



House of Commons
Committee of Public Accounts

Tax Credits and PAYE

Eighth Report of Session 2007–08

Report, together with formal minutes, oral and written evidence

*Ordered by the House of Commons
to be printed 28 January 2008*

The Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

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The following were also Members of the Committee during the period of the enquiry:

Annette Brooke MP (*Liberal Democrat, Mid Dorset and Poole North*); Chris Bryant MP (*Labour, Rhondda*), Mr John Healey MP (*Labour, Wentworth*), Ian Lucas MP (*Labour, Wrexham*), Mr Iain Wright MP (*Labour, Hartlepool*), and Derek Wyatt MP (*Labour, Sittingbourne and Sheppey*).

Powers

Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via www.parliament.uk.

Publication

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the Internet at <http://www.parliament.uk/pac>. A list of Reports of the Committee in the present Session is at the back of this volume.

Committee staff

The current staff of the Committee is Mark Etherton (Clerk), Philip Jones (Committee Assistant), Emma Sawyer (Committee Assistant), Pam Morris (Committee Secretary) and Alex Paterson (Media Officer).

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Summary

HMRC has paid £65 billion to tax credit claimants since the scheme was introduced in 2003. Awards are made on an annual basis and payments are initially made on provisional data; a final assessment is made once the claimant's actual circumstances are known after the end of the year, which can change the final value of the award. The Department overpaid £6 billion in the first three years of the scheme. By the end of March 2007 it had collected £2 billion of this debt and written off £0.7 billion. £3.3 billion of these overpayments remain to be collected. It is unlikely to recover £1.6 billion of the debts.

This is the Committee's fifth report on the current tax credits system. Although the administrative cost has increased from £406 million in 2003–04 to £587 million in 2006–07, there is little evidence the Department has the scheme under control. Many claimants continue to struggle to understand tax credits and why they are overpaid. There have been many complaints about the process for recovering overpayments and the Ombudsman continues to receive and to uphold a large number of complaints.

Tax credits continue to suffer from the highest rates of error and fraud in central government. HMRC estimates that claimant error and fraud led to incorrect payments of between £1.04 billion and £1.30 billion in 2004–05. This level of error led the C&AG to qualify his opinion on the HMRC Trust Statement for the fifth year running. The Department still has no targets for reducing error and fraud.

In November 2005, the Department concluded a settlement of £71.25 million with EDS in respect of the computer problems during the introduction of Tax Credits. Of the sum, £26.5 million depends on EDS winning future work from the Government, but the flow of payments from EDS has been extremely small, and it is highly unlikely that new business to EDS will generate the full payment.

Progress in addressing many of the Committee's previous recommendations on tax credits has been disappointing, and the Committee will wish to return to this subject in the future to establish the extent to which these difficulties have been addressed.

On a separate issue, the Department has not been collecting income tax on certain small pensions since the early 1980s, with a potential tax loss of some £135 million per annum. It will not recover tax due from previous years, but will start to collect tax on these pensions from 2008–09.

Conclusions and recommendations

Tax Credits

1. **The Department has overpaid £6 billion in tax credits in the first three years of the scheme.** By the end of March 2007 the Department had collected £2 billion, written off £0.7 billion and made provisions for a further £1.6 billion of overpayments it is unlikely to recover. Overpayments currently affect 1.9 million families a year, significantly greater than the estimate of 750,000 when the scheme was designed. The policy changes to reduce overpayments included in the 2005 Pre-Budget Report have yet to take full effect. The Department should report on their actual cost and effect in terms which show whether they meet their objective of reducing overpayments by one third.
2. **Claimants may not understand why they have to make repayments, especially where they find themselves owing money to the Department where they were not previously in debt.** Some regret ever getting involved with the scheme. The Department is looking to introduce more flexibility into the system to allow it to deal with certain categories of claimant more effectively. It needs to explain clearly in its award notices how the scheme works and how overpayments may arise.
3. **The Department has yet to succeed in clarifying its procedures for recovering overpayments.** The Department has not sought to recover overpayments where it has made a mistake and the claimant could reasonably have thought the payment was right, but has had to make difficult judgements about what claimants could be expected to know. In 2006–07, 371,000 households disputed the recovery of overpayments, of which some 10,000 resulted in write-off. The Department needs to devise and implement a more objective test for assessing when tax credits claimants could reasonably have known they were overpaid.
4. **The Department has made a series of changes to the tax credits computer system, but software errors continue to affect some payments and it still has to fallback on manually processing certain awards.** The Department accepts that the computer system is fragile which makes it very difficult to improve processing. The Department needs to strengthen its computer systems to make them more capable of supporting desired changes to processing.
5. **In 2006–07 the Ombudsman reviewed 393 complaints about tax credits, of which 74% were fully upheld or partially upheld.** The proportion of complaints upheld on tax credits is higher than for any other department investigated by the Ombudsman. It is unsatisfactory that so many people have to pursue their complaint through the Ombudsman, having exhausted the Department's own complaints procedures. The Department needs to determine why such a high proportion of complaints to the Ombudsman are upheld and reassess its own procedures.
6. **Levels of claimant error and fraud remain unacceptably high, and the Department is still losing £1 billion each year.** The Department has accepted the Committee's previous recommendations on the need to set targets for reducing error and fraud, but says it cannot set a target until 2008 when it will hold two years of

good data. The Department should not have taken five years to get these targets in place. When setting these targets, it should also determine the additional resources required to achieve the target reduction in error and fraud.

7. **The Department accepts changes in income and circumstances notified to it by claimants, so erroneous or fraudulent disclosures may only be detected by post payment checking and may go undetected altogether.** The Department needs to assess in detail the risks of claimant error and fraud and establish whether the responses it currently has in place are sufficient to achieve its target reduction in error and fraud.

The Department's settlement with EDS

8. **In settling its claim against its contractor EDS for the problems encountered in implementing the tax credit system, the Department agreed that £26.5 million of the settlement could be paid in instalments reflecting new government business won by EDS.** The Department has recovered little of the £26.5 million and may not obtain payment of full settlement by the end of 2008. We have previously criticised the invidious arrangement that requires the Government to commission further work from the contractor in order to recover compensation for underperformance. The Department needs to work with EDS to accelerate the rate of payments, and should consider litigation if the full amount of the settlement is not forthcoming in 2008.

The taxation of small pensions

9. **The Department is failing to collect an estimated £135 million income tax on certain small pensions each year because of incorrect guidance and failures by local HMRC offices to implement agreed procedures.** The Department's steps to regularise this position mean that some pensioners will have an additional and unexpected tax liability notified to them in 2008–09. The Department needs to alert pensioners to the possibility that their tax liability may change and provide them with longer periods of time to settle any additional tax liability that would affect their ability to pay.

