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**Evaluation of HMRC anti-avoidance and
operational measures**

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Evaluation of HMRC anti-avoidance costings and operational measures

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Abstract

Governments have introduced over a hundred anti-avoidance and operational measures since the OBR's formation in 2010, and we consider the prevalence and increasing reliance on the relatively uncertain revenue from these to be a potential source of fiscal risk when compared to the relatively certain costs of tax cuts.

In this paper we consider the costings for 19 HMRC anti-avoidance and operational measures announced between 2012 and 2016, evaluating them within six relevant categories. In five of these categories the costings have fallen short of the original estimates – by amounts that vary between 15 and 65 per cent. Since most of these costings were chosen for evaluation because we knew they had proved inaccurate, the results are not necessarily representative of all such measures. But we draw broader conclusions by considering these new evaluations alongside the results from more than 80 measures that we have now evaluated. The number of measures that have yielded more than expected is broadly similar to the number that have raised less. However, for those measures with the largest original expected yield, more have under- than over-performed. For operational measures the main conclusion is that it has often taken longer than expected for measures to become fully effective.

The question for us is whether the revealed optimism bias in these larger costings is explained by something that we need to account for in future measures. Is there one or more aspect in these costings that consistently explains the shortfall? The answer appears to be 'no', with a variety of explanations specific to each costing. So while there are many lessons that can be learnt, there is no simple adjustment factor that could be applied to overcome the apparent bias.

I would like to thank analysts from HMRC for their assistance with this evaluation and also colleagues at the Office for Budget Responsibility.

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1 Introduction

The OBR and the costings process

- 1.1 The Office for Budget Responsibility (OBR) was created in 2010 to provide independent and authoritative analysis of the UK's public finances. To that end we produce two 5-year-ahead forecasts for the economy and the public finances each year, alongside the Budget and other fiscal statements. In each of these forecasts we need to estimate and explain the likely fiscal impact of any newly announced tax and spending policies.
- 1.2 Although we are ultimately interested in the aggregate fiscal impact of all the policies announced in each statement, in the interest of transparency it is helpful to show the impact of individual measures. Alongside each statement the Treasury publishes a 'scorecard' showing a measure-by-measure impact on public sector net borrowing. Under the *Charter for Budget Responsibility*, the Treasury is free to decide which measures to include in the scorecard and what costs or yields to attribute to them. In practice, it does so after a detailed process of scrutiny and discussion with the OBR and officials from the department responsible for implementing the policy – primarily HM Revenue and Customs (HMRC) for tax changes and the Department for Work and Pensions (DWP) for welfare measures.
- 1.3 The policy costing will include the static impact of the policy (i.e. the impact we would see in the absence of any resulting change in behaviour), plus the direct impact of 'first round' behavioural effects. Take the example of an increase in an existing duty rate: the static costing takes the current level of consumption (the tax base) as fixed and applies the duty increase; but typically, individuals respond to a price rise by lowering their consumption and this is captured as a behavioural effect in the final costing.¹
- 1.4 Once we deem a costing to be reasonable and central it is given a formal certification. At each fiscal event, we publicly state whether we believe that each of the Treasury's published costings are reasonable and central. This is normally done in Annex A of our *Economic and fiscal outlook (EFO)*, which is reproduced in the Treasury's *Policy costings document*.
- 1.5 We then incorporate these costings (or, if we disagreed with the Treasury's published scorecard, our preferred ones – something we have not yet found necessary) in our forecasts, together with the impact of any relevant policy measures that the Treasury chooses not to present on the scorecard. We also consider broader 'second round' macro-level behavioural effects resulting from individual policies or the policy package as a whole. In doing so, our goal is to end up with the best central forecast for the public finances that we can, given the information available, incorporating the expected impact of all

¹ More information on the costings process and costings methodology is presented in our *Briefing Paper No.6: Policy costings and our forecast*, available on our website.

announced policy decisions. We do not include the effect of policy goals or ambitions for which the Government has yet to decide precisely how it intends to achieve them. In such cases, we note them as fiscal risks to the forecast, as required by the *Charter*.

- 1.6 To be transparent about the uncertainty around individual policy costings, we assign each a subjective uncertainty rating. These range from 'low' to 'very high' and are based on our assessment of the uncertainty arising from each of three sources: the data underpinning the costing; the complexity of the modelling required; and the possible behavioural response to the policy change. We consider the relative importance of each source of uncertainty when determining the overall rating.²
- 1.7 Estimates of the tax revenue from anti-avoidance measures tend to be subject to high levels of uncertainty since they target specific subsets of taxpayers who are already actively changing their behaviour to lower their tax liabilities. As a result, there is usually relatively high behavioural uncertainty. Similarly, since the measures are directed at uncollected tax, there is usually less reliable data available to inform the costing.
- 1.8 Operational measures are those where HMRC is receiving funding on top of its Spending Review settlement to increase tax revenue or make savings in the tax credit and child benefit systems from additional compliance activity or enforcement powers. If the funding for these activities is not additional, and shown on the Treasury's scorecard, then we consider any yield or savings to be essentially captured within HMRC's existing compliance activity – i.e. if the funding is not additional, the activity must have an opportunity cost by displacing some other activity that would have been funded instead. Operational measures have their own set of uncertainties, often relating to time delays between announcement and implementation and problems with delivery, especially where new IT is involved.
- 1.9 Chapter 3 shows that anti-avoidance and operational measures have typically received one of our higher uncertainty ratings when compared to other measures.
- 1.10 It is important to remember that each certified measure represents our central estimate of the costing, regardless of the level of uncertainty: there remains a 50 per cent chance that the measure saves or costs more and a 50 per cent chance that it saves or costs less. Others of course may differ in their views of the central estimate or degree of uncertainty around it, with the scope for different views likely to be greater for more uncertain costings.

Reasons to evaluate

- 1.11 The OBR's remit includes a requirement to assess the accuracy of our previous forecasts. We do this annually in our *Forecast evaluation report (FER)*, where we compare the latest outturn data for the economy and public finances to our earlier forecasts and try to explain the differences and to identify any lessons that can be applied to future forecasts. One source of

² Our uncertainty ratings can be found in Annex A of each *EFO*, with the detailed breakdown of how we arrive at the judgements available in a database on our website.

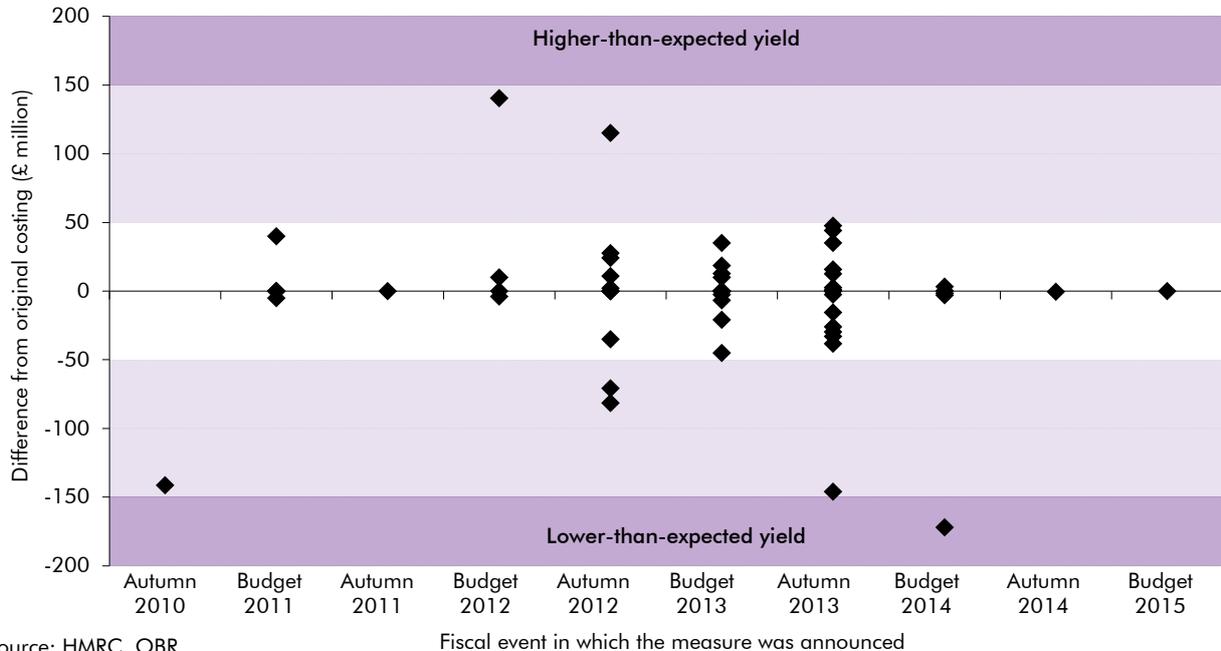
potential forecast difference is that original estimates of policy costings proved inaccurate, so the same rationale can be applied to evaluating costings.

- 1.12 Until a policy has been implemented, we continue to monitor the costing and update it in subsequent forecasts to reflect new evidence, changes to our underlying forecasts or changes in policy design. We report any significant changes to costings in Annex A of our *EFO*. Once a policy has been implemented, its impact is usually captured in outturn data that feeds into the forecast baseline, so an updated costing is usually not required. With the stock of past policy measures ever-growing – close to 800 since the OBR’s formation – it is also not practical to update the estimated effect of every measure. However, we continue to monitor larger measures, especially those that we have identified as particularly uncertain, and will make adjustments to our forecast if the evidence suggests that is necessary.
- 1.13 There has been specific interest in evaluating anti-avoidance policy measures from the Treasury Select Committee (TSC). In its report on Autumn Statement 2013, the TSC recommended that *“the OBR should do all it can to report on whether yields [from anti-avoidance measures] were attained as originally costed.”*
- 1.14 As we noted in our 2017 *Fiscal risks report*, one source of risk to our forecasts is the need to include the estimated effect of newly announced policies, in particular the relatively uncertain yield from anti-avoidance and operational measures to meet the relatively certain costs of tax cuts. As these types of measures are inherently uncertain, there is more value to be gained from evaluating their effects on a more systematic basis. The lessons we learn can then help inform judgements on similar measures in the future.
- 1.15 In our first comprehensive evaluation we considered 60 measures announced between 2010 and 2015. By number of measures, we found no systematic bias in the overall revenue expected – the numbers of measures that under-performed were broadly matched by the number that over-performed.³ But in value terms, the errors were dominated by the large shortfall in the expected yield from the UK-Switzerland tax agreement. Abstracting from that single measure, there was no strong evidence of systematic bias by value. Chart 1.1 shows the main results from the previous evaluation, excluding the Swiss agreement.
- 1.16 For this evaluation we have been selective in the measures to evaluate, mostly choosing those where we were already aware that the original costing was inaccurate and have adjusted subsequent forecasts to reflect that. The objective has been to understand the reasons behind those known differences so that any lessons can be learnt. Unlike our comprehensive first evaluation, the results of this one cannot be extrapolated to draw conclusions about anti-avoidance and operational measures *in general* or *on average*. That said, looking across both evaluations suggests that, among the larger measures, more have under- than over-performed. The reasons for the shortfalls vary considerably, suggesting that the revealed optimism bias in these costings is not down to a common factor (beyond them all being relatively complicated and based on limited information). So while there are many lessons that can be learnt, there is no simple adjustment factor that could be applied

³ Johal and Sousa (2016): *Working Paper No 9: Anti-avoidance costings: an evaluation*, available on our web site.

to overcome the apparent bias. We will therefore need to continue to assess the assumptions underpinning each step of any new costing on a case-by-case basis.

Chart 1.1: Results from our 2015 evaluation: difference between original and revised estimates of average revenue per year (excluding UK-Swiss tax agreement)



Source: HMRC, OBR

Fiscal event in which the measure was announced

1.17 Our previous evaluation also found that a number of operational measures were optimistic about timing and delivery and so underestimated the time it would take before a measure became fully effective. This is another lesson we have incorporated into our scrutiny of new measures – for example we consider the appropriateness of the contingency included in delivery timetables. Absent such contingency margins, the risks around the timely implementation would lie in one direction.

Structure of the paper

1.18 The rest of the paper is structured as follows:

- **Chapter 2** presents the methodological approaches we have used and the types of measures that we evaluate;
- **Chapter 3** describes the trends in anti-avoidance and operational measures since 2010 and discusses the relatively high uncertainty behind their costings;
- **Chapter 4** reports our results; and
- **Chapter 5** draws some conclusions.

