



**Response from ICAS to the
HMRC consultation**

**Cash, tax evasion and the hidden economy
Call for evidence**

26 January 2016

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Call for evidence

About ICAS

1. The following submission has been prepared by the ICAS Tax Committee. This Committee, with its five technical sub-Committees, is responsible for putting forward the views of the ICAS tax community, which consists of Chartered Accountants and ICAS Tax Professionals working across the UK and beyond, and it does this with the active input and support of over 60 committee members. The Institute of Chartered Accountants of Scotland ('ICAS') is the world's oldest professional body of accountants and we represent over 20,000 members working across the UK and internationally. Our members work in all fields – predominantly across the private and not for profit sectors.

General comments

2. ICAS welcomes the opportunity to comment on the call for evidence on 'Cash, tax evasion and the hidden economy,' issued by HMRC on 25th November 2015.
3. It is clearly difficult to obtain evidence about the hidden economy and so the following is based on anecdotal input.

Cash in the hidden economy

4. Paragraph 1.7 in the call for evidence, commenting on 'spontaneous payments' refers to Bank of England figures which indicate that "the absolute value of such cash payments has been quite stable over the last 15 years and stands at less than 50% of all consumption."
5. It further comments at paragraph 2.4 that it estimates that no more than 50% of Bank of England notes issued are in the domestic visible economy. This leaves a very significant amount of cash, much of which may be available to the hidden economy.
6. Taking these points together suggests that cash is, and is likely to remain, a significant tool within the hidden economy. It is not proven that any increase in disruptive payment technology will make any significant impact on this state of affairs for the foreseeable future.

Impact of disruptive payment technologies and the approach to compliance

7. Increasing use of online wallets, contactless payment, cryptocurrencies or peer-to-peer payment and the like, from a detection point of view does not change the bottom line that the most effective way to identify tax evasion is lifestyle comparison. The hidden economy is criminal activity and detective work is needed to identify and prosecute offenders. No amount of information technology can replace the need for trained staff and detailed compliance work.
8. Lifestyle comparison compares the resources needed to sustain the individual's lifestyle and wealth, with their income as declared for tax purposes. This highlights discrepancies, whatever the hidden source of income. Sometimes business visits or surveillance may be needed to identify businesses with 'two sets of books', where declared cash takings are significantly below the volume of sales suggested by physical observation.

Non-cash activities within the hidden economy

9. Within the hidden economy there are issues beyond cash and financial technologies. One of these is the use of barter.
10. For example, a tree surgeon might be 'paid' in kind through being supplied with firewood for personal use. An individual might provide a building service, such as tiling a bathroom or kitchen, and be 'paid' by having the lawn mowed. Services may even be exchanged

via a time bank arrangement. This can be used both informally within the UK and internationally.

11. Barter does not leave the sort of audit trail one might find with electronic payment. Again, it may first show up through lifestyle comparison. However at low levels it can be hard to spot.
12. Sometimes failure to recognise the tax implications of barter may be due to ignorance rather than any deliberate attempt to evade tax. Raising awareness through education may be of service here.

Drifting into non-compliance

13. Another strand within the hidden economy is individuals who have 'drifted' into non-compliance. An example would be the hairdresser who initially provides a service from home for family and friends, but without recognising that the line has been crossed, 'tests the water' by opening a high street shop.
14. Initially profits may be below the tax and National Insurance limits, so, even if registered with the authorities, no tax would be due. But, time passes and profits become taxable, yet the move to register is now delayed due to fear of having broken the law.
15. One way to reduce this area of the hidden economy would be to create a simpler way back to compliance for such businesses.
16. Paradoxically, the move to digital services, with on-line registration via Gov.uk and increased regulation may make it harder for such individuals to get started on the right footing.
17. The process can seem intimidating and alien to individuals who are involved in 'business' in a very small way – from students busking, to individuals trying to put their life back together after a life changing event like separation or bereavement, it may seem to make life simpler to ignore the question of registration. This can be particularly so if there is any ambiguity around employment status and / or wages are paid in cash.
18. There is a case for a dedicated helpline, and even high street enquiry centres, where such individuals could obtain face to face, personal advice before the matter escalates.

Specific questions

Question 1: What does the relative decline in cash usage mean for tax non-compliance in the future?