1 The service provided to tax credit claimants

1. In April 2003 Child Tax Credit and Working Tax Credit (tax credits) replaced the previous tax credits system as part of the Government's reforms of the tax and benefits system. The new arrangements were designed to help families with children and working people on low incomes. HM Revenue and Customs (the Department) has paid some £65 billion of tax credits in the first four years of the scheme and it has estimated that an average of 5.3 million families benefited in 2005–06.¹

2. The Department has increased the numbers of staff employed in managing the scheme from 7,300 in 2003–04 to 10,120 in 2006–07. Over the same period the administrative cost has risen from £406 million to £587 million.²

3. This Committee has previously reported on the poor quality of service given to tax credit claimants.³ A significant number of the complaints are about the Department's process for handling recoveries of overpayments and the misery that this causes. The Department accepts that it has not made enough progress in its handling of disputed overpayments and complaints.⁴

4. The Ombudsman's October 2007 Report, 'Tax Credits: Getting it Wrong?' has also drawn attention to a number of continuing problems in the administration of tax credits.⁵ While the Report pointed out that tax credits work for a lot of people, there are continuing problems with the unfair and inconsistent application of the Code of Practice on the recovery of overpayments, the unduly harsh nature of the decisions on recovery and the fact that some of the Department's decisions seem to run counter to the aims of the tax credit policy.⁶ The report also pointed to a particular group of the poorest people in the United Kingdom who are saying that their experience has got them into debt where they previously had not been in debt—causing distress, anxiety and even family break-up—and wishing to have nothing more to do with the scheme.

5. The Code of Practice on the recovery of overpayments, introduced in April 2006, provides for the Department to suspend the recovery of disputed overpayments in cases of genuine hardship until the dispute is resolved. It will also write off overpayments where it is responsible for the error and the claimant could reasonably have thought the payment was correct. In 2006–07, 371,282 households disputed the recovery of overpayments, less than 3% of which resulted in write-off. The number of overpayments written-off following dispute is significantly lower than the levels experienced in 2005–06, as shown in **Figure 1**.

1 C&AG's Report, *Standard Report on the Accounts of HM Revenue and Customs 2006–07*, Part Two: Tax Credits, Figure 1, page R15, HC (2006–07) 626

2 C&AG's Standard Report 2006–07, Part Two: Tax Credits, Figure 1, page R15

3 Committee of Public Accounts, Twenty-second Report of Session 2006–07, *Tax Credits*, HC 487

4 Q 10

5 Parliamentary and Health Service Ombudsman, 5th Report, Session 2006–07, HC 1010

6 Code of Practice 26: What happens if we have paid you too much tax credit? HMRC

Figure 1: Disputed overpayments

	2004–05	2005–06	2006–07
Disputes received	216,679	364,380	371,282
Number of overpayments written off following the dispute	10,300	160,702	9,912

Source: HMRC

6. Many claimants have been concerned about the Department’s application of the “reasonable belief” test in determining whether overpayments should be repaid or not. The Department is reviewing this test to seek to make it more objective, and less reliant on difficult judgements about what people could reasonably believe. Under the new test the Department will be more explicit in setting out the information it expects claimants to check. The Department is also considering its own obligations to act promptly in response to revised information from claimants, for example, by not pursuing overpayments where it has received information but failed to act on it within a given period.⁷

7. The Department has operated a relatively uniform process for dealing with tax credits claimants. It accepts that its approach has lacked the flexibility to provide a service tailored to the circumstances of claimants. It is seeking to move to a system which is more flexible with the aim of uniformity of outcome rather than relying on uniformity of process.⁸ It has piloted service improvements for those who need to make a new claim following the breakdown of the household which ended an earlier joint award. Other improvements involve proactive questioning to establish all relevant facts to allow the effective processing of awards where the circumstances of claimants change.⁹

8. A number of the difficulties experienced by claimants stem from the problems encountered with the tax credits computer system following its implementation in 2003. A number of enhancements have been made to the system to improve the processing and payment of awards and the information provided to claimants. The Department considers that many of the original problems encountered with the system have been largely resolved and that the system is now stable, although software errors continue to result in incorrect payments, and some claims are still processed manually. It also considers the system to be fragile which makes it difficult to develop further.¹⁰

9. The Department has targets for processing information, but these do not show how accurately it is paying claimants. Whilst the Department wrote off £61 million in respect of official error in 2006–07, it does not know the full extent to which official error causes

7 Q 34

8 Q 57

9 C&AG’s 2006–07 Standard Report, para 2.44

10 Q 93

incorrect payment. It is now designing a new check which aims to establish if it is paying the right amount to the right people at the right time.¹¹

Complaints

10. Claimants can complain where they are dissatisfied with the Department's handling of their case. In 2006–07 the Tax Credits Office received 54,483 complaints, representing 55% of all complaints received in the Department.¹² The majority of these complaints relate to the Department's handling of disputed overpayments.¹³ If claimants are unhappy with the Department's initial decisions they can ask it to review their case again. If claimants continue to be dissatisfied, they can ask the Adjudicator to review their case.

11. Claimants can also ask their Member of Parliament to refer their case to the Ombudsman. During 2006–07 the Ombudsman reviewed 393 cases, and either fully or partly upheld 74%.¹⁴ This percentage is lower than the 90% of claims fully or partly upheld in the previous year, but still remains higher than for other Parliamentary complaints investigated by the Ombudsman, where 58% were fully or partly upheld. The Department acknowledges that the proportion of cases being upheld is too high.¹⁵

11 C&AG's 2006–07 Standard Report, para 2.40

12 C&AG's 2006–07 Standard Report, para 2.47

13 C&AG's 2006–07 Standard Report, para 2.47

14 C&AG's 2006–07 Standard Report, para 2.51

15 Q 78

2 Overpayments of Tax Credits

12. Tax credits operate on an annual basis and claimants' ultimate entitlement will depend on their overall income during the year and any changes in circumstances they encounter. The difference between the payments the Department makes, based on information it holds, and ultimate entitlement, results in significant uncertainty for claimants. It also gives rise to a substantial level of overpayments that have to be recovered from claimants.

13. Over the first three years of tax credits the Department has overpaid £6 billion to claimants that has to be recovered, as shown in **Figure 2**. A significant proportion of these overpayments will never be recovered. The Department has so far written off £700 million and considers it unlikely it will recover a further £1.6 billion.

14. The number of families affected by overpayments of tax credits is significantly greater than originally envisaged. At the time the scheme was introduced the Government expected around one million awards to be reassessed as a result of income rises in the first year of the scheme, compared to around 750,000 in subsequent years.¹⁶ As Figure 2 shows, some two million families have been affected by overpayments in each of the first three years of the scheme.

Figure 2: Recovery and write-offs of overpayments from 2003–04 to 2005–06

	2003–04	2004–05	2005–06	TOTAL
Families affected by overpayments	1.9m	2.0m	1.9m	
Total overpayments	£2.3bn	£2.0bn	£1.7bn	£6.0bn
Amounts written off by 5 April 2007	(£0.4bn)	(£0.3bn)	(£0.1bn)	(£0.7bn)
Amounts recovered by 5 April 2007	(£1.1bn)	(£0.6bn)	(£0.3bn)	(£2.0bn)
Debt to be recovered at 5 April 2007	£0.9bn	£1.1bn	£1.3bn	£3.3bn
<i>Figures may not sum due to rounding</i>				

Source: C&AG's 2006–07 Standard Report, Figures 3 & 4

15. The 2005 Pre-Budget Report announced changes which were designed to provide greater certainty to claimants, particularly when claimants see a rise in income. The measures included an increase in the level of income rises disregarded when finalising awards from £2,500 to £25,000 for awards for 2006–07 and subsequent years. There were also a range of other measures designed to encourage claimants to tell HMRC promptly about changes in their circumstances.

