



HMRC Call for evidence

Cash, tax evasion and the hidden economy

The collection of tax revenue is fundamental to the sound functioning of a sustainable and prosperous society. The challenge with the modern complex of a constantly evolving payments landscape is how to ensure tax laws keep pace with consumer preference. The relative decline in cash usage can be seen in both a positive and a negative light: on the one hand, consumers should benefit from greater choice and more convenience when making a payment, and a larger digital footprint should ensure that taxes are collected appropriately and a reduction in illicit behaviour; on the other, those who prefer or predominantly rely on cash for making payments (the unemployed, elderly and those on low incomes), may find life more difficult. They must not be excluded from the payments landscape of tomorrow, nor denied the ability to choose how they manage their money.

Cash Services welcomes this call for evidence and looks forward to engaging with HMRC with its wider research to understand the hidden economy, and the ways in which businesses and consumers use cash and non-cash alternatives in transactions.

ABOUT CASH SERVICES

Cash Services acts as a focal point for the provision of strategic direction on co-operative (non-commercial) issues for cash as a component of the UK Money Transmission and Payments Industry. As a membership organisation, Cash Services provide strategic direction and management of the collaborative elements of the cash cycle in the UK.

Through inter-bank co-operation, Cash Services aims to ensure that cash can circulate freely and effectively, and that risks to the cash cycle are identified and mitigated.

Cash Services' objectives are to:

- Maintain the integrity of the cash cycle by ensuring an orderly market for the distribution of cash.
- Ensure an efficient industry model exists for the management of wholesale cash supply and demand, against the background of a changing market.
- Facilitate collaboration to ensure sufficient cash is available to meet customer expectation and ensure cash remains an integral part of the UK payments landscape.

A full list of our members, as well information about who we work with, can be found on our website www.cashservices.org.uk. An overview of our objectives and cash use by demographic has been submitted separately.

The latest details about the cash machine industry and cash payments are available in *UK Cash & Cash Machines Summary 2015* (a copy has been attached to the submission email).¹ The 2016 version will be available later this year.

QUESTION 1: WHAT DOES THE RELATIVE DECLINE IN CASH USAGE MEAN FOR TAX NON-COMPLIANCE IN THE FUTURE?

With the projected rise in the proportion of sales through credit and debit cards, and mobile payments, consumers are increasingly using cash alternatives to pay for purchases and businesses are adopting more electronic ways to accept payment. As outlined in section 2.2 of the call for evidence, an increase in transaction data received by HMRC will improve their ability to collect appropriate revenue, and as outlined in 2.1, a larger digital footprint will reduce the opportunity for deliberate tax non-compliance to take place. Furthermore, the ability to better target non-compliant businesses reduces the need for HMRC to contact compliant businesses and could improve relations between the two.

The relative decline in cash usage should therefore have an overall positive impact on HMRC's compliance work. The tax gap is estimated to be £34 billion (2013-14), which is 6.4% of tax liabilities (this has reduced steadily from 8.4% in 2005-06). Of the £34 billion, it is estimated that a total of £10.6 billion is lost from tax evasion and the hidden economy. However, a total of £18.4 billion was lost through non-payment, customer error and failure to take reasonable care, tax avoidance and criminal attacks (defined as goods smuggling, VAT repayment fraud and VAT Missing Trader Intra-Community fraud).² HMRC also lost £4.9 billion in legal cases with customers over the legal interpretation of specific transactions.³ HMRC must therefore ensure that all options to close the tax gap are explored and that the progress in their compliance work continues (as noted in last year's National Audit Office report⁴).

It is worth stating here that cash is not projected to disappear any time soon, if at all (see Question 4), therefore those who wish to use cash legitimately must be able to do so without fear of suspicion or being subject to unjustified surveillance. HMRC must take steps to ensure a broad approach that incorporates all payment methods is taken when looking at the future for tax compliance. The relative decline in cash is not the panacea to reducing the tax gap or halting tax evasion.

QUESTION 2: WHAT EVIDENCE IS AVAILABLE ABOUT THE USE OF CASH TO CONCEAL TRANSACTIONS WITHIN THE HIDDEN ECONOMY?

