



HM Revenue
& Customs

Tackling the hidden economy: Sanctions

Summary of Responses
20 March 2017

Contents

| | | |
|---------|---|----|
| 1 | Introduction | 1 |
| 2 | Summary of responses | 6 |
| 3 | Responses to the consultation questions | 9 |
| 4 | Next steps | 21 |
| Annex A | List of stakeholders consulted | 22 |

On request this document can be produced in Welsh and alternative formats including large print, audio and Braille formats

1. Introduction

- 1.1 This document summarises responses to the consultation document ‘*Tackling the hidden economy: Sanctions*’, which made the case for tougher sanctions and increased monitoring for those who repeatedly operate in the hidden economy. The proposals presented in the consultation gave respondents an early opportunity to comment on the government’s thoughts in this area. It should be noted that the consultation document did not present finalised plans for any future penalties or sanctions model(s). The next steps for this policy are outlined later in chapter 4.
- 1.2 The consultation opened on 26 August 2016 and closed on 21 October 2016. The government is grateful to all those who responded or participated in meetings for taking the time to consider the issues raised by this consultation. A copy of the consultation document is available at: <https://www.gov.uk/government/consultations/tackling-the-hidden-economy-sanctions>

Context for the consultation

- 1.3 The majority of UK taxpayers pay what they owe, but a small minority seek to evade or avoid paying their fair share. The hidden economy consists of those who fail to register for tax, and those who fail to declare a source of income. HM Revenue and Customs (HMRC) estimates that the 2014/15 tax gap due to the hidden economy stood at £6.2bn, which equates to 17% of the total tax gap. The tax gap is the difference between the receipts HMRC actually collects and the amount of tax that should be collected if all taxpayers complied with the letter and spirit of the law.
- 1.4 The UK has one of the smallest reported tax gaps in the world. HMRC remains committed to reducing it further, and as part of this, achieving a significant and sustained narrowing of the hidden economy tax gap. To accomplish this, we must make compliance the easy option for our customers. HMRC’s approach to compliance is based on three principles:
- **Promote** good compliance, making it easier for people to get things right.
 - **Prevent** non-compliance, preventing mistakes and stopping things from going wrong.
 - **Respond** to non-compliance, targeting our approach to tackle complex cases and deliberate cheats.
- 1.5 Hidden economy activity disadvantages compliant businesses. Tackling the hidden economy will ensure a level playing field for those who comply

with their tax obligations. This means working to improve the ways in which our customers register for tax and report their income, helping them to get things right first time. We will also make it increasingly difficult for businesses and individuals to enter the hidden economy, and robustly tackle those who continue not to pay the right amount of tax.

- 1.6 Those who operate in the hidden economy may also demonstrate non-compliance in areas of their business besides tax, which might include health and safety violations, failure to comply with employment rights for workers or immigration offences. By tackling the hidden economy we can help to shrink the space for wider criminality and non-compliance to flourish. This reduces opportunities for businesses to profit from illegal workers and criminal activity, and so delivers wider benefits for society.

Overview of the consultation

- 1.7 The consultation sought views from stakeholders on the approach the government might take when considering options to tackle repeated hidden economy non-compliance. It focused on the potential for two distinct proposals to tackle this behaviour:
1. Stronger financial sanctions for repeat hidden economy activity in the form of escalated behavioural penalties that took account of past behaviour (namely ‘failure to notify’ HMRC of a tax liability - Schedule 41, Finance Act 2008).
 2. Strengthened non-financial penalties, through increased monitoring of those previously caught operating in the hidden economy.
- 1.8 The consultation included a series of questions on the scope for any future penalties model. It offered two high level models of how ‘failure to notify’ penalties might be strengthened, not as formal proposals but as examples to help focus responses to the consultation questions.
- 1.9 The consultation also explored the case for strengthening the monitoring of hidden economy participants. Questions were framed around the current monitoring models and stakeholders were asked what more could be done in this area.
- 1.10 Finally, the consultation asked about illegal working – i.e. doing work which a migrant is not permitted to undertake as part of their conditions for being in the UK, or working when they have no right to be in the UK. HMRC’s experience is that employment of illegal workers is often associated with failure to register with HMRC and pay tax. Respondents were asked for their views on whether or how the penalties for tax failures could be strengthened where an immigration offence has also been committed.
- 1.11 Two parallel consultations on measures to tackle the hidden economy were launched alongside this one in October 2016, demonstrating that

the government is exploring a full range of options to promote compliance, prevent non-compliance and respond to hidden economy activity when it occurs:

1. *'Tackling the hidden economy: extension of data-gathering powers to Money Service Businesses'*. At Autumn Statement 2016, the government confirmed its intention to proceed with this measure with legislation in Finance Bill 2017. The government's response is available at:

<https://www.gov.uk/government/consultations/tackling-the-hidden-economy-extension-of-data-gathering-powers-to-money-service-businesses>

2. *'Tackling the hidden economy: conditionality'*. Conditionality is the principle of making access to licenses or services for businesses conditional on them being registered for tax. At Spring Budget 2017, the government announced that it will develop further proposals on conditionality and explore options to trial conditionality through pilot activity. There is a good case for conditionality as a tool to prevent non-compliance. The government recognises that conditionality must also minimise burdens for compliant businesses and providers of licences or services. A summary of responses has been published alongside this document, available at:

<https://www.gov.uk/government/consultations/tackling-the-hidden-economy-conditionality>

- 1.12 The government is also consulting on sanctions to tackle tobacco duty evasion and other excise duty evasion, with a particular focus on repeat offenders. The consultation closes on 12 May 2017 and is available at:

<https://www.gov.uk/government/consultations/sanctions-to-tackle-tobacco-duty-evasion-and-other-excise-duty-evasion>

Structure of the consultation response document

- 1.13 This consultation response document is presented in three further sections:

- Section 2 sets out a summary of responses to the consultation together with the government's headline response.
- Section 3 summarises responses HMRC received to specific questions posed in the consultation document and presents the government's response on each.
- Section 4 sets out the next steps for the hidden economy sanctions consultation and policy.
- Annex A lists all organisations that responded to the consultation and/or met with HMRC to discuss it (excluding named individuals).

2. Summary of responses

Overview of responses

- 2.1 HMRC received 17 written responses to the consultation and met with 12 stakeholders to discuss it.
- 2.2 A list of the respondents to the consultation and organisations that attended meetings during the consultation period (excluding named individuals) can be found in Annex A.

Stronger financial sanctions for hidden economy activity

- 2.3 The consultation considered the case for introducing escalated penalties for repeated non-compliance. It suggested that HMRC's existing penalty models did not go far enough to penalise repeat or persistent non-compliance in the hidden economy and sought views on how escalated penalties might change behaviour and encourage compliance.
- 2.4 Penalties for failing to meet an obligation such as notifying a liability to tax or a taxable status or not complying with a regulatory regime apply most often to hidden economy activity. The consultation therefore focused on these 'failure to notify' penalties.
- 2.5 Most respondents agreed with the principle of levying escalated penalties for repeated non-compliance, and that this could change the behaviour of those who operate in the hidden economy. Many stakeholders believed that any new penalty model should be simple, clear and fairly applied. There was also strong support for appropriate levels of communication around any changes to the current penalties regime.
- 2.6 Respondents were keen that any changes to existing penalties, or new penalty models to tackle the hidden economy should:
 - Be proportionate to the non-compliance.
 - Distinguish between deliberate and non-deliberate behaviour.
 - Be set at an appropriate level which does not deter people from coming forward or inadvertently push businesses further into the hidden economy.
 - Consider the potential for suspended instead of escalated penalties to address behavioural issues.
 - Be accompanied by increased HMRC activity and education to make taxpayers aware of their tax responsibilities.
- 2.7 Many respondents also signalled that the design of any new penalties regime should be based on a good understanding of why some taxpayers are non-compliant. Stakeholders thought that penalties should consider

past behaviour, unprompted disclosures and distinguish between serious, and more routine or simple non-compliance such as small errors.