16. The Department will publish details on finalised 2006–07 awards in May 2008 which will provide more information on the effect of these measures. It expects that the package

will reduce the value of overpayments by a third. The Department considers this will reduce the level of overpayments to those that were anticipated at the time the policy was introduced.¹⁷

3 Claimant error and fraud

17. Tax credits are vulnerable to fraud through applicants providing false information, for example by failing to declare or understating their income, or by misrepresenting their circumstances, for example by failing to declare the existence of a partner. Claimants may also make genuine errors in their applications which result in incorrect awards.

18. In our last report on tax credits we concluded that the design of the tax credits scheme does not give proper protection against error and fraud.¹⁸ The Department tries to maintain a balance between ensuring the accessibility of the scheme to claimants and maintaining safeguards against the risk of error and fraud. But tax credits continue to suffer from the highest rates of error and fraud in central government. While the Department has a range of measures to combat fraud, including verification checks before the claim is paid, it explained that it accepts changes in income and circumstances notified to it by claimants in good faith.¹⁹ This approach means that erroneous or fraudulent disclosures may only be detected by post payment checks and may go undetected altogether.

19. The Department's most recent estimate of claimant error and fraud in tax credits is based on awards for 2004–05. It shows that between £1.0 billion to £1.3 billion (between 7.3 to 9.1% of the final value of awards) was paid to claimants where they were not entitled. These are HMRC's latest figures for overall levels of error and fraud. The C&AG concluded that these levels of error and fraud are unacceptably high and qualified his opinion on HMRC's Trust Statement.

20. At the Committee's previous hearing, and in response to our last report on Tax Credits, the Department undertook to set a target for reducing error and fraud. The Department has now said that it cannot set targets for the reduction of error and fraud until early in 2008, when it has two good years of data from the early operation of the scheme.²⁰ So the Department will have operated the scheme for five years without a target for reducing error and fraud.

21. The Department is taking steps to accelerate the production of estimates on the level of error and fraud and will publish results for 2005–06 at the end of 2007. It plans to publish figures for 2006–07 during the summer of 2008. It is also examining how it can obtain early indicators of attempted error and fraud, for example, by deriving an estimate from its compliance work on new claims.²¹

18 Committee of Public Accounts, Twenty-second Report of Session 2006–07, *Tax Credits*, HC 487

19 Treasury Minute; Committee of Public Accounts, Twenty-second Report of Session 2006–07, *Tax Credits*, HC 487, paras 15–17; Q 48

20 Q 8

21 C&AG's 2006–07 Standard Report, para 2.32

4 The Department's settlement with EDS

22. Serious problems with the introduction of the computer systems used to support tax credits delayed the processing of claims and led to incorrect payments being made. In November 2005 the Department announced it had settled its claim for compensation with EDS for £71.25 million. The settlement includes cash payments by EDS and the off setting of certain amounts which would have otherwise been due from HMRC to EDS. Of this sum, staged payments of up to £26.5 million are contingent on EDS winning new business with the United Kingdom Government. Final settlement of the dispute is contingent on EDS paying the full amount of £71.25 million and the Department has reserved the right to reopen court proceedings if the full amount is not received.

23. In practice, the flow of payments from EDS has been extremely slow because EDS has been less successful in winning government contracts than the Department expected.²² It is highly unlikely that new business for EDS will generate the full payment by the end of 2008 that the Department envisaged. The Department acknowledged that it would take a long time to receive the full amount at the present rate of payment.²³

24. The Department has held meetings with EDS. It is determined to ensure that it obtains the full settlement even if the new business for EDS is not enough to generate the full payment. The Department is taking steps with EDS that it believes will accelerate the rate of payments from January 2008 and will return to litigation if the full amount of the settlement does not look to be forthcoming within the envisaged period. The Department has discussed with its lawyers a process for bringing the matter back to the courts if the acceleration of payments during 2008 does not meet its expectations.

22 Q 58

23 Q 63

5 The taxation of small pensions

25. Incorrect guidance and failures by local HMRC offices to implement agreed procedures has meant the Department has not been collecting income tax on certain small pensions in line with Pay As You Earn regulations. This issue dates back to the early 1980s but the Department only became aware of the problem in 2005. It changed its guidance, but it did not write to pension providers to alert them to the changes. As a consequence the changes went unnoticed and were not implemented. Some local tax offices allowed pension providers to continue their previous incorrect agreements even when the providers queried the changed instruction.

26. The Department estimates it may not be receiving income tax from 420,000 pensions with a tax loss of around £135 million per annum. It has now begun work to put these pensions on a proper footing but it does not intend to recover tax which was not been deducted in years earlier than 2007–08. Pensioners affected will have started to accrue debts from April 2007 and the Department will start to collect these amounts from April 2008. It may take longer to identify some pensioners.

27. The Department has considered writing to pension providers to try to identify those most likely to be affected. It explained that any requirement it placed on pension providers to provide it with information could only be voluntary, which could lead to only those pensioners where their provider had provided information being approached.²⁴

28. The Low Income Tax Reform Group have pointed out that the Department's approach could leave some 420,000 pensioners affected unaware they have a liability until 2008–09.²⁵ It has also expressed concern that the decision to recover unclaimed tax back-dated to April 2007 might deprive people of the opportunity to make claims to the Department of Work and Pensions (DWP) for adjustment to their pension credit entitlement. The Department are in discussions with the DWP to overcome this problem by extending entitlement to pension credit.

24 Q 77

25 Q 75; Ev 21

Formal Minutes

Monday 28 January 2008

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Angela Browning
Mr Philip Dunne
Mr Nigel Griffiths
Mr Keith Hill

Mr Austin Mitchell
Dr John Pugh
Geraldine Smith
Mr Don Touhig

Draft Report (*Tax Credits and PAYE*), proposed by the Chairman, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 28 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Eighth Report of the Committee to the House.

Ordered, That the Chairman make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned until Wednesday 30 January 2008 at 3.30 pm.]

Witnesses

Wednesday 10 October 2007

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Paul Gray CB, Chairman, **Sarah Walker**, Director, Benefits & Credits, and
Michael Shipp, Director PAYE, Self Assessment & NICs, HM Revenue & Customs

Ev 1

List of written evidence

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Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 10 October 2007

Asterisks in the oral evidence denote that part or all of a document has not been reported, at the request of HM Revenue and Customs and with the agreement of the Committee.

