National Audit Office

REPORT

Tackling tax evasion in high street and online retail

HM Revenue & Customs

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Tackling tax evasion in high street and online retail

HM Revenue & Customs

Report by the Comptroller and Auditor General

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Gareth Davies
Comptroller and Auditor General
National Audit Office

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Key facts

£5.5bn

HM Revenue & Customs' (HMRC's) illustrative estimate of tax lost due to evasion in 2022-23, equivalent to 0.7% of total theoretical tax liabilities which has been stable since 2019-20

81%

proportion of estimated evasion losses in 2022-23 that come from small businesses (which include companies, partnerships and sole traders), up from 66% in 2019-20

20%

increase in UK company incorporations recorded by Companies House from 665,000 in 2019-20 to 801,000 in 2022-23, prior to new checks coming into force (from March 2024)

42%	proportion of currently registered retail companies that were incorporated since January 2023, compared with 23% for companies in all sectors, indicating a potentially higher risk of fraud in the retail sector
March 2024	the date that Companies House received new powers to check information for company registrations, request evidence and remove inaccurate information
£450 million	HMRC's latest indicative estimate (from 2019) of annual tax lost due to electronic sales suppression, which involves using software to reduce the recorded value of transactions
£500 million	annual tax that may be lost, based on HMRC's latest indicative estimate of 15% of tax debt losses (from 2022-23), due to phoenixism, which involves companies falsely declaring themselves insolvent then continuing the same business as a new company to evade their debts
£300 million	HMRC's latest indicative estimate (from 2021-22) of annual VAT evasion by overseas retailers selling goods and services online
£1.5 billion	additional tax that HMRC estimates it now collects each year following 2021 changes that made online marketplace liable for the VAT from overseas sellers
19:1	average return on investment for 16 HMRC compliance projects aimed at tackling non-compliance in online retail

Summary

1 HM Revenue & Customs (HMRC) estimates that tax evasion costs around £5 billion a year in lost revenue and is most prevalent among small businesses. Tax evasion occurs where taxpayers deliberately omit or falsify information in tax returns to reduce their tax liability.[1] As well as resulting in lost revenue, it can also prevent a level playing field between businesses, by giving evaders an unfair competitive advantage.

2 HMRC is responsible for tackling tax evasion for the taxes it administers and works with other public bodies to do so. This includes Companies House (responsible for company registrations), the Insolvency Service (responsible for enforcement relating to director disqualifications and corporate abuse) and local authorities (various responsibilities relating to high street businesses). Local authorities are responsible for tackling evasion of local taxes such as business rates.

3 Tax evasion takes different forms and motivations can vary, from businesses struggling with financial pressures to wilful and persistent evasion. Stakeholders and correspondents have raised concerns with us about new and evolving evasion risks in the retail sector, both on the high street (including souvenir and sweet shops) and by overseas retailers selling goods online. Examples include fraudulent company registrations, overseas sellers evading VAT through online marketplaces, and businesses understating sales figures or companies artificially declaring themselves insolvent and setting up a new company (known as "phoenixism"). Our past reports have highlighted risks of online VAT fraud and phoenixism.[2,3] The Committee of Public Accounts recommended in May 2023 that there was a strong value for money case for increasing resources for HMRC's compliance work.[4]

4 Government has introduced legislative changes to help tackle tax evasion. Some changes have focused specifically on tax compliance (such as making online marketplaces liable for VAT from overseas sellers since January 2021), while others relate to economic crime more widely (such as 2024 reforms to the role of Companies House in registering companies).

1 Tax evasion does not include error or failure to take reasonable care and is different to the hidden economy and organised crime.
2 Comptroller and Auditor General, *Investigation into overseas sellers failing to charge VAT on online sales*, Session 2016-17, HC 1129, National Audit Office, April 2017.
3 Comptroller and Auditor General, *Managing tax debt through the pandemic*, Session 2021-22, HC 799, National Audit Office, November 2021.
4 Committee of Public Accounts, *Managing tax compliance following the pandemic*, Forty-Ninth Report of Session 2022-23, HC 739, May 2023.

Scope of this report

5 This report examines whether HMRC, with other relevant parts of government, is well-placed to tackle tax evasion in high street and online retail. It covers:

- how well HMRC understands and assesses the risk and scale of tax evasion in retail, and its strategy to tackle evasion (Part One);
- whether HMRC, with key partners, has cost-effective systems and controls to reduce the risk of tax evasion in retail (Part Two); and
- whether HMRC responds effectively to different methods of tax evasion in retail, and ensures lessons are learned to improve its approach (Part Three).

6 As well as assessing HMRC's overall approach to tax evasion in retail, we examined specific risk areas in more depth. These were: contrived business insolvency and phoenixism, VAT evasion by overseas retailers selling through online marketplaces, and sales suppression (under-declaring income to reduce taxes). In some cases, our findings may also be relevant to HMRC's compliance work with other business sectors. Our approach is outlined in Appendix One.

7 We have not directly assessed the work of local authorities to tackle tax evasion locally, HMRC's approach to other forms of tax non-compliance, or wider government efforts in tackling crime. However, some of our findings have wider application to risks of organised crime or money laundering, or to the hidden economy (for example where business deliberately do not register at all for VAT, which HMRC measures separately from evasion).

Key findings

The risk of tax evasion in retail and HMRC's strategy to address it

8 **HMRC estimates that levels of tax evasion have been stable overall in recent years, but that it has been increasing among small businesses.** HMRC's illustrative estimate is that the evasion tax gap was £5.5 billion in 2022-23, equivalent to 0.7% of taxes owed.[5] This percentage has remained stable since 2019-20. Evasion from small businesses – which include companies, partnerships and sole traders – increased from £3.1 billion (66% of the evasion tax gap) in 2019-20 to £4.4 billion (81%) in 2022-23. HMRC does not estimate levels of evasion by sector but has identified certain types of retailers as higher risk. It has carried out research and campaigns on certain industries, including takeaways and sweet shops, and on widely used methods such as suppressing sales figures. Evasion can be difficult to detect because evaders seek to keep it hidden, and identifying it depends on HMRC demonstrating that taxpayers wilfully intend to evade tax. HMRC does not put a range on its estimates, and levels of evasion could be much higher or lower (paragraphs 1.4 to 1.9).

5 The tax gap is the difference between taxes collected by HMRC and the theoretical liability, or what, in theory, should be collected. HMRC estimates the overall tax gap was £39.8 billion in 2022-23, or 4.8% of total theoretical liabilities. This includes errors, defaulting on tax bills, and deliberate non-compliance.

9 **HMRC does not have a specific strategy for addressing tax evasion, focusing instead on tackling strategic risks of non-compliance to prevent the overall tax gap from increasing.** HMRC has an overall compliance strategy that focuses on tackling all forms of non-compliance, with an overall aim to stop the tax gap increasing. The strategy is primarily tailored around types of taxpayers, such as small or medium-sized business. HMRC has chosen not to develop a specific strategy for tackling tax evasion, or other forms of non-compliant behaviour (such as tax avoidance) in case this undermines its ability to deploy resources flexibly to changing risks. This means HMRC does not have a specific focus on, or explicit objective for, its performance in tackling tax evasion. Instead, it estimates the overall level of non-compliance through its estimate of the tax gap, and focuses its assessment and approach on the risks to revenue for the taxes it administers. However, its risk assessments are specific to HMRC and do not consider the wider consequences of evasion to the revenue of other public bodies. Its approach gives less emphasis to the controls and mitigations available through other parts of government, and the wider impact of evasion on competition within retail markets (paragraphs 1.20 to 1.24).

10 **HMRC has identified overseas retailers evading VAT online as a significant strategic risk for tax evasion in the retail sector.** This type of evasion can take different forms and includes both direct sales and those made through online marketplaces. For example, it can happen when an overseas retailer falsely represents itself as a UK-established business so that online marketplaces do not apply the correct VAT liability.[6] HMRC recognises VAT non-compliance by overseas retailers as a distinct strategic risk, assesses its scale each year, and sets a specific plan that considers the effectiveness of controls in reducing the risk. HMRC's latest indicative estimate is that, in 2021-22, VAT non-compliance by overseas retailers selling goods and services online resulted in losses of around £700 million, of which around £300 million was deliberate evasion. HMRC's best estimates indicate that £150 million of non-compliance may occur through online marketplaces, though the estimates are uncertain. The growth of online sales and ability of companies to operate from anywhere in the world means that tax evasion from online sales has the potential for significant growth (paragraphs 1.14, 1.16 and 1.24).

11 **HMRC's approach may not sufficiently prioritise some pervasive forms of tax evasion, such as electronic sales suppression (ESS) and phoenixism.** HMRC focuses its strategic risks and associated plans on tax types and taxpayer groups. Some forms of non-compliance that affect multiple taxes or connected taxpayers are not captured effectively by this approach, even though some are large, and HMRC does not have a clear basis on which to decide when a separate strategy is needed or should be updated (paragraphs 1.23 and 1.24). HMRC does not treat two of our three case study areas as strategic compliance risks, but has developed a more coordinated approach, with varying levels of impact.

6 For VAT purposes, HMRC considers that a business is UK-established if the place where essential management decisions are made and central administration is carried out is in the UK, or the business has a permanent physical presence in the UK and is able to make or receive taxable supplies in the UK.

- HMRC does not treat phoenixism as its own strategic risk and has instead considered its effect within its assessments of other strategic risks each year. In 2021, HMRC recognised it needed a dedicated insolvency strategy for the first time and introduced one in 2022, including a focus on phoenixism within it. Its updated approach focuses on minimising lost revenue and preventing phoenixism, including by identifying where insolvencies are likely to occur and proactively targeting interventions. While phoenixism has existed for many years, HMRC did not fully assess its scale until 2023. HMRC's latest indicative estimate is that phoenixism accounted for 15% of its tax debt losses in 2022-23, which equates to more than £500 million. However, HMRC's strategy gives limited consideration to the important role of the Insolvency Service and private sector insolvency practitioners in identifying and addressing phoenixism. It also does not consider potential overlaps with losses to other public sector creditors, such as business rates owed to local authorities (paragraphs 1.12, 1.13, 1.24, 3.5 and 3.6).
- Sales suppression has increasingly involved the supply and use of ESS software to remove or reduce the recorded value of transactions. HMRC found in 2016 that a certain form of ESS may result in £100 million of tax losses, before making an overall indicative estimate in 2019 that losses due to all ESS could be at least £450 million per year. HMRC introduced an ESS strategy in 2019, which included objectives to improve its understanding of and response to ESS and a series of actions to meet those objectives. However, HMRC has not updated this strategy or kept its assessment of the risk up to date. More sophisticated electronic sales suppression methods are increasingly marketed to businesses. HMRC has not updated its estimate of the scale of tax losses since 2019, but plans to do so in December 2024 (paragraphs 1.19 and 1.24).

12 **HMRC does not know how successful it is in tackling tax evasion, in aggregate or for particular taxpayer groups.** HMRC estimates that its compliance work reduces the tax gap to around half the level it would otherwise be, but it does not track how much of this reduction relates to different types of non-compliant behaviour. HMRC calculates the 'compliance yield' from its work on individual strategic risks, but many such risks include multiple types of non-compliance. For example, VAT non-compliance by overseas sellers includes errors and failure to take reasonable care, as well as wilful evasion. We previously recommended that HMRC be more consistent in evaluating the effectiveness of compliance work, which could provide greater insight into its impact. While HMRC has increased how many evaluations it conducts, it does not use these to consider its overall impact in tackling tax evasion or feed lessons on what works well into its plans (paragraphs 1.25 to 1.27 and 3.13).

The effectiveness of controls to prevent tax evasion in retail

13 **Weaknesses in company registration requirements and tax processes have left the UK too open to tax evasion.** Since 2011, it has been quick and easy to set up UK companies online from anywhere in the world. Until 2024, Companies House had limited powers to be a control or to check the validity of information provided by registered companies, and companies have been able to register and dissolve before submitting a tax return. Company registrations surged in 2022-23 with 801,000 registrations, 136,000 (20%) more than in 2019-20. Of registered companies declaring themselves as retailers, 42% were incorporated since January 2023. This compares with 23% of companies in all sectors, which may indicate a potentially higher risk of fraud in the retail sector. Separately, HMRC conducts checks of whether businesses registering for VAT are UK-established based on known indicators of risk, but does not verify this in most cases. The UK may be more attractive to tax evaders where it has fewer requirements than other countries. Many Organisation for Economic Co-operation and Development (OECD) countries require businesses to use electronic cash registers or to regularly report transactions to the tax authority (paragraphs 2.5, 2.8, 2.11, 2.12 and 2.20 and Figure 11).

14 **HMRC took steps to reduce online VAT non-compliance in 2021 and has raised far more revenue than it expected.** To reduce the risk of overseas sellers evading VAT, the government introduced a legislative change in January 2021 which made online marketplaces liable for VAT on sales from overseas retailers. Other jurisdictions subsequently introduced similar changes, including the European Union (EU) (from July 2021). HMRC estimates that, following the change, it now collects at least £1.5 billion a year more VAT. This is five times the level HMRC predicted, which it attributes primarily to increased online sales during and since the COVID-19 pandemic. HMRC has not quantified the impact of this to confirm its assessment (paragraphs 1.15, 2.6 and 2.7).

15 **Significant gaps remain in checks around online retailers, and overseas companies can falsely present themselves as UK-based to evade VAT.** Online marketplaces are liable for VAT from overseas retailers, increasing incentives for sellers to falsely represent themselves as UK-established. To meet their obligations, online marketplaces must charge VAT on sales made by overseas sellers. They need to determine the correct liability or demonstrate they have taken reasonable steps to do so, including whether sellers are UK-established. However, they do not have access to HMRC data due to rules on taxpayer confidentiality, and HMRC has not provided clear advice, guidance or support, such as a data matching service that could help them make the determination. Some online marketplaces told us they were concerned there is too much reliance on sellers providing documentary proof that is difficult to verify, and have seen an increase in false documentation and services marketed overseas to help evaders systematically avoid the rules. HMRC told us it regularly reviews and updates the information and processes it uses to assess the risk of a business providing an incorrect address or falsely presenting itself as UK-established. In early 2024, HMRC identified and wrote to 12,000 businesses to inform them that it considered they had no UK establishment and would inform any relevant online marketplaces, unless the businesses provided evidence that they were UK-established (paragraphs 2.6, 2.7 and 2.14 to 2.17).