2 Methodological approach

Introduction

- 2.1 Our approach to evaluating the costing of anti-avoidance and operational measures is similar to the approach we take to the evaluation of forecast differences in our annual *Forecast evaluation report (FER)*. Our main objectives are to identify the source of differences between costings and outturns, to understand why they occurred and to apply the lessons we learn when similar issues arise in future costings.
- 2.2 One key difference to the *FER* is the level of granularity required to understand differences in costings compared to differences between forecasts and outturns. While the focus in a costing evaluation is narrower, the richness of available information is often insufficient to allow us to decompose changes as we do with a forecast. This is especially true for those measures that are still at a relatively early stage of implementation or where it is difficult to isolate the effect of a single measure among many. Similarly, isolating the effect of a measure relative to broader developments in the economy or the relevant sector or activity can be difficult.

Costing models

- 2.3 Policy costings are generated from a large number of models that are typically owned and maintained by the individual department responsible for the measure. For this evaluation, the estimates are all generated from HMRC-owned costing models. Models that are frequently used for policy costings are put through an OBR scrutiny process before being approved for use at a fiscal event. When HMRC proposes a significant change to a model, perhaps to reflect new research, it typically presents the updated model to us for approval ahead of a fiscal event.
- 2.4 The Treasury's September 2015 review of the OBR recommended a more systematic approach to the analysis of fiscal forecasting errors, including a review of forecast models. The first of these reviews will be published in our October 2017 *FER*, where we will assess models against the criteria described in our October 2016 *FER*. In assessing the performance of a costing model, we use a similar approach, considering:
- **Accuracy:** how well does the model match outturns?
 - **Plausibility:** how well do the model outputs align with theory and experience? Does the model reflect the underlying tax or spending system?
 - **Transparency:** how easily can the model outputs be understood and scrutinised?

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- **Effectiveness:** is the model structured in the best way, and with effective quality assurance processes?
- **Efficiency:** can the model be run and quality assured in a short time span?

2.5 Costings for anti-avoidance and operational measures often rely on bespoke models that, due to the nature of the activity being modelled, might not perform well against some of these criteria, mainly due to poor data availability and/or behavioural uncertainty. Transparency might also be affected for very narrowly focused measures where we are unable to see the underlying data due to restrictions around taxpayer confidentiality. Despite these possible limitations, they are still likely to be the best model available to estimate the yield of such policy measures.

Types of measures

2.6 There are two types of measures that we evaluate in this paper:

- **Anti-avoidance measures:** these provide HMRC with enhanced legislative powers to tackle tax avoidance or evasion. One example is the 'onshore employment intermediaries' measure in Autumn Statement 2013, which sought to prevent people using intermediaries to make false claims of self-employed status to avoid PAYE income tax.
- **Operational measures:** these typically involve enhanced HMRC enforcement and compliance activity, often through additional resources or access to better information. Examples include the various offshore tax agreements entered into since 2010 – these provide HMRC with new information that they can use to better target tax evasion. Some operational measures focus on reducing tax credits error and fraud or improving collection of tax credits debt. An example here is 'error and fraud additional capacity', which brought in private sector support for HMRC compliance activity.

Sometimes an announced measure will include both a change in anti-avoidance legislation and supporting HMRC operational activity.

2.7 There are some anti-avoidance legislative changes that do not appear on the Treasury's scorecard as they are designed to prevent future revenue losses from occurring rather than generating additional yield. For example, HMRC may discover a new avoidance scheme that, if not addressed, would lower future revenue relative to our latest forecast. These 'revenue protection' measures have a zero scorecard costing as their impact has not yet affected outturn data, so does not affect our baseline forecast. Some measures feature a combination of yield and revenue protection and, as part of the costings scrutiny process, we ask HMRC to make the distinction between the two and avoid double counting.

Approaches to evaluation

- 2.8 One of the main difficulties with evaluating any policy costing after the event is knowing what would have happened in the absence of the policy – the ‘counterfactual’. Estimating the counterfactual is not easy, since it is a measure of something that cannot be observed. But, if it can be estimated with reasonable confidence, its inclusion improves the robustness of an evaluation’s results. In some cases, statistical techniques can be used to estimate the counterfactual, but for many anti-avoidance measures there is insufficient detail in the underlying data to allow them to be used. Furthermore, the fact that the Government has introduced several overlapping measures across a number of Budgets and Autumn Statements makes it very difficult to isolate the effects of any single measure.
- 2.9 As a result, the evaluations summarised in this paper are not based on estimating a counterfactual. Instead we rely on HMRC operational intelligence, the monitoring of tax receipts and re-estimating the original costings with updated assumptions and economic determinants. The different methodological approaches we have taken are defined below. The evaluation of a single measure may use more than one of these approaches:
- **Operational intelligence:** this approach relies on consulting with HMRC’s operational officials, who are able to observe the taxpayers targeted by a specific measure, and HMRC’s policy officials, who have detailed knowledge of the measure’s intent and effectiveness. This type of evaluation is most appropriate when the measure relates to a targeted intervention or a change that would be difficult to identify in aggregate receipts. It is also useful in cases where the data are disclosive.
 - **Monitoring of outturn data:** this approach is appropriate for measures that generate accurate, disaggregated, outturn data. Examples include operational measures where the number of notices issued can be monitored or the amount of tax credits debt collected by a private contractor can be measured. It could also apply to a measure that creates a new tax or spending category that can be monitored separately, as with the ‘annual tax on enveloped dwellings’ (ATED). Although these evaluations are more data-driven, they do not use a counterfactual, and so may need further detail to explain changes from the original costing.
 - **Re-estimation of costings:** this approach re-estimates the original costing to reflect initial outturn data, more recent economic and fiscal forecasts or data, and updated evidence on modelling assumptions. These evaluations might be appropriate in cases where the measure has not been in place for very long and/or there have been significant changes to the key parameters. For example, the costing for a measure seeking to raise additional corporation tax receipts would be affected by unrelated changes in the profitability of companies.
 - **Empirical evaluations:** this approach estimates a counterfactual and attempts to isolate the policy impact, including behavioural effects. Such evaluations often make use of econometric techniques to identify causality. As described above, this approach

Methodological approach

requires high quality data and the ability to separate the specific measure from others. These challenges mean we are not able to use this approach very often.

What we are not evaluating

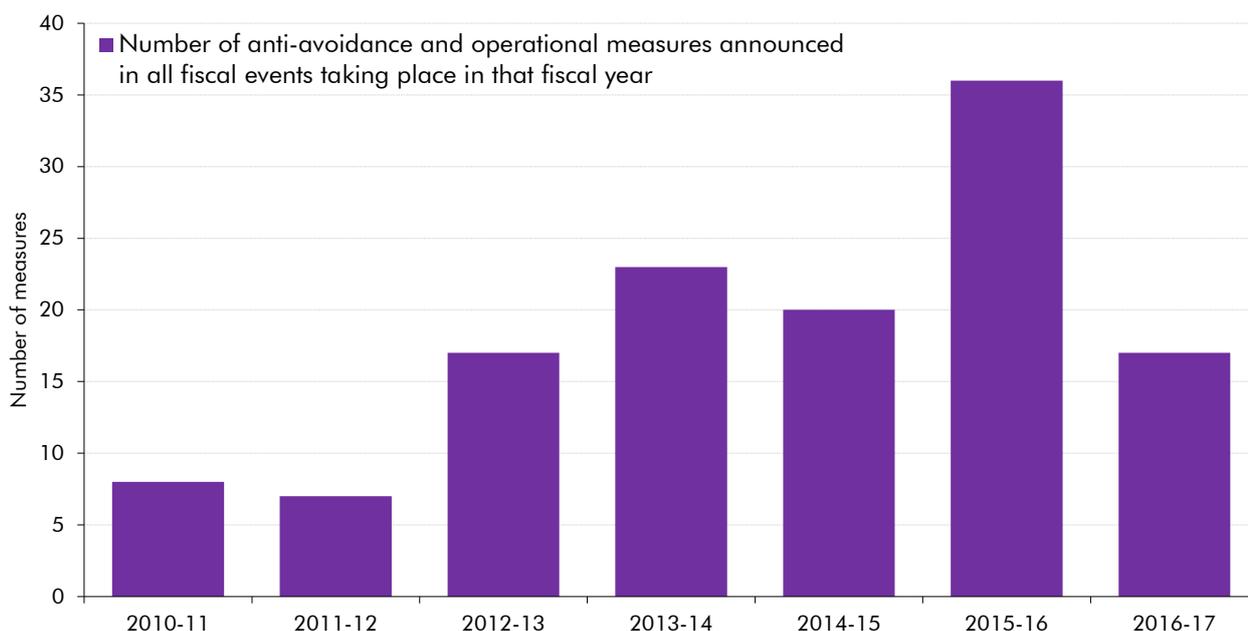
- 2.10 Consistent with the remit set for us by Parliament, our interest is strictly limited to establishing the actual impact of anti-avoidance and operational measures on the public finances – compared to the original costing – and the lessons we can apply to future costings to improve the accuracy of our forecast. We do not evaluate whether the policy was efficiently delivered, whether it met all the stated objectives, whether there were any wider effects or whether it provided ‘value for money’.

3 Anti-avoidance and operational measures since 2010

Trends in anti-avoidance and operational measures

3.1 Governments have introduced over a hundred anti-avoidance and operational measures since the OBR's formation in 2010 (Chart 3.1). As we noted in our 2017 *Fiscal risks report*, we consider the prevalence and increasing reliance on the relatively uncertain revenue from anti-avoidance and operational measures to be a potential source of fiscal risk when compared to the relatively certain costs of tax cuts.

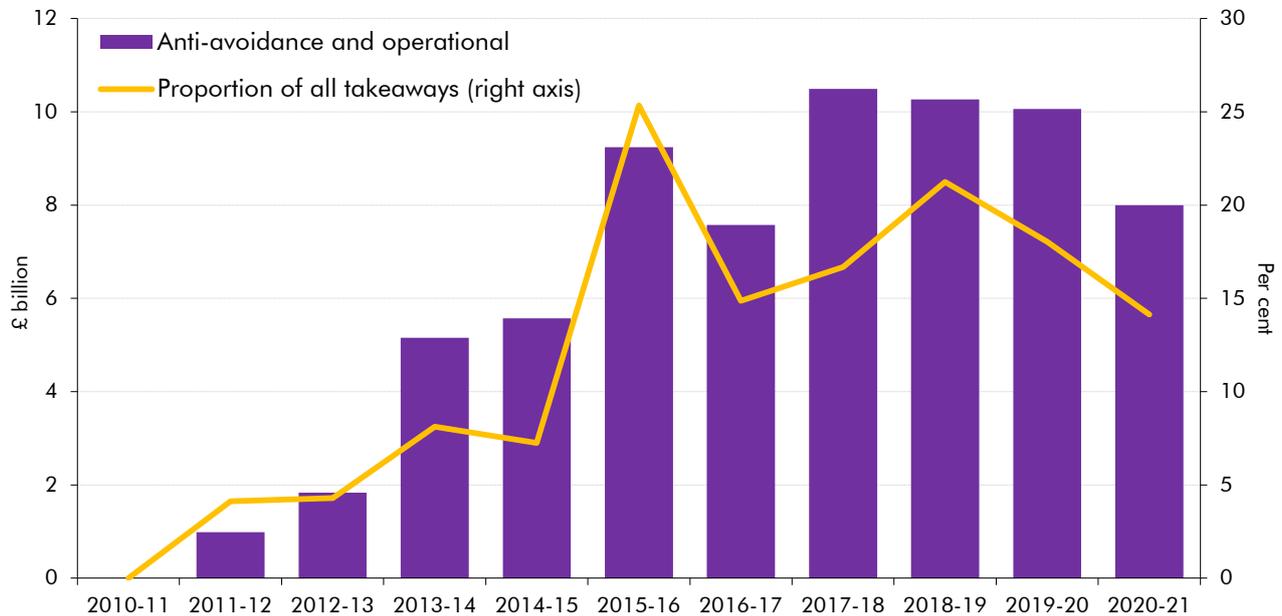
Chart 3.1: New anti-avoidance and operational measures announced by the Coalition and Conservative Governments



Source: OBR

3.2 Chart 3.2 shows the cumulative revenue that was expected to be raised, based on the original costings, is around £10 billion a year in each year from 2017-18 to 2019-20. It also shows that these measures became an increasingly important source of 'takeaways' – i.e. tax raising or expenditure cutting measures – first for the Coalition, and then more strikingly the Conservative Governments. Almost a fifth of the expected yield from takeaways between 2015-16 and 2020-21 comes from anti-avoidance and operational measures.