Members present:

In the absence of the chairman, Mr Alan Williams was called to the chair

Mr Richard Bacon
Angela Browning
Mr David Curry

Mr Philip Dunne
Mr Austin Mitchell
Mr Don Touhig

Sir John Bourn KCB, Comptroller and Auditor General, **Mr Tim Burr**, Deputy Comptroller and Auditor General and **Mr John Thorpe**, Director National Audit Office, were in attendance and gave oral evidence. **Ms Paula Diggle**, Treasury Officer of Accounts, HM Treasury, was in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HM Revenue & Customs 2006–07 (HC 626)

Witnesses: **Mr Paul Gray CB**, Chairman, HM Revenue & Customs, **Ms Sarah Walker**, Director, Benefits and Credits, HM Revenue & Customs and **Mr Michael Shipp**, Director PAYE, Self Assessment, NICs, HM Revenue & Customs, gave evidence.

Q1 Mr Williams: Before we start, may I welcome our guests from overseas, from various parts of the Commonwealth who are members of the Trust in Government Study Group. I had been going to say I hope you will be comfortable here, even if you will not be interested, but looking around I see most of you are not even going to be comfortable, so I hope we can compensate on the interest. The hearing today is with Her Majesty's Revenue & Customs on Tax Credits and PAYE. Our principal witness has been with us on various occasions, Paul Gray. Would you introduce your colleagues, please?

Mr Gray: Thank you, Mr Williams. On my right is Sarah Walker, who is the Director in charge of the Benefits and Credits Directorate in the Department, and therefore has particular accountabilities on Tax Credits. On my left is Mike Shipp who is the Director in charge of our PAYE, Self Assessment and National Insurance Directorate, and therefore has particular accountabilities around PAYE, the other aspect of the hearing.

Q2 Mr Williams: Thank you. First of all if we turn attention to you, Mr Gray, and the issue of overpayments, I see from the Report that since the system was set up in 2003 there have been overpayments of £6.6 billion, but £3.9 billion of this still has to be collected and that you are calculating that probably £1.6 billion never will be recovered. These are staggeringly high figures, are they not?

Mr Gray: They are large figures, Mr Williams. The only figure I would comment on if I may is the last of them where you said £1.6 billion we are expecting not to collect. The £1.6 billion is actually the provisions

that we have made in our accounts; we certainly aim and hope to collect a further proportion of those overpayments, but in accordance with proper accounting practice as audited by the NAO we have made provisions for that in our accounts. The level of over-payments over the first three years of the operation of the new Tax Credits has come down somewhat; it was £2.2 billion in the first year, 2003–04, it has come down to £1.7 billion—

Q3 Mr Williams: That is only a 25% drop.

Mr Gray: Yes, and it is still a large figure. As a result of both the actions we are taking to seek to improve the administration of Tax Credits and as a result of the range of policy adjustments that were made in the pre-Budget Report two years ago, the 2005 Report, we are anticipating that those on their own will bring down the level of overpayments on an annual basis by about a third, which will bring it much closer to the level of continuing overpayment that was always anticipated and was debated in Parliament at the time that the policy was introduced.

Q4 Mr Williams: As a department you do not seem to have discovered millions; when you do things you do them in billions, like your fraud and error record: you are losing £1 billion each year on fraud and error and you actually do not believe anyone when they say that you fail to give proper protection. When you look at the Treasury minutes, minute 15 on page 11 says: "The Department notes [that is your department] the Committee's conclusion but disagree that it failed to design a scheme to give proper protection against

HM Revenue & Customs

error and fraud.” Can you seriously sit there and say that with error and fraud running in the billion range you have an effective or a worthwhile system?

Mr Gray: I am not satisfied yet that we have—

Q5 Mr Williams: I am glad of that.

Mr Gray: Brought down the level of error and fraud to anything like the levels that we need to, so I am not sitting here feeling remotely complacent about the position that we are in, far from it. The point of that comment in the Treasury Minute was that we do feel we put in place appropriate systems at the start of the introduction of the policy; we are now progressively seeking to put in place ever more effective methods. On your point about billions rather than millions, I would certainly often sooner sit here talking to you in millions rather than billions, but the scale of our operations is extremely high here. We are now paying out of the order of £20 billion a year in Tax Credits, we operate a very large business, but as I have just said I am extremely keen that we get in a position in which we can very significantly reduce those levels of fraud and error from the figures collated in the first two years.

Q6 Mr Williams: But if you find a billion evidence of proper protection in relation to fraud and error, what would you regard as failure?

Mr Gray: Can I just refer to them perhaps as error and fraud. What we are talking about here, and we have only had measurements for the first two years of the system, 03/04 and 04/05 up to this point, the great majority of that figure as measured in the first two years is error rather than fraud.

Q7 Mr Williams: Can you tell us the proportion?

Mr Gray: In the first year it was something like 90% error, in 04/05 it was rather higher than 90%—Sarah Walker may be able to supplement the figure—but we are talking about well over 90% in those first two years. We recognise that in the first two years of the operation of the system we had not done enough to support claimants for Tax Credits being in a position where we were supporting them to make their applications and their renewals with us, in a way which reduced the amount of claimant error. That has been the focus of a large number of the administrative changes that we brought in.

Q8 Mr Williams: We have three times recommended in three Reports that you should set yourselves targets, and three times you have ignored that recommendation. Was that not a bit presumptuous in the circumstances?

Mr Gray: I certainly would not wish to be presumptuous, and I do not think we have ignored it, if I might say so. What I said when I appeared before the Committee last on this subject—and it was repeated in that Treasury Minute to which you referred—was that we firmly intend to set targets for the reduction of error and fraud. What we said in that last Treasury minute was we felt it was important to have two good years of data from the early operation of the system before we could meaningfully set targets for the reduction. What I have put in place since the

Committee’s last hearing on this subject is measures to speed up very much the collection of the fraud and error statistics by the random enquiry process; I am hoping that by the end of this year we will be able to publish the results for 2005–06; by the middle of next year to have published the figures for 2006–07, so we will have speeded up by 12 months the timetable where we are able to publish the estimates. As part of the spending review settlement which was announced yesterday by the Chancellor, which included provisions for the targets that departments will operate to over the next three years, that includes a provision for us to set explicit targets for the reduction of error and fraud in Tax Credits. In line with what we have said before I do not think it would be sensible to seek to do that until we have got the figures for 2005–06, which as I say I hope we will have by the end of this calendar year; I then envisage that, alongside the setting of all our other three year departmental targets, early in 2008 we will be bringing forward and setting explicit targets for the rate of reduction in tax credit error and fraud.

Q9 Mr Williams: I must say I am surprised the Treasury has not been applying pressure on you to set targets earlier than that, but that is for the Treasury—

Mr Gray: This is a process I was extremely keen to enter into myself, Mr Williams, I have not been pressured to do this, I think it is entirely appropriate as the head of the department that we should do this but only when we have a reasonably firm basis on which to do so.

Q10 Mr Williams: Switching to the overpayments, there have been two rather damning reports, there is Ann Abraham, the Ombudsman, who has said that 91% of all complaints handled by her office in relation to your department result from what she described as: “the unfair and inconsistent application of rules to claim the money back” and she is quoted as saying that: “this is often with a distressing, devastating even, effect on families”. Does that not worry you?