16 **Stricter requirements introduced at Companies House from March 2024 should make fraudulent company registrations more difficult, but the changes will take time to implement, and gaps remain.** The Economic Crime and Corporate Transparency Act 2023 significantly changes the role of Companies House, in order to improve the reliability of information on the company register. The first changes came into force in March 2024, including new powers to check information for company registrations, request evidence and remove inaccurate information, and increased sharing of data. The recent surge in registrations may include an attempt to stockpile companies before checks came into force. Some new measures will not be fully operational until Companies House develops the necessary systems and capability, or until further secondary legislation is in place, such as verifying directors' identities. The new controls are also not intended to verify the address or place of business, limiting the direct impact in reducing VAT evasion (paragraphs 2.9, 2.11 and 2.18).

17 **HMRC and Companies House have discussed closer integration of systems to tighten registration requirements but estimate these will take five to 10 years to implement.** HMRC and Companies House have explored opportunities from Companies House's new powers. They have established immediate and short-term improvements, including 'cleaning' the company register to improve its accuracy, and greater sharing of data and intelligence. They have also identified more ambitious changes with a larger impact in preventing tax non-compliance. This includes single streamlined systems for company, corporation tax and VAT documentation that would provide assurance over companies' addresses. However, these changes require investment and would rely on other initiatives being further progressed first, including Making Tax Digital and the cross-government OneLogin system that supports public service users to prove their identity (paragraphs 2.21 and 2.22).

Responding to tax evasion in retail

18 **While HMRC makes extensive use of data to identify non-compliance, there is a risk that failing to establish and penalise deliberate evasion weakens the deterrent effect of HMRC's compliance work.**

- **With finite resources, HMRC often does not seek to establish whether non-compliance in retail is deliberate evasion, in order to maximise its reach.** HMRC uses specialised software to collate and analyse data from other government bodies and the private sector to identify risky businesses or transactions for further investigation. In many cases, HMRC has identified groups of businesses whose tax returns looked lower than expected (such as thousands of takeaway restaurants it identified from 2021-22 to 2023-24). It has written to these and found that many then corrected their tax returns. This can be an efficient way to increase compliance among specific taxpayer groups, particularly where non-compliance may be due to error or carelessness. HMRC seeks to balance this approach with in-depth one-to-one investigations to maximise its reach across large numbers of taxpayers. However, evaders may avoid detailed scrutiny by simply correcting their tax returns if HMRC does not target individual investigations effectively. While individual investigations are more costly, HMRC data indicate they can be far more effective in tackling evasion when targeted in high-risk populations or sectors (paragraphs 3.14 to 3.18).
- **HMRC has reduced its use of prosecutions, instead pursuing the worst offenders more vigorously.** The number of prosecutions resulting from HMRC's criminal investigations reduced from 749 in 2018-19 to 344 in 2023-24. In part, this reduction was due to the COVID-19 pandemic, but it also reflects HMRC focusing its criminal enforcement work more towards high-value, high-harm fraud. In response to concerns raised by the Committee of Public Accounts in May 2023, HMRC agreed to examine the deterrent effect of its criminal investigations resulting in prosecutions. It finished the first phase of this in June 2024 and expects to complete the work by summer 2025 (paragraph 3.19).

19 **HMRC's compliance work has yielded additional tax revenue, but it has not yet used all the powers it has secured to tackle evasion in retail.** In the areas we examined, we found the following.

- To help tackle phoenixism, HMRC has powers to require securities against future tax liabilities for successor companies where it identifies a risk of tax loss. For example, a compliance project in 2020 used these powers to protect £31 million of revenue from 103 cases. HMRC also gained new powers in 2020 to pursue directors for company debt where it considers they are declaring insolvency simply to avoid paying tax. HMRC said in 2023 it would report on the performance and impact of its phoenixism work in its 2023-24 annual report. While HMRC reported partial results of its activity in its annual report, it did not give a clear overview of its performance or impact (paragraph 3.5).

- HMRC first recognised online VAT fraud and error as a priority in 2014. It introduced several measures between 2016 and 2020, including new powers to hold online marketplaces jointly and severally liable for unpaid VAT. HMRC provided us with a list of 16 compliance projects targeting online retail. These raised £87 million of additional tax revenue at an average return of £19 to every £1 HMRC spent. HMRC was also given powers to require overseas businesses with no UK establishment to appoint a UK VAT representative, but to date it has not used these powers. Tax losses did not significantly reduce until changes in 2021 to make online marketplaces liable for collecting VAT from overseas sellers (paragraphs 3.7 and 3.8).
- HMRC first assessed a certain type of ESS in 2016, and more fully assessed it in 2019 indicating annual losses of £450 million. It was not until 2022 that the government introduced new civil enforcement and data collection powers for HMRC to tackle ESS. It has not yet issued any penalties using these powers, but it told us that these powers have generated publicity which it believes has had a deterrent effect. HMRC said it would evaluate these powers again in the next phase of ESS work. HMRC estimates that the compliance yield from its work on ESS has increased from £17 million in 2022-23 to £98 million in 2023-24 due to increased focus and casework (paragraphs 3.9 and 3.10).

20 HMRC has made changes to improve how it manages fraud and evasion after missing earlier opportunities to tackle phoenixism and other tax evasion among London souvenir shops. From 2011 onwards, HMRC was made aware of detailed concerns that some London souvenir shops were evading tax. When HMRC later reviewed its response, it found that it had handled the concerns in line with its guidance and prevailing practice at the time. It concluded that the cases were handled in the manner that HMRC would have expected, bearing in mind the maturity of its systems and processes in earlier years covered by the case. It identified limitations in its approach that had led to a narrow focus on individual risks, with little consideration of risks that cut across different businesses or tax types, and stopping cases where the business was insolvent when further examination would show the trade had continued in a phoenixed business. HMRC's review found that the results secured by HMRC's Individual and Small Business compliance directorate were small compared with the concerns raised. As a result of the review HMRC made changes to how it manages fraud and evasion, including improved guidance and ensuring greater referral of casework to specialist teams, such as those specialising in fraud and insolvencies (paragraph 3.4).

21 The Insolvency Service disqualifies very few company directors specifically for phoenixism. It disqualified 6,274 directors between 2018-19 and 2023-24; only seven of these were for phoenixism. The Insolvency Service told us that phoenixism is defined very precisely, requires a high burden of proof, and in many cases may be less serious than other forms of misconduct identified. Other company directors HMRC has referred to the Insolvency Service (which totalled 200 in 2023-24) may also have phoenixed but were disqualified for different reasons. Neither organisation knows how many this is likely to be. The Insolvency Service told us it is reviewing how it measures its performance in tackling phoenixism (paragraphs 3.20 to 3.21).

Conclusion on value for money

22 Tax evasion costs the UK significant sums each year in lost tax revenue. HMRC has had success in raising more tax from online retail by making online marketplaces liable for the VAT on sales by overseas retailers, which generated more than HMRC expected. However, significant weaknesses remain in government systems which tax evaders can easily exploit, most notably around company registrations and the ability of overseas businesses to falsely represent themselves as UK-established.

23 Tax evasion has been growing among small businesses, and HMRC has so far lacked an effective strategic response. There are good examples of localised campaigns targeting some retailers, but HMRC missed earlier opportunities to tackle others, potentially allowing their market share to grow. HMRC's assessment of risks has given too little emphasis to widely used methods of evasion such as sales suppression and phoenixism, despite identifying that they were large and potentially growing. This means HMRC may not prioritise the most effective compliance interventions. It has also not used some new powers to tackle tax evasion. While these remain untested, they will offer less deterrence.

24 Tackling tax evasion is not a straightforward task, and with finite resources HMRC must work with the rest of government and other stakeholders to find the most cost-effective way to reduce evasion. HMRC's overarching strategy to tackle non-compliance by preventing it from occurring is sensible, but it has not followed through on this principle sufficiently for tax evasion. Real opportunities exist for HMRC to work more systematically across government to reduce evasion. It does not measure its overall performance in responding to tax evasion, but the examples we have seen suggest high returns. The likelihood is that tighter controls and more compliance work could raise significant sums and would be cost-effective and improve value for money.

Recommendations

On setting a clear strategic approach

a **HMRC should demonstrate it has a sufficient strategic focus to tackling tax evasion in key areas of risk.** This should include:

- regularly setting out how it is bearing down on tax evasion and other forms of deliberate non-compliance in line with its strategy, including an assessment of the effectiveness of preventative controls and how it is holding tax evaders responsible for deliberate evasion, rather than general non-compliance; and
- further developing how it analyses, measures and reports its performance and outcomes in tackling evasion, such as the number of penalties it issues for tax evasion and the associated compliance yield.

b **HMRC should take a leadership role in working with other relevant parts of government to develop a shared understanding of the drivers of tax evasion and a more joined-up approach to tackling it.** This should include considering inter-dependencies between tax evasion and wider risks and controls that sit elsewhere in government.

c **HMRC should work with relevant partners in government to assess what end-to-end system across government would be most efficient and effective in tackling tax evasion by businesses. HMRC should work with Companies House and the Insolvency Service, and each should assess whether it has the resources and capabilities to prevent, detect and respond to tax evasion cost-effectively.** This should include whether relevant teams have the capacity and expertise to identify whether there is deliberate evasion, and whether enforcement action is likely to maintain a credible deterrent effect.

On developing effective controls to prevent evasion

d **HMRC and Companies House should ensure they work together to develop and implement further improvements to the way that businesses register as a company and register for corporation tax and VAT.** This should include considering additional powers for Companies House to verify addresses; which organisation is best placed to manage relevant controls; the resources and capabilities needed; and any wider benefits and risks of such changes.

e **HMRC should work with key stakeholders to ensure the arrangements making online marketplaces liable for VAT from overseas sellers are effective in preventing evasion, and explore areas where closer working with HMRC could increase tax revenue cost-effectively.** This could involve working with online marketplaces to establish what reasonable steps they should take to determine whether sellers are UK-established based on their different risks and business models, and to identify what further support HMRC can provide through advice or data.

f **HMRC should tighten controls to prevent tax evasion. As part of this, it should understand the effectiveness of controls adopted in other countries and assess the appropriateness, feasibility and potential costs and benefits of introducing similar controls in the UK.** This could include:

- routine verification of UK establishment for VAT registrations, including with reference to verified addresses or other data;
- transaction-based reporting, requiring businesses to regularly report transaction data; and
- mandatory use of electronic cash registers.

On responding to tax evasion

g **HMRC should assess the risk posed by online marketing of services to enable tax evasion and develop an appropriate response.** This should include working with online platforms to explore opportunities to address the risks, and considering feasibility of working with overseas authorities.

h **HMRC and the Insolvency Service should work together to set out how they will tackle phoenixism and monitor the effectiveness of their work.** This should include determining a shared definition and understanding of phoenixism and barriers to enforcement action and, where relevant, engaging with other relevant public bodies and local authorities.

i **HMRC should develop a systematic way to identify and share common lessons from evaluations across its compliance projects and feed this into its plans to tackle evasion.** It should use this approach to embed a culture of learning and continuous improvement.

j **HMRC should evaluate the extent to which it is using the range of investigatory and enforcement powers it has for tackling tax evasion, establish what barriers it faces to using specific powers, and identify whether there are any gaps that limit the actions it can take.** In relation to the areas on which this study focused, this should include HMRC's powers to:

- investigate the use and supply of ESS technology;
- direct traders based overseas to appoint a VAT representative in the UK; and
- verify UK establishment for VAT registrations.

Part One

The risk of tax evasion in retail and HM Revenue & Customs' strategy to address it

1.1 Tax evasion occurs where taxpayers deliberately omit, conceal or misrepresent information to reduce their tax liabilities. Evasion differs from other types of non-compliance, including tax avoidance, error or failure to take reasonable care (**Figure 1**). It does not include the hidden economy, which HM Revenue & Customs (HMRC) categorises as businesses deliberately not registering at all to pay tax (and includes legal but not illegal trades). As well as resulting in lost revenue, tax evasion can prevent a level playing field between businesses, by giving evaders an unfair competitive advantage.

1.2 HMRC is responsible for tackling tax evasion and other forms of non-compliance for the taxes it administers. In doing so, it often must work collaboratively with other public bodies. This includes Companies House (responsible for company registrations), the Insolvency Service (responsible for enforcement relating to director disqualifications and corporate abuse) and local authorities (various responsibilities relating to high street businesses). Local authorities are responsible for tackling evasion of local taxes, such as business rates.

1.3 This part of the report examines how HMRC understands and assesses risks of tax evasion and determines how best to respond. It covers:

- HMRC's understanding of the overall scale of tax evasion, in total and within specific sectors or taxpayer groups;
- HMRC's assessment of areas where the risk of tax evasion is greater; and
- HMRC's strategy to tackle tax evasion.

Figure 1
Types of tax non-compliance

HM Revenue & Customs (HMRC) defines eight tax non-compliance behaviour types, one of which is evasion

Behaviour type	HMRC definition
Avoidance	Involves bending tax rules to try and gain a tax advantage that Parliament never intended. It often involves contrived, artificial transactions that serve little or no purpose other than to produce a tax advantage. It involves operating within the letter, but not the spirit of the law.
Criminal attacks	Coordinated and systematic attacks on the tax system, including smuggling goods such as alcohol or tobacco or fraudulent claims for VAT repayments.
Error	Results from mistakes made in preparing tax calculations, completing returns or supplying other relevant information, despite the taxpayer taking reasonable care.
Evasion	An illegal activity where registered individuals or businesses deliberately omit, conceal or misrepresent information in order to reduce their tax liabilities.
Failure to take reasonable care	Results from a taxpayer's carelessness and/or negligence in adequately recording their transactions and/or in preparing their tax returns. HMRC assesses 'reasonable care' based on a taxpayer's knowledge, ability and circumstances.
Hidden economy	Sources of taxable economic activity that are entirely hidden from HMRC. It includes businesses that are not registered for VAT, employees who do not declare earnings from other sources of income (moonlighters) and individuals who do not declare any of their income to HMRC, whether earned or unearned (ghosts).
Legal interpretation	Arises where the taxpayer's and HMRC's interpretation of the law and how it applies to the facts in a particular case result in a different tax outcome, and there is no avoidance.
Non-payment	Tax debts that are written off by HMRC and result in a permanent loss of tax – mainly due to insolvency. It does not include debts that are eventually paid.