Non-financial sanctions for hidden economy activity (increased monitoring)

- 2.8 The second part of the consultation focused on non-financial sanctions that apply after hidden economy activity is detected by HMRC. HMRC already monitors this population in a number of ways. For example, the Managing Serious Defaulters (MSD) programme applies to those who have deliberately sought to evade paying tax that is due (sometimes through hidden economy activity). However, much of this activity is not tailored to hidden economy non-compliance and applies across a variety of taxes and types of non-compliant customers. The consultation made a case for increased, strengthened or tailored monitoring for those found to be operating in the hidden economy. It asked respondents for their views on the effectiveness of monitoring as a tool for sustaining compliance, and for suggestions on ways to strengthen HMRC's approach.
- 2.9 Many respondents welcomed the proposal to strengthen monitoring for hidden economy activity, and would like to see this accompanied by increased HMRC engagement, communications and general tax education. Stakeholders thought that the existing Managing Serious Defaulters (MSD) model could provide a suitable vehicle for strengthened monitoring.
- 2.10 Respondents were keen that any changes to monitoring of hidden economy activity should:
- Be transparent and clearly explained.
 - Include improved communications at all stages of monitoring.
 - Be well evidenced and follow a clear process.
 - Constitute a proportionate and appropriate deterrent for the offence.
 - Consider using existing monitoring schemes to achieve the government's policy objectives.
 - Carefully consider any timeframes and appeals process.

Government's overarching response

- 2.11 The government would like to thank all organisations and respondents who took the time to engage with this consultation. The government has carefully considered all of the responses to this consultation and a summary of its key messages can be found below.

- 2.12 The government is committed to tackling the hidden economy, and in doing so, supporting the majority of UK businesses by levelling the playing field between the compliant and non-compliant.
- 2.13 The government will consider the design of a stronger 'failure to notify' hidden economy penalty which may take account of past behaviour. This will be delivered as part of the longer term HMRC Penalties Review.
- 2.14 HMRC will strengthen its monitoring of taxpayers previously found to be operating in the hidden economy, to keep them compliant.
- 2.15 These announcements build on progress that the government has already made to identify and take action against those who misuse online intermediaries and cash services offered by Money Service Businesses to hide sources of income from HMRC and operate in the hidden economy. In 2015, the government also invested in HMRC to fund more frontline investigators to step up their response to the hidden economy. Announcements today will further support HMRC in that important work.

3. Responses to questions posed in the consultation document

Proposal 1: Changes to ‘failure to notify’ penalties (Schedule 41) for repeat hidden economy failures

3.1 The consultation set out an illustrative proposal to change Schedule 41 ‘failure to notify’ penalties. The government sought views on how introducing escalated penalties for a second ‘failure to notify’ hidden economy activity might act as a deterrent for repeat offences.

Q1: What are your views on the principle of an escalated financial penalties regime associated with repeat ‘failure to notify’ failures?

AND

Q2: Do you think increased financial penalties for repeat failures will deter repeat failures? If not, why not? What more could be done?

- 3.2 Most respondents agreed with the principle of escalated penalties for repeat offenders. They said that this approach could change the behaviour of some offenders if these changes were well publicised and communicated appropriately to taxpayers.
- 3.3 Respondents offered views on how escalated penalties should be applied. Some responses indicated that any escalated penalty should be proportionate to the non-compliance and take into account the past behaviour of the taxpayer. Most respondents also felt that there should be a distinction between deliberate and non-deliberate behaviour and that this should be considered when HMRC was making a decision to apply an increased penalty.
- 3.4 Some respondents said that a penalties model should not prevent non-compliant taxpayers coming forward to notify. They said that an escalated penalty should not be so high as to discourage businesses or individuals coming forward to correct any wrong doing and become compliant.
- 3.5 Some respondents indicated that further work is needed to understand why some taxpayers become non-compliant and that research should focus on behaviours, circumstances and cash flows of small businesses to better understand the reason some taxpayers operate in the hidden economy.

Government response

3.6 The government thinks that there is a good case for strengthening ‘failure to notify’ penalties to sanction repeat non-compliance and deter future

non-compliance. These changes should be designed to maximise behaviour change amongst the small minority of individuals and businesses who persistently operate in the hidden economy.