Mr Gray: It does concern me that we have not improved as much as I would like our handling of overpayments and complaints. I frequently discuss these matters with Ann Abraham, the Ombudsman, and indeed was doing so earlier this week. Actually, in the latest year of her findings the percentage you quoted, 91%, has come down to just over 60%¹; that is still too high and I am very keen to see it come down further. In her latest report on Tax Credits which was published yesterday she has made a number of further recommendations for the way in which we do handle overpayment disputes. I am very happy to take on board those recommendations and, as I say, earlier this week I was having a constructive discussion with her about how we implement them. The only other thing I would say is that by definition the number of cases that come the Ombudsman’s way is an extremely small proportion of the total; she gets perhaps 100 or 200 cases a year. I say that not to

¹ *Note by witness:* 63% is the proportion upheld in whole or in part for Parliamentary Ombudsman cases generally in 2006–07. The corresponding figure for Tax Credits cases in 2006–07 is 74%.

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minimise the importance of the points she makes nor to minimise the need for us to get better at the way we handle our complaints, but the vast majority, over 95% of the overpayment disputes which we handle, do actually involve no official error and do not give rise to the sort of issues that she has highlighted in here.

Q11 Mr Williams: The example quoted in *The Guardian* the other day was of a man dying of cancer who had correctly provided information; you then told him he had received £5,700 in overpayment, and when the Ombudsman took it up with you, you eventually relented even to the extent of saying that you would also provide £170 in compensation, which unfortunately went to his estate and not to him because he had already died; it took you that long to sort the problem out. The Citizens' Advice Bureau in their report this week say that more than half of claimants would be less likely to claim the means-tested benefit in future as it as a result of their experience. That is very, very worrying.

Mr Gray: That is a worrying finding on their part. Again, we regularly discuss these issues with the Citizens Advice Bureau and I do not seek to minimise the significance of the points that they are raising. In the particular case and some other cases that you quoted it is quite clear we have not handled as appropriately as we should, and I am not infrequently in correspondence with various of you around the table and other Parliamentary colleagues in relation to cases that we have not handled well. I do not seek to defend that, we need to get better on handling those cases, but again without trying to imply any complacency on my part it is a very small proportion of the total cases being handled; on average every Member of this House has something like 10,000 families in their constituency who are in receipt of Tax Credits. Even if you have 10 or 20 problem ones, that is 10 or 20 too many but it is in proportionate terms the tip of a very large iceberg, but we need to resolve all of them I accept.

Q12 Mr Touhig: Mr Gray, in paragraph 2.4, page 2, we see that the Department's performance targets are based on whether or not the information is correctly entered into your tax credit system, not on whether the actual payment is correct. Why is that?

Mr Gray: That has been the way in which the targets have been set in the past; as we are moving forward we are looking at ways in which we can improve the way in which the targets are set. I do not know if Ms Walker wants to add anything on this point, but in the first round of Tax Credits we were operating on a particular set of targets, we are looking to see whether there are ways in which we can improve that.

Q13 Mr Touhig: As I understand it, Mr Gray, tens of thousands of people can be getting the wrong amount of credit, but so long as you have correctly entered in the information, you meet your targets.

Mr Gray: We are measuring the accuracy of what we put into the system, but at the end of the day we seek to ensure that people are actually getting the right amount of money to which they are entitled.

Q14 Mr Touhig: But your target is based not on whether they are the right amount but whether you have correctly inputted the information. Do you get a bonus if you meet your targets; you and your senior colleagues, do you get bonuses?

Mr Gray: Not specifically in relation to that individual target.

Q15 Mr Touhig: But you get bonuses.

Mr Gray: We are eligible for bonuses.

Q16 Mr Touhig: So here we have a target which is in no way beneficial to the recipient but provided you have correctly inputted the information, you have hit the target.

Mr Gray: That particular target; I am subject to a much wider range of targets in terms of the overall performance.

Q17 Mr Touhig: In 2006–07 you wrote off £61 million in respect of official error, so therefore we could have thousands of people across the country not getting their correct benefit, you have to write-off money in error and you still meet your targets because your target is based upon inputting information, whether it is correct or not, no matter what the customer eventually gets at the end of the day.

Ms Walker: Perhaps I can help. The target is expressed in terms of the actions taken by our staff because that is what we are trying to measure at that point, but it is true that we also look at the accuracy of the payment, and the level of accuracy of payment is similar; there is no evidence that there is anything wrong in between the inputting of the information and the payment going out, but we are looking to change so that we do actually measure the payment going out. The official errors that result—

Q18 Mr Touhig: That might be some more incentive to you then to actually get it right, if your target is based upon making sure that people get the right amount of money.

Ms Walker: Of course.

Q19 Mr Touhig: Yes. In response to our earlier Report you rejected our view that you operated a: "pay now check later approach" in processing claims. You go on to say you designed the scheme to give proper protection against fraud and error, and in support of that on page 11 of the Treasury Minute you say that one of these measures actually means that you carry out verification checks of claims before payment. If that is the case, how have you overpaid £6.6 billion?

Mr Gray: At the point at which we are verifying the payment we are verifying that in relation to the information we have available at that point we are correctly paying out the right amount of the claim.

Q20 Mr Touhig: So we were right to say you were actually pay now check later.

Mr Gray: Sorry, can I just finish? In relation to the way Tax Credits operate, as I think you are aware, Mr Touhig, this is an annual system. The precise entitlement at the end of the year depends on the

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claimant's overall income over the course of that year and any change of circumstances that they encounter, so there is a potential difference between us paying the right amount of money at the point of claim in relation to the information that we then have available, and the eventual entitlement after the end of the year which, in accordance with the Act—

Q21 Mr Touhig: I understand the point you are making, so that verification check is nothing really, is it, it does not mean anything?

Mr Gray: It does mean something. What it does mean is that if there is any evidence of fraud at the point of claim then we are making checks to seek to ensure we are not paying out inappropriately.

Q22 Mr Touhig: If that is a bit belt and braces it still has not stopped you overpaying £6.6 billion; you need to pull your socks up a bit.

Mr Gray: For the reason that I have sought to explain, as was indicated at the introduction of the system, because of the Government's wish to have a very flexible system that responded to people's changing circumstances it was anticipated that there would be very significant overpayments.

Q23 Mr Touhig: Do you understand the misery that you cause people when—I believe because of errors on your part—you then seek to recover money?

Mr Gray: I seek to understand their position. I am not a tax credit recipient myself.

Q24 Mr Touhig: Do any of your family receive Tax Credits?

Mr Gray: They do not.

Q25 Mr Touhig: Any friends?

Mr Gray: Some other members of my family do.

Q26 Mr Touhig: So you do have some knowledge and experience.

Mr Gray: I have some knowledge.

Q27 Mr Touhig: If they come and tap on your door and say: "Hey, you know, your office has really mucked up my tax credit", you are face-to-face as we face people daily with these problems.

Mr Gray: I seek to understand that and, as you know, I very deliberately personally involve myself in a large number of the cases that you and other colleagues write to me about, so I seek to understand the position. What we are aiming to do is to operate the recovery of overpayments in the way in which the whole system was designed; I accept, as I said to Mr Williams, that in a proportion—I believe it is quite a small proportion—of cases we have not operated this in the past as effectively as we should have done.