Source: National Audit Office review of HM Revenue & Customs documentation

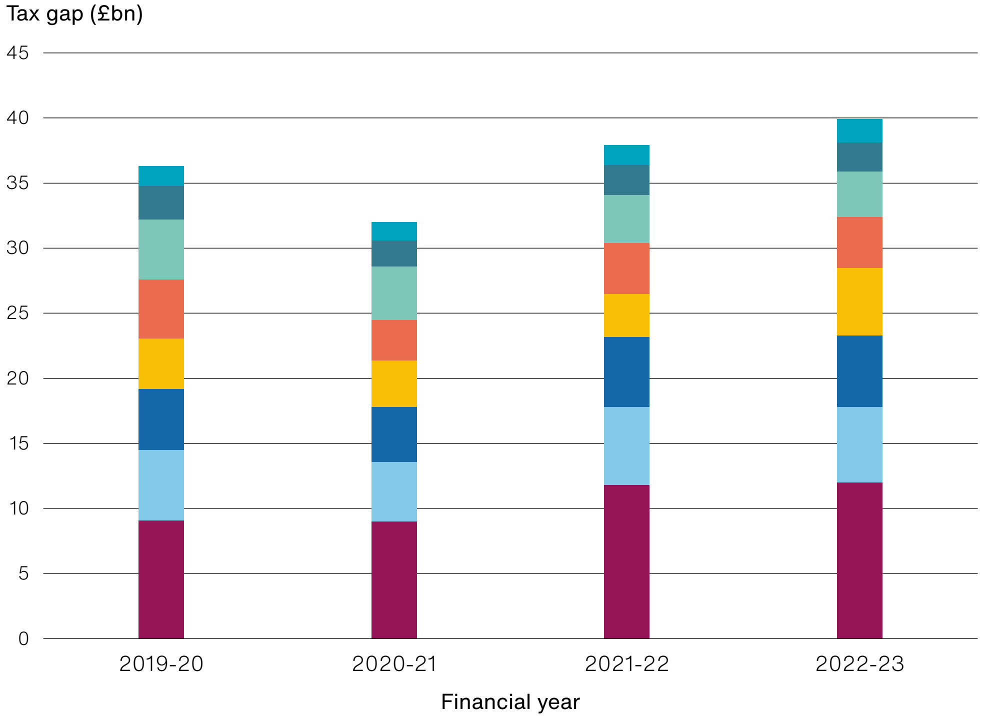
Understanding the overall scale of tax evasion

1.4 HMRC estimates that tax evasion cost £5.5 billion in lost revenue in 2022-23, equivalent to around 0.7% of all taxes owed. This is stable relative to tax revenue, although it has increased in cash terms since 2019-20 as overall levels of tax revenue have increased (**Figure 2** overleaf). The figure HMRC reports represents its best estimate. Tax evasion is inherently difficult to estimate, not least because evaders aim to keep it hidden. HMRC does not put a range on its estimate, and actual levels of evasion could be much higher or lower.

1.5 HMRC estimates that most tax evasion occurs in small businesses, which can include companies, partnerships and sole traders. This has increased, from £3.1 billion in 2019-20 (66% of the evasion tax gap) to £4.4 billion in 2022-23 (81% of the gap) (**Figure 3** on page 19). Corporation Tax, Self Assessment and VAT together made up 98% of estimated evasion by small businesses in 2022-23.

Figure 2
Tax gap broken down by behaviour, 2019-20 to 2022-23

HM Revenue & Customs (HMRC) estimates that tax lost due to evasion increased from £4.7 billion in 2019-20 to £5.5 billion in 2022-23, which was stable at 0.7% of total taxes owed



	2019-20	2020-21	2021-22	2022-23
Failure to take reasonable care	9.1	9.0	11.8	12.0
Error	5.4	4.6	6.0	5.8
Evasion	4.7	4.2	5.4	5.5
Non-payment	3.9	3.6	3.3	5.2
Legal interpretation	4.5	3.1	3.9	3.9
Criminal attacks	4.6	4.1	3.7	3.5
Hidden economy	2.6	2.0	2.3	2.2
Avoidance	1.5	1.4	1.5	1.8
Total tax gap	**36.3**	**32.0**	**38.1**	**39.8**

Notes

1 The tax gap is HMRC's estimate of the difference between the tax theoretically owed and the tax actually paid.

2 HMRC uses a range of methods to estimate tax gaps, including external data sources, random enquiry programmes, surveys and management information.

3 HMRC defines its tax gap behaviours as follows: avoidance, where a taxpayer bends tax rules to try and gain a tax advantage that Parliament never intended; criminal attacks, where organised criminal groups undertake co-ordinated and systematic attacks on the tax system; error, where a taxpayer makes a mistake in their tax calculations, despite taking reasonable care; evasion, an illegal activity where registered individuals or businesses deliberately omit, conceal or misrepresent information in order to reduce their tax liabilities; failure to take reasonable care, where a taxpayer's carelessness and/or negligence in adequately recording transactions and/or preparing their tax return results in them paying less tax than due; hidden economy, sources of taxable economic activity entirely hidden from HMRC; legal interpretation, where a taxpayer's and HMRC's interpretation of the law and how it applies results in a different tax outcome; and non-payment, tax debts that are written off by HMRC and result in a permanent loss of tax.

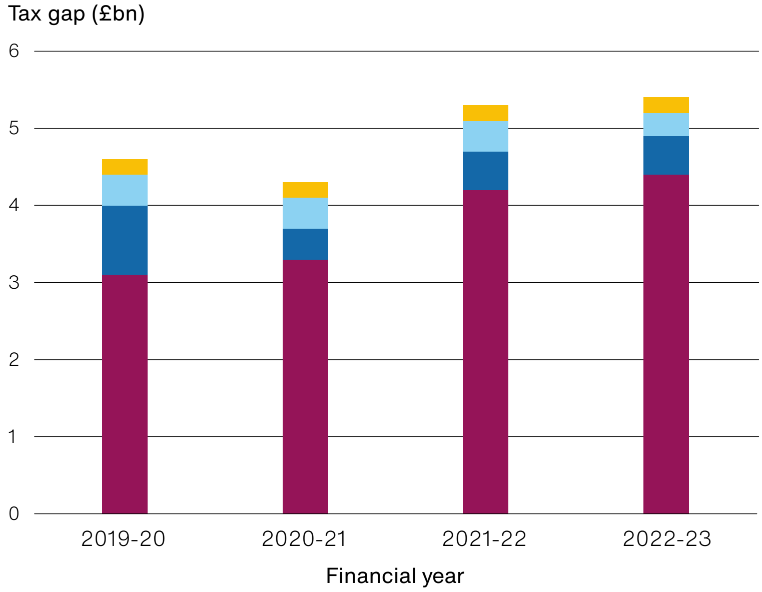
4 Figures in 2021-22 and 2022-23 do not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

Figure 3

Evasion tax gap broken down by taxpayer group, 2019-20 to 2022-23

HM Revenue & Customs (HMRC) estimated in June 2023 that the tax lost due to tax evasion from small businesses increased from £3.1 billion in 2019-20 to £4.4 billion in 2022-23



	2019-20	2020-21	2021-22	2022-23
Small businesses	3.1	3.3	4.2	4.4
Mid-sized businesses	0.9	0.4	0.5	0.5
Individuals	0.4	0.4	0.4	0.3
Wealthy individuals	0.2	0.2	0.2	0.2
Large businesses	0.0	0.0	0.0	0.0
Total evasion tax gap	**4.7**	**4.2**	**5.4**	**5.5**

Notes

1 The tax gap is HMRC's estimate of the difference between the tax theoretically owed and the tax actually paid.

2 HMRC defines tax evasion as an illegal activity where registered individuals or businesses deliberately omit, conceal or misrepresent information in order to reduce their tax liabilities.

3 HMRC defines taxpayer groups as follows: large businesses, businesses with a turnover exceeding £200 million or £2 billion in assets; mid-sized businesses, businesses with a turnover between £10 million and £200 million, or typically 20 or more employees; small businesses, businesses with a turnover below £10 million and typically fewer than 20 employees; individuals, taxpayers with incomes below £200,000 and assets below £2 million in each of the last three years; and wealthy individuals, individuals with incomes above £200,000 or assets equal to or above £2 million in any of the last three years.

4 Businesses can be companies, partnerships or sole traders.

5 HMRC has estimated the evasion tax gap for customer groups using management information, assumptions and judgement combined with projections from historical data. It told us that these estimates are subject to uncertainty which it cannot quantify.

6 Figures do not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

1.6 Tax evasion can be difficult to determine because it depends on HMRC demonstrating wilful intent, leading to a risk of under-estimating it. Where intent is unclear, HMRC may record losses as failure to take reasonable care (FTRC), or error, which are also affected by other factors. Tax lost from FTRC has grown in recent years and accounted for £10.1 billion of the tax lost among small businesses in 2022-23, up from £7.1 billion in 2019-20. It is unclear what is behind the increase and whether it simply reflects increased carelessness by taxpayers or other factors such as increased complexity in the system, taxpayer circumstances or evasion where intent cannot be proven. We recently recommended that HMRC should look at cases of taxpayers failing to take reasonable care, to understand the main reasons.[7]

1.7 HMRC takes steps to counter the risk it might under-estimate the evasion tax gap. It estimates how much it under-detects non-compliance in its casework, using panels of expert HMRC staff, and uses this to increase its tax gap figures. It applies a larger increase to evasion than other components because of the difficulty in detecting and demonstrating deliberate evasion. HMRC told us it is constantly reviewing its approach to estimating the tax gap, and in 2023 it updated the models it uses to calculate the evasion tax gap that relied on historic assumptions.

Assessing areas of higher risk

1.8 The tax gap methodology does not provide sufficient coverage to estimate the tax gap by sector. In 2020, the Committee of Public Accounts recommended that HMRC analyse the tax gap for industrial sectors.[8] HMRC disagreed because it does not collect data which would allow it to produce reliable estimates, and to do so would increase the burden on taxpayers. HMRC told us there are practical limitations including absence of industry data, the cost to HMRC and taxpayers of collecting and analysing additional data, model complexity, the fact that many businesses derive income from several sectors, and the fact that some components of the tax gap are at an aggregate level only.

1.9 Instead, HMRC identifies certain sectors and types of retailers as higher risk of tax evasion and non-compliance, using data and intelligence. For example, random tax enquiry programmes provide indications of the level of tax compliance in specific sectors. HMRC has carried out research and campaigns targeted at certain retail industries, including takeaways and sweet shops, and on widely used methods such as suppressing sales figures to pay less tax.

7 Comptroller and Auditor General, *Customer Service, HM Revenue & Customs*, Session 2023-24, HC 726, National Audit Office, May 2024.

8 Committee of Public Accounts, *Tackling the tax gap*, Twentieth Report of Session 2019–2021, HC 650, October 2020; and HM Treasury, Government responses to the Committee of Public Accounts on the Eighteenth and the Twentieth to the Twenty-Fourth reports from Session 2019–2021, Treasury Minutes, CP 363, January 2021.

1.10 In recent years, HMRC has seen new and potentially growing methods of tax evasion in high street and online retail. In the areas we examined, this includes:

- contrived insolvencies and phoenixism (companies artificially dissolving and reappearing);
- overseas retailers evading VAT from online sales to UK consumers; and
- new ways of suppressing sales figures, including electronic sales suppression using third-party software.

Contrived insolvencies and phoenixism

1.11 Office for National Statistics (ONS) data show that more than 300,000 new businesses are created each year, with around a tenth of these in the retail sector.[9] More than a quarter of businesses survive for less than two years and around half survive less than four years. Insolvency rules exist to allow companies to take risks and support innovation and economic growth. Unsuccessful companies can declare themselves insolvent and default on their debts, including tax liabilities. However, some companies abuse the rules. Phoenixism is the practice of carrying on the same business through a series of companies, where each becomes insolvent only to continue trading as a new separate company to deliberatively evade paying debts, including tax liabilities. This practice may not be conducted solely or primarily to evade tax, and may involve other types of corporate abuse such as avoiding repaying bank loans or laundering money.

1.12 HMRC's latest indicative estimate is that phoenixism accounted for 15% of its tax debt losses in 2022-23, which equates to at least £500 million, similar to its estimate for 2019-20. This covers national taxes that HMRC administers. Phoenixism may also result in losses to other public sector creditors, such as business rates owed to local authorities. HMRC does not have estimates of the scale of phoenix activity earlier than 2017-18.

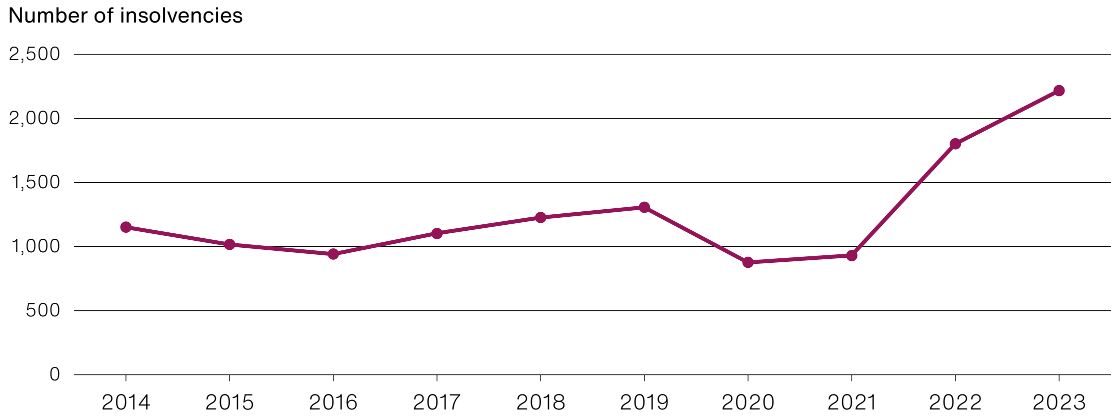
1.13 While its estimate of tax losses has not changed significantly, HMRC considers that there could be an increased risk of phoenixism due to higher levels of tax debt and insolvency since the COVID-19 pandemic. During the pandemic, HMRC's ability to tackle insolvency and phoenixism was limited by a moratorium on winding-up petitions, creating a backlog. We reported in 2021 that this increased the risk that phoenix activities go undetected.[10] Annual company insolvencies increased by 14% in 2023 to their highest recorded level since 1993, driven by adverse economic circumstances and the end of government support to businesses during the pandemic. The retail sector and accommodation and food service sector were most affected. Annual retail company insolvencies increased by 138% between 2021 and 2023 (**Figure 4** overleaf), compared with 79% for all sectors.