Chart 3.2: Expected yield from anti-avoidance and operational measures announced under the Coalition and Conservative Governments and proportion of all takeaways

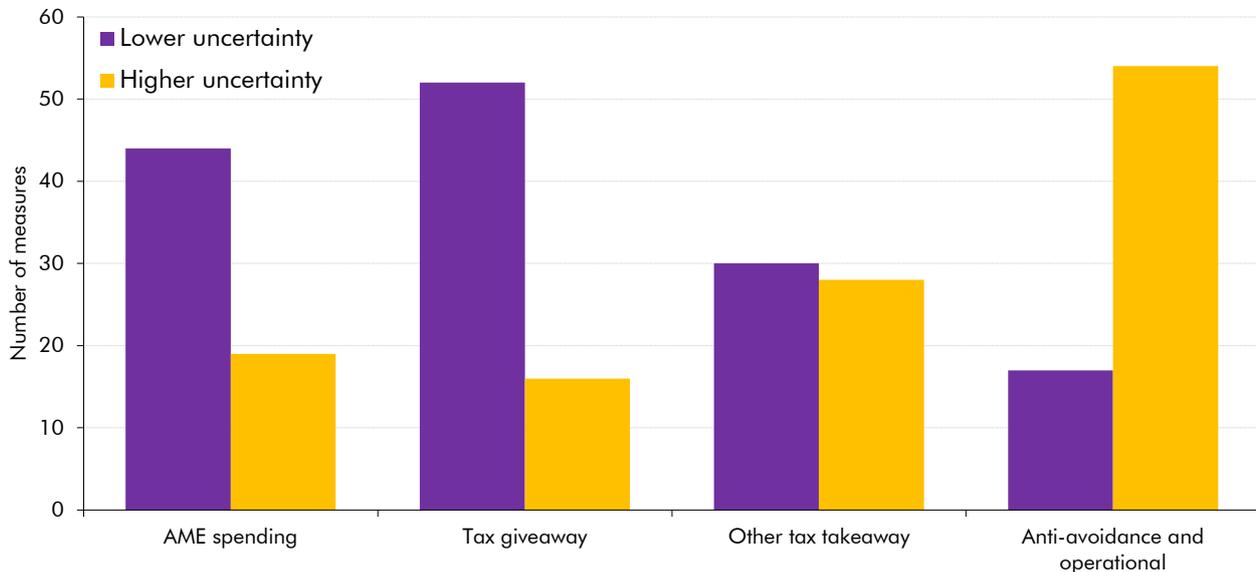


Source: OBR

Uncertainty

3.3 Anti-avoidance and operational measures typically attract our highest uncertainty ratings as they target a subset of taxpayers who are already actively changing their behaviour to lower their tax liability. As a result, there is usually relatively high behavioural uncertainty. Similarly, since the measures are directed at uncollected tax, less reliable data are available to inform each costing. Chart 3.3 shows that we have typically assigned higher uncertainty ratings to anti-avoidance measures than other tax-raising measures. Tax giveaways also tend to be less uncertain than tax takeaways or annually managed expenditure (AME) spending measures (e.g. welfare spending measures).

Chart 3.3: Uncertainty ratings of anti-avoidance and operational measures versus other measures



Note: 'Lower uncertainty' includes our three lowest ratings ('low', 'medium-low' and 'medium') while 'Higher uncertainty' covers our three highest ratings ('very high', 'high' and 'medium-high').

Source: OBR

Behavioural effects

3.4 Delving deeper into the uncertainty ratings reveals that we have generally considered modelling uncertainty for anti-avoidance and operational measures to be relatively low, but that uncertainty around data and, in particular, behavioural effects is relatively high. This makes sense as often a shortage of data makes sophisticated or complex – and therefore more uncertain – modelling impossible, while increasing the reliance on the judgements of HMRC's operational officials in informing adjustments for behavioural effects.

3.5 One distinction between anti-avoidance and operational costings is that the behavioural effect tends to be relatively more important to the former. Behaviour in anti-avoidance costings is often what we term 'attrition' and reflects the expected decline in the yield from a measure that results from firms or individuals discovering new avoidance routes after the measure closes one that has been in use. The choice of attrition rate and its profile reflects the likely behaviour of the groups affected and judgements about the opportunity for other forms of avoidance. Attrition rates will tend to be higher if targeting aggressive tax avoiders or if narrowly targeting a single loophole.¹

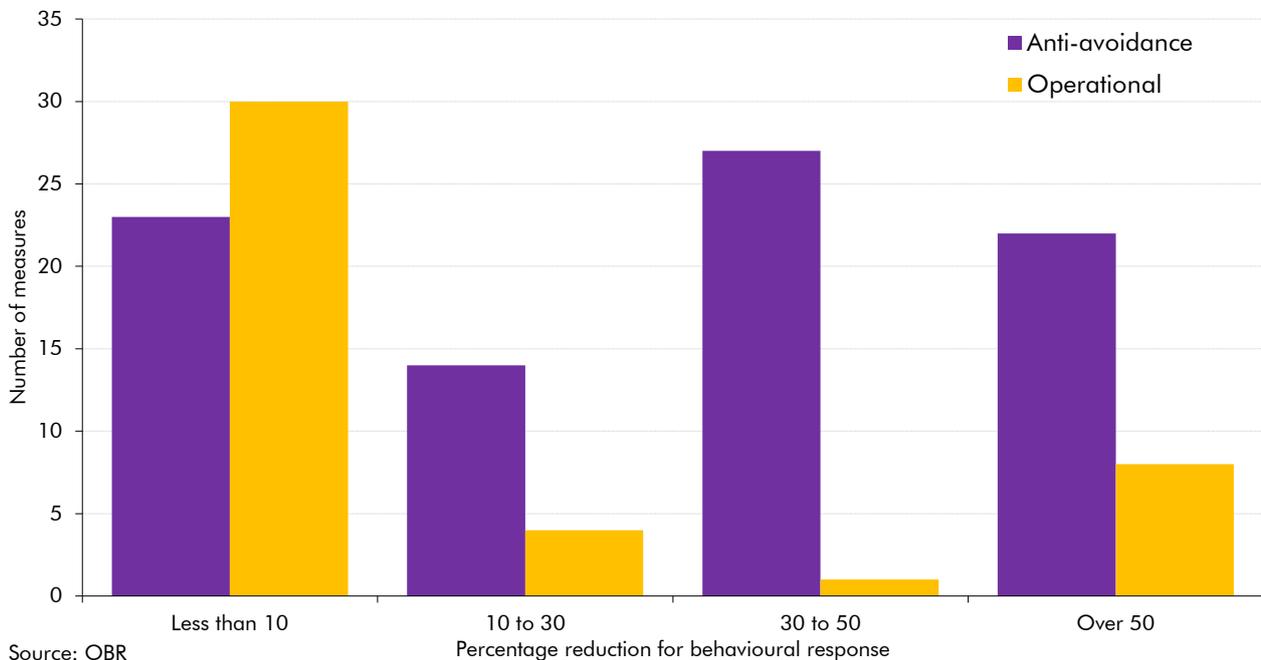
3.6 Forestalling is the bringing forward of income so that it is taxed at a lower rate, and occurs when a Government announces a tax rate increase but delays implementing it. It is less common for anti-avoidance measures, where the legislation often applies from the point of announcement, but there are some examples where a costing has allowed for it.²

¹ For more on attrition, see our *Briefing Paper No.6: Policy costings and our forecast*, available on our website.

² For more on forestalling see Mathews (2016) *Working paper No.10: Forestalling ahead of property tax changes* or Box 4.3 *The effect of dividend forestalling on self-assessment receipts* from our March 2017 *EFO*, available on our website.

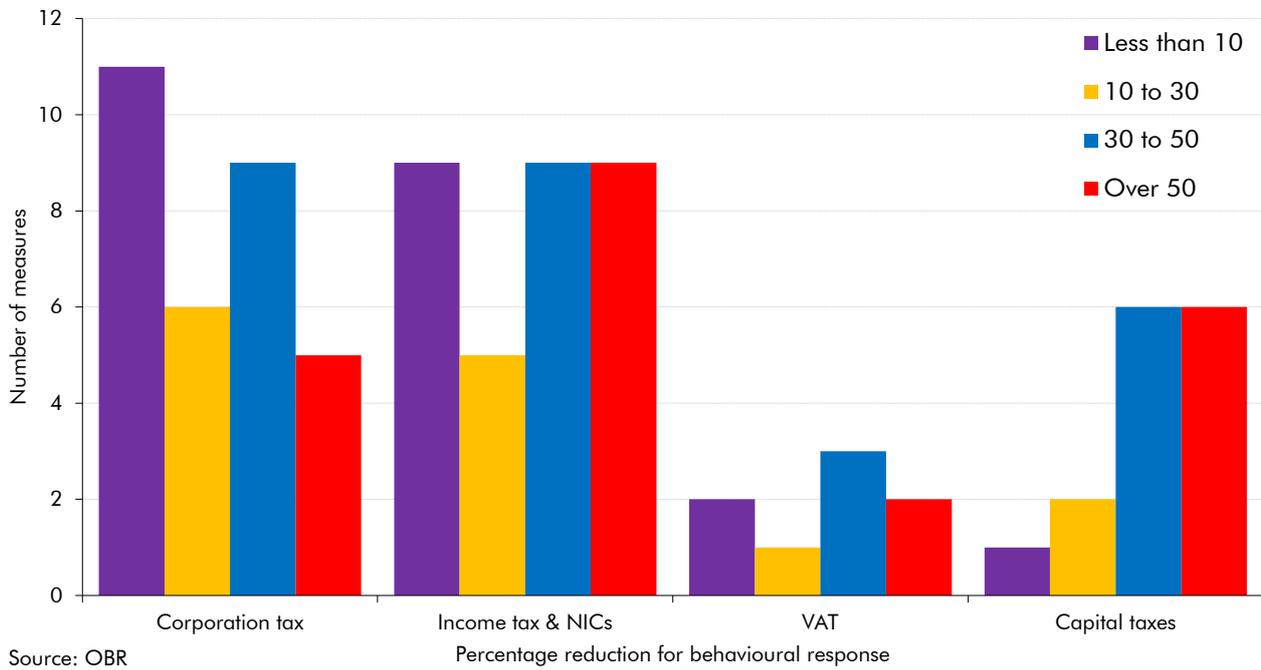
3.7 Chart 3.4 shows that we make significant adjustments to anti-avoidance costings to allow for behavioural responses, lowering the yield relative to static costings. The chart shows the percentage reduction in total yield across the entire scorecard period for each anti-avoidance and operational costing since 2010. For over half of anti-avoidance measures we adjusted the yield down by more than 30 per cent, and for around a quarter, by more than 50 per cent. The chart also clearly shows that behavioural uncertainty is considered less important in operational measures with the majority of costings having very little or no behavioural effect. The operational measures with the highest reductions for behaviour are those involving offshore evasion, which we discuss in Chapter 4, and measures targeting the illicit tobacco and alcohol sectors, both well-known for non-compliance.

Chart 3.4: Size of behavioural effect in anti-avoidance and operational measures



3.8 The split of anti-avoidance measures across different tax groups, shown in Chart 3.5, shows that the pattern is fairly consistent. For measures targeting corporation tax the behavioural effect is over 30 per cent for just under half the costings, while for income tax and NICs and VAT it is well over half, and for capital taxes (capital gains tax, stamp duty and inheritance tax) it is higher still. The size of these behavioural adjustments is one of the main uncertainties when we judge whether the costing for an anti-avoidance measure is reasonable and central.

Chart 3.5: Behavioural effect in anti-avoidance costings for different taxes

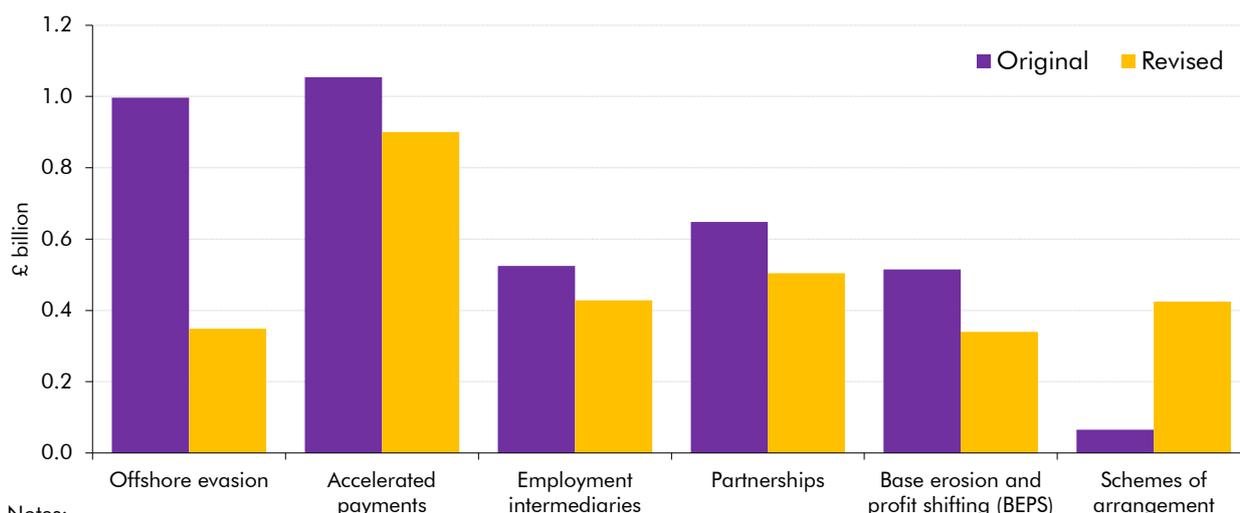


4 Evaluation results

Introduction

- 4.1 We have been evaluating HMRC anti-avoidance and operational measures since 2014 and have now considered around 80 measures. For this exercise, we asked HMRC to provide updates on 37 costings of which 19 are covered in this paper. For the remaining 18 measures there is insufficient outturn data to properly evaluate the costings at this stage, so we will return to them in the future.
- 4.2 We have generally chosen costings with multiple years of outturn data, which means that we already knew some were inaccurate. This allows us to explore the reasons behind the differences in more depth, but is different to our earlier evaluations where the coverage was more comprehensive but less detailed.¹ This means the results are not necessarily representative of all such measures. In Chapter 5 we combine these results with those from previous evaluations to draw broader conclusions about anti-avoidance and operational measures.
- 4.3 Chart 4.1 presents a high-level summary of our findings. Each of the categories shown are discussed in detail in the remaining sections of this chapter.