3.7 Many of the suggestions made by respondents on the design of a new penalty align well with HMRC's penalty principles, set out under the HMRC Penalties Review.¹ The government and HMRC will design any new penalty in accordance with these principles:

- The penalty regime should be designed from the customer perspective, primarily to encourage compliance and prevent non-compliance. Penalties are not to be applied with the objective of raising revenues.
- Penalties should be proportionate to the failure and may take into account past behaviour.
- Penalties must be applied fairly, ensuring that compliant customers are (and are seen to be) in a better position than the non-compliant.
- Penalties must provide a credible threat. If there is a penalty, HMRC must have the operational capability and capacity to raise it accurately, and if HMRC raises it, it must be able to collect it in a cost-efficient manner.
- Customers should see a consistent and standardised approach. Variations will be those necessary to take into account customer behaviours and particular taxes.

3.8 The government will consider the design of a stronger 'failure to notify' hidden economy penalty which may take account of past behaviour. This will be delivered as part of the longer term HMRC Penalties Review.

3.9 The government also recognises that any future changes to penalties will need to be communicated clearly and effectively to taxpayers.

3.10 The consultation set out two illustrative models for stakeholders to consider when answering questions relating to the design of any future escalated model for 'failure to notify' penalties:

- Option A focused on simple escalation through increasing percentages for second or third failures by the same individual or business.
- Option B proposed to increase the second or subsequent penalties in line with the penalty percentages faced by those who receive deliberate penalties.

Q3: What are your views on the design proposals for escalating financial penalties regime associated with repeat 'failure to notify' failures set out here and in Annex B?

¹ <https://www.gov.uk/government/consultations/hmrc-penalties-a-discussion-document>

AND

Q4: Do you have initial views on the detailed design points in paragraph 3.7?

AND

Q5: What other design points should be taken into consideration?

- 3.11 Most respondents said that Option A would be the simplest model to implement and might be easier to navigate for taxpayers. Some said that Option B might not be flexible enough to consider and account for behaviours or complex reasons driving non-compliance.
- 3.12 Some stakeholders said that introducing suspended penalties could be an effective, alternative tool in changing behaviour and ‘keeping people on the right track’.
- 3.13 Respondents proposed a series of safeguards if Option A was implemented. These focused on provisions for ‘reasonable excuse’, lower penalty rates for unprompted disclosures and a distinction between deliberate and careless behaviours.
- 3.14 At Q5, some respondents suggested that penalties should be proportionate to the non-compliance and that taxpayers’ circumstances should be a factor for HMRC to consider when making a judgement about what level of penalty should apply in individual cases. Respondents felt that Option A could allow for this flexibility.

Government response

- 3.15 The government will consider the design of a stronger ‘failure to notify’ hidden economy penalty which may take account of past behaviour. This will be delivered as part of the longer term HMRC Penalties Review.
- 3.16 The government agrees that any future penalty model will need to be simple to understand. The government and HMRC will design any new penalty in accordance with the penalty principles set out under the Penalties Review and the existing safeguards.
- 3.17 The design of any future penalty model will be subject to further public consultation.

Inaccuracies in returns (Schedule 24)

- 3.18 The consultation explained that other financial penalties can apply to hidden economy activity, including the penalty for inaccuracies in a return (Schedule 24, Finance Act 2007).
- 3.19 When HMRC identifies an individual operating in the hidden economy who has deliberately failed to record one or more sources of income on

the relevant tax return, and has sought to conceal their tax liability, under Schedule 24, that individual will face a financial penalty.

- 3.20 The consultation said that these inaccuracy penalties were not specific to the hidden economy and applied across a much wider variety of behaviours and taxpayers than the ‘failure to notify’ penalty.
- 3.21 The consultation argued that it would be difficult to design changes to inaccuracy penalties without wider impact and potentially unintentional consequences. But it also recognised the downsides of making changes to ‘failure to notify’ penalties in isolation, most notably the risk of creating imbalances between different penalties that applied to the hidden economy. Acknowledging this context, the consultation did not propose any changes to inaccuracy penalties at this time.