9 For the purpose of these statistics, the ONS defines a business as an organisational unit producing goods or services that has a certain degree of autonomy in decision-making. The ONS identifies a business birth when a business registers for VAT and PAYE. These figures therefore differ from company registration figures.
10 Comptroller and Auditor General, *Managing tax debt through the pandemic,* Session 2021-22, HC 799, National Audit Office, November 2021.

Figure 4

Number of annual retail company insolvencies, 2014 to 2023

Annual retail company insolvencies increased by 138% between 2021 and 2023



	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
Retail insolvencies	1,152	1,017	941	1,103	1,226	1,307	877	930	1,802	2,216

Notes

1 The data include compulsory and voluntary liquidations.

2 In the data, retail companies are defined as companies with UK Standard Industrial Classification 2007 (SIC) code 'G47 – Retail trade, except of motor vehicles and motorcycles'. These SIC codes are self-reported by companies on the Companies House register.

3 Between March 2020 and September 2021 there was a moratorium on winding-up petitions, meaning companies were protected from creditor action during this period.

Source: National Audit Office analysis of Insolvency Service data

Overseas retailers evading VAT on online sales

1.14 Around a quarter of retail sales are online, a figure that has grown steadily since 2006, with a peak of 38% during the pandemic. This includes both direct sales and sales through online marketplaces, which provide a platform through which other retailers can sell to consumers. We reported in 2017 that there was an increasing risk of online sellers committing VAT fraud, and that the scale and impact were difficult to measure.[11] The growth of online sales and ability of companies to operate from anywhere in the world means that tax evasion from online sales could be prevalent and has the potential for significant growth.

1.15 HMRC has taken various actions to tackle tax non-compliance on online sales, including changing the role of online marketplaces in 2021 to make them liable for the VAT from overseas sellers. HMRC estimates that, following the change, it now collects at least £1.5 billion a year more VAT. This is five times the level HMRC predicted, which it attributes primarily to increased online sales during and since the COVID-19 pandemic. HMRC has not quantified the impact of this to confirm its assessment. We examine the effectiveness of the 2021 change in Part Two.

11 Comptroller and Auditor General, *Investigation into overseas sellers failing to charge VAT on online sales,* Session 2016-17, HC 1129, National Audit Office, April 2017.

1.16 There continues to be media reporting of fraudulent company registrations, and these being used in VAT evasion through online sales by overseas retailers. HMRC's latest indicative estimate is that, in 2021-22, VAT non-compliance by overseas retailers selling goods and services online resulted in losses of around £700 million, of which around £300 million was deliberate evasion. HMRC's best estimates indicate that £150 million of non-compliance may occur through online marketplaces, though HMRC's figures are uncertain, and it uses them for internal planning purposes only. By value, online VAT non-compliance is one of the most significant strategic compliance risks HMRC has identified for tax evasion in the retail sector. HMRC has identified several methods for this type of evasion, including:

- using company registrations or other documentation to falsely appear as UK-established businesses to avoid online marketplaces being liable for, and therefore withholding, the VAT on sales. UK-established businesses with turnover less than £90,000 also do not need to charge VAT at all;[12] and
- hijacking existing VAT registration numbers to adopt the identity of a genuine taxable business, usually without that business's knowledge.

Sales suppression

1.17 'Sales suppression' is falsifying financial records to reduce taxable income. It is one of the most common forms of tax evasion. HMRC estimates that misreporting of income accounts for at least half the tax gap for VAT, income tax self-assessment, and Corporation Tax among small businesses.

1.18 HMRC splits sales suppression into two distinct types depending on whether it relates to cash or electronic transactions, and takes a different approach to each. Cash-facilitated suppression is a long-standing source of tax non-compliance, and can be difficult to trace because there is no audit trail. A business using this form of sales suppression may conduct some trade, such as paying staff or suppliers, 'off book' with cash to appear to be operating in line with its under-stated income levels.

12 For VAT purposes, HMRC considers that a business is UK-established if the place where essential management decisions are made and central administration is carried out is in the UK, or the business has a permanent physical presence in the UK and is able to make or receive taxable supplies in the UK.

1.19 Electronic sales suppression (ESS) is a growing method that uses third-party software to manipulate electronic sales data, either during or after the point of sale. A business using this approach will seek to hide or reduce the real value of transactions to reduce turnover and tax liabilities, while having what appears to be a legitimate audit trail. It can be relatively straightforward to perpetrate (for example, putting transactions through a cash register's training mode), but more sophisticated methods are increasingly marketed to businesses. HMRC estimated in 2016 that a certain form of ESS may result in at least £100 million of tax losses. In 2019 it conducted a full threat assessment, and its indicative estimate was that annual tax losses from all ESS could be at least £450 million. HMRC told us that its estimates were based on small subsets of data and various assumptions that may not apply across the wider small business population.

HMRC's strategy to tackle tax evasion

HMRC's overall strategy

1.20 HMRC is funded to prevent the tax gap from increasing. It may be given additional funding at fiscal events for targeted work to reduce the tax gap, in certain areas or in general, but does not set an overall aim to do so. In 2019, HMRC set its latest strategy to tackle tax non-compliance.[13] Its approach involves three types of work:

- **promoting** good compliance through education and support to help taxpayers get things right from the start;
- **preventing** non-compliance by improving policies and systems to make it easier for taxpayers to comply with the rules and harder to break them; and
- **responding** when non-compliance occurs by identifying and targeting areas of risk and using tough measures to tackle those who deliberately try to cheat the system.

1.21 HMRC does not have a specific strategy or goals for addressing tax evasion, or any other non-compliant behaviours. A good strategic approach should be clear about what the organisation is trying to achieve and set a clear direction and priorities for partners elsewhere in government or the private sector. HMRC's overall strategy implicitly covers all forms of non-compliance, and is primarily tailored around types of taxpayers (such as small, medium-sized or large businesses). It has chosen not to develop a specific strategy for tackling tax evasion, or other forms of non-compliant behaviour (such as tax avoidance) in case this undermines its ability to deploy resources flexibly to changing risks. HMRC also published a policy on tax fraud in 2021, which similarly covers a range of fraudulent behaviours and is not specific to evasion.[14]

13 HM Treasury and HM Revenue & Customs, *Tackling tax avoidance, evasion, and other forms of non-compliance,* March 2019.
14 HM Revenue & Customs, *HMRC's approach to tax fraud,* policy paper, December 2021.

1.22 Between its overall strategy and fraud policy, HMRC has not clearly articulated certain features we would expect to see from a robust strategic approach.

- **Specific goals or priorities for tackling tax evasion:** For example, HMRC has not defined what level of evasion it considers proportionate to the costs of reducing it (such as a risk appetite or tolerance). It has an annual target for overall compliance yield (the additional revenue collected or protected by its compliance work) and an aim to stop the tax gap from increasing, but neither is specific to evasion or other behaviours.
- **Inter-dependencies between tax evasion and wider risks:** HMRC focuses its assessment and approach on the risks to revenue of taxes it administers and the actions it can take. This means it gives less emphasis to the wider consequences of evasion to the revenue of other public bodies, the controls and mitigations available through other parts of government, and the wider impact of evasion on competition within some retail markets. HMRC's strategy focuses on its own work rather than a 'whole system' view that includes other public and private bodies.
- **How HMRC will share data with the rest of government to tackle tax evasion:** While HMRC increasingly makes use of data to identify risks and inform its work, it has not set out a strategic approach to using data sharing with other parts of government to strengthen its ability to understand and address evasion risks.

Plans and strategies to address specific risks

1.23 HMRC told us that it approaches tax evasion through its overall compliance strategy, including identifying strategic compliance risks and developing plans to address them. It assesses these risks each year based on the tax regimes, taxpayer groups and non-compliant behaviours (including evasion) they relate to. As at 2023, HMRC has recognised 61 risks that currently (or within two years are likely to) result in at least £250 million of potential tax losses, or have potential to cause reputational damage to HMRC or government, or social or economic harm to the country. For each risk, HMRC produces a 'risk treatment plan'. HMRC told us it uses these plans to facilitate a joined-up approach to addressing each risk across HMRC. This includes considering the balance of different compliance activities, the effectiveness of its existing approaches to promoting compliance and preventing non-compliance, and the residual risk that needs to be monitored and responded to.

1.24 HMRC's approach may not sufficiently prioritise some pervasive forms of tax evasion affecting the retail sector. Some forms of non-compliance that affect multiple taxes or connected taxpayers are not captured effectively by HMRC's approach, even though some are large, and HMRC does not have a clear basis on which to decide when a separate strategy is needed or should be updated. While HMRC only recognises one of our three case study areas as a strategic compliance risk, it has developed a more coordinated approach for the other two, with varying levels of impact.

- **Overseas retailers evading VAT on online sales:** HMRC recognises this as a distinct strategic risk, assesses its scale each year, and sets a specific risk treatment plan that sets out HMRC's current and planned response to mitigate the risk. This includes some consideration of the work of stakeholders, such as Companies House and online marketplaces. Risk treatment plans are not shared outside of HMRC, but it told us that it directly engages with stakeholders on the relevant content from its plans.

- **Contrived insolvency and phoenixism:** HMRC does not treat phoenixism as a distinct strategic risk and has instead considered its effect within its assessment of other strategic risks each year. In 2021, HMRC recognised it needed a dedicated insolvency strategy for the first time and introduced one in 2022, including a focus on phoenixism within it. While phoenixism has existed for many years, HMRC did not fully assess its scale until 2023 and its latest indicative estimate suggests that phoenixism accounted for more than £500 million of national tax losses in 2022-23. However, HMRC's strategy gives limited consideration to the important role of the Insolvency Service and private sector insolvency practitioners in identifying and addressing phoenixism. It also does not consider potential overlaps with losses to other public sector creditors such as local authorities.

- **Electronic sales suppression:** HMRC does not treat ESS as a distinct strategic risk. HMRC introduced an ESS strategy in 2019, which included objectives to improve its understanding of and response to ESS and a series of actions to meet those objectives. HMRC has not updated this strategy or kept its assessment of the risk up to date. HMRC has not assessed the scale of ESS since its 2019 indicative estimate that it accounted for £450 million of lost tax revenue. It plans to conduct a new assessment in December 2024, its first in five years.

Understanding overall performance in tackling tax evasion

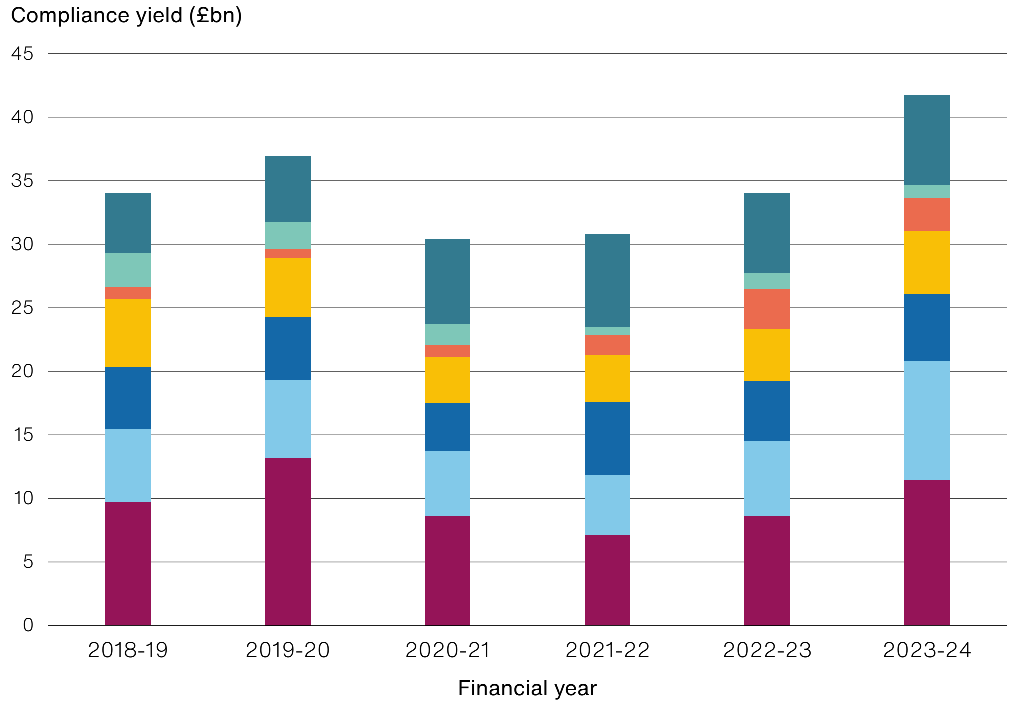
1.25 HMRC does not know how successful it is in responding to tax evasion, in aggregate or for particular taxpayer groups. Its illustrative estimates of the tax gap by type of non-compliant behaviour indicate the scale of the problem, but do not directly measure HMRC's impact in responding to it. HMRC's estimates of the tax gap as a proportion of total taxes owed – both as a whole and for evasion specifically – have remained stable since its 2019 strategy, despite it receiving at least £700 million of additional funding aimed at reducing the tax gap.

1.26 HMRC's main measure of compliance performance is 'compliance yield' – the additional revenue collected or protected as a result of its work – but it does not monitor this for different types of non-compliant behaviour. HMRC estimates that its compliance work reduces the tax gap to around half the level it would otherwise be, but it does not track how much is for tax evasion. HMRC's overall compliance yield had decreased in 2020-21 and 2021-22 following reduced compliance activity during the COVID-19 pandemic. Yield figures started to increase again in 2022-23, and in 2023-24 they totalled £41.8 billion (5.0% of total revenues), compared with around £31 billion in each of the pandemic years (**Figure 5** overleaf).

1.27 For each of its strategic compliance risks, HMRC breaks down compliance yield by tax type and taxpayer group but not by behaviour. A small number of these risks relate only to tax evasion, but many include multiple types of non-compliant behaviour. For example, VAT non-compliance by overseas sellers includes errors and failure to take reasonable care, as well as wilful evasion.

Figure 5
Compliance yield by compliance directorate, 2018-19 to 2023-24

A range of HM Revenue & Customs (HMRC) compliance directorates work to tackle tax evasion and other non-compliance



	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Large Business	9.8	13.2	8.6	7.1	8.6	11.4
Wealthy and Mid-Sized Business Compliance	5.7	6.1	5.2	4.7	5.9	9.4
Individuals and Small Business Compliance	4.9	5.0	3.7	5.8	4.8	5.3
Fraud Investigation Service	5.4	4.7	3.6	3.7	4.1	5.0
Risk and Intelligence Service	0.9	0.7	1.0	1.5	3.2	2.6
Counter Avoidance	2.7	2.1	1.7	0.7	1.2	1.0
Other compliance activities	4.7	5.2	6.7	7.3	6.3	7.1
Total compliance yield	**34.1**	**36.9**	**30.5**	**30.8**	**34.0**	**41.8**

Notes

1 Compliance yield is HMRC's estimate of the additional revenue collected or protected as a result of its work.

2 Values are in cash terms and have not been adjusted for inflation, to align with conventional reporting of tax revenues.