Chart 4.1: Summary of comparison between original costings and latest estimates



Notes:

Offshore evasion shows average yield per year from 2010-11 to 2016-17.
Accelerated payments shows average yield per year from 2014-15 to 2018-19.
Employment intermediaries shows average yield per year from 2014-15 to 2018-19.
Partnerships shows average yield per year from 2014-15 to 2018-19.
BEPS shows yield for 2016-17.
Schemes of arrangement shows average yield per year from 2015-16 to 2016-17.

Source: HMRC, OBR

¹ The exception to this is the 'base erosion and profit shifting' package where, for some measures, there is less substantive outturn.

Offshore evasion

- 4.1 Since 2009, Governments have announced numerous measures where HMRC has entered into arrangements to bring in revenue from the overseas assets of UK taxpayers. These have had two main features: facilities that provide taxpayers the opportunity to disclose their information to HMRC voluntarily and to settle their tax affairs on relatively favourable terms; and information exchange agreements between the UK Government and countries where offshore accounts are located, with the intention that the loss of anonymity would prompt taxpayers to regularise their affairs as well providing information to enhance HMRC compliance activity and yield.
- 4.2 In this paper, we mainly focus on the three measures announced between 2009 and 2013 involving Liechtenstein, Switzerland and the crown dependencies. Each has now closed and we have near-final outturn data from HMRC.
- 4.3 The **Liechtenstein disclosure facility** (LDF) was set up following an agreement between the UK and Liechtenstein in August 2009. It was initially due to run until 31 March 2015, but was extended to 31 December 2015. Announced at the March 2010 Budget, the measure allowed people with unpaid taxes linked to their worldwide investments or assets – not just those in Liechtenstein – to settle their UK tax liability by disclosing to HMRC via the LDF. This measure was announced before the OBR's formation, so did not go through the costings scrutiny process described in Chapter 1, but it did feed into our initial forecast in June 2010 and also interacts with the yield from the other measures, hence our decision to evaluate it here. The terms of the LDF included a number of incentives to encourage disclosure: for tax liabilities in the 10-year period from April 1999 to April 2009 there were lower penalty rates when compared to disclosing directly to HMRC; and there were some guarantees around protection from criminal investigation and publicity (unless there was evidence of wider criminality). Disclosures were entirely voluntary but after the first two years UK investors with assets in Liechtenstein were sent letters prompting disclosure.
- 4.4 '**Tax repatriation from Switzerland**' was an agreement between the UK and Swiss Governments that was signed in October 2011 and announced as a scorecard measure at Autumn Statement 2012. The agreement ended on 31 December 2016. UK residents with assets held in Swiss bank accounts were given two options: authorise their bank or paying agent to make a disclosure to HMRC; or be subject to a one-off levy covering tax liabilities between 2003 and 2012, plus a future withholding tax on income and gains from 1 January 2013 onwards. Disclosure was generally considered to be individuals' cheaper option, particularly if made via the LDF, which was allowed under the terms of the Swiss agreement. Once a disclosure was made, account holders were expected to submit self-assessment (SA) income tax returns in future years. The cost of the levy for past liabilities was typically higher than disclosure, but enabled the account holder to retain anonymity. It was also the default option if the account holder chose to do nothing. The levy, which was classified as a capital tax by the ONS, came via a deduction from relevant bank accounts, based on a formula negotiated between the two governments. It took place during 2013-14 and was administered by the Swiss authorities. Ahead of that, Swiss banks made an initial

payment of 500 million Swiss francs in January 2013 (£340 million at the exchange rate at the time). The withholding tax also took the form of a deduction and would apply to future gains if no subsequent disclosure was made. The agreement had an inheritance tax element in the event of the account holder's death, which also took the form of a deduction.

- 4.5 **'Tax repatriation from Jersey, Guernsey and the Isle of Man'** was a Budget 2013 measure that set up a disclosure facility with the crown dependencies to support the voluntary declaration of unpaid past UK tax liabilities. It also included information exchange agreements with the crown dependencies whereby HMRC would receive annual financial information on UK-resident account holders, which would be used to generate future compliance yield. The disclosure facility was available to those with assets in the crown dependencies before 2014 and, though similar to the LDF, its terms were somewhat less generous and it did not have the same protection from criminal investigation. It closed at the end of December 2015.
- 4.6 Two smaller yielding measures are the **'enhanced tax information sharing agreement between the UK and the United States of America'**² (announced in Autumn Statement 2012) and **'automatic exchange of information agreements with overseas territories'** (from Autumn Statement 2013). The first included a provision to supply HMRC, from 2015-16, with financial information on the US accounts of UK taxpayers. The second was for the UK to receive similar information, from September 2016, from accounts and assets in Bermuda, the British Virgin Islands, the Cayman Islands, Gibraltar, Montserrat and the Turks and Caicos Islands. Both measures were expected to provide HMRC with relevant data to generate additional yield from compliance activity.
- 4.7 Figures 4.1 and 4.2 show the methodology for the Switzerland and crown dependency costings. Offshore evasion measures have been among the most difficult we have had to scrutinise as each element tends to be subject to a high degree of uncertainty. Both costings started by attempting to estimate the total level of taxable assets – the tax base for these costings. Unsurprisingly, given the long-standing tradition of secrecy and anonymity around offshore accounts, there is little data upon which to base such an estimate. Another difficulty in identifying the relevant tax base was navigating the complexity of some of the investment structures, such as discretionary trusts with large numbers of trustees. To compensate for the absence of reliable data, the costings used a variety of secondary and anecdotal information to narrow the range of plausible figures and settle on what could be certified as a central estimate. From this point a multi-stage, assumption-heavy, modelling approach was necessary to determine how much of the total funds would be liable to UK tax and, in the Swiss case, correctly identified by the authorities.
- 4.8 Another major uncertainty with these type of costings is the behavioural response. Without a reliable evidence base, each costing needed to estimate the proportion of the estimated tax base that would choose to disclose voluntarily, the proportion that would do nothing and the proportion that would choose to move their assets elsewhere ('capital flight'). The decision to disclose voluntarily took into account the advantages, such as lower penalty rates and

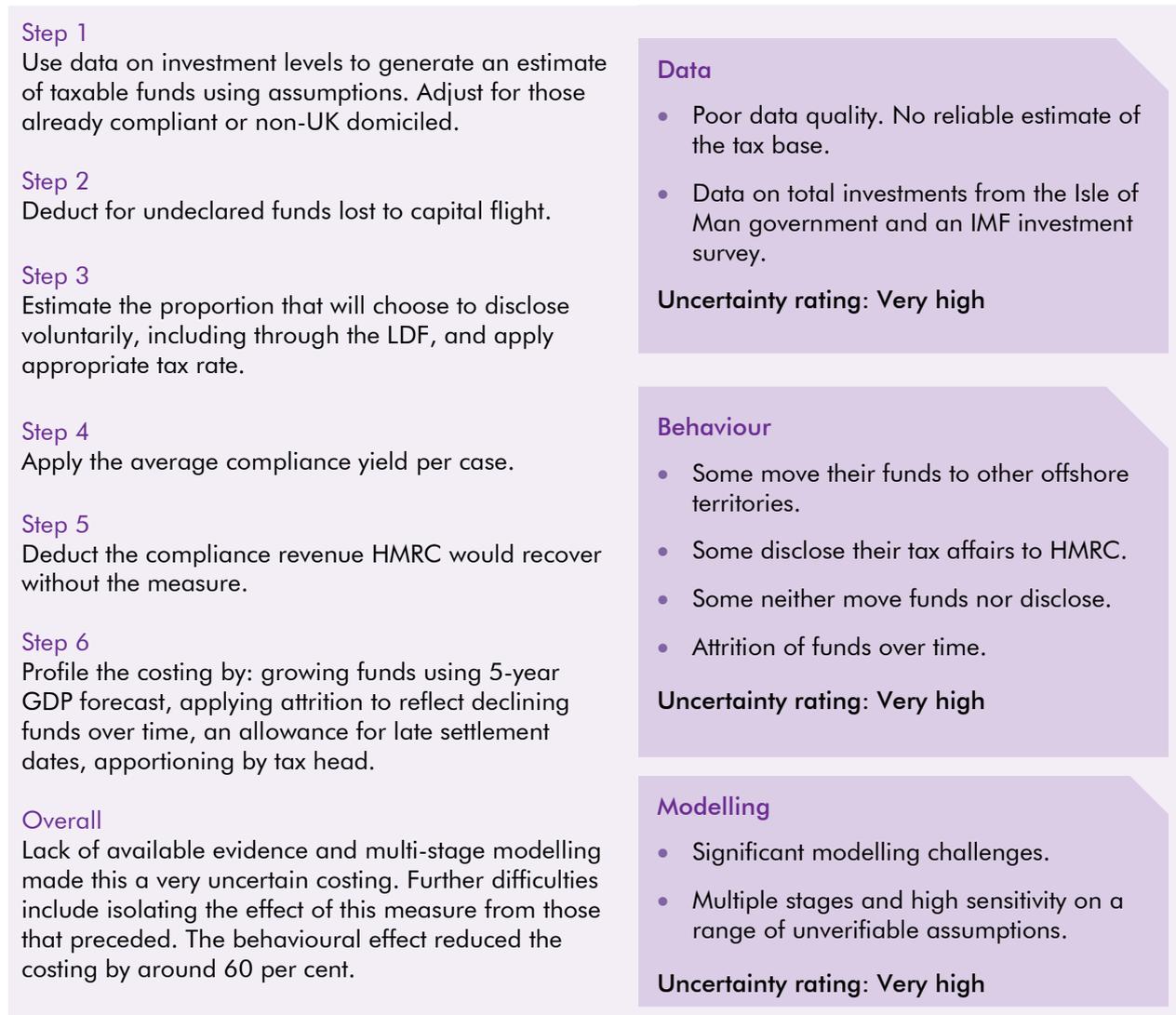
² This measure formed part of a wider package that appeared on the Treasury's scorecard as 'HMRC: anti-avoidance'.

protection from criminal investigation, versus disadvantages like losing anonymity and the amount of tax to be paid. For those that chose capital flight, the costing needed to factor in the diminishing number of favourable destinations as more international agreements were signed. The unpredictability of when someone would choose to make a voluntary disclosure adds a further layer of uncertainty when allocating yield to individual years. The behavioural reductions in these costings were significant at 55 per cent for Switzerland and 60 per cent for the crown dependencies.

Figure 4.1: Tax repatriation from Switzerland costing methodology



Figure 4.2: Tax repatriation from Crown Dependencies costing methodology



4.9 The original costings for the five measures were expected to generate an average of £1 billion a year from 2010-11 to 2016-17. Since the original costings for the three large measures we have learned that:

- **Liechtenstein:** Initially the LDF raised more than expected. Indeed, at the time of the Swiss costing it appeared on track to surpass its original estimate and it seemed that voluntary disclosure under favourable terms had proved sufficiently attractive to overcome the disadvantages of disclosure. At that stage there was also a significant number of registrations that had yet to contribute any yield and the prompted disclosure phase had yet to begin, so significant further yield was expected. Since then, the number of registrations and average value of cases has been lower than expected, although the costing overall has largely met original estimations.
- **Switzerland:** The Swiss capital tax brought in considerably less than expected, probably due to both a smaller tax base and a larger behavioural response than assumed in the

costing. The smaller tax base is likely to be due to a combination of factors – fewer assets held by UK individuals in Swiss banks, more of the assets belonging to non-domiciles or people who were already compliant and some failure among Swiss banks to identify correctly UK individuals holding assets. Capital flight to other offshore centres is likely to have been greater than expected, as is the proportion of individuals that chose to disclose via the LDF or to HMRC directly. For the other revenue streams – the withholding tax, SA income tax and inheritance tax – HMRC estimates less than originally expected has been raised, although some yield is still due in 2017-18 and 2018-19 from the latter two.

