises through using employers as agents to collect tax on employees' earnings. Inevitably this leads to mistakes - and equally inevitably, some employers cannot resist the temptation to hold on to the tax deducted from employees' earnings, falsifying returns to conceal this. The evidence is that such irregularities are on the increase: between 1965 and 1973, just a quarter of visits to employers to check on PAYE operations threw up something unsatisfactory - but in the year ending 31st October 1980, more than half of such visits showed something wrong. Part of this growth reflects the better selection of cases to investigate, but much of it must be put down to increasing fraud by employers. The response to this has been to expand the number of staff involved in PAYE audit and to form six "Audit Groups" to tackle larger employers with nationwide operations. Currently an employer can expect to be visited once every 21 years and when the expansion programme is completed this figure should be halved but it will still be a long way from the once every five years regarded as ideal by the Board of Inland Revenue. Unless far

more resources are devoted to curbing fraud among employers, the system is in danger of breaking down.

#### HOONLIGHTING AND CASUALS

13. Perhaps the most intractable problem faced by western economies is the growth of the "cash sub-economy", the world of weekend and evening jobs settled in untraceable cash payments. Certainly no country has yet found the solution to this problem, but there is much which could be done to curb it.

14. For example, one large area of abuse is in household repairs and improvements - plumbing, electrical repairs, building, roofing and decorating. These services are often advertised in newspapers, newagents' windows and by circulars - usually contacted only by telephone number. Given the resources, such subterfuges could be penetrated - and once it is established that a particular individual is in business part-time, the normal procedure for dealing with the self-employed should be adequate.

15. It has been suggested that one feature of the UK tax system which encourages taxpayers not to declare spare-time earnings is the relative infrequency that tax returns are sent out - "If they don't ask, I won't tell". The Revenue is known to be considering reducing the number of returns sent out as an economy measure, which can only accelerate this trend. Indeed, it would make sense to send returns more often to people with readily marketable skills coupled with judicious notes about the penalties for not declaring earnings.

16. Another well-known area of abuse is that of earnings from casual evening or weekend work in pubs, clubs, restaurants, garages and the like. If people with such casual jobs tell their part-time employer that they have no other source of earnings, then no tax need be deducted from the casual earnings so long as they are below a certain threshold (£26.50 a week in 1980-81). Unless these casual earnings are voluntarily declared on the tax return, they are effectively tax-free - even if the casual concerned has other earnings to which they should be added for tax purposes.

17. Tax offices should already have the information to track down this type of abuse. The employer concerned will claim the wages paid out as a trading expense, to be deducted from his receipts before arriving at his taxable profit. When the employer pays casual employees without deducting tax, the tax office can ask for a list of the casuals on form P38. In practice, P38s are often not sent out or followed up, due to lack of staff. When they are, it

may take time to trace the casuals concerned - their tax affairs are outside the tax office's area. If the names turn out to be false, then it needs further efforts to ensure that correct names are submitted. Faced with diminishing staff numbers, it is hardly surprising that most tax offices fail to bother with the procedure at all.

18. The P38 procedure will not cope with casuals who are paid out of cash takings, without a claim against business receipts. In theory, such abuses should be picked up on visits to business premises by PAYE audit staff and Inspectors investigating the business accounts. It should be obvious - if such visits are made in the normal working hours of the business - that the numbers of staff working do not tally with the records. However, there are insufficient resources for visits by either group to be a real threat.

#### DIRECTORS

19. The taxation of directors provides particular problems for the Inland Revenue, because they are so closely involved in the running of their companies. It is not always easy to detect payments and other benefits drawn from company funds by directors until long after the period concerned, by which time the company may have ceased to exist. Ensuring the correct operation of the PAYE system as promptly as possible is essential if directors are to pay their fair share of tax.

20. Unhappily, this is another area of work which can be set aside when the pressure is on to clear other arrears. A sample of ten per cent of director cases in a selection of tax offices showed that 45 per cent had the potential to yield significant amounts of tax if pursued - and seven out of ten clearly had been neglected. The survey concluded that directors' returns were subject only to superficial examination. One tax office managed to produce £ $\frac{1}{2}$  million of extra tax simply by making sure that directors filled in the correct returns - accepting the answers without question.

21. The Department has recognised these difficulties by encouraging the formation of "Director Groups" in Districts to specialise in the problem, and by collating relevant material in a Directors' Handbook. The new Inspector (S)(T) will direct much compliance work in Districts and should be able to encourage a more thorough approach to director cases. But these measures will only be pious resolve if there are not the resources at all levels to implement them.

INFORMATION PROVIDED TO TAX OFFICES

22. Tax offices are sent a good deal of information by banks, buildings societies and other savings institutions, so that they can check that taxpayers are declaring all their sources of income. For example, banks currently send tax offices details of any account which yields more than £150 interest during a tax year. The amounts above which details of interest must be returned have recently been vastly increased to cut staff - reducing the flow of slips which are often the source of information about undeclared income. But even with this reduced flow, slips are often set aside for more pressing work - inevitably leading to loss of tax.

23. It is clearly important that there should be sufficient resources to process all information received in tax offices. But it is also worth asking whether more information could be profitably sought. For example, random checks on all interest paid out by a limited number of institutions each year would detect and deter those who conceal investment income by spreading it around in order to keep below the well-known limits governing the issue of information slips.

