

Softly, softly...

Nudge letters are a powerful tool for tax compliance, says Sarah Mawson

It's no secret that HMRC's use of nudge letters has become a key method in their attempt to improve tax compliance. These letters are designed to encourage taxpayers to self-correct errors in their tax affairs. While these letters can appear as a friendly reminder, their growing use signals a shift toward a more active HMRC with a renewed focus on upstream compliance. In this article, we explore the purpose of nudge letters, their effectiveness, and examine some of the ongoing campaigns that HMRC is focusing on in 2025.

What are nudge letters?

Nudge letters can be sent to taxpayers where HMRC identifies potential discrepancies or areas where they may be failing to meet their obligations. The letters are typically not punitive, but are intended to 'nudge' individuals toward voluntarily disclosing any tax errors or omissions, often via different routes.

Effectiveness of nudge letters

The aim of nudge letters is to prompt taxpayers to review their tax records and take corrective action before HMRC needs to intervene. These letters can be particularly effective when it comes to self-assessment taxpayers, who may overlook or misunderstand their obligations. By making the process less daunting and presenting taxpayers with clear guidance, HMRC hopes to increase accuracy. The letters are seen by HMRC as a cost-effective way to improve compliance, and their use is expected to continue growing in the coming years.

HMRC's nudge letter campaigns have been highly effective in prompting voluntary disclosures, where necessary. However, the 'where necessary' is key. Many incorrectly assume that when a taxpayer receives a nudge letter that there is certainly a disclosable position. On the contrary, based on personal experience, a number of clients who received a nudge letter did not in fact have anything 'wrong' with their tax affairs.

HMRC uses data from their Connect system which employs sophisticated algorithms and data matching techniques to identify inconsistencies or discrepancies that may indicate non-compliance. By cross-referencing data from various sources, HMRC can pinpoint individuals or businesses that may be underreporting income, overclaiming expenses or engaging in other forms of tax evasion. However, this is not always accurate.

The nudge campaigns allow HMRC to send a large volume of letters to taxpayers, via a 'one-to-many' approach, based on this Connect data. The minimal review on an individual level, does mean that some taxpayers who receive a nudge letter have nothing to correct. It is therefore imperative that anyone in receipt of a nudge letter seeks support from a tax specialist to review their tax affairs and advise them if a disclosure is in fact required.

Current trends

Nudge letters can help HMRC identify patterns of non-compliance across different sectors, leading to more focused enquiries and investigations. For this reason, HMRC uses nudge letters in various campaigns, targeting different sectors and types of taxpayers. Below are just some of the current areas that we've seen HMRC focus on.

Wealthy individuals

In recent years, HMRC has focused on individuals who may not have reported all their income, especially those who earn money through gig economy work, freelance jobs or renting out property. In these cases, HMRC is particularly keen on ensuring that taxpayers report all their sources of income, including any that might have been missed or under-reported.

In Autumn 2024, HMRC sent a batch of nudge letters to wealthy individuals earning over £200,000 a year, who were not registered for self-assessment, received a Notice to File a return for 2021/22 but did not submit one, and those who have never been registered for self-assessment. If non-compliance is identified on receipt of such a letter, Failure to Notify penalties could be applicable.

Undeclared rental income

HMRC continues to focus on rental income, with the 'Let Property Campaign' aimed at individual landlords who have not declared their rental income. In many cases, landlords are unaware of their obligations to pay tax

on rental income or fail to report the full extent of their earnings. HMRC typically sends these letters after detecting that rental income is being underreported or omitted, often after a pattern of behaviour is identified through third-party data, such as online letting platforms or estate agents.

Cryptocurrency and digital assets

With the rise of cryptoassets, HMRC has intensified its focus on digital asset traders. Many individuals who trade cryptoassets fail to understand their tax liabilities, with many mistakenly assuming that trading, or investing in, digital assets is not taxable.

In this area, nudge letters serve as an early intervention strategy. They are typically sent to individuals who have engaged in cryptoasset trading but have not reported it on their tax returns. These letters remind taxpayers that cryptocurrency is treated like any other asset for tax purposes, and any gains from its sale or exchange are subject to tax.

Cross tax non-compliance

Since 2022, and more recently in 2024, HMRC focused on areas such as Electronic Sales Suppression and businesses selling goods via online marketplaces. HMRC has used nudge letters in this area to remind businesses of the VAT registration requirement and encourage them to register voluntarily. Letters often target businesses that have a taxable turnover close to, or above, the VAT threshold but have not registered for VAT.

New for 2025, HMRC is turning its attention to private equity firms, with nudge letters asking firms to review their procedures to ensure they are following HMRC's guidance on VAT for the Private Equity and Venture Capital sector. Key risk areas for HMRC in this sector include the extent to which a Private Equity VAT Group's outputs are supplies for consideration made in the UK, in addition to the partial exemption methodology used by firms and whether this is appropriate.

Offshore tax issues

HMRC has long had an active campaign against offshore tax evasion or avoidance, targeting individuals who they consider have not reported income earned abroad, or who may be claiming that this foreign income is exempt from UK tax.

As part of this ongoing crackdown, HMRC continues to send nudge letters to individuals suspected of having undeclared foreign income or assets. These letters remind individuals of their potential obligations to UK tax and encourage them to disclose any missed, or under-reported, income through HMRC's 'Worldwide Disclosure Facility'.

HMRC is particularly keen to identify individuals who may be using complex offshore structures to evade/avoid tax, and nudge letters are one of the first steps in this process. Taxpayers need to take particular care in disclosing offshore income and gains, due to HMRC's punitive penalty regime for offshore non-compliance.

Conclusion

HMRC's nudge letters are a critical part of their broader tax compliance strategy. By sending reminders to taxpayers, and offering the chance for voluntary disclosure, HMRC hopes to increase self-compliance and reduce the burden of enforcement actions. The campaigns currently in focus highlight the range of issues that nudge letters address.

While nudge letters are generally non-punitive, they can act as a precursor to more serious enforcement actions. HMRC uses them to gauge the level of non-compliance and to identify areas where further intervention may be needed. Taxpayers who ignore these letters risk facing more severe consequences, including increased penalties.

For taxpayers, the key takeaway is for them to stay vigilant about their tax obligations and respond to any nudge letters received. It is also vital to get expert advice to understand the disclosure options available, particularly where protection from criminal prosecution is required.

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