

Mind the tax gap

Nicola Kelleher explains the ways by which HMRC can close the tax gap

The tax gap was estimated at £39.8 billion or 4.8% of tax owed in 2022/23. This gap represents the difference between the amount HMRC is expected to collect and what it actually collects. The National Audit Office (NAO) has recommended improvements for HMRC to reduce the size of the tax gap. So, what could this mean for future compliance activity?

In November 2024, the National Audit Office, the UK's independent public spending watchdog, produced ['An Overview of the impact of fraud and error on public funds for the new Parliament 2023/24'](#).

This report estimates the size of the UK's tax gap at £39.8 billion for 2022/23 and offers insights to help those who manage and govern public bodies to improve public services.

HMRC's strategy to close the tax gap and tackle error and fraud has shifted in recent years, moving away from traditional 'respond' techniques (e.g. statutory enquiries) and towards 'promote and prevent' activity (e.g. one-to-many approaches, also known as nudge letters), which aim to provide a wider solution to a volume problem.

Over 60% of the tax gap (£24.1 billion) relates to small businesses. This has increased year-on-year since 2017/18, when small businesses accounted for 37% of the tax gap. While HMRC may be getting better at identifying error and fraud, and therefore increasing the values identified, the uplift suggests they are also getting worse at prevention.

The NAO report highlights three main ways that HMRC can receive more of the tax revenue it is due and, in doing so, reduce the size of the tax gap.

1. Ensure that HMRC understands the impact of its compliance work, including relative rates of return, so that it can target activities to bring in the most tax revenue.

The NAO repeated comments from its 2022 report, 'Managing tax compliance following the pandemic', that while there is "little doubt that HMRC's compliance work offers good value for money", "the compliance yield measure needs to be sufficiently robust and transparent to instil confidence in the absolute levels of return it can generate".

2. Make it easier for taxpayers to comply and get help, so they pay the right amount of tax.

It is well publicised that contacting HMRC by phone has become increasingly difficult and frustrating for taxpayers and agents alike. The NAO repeated its earlier findings that "around a third of calls to HMRC advisors weren't answered in 2023/24, falling short of HMRC's target to answer 85% of calls."

3. Ensure that tax rules are well designed and straightforward.

The NAO signposted its 2024 report 'Tax measures to encourage economic growth', which discusses the way government evaluates tax reliefs. It found that more focus is needed to assess whether reliefs are working, with prompt action required to address fraud and error in the system.

HMRC investigations

With a large proportion of the tax gap relating to small businesses, it would be reasonable to expect HMRC staff to focus their compliance efforts on closing the tax gap in this area.

HMRC has increasing volumes of data available both internally and externally, such as banking information via the Common Reporting Standard and its own intelligence gathering system 'Connect', which contains over 50 billion lines of data.

While it is encouraging to see HMRC use the information available to tackle error and fraud, there will always be a degree of collateral damage that occurs when there has not been accurate interrogation of the data to identify problems.

Labour's first Budget announced its commitment to additional funding to close the tax gap. This will include overhauling HMRC's IT system to improve its debt management and ensure tax debt enquiries can be dealt with faster, hopefully improving the productivity of the organisation.

Some 5,000 additional compliance staff will also be recruited, and 1,800 debt management staff will also be maintained and recruited. HMRC's services will be also digitised to make it easier and simpler for taxpayers to self-serve and manage their tax affairs.

Spring Statement 2025

Within the 2025 Spring Statement it was estimated that unpaid tax liabilities had grown to £44 billion at the end of December 2024, which is more than double the level from five years ago.

The 2025 Spring Statement provided further investment from the Exchequer to assist with closing the tax gap. Further funding for HMRC over the coming five years was announced, confirming that £87 million will be used for private debt collection services, presumably this is to focus on the £20 billion of outstanding tax debts that are currently over 12 months old and comes alongside an announcement for a 'test and learn' pilot to collect more aged debts, in an effort to move towards more automated debt recovery.

In addition to this, there will be a further £114 million to bolster staff for HMRC to recruit 600 people into debt management and £100 million for further compliance staff, this is with the intention to raise over £1 billion in additional gross tax revenue per year by 2029/30.

We can also expect to see HMRC utilising their criminal investigation powers more often, with a target to increase annual charging decisions by 20% by 2029/30. Focus will be on fraud committed by the wealthy, complex money laundering and fraud facilitated by those in large corporations, along with complex money laundering schemes and those who enable others to hide money offshore.

These focused, strategic measures and additional resource are intended to support HMRC to close the UK's tax gap by bringing in an additional £7.5 billion over the next five years. Labour states that the revenue will go directly to funding UK public services and fixing the foundations of the economy.

This increase in resource will presumably assist HMRC in addressing the NAO recommendation that HMRC needs to improve its ability to help customers comply and get the right level of help. Without this support, and while tax rules remain complex, there are bound to be people who do not pay the correct amount of tax, whether that be through genuine misunderstanding or deliberate conduct.

The report also recommends HMRC should focus resource where it will have the biggest impact. Therefore, it seems that small businesses will be under HMRC's spotlight. Dealing with any kind of HMRC investigation is a headache that most small business owners can do without.

How Crowe can help

Crowe can help you understand your tax obligations, provide guidance on how to manage any risks and guide you on the documentation you should be retaining to evidence any decisions the business is making.

For more information, get in touch with a member of Crowe's Tax Resolutions team.

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