- **Crown dependencies:** The Crown dependency disclosure facility closed on 31 December 2015 and yielded less through voluntary disclosures than originally estimated. As we explained in our March 2016 *Economic and fiscal outlook (EFO)*, we also reduced the amount HMRC expected to yield from compliance work related to this measure, although this work is ongoing so remains subject to uncertainty. The costing overestimated the appetite for voluntary disclosures, which proved lower than was seen with the LDF. This may have been due to a number of factors, including, as with the Switzerland costing, that those that did want to disclose chose the more favourable LDF route. It might also reflect a lack of awareness from taxpayers regarding their UK tax liability, and lower engagement with the disclosure process despite HMRC attempts to raise awareness with a communications campaign that involved compliance letters to advisors and engagement with the Crown dependencies and industry.

4.10 Chart 4.2 shows that HMRC's current estimate of the yield from these measures is an average of £0.3 billion a year from 2010-11 to 2016-17. The shortfall of around two-thirds relative to original estimates is dominated by the underperformance of the Switzerland agreement. One of the difficulties in evaluating the costings for these types of measure is we cannot say with certainty, even after the event, whether the difference was due to there being less taxable wealth than originally estimated, whether taxpayers were better able to manoeuvre around the new rules than we expected or some combination of the two.

Chart 4.2: Offshore evasion: comparing original and revised costings



Source: OBR

Accelerated payments

4.11 Accelerated payment (AP) notices require those involved in avoidance schemes within the disclosure of tax avoidance schemes (DOTAS) rules, whose arrangements have been counteracted under the general anti-abuse rule (GAAR), or who have received a follower notice, to pay any disputed tax upfront. Previously they would only have been required to do so once a case had been settled in HMRC's favour. A follower notice is issued to those individuals and businesses engaged in tax avoidance that HMRC believes has in effect been shown to fail by a court ruling in another party's litigation. AP notices and follower notices can only be issued if certain conditions are met and there is an open enquiry or appeal. AP notices do not resolve the dispute, they merely allow the disputed amount to be transferred to the Exchequer while the dispute plays out; follower notices are designed to accelerate resolution of the dispute. For the most part, these routes therefore bring forward revenue that HMRC would have received eventually. This timing effect often meant that the yield from the measures brought revenue from beyond the 5-year scorecard period into it.

4.12 Both follower and AP notices were initially announced in 2013 and extended with subsequent measures – a total of seven measures in all, five of which we evaluate in this paper. These five are:

- **'Penalties in avoidance cases'** from Budget 2013: this affected followers of an avoidance scheme for which a lead case had already been defeated in litigation. Followers with an open enquiry or appeal were required, after receiving a notice, to disclose their tax advantage to HMRC and, if they chose not to concede their case and lost in subsequent litigation, would be liable to a penalty.

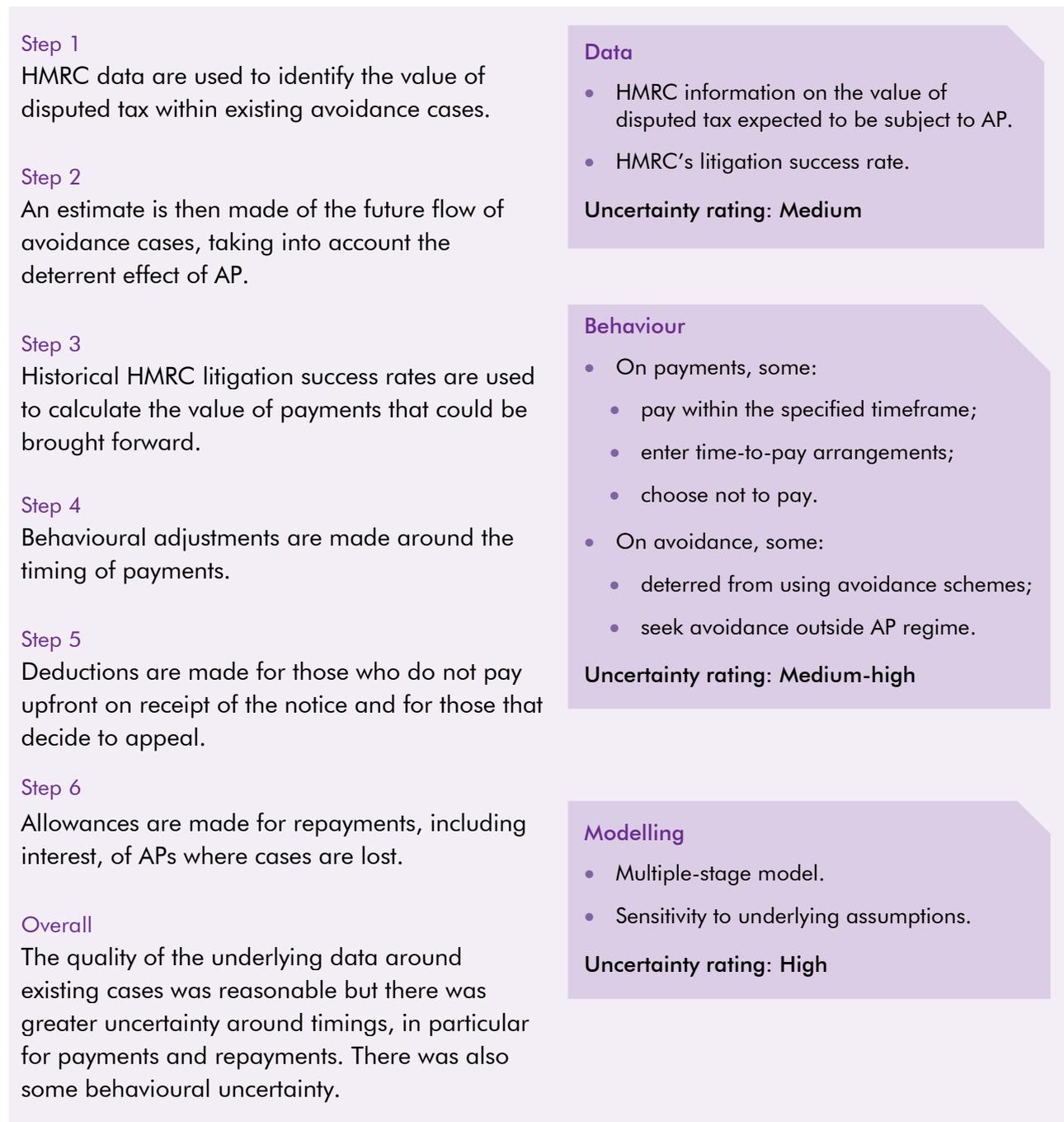
- **'Accelerated payments in follower cases'** from Autumn Statement 2013: this went further than the previous measure by requiring those who received a follower notice to pay the disputed tax to HMRC upfront.
- **'Accelerated payments: extension to disclosed tax avoidance schemes and the GAAR'** from Budget 2014: this allowed HMRC to issue AP notices to all users of DOTAS arrangements from Finance Act 2004 onwards and to users of any schemes under the GAAR.
- **'Corporation tax: accelerated payments and group relief'** from Autumn Statement 2014: this widened the scope of AP to prevent companies from surrendering a tax advantage gained through the use of an avoidance scheme as group relief.
- **'Accelerated payments: extension'** from Budget 2015: this was an operational measure setting out how and when HMRC would issue notices for additional users and cases it had identified. It did not change the AP legislation.

4.13 HMRC has been issuing notices since 2014 and as these five measures are now captured in outturn data we consider them collectively in our forecast and that is how we report them here. We are not evaluating two further measures – **'DOTAS regime change'** from Autumn Statement 2014 and **'HMRC litigation and settlement'**³ from Autumn Statement 2016 – as outturn data are not yet available. We will continue to monitor them and report on any significant changes in future *EFOs*. Figure 4.3 describes step-by-step the original costing methodology for the Budget 2014 measure, which had the highest expected yield.

4.14 The main uncertainty with this and other AP costings was around the large number of modelling assumptions required. The Budget 2014 measure applied to all DOTAS disclosures from Finance Act 2004 onwards and, while there were reasonable data on the likely number of cases and value of the tax involved in each, a number of assumptions needed to be made on when notices would be issued and payments received by HMRC. Assumptions around payment timings were further complicated by behavioural responses for which there was no reliable evidence – for example, the extent to which the AP regime would deter future usage of avoidance schemes or incentivise avoiders to switch to methods outside its scope. Further assumptions were required to estimate when the offsetting future revenue losses would arise, with most expected beyond the 5-year scorecard period.

³ This was part of a wider package presented on the Treasury's scorecard as 'HMRC: administration and operational measures'.

Figure 4.3: Accelerated payments costing methodology (Budget 2014)



4.16 Chart 4.4 shows that the measures in combination were expected to raise an average of £1.1 billion a year across the five years from 2014-15 to 2018-19. Since the original costings we have learned that:

- **Tax base:** The initial estimate of the existing stock of disputed tax that would be subject to AP notices was too high, partly due to some cases falling out of scope and partly due to more taxpayers choosing to settle with HMRC than expected.

- **AP notices:** The original costings underestimated the number of notices issued, but also the length of time required to do so. This is partly due to HMRC needing to issue separate notices for tax and NICs, but also because the original costings underestimated both the number of relevant avoidance cases and the proportion of cases where AP notices would be used. Outturn data also suggest the average value of cases was lower than assumed in the original costings.
- **Timing:** More payments were made upfront than assumed in the original costings and, for those that made payment arrangements with HMRC rather than paying upfront, the time period was shorter than originally expected.
- **Behavioural response:** It appears that the threat of receiving an AP notice has acted as a stronger deterrent than originally assumed. The number of avoidance schemes disclosed under DOTAS and declared usages of DOTAS schemes on tax returns, though already on a downward trend prior to the introduction of APs, has fallen significantly faster since (see Chart 4.3). HMRC estimates that the number of DOTAS scheme usages has fallen by over a half due to the deterrent effect of AP notices.

Chart 4.3: Number of DOTAS disclosures



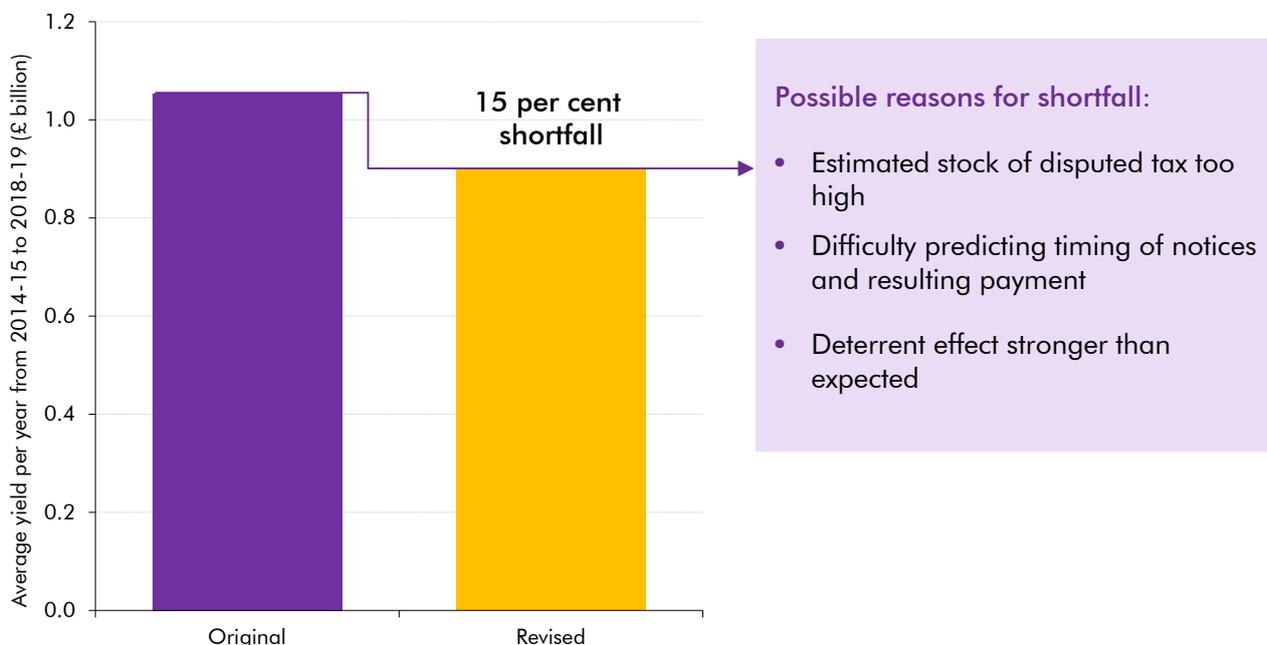
4.17 During the three-year period to the end of 2016-17 HMRC issued around 76,000 AP notices worth over £7 billion, so far bringing forward £4.5 billion of disputed tax.