3 'Other compliance activities' includes compliance yield from other areas of HMRC, for example its debt collection work.

4 Figures in 2019-20 and 2022-23 do not sum due to rounding.

Source: National Audit Office analysis of HM Revenue & Customs data

Part Two

The effectiveness of controls to prevent tax evasion in retail

2.1 It is normally harder to detect and pursue fraud and error after the act has been committed than to prevent it taking place. In recent years, HM Revenue & Customs (HMRC) has increasingly focused on preventing non-compliance from occurring in the first place. This includes updating the design of tax systems to make them harder to exploit, and supporting taxpayers to make fewer mistakes.

2.2 This part of the report examines the effectiveness of controls to prevent tax evasion in high street and online retail. It covers:

- tax rules and requirements for retailers selling to UK customers;
- recent changes aimed at addressing weaknesses in preventative controls;
- our assessment of the impact of these changes and any residual control weaknesses; and
- HMRC's plans for further improvements.

Tax rules and requirements for retailers selling to UK customers

2.3 Retail businesses can operate as sole traders or partnerships but may wish to incorporate as a limited company. Companies House is responsible for incorporating and dissolving limited companies. Companies must appoint a director responsible for filing company records and Corporation Tax, and provide a registered address in the UK.

2.4 The taxes that retailers are required to pay, and how these taxes are paid to HMRC, depend on how the business is structured. These taxes include the following.

- **Corporation Tax:** Limited companies, and foreign companies with a UK branch or office, must pay Corporation Tax on their profits. In 2023-24, the main rate of Corporation Tax was 25%. Most companies register for Corporation Tax when they register with Companies House.
- **Income Tax:** Sole traders and partnerships pay Income Tax on business profits. Businesses of these types are required to register with HMRC and complete a Self-Assessment tax return each year.

- **Value Added Tax (VAT):** VAT is a tax added to most products and services sold by VAT-registered businesses. VAT-registered businesses must include VAT in the price of goods and services they sell and report their net VAT position to HMRC in a VAT return, usually every three months. The standard VAT rate is 20%, but lower rates apply for some goods and services. UK-established businesses do not need to register for VAT if they earn less than £90,000, but overseas businesses with no UK establishment must register and charge VAT on all sales to UK customers.
- **Other taxes:** Retail businesses may also have other tax responsibilities, for example registering for Pay As You Earn (PAYE) for their employees.

Recent legislative changes to address weaknesses in controls

2021 changes to the role of online marketplaces

2.5 When businesses register for VAT, HMRC does not verify whether they are UK-established in most cases. It conducts checks based on known indicators of risk to ensure that addresses are accurate when businesses claim to be UK-established. But this requires a robust, up-to-date assessment of key risk indicators, and there has been reporting of fake companies selling fraudulently online. Those based overseas are also more difficult for HMRC to identify and pursue.

2.6 The government introduced a legislative change in January 2021 to tackle tax non-compliance through online marketplaces. This removed responsibility for accounting for the VAT on sales from overseas retailers, and instead made the online marketplaces liable for the VAT. VAT liability rules operate differently for overseas retailers that sell directly to consumers. Some other jurisdictions subsequently introduced similar changes. For example, the European Union (EU) implemented a similar requirement in July 2021, shortly after the UK.

2.7 HMRC estimates that the change to the role of online marketplaces had a significant impact in reducing VAT non-compliance by overseas retailers selling online. Its latest estimate is that it now collects at least £1.5 billion a year more tax, and that levels of evasion are around half of what it estimated they were before the change came into force.

2024 changes to the role and powers of Companies House

2.8 In 2011, Companies House introduced online incorporation, making it quick and easy to set up companies online from the UK or overseas. Until April 2024, Companies House had limited powers to be a control or to check the validity of information provided by registered companies. Companies House had limited enforcement and intelligence-gathering powers, and limited scope to share data or insight into potential indicators of fraud that could have informed the work of other public bodies such as HMRC. The lack of checks meant it was easy for fraudsters to set up legitimate UK companies for illegitimate means, whether based in the UK or overseas. Companies can also register and dissolve before submitting a tax return.

2.9 In March 2024, the first measures under the Economic Crime and Corporate Transparency (ECCT) Act 2023 came into force. The ECCT Act introduces significant changes to the role of Companies House that are intended to improve the reliability of the information of the company register and reduce the risk of false registrations. The new measures in March 2024 included new powers to check information for company registrations, request evidence and remove inaccurate information, and the ability to proactively share information with other government departments and law enforcement agencies. Some measures introduced under the ECCT Act will not be fully operational until Companies House develops the necessary systems and capability, or until further secondary legislation is in place. This includes verifying directors' identities. Companies House told us it intends to communicate implementation dates for the remaining measures with key stakeholders in autumn 2024. Companies House told us it had so far had helpful support from HMRC and the Insolvency Service in implementing the changes.

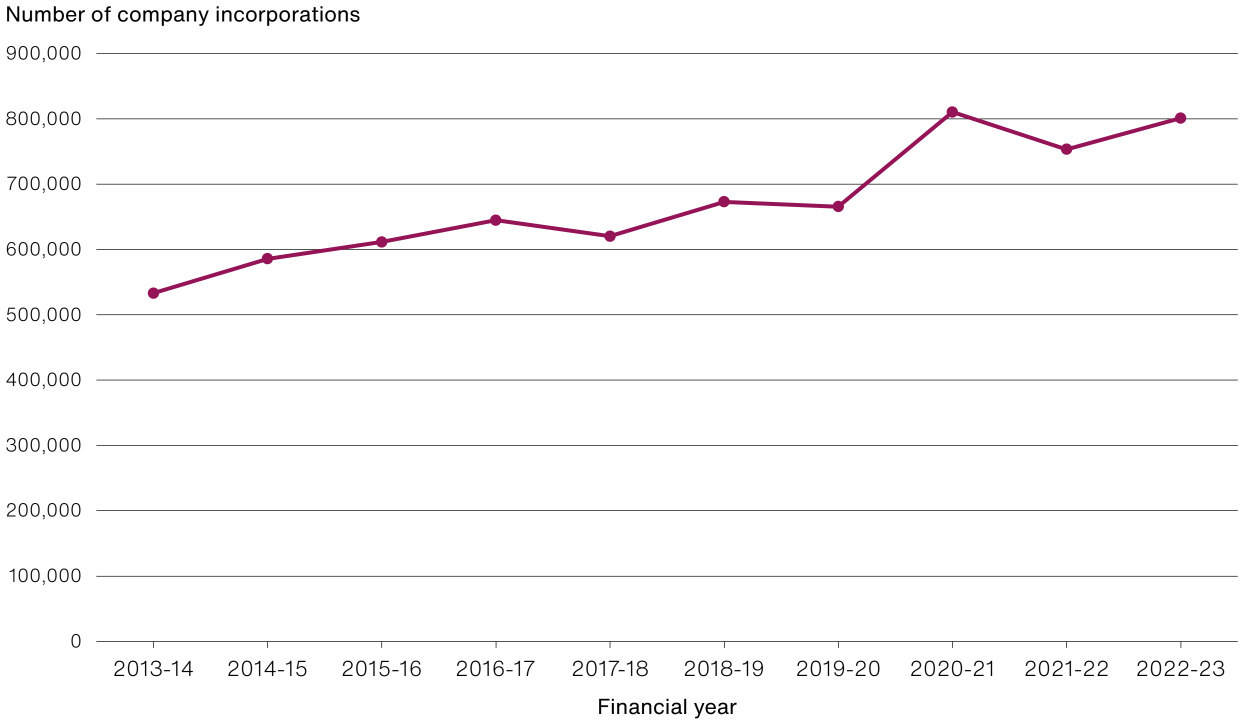
2.10 Companies House was allocated £20 million at Spending Review 2020 to invest in the transformational changes required to deliver the ECCT Act reforms. It has also increased its fees to fund ongoing responsibilities as a result of the changes. In 2022-23, Companies House generated 95% (£84.6 million) of its income from its registration services, including incorporation fees. In 2023 it identified that it would need additional funding of £33.7 million in 2023-24, and £132.7 million in 2024-25 to deliver the legislative reforms from the ECCT Act. Companies House determined that it could fully fund this by increasing its fees. In May 2024, it increased fees to incorporate a UK company from £12 to £50, and to register a UK establishment of an overseas company from £20 to £71. Companies House identified that it would need to increase its workforce by 500 full-time equivalent (FTE) staff, and increased it by 331 FTE between 2022-23 and the start of 2023-24.

2.11 Company registrations surged in 2022-23, prior to the ECCT Act coming into force. Companies House recorded 801,000 company registrations in 2022-23, 136,000 (20%) more than in 2019-20 and similar to the peak seen in 2020-21 during the COVID-19 pandemic (**Figure 6**). In a 2023 business case for increasing its fees, Companies House indicated that the rise in registrations was due to increases in both legitimate entrepreneurship and fraud. The surge may have included an attempt to stockpile registered companies before Companies House implemented new checks.

Figure 6

UK company incorporations, 2013-14 to 2022-23

Companies House recorded 136,000 (20%) more company incorporations in 2022-23 than in 2019-20



	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23
Number of incorporations	533,011	585,752	611,371	644,750	620,287	672,893	665,495	810,316	753,168	801,006

Note

1 The number of incorporations in each financial year is the number of incorporation documents received by Companies House in that period.

Source: National Audit Office analysis of Companies House data

2.12 The retail sector has a particularly high concentration of newly registered companies, which may indicate a potentially higher risk of fraud. Companies House does not record the new registrations it receives by sector, meaning government cannot assess which sectors are most affected. However, for companies that are still on the register (and have not dissolved), the register includes information about what sector the businesses declare they primarily operate in. We analysed Companies House data from June 2024 and found that 42% of retail companies currently on the register were incorporated since January 2023 (**Figure 7**). This compares with 23% of companies in all sectors.

The effectiveness of controls including those following recent changes

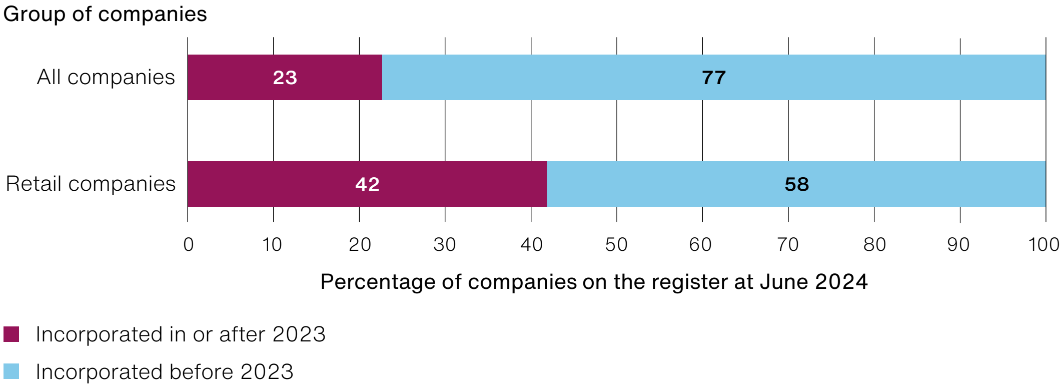
2.13 Despite improvements, there remain weaknesses in controls that tax evaders can exploit. We examined the effectiveness of the changes in strengthening controls in our case study areas:

- overseas retailers evading VAT on online sales;
- contrived insolvencies and phoenixism; and
- electronic sales suppression.

Figure 7

Proportion of companies on the Companies House register incorporated in or after 2023

42% of retail companies currently on the Companies House register were incorporated since January 2023, compared with 23% for all sectors



Notes

1 Data are taken from the Companies House free data product, a snapshot of all companies on the register, as at June 2024.

2 In the data, retail companies are defined as companies with UK Standard Industrial Classification 2007 (SIC) code 'G47 – Retail trade, except of motor vehicles and motorcycles'. These SIC codes are self-reported by companies on the Companies House register.

3 The data cover only companies currently on the register. This means companies which were incorporated in earlier years and have since gone insolvent are not included here.

Source: National Audit Office analysis of Companies House data

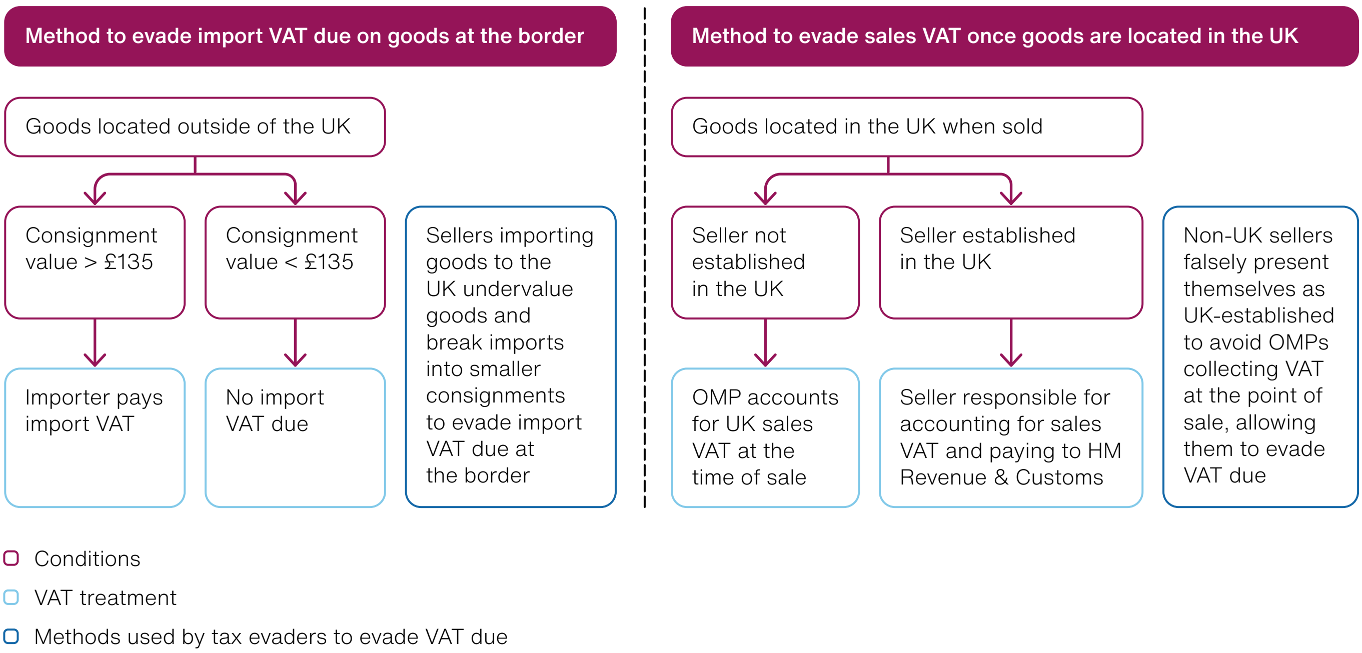
VAT from online sales by overseas retailers

2.14 Online marketplaces are now liable for the VAT from overseas retailers. Marketplaces are also liable for the VAT on imported goods being sold to consumers in consignments worth up to £135, regardless of where the seller is from. While the change has helped reduce non-compliance, overseas sellers can evade VAT by breaking imports into small consignments and falsely presenting themselves as UK-established for VAT purposes (**Figure 8**). For sellers trading from overseas, there is little risk they will be penalised if caught.