As the call for evidences points out, given the untraceable nature of cash, it is inherently difficult to determine precisely how much cash is present within the hidden economy. The Bank of England's Quarterly Bulletin 2015 Q3 summarised the estimated size of the hidden economy and stated it is one of the lowest of all OECD countries.⁵

¹ *UK Cash & Cash Machines Summary 2015*

http://www.cashservices.org.uk/sites/default/files/payments_uk_uk_cash_and_cash_machines_summary.pdf

² Criminal attacks £5.1bn; avoidance £2.7bn; non-payment £4.1bn; failure to take reasonable care £3.9bn; error £2.6bn

³ Examples include the correct categorisation of an asset for allowances, the allocation of profits within a group of companies, or VAT liability of a particular item.

⁴ *Tackling tax fraud: how HMRC responds to tax evasion, the hidden economy and criminal attacks*, National Audit Office, p.11

<https://www.nao.org.uk/wp-content/uploads/2015/12/Tackling-tax-fraud-how-HMRC-responds-to-tax-evasion-the-hidden-economy-and-criminal-attacks.pdf>

⁵ *How has cash usage evolved in recent decades? What might drive demand in the future?* Bank of England Quarterly Bulletin 2015 Q3
<http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q301.pdf>

QUESTION 3: TO WHAT EXTENT DOES CASH FACILITATE TAX NON-COMPLIANCE?

By its nature it is difficult to accurately monitor the role cash plays in the hidden economy and paint an accurate picture of the relationship between cash and non-compliance. However, as the use of cash declines it will be interesting to see the effect on tax receipts. HMRC should pay close attention to the relationship between cash use and tax receipts in countries such as Sweden where cash use is far below the global average.⁶ OECD revenue statistics show that despite an above average decline in cash use between 2004 -14, Swedish tax revenue as GDP has fallen from 45.6% to 42.7%. In comparison the UK's tax revenue fell by only 0.5% (from 33.4% to 32.9%) over the same time period.⁷ There are of course numerous variables to consider when making this comparison but it is interesting to note nonetheless.

HMRC should also take in to account that a rise in electronic payments will inevitably cause criminal organisations (in this case, those wishing to evade tax), to focus their attention on developing new ways to cheat the system. Monitoring developments in countries with low levels of cash use will be important in this case also: in Sweden, the number of electronic fraud cases has doubled over the past decade.⁸

QUESTION 4: WHAT EVIDENCE IS THERE THAT THE RELATIVE TREND AWAY FROM CASH TO OTHER PAYMENT METHODS WILL OR WILL NOT CONTINUE?

It is right for the call for evidence to stress that cash remains a popular method of payment for many individuals and businesses. Indeed, cash is the most commonly used payment mechanism in the UK. During 2014, over 18 billion payments were made in cash, accounting for 48% of all payments made worth around £253 billion.

However, cash volumes are forecast to fall by 30% over the next ten years. A number of factors are expected to contribute to this decline, most notably a migration to debit cards, reinforced by an increase in the usage and awareness of contactless payments. Mobile payment services such as Paym may also provide an alternative for consumers and businesses to make small value payments that were previously made using cash. Values are forecast to decline at a slower rate, falling in nominal terms from around £253 billion to £245 billion. The proportion of consumer payments in the UK paid using cash has fallen from 73% in 2004 to 53% in 2014; it is predicted to fall to 34% by 2024.⁹ The trend away from cash to other payment methods is therefore set to continue but as the Bank of England has pointed out, demand for cash is likely to remain salient and is 'not likely to die out any time soon'.¹⁰

It is unlikely that one method of payment will command the payments landscape, as once done so by cash. As opposed to simply being the dominant payment method of choice, cash will be a key component of the plethora of payment options available to the consumer in years to come and is predicted to account for 3 in every 10 payments made in 2024. Most cash payments by consumers are for low transactions: more than half of consumer cash payments in 2014 were for a value of £5

⁶ In Sweden, cash is no longer king https://sweden.se/wp-content/uploads/2015/12/SI_cashlessociety_press_release_151216.pdf; *Global Cash Study 2014 – Summary of Findings*, Secura Monde International Ltd, 2014, p.27

⁷ OECD Revenue Statistics – Comparative tables <https://stats.oecd.org/Index.aspx?DataSetCode=REV> - Data correct as of 10/01/2016

⁸ Welcome to Sweden – the most cash-free society on the planet, The Guardian 12th November 2014 <http://www.theguardian.com/world/2014/nov/11/welcome-sweden-electronic-money-not-so-funny>

⁹ UK Cash & Cash Machines Summary 2015 http://www.cashservices.org.uk/sites/default/files/payments_uk_uk_cash_and_cash_machines_summary.pdf

¹⁰ How has cash usage evolved in recent decades? What might drive demand in the future? Bank of England Quarterly Bulletin 2015 Q3 <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q301.pdf>

or less, encouraging low value spontaneous payments. It will be interesting to see whether the expected rise in contactless payments erodes the use of cash in this area.