Q6: What are your views on excluding changes to Schedule 24 from the wider package of proposed sanctions to deter hidden economy activity including repeated non-compliance?

AND

Q7: Would such an exclusion create any imbalances in the way in which hidden economy activity is penalised by HMRC?

- 3.22 Most respondents agreed that the exclusion of Schedule 24 penalties from any escalated hidden economy penalties model was a sensible approach. They said the wide range of errors and contexts in which inaccuracy penalties might apply meant that changes to inaccuracy penalties might have broad consequences beyond the stated policy intention of the consultation – to tackle the hidden economy.
- 3.23 Recognising difficulties flagged by the consultation, some respondents said that penalties for inaccuracies and ‘failure to notify’ should ideally be broadly consistent. But there was recognition that this would be challenging to achieve.
- 3.24 Some respondents highlighted that existing penalties for inaccuracies can be suspended in some circumstances. They thought that the government should consider this option in any new penalty models as a tool for sustaining compliance.

Government response

- 3.25 The government will consider the design of a stronger ‘failure to notify’ hidden economy penalty which may take account of past behaviour. This will be delivered as part of the longer term HMRC Penalties Review.
- 3.26 The government recognises that changing penalties for ‘failure to notify’ in isolation may create unhelpful inconsistencies or differences between penalty models which apply to hidden economy activity. This is why it has

decided that penalties for ‘failure to notify’ will be looked at as part of the wider HMRC Penalties Review.

- 3.27 The government and HMRC will design any new penalty in accordance with the penalty principles set out under the Penalties Review. In particular, future penalty models will be designed so as to produce a consistent and standardised approach whenever possible. Variations will be those necessary to take into account customer behaviours and particular taxes.

Schedule 55: late returns from employers

- 3.28 The consultation explained that other financial penalties can apply to hidden economy activity, including the penalty that applies to employers for failure to make returns of real time information for PAYE (Schedule 55, Finance Act 2009).
- 3.29 Some hidden economy businesses employ staff but fail to operate PAYE when that obligation applies. Those businesses fail in their obligation to collect and pay relevant income tax and NICs to HMRC and the exchequer. In these cases, because the business fails to hand over sums that should have been collected from employees, that non-compliance has a broader impact than failures just relating to the tax affairs of the business itself.
- 3.30 The consultation explained that HMRC is considering changes to the penalties that apply to employers who fail to make or report PAYE deductions and therefore fail to operate PAYE correctly. It made the case that when applied to hidden economy employers, the Schedule 55 model typically results in much lower financial penalties than the equivalent ‘failure to notify’ or inaccuracy penalty models. It also said that because Schedule 55 applies to late returns from any employer required to submit RTI returns, not just those operating in the hidden economy, it has a wider application than ‘failure to notify’ penalties.

Q8: Do you think that there is an inconsistency between the strength of penalties for hidden economy employers that fail to operate PAYE, and penalties for other hidden economy failures like ‘failure to notify’?

AND

Q9: What options should HMRC consider for strengthening penalties for hidden economy employers that fail to operate PAYE?

- 3.31 Most respondents gave broad support for strengthening penalties for those failing to operate PAYE in a hidden economy context. Some explained what they saw as an important distinction between the behaviour of employers and employees in this situation. They were concerned about the behaviour of employers who failed in their PAYE obligations, and emphasised that in some cases, their employees might

have no choice or awareness of how they were employed with regards to tax.

- 3.32 Some respondents went on to say that there was a good case for stronger penalties for employers. Those respondents agreed that there was an inconsistency between the level of financial sanction arising from 'failure to notify', inaccuracy and failure to make PAYE return penalties, when applied in a hidden economy context. Some said that these penalties should be better aligned and more consistent with each other.
- 3.33 One respondent suggested that penalties for failure to make PAYE returns could be strengthened via higher rates for repeat occurrences or when the employment taxes at stake were above a certain level.

