Blatherings and facts about the tax gap [1]

Written by **Tim Worstall** [2] | Sunday 13 October 2013

HMRC's just released their estimates of the tax gap. What should be paid under the law of the land against what is actually paid. And as a result we've got Richard Murphy shouting that HMRC's estimations are all wet for he's the guy with the real facts.

Now I am actually under a promise to Madsen not to mention Murphy too much here but he's given us a perfect example of why the numbers differ: because the definitions do. Here's Murphy on corporation tax revenues [3]:

> Instead let me just highlight some of the absurd anomalies in this year?s report that I have noted so far. Let?s take corporate tax avoidance for a start. According to HMRC in 2011-12, they year to which this report relates UK tax avoidance in that year was just £4 billion and was split down as follows: (*chart excluded-Ed*)Now this report in the Mail on Sunday in April 2012 ? covering the same year as a result ? gave an estimate (and in my opinion a fair one) of the tax avoidance of just a few giant tech companies: (*chart excluded*) That?s, as they note, £685 million lost to five companies. Microsoft and Yahoo are not in there. And there are, we know, plenty more playing such tricks. But apparently the total lost is just £1.5 billion. Actually, that?s because none of these losses to tech companies is in HMRC?s figures. They may have been in David Cameron?s sight lines when attacking tax avoidance but HMRC refuses top recognise they do anything wrong. And that?s ludicrous.

Now what he's talking about is of course the way in which various tech companies sell into the UK from Ireland or Luxembourg, paying their corporation tax there. Murphy is claiming that the tax on this money that is paid (or not paid) in Ireland is thus tax avoidance from the UK tax system. What he's missing is that it isn't. Here's HMRC on the subject [4]:

> In broad terms, companies are required to pay corporation tax in the country where they carry on the economic activity that generates their profits, not where their customers are located.

Hmm, so where the customers are is not the determinant of where the tax liability is. Not even in theory: in fact theory, that spirit of the law, operates exactly the other way around. That people are selling to UK based firms or consumers does not, in any manner, create a tax liability in the UK. It is entirely other and very different criteria that decide that question. And as HMRC goes on to state:

> Non-resident trading companies which do not have a branch in the UK, but have UK customers, will therefore pay tax on the profits arising from those customers in the country where the company is resident, according to the tax law in that country. The profits will not be taxed in the UK. This is not tax avoidance: **it is simply the way that corporation tax works**.

So, the reason that HMRC does not include such numbers in its estimates of tax avoidance is that under the basic system of corporation tax, under both the spirit and letter of the law of this and most other nations, there's not any tax avoidance going on. This is the way that Parliament, the OECD and before them, the League of Nations (where the basic structure of international tax treaties come from) set the whole system up.

Murphy's numbers try to include such sums which is most odd for someone prclaimed as one of the nation's leading tax experts.

What is actually happening here is that Murphy thinks that settled law should not be as it is. Which is fine, of course, there's plenty of areas of life where I think settled law should not be as it is. I wouldn't be allied with a radical think tank if I didn't. But there is something important to therefore note about these tax gap estimates.

Murphy's numbers and thus, for they all run with them, those of the TUC, PCS, Unite, Polly, nef, Margaret, Lady Hodge and the rest of the rag tag groups that is the British left, estimate what the tax gap would be if the law were changed to conform to their prejudices and misconceptions about what settled tax law should be.

HMRC's numbers are based on what settled tax law actually is.

All of which does lead to a small amusement: those campaigning for tax law to be changed to reflect their prejudices are of course campaigning to increase the tax gap. For if the law were changed in the manner they desire then that tax gap would be closer to their figures: figures note which are larger than those under current tax law.

And it's very odd indeed to see lefties arguing that there should be even more uncollected tax around the place.

Links:
[1] http://www.adamsmith.org/blog/tax-spending/blatherings-and-facts-about-the-tax-gap
[2] http://www.adamsmith.org/taxonomy/term/5778
[3] http://www.taxresearch.org.uk/Blog/2013/10/11/hmrcs-new-tax-gap-report-a-work-of-fiction-and-guess-work/
[4] http://www.fcablog.org.uk/2012/10/game-over-for-ritchie-on-tax-avoidance/
[5] http://disqus.com/?ref_noscript
[6] http://disqus.com