Cash is highly valued by consumers from all walks of life for its familiarity, widespread acceptance and trustworthiness. People are accustomed to cash; they trust it as a method of payment and thus plays a pivotal role within society. 1.6 million people rely exclusively or predominantly on cash for all their day-to-day transactions, of which around 78% are aged 45 or over (40% of which are over 65 or over), representing 3.1% of all adults; 2.3 million (4.4% of adults) use cash to make payments once a month or less. In total, nearly 4 million use cash and whilst not the payment method of choice for the young, it's clearly one that is relied on by their parents and grandparents and could therefore indirectly support them.

As outlined in *UK Cash & Cash Machines Summary 2015*, those on low incomes are far more likely to rely predominantly on cash for making payments than those with higher incomes. 40% of consumers reliant on cash have a total household income of less than £10,000 per year. Cash is a useful tool for those with a limited income to manage household budgets, enabling them to ration available funds and avoid the high costs of inadvertently going overdrawn on an account. For the nearly 2 million people in the UK without a bank account, collectively known as the 'unbanked', cash is the only payment method available.¹¹ The launch of fee-free basic bank accounts will go some way to improve the situation for those that struggle financially, but research shows that around half of people with basic bank accounts choose to manage their money in cash, suggesting that cash is the preferred method of payment for around an extra 2 million people.¹²

From a wholesale perspective, a total of £383bn was processed in 2015 through the cash centres of Members of Cash Services. Of this, some £373bn was in notes, including an additional £13bn of new notes drawn from the Bank of England and issued through cash centres to retailers, ATM deployers and other wholesale customers. A total of £9bn in coins were processed and recycled, with £0.3bn in new coins issued by Members on behalf of the Royal Mint.¹³

Investment in banknote modernisation from the Bank of England and issuers in Scotland, as well as the Royal Mint's commitment to bring in to circulation a new £1 coin, demonstrate the dedication to modernising cash and validates the statement by Victoria Cleland, Bank of England's Chief Cashier, that there is a 'lot of life left in cash'.¹⁴ Indeed, with the rapid rate of fintech development we may very well go cardless before we go cashless, as the payment innovations of today are overtaken by those of tomorrow.

QUESTION 5: CONSIDERING THE RAPIDLY CHANGING PAYMENT LANDSCAPE, WHAT CHALLENGES AND OPPORTUNITIES DOES FURTHER INNOVATION RAISE FOR:

5a: HMRC'S COMPLIANCE ACTIVITIES?

HMRC are correct to consider the rapidly changing payment landscape in this call to evidence. As mentioned above (Question 4), the rapid rate of fintech development and payment innovation may mean that today's innovations are obsolete in a short space of time. HMRC must be aware of new payment methods and the potential for tax non-compliance that comes with them.

¹¹ *Improving the Financial Health of the Nation*, Financial Inclusion Commission, 3.22

http://www.financialinclusioncommission.org.uk/pdfs/fic_report_2015.pdf

¹² *Free bank accounts launched*, GOV.UK <https://www.gov.uk/government/news/fee-free-bank-accounts-launched>

¹³ Cash Services data – available upon request

¹⁴ *Working together to deliver banknotes for the modern economy*, Speech by Victoria Cleland, Chief Cashier and Director of Bank Notes, Bank of England www.bankofengland.co.uk/publications/Documents/speeches/2015/speech838.pdf

5b: HMRC'S CUSTOMERS?

Innovation and competition in the payment landscape can only be a good thing for the consumer, however a method of payment must be trusted before it is fully embraced and adopted (the gradual but rapid acceptance of contactless is a case in point). According to a recent report by Symantec, half of UK consumers are worried about the security of their data and only 21% trust retailers to keep their information safe. The report suggests that such security concerns will grow and may cause a change in consumer online behaviour: a trend that may apply to electronic payment methods as usage grows.¹⁵

QUESTION 6: WHAT DO CHANGES IN THE USE OF CASH MEAN FOR MONEY LAUNDERING?