Government response

- 3.34 The government is concerned about the small minority of employers who operate in the hidden economy without operating PAYE on behalf of their employees. However, the government notes that Paragraph 6D of Schedule 55, amended in the Finance Act 2013, allows HMRC to levy a higher financial penalty for extended failures. An extended failure is where a failure to make a return continues for longer than three months. The higher penalty is 5% of the total liabilities which should have been shown on each outstanding return.
- 3.35 The consultation did not propose changes to PAYE penalties, but they will be kept under review and considered in the round as part of the Penalties Review.

Safeguards for an escalated 'failure to notify' penalty

- 3.36 Safeguards ensure that taxpayers are treated fairly and in accordance with the law. The consultation explained that there are already existing safeguards for 'failure to notify' penalties. In any new model or change to existing models, the government would not seek to alter those established safeguards. They are:
- The taxpayer may request a review or accept HMRC's offer to review the issue before the appeal is referred to the tribunal.
 - A taxpayer can appeal to the relevant Tribunal against a decision that a penalty is payable.
 - The amount of a penalty can be reduced depending on the timing, nature, and extent of any disclosures made by the taxpayer about the inaccuracy in point.

Q10: Do you think there should be any additional safeguards put in place to ensure the fair application of changes associated with repeat 'failure to notify' failures?

3.37 Most respondents agreed that existing safeguards should be maintained in any new or changed design. Some respondents went further and suggested further safeguards. These included:

- A suspended penalty to incentivise compliance after a first warning.
- Improved HMRC communication with the general taxpayer population about their tax responsibilities.
- Improved, targeted communications with those found to be operating in the hidden economy.
- Communications at penalty decision points to indicate why the penalty has occurred and what further behaviour could lead to an escalated penalty.
- A reasonable excuse and/or carelessness provision.
- Discretion to tailor a penalty's application or level in response to individual circumstances or vulnerable taxpayers,

Government response

3.38 The government recognises that safeguards are important to ensure that taxpayers are treated fairly and in accordance with the law.

3.39 In any new model or change to existing models, the government would aim to build in safeguards along the lines of those currently in place.

3.40 The design of any future penalty model will be subject to further public consultation.

Proposal 2: Increased monitoring of individuals and businesses engaging in hidden economy activity

3.41 The consultation proposed increased monitoring of those found to be operating in the hidden economy to motivate future compliance and spot further non-compliance more quickly. It set out a number of potential options for non-financial deterrents for those operating in the hidden economy.

3.42 The consultation set out the details of a number of existing monitoring programmes which HMRC deploys to deter and monitor repeated non-compliance. Some, but not all of these can apply to hidden economy non-compliance. They are:

- the Managing Serious Defaulters (MSD) programme,
- the Publishing Details of Deliberate Defaulters programme; and
- the Serial Avoiders regime.

- 3.43 The consultation explained how these programmes work. In particular, it explained that MSD applies only where hidden economy activity has resulted in a deliberate penalty. Based on figures published in the consultation document, (covering 2014/15) this means that at least 20% of taxpayers in receipt of a 'failure to notify' penalty are not eligible for the programme. Moreover, when a business's records and affairs are undocumented or hidden from HMRC, it can be hard to 'prove' a behavioural penalty like the 'failure to notify' penalty.
- 3.44 The consultation made the case for increased or improved monitoring of hidden economy participants. It said that HMRC was considering additional tracking and potentially enhanced monitoring of taxpayers with a history of hidden economy non-compliance. That would allow any further non-compliance to be identified early and penalties escalated appropriately for repeat failures.
- 3.45 The consultation asked stakeholders to consider the potential for increased or improved monitoring to help tackle the hidden economy.

Q11. What are your views on increased monitoring of individuals and businesses engaging in hidden economy activity?

AND

Q12. How could increased monitoring be designed to effectively target hidden economy individuals and businesses and motivate future compliance?

AND

Q13: What safeguards do you think would be necessary and proportionate to ensure the fair application of increased monitoring?

