Impact case study (REF3)

Institution: University of Warwick

Unit of Assessment: C16 - Economics and Econometrics

Title of case study: Tackling Tax Evasion and Maximising Revenue

Period when the underpinning research was undertaken: 2017-2020

Details of staff conducting the underpinning research from the submitting unit:

Name(s):	**Role(s) (e.g. job title):**	**Period(s) employed by submitting HEI:**
Arun Advani	Assistant Professor	July 2017- Present

Period when the claimed impact occurred: 2017 - (ongoing)

Is this case study continued from a case study submitted in 2014? No

1. Summary of the impact (indicative maximum 100 words)

With assistance from HMRC, Arun Advani carried out research into the determinants of tax compliance and the long-term revenue effects of tax audits. Following the recommendations arising from the research, the UK Government committed to providing HMRC with the resources to employ 1,300 additional auditors, which is expected to bring in GBP3,900,000,000 of additional revenue over five years. [**Text removed for publication**] Advani's work informed the development of the Labour Party's tax policy ahead of the 2019 general election and has attracted interest from tax administrators internationally.

2. Underpinning research (indicative maximum 500 words)

The research focused on two questions:

1. Among self-assessment income taxpayers, which taxpayers are most likely to be non-compliant (i.e., to underpay taxes)?

2. When such taxpayers are audited, how and why does their compliance behaviour change?

The analysis was based on evidence from administrative data on all self-assessment taxpayers (around 10,000,000 people per year) from 1997-2012, merging information from tax returns with data generated from the random audit programme conducted by HMRC. HMRC provided access to data through its Datalab.

To examine the first question, Advani investigated which factors predict underpaying taxes, and the amount of underpayment. The research uncovered four new facts about UK compliance behaviour. First, non-compliance is relatively widespread, with just over a third of self-assessment taxpayers underreporting. Second, just 4% of self-assessment taxpayers account for more than 40% of the missing revenue. Third, non-compliance varies with individual characteristics: it is higher among men; those working in hospitality (e.g., bed and breakfast owners) and transport (e.g., cab drivers); and those living in Northern Ireland. Finally, non-compliance is concentrated in particular income sources, notably self-employment income. Incomes that must also be reported by third parties have higher compliance rates. [**3.1, 3.4**]

To examine the second question, Advani compared individuals who were audited with similar individuals who could have been audited in the same year but were not, following their subsequent income declarations over time. The systematic differences in income declarations following audits provide a measure of the additional tax revenue resulting from audits. The research found that people who were audited continue to pay higher taxes not only immediately

following the audit (the 'direct' effect of the audit) but for 5 to 8 years after the audit (an 'indirect', dynamic effect), with 60% of the additional revenue triggered by audits coming from these dynamic effects. Accounting for only the immediate effects of audits therefore greatly understates their revenue benefits. [**3.2, 3.3**]

Advani used testable predictions from a theoretical model to discriminate between alternative determinants of post-audit compliance behaviour in the data. The modelling showed that the most likely explanation for the sustained increase in tax payments post audit is that, once non-compliant individuals are audited and HMRC uncovers under-reported income, it becomes difficult for them to hide this income again. Other explanations, such as taxpayers' learning about the cost of an audit or thinking that they are now more likely to be targeted, can be ruled out. [**3.3**]

The research has important implications for clamping down on tax evasion and bringing in additional revenue to fund public services. By showing who is most likely to underpay taxes and how and why the long-term compliance behaviour of individuals changes after being audited, the research indicates where HMRC should focus its resources (i.e., which groups of people to target), and what the return to audits is, and therefore how many audits HMRC should do. The trend over the past fifteen years has been for audits to decline, but the research indicates that more should be done.

The analysis and write-up of **3.1** was entirely done since Advani joined Warwick (and subsequently written up as **3.4**). The analysis described in **3.2** was initiated at the IFS but continued after Advani joined Warwick. **3.2** was later extended and published as **3.3** to include additional underpinning research conducted at Warwick – for example, uncovering, for the first time, that effects on revenues can be attributed to responses by mis-reporters who have predictable income sources.

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3. References to the research (indicative maximum of six references)

3.1 Advani, A. (2017). "Who does and doesn't pay taxes?" *IFS Briefing Note* No. 218.
https://www.ifs.org.uk/uploads/BN218.pdf

3.2 Advani, **A.**, Elming, W., and Shaw, J. (2017). "The dynamic effects of tax audits." *IFS Working Paper* No. W17/24. London: Institute for Fiscal Studies.
https://www.ifs.org.uk/uploads/WP201724.pdf

3.3 Advani, **A.**, Elming, W., and Shaw, J. (2019). "The dynamic effects of tax audits." *Warwick Economics Research Papers Series* (*TWERPS*) No.1198. Coventry: University of Warwick. Department of Economics. http://wrap.warwick.ac.uk/119640/

3.4 Advani, A. (2020). "Who does and doesn't pay taxes?" *Warwick Economics Research Papers Series* (*TWERPS*) No.1321. Coventry: University of Warwick. Department of Economics. http://wrap.warwick.ac.uk/147262
Also to appear in *Fiscal Studies: The Journal of Applied Public Economics*, 2021.
doi:10.1111/1475-5890.12257

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4. Details of the impact (indicative maximum 750 words)