Q28 Mr Williams: There is no doubt, there is no doubt.

Mr Gray: We have progressively introduced changes to improve it, I am committed—

Q29 Mr Touhig: We have produced several Reports and you have not really made a lot of progress since we were producing these Reports. Mr Gray, the average income of in-work families receiving tax credit is £22,000 a year; 48% of those actually get £20,000 or less. Looking at your department's accounts, I see that you have substantially more as your income, £165,000–£170,000 a year, additional benefits in kind of £33,900. Families who face having their Tax Credits cut because of some problem which I believe is your fault can have up to 30% of their income cut in a week; how do you think you would feel if somebody cut your income by 30% in a week?

Mr Gray: The point you have just made is the point I was seeking to address just now, that I seek to understand the position of people in that situation. What we are doing through this system is supplementing people's income; if people's circumstances have changed such that their entitlement to Tax Credits, in accordance with the parameters of the system which Parliament laid down, has changed, then it is appropriate for me within those parameters to make an adjustment to the net amount of additional income that we are putting into that household.

Q30 Mr Touhig: You said earlier that you did not think the Parliamentary Ombudsman had a great many cases—I am paraphrasing what you said.

Mr Gray: That is not quite what I said.

Q31 Mr Touhig: I have seen the report that Mrs Ann Abraham produced, she says Tax Credits represent 26% of all the cases she handles.

Mr Gray: Yes, and that is too high a proportion and I am interested—

Q32 Mr Touhig: You are telling me it is too high.

Mr Gray: —in seeing it coming down.

Q33 Mr Touhig: One key area of complaint, she says, is the unreasonable recovery of payment system that you have got; you make people's lives a misery; you harass them, you harangue them and you make them almost desperate.

Mr Gray: I am not sure those are quite the words that she used.

Q34 Mr Touhig: No, those are my words, that is what happens when people come to see me when we cannot get any sense or any positive response out of your office.

Mr Gray: I said just now I am committed to introducing further improvements in the way in which we do this. The particular issue that I know has troubled some of your constituents and others is the operation of what we have termed the reasonable belief test which we apply as to whether or not we think people should repay overpayments to us. The former Paymaster General announced to the House in June that we were going to have another look at the definition of that test and to seek to make it rather more objective, less reliant on, inevitably, difficult judgments about what people could reasonably believe. Following the consultation that is nearly

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completed on this exercise, we will be introducing a revised approach to that test where we will move away from reliance on judgments of reasonable belief and we will be much more explicit in setting out a contract of responsibility in which we will be very transparent about the things we believe it is appropriate for claimants to check, but equally we will be very explicit about the side of the contract that we need to live up to, and in particular one change we will be making in that is we will impose a maximum of 30 days. We are still considering whether it should be a smaller period than that in which case, if we have been given revised information by a claimant and we have failed to act on it, we will accept the responsibility is ours and we will not pursue the overpayment in those circumstances.

Q35 Mr Touhig: In *Accountancy Age* on 8 March it said of you that you were a popular figure. Advisers like your open manner and your willingness to solve problems. I have asked you to come to Wales to meet some of my constituents; will you come? I will pay your fare.

Mr Gray: I think I could even manage to pay it myself.

Q36 Mr Touhig: You might even manage to pay it yourself.

Mr Gray: Given the things you commented on earlier. I certainly make it a practice to be out and about in the country very regularly; I am very keen, as I do on those occasions, both to meet members of my staff and the people we are seeking to serve.

Q37 Mr Touhig: So you will come.

Mr Gray: If you are offering me an invitation, Mr Touhig.

Q38 Mr Touhig: I wrote to you; I have not had a reply, so I will take it now that you will come. I have got one or two witnesses now.

Q39 Mr Williams: You could go on a Celtic tour.

Mr Gray: Is this going to be a kind of joint Welsh invitation?

Mr Touhig: Yes, you will find it very polite.

Q40 Mr Curry: Mr Gray, you run a business you said which is paying out about £20 billion, which must be roughly what the Bank of England has lent Northern Rock over the last few weeks.

Mr Gray: That is just Tax Credits.

Q41 Mr Curry: Yes, that is just Tax Credits. My constituents are probably earning a great deal less than the mean of the people you are helping, and the problem arises how does the little chap or lady in Skipton deal with this huge organisation which you run. What happens when they phone? If they phone you what happens; what do they get on the end of a line. When did you last phone Customs & Excise—not to your office but the general line?

Mr Gray: I do it periodically because I wish to test the effectiveness of my organisation. What they find increasingly is that the phone is answered quickly and they get a reasonable service. In the past we have had

difficulties with our contact systems, but in the last year 2006–07 99% of the people who called were able to get through on the day they called and 85% of the calls were answered within 20 seconds and the overall satisfaction levels—and we have independent surveys done on this, we do not just run our own survey and 87% of the people surveyed who use our telephone service expressed either that they were very satisfied or satisfied.² I wish to make that higher than 87%, but I think that is not too bad a record and one that compares pretty favourably with other large organisations.

Mr Williams: There is a division so we will pause for about ten minutes. Can Members be back as soon as possible.

The Committee suspended from 4.00pm to 4.06 pm for a division in the House.

Mr Williams: Thank you, Mr Curry, continue, please.

Q42 Mr Curry: Mr Gray, what I am getting at is that when we were talking a couple of years ago I guess the issue of overpayment would have been the predominant issue in my constituents' postbag. I do not argue, this is public money and you are not in the business of handing out gifts, it is a question of recovering it in a manner which is as little damaging as possible, but the problem I am finding now increasingly is people saying: "Our circumstances changed, we did our best to inform Customs & Excise that our circumstances had changed, and yet it was like tickling a crocodile, we could not get a response, the message never seemed to get through." There is a constant series of adjustments—it is like the worst days of the Child Support Agency, exactly the same problem where we get through but nothing seems to happen, the file is not available. When somebody does phone, first of all does a human being answer the phone, in the first instance?

Mr Gray: A human being answers the phone.³

Q43 Mr Curry: So there is no recorded message, none of this stuff where you need a degree in physics to work out where you are trying to go.

Mr Gray: And no *Greensleeves*.

Q44 Mr Curry: And the people are based in the UK?

Mr Gray: Yes.

Q45 Mr Curry: If I phone and say, "I just want to let you know that I am in receipt of Tax Credits and my partner has got a new job, he has ceased to have a job, or he has got into a job" or something like that, what happens to that information?

² *Note by witness:* Survey figures refer to 2006–07.

³ *Note by witness:* HMRC operate a number of different help lines, with differing arrangements to help callers navigate to the assistance that they are seeking. On further investigation it has been established that recorded introductory messages are played on the Tax Credits Helpline as well as interactive voice recording which gives caller options to aid call routing to the appropriate human adviser. Recorded music is played while customers are held in any queues.

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Mr Gray: What happens is they will get through to one of our call centre staff who, having gone through the appropriate identification checks—and that is of course very important—will—

Q46 Mr Curry: What, ask you things like date of birth?