- 3.46 Most respondents felt that increased or improved monitoring would be appropriate if managed carefully by HMRC and applied in a way that was proportionate to the hidden economy failure. Stakeholders said that increased or improved monitoring was most likely to succeed in deterring future non-compliance if it was accompanied by high quality and timely education.
- 3.47 Most respondents thought that the MSD model could be adapted or better-utilised by HMRC to achieve increased or improved monitoring for hidden economy activity. Some said that HMRC's existing monitoring models should not be duplicated and could provide the starting point for any shift in approach.
- 3.48 Some respondents felt that any increased monitoring should be accompanied by improved communications by HMRC that clearly explained why the taxpayer is subject to increased monitoring and the tax liabilities that apply to them.
- 3.49 Of those who thought MSD could be adapted or improved, most said that existing safeguards, set out in HMRC guidance, were a sufficient starting

point. For example, most people on the programme can only be monitored for two to five years. Some respondents went further and emphasised the following, additional or existing safeguards:

- Transparency or taxpayer awareness of the monitoring to avoid perception of entrapment (existing).
- A formal appeal process if a taxpayer can demonstrate compliance (existing).
- Subject to taxpayer confidentiality so as to protect the privacy rights of businesses and individuals being monitored (existing).
- Accompanied by greater HMRC communications and tax education (additional).
- A clear timescale for those being monitored to leave the programme after a period of compliance (existing).

Government response

- 3.50 The government wants to improve the monitoring of hidden economy participants that are detected by HMRC, to deter future non-compliance and respond to observed non-compliance in that group. It agrees with the majority of respondents that this aim can be met without legislative change, through changes to existing HMRC monitoring arrangements.
- 3.51 HMRC has reviewed existing monitoring arrangements, including MSD and those that apply to hidden economy participants who are detected and registered by HMRC, but do not receive a deliberate penalty. It has advised the government that process, resourcing and technological improvements can be made to strengthen existing programmes. HMRC will further review these arrangements and make improvements in 2017.
- 3.52 Any changes to established published guidance concerning monitoring, including MSD, will be highlighted via published updates.

Further areas of interest

- 3.53 The last section of the consultation document covered further areas of government interest.

Illegal working in the hidden economy

- 3.54 The ability to work illegally – i.e. doing work which a migrant is not permitted to undertake as part of their conditions for being in the UK, or working when they have no right to be in the UK – is a key driver for illegal immigration that requires a robust cross-government response.

- 3.55 The government is continually assessing and strengthening its response to illegal employment, and has already used the Immigration Act 2016 to make it easier to prosecute employers of illegal workers and to increase the maximum custodial sentence for these offences. The government also introduced a power to close businesses and request a court to put them under special compliance measures in cases where employers repeatedly flout the law and these measures are necessary to prevent continued illegal working. These measures build on the doubling of the maximum civil penalty to £20,000 for employing an illegal worker in 2014.
- 3.56 HMRC's experience is that employing workers illegally is often associated with a range of tax failures including non-payment of personal and business taxes, not registering with HMRC for the appropriate tax regimes and other workplace compliance breaches.
- 3.57 The consultation asked stakeholders for their views on whether or how the penalties for tax failures could be strengthened where an immigration offence has also been committed.

Q14: Where illegal working is found alongside tax non-compliance, could the penalty regime for tax failures be strengthened or changed?

- 3.58 Most respondents said that the current penalties regime for illegal working was suitable and did not need changing or linking to the tax system. They said that immigration and tax failures were distinct, and that different sanctions should apply.

Government response

- 3.59 The government has no intention at this stage to change the penalty regime for tax failures that apply in cases where illegal working is also detected.
- 3.60 HMRC plays a key role in supporting legitimate employers and contributing to the government's strong and consistent cross-Whitehall response to illegal working. This includes collaborating with the Home Office and other departments to improve intelligence and data sharing, and to roll out a UK-wide programme of operations targeting sectors at high risk of employing illegal workers.

Conclusions

- 3.61 The consultation asked respondents to consider any further financial or non-financial sanctions that could be implemented to tackle the hidden economy.

Q15: Do you have any other suggestions for financial or non-financial sanctions that could be effective in responding to hidden economy non-compliance and promoting good compliance?

AND

Q16: Do you have any suggestions or comments on the most effective way to understand and measure the likely impacts arising from potential policy changes set out in this consultation?