4.18 As Chart 4.4 shows, collectively these measures are now expected to raise an average of £0.9 billion a year in the five years to 2018-19.⁴ That represents a shortfall of 15 per cent relative to the original estimates of £1.1 billion a year. The legality of the AP regime has

⁴ Note that the revised estimate for the costing, which is in terms of net Exchequer yield, is on a different basis to the £4.5 billion mentioned above and is therefore not directly comparable.

been challenged in the courts and while the High Court has found in HMRC’s favour in the six cases decided so far, this is still subject to appeal and remains an ongoing fiscal risk.

Chart 4.4: Accelerated payments: comparing original and revised costings



Source: OBR

Employment intermediaries

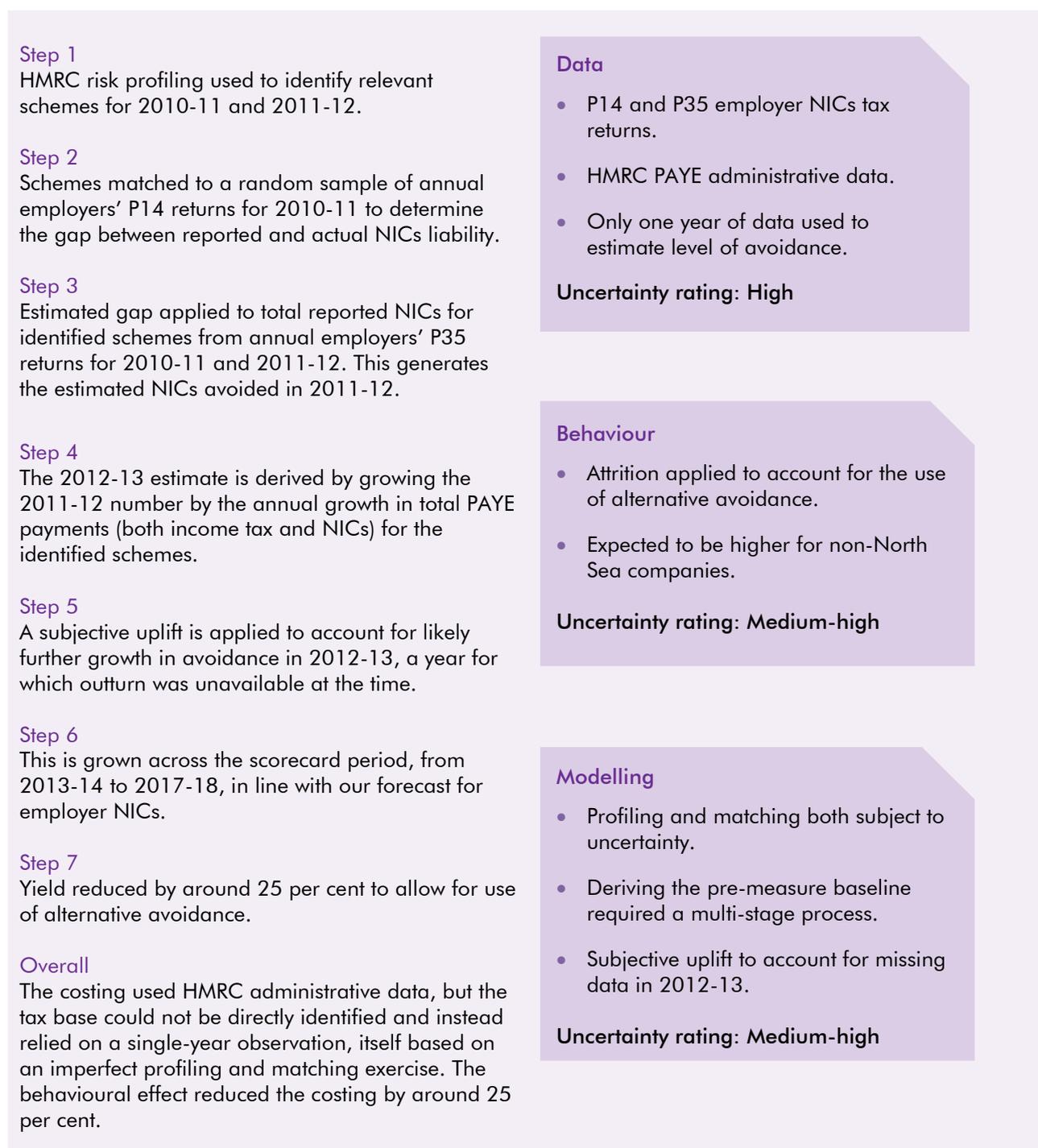
4.19 The Coalition Government introduced a number of measures aimed at countering avoidance through the use of employment intermediaries. An intermediary, also known as an employment agency, is a business or individual that is placed between an employee and their place of work, and there may be more than a single intermediary in such a chain.

4.20 ‘Offshore employment intermediaries’ was a measure announced in Budget 2013 to prevent the avoidance of employer National Insurance contributions (NICs) through the use of an offshore intermediary or when workers were employed by an offshore company. It introduced legislation, effective from April 2014, setting out the responsibility for operating PAYE for these workers, who were typically in the North Sea oil and gas sector, and also introduced a new quarterly reporting obligation. Figure 4.4 sets out a step-by-step description of the original costing methodology and the degree of uncertainty around the quality of data, the expected behavioural effects and modelling complexities.

4.21 The main uncertainty with this costing was the lack of reliable data and the modelling assumptions required to overcome that. The amount of NICs lost to the Exchequer through the use of these schemes was not directly observable and HMRC identified potential schemes by looking at those companies based offshore with a reported NICs liability below an assumed threshold. This uncertainty was compounded by the information only being available for 2010-11 and 2011-12, so the tax base had to be extrapolated forward three years to the implementation date, informed by just a single year’s estimated growth. The

starting point for the costing was therefore particularly uncertain and relied to a significant degree on judgement. The time gap also made it important but difficult to distinguish between additional yield and revenue protection.

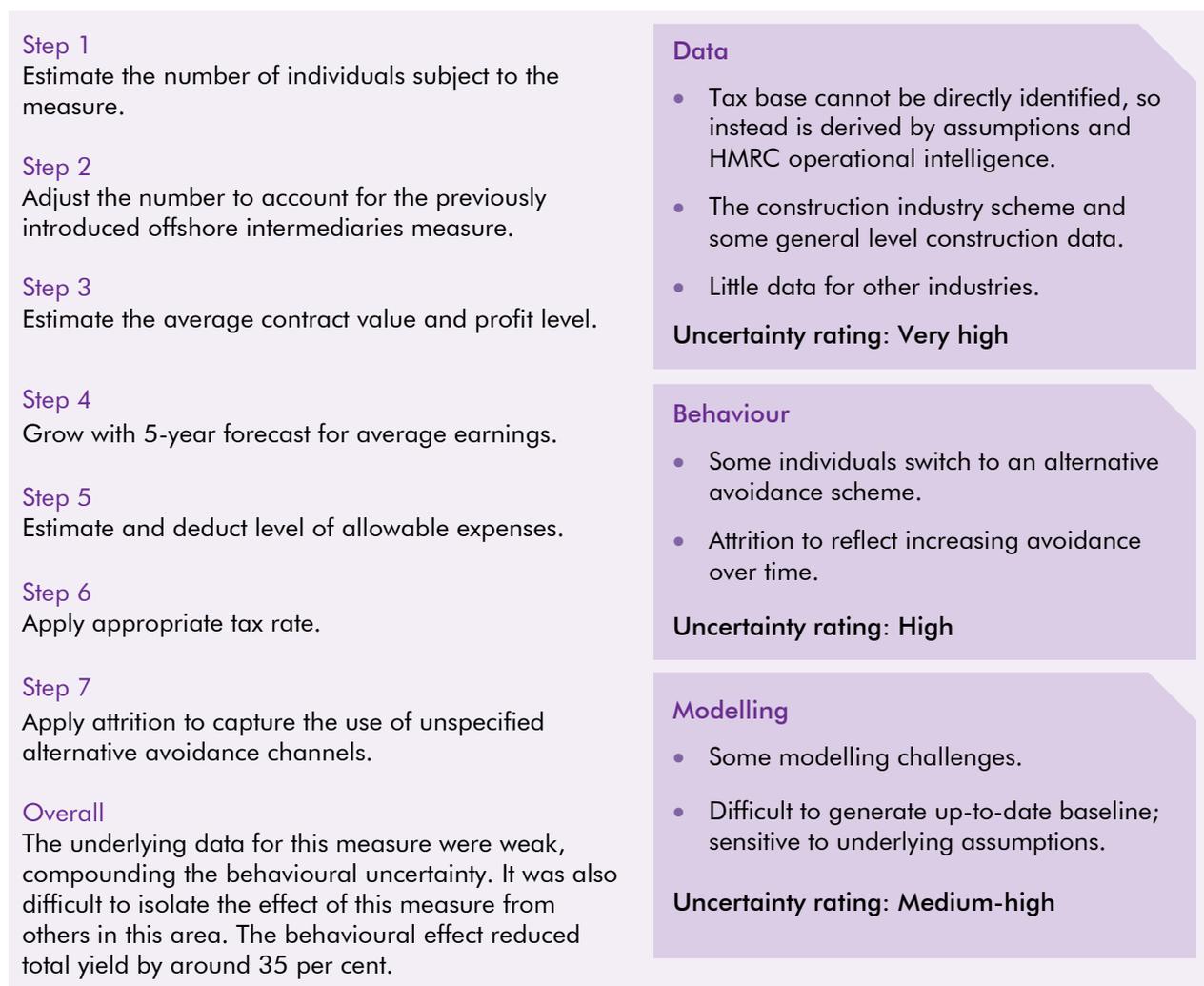
Figure 4.4: Offshore employment intermediaries costing methodology



4.22 'Onshore employment intermediaries' was announced at Autumn Statement 2013 and was also effective from April 2014. It tackled avoidance through the use of intermediaries that facilitated false self-employment. Under this self-employment arrangement, the final employer does not have to pay employer NICs and the worker also pays a lower rate of

NICs than a regular employee, while also benefiting from more generous tax-deductible expenses. This type of practice was common in the construction sector, and at the time of the measure HMRC thought it had spread to a number of other sectors. The same new reporting requirements introduced for the offshore measure also applied here. Figure 4.5 describes the costing methodology in more detail.

Figure 4.5: Onshore employment intermediaries costing methodology



4.23 This costing was much larger than the offshore intermediaries measure and also subject to greater uncertainty:

- **Tax base:** It was not possible to use HMRC’s administrative data to separate those falsely self-employed from others in self-employment, which meant there were no directly observable data that could reliably identify the tax base. This meant relying on the operational judgement of HMRC case workers and evidence from third parties.
- **Modelling:** As with the offshore measure, there were modelling uncertainties around growing the tax base across the two years between the original estimate and the date that the legislation became effective.

- **Behaviour:** This measure was subject to greater behavioural uncertainty than the offshore one, with attrition assumptions used to capture the expected shift to alternative avoidance methods. HMRC felt it might take some years to reach a steady-state level of attrition and also that it might be relatively higher within the construction sector.

4.24 Once again there were also uncertainties around separating how much of the estimated yield was additional and how much was revenue protection. The two measures were originally expected to generate additional yield from income tax and NICs of around a combined £0.5 billion a year from 2014-15 to 2018-19 (see Chart 4.5).

4.25 A third related measure was the March 2015 Budget's '**Employment intermediaries: travel and subsistence (umbrella companies)**' that came into effect from April 2016 and is expected to raise around £160 million a year. It disallowed travel and subsistence tax and NICs relief for workers employed through an intermediary, such as an umbrella company, or in a personal service company, and who are providing personal services "*under the supervision, direction or control*" of someone else. The intention was to bring the travel and subsistence rules in line with other temporary workers or contractors, while those working unsupervised could continue to claim – in line with the rules for the self-employed. It is too early to evaluate this measure, but it is worth noting as it overlaps with the previous two.