Mr Gray: Yes, for verification. Having got that identification complete will go into the online Tax Credits system.⁴

Q47 Mr Curry: When somebody calls and says my name is Mrs Bloggs they will pull up the data on the screen.

Mr Gray: Yes, and in the great majority of cases they then successfully record whatever the change of circumstance is which will then automatically generate an adjustment to that case and will generate a revised award notice, or award notices, given that we are legally obliged in the case of couples to send award notices to both, recording hopefully accurately the change of information that has been given. That is accompanied by a request to the claimant or claimants to check that we have satisfactorily recorded the change and implemented what they have reported. In the great majority of cases that works very satisfactorily.

Q48 Mr Curry: Is there a process of verification that what you have been told is accurate at that stage or not?

Mr Gray: Not in terms of—let us say it is a change of income, my income has gone up by £2,000 or whatever. We accept that change in good faith, we then get to the end of the year in question—coming back to what I was saying that it is an annual system—we then send out a form to people that they are required to fill in giving their income and other circumstances for the year, and we then go through a process of finalisation which, if there is any change in that information, will generate either an underpayment or an overpayment to be implemented. That is how the system is meant to work, in the great majority of cases it does. In some cases, as you imply, we do not get complete success with that and either the information is not correctly inputted to the system or there is some other error on the way.

Q49 Mr Curry: But it is the person in the call centre who puts the new input in, and that goes straight through, without an intermediate phase, to the payment body.

Mr Gray: Yes, it is a computerised system, as the input goes in that will happen.

Q50 Mr Curry: Have you got any note of the percentage of accuracy of the new information given, because if I were to call you in May how soon would the new payments come through?

Mr Gray: Typically within a few weeks. I do not know if Sarah wants to be more accurate on that, but the information is input, the system is operated and there are then, obviously, kind of lags in terms of, for example, most people are paid into the bank and the thing has to go through the bank system and so on. Typically it would happen in a few weeks, is that right?

Ms Walker: Yes.

Q51 Mr Curry: What proportion of your claimants do in fact have changed circumstances in the course of a year?

Mr Gray: The great majority, to one extent or another, but the extent in the change of circumstances varies a great deal and the significance of the change of circumstance also varies, because people who are at the upper end of the income range who are just getting the simple child payment who are not on the taper within the system, then a modest change in their income will not generate any change in entitlement. For the people who are in the taper part where, as their income goes up their entitlement goes down, there is a significant gearing because the taper is 37% as you go up the scale.

Q52 Mr Curry: Yes, but you cannot have a criterion which says to the claimant there is a point at which it might not be worthwhile your letting us know, can you?

Mr Gray: No.

Q53 Mr Curry: You must require that all changes in circumstances are notified to you.

Mr Gray: All changes except in relation to where we have a *de minimis* income range which was £2,500 and now is actually £25,000.

Ms Walker: But even in those cases we need the customer to tell us because even if it does not affect the payments they get in that year it will affect the payments they get in the subsequent year, so all relevant changes of circumstances we encourage people to report.

Q54 Mr Curry: How many people drop out of the system roughly a year, other than by dying, which is a fairly dramatic way of dropping out?

Mr Gray: I do not have the precise figure, I am afraid, I do not know if Sarah has. There obviously are people moving out of entitlement, particularly in relation to children because as their children move beyond the fulltime education stage then they cease to be eligible, so it is probably getting on for a million possibly.

Ms Walker: I do not know. There are people who change awards; if they leave a partner—for instance they split up and they start again as a single parent—they will have a different award so the cycling between awards is quite a high number, but also there are people whose income goes up above the point at which they are entitled to Tax Credits.

⁴ *Note by witness:* This is a reference to HMRC's computerised Tax Credits system which can only be accessed by HMRC staff. It is not an online system.

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Q55 Mr Curry: You are keeping a lot of balls in the air simultaneously, almost on every single claimant. The people who work in your call centres, what sort of rate of turnover is there, is that a very stable workforce?

Mr Gray: In our contact centres it is relatively high compared with the rest of our organisation, something like 15%; it is relatively low compared with the contact centre industry in general. For our back office staff—we have just been talking about telephone contact here but a lot of the work within the tax credit office will be paper-based work—there the turnover is significantly lower, probably not much more than 5%.

Q56 Mr Curry: But basically you are operating a business in which you have a very large number of claimants, you are dependent upon the information given to you by those claimants and the interface between the two is a workforce which is subject to relatively rapid turnover compared with the rest of the organisation. I guess it is quite a stressful job, is it not?

Mr Gray: The fact that our turnover in our contact centres is less than the generality of contact centres says to me that it is not particularly stressful compared with that type of telephone work generally. We have no significant difficulty in any area of the country in recruiting people.

Q57 Mr Curry: My final question, Chairman, if somebody gives you new information and they feel that you have got it wrong, let us put it in those terms, have you got a fire brigade mechanism which says there is obviously a problem with that case, can we just sort it out, so they do not just rumble on and on?

Mr Gray: Traditionally we have operated a relatively uniform approach for dealing with all claimants and have relied, if we have got something wrong, on the claimant recontacting us when they get their new award notice. What we are increasingly introducing is what we are calling the Tax Credits Transformation Programme, under which we are seeking to identify particular categories of tax credit claims and particular changes of circumstance that we know are liable to cause difficulty—the break-up of a partnership is probably the most significant of these—and we are looking to have a much more dedicated approach to dealing with people in that circumstance and also in cases which have had significant difficulty, and a number of you may have seen references in letters I have sent to you, we are appointing individual case workers now to deal with those cases. Frankly, we could not do that for six million families but we are seeking to move to a system in which we are more flexible about the way we operate the system with different categories of claimants so that we get more uniformity of outcome for people rather than relying on uniformity of process.

Q58 Mr Bacon: Mr Gray, I would like to start by asking you about the settlement with EDS and the payments that you have received under this. You

wrote to this Committee last year to say that the level of payments had been lower than expected and that this was a real concern. You will recall that the settlement was originally some £71 million of which £44 million or so was upfront in cash or near cash and the rest, about £26.5 million, was deferred; when I asked you about this before you told us also that you were not happy with the level of payments—from the figures you gave us less than £250,000 had been paid. How much has been paid now?

Mr Gray: As I explained to you last time we had this discussion in public session, Mr Bacon, I am not in a position in public to give you the precise figures. As you will recall I have agreed on previous occasions if you wanted to pursue that to go into private session and to give you precise figures. The reason for that is that I am bound by a confidentiality agreement and given that, following an earlier hearing with my predecessor, the Committee published the formula which determines how much EDS should be paying us in relation to the amount of new business they are getting, if I give a figure of how much they have paid us it is possible for people to work out precisely how much new business they have got. I cannot do that in public; I am happy later to go into private session if you wanted. What I can say, Mr Bacon, is that the flow of further payments over the last few quarters has continued to be extremely small. It is quite clear that over the last two years EDS has been less successful in winning contracts for provision of public sector IT support in the UK than it was expected to be. Against that background we have recently been having a series of meetings with the management of EDS here in the UK; I have been in contact with my counterpart, the Chairman of EDS in the US as part of that process. I and my team have been making clear to EDS that the present level of payments cannot continue indefinitely, I am determined to ensure that we do obtain the full amount of the settlement even if the flow of new business to EDS is not enough to generate the full payment to us.