Influencing central government resourcing for HMRC

The findings of Advani's research had direct impact on the resourcing of tax audits.
In partnership with *The Spectator* and *New Statesman* magazines, Advani organised panel events at the Conservative and Labour Party conferences in autumn 2019 to present his work to a policymaker audience. Jesse Norman MP (Financial Secretary to the Treasury) was a panellist at the Conservative Party event, enabling Advani to draw his attention to the value of

audits for raising income. He also made contact with Tim Leunig (Economic Advisor to the Chancellor) through the event, and subsequently had meetings with Norman, Leunig and other Treasury officials to discuss the implications of his research for HMRC resourcing in the context of the number of audits they should be doing. [**5.1**]

Building on Advani's work, the Treasury asked HMRC to provide costings for an expansion of compliance staff across a range of taxpayer groups. In the spring 2020 budget, the Chancellor committed to providing HMRC with the resources to employ 1,300 additional auditors, which is expected to bring in an average of GBP770,000,000 per year over the next five years (GBP3,900,000,000 in total), or almost GBP600,000 a head. [**5.1**]

Shaping HMRC practices

Advani discussed the research findings with senior members of the HMRC Tax Gaps and Compliance teams. He presented the findings to high-level HMRC staff, including the Permanent Secretary and other senior directors, in December 2017, providing "… sound evidence around different options HMRC could pursue" (Jim Harra, Director General, HMRC Customer Strategy & Tax Design), and offering "new insights about self-assessment taxpayer behaviour and the impact of HMRC's compliance activities [that] will have value both within and outside of HMRC" (Kevin Fletcher, Director, HMRC Knowledge, Intelligence & Analysis Unit). [**5.2**] In March 2020 Advani also discussed the implications of his work with Ruth Stanier, Director General of Customer Strategy and Tax Design at HMRC, having been put in touch directly by Tim Leunig.

[**Text removed for publication**]

The research is also referenced in the Office for Statistics Regulation's 'Compliance check on HMRC measuring tax gap statistics' as an example of innovative use of HMRC data. It recommends that HMRC publish links between its data and resulting research, specifically mentioning Advani's research, to help promote greater use of its Datalab. [**5.5**]

Informing opposition party policy and third sector campaigning

The research informed the development of the Labour Party's tax policy ahead of the 2019 general election. Following the Labour Party conference event, Advani was contacted by economic advisors to the then Shadow Chancellor, John McDonnell, [**Text removed for publication**].

Later that day, McDonnell gave a speech in Parliament during a debate on tax avoidance and argued the need for increasing the number of targeted audits, referencing the same research findings drawn on in the Fair Tax Programme. [**5.6**]

Tax Justice UK also drew on Advani's work in its Manifesto for Tax Equality, published at the start of the 2019 general election campaign to urge political parties to address tax inequality and avoidance by resourcing HMRC to increase targeted audits. [**5.8**]

Informing international tax practice and wider debate

The influence of the research has had an international reach. Advani presented his work to representatives from the Norwegian Tax Authority in May 2018 and had follow-up discussions with them later in the year, helping to inform their subsequent study to understand the long-term effects of tax audits in Norway. [**5.9**]

Advani has also presented his work to tax administrators from four states in East India (West Bengal, Mizoram, Sikkim, and Assam). He has had email discussions with the New Zealand and Ethiopian tax authorities about learnings that might be relevant for them and spoke to officials from the South African Revenue Service in March 2020 about improving their measures of

compliance.

Furthermore, Advani's work was cited by the Abdul Latif Jameel Poverty Action Lab and in the IFS Green Budget 2018 to highlight the value of targeted audits. The latter was subsequently used by the OECD to call for more targeted audits in its UK Economic Survey report. [**5.10**]

5. Sources to corroborate the impact (indicative maximum of 10 references)

5.1 Supporting Statement email from Tim Leunig, Economic Advisor to the Chancellor, HM Treasury (March 2020).

5.2 Letters from Kevin Fletcher, HMRC Chief Economist (November 2017), and Jim Harra, Second Permanent Secretary of HMRC and Tax Assurance Commissioner (December 2017).

5.3 Supporting Statement email from Economic Advisor (Tax Compliance) at HMRC (September 2020).

5.4 'Tackling the tax gap', National Audit Office (NAO) Report - acknowledging Advani's contribution on p.56 (July 2020). Combined with **Supporting Statement** from NAO Director of HMRC Value for Money (September 2020).

5.5 Letter from Office for Statistics Regulation to HMRC -acknowledging **3.1** in Recommendations 4(e) and 5 (May 2019).

5.6 Citations in the Labour Party's Fair Tax Programme. Combined with **transcript** of John McDonnell's Parliamentary speech (25th February 2020).

5.7 Testimonial email from John McDonnell MP's office (March 2020).

5.8 *A Manifesto for Tax Equality,* Tax Justice UK, p. 12, (November 2019).

5.9 Slides from Norwegian Tax Authority presenting results from a Study into the Effects of Tax Audits in Norway and citing Advani's research (March 2019)

5.10 Combined **report citations**: Increasing accountability and reducing corruption through government audits*, Abdul Latif Jameel Poverty Action Lab (August 2020); The IFS Green Budget, Institute for Fiscal Studies, p. 189 (October 2018); OECD Economic Surveys UK, OECD, reference to IFS Green Budget, p.54 (October 2020).