- 3.62 Some respondents returned at this stage to the theme of increased HMRC communication and taxpayer education. They said that this could help to reduce inadvertent hidden economy activity and that there was a balance to be struck between sanctions and support.
- 3.63 One respondent said that suspended penalty models should be considered as a tool for keeping taxpayers compliant after a first warning.
- 3.64 Another respondent said that the government should consider tax reductions for early or prompt payment of taxes due.
- 3.65 Some respondents called for further research to understand how increased sanctions will improve compliance.

Government response

- 3.66 The government will consider the design of a stronger ‘failure to notify’ hidden economy penalty which may take account of past behaviour. This will be delivered as part of the longer term HMRC Penalties Review.
- 3.67 HMRC will strengthen its monitoring of taxpayers previously found to be operating in the hidden economy, to keep them compliant.
- 3.68 The focus of this consultation is on the small minority who deliberately and persistently seek to hide their income from HMRC and operate in the hidden economy. It is right that the government considers further action to respond to that behaviour and deter future non-compliance.
- 3.69 However, the government recognises the importance of HMRC communication and education in guiding businesses towards tax compliance. It acknowledges that some individuals and businesses operating in the hidden economy can benefit from such interventions, and will continue to support HMRC in delivering them. For new businesses and self-employed individuals, some of which inadvertently operate in the hidden economy, HMRC is launching a new, dedicated phone line and online business forum to help and support them about filing and paying tax for the first time. New businesses are also enrolled into HMRC’s free business support email service which supports the first year in business - signposting to e-learning, online seminars and video content that covers a range of relevant business-related topics such as business expenses and record keeping.
- 3.70 HMRC’s Online Tax Registration Service ² allows businesses to easily and quickly register for taxes 24 hours a day, so they can do so at a time

² <https://www.gov.uk/new-business-register-for-tax>

that suits them. HMRC provides a variety of help sheets and guides on key topics to help run a business including;

- Self-Assessment - <https://www.gov.uk/self-assessment-forms-and-helpsheets>,
- PAYE and employing people - <https://www.gov.uk/browse/employing-people>,
- VAT - <https://www.gov.uk/browse/tax/vat>,
- Corporation Tax - <https://www.gov.uk/topic/business-tax/corporation-tax>; and
- Record Keeping Applications - <https://www.gov.uk/government/publications/record-keeping-and-simpler-income-tax-applicationssoftware/simple-record-keeping-applications-commercial-software-suppliers>.

3.71 HMRC continues to work closely with the software industry as part of Making Tax Digital.

4. Next steps

Government's concluding statement

- 4.1 Following an announcement at Spring Budget and the publication of this consultation response document, the government and HMRC will implement the changes set out here to tackle the hidden economy.
- 4.2 The government will consider the design of a stronger 'failure to notify' hidden economy penalty which may take account of past behaviour. This will be delivered as part of the longer term HMRC Penalties Review.
- 4.3 The design of any future penalty model will be subject to further public consultation.
- 4.4 HMRC will strengthen its monitoring of taxpayers previously found to be operating in the hidden economy, to keep them compliant.
- 4.5 Any changes to established published guidance concerning monitoring, including MSD, will be highlighted via published updates.
- 4.6 The government is committed to tackling the hidden economy, and in doing so, supporting the majority of UK businesses by levelling the playing field between the compliant and non-compliant.
- 4.7 The government will continue to explore a full range of options to promote compliance, prevent non-compliance and respond to hidden economy activity when it occurs.

Annex A: List of stakeholders consulted

- Association of Accounting Technicians (AAT)
- Association of Chartered Certified Accountants (ACCA)
- Association of Convenience Stores
- Armstrong Watson
- BDO UK LLP
- British Hospitality Association (BHA)
- Chartered Institute of Payroll Professionals (CIPP)
- Chartered Institute of Taxation (CIOT)
- Federation of Master Builders
- Federation of Small Businesses (FSB)
- Institute for Chartered Accountants in England and Wales (ICAEW)
- Institute of Certified Bookkeepers.
- International Association of Bookkeepers
- Low Income Reform Group of the Chartered Institute of Taxation
- The National Federation of Gypsy Liaison Groups
- Tax Aid
- Tourism Alliance
- Whitefield Tax Ltd