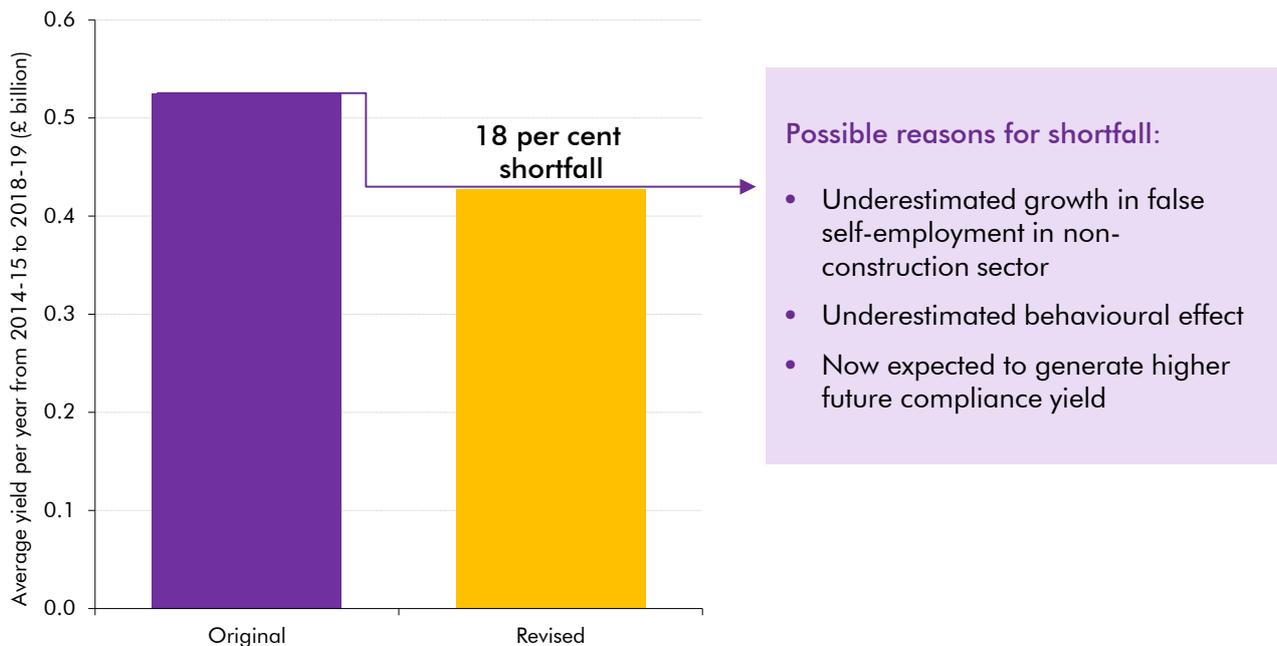
4.26 Since the original costings we have learned that:

- **Reporting requirement:** The introduction of the quarterly reporting obligation was initially deferred until 2015-16, so HMRC has been receiving quarterly returns from employment intermediaries since April 2015. However, at the time of this evaluation only information from the analysis of the first five returns was available, and this was not sufficient to allow us to learn any lessons about this element of the costings.
- **Tax base and attrition:** HMRC believes that its initial estimate of the number of falsely self-employed in the construction sector was broadly accurate but that it significantly underestimated the growth in other sectors. But HMRC also thinks the behavioural effect in terms of continued or alternative avoidance in the construction sector was greater than expected.
- **Umbrella companies:** Employment within umbrella companies and, to a lesser extent, agencies looks to have increased as a result of this measure. Early results from employment intermediaries returns suggest a slight decrease in those falsely self-employed between July 2015 and July 2016. It is possible some of the unexpected growth in employment within umbrella companies might increase the yield for the Budget 2015 measure, which we will revisit ahead of our next forecast.
- **Compliance activity:** HMRC believes that its future compliance work in the construction sector will bring in more yield in 2018-19 than originally estimated. Though the benefit of this compliance activity is related to the costing, it is being funded within HMRC's existing spending settlement so we consider it to be already captured within our 'business-as-usual' receipts baseline, and we make no further adjustment for it.

Evaluation results

4.27 Overall, the revised costings for the two employment intermediaries measures are around an average of £0.1 billion a year lower than the original estimates (around a fifth, see Chart 4.5). However, outturn data for these measures remain preliminary, so this is an area we will likely need to revisit in future evaluations.

Chart 4.5: Employment intermediaries: comparing original and revised costings



Source: OBR

Partnerships

4.28 In 2013 the Coalition Government announced two measures to counter commonly used structures involving partnerships that gave rise to a tax advantage for the individuals involved. 'Partnerships' from Budget 2013 and 'partnerships: confirming extension to alternative investment funds' from Autumn Statement 2013 were split into two scorecard measures but were covered by the same legislation so we consider them together.

4.29 Legislation was introduced from April 2014 to ensure that salaried members of limited liability partnerships (LLPs) would be treated as employees for income tax, corporation tax (CT) and NICs purposes. It also prevented "partnerships with a corporate member allocating profits, expenses and losses artificially to minimise tax liabilities". There were two main parts to the costing and three smaller elements:

- **disguising employment** gave rise to a tax advantage, for example by classifying an 'employee' as a 'partner' and not liable to employer NICs;
- **profit shifting** allowed individuals to route profits to corporate members and gain a tax advantage from the lower rate of CT and the more generous system of reliefs; and

- **other smaller elements** included loss allocation, intellectual property (IP) shifting and disallowed expense shifting, with each based on the selective use of the personal and corporate tax regimes to ensure that the tax that is due is paid at the lower CT rate while deductions are made at the higher income tax rate.

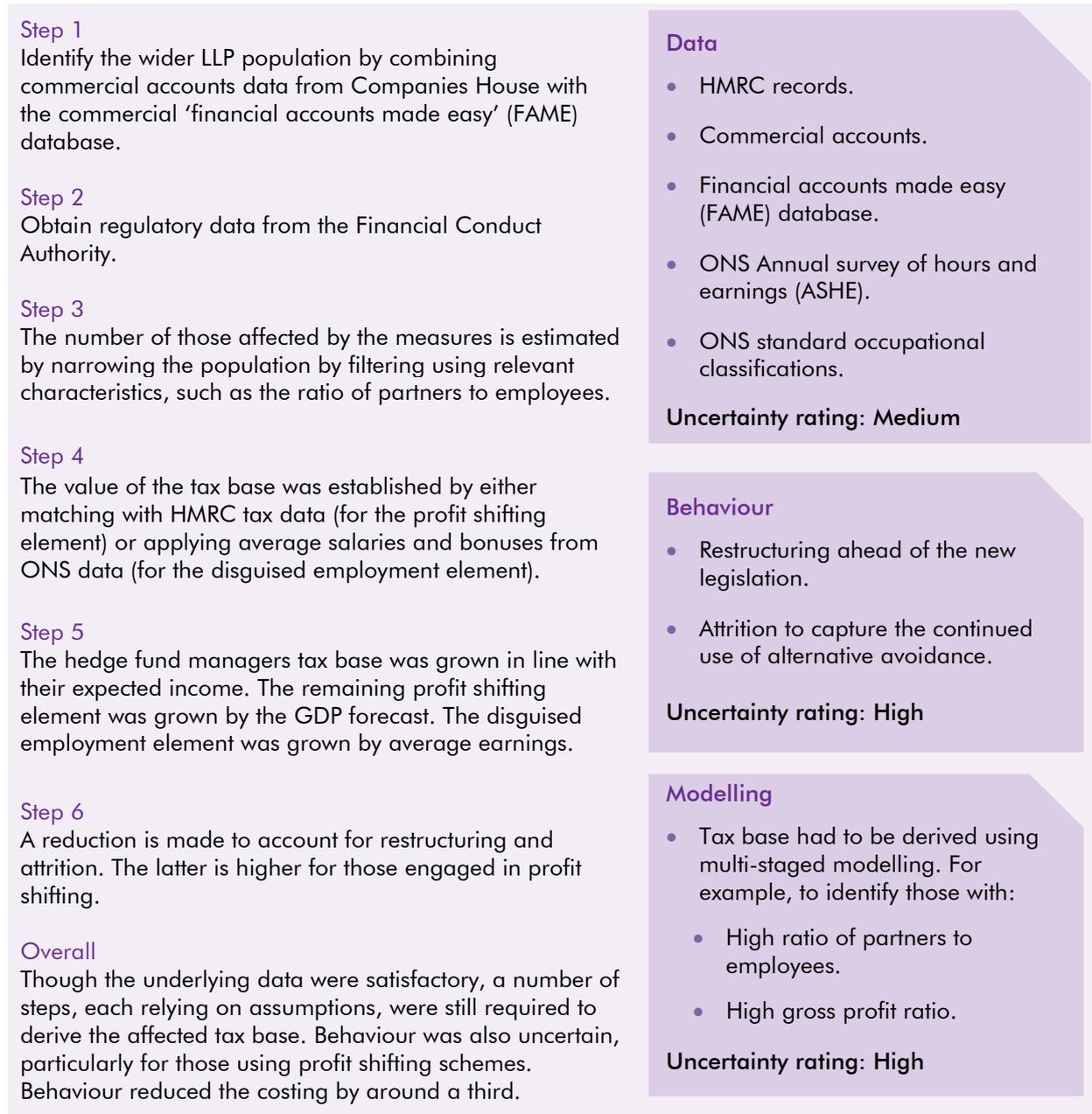
4.30 Figure 4.6 sets out the costing methodology and the main uncertainties. The first major uncertainty was that the affected tax base was not directly identifiable and instead had to be estimated through an uncertain multiple-stage process narrowing down from the entire population of LLPs through the use of various assumptions and thresholds. Behaviour was also an uncertainty with this costing. For the disguised employment, IP shifting and disallowed expense shifting aspects HMRC felt the level of attrition would be low, with the legislation likely to be effective. There was considered to be more scope for attrition for the profit shifting element, which made up over two-thirds of the combined yield, and also the loss allocation element, which was relatively small. Overall, the behavioural effect reduced yield by around a third. The level of attrition took into account factors like:

- **the difference between income tax and CT rates**, which creates an ongoing incentive to arrange tax affairs in order to take advantage of it;
- **the scope for restructuring** given the number of months available to do so before the legislation came into force – we have often seen that when the incentives are sufficiently large, this type of behavioural response can be significant; and
- **the sizeable proportion of fund managers that were non-domiciled**, and thought to have a greater opportunity of reducing the measures' impact.

4.31 The two measures were expected to raise an average of £0.6 billion a year between 2014-15 and 2018-19. Since the original costings we have learned that, as a result of the measures, and controlling for other factors:

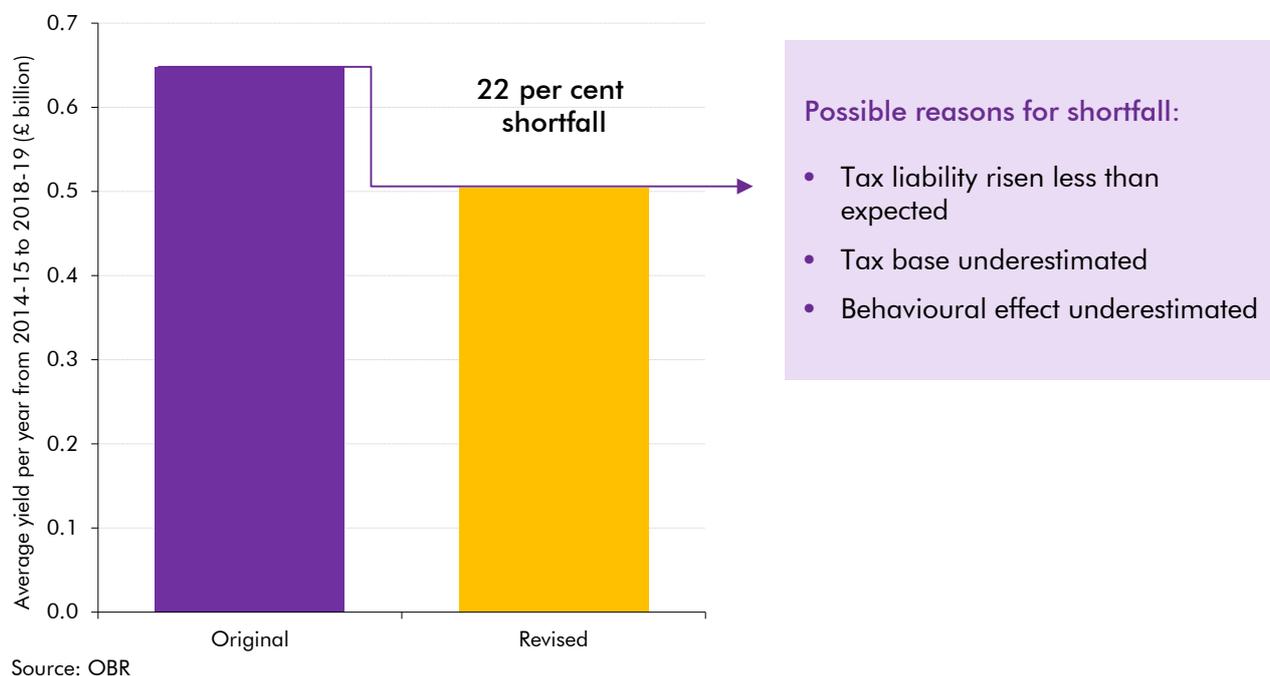
- **Disguised employment:** HMRC believe that the increase in the number of employees has been broadly in line with what was expected in the original costing of the disguised employment element. Though employment growth in 2014-15 was slower than expected, it picked up considerably in 2015-16.
- **Profit shifting:** For this element, the tax liability for affected partnerships has increased, though less than expected in the original costings. This is partly offset by the size of the tax base being slightly underestimated. For example, growth in the hedge fund sector has been faster than expected. Attrition may have been underestimated in the original costings, and there is also high level evidence to suggest partnerships may have brought forward profits ahead of the introduction of the measure, which was not factored into the original costings.
- **Smaller elements:** The other elements of this legislation have been effective and HMRC's analysis of the available evidence suggests that the types of schemes that it targeted are no longer in use.