SPECIAL OFFICES

24. The Special Offices first established in 1976 - are able to look at any area where the Revenue is at risk and bring to the task of countering avoidance and evasion an intensity of approach which it is not always possible to adopt in the District Offices. In the event they have been highly effective. For example, an investigation of practices in the Smithfield Meat Market started by Special Office and handed over to the local District now produces an estimated £300,000 profits per annum. Very substantial settlements have been made in individual cases and there has been considerable success in countering losses of tax in particular industries. For instance, the regulation of PAYE in Fleet Street produces additional tax estimated at £2m per annum. In addition they have gathered information for Districts and other Head Office agencies which have enabled them to bring into charge significant additional amounts of tax.

25. Despite the recommendation that there should be a network of Special Offices covering all Inland Revenue Regions only six presently exist, the latest being London No.2 office (only recently brought up to strength) and Sheffield opened in July 1980. However the yield from the first four is quite spectacular:

Year ended 30 September 1977	- (3 offices)	£6.4 million
Year ended 31 October 1978	- (4 offices)	£11.6 million
Year ended 31 October 1979	- (4 offices)	£14 million
Year ended 31 October 1980	- (4 offices)	£20 million

Cases presently under investigation by the Special Offices are

likely to bring in tax of more than £80 million (a once and for all figure).

26. These very positive results and the evidence which has been provided of the value of indentifying different methods of investigating a person's or a group of persons tax affairs must be foundations to be built on not an end in themselves. It is evident that in London alone there must be almost unlimited potential for tax investigators and there is virtually no coverage of the North East with Liverpool, the South West and Wales with Bristol and Cardiff and Eastern England. The existing offices provide only the barest minimum liaison with local districts and can only be seen as a semblance of a national network. This contact with local tax districts is considered to be a key feature of Special Office work and largely justified the setting-up of the second London office - but even two offices are stretched to the limits with nearly 250 districts to cover. In regions where no Special Office exists liaison is impossible. It is manifest that the network is grossly inadequate and there is a clear case for expansion.

27. What has governed the rate of setting up the existing offices and prevents further expansion is the present manpower policies which force the Department to choose between maintaining the existing resources on traditional work rather than creating new Special Offices. The resources required are highly skilled and scarce Inspectors of Taxes, the numbers of which have remained pretty constant over recent years. What is needed is a relaxation of the manpower constraints to expand the stock of these highly skilled specialist staff and enable the Department to set up further Special Offices over a period of years without taking resources which are already overstretched on the highly productive work. Whether one is thinking in terms of taking more graduate recruits or training more in-service staff an early start needs to be made as training is a lengthy process. Such growth will be very modest in terms of the total size of the Revenue (each Special Office has less than 20 staff) but it will add significantly to the Department's experience and effectiveness in countering avoidance and evasion. In our view it is wrong to say that additional Special Offices can only be justified if savings in staff are made elsewhere. Particular in this area staff savings bring with them very high risks of revenue loss. Although the Special Offices have been highly effective in the evasion and avoidance field it must be stressed that the most cost effective use of valuable trained resources is in the local District Offices where £250 million was added to returned profits for the year ended 31st October 1979 as a result of the examination of accounts and computations submitted to the Department.

#### CONCLUSIONS - MANPOWER

28. It would be easy to dismiss the Associations' claims as simply a demand for more staff and an attack on the Government's policy

of reducing the size of the Civil Service, but this would be a far too simplistic approach. The concern of the Associations is that the Inland Revenue Department should be properly equipped to carry out the tasks that Parliament has given it to do. Criticism of the Department over its failure to tackle the Black Economy may well be properly directed but it cannot be effective in carrying out its tasks if it does not have the resources to do so.

29. The Department has already made a very substantial contribution to the reduction in Civil Service manpower and no doubt where genuine savings can be made by fiscal or management means it will continue to do so - but this cannot be an end in itself. In its 8th Report of the 1979-80 session the Committee of Public Accounts (para.23) said: "At a time when the Government are seeking substantial reductions in public expenditure, we think it particularly important to guard as far as possible against avoidable losses of revenue." - and the leading article of 8 March 1980 in Taxation: "At the present time pressure is being exerted to reduce the cost of Government agencies ..... This is wholly commendable but if it results in a real fall in net revenue the whole exercise is self-defeating. Where increased expenditure ..... does result in a greater yield from tax collection common-sense must prevail at the expense of political dogma."

30. A few staff in each tax office devoted to tackling the black economy could ensure that each major area of evasion is tackled in turn - swinging the spotlight round in a random fashion. The gains of one year's searches will of course feed through into succeeding years while the beam moves on to cover new fields. But the one inescapable fact is that it is a matter of sufficient staff. There is a need for more Inspectors for Tax Districts and Special Offices, together with the necessary clerical support and also for clerical and executive resources to deal with the presently neglected areas of work outlined in this paper.

31. In particular we ask:

- (a) In any current or future manpower exercises the Inland Revenue should not be required to make savings simply to contribute to an arbitrary reduction in Civil Service numbers especially when to do so would put at risk the revenue yield.
- (b) Genuine manpower savings should be allowed to be re-deployed, where practicable, into an increased effort in the battle against evasion and avoidance.
- (c) Arbitrary ceilings on the numbers of staff in certain grades should be removed to allow controlled expansion of the Special Office network.

- (d) Since for many years the Department has suffered a chronic shortage of fully trained Inspectors, and given that it takes five years to train them, the bid to the Civil Service Commission should be allowed to be increased so that an adequate supply of such officers will become available in the future. Similar increases in the number of internal selections for full training should be permitted where suitable candidates are available.
- (e) Where suitable candidates are available there should be further selections of TOSHG for technical training to enable an expansion of non-company investigations to proceed.