Figure 8

How overseas retailers selling goods to UK consumers through online marketplaces (OMPs) evade VAT

Overseas retailers bypass checks by breaking imports into small consignments and falsely presenting themselves as a UK-established business for VAT purposes



Notes

1 These are known methods used to evade VAT.

2 For VAT purposes, HMRC considers that a business is UK-established if the place where essential management decisions are made and central administration is carried out is in the UK, or the business has a permanent physical presence in the UK and is able to make or receive taxable supplies in the UK.

Source: National Audit Office analysis of HM Revenue & Customs documentation and guidance

2.15 To meet their obligations, online marketplaces must charge VAT on sales made by overseas sellers. They need to determine the correct liability or demonstrate they have taken reasonable steps to do so, including whether sellers are UK-established. However online marketplaces do not have access to HMRC data, such as on other taxes including PAYE, due to rules on taxpayer confidentiality. HMRC has not provided clear advice, guidance or support – such as a data matching service allowing relevant data to be reconciled between marketplaces and HMRC – that could help them make the determination. Some online marketplaces told us they were concerned there is too much reliance on sellers providing documentary proof that is difficult to verify. Marketplaces and other stakeholders have seen an increase in techniques to sidestep VAT collection, including:

- increasingly sophisticated false documentation;
- purchasing UK citizens' private individual accounts to not appear as retail businesses; and
- use of shell companies registered in the UK; research published in 2024 found that the UK has more indicators of the use of shell companies (5 million instances) than any other country.[15,16]

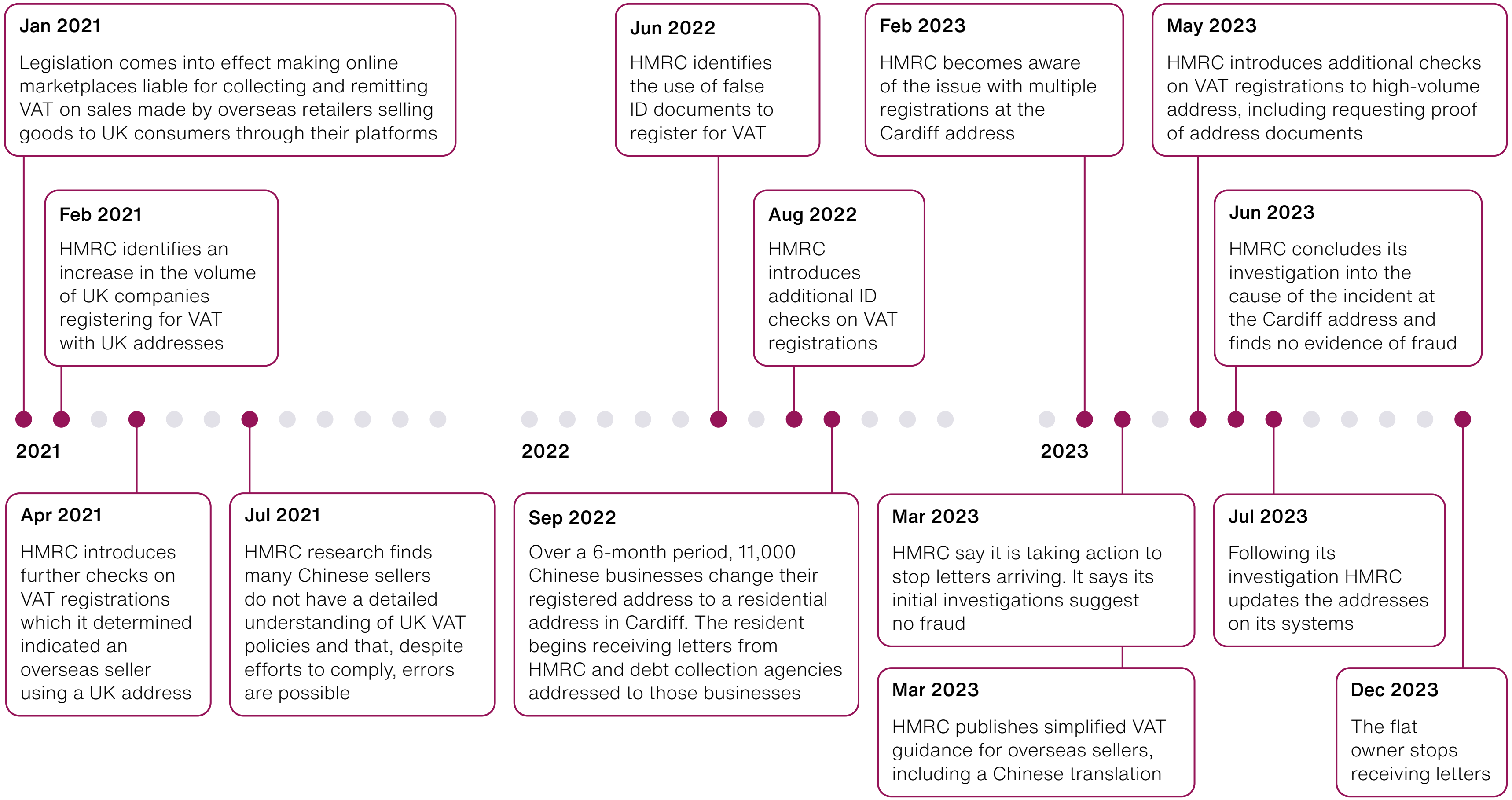
2.16 The January 2021 changes made online marketplaces liable for the VAT but are not intended to stop incorrect addresses being used in VAT registrations. Over a six-month period starting in September 2022, a large number of VAT-registered overseas businesses changed their registered address to one residential property in Cardiff (**Figure 9** overleaf). The resident received more than 11,000 letters from HMRC and debt collection agencies regarding unpaid VAT. HMRC's systems did not initially flag this as a risk for further investigation, and it did not become aware and start investigating until February 2023. HMRC's investigation concluded that there were no indicators of evasion, and the issue arose due to an overseas tax agent making a simple typing error when entering the address on behalf of their clients. It also established that most of the sellers were using an online marketplace that was correctly accounting for the VAT, and concluded that the error did not increase risks of fraud. However, there remain a large number of payments overdue from before the 2021 changes making online marketplaces liable for VAT, and the case brought to light the wider weaknesses in checks over businesses' registered addresses.

15 The 5 million instances refer to flags indicating the use of shell companies, not the number of shell companies.
16 Moody's Analytics, *Looking inside the shell - Moody's Shell Company Indicator*, January 2024.

Figure 9

Key developments in incorrect addresses in UK VAT registrations from overseas sellers, January 2021 to December 2023

A large number of VAT-registered overseas businesses changed their registered address to a residential address in Cardiff, and HM Revenue & Customs' (HMRC's) systems did not flag it as a risk for further investigation



Note

1 This timeline is not exhaustive and does not cover all events in the period.

Source: National Audit Office analysis of HM Revenue & Customs data

2.17 HMRC told us it regularly reviews and updates the information and processes that it uses to assess the risk of a business providing an incorrect address or falsely presenting itself as UK-established. In early 2024, HMRC identified and wrote to 12,000 businesses to inform them that, based on its initial checks, it had decided they did not have UK establishment and would inform any relevant online marketplaces of this decision unless the businesses provided evidence that they were UK-established. HMRC told us that, as at May 2024, the vast majority had not provided such evidence. One online marketplace confirmed to us that it had been notified of this by HMRC, but that HMRC advised that this was not a determination on whether the seller was UK-established, and that the marketplace should still form its own view. HMRC does not know how many other businesses may be falsely appearing as UK-established but not identified in its risk assessment. Online marketplaces have seen evidence of services marketed overseas to help evaders systematically avoid the rules and change how they do so to avoid detection. We were shown an example of a translated transcript of a video marketing such services (**Figure 10**).

Figure 10

Example of marketed services to help overseas businesses evade VAT, 2024

Videos on overseas social media advertise services to help sellers evade VAT in the UK and EU

“Countless UK/EU domestic accounts have been blocked, so what is the reason? In fact, the foreign tax authorities are not stupid, they certainly know that we register this kind of secretarial address and postal address of the domestic number to avoid VAT collection and remittance by the platform. Since 2021, the registration of domestic companies from overseas has become more and more crazy. In nearly three years, the tax department has noticed that the situation is not right. Since the end of last year, they have started to investigate the authenticity of domestic companies. Whether they are truly operating locally? Whether they have a real address locally? Many companies have actually relied on some virtual addresses and mailbox addresses, and they can't receive any mail at all. They cannot provide the tax authorities with real utility bills, real addresses, and employees' social security, etc., which has led to the block of the accounts. Now, in response to this situation, we also have corresponding measures. From the beginning of our registration of domestic companies for sellers, we directly use the real business address, and we can provide the water, electricity, gas, and network bills for this address. As for employees, we can hire employees in advance, or we can hire employees after encountering the review. Even if we encounter it later and then deal with it, there is no problem, because the marketplace will give you a month's processing time. At that time, we will provide local employees, payslips, invoices, social security and so on. Guarantee sellers to have a domestic company at low cost, and to ensure the normal operation and capital flow of the store. This can meet the requirements, and also ensure the normal operation and capital flow of the store.”

Note

1 This is a translated transcript we were shown of a video allegedly circulated on overseas social media and chat services. We have not verified the accuracy of the translation.

Source: Translated transcript of a video on overseas social media

Wider controls that also affect sales suppression and phoenixism

2.18 The identity checks that Companies House is now responsible for, while helpful, are not intended to verify the address or place of business. Verifying addresses is important for VAT, which depends on whether a business is established in the UK, but also has wider implications for HMRC's ability to identify risks. It will also take time for Companies House to verify directors' identities for existing companies, alongside doing so for all new registrations.

2.19 Both online and on the high street, HMRC primarily uses the information businesses provide in tax returns. It has powers to request data on individual transactions directly from businesses, but only does so when it suspects there is an issue and requests the data. It also receives and analyses a range of data from other sources to identify risks of non-compliance, which we examine in Part Three.

2.20 HMRC has not pursued some controls used in other countries (**Figure 11**). The UK may be more attractive to tax evaders where it has fewer requirements than other countries. Implementing fewer requirements can make trading less burdensome for businesses but may also increase risks of tax evasion. Many Organisation for Economic Co-operation and Development (OECD) countries are introducing 'transaction-based reporting'. This requires businesses to regularly report all sales and purchases – or specific subsets at higher risk of fraud – to the tax authority, giving up to date information on VAT that should be owed. HMRC has introduced its Making Tax Digital programme for VAT, which could provide systems through which similar controls could be implemented in the UK, but it has not yet assessed the costs and benefits of doing so.

Plans to further improve preventative controls

2.21 HMRC and Companies House have explored different opportunities that the changes to Companies House's powers bring. They recognise that the lack of address verification limits the effectiveness of the changes in directly reducing tax evasion and have established plans for further work in the short term that may help. This includes expanded sharing of data and intelligence. It also includes Companies House's work to 'clean' the company register and improve the accuracy of information on UK companies, which has had numerous cases of suspicious and fraudulent registrations (**Figure 12** on page 40).

Figure 11
Examples of controls used in other countries

HM Revenue & Customs (HMRC) has not introduced some controls and systems that are in place in other countries

Control	Examples of use in other countries	Current UK government position
Transaction-based reporting, where transaction data is transmitted to the tax authority either in real-time or at regular intervals, giving up to date information on VAT owed.	**Used in many Organisation for Economic Co-operation and Development (OECD) countries**. The OECD reported in 2022 that **18 of the 37 OECD countries with a VAT regime** require systematic transmission of some or all transaction data, of which **10** require it in close to real time. **Eight** OECD require invoices to be 'cleared' by the tax authority to be considered a valid accounting document. In 2022, the European Commission proposed an EU-wide digital reporting system based on electronic invoicing.	There is no systematic reporting of transaction data. All VAT-registered businesses must keep records of invoices, which HMRC can request as part of a compliance check. These invoices can be paper or electronic. HMRC has yet to assess the costs and benefits of adopting transaction-based reporting in the UK but told us it is exploring the potential impact.
Mandatory use of **electronic cash registers** that generate and preserve sales data from cash transactions for tax compliance purposes.	**Used in almost half of OECD countries**. The OECD reported in 2022 that **16 of 37 OECD countries with a VAT regime** require suppliers to use electronic cash registers. **Five** of these require systematic transmission of this data to tax authorities.	HMRC is yet to assess the cost and benefits of implementing electronic cash registers in the UK.
Split payment mechanisms where VAT charged to a consumer is paid directly to the tax authority by the payment provider.	**Some countries** apply split payment mechanisms to certain transactions they consider risky. For example: **Italy** applies it for supplies made to public bodies; and **Poland** applies it to business-to-business supplies of specified goods and services it considers sensitive to fraud.	In 2017, HMRC launched a call for evidence on proposals to extract VAT from online purchases at the point of sale. Responses indicated that introducing split payments would be difficult but technically feasible. HMRC developed models for such a mechanism. In 2018, the government launched a further consultation to evaluate the overall feasibility of split payments. In 2023, HMRC contracted two payment technology companies to develop a proof of concept demonstrating whether or not a VAT split payment system is feasible, due to complete by January 2025.
Address verification on company or VAT registrations, to ensure that the address provided is legitimate and appropriate.	**Some countries** have specific checks in place. For example, in **Spain** authorities check the validity of documents and corporate agreements submitted before companies are added to the business register. In the **Netherlands**, authorities verify the business address during the company registration process; in some cases, this allows the tax authority to issue VAT numbers without additional address verification.	As part of the reforms introduced by the Economic Crime and Corporate Transparency Act 2023, Companies House will require directors to provide ID when registering new companies, but there will be no verification of company addresses. HMRC currently conducts risk-based checks on some VAT registrations but does not verify addresses for all registrations.