Figure 4.6: Partnerships costing methodology



4.32 Overall, the latest estimate suggests a shortfall or around 20 per cent relative to the original costings. HMRC expects to raise an average of around £0.5 billion a year across the original scorecard period instead of £0.6 billion (see Chart 4.6). The shortfall is around 25 per cent for profit shifting but less than 10 per cent for disguised employment. However, there is still not a great deal of outturn data at this stage and we will continue to monitor these costings and report any significant changes in future publications.

Chart 4.6: Partnerships: comparing original and revised costings



Updates on other measures

4.33 In this section, we provide brief updates on those measures where the outturn data remains patchy, but some useful information was generated in the evaluation process.

Base erosion and profit shifting

4.34 Base erosion and profit shifting (BEPS) is an OECD-led initiative that seeks to counter tax avoidance by multinational enterprises through governmental co-operation. The ultimate goal is to reform the international tax system so that the reporting of profits is more closely aligned with where the underlying economic activity takes place. The final BEPS report was published in October 2015 and the UK has announced six supporting measures, four of which we consider here.⁵ These are:

- **‘Diverted profits tax’ (DPT)** announced at the Autumn Statement 2014 and applied from April 2015: this introduced a new 25 per cent tax rate that would apply when a multinational enterprise sets up connected entities in a contrived arrangement “*lacking economic substance*” in order to divert profits to lower tax jurisdictions. DPT can also be charged when multinational groups are deemed to have “*avoided a UK permanent establishment*” (PE) to avoid paying CT in the UK.
- **‘Corporation tax: hybrids’** announced at the Autumn Statement 2014 and augmented by **‘corporation tax: extend scope of hybrid mismatch rules’** at Budget 2016: this legislation implemented the proposed OECD rules on hybrid mismatch arrangements,

⁵ The other two measures, for which no outturn data are yet available, are ‘corporation tax: country-by-country reporting’ from Autumn Statement 2014 and ‘corporation tax: restrict relief for interest’ from Budget 2016.

and applied from January 2017. These arrangements allowed companies to exploit differences in countries' tax rules, for example by making a tax deduction in both countries for a single expense or by making a tax deduction without there being a corresponding taxable gain.

- **'Corporation tax: withholding tax on royalties'** announced at Budget 2016: this sought to counter the use of intra-group royalty payments by multinationals to shift profits from the UK to lower-tax countries. From June 2016, it widened the definition of royalty payments where the withholding tax would apply by including all intangible assets such as trademarks and brand names. It also broadened the rules on when royalties are regarded as having a UK source so that the withholding tax applied when a payment is attributable to a UK PE, even if the actual payment is made from outside the UK. And it introduced provisions against 'treaty-shopping' – sending royalties through third countries where the main purpose is to take advantage of favourable tax treaty terms.⁶ The DPT legislation was also changed to ensure this measure applied equally when a payment was similarly attributable to an avoided PE. Despite its name, this measure applies to income tax and DPT rather than CT.

4.35 Collectively, the original costings for the six BEPS measures estimated a yield of close to £2 billion a year from 2017-18 onwards and we will revisit these estimates more fully in future publications. For now, the four measures mentioned above were expected to raise just over £0.5 billion in 2016-17. HMRC's latest estimate is that they raised just over £0.3 billion, a shortfall of almost 35 per cent (see Chart 4.1). The early evidence suggests that:

- **Assumptions about permanent establishments:** The shortfall so far is entirely due to a re-profiling of the yield from the royalty withholding tax measure, in large part relating to assumptions about PEs. HMRC now believes that the income tax yield will be much lower, as the original costing overestimated the number of PEs. However, it also believes that there are a number of cases involving potentially avoided PEs that would be liable to DPT instead, and therefore further yield will come in future years. This is an issue we will consider ahead of our next forecast and report on at that time.
- **Behavioural response:** The revised DPT costing is slightly higher than the original, though around half of the yield has come from groups choosing to restructure and pay (the lower) CT rate rather than (the higher) DPT rate.⁷ This suggests the original costing underestimated the extent of the behavioural response to the measure, but also that the tax base – the number of groups affected – was larger than originally thought.

4.36 At this stage, the 2016-17 estimate for the combined hybrid measures is unchanged.

⁶ This element came into effect from the announcement date.

⁷ More information on the latest DPT outturn can be found in *Transfer Pricing and Diverted Profits Tax statistics to 2016/17*, HMRC, September 2017.

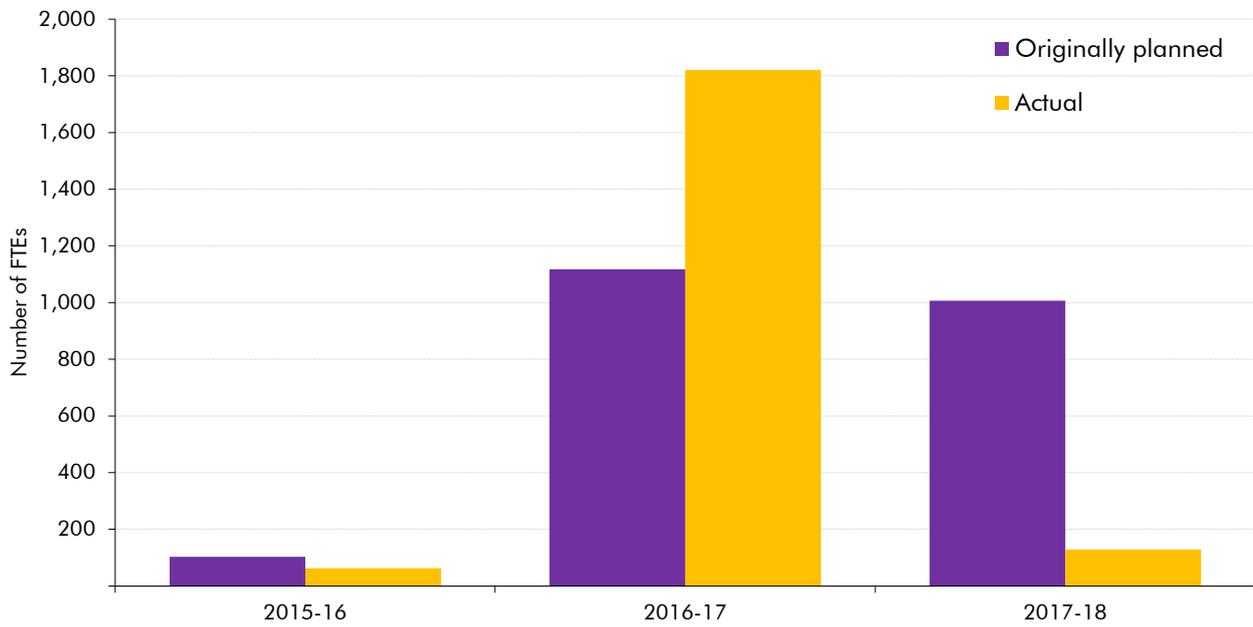
Schemes of arrangement

- 4.37 **'Stamp duty on shares: schemes of arrangement'** was announced at Autumn Statement 2014 to tackle the avoidance of stamp tax by preventing the use of share cancellations by a targeted company in a takeover using a 'scheme of arrangement'. Structuring a takeover in this way meant no stamp tax was due because the cancellation and then re-issue of new shares to the bidder meant there was no liable transfer of shares.
- 4.38 The evidence suggests a significant number of very large takeovers were structured in this way and, as we emphasised at the time, the original costing was sensitive to the uncertain number and the frequency of such takeovers. The costing allowed for two behavioural effects. First, the bringing forward or forestalling of some deals to avoid the legislation, which was due to take effect from March 2015. Second, the use of alternative avoidance through an attrition assumption. Behaviour reduced the costing by around 10 per cent in earlier years, rising to 40 per cent in the final scorecard year.
- 4.39 Since the measure came into effect there have been more takeovers than expected, including a number of large ones, yielding more stamp duty than expected. This suggests the behavioural assumptions in the original costing may have been overstated, though given the high sensitivity of the yield to a handful of takeovers that remains uncertain. For the two years for which we have outturn data the average yield has been over £0.4 billion a year compared to less than £0.1 billion in the original costing.

HMRC operational delivery

- 4.40 One of the lessons we have learned from our previous costings evaluation was the tendency for departments to underestimate the time before new activities begin to deliver benefits. This may be due to a variety of causes including legal challenges, unexpected IT issues, lack of public awareness, difficulties with external contractors and problems recruiting, training and retaining staff. The risk around the timely implementation of measures typically lies in one direction and we have incorporated the lessons from past costings into our scrutiny of new measures. For example, we insist that an appropriate contingency margin is included when assessing delivery timetables and we routinely monitor progress and report on any changes in Annex A of our *EFOs*.
- 4.41 In the July 2015 Budget, the Government announced a large package of HMRC operational measures that targeted evasion and non-compliance. Collectively they were expected to raise close to £3 billion a year by 2020-21. It is too early to evaluate these costings but we have asked HMRC to provide updates on delivery, which suggest that the measures remain broadly on track. One example of the type of management information we scrutinise relates to the success of staff recruitment plans. Chart 4.7 shows that for this package it is ahead of schedule, with a larger proportion of the recruitment completed in 2016-17 than originally planned. We will provide an updated revenue forecast for these measures in our next *EFO*.

Chart 4.7: HMRC staff recruitment for July 2015 package of operational measures



Source: OBR

5 Conclusions

- 5.1 In this paper we have considered the costings for 19 HMRC anti-avoidance and operational measures announced between 2012 and 2016, evaluating them within six relevant categories. In five of these categories the costings have fallen short of the original estimates – by amounts that vary between 15 and 65 per cent. The exception is the stamp duty ‘schemes of arrangement’ measure, which, in the first two years for which we have outturn data, has yielded significantly more than expected.
- 5.2 Since most of these costings were chosen for evaluation because we knew they had proved inaccurate, the results are not necessarily representative of all such measures. But we draw broader conclusions by considering these new evaluations alongside the results from more than 80 measures that we have now evaluated.
- 5.3 In terms of numbers of measures, our previous conclusions hold that similar numbers have yielded more or less than expected. However, it also remains the case that for those measures with the largest original expected yield, more have under- than over-performed.
- 5.4 The question for us is whether the revealed optimism bias in these larger costings is explained by something that we need to account for in future measures. Is there one or more aspect in these costings that consistently explains the shortfall? The answer appears to be ‘no’, with a variety of explanations specific to each costing. For example:
- while it is highly likely the **tax base** for the Switzerland costing was overestimated, the tax base for the measures on employment intermediaries, partnerships and diverted profits tax were probably underestimated;
 - in terms of **attrition**, while the measures on offshore evasion, employment intermediaries and partnerships seem likely to have underestimated the yield that would be lost, the reverse is probably true for ‘schemes of arrangement’ and previously evaluated measures like the annual tax on enveloped dwellings; and
 - it seems that both the accelerated payments and diverted profits tax measures have probably had a stronger **deterrent effect** than assumed in the original costings.
- 5.5 So while there are many lessons that can be learnt, there is no simple adjustment factor that could be applied to overcome the apparent bias. We will therefore need to continue to assess the assumptions underpinning each step of any new costing on a case-by-case basis.

Conclusions

- 5.6 For operational measures the main conclusion from our previous evaluation still stands: some have taken longer than expected to become fully effective. We have highlighted a number of these delays in Annex A of our *Economic and fiscal outlooks*. However, the large package of measures introduced in July 2015 appears to be on track at this stage.
- 5.7 The inherent uncertainty around anti-avoidance and operational measures coupled with the increasing reliance that Governments have placed on them to meet the relatively certain cost of tax cuts and additional spending make this a continuing risk to our central forecast – one that we aim to ensure lies in both directions, in terms of overall yield and the timing of that yield across specific years.