19. As mentioned in the general comments above, the figures provided in the consultation paper do not appear to suggest any dramatic decline in the absolute value of cash used, or of the availability of cash to the hidden economy. In many ways it seems to our members like 'business as usual' in terms of tax compliance.

Question 2: What evidence is available about the use of cash to conceal transactions within the hidden economy?

20. There has always been a variety of evidence showing the use of cash to conceal taxable income. In cases of fraud, such as where brewery staff were selling off beer (unknown to management), by falsely recording the volume of beer actually brewed, and disposing of the excess for cash; cash assisted the concealment as it bypassed the company's accounting records.
21. Similarly, in diesel bunkering, a fraud involving booking out incorrect volumes of fuel to haulage firms was facilitated by staff re-selling the fuel for cash. This concealed the fraud, as bills to the haulage firms matched the fuel supplied, it was simply that the haulage firms paid for fuel they never received, but had been re-sold for cash.

22. As mentioned above, lifestyle comparison is an approach which can quite quickly show discrepancies.
23. It is noted that very few cases of undeclared takings have come before the First –tier Tax Tribunal in recent years when compared to the years around the turn of the millennium. It is unclear if this reflects a reduced use of cash, a change in investigation policy or more sophisticated evasion.

Question 3: To what extent does cash facilitate tax non-compliance?

24. Cash certainly can facilitate non-compliance. The extent to which this happens is very difficult to estimate, primarily because it is in the hidden economy and therefore unrecorded. The means by which tax non-compliance is facilitated is simply the lack of audit trail. This is not unique to cash, as other systems, such as barter, may similarly lack audit trail.

Question 4: What evidence is there that the relative trend away from cash to other payment methods will or will not continue?

25. This is not an area on which we have any evidence; however, looking at market reports, it seems likely that the trend away from cash is likely to continue; but it is perhaps unlikely that there will be any dramatic change in the foreseeable future.

Question 5: Considering the rapidly changing payment landscape, what challenges and opportunities does further innovation raise for:

5a: HMRC's compliance activities?

26. As mentioned above, perhaps the most effective means of identifying un-declared or under-declared income is lifestyle comparison. This approach is not substantially affected by the method of payment. It applies even where individual transactions remain hidden.
27. HMRC's bulk data powers obviously have a role to play here in making it harder for transactions to be hidden, and the extended data gathering powers will have reach within disruptive payment technologies.
28. Yet there remains the issue that payment systems with an audit trail are unlikely to be favoured by people in the hidden economy. One issue here is whether individuals within the hidden economy will be aware of their own digital footprint, and of HMRC's ability with Connect software to identify this.
29. In terms of compliant businesses, bank charges for handling cash are increasingly high and this is persuading many businesses to look for alternative methods of payment for their customers. As a result, a reduction in cash sales transaction may reflect a business owner's decision to make more efficient use of bank transfer and contactless payment methods, rather than indicating any understatement of profit.

5b: HMRC's customers?

30. The rate of change into digital payment is debatable; as is its impact. One significant change may be changes to contactless payment meaning that many more small purchases can be made electronically. This may reduce the use of cash, but as it concerns large volumes of small value transactions it is hard to judge the overall financial impact.
31. From an accounting point of view, the changing technology is making data capture on income and payments, particularly in retail businesses, more secure. However for business who are already compliant, this is not a dramatic change.
32. Businesses who are not already 'HMRC customers' may be more likely to be 'caught out', for example by 'feeding' their PayPal or apple-pay accounts with cash. The more savvy might realise the risks and avoid creating such digital footprints.
33. It is likely that cash will continue to be a major force for a long time to come.

Question 6: What do changes in the use of cash mean for money laundering?

34. Money laundering is working in a very different direction. Whereas those in the hidden economy would be content to keep all transactions invisible, criminals wishing to 'launder' income from criminal activities are deliberately aiming to make the income visible while hiding its origin.
35. If there were to be a substantial reduction in the use of cash, it seems likely that criminals might turn to digital payment methods and hide the origin of the funds by using misleading descriptions. Particularly on international orders, fake invoices could be used to give the impression of legitimate trade, while hiding illicit trading. One is reminded of the ruse of sending empty wagons across international borders – where the paperwork is all in order – but the goods have been left in the original country and are now 'non-existent' within that jurisdiction.