Note
1 This list of measures is not exhaustive.

Source: National Audit Office analysis of HM Revenue & Customs and Companies House data and publicly available information

Figure 12
Examples of suspicious data on the UK company register

Data on the company register indicate the use of aliases, fake information and mass appointments by single individuals

Type of data	Examples
Director details	• There has been media reporting of directors on the company register named after cartoon characters, historical and religious figures, or otherwise using names that appear to be false. For example, several companies include a director called Miser Lord Trueman Michael Scr00Ge-Spypriest. • Published research has found directors on the register who were as young as zero or older than the world's longest-living person on record.
Company addresses	• There has been extensive reporting of companies registered to false addresses, including thousands of companies registered at a single residential address.
Mass appointments	• We found 29 individuals who were each appointed as a director of more than 2,000 different companies, with one associated with around 50,000.

Note

1 Companies House has removed or amended a large amount of suspect data on its register, including some of the examples above.

Source: National Audit Office analysis of Companies House data and Moody's Analytics research

2.22 HMRC and Companies House have also identified possibilities for more ambitious changes that could be more effective to prevent tax evasion and other forms of non-compliance or economic crime. This includes, for example, single streamlined systems for registering and filing company, Corporation Tax and VAT documentation that would provide more assurance over the addresses of registered businesses. However, these changes require investment and would rely on other initiatives being finalised first. This includes Making Tax Digital.[17] It also includes the cross-government OneLogin system that supports public service users to prove their identity. HMRC and Companies House estimated in early 2024 that closer integration of systems would take between five and 10 years to implement.

17 Comptroller and Auditor General, *Progress with Making Tax Digital,* Session 2022-23, HC 1319, National Audit Office, June 2023

Part Three

Responding to tax evasion in retail

3.1 Controls are rarely able to entirely prevent fraud and error. Where non-compliance occurs, HM Revenue & Customs' (HMRC's) 2019 compliance strategy sets an aim to "respond by identifying and targeting the areas where there may be tax risk – and using tough measures to tackle those who deliberately try to cheat the system".

3.2 This part of the report examines how HMRC responds to tax evasion in high street and online retail. It covers:

- HMRC's performance in tackling tax evasion in the retail sector;
- whether HMRC sets clear plans and priorities to respond to tax evasion risks; and
- how effective HMRC is in addressing individual instances of tax evasion, including through enforcement action.

Performance in tackling specific risks of evasion in retail

3.3 In the absence of an overall measure of HMRC's performance in tackling evasion (paragraph 1.25), we examined its performance in dealing with the three areas of risk our study focused on. In doing so, we considered how effectively HMRC has used legislative powers it has secured to address the risks. In all three areas, HMRC has secured new powers to tackle the risks and take action against non-compliance, but the speed and impact of its response has varied.

Phoenixism

3.4 Phoenixism is a long-standing issue that HMRC has found difficult to address. From 2011 onwards, it was made aware of detailed concerns that some London souvenir shops were using the practice among other forms of evasion. When HMRC later reviewed its response, it found it had handled the concerns in line with its guidance and prevailing practice at the time. It concluded that the cases were handled in the manner that HMRC would have expected, bearing in mind the maturity of its systems and processes in earlier years covered by the case. However, it also found limitations in its approach (**Figure 13**). These had led to a narrow focus on individual risks, with little consideration of risks that cut across different businesses or tax types, and stopping cases where the business was insolvent when further examination would show the trade had continued in a phoenixed business. HMRC's reviews found that the results secured by its Individuals and Small Business Compliance directorate were small compared with the concerns raised. As a result of the review HMRC made changes to how it manages fraud and evasion, including improved guidance and ensuring greater referral of casework to specialist teams, such as those specialising in fraud and insolvencies.

3.5 HMRC gained new powers in 2020 to pursue directors for company debt where it considers they are declaring insolvency simply to avoid paying tax. It also has powers to require securities against future tax liabilities for successor companies where it determines there is a risk of tax loss, which it used in a compliance project in 2020 to protect £31 million of revenue from 103 cases. HMRC introduced a new insolvency strategy in 2022 that included a focus on phoenixism. HMRC's updated approach focused on minimising lost revenue and preventing offenders from repeating the practice. HMRC said in 2023 it would report the performance and impact of its phoenixism work in its 2023-24 annual report. HMRC reported partial results of its activity, but did not give a clear overview of its performance or impact.

3.6 Even with its new powers and updated approach, HMRC needs to be able to identify cases of phoenixism effectively. It has implemented a new case management system to help identify where contrived insolvencies were likely to occur and proactively target interventions. However, there may also be opportunities to join up more consistently with local authorities, which have reported concerns over phoenixism leading to evasion of business rates. While HMRC is not responsible for local business rates, there may be considerable overlap with evasion of national taxes by phoenix companies. A more joined-up approach could provide useful intelligence for identifying and tackling cases of phoenixism.

Figure 13

Case example: phoenixism among London souvenir shops since 2011

HM Revenue & Customs (HMRC) has made changes to improve how it manages fraud and evasion after missing early opportunities to tackle phoenixism and other tax evasion among London souvenir shops

Concerns raised	From 2011 onwards, HMRC was made aware of detailed concerns of tax evasion among some London souvenir shops. These covered a range of offences, including extensive use of 'phoenix' companies to avoid having to keep proper records or submit accounts, as well as VAT evasion, Corporation Tax evasion, paying employees in cash, and employing people not entitled to work in the UK. In August 2019, the media reported concerns that a large network of souvenir shops were operating through companies that are regularly closed before filing accounts at Companies House.
How HMRC responded	Following the media reports, HMRC's Fraud Investigation Service (FIS) reviewed data and intelligence on London souvenir trade and found that several businesses were subject to ongoing enquiries by HMRC's compliance directorates responsible for small and medium-sized businesses. FIS reviewed 26 companies and three individuals, identifying risks in VAT, Corporation Tax and directors' Self Assessment. Between 2010 and 2020, the small and medium-sized business directorates generated a total of 44 enquiries relating to souvenir shops. As at March 2020, when HMRC first reviewed its response: • nine cases had generated a total yield of £356,877; • eight cases closed generating no yield; • 12 cases were deselected or rejected; • 10 cases were still open, and five cases had not yet started; and • nobody had been prosecuted.
What HMRC found when it reviewed its response	HMRC concluded that the cases were handled in the manner that HMRC would have expected, bearing in mind the maturity of its systems and processes in earlier years covered by the case. HMRC initially reviewed its response in March 2020 and found it had handled the concerns in line with its guidance and prevailing practice at the time. The review identified 11 recommendations to bolster HMRC's understanding of the risks and the efficacy of its compliance work, including creating a strategy and improving coordination to ensure a more consistent and joined-up approach across different compliance directorates. HMRC conducted a further review in November 2022, which was broadly consistent with the initial review but also identified limitations in HMRC's approach. Until 2015-16, HMRC's Individual and Small Business Compliance (ISBC) directorate was structured around tax types – for example, indirect tax teams examined VAT risks while direct tax teams examined Corporation Tax and PAYE. ISBC did not have capability to look at risks that cut across tax types, and fraud specialists in FIS were unaware of many cases. Most cases focused on one individual risk from a single business, even where there was information on connections to other businesses or individuals. ISBC also did not pursue cases if the business appeared insolvent, even when a little more case investigation would show that the trade has continued in a phoenixed business. Overall, ISBC results secured were small compared with the concerns raised.

Source: National Audit Office analysis of HM Revenue & Customs documentation

VAT evasion in online sales

3.7 HMRC first recognised online VAT fraud and error as a priority in 2014. It was given new legal powers to tackle the problem in 2016, including to make online marketplaces jointly and severally liable in cases where HMRC identified evasion by a seller. We reported in 2017 that stakeholders such as UK trader groups considered HMRC's initial response to have been slow.[18]

3.8 Between 2016 and 2020, HMRC introduced other measures, including a requirement for online sellers to display a valid VAT number, and a due diligence scheme on the use of fulfilment houses (where goods being sold from overseas can be stored in the UK in advance). HMRC provided us with a list of 16 compliance projects targeting online retail. These raised £87 million of additional tax revenue at an average return of £19 to every £1 HMRC spent. However, it was not able to enforce the new measures at sufficient scale to meaningfully reduce the risk. HMRC was also given powers to require overseas businesses with no UK establishment to appoint a UK VAT representative but has not yet used these powers. Tax losses did not significantly reduce until 2021, when changes to make online marketplaces liable for the VAT from overseas sellers came into force (Part Two).

Electronic sales suppression

3.9 HMRC identified the threat of certain types of electronic sales suppression (ESS) in 2016. It more fully assessed the issue in 2019, estimated that net losses were around £450 million and identified a need for further powers to tackle the issue. It was not until 2022 that the government introduced new civil enforcement and data collection powers for HMRC in addition to its existing criminal enforcement powers, six years after it first identified the problem. This includes powers to tackle not only businesses using ESS, but also those involved in producing or supplying software. HMRC has not yet issued any civil penalties using these powers, but it told us that these powers have generated publicity which it believes has had a deterrent effect. HMRC said it would evaluate these powers again in the next phase of ESS work.

3.10 HMRC estimates that compliance yield from its work on ESS increased from £17 million in 2022-23 to £98 million in 2023-24, due to increased focus and casework (from 253 cases to 1,275). Stakeholders we interviewed had mixed views on whether HMRC's enforcement action is adequate. This included, for example, positive views about HMRC's approach to tackling suppliers of ESS technology, and concerns about the extent to which HMRC pursues businesses that appear to be using ESS to reduce their tax liability.

18 Comptroller and Auditor General, *Investigation into overseas sellers failing to charge VAT on online sale*, Session 2016-17, HC 1129, National Audit Office, April 2017.

Setting clear plans and priorities to address evasion risks

3.11 HMRC has a 'risk treatment plan' for each of its strategic compliance risks, although these do not directly cover issues that cut across its strategic risks such as phoenixism or ESS (paragraph 1.24). We reviewed the plans that covered tax evasion (in some cases alongside other forms of non-compliance) in the retail sector. These plans were detailed, and considered the whole of HMRC's work on improving compliance, including a high-level assessment of how well HMRC's 'upstream' work (such as preventative controls or educating taxpayers to help them comply) is likely to reduce the risks. The plans also reflected limitations and challenges HMRC faces in addressing each risk.

3.12 However, the plans include a large number of different compliance activities but do not prioritise the actions or make a clear assessment of their impact. The plans we reviewed each contained between 10 and 22 separate compliance activities. These ranged from educational tools to prompt compliance – such as guidance, nudges and prompts – to different types of compliance checks, investigations and enforcement action. HMRC assigns each activity a 'confidence score' but does not set out an assessment of the cost or likely impact, or how different activities may affect each other. This makes it difficult to know which are most important or likely to be most cost-effective. HMRC told us it instead monitors overall costs of compliance projects, and evaluates those projects to understand outcomes.

3.13 Evaluations are an important source of evidence to support public bodies to assess what impact interventions have had, and understand what actions are effective and in what circumstances. In 2022, we recommended that HMRC ensure it was more consistent in evaluating the effectiveness of its compliance activity.[19] HMRC has since increased how many evaluations it conducts, and now plans to evaluate the vast majority of compliance projects. HMRC uses its evaluations to inform future iterations of its compliance projects. However, it does not have a systematic way to identify and share wider learning from these evaluations or use them to consider its overall impact in tackling tax evasion or feed lessons on what works well into its plans.

19 Comptroller and Auditor General, *Managing tax compliance following the pandemic*, Session 2022-23, HC 957, National Audit Office, December 2022.

Responding to instances of tax evasion

Using data to identify non-compliance and evasion

3.14 HMRC makes extensive use of data to identify risks to tax revenue and potential instances of non-compliance. It has legislative powers to request data from a range of organisations, such as banks, online marketplaces and other intermediaries. It also has agreements with other parts of government to proactively share data and intelligence. In total it has 400 live memoranda of understanding with other public bodies that cover data sharing relevant to its compliance work. HMRC uses specialised software to collate and analyse the data it collects, to identify risky businesses or transactions for further investigation.

3.15 We have seen examples of HMRC using these processes to inform its responsive work. In some cases, it has conducted targeted investigations, such as work to tackle evasion in sweet shops in collaboration with Westminster City Council. In many cases, HMRC has identified groups of businesses whose tax returns looked lower than indicated by the data available (such as thousands of takeaway restaurants it identified from 2021-22 to 2023-24). It has written to these groups and found that many corrected their tax returns.

3.16 We have seen evidence that 'one-to-many' interventions like this can be an efficient way to increase compliance among specific taxpayer groups. This can be particularly helpful where non-compliance is likely to be due to error or carelessness, allowing HMRC to broaden its reach with less intrusion to taxpayers and lower operational cost. HMRC faces limitations in the capacity and skills in some of the teams that are involved, but largely do not specialise, in tackling evasion. It tries to mitigate this with increased support from specialists in other parts of HMRC, including its Fraud Investigation Service.