In an effort to reduce money laundering and tackle the hidden economy, several European countries have used legislation to introduce limits on cash payments between consumers and traders. For example, in France there is a limit of €1,000 in cash for French citizens (dropped from €3,000 in September 2015) and €10,000 for non-residents (mainly tourists), (again, dropped from €15,000 in September). In Spain, residents can pay up to €2,500 in cash whereas foreigners can go up to €15,000. In Italy, cash payments are only allowed up to €999.99.¹⁶

In Sweden and Denmark, where cash payments have declined faster than the European average, there is no limit but restrictions are used in practice. For example, in Sweden, a trader is not obliged to accept cash as payment if the limitation is stated clearly before the making the sale. There are no such limitations in Germany, Austria, Slovenia or Iceland.

In the UK, whilst there is no legally stipulated maximum limit, under Money Laundering Regulations traders that accept cash payments in excess of €15,000 need to register with HMRC as 'High Value Dealers'.¹⁷ The regulations also contain the 'know your customer' requirements for employees of UK financial institutions and when to use them; that is, the importance of customer ID procedures, obtaining additional information and monitoring customer activity to tackle money laundering.¹⁸

The introduction of new £5, £10 and £20 banknotes on polymer as well as the new £1 coin over the next few years will improve the resilience of cash against counterfeiters. The gradual withdrawal from circulation of current paper notes and £1 coins will bring cash from the hidden economy and back in to the real economy. There is evidence from euro-area countries that only 1% of legacy domestic currencies (for which the deadline had passed) were not returned.¹⁹ Hence, the upcoming programme of currency modernisation presents a unique opportunity to 'reset cash levels' and under the right controls, reduce the unaccounted levels of cash that is hoarded, held overseas or used in the hidden economy.

In 2013 the Bank of England announced that the next £5 and £10 banknotes will be printed on polymer; the £5 note will be issued in September 2016 and the £10 in 2017. According to Bank of England research, polymer banknotes are cleaner, more secure, and more durable than paper banknotes. They will provide enhanced counterfeit resilience, and increase the quality of banknotes

¹⁵ *State of Privacy Report 2015*, Symantec <https://www.symantec.com/content/en/us/about/presskits/b-state-of-privacy-report-2015.pdf>

¹⁶ *Cash payment limitations*, European Consumer Centre France <http://www.europe-consommateurs.eu/en/consumer-topics/buying-of-goods-and-services/cash-payment-limitations/>

¹⁷ Details and exemptions can be found here <https://www.gov.uk/guidance/money-laundering-regulations-high-value-dealer-registration>

¹⁸ *Joint Money Laundering Steering Group* <http://www.jmlsg.org.uk/> - Guidance Part I p. 164

¹⁹ *How has cash usage evolved in recent decades? What might drive demand in the future?* Bank of England Quarterly Bulletin 2015 Q3 <http://www.bankofengland.co.uk/publications/Documents/quarterlybulletin/2015/q301.pdf> p.224

in circulation. In 2015, the Bank of England announced that a polymer £20 banknote will be issued by 2020.²⁰

Clydesdale Bank introduced a limited edition commemorative polymer £5 note in March 2015 in Scotland. All three Scottish Note Issuers (Bank of Scotland, Clydesdale Bank and The Royal Bank of Scotland) have confirmed their intention to replace their paper £5 and £10 banknotes with new polymer in similar timescales to the Bank of England. As it stands, there are no plans from Northern Irish note issuers to produce polymer banknotes. 2017 will see the introduction of a new £1 coin. With security features such as a bi-metallic construction (of two colours), a 12 sided design and the inclusion of the Royal Mint's new anti-counterfeiting technology, it will be the most secure coin in the world in circulation.²¹

RECOMMENDATIONS

In light of this call for evidence, Cash Services would like to recommend the following:

- HMRC closely monitors the relationship between tax receipts and non-compliance in countries where cash use is declining at a rate quicker than the global average.
- HMRC ensures that those who wish to use cash legitimately are able to do so without fear of suspicion or being subject to unjustified surveillance.
- HMRC must take steps to ensure a broad approach that incorporates all payment methods is taken when looking at the future for tax compliance. The relative decline in cash is not the panacea to reducing the tax gap or halting tax evasion.
- HMRC must be aware of new payment methods and the potential for tax non-compliance that comes with them.

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²⁰ *Moving to Polymers Banknotes*, Bank of England <http://www.bankofengland.co.uk/banknotes/polymer/Pages/default.aspx>

²¹ *New £1 coin design unveiled*, GOV.UK <https://www.gov.uk/government/news/new-1-coin-design-unveiled>