Enforcement action

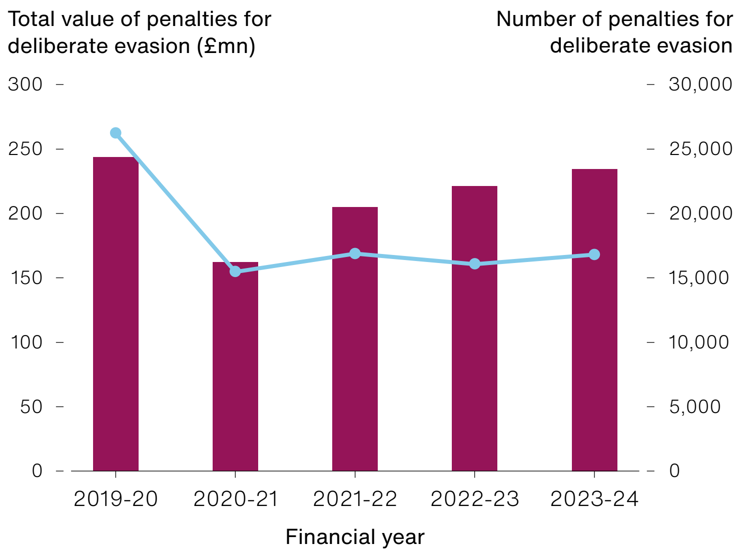
3.17 While one-to-many interventions can be helpful, HMRC will not always be able to establish whether non-compliance in retail is deliberate evasion. With HMRC's finite resources, one-to-many interventions are a useful means of influencing taxpayers to ensure they are declaring the right amount of tax. It enables HMRC to extend its reach into larger populations and is less intrusive for customers. HMRC seeks to balance one-to-many campaigns with in-depth one-to-one investigations in cases where it sees a greater risk of deliberate evasion. Where HMRC does investigate an individual taxpayer, it also needs sufficient evidence to demonstrate deliberate intent, which can be difficult to prove. However, some customers may choose to correct their tax returns, thus potentially avoiding more intrusive investigations. This could have an effect on the wider deterrent impact of HMRC's work. We have seen this issue before with HMRC's compliance work on COVID-19 schemes, and research and development tax reliefs.

3.18 While individual investigations are more costly, HMRC data indicate they can be effective in tackling evasion in more targeted populations and sectors, and can raise far more revenue in tackling evasion. For example, in 2021-22 HMRC wrote to more than 2,000 takeaway restaurants and identified £4 million of additional tax it collected as a result. It wrote to similar numbers in the following two years but was unable to measure any impact, and concluded that further letters were unlikely to be effective with this group of businesses. By comparison, it completed around 400 individual investigations into takeaways over the same three-year period and yielded £30 million, with HMRC's work increasingly well-targeted over time. Where HMRC can prove deliberate evasion, it can apply larger penalties in addition to collecting unpaid taxes. The number and total value of penalties it has applied to taxpayers who deliberately evaded taxes fell during the pandemic but has risen since (**Figure 14**).

Figure 14

Penalties for deliberate tax evasion, 2019-20 to 2023-24

The penalties that HM Revenue & Customs has charged taxpayers for deliberate evasion have been rising since they initially fell during the COVID-19 pandemic



	2019-20	2020-21	2021-22	2022-23	2023-24
Total value of penalties for deliberate evasion (£mn)	243.8	162.2	204.9	221.1	234.5
Number of penalties for deliberate evasion	26,225	15,471	16,881	16,071	16,802

Note

1 HMRC can apply penalties of 20% to 100% of the tax owed depending on a range of factors, including whether the taxpayer discloses the evasion or tries to conceal it.

Source: National Audit Office analysis of HM Revenue & Customs data

3.19 Some of HMRC's investigations result in criminal prosecutions, which encompass, but are not limited to, tax evasion. The number of prosecutions resulting from HMRC's criminal investigations reduced from 749 in 2018-19 to 344 in 2023-24 (**Figure 15**). We reported in 2022 that this reduction was affected by the COVID-19 pandemic, but also reflected HMRC focusing its criminal enforcement work more towards high-value, high-harm fraud, and away from a larger number of lower-value cases that can be tackled by mainstream compliance work. This contrasts with other areas of government such as the Department for Work & Pensions, which normally pursues prosecutions for benefit fraud of £5,000 or more. The Committee of Public Accounts raised concern in May 2023 that fewer prosecutions could weaken the deterrent effect of HMRC's compliance work.[20] In response, HMRC agreed to examine the deterrent effect of its criminal investigations resulting in prosecutions. It finished the first phase of this in June 2024 and expects to complete the work by summer 2025.

3.20 HMRC also supports the Insolvency Service's efforts in investigating directors for potential wrongdoing. It refers directors for disqualification, and provides information to support the Insolvency Service's investigations into both disqualifications and bankruptcy restriction orders (BROs). Director disqualifications and BROs can help HMRC tackle phoenixism as both actions prevent individuals from acting as a director. The Insolvency Service also tackles phoenixism through other activity, including taking action against directors who re-use company names or who continue to act as a director when disqualified.

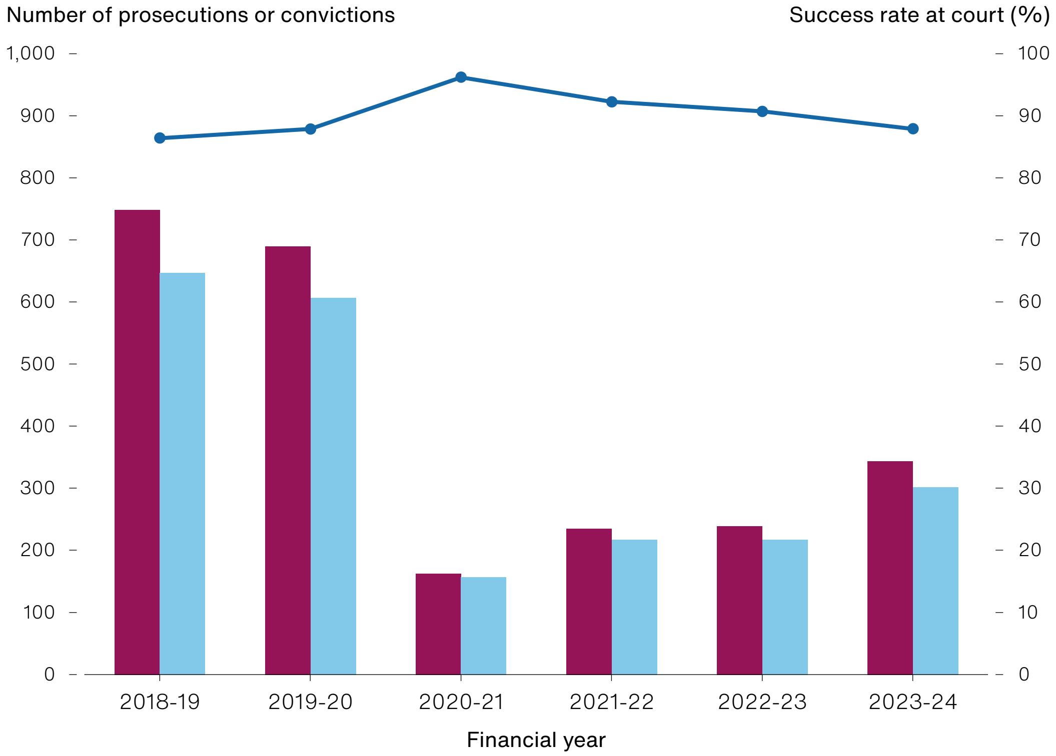
3.21 Between 2018-19 and 2023-24, the Insolvency Service disqualified 6,274 directors; only seven of these were specifically for phoenixism. The Insolvency Service told us that phoenixism is defined very precisely and requires a high burden of proof, and in many cases may be less serious than other forms of misconduct identified. HMRC referred 200 directors for disqualification in 2023-24, with 82% of these referrals warranting an investigation by the Insolvency Service. This was an increase from lower levels during the pandemic of 65 in 2022-23 and 20 in 2021-22. These referrals may have included more directors who had phoenixed but were disqualified for different and potentially more serious reasons, but neither organisation knows how many this is likely to be. The Insolvency Service told us it is reviewing how it measures its performance in tackling phoenixism.

20 Committee of Public Accounts, *Managing tax compliance following the pandemic*, Forty-Ninth Report of Session 2022-23, HC 739, May 2023.

Figure 15

Number of compliance-related prosecutions and convictions, 2018-19 to 2023-24

The total number of criminal prosecutions and convictions decreased markedly during the COVID-19 pandemic and has not yet recovered



	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Number of prosecutions	749	691	163	236	240	344
Number of convictions	648	608	157	218	218	302
Success rate at court	87%	88%	96%	92%	91%	88%

Notes

1 Success rate at court is the proportion of prosecutions which result in convictions.

2 Since 2019-20, in response to a National Audit Office recommendation, HM Revenue & Customs (HMRC) has published several metrics on a quarterly basis, including total number of prosecutions and success rate at court.

3 HMRC does not monitor the number of prosecutions or convictions for tax evasion, or the number against businesses in the retail sector.

Source: National Audit Office analysis of HM Revenue & Customs data

Appendix One

Our audit approach

Our scope

1 HM Revenue & Customs (HMRC) is responsible for tackling tax evasion for taxes it administers and works with other public bodies to do so. This includes Companies House (responsible for company registrations), the Insolvency Service (responsible for enforcement relating to director disqualifications and corporate abuse) and local authorities (various responsibilities relating to high street businesses). Local authorities are responsible for tackling evasion of local taxes such as business rates.

2 This report examines whether HMRC, with other relevant parts of government, is well placed to tackle tax evasion in high street and online retail. It covers:

- how well HMRC understands and assesses the risk and scale of tax evasion in retail, and its strategy to tackle evasion;
- whether HMRC, with key partners, has cost-effective systems and controls to reduce the risk of tax evasion in retail; and
- whether HMRC responds effectively to different methods of tax evasion in retail, and ensures lessons are learned to improve its approach.

3 We supplemented our assessment of HMRC's approach to tax evasion in retail with a sample of specific risk areas that we examined in more depth. These are explained in the next section, which sets out our evidence base. In some cases, our findings are more widely applicable or cannot be distinguished from other sectors.

4 We have not directly assessed HMRC's approach to other forms of tax non-compliance, or wider government efforts in tackling crime. However, some of our findings have wider application to risks of organised crime or money laundering, or to the hidden economy.

Our evidence base

5 Our independent conclusions on whether HMRC, with other relevant parts of government, is well placed to effectively tackle tax evasion in the high street and online retail sectors were reached following our analysis of evidence collected primarily between November 2023 and August 2024.

Case studies

6 We conducted three case studies of specific tax evasion methods or issues to support our assessment of whether HMRC, with other relevant parts of government, is well-placed to effectively tackle tax evasion in the high street and online retail sectors. The case studies were selected purposively based on criteria that include: whether the evasion method presents an emerging or long-standing risk; the scale of the risk; whether the evasion method exploits weaknesses in the UK government's control arrangements; and whether HMRC or other government departments have been given additional powers to control or respond to the risk of the method. The methods selected on this basis are:

- VAT evasion by overseas retailers selling through online marketplaces
- contrived insolvency and phoenixism; and
- sales suppression, with a focus on electronic sales suppression.

7 For each of the case studies, we considered: HMRC's understanding of the risk and scale of the method and strategy to tackle it; the systems and controls in place, including how HMRC works with others to reduce the risk of the method; and HMRC's response to the method through its compliance work, including its work with other government bodies.

8 We undertook these assessments utilising a range of methods including the following.

- **Document review:** We reviewed a range of documents relating to each evasion method, including strategic and risk documentation and operational planning documents.
- **Interviews:** We spoke to representatives from HMRC and other public bodies to understand their plans to tackle the risk posed by each evasion method. We also conducted semi-structured and unstructured interviews with stakeholders outside government, including sectors and industries affected by the method.
- **Quantitative analysis:** We analysed a range of data to understand how the scale of the tax losses due to each method had changed over time, and HMRC's performance in responding to the risks posed.
- **International comparisons:** We compared HMRC's approach to control and respond to the risk posed by each evasion method to approaches in other jurisdictions.

Document review

9 We conducted desk research of publicly available evidence and reviewed documents provided by HMRC, Companies House and the Insolvency Service that are not available in the public domain. These included:

- previous National Audit Office (NAO) reports on tax evasion and non-compliance to identify previous recommendations, findings and consistent themes;
- previous and ongoing work by Parliamentary committees on tax evasion and company registrations;
- documents relating to the government's strategy to tackle tax evasion and other non-compliance;
- strategic risk and threat assessment documentation;
- HMRC research and evaluation reports;
- operational planning documents;
- agreements and working papers between HMRC and other government departments; and
- documents on drivers of the tax gap, insolvencies and other key statistics available in the public domain.

Quantitative analysis

10 We reviewed and analysed public data as well as data and management information provided by HMRC, Companies House and the Insolvency Service. These included:

- HMRC's compliance yield data to assess performance in managing compliance risks;
- levels of compliance activity, through investigations and prosecutions;
- tax gap data;
- HMRC, Companies House and the Insolvency Service data on staff and resources;
- insolvencies, including by sector;
- aggregate data on retail sales and employment, to understand the nature and growth of the sector in recent years;

- UK registered company data downloaded from a snapshot of the Companies House register; and
- other relevant management information from HMRC, Companies House and the Insolvency Service.

Interviews

11 We conducted 23 virtual interviews and meetings between November 2023 and August 2024 with representatives from HMRC, other government departments and wider stakeholders to inform our audit. These typically lasted an hour each and we took detailed notes. These included the following.

- **Walkthroughs and teach-ins with HMRC:** We attended online 'teach-ins' with officials from HMRC to understand: HMRC's approach to tackling evasion in high street and online retail; HMRC's work with other government departments; HMRC's research and evaluation of its compliance work; and HMRC's work with international bodies. We also attended walkthroughs where officials from HMRC explained their approach to managing key compliance risks.
- **Semi-structured interviews with stakeholders:** We interviewed tax stakeholders and business groups to discuss their views on HMRC's and key partners' work to prevent and respond to tax evasion and the impact this has on the retail sector. We spoke with representatives from:
  - Chartered Institute of Taxation (CIOT);
  - Federation of Small Businesses (FSB);
  - Institute of Chartered Accountants in England and Wales (ICAEW);
  - Local Government Association (LGA);
  - Retailers Against VAT Abuse Schemes (RAVAS); and
  - TaxWatch.
- **Engagement with online marketplaces:** We spoke to representatives from a range of online marketplaces, and invited their views on HMRC's performance in implementing the January 2021 changes to the role of online marketplaces in collecting VAT from overseas sellers.

International comparisons

12 To benchmark HMRC's performance and understand the range of approaches taken, we compared HMRC's approach to tackling tax evasion in retail, in particular VAT evasion and the use of limited companies, to the approach taken in other countries. This involved the following activities.

- **Analysis of performance metrics:** We compared HMRC's performance in tackling VAT evasion, as measured by the VAT gap, to that of other countries. We used data from the Organisation for Economic Co-operation and Development (OECD), European Union, and the tax administrations of Australia and Canada.
- **Desk research:** We conducted desk research to establish specific measures in place in other countries and compared these to the measures in place in the UK.
- **Survey of international Supreme Audit Institutions (SAIs):** We asked SAIs about the measures in place in their countries to inform our audit. We contacted the SAIs of Australia, Canada, Finland, France, Germany, Republic of Ireland, Italy, the Netherlands and Sweden.

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