Q59 Mr Bacon: Can I stop you there, that was a very helpful summary. You said to us a year ago—I did not look up the date before I came but it was roughly a year ago—

Mr Gray: I think I said I was getting concerned; I am seeking to sound a little more concerned now than I was then.

Q60 Mr Bacon: You sounded quite concerned then and I know that it is okay for this Committee to pursue it because I asked the Prime Minister about this on 4 July and he said, and I quote, “The Committee of Public Accounts is welcome to look at it”.

Mr Gray: He did.

Q61 Mr Bacon: So I know from the highest possible authority that this is an okay thing to look at.

Mr Gray: And I hope you will accept that I have been extremely open with you.

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Q62 Mr Bacon: You have. I hope, Chairman, therefore that we can ask further questions on this in private. But I would still like to know, your department has issued a statement in which you said “We are exploring with EDS whether the number of contracts in which HMRC receives payment and the proportion of each contract paid over to HMRC can be increased.” What does this mean?

Mr Gray: It means exactly that. At a meeting with EDS just yesterday we have now agreed steps that we believe will accelerate the rate of payments from January 2008. However, the proof of the pudding will be in the eating; I am making it absolutely clear to EDS that if the full amount of the settlement does not look likely to be forthcoming within the originally envisaged period, roughly towards the end of 2008—

Q63 Mr Bacon: I calculated that at the rate you were receiving it, it would take 106 years. Do you differ from that?

Mr Gray: I am not going to comment on the precise figures for the exact reason that I gave you before, Mr Bacon; it would clearly take a long time at the present rate and that is why I am making absolutely sure that should it prove necessary we will, as the agreement provided for, return to litigation. We have carefully archived millions of relevant documents in case that proves to be necessary and I have been discussing with our lawyers a process for bringing the matter back to the courts if the acceleration of payments during the course of next year does not meet my expectations. I hope that it will.

Q64 Mr Bacon: Thank you. I will move on. What did you think of Ann Abraham’s report that was published earlier this week? This one.

Mr Gray: Yes, indeed, I have got it in front of me.

Q65 Mr Bacon: I am sorry, I waved the wrong one, I was waving the June 2005 one. The red one not the orange one.

Mr Gray: It is an even brighter red one.

Q66 Mr Bacon: It is even brighter; it is getting worse. The first one was called *Tax Credits: Putting Things Right*, two years later it says *Tax Credits: Getting it Wrong?* What does that tell you about what sort of progress you are making?

Mr Gray: With a question mark, but I agree it was an interesting title. I am very happy to be in receipt of Ann Abraham’s report, in which she has obviously been discussing her emerging findings as they have been proceeding with us. As I sought to say to one of your colleagues—I think it was the Chairman earlier on—she raises a number of issues which I am extremely happy and keen to pursue.

Q67 Mr Bacon: Are there significant points in it with which you disagree?

Mr Gray: Some of the tone and precise language probably uses words which I would not have put in exactly those words myself.

Q68 Mr Bacon: Can I just refer you back to the June 2005 one, because actually the tone of this latest report, published on 8 October, in that she bends over backwards to be fair to you and to provide ministers with things that they can quote. “I am in absolutely no doubt from the discussions and exchanges that I and my staff have had with HMRC at the most senior levels that they are continuously seeking to improve their own performance” and so it goes on. You find loads of quotes like that, but the point is that the Report from two years ago said, without questioning the policy in itself, “it raises wider and more fundamental issues which are not for me but are for the Government and Parliament to address, such as whether a financial support system which includes a degree of inbuilt financial uncertainty can meet the needs of this particular group of families.” That was two years ago, and now she is saying, in questioning whether it was appropriate to return to the subject and have another full report like this, that the unfair and inconsistent application of code of practice 26, the unduly harsh nature of some of the decisions on recovery that she had seen, the extreme distress thereby caused to low income families and the fact that the outcomes of these decisions seem to fly in the face of the aims of the tax credit policy, were sufficient to warrant a further Report, and indeed Ann Abraham said on the radio the other day that although Tax Credits work for a lot of people, there is a particular group of the poorest people in the UK who are saying their experience is such that whether or not they are entitled to it they want nothing more to do with it, it has got them into debt where they were not previously in debt, it has caused distress, anxiety and even family break-up, so you have still got quite a long way to go. I am glad to say I will not read them all out because it would take too long, but on page 10 there is a whole litany of things that you are still getting wrong and I will just identify one. “One of the problems is that HMRC does not take account of the number of times someone had notified HMRC of things that might well affect their award, such as a mistake on their award notice, a change of circumstances, and that HMRC had failed to act.” This is two years after her earlier report and there is still an awful lot wrong with it, is there not?

Mr Gray: In her latest report she does also make various remarks about how, for the great majority of people, the system is operating satisfactorily.

Q69 Mr Bacon: So you did like the tone.

Mr Gray: As I said to you, I was rather selective of that aspect. Picking up your specific point on the way in which we have been dealing with some of the cases that clearly we have not handled as well as we should have done, the particular point about the number of times that we have been notified about a change is one of the very specific issues that we are looking to amend as we revise code of practice 26, as I was touching on earlier, and in particular this point that if we have not acted on the notification to us within a relatively short defined period then we will amend the practice we have taken hitherto as to whether we pursue the overpayment. She also welcomes in this latest report the fact that we are going through this

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latest revision of code of practice 26 and the six specific recommendations that she has made in the latest report will be helpful—

Q70 Mr Bacon: Will you be publishing a response to those recommendations, or would you send us, so perhaps we can include it in our Report, your views on those recommendations?

Mr Gray: Whether we will be making a formal response, which is not normal to an Ombudsman's Report, we will certainly be responding one way or another to the Report and obviously I am more than happy to keep the Committee in touch with that, but this will be in the context of us operating a revised approach to the implementation.

Q71 Mr Bacon: You are being very helpful, although your answers are quite long and I have got limited time. I just want to ask you a quick question about targets and then move on to something else. You said to the Chairman that there would be no purpose in setting targets, because I think you said you needed the data from 2006 which you expected to do by the end of calendar 2007. When after that can we expect you to be setting targets?

Mr Gray: I would expect it to be early in 2008 and to be part of an overall process within our new spending review settlement.

Q72 Mr Bacon: What do you call early, the first quarter?

Mr Gray: Probably the first quarter, but the key date in a sense is the start of the next financial year, 2008–09, which is the beginning of the new three-year period over which the generality of our targets will be set.

Q73 Mr Bacon: I just want to move on to the taxation of small pensions. You may be familiar with the work of the Low Incomes Tax Reform Group (LITRG) which has sent us a brief on this because of mistakes made by the Revenue—this is referred to in paragraph 3.48 and onwards of the Comptroller and Auditor General's Report where it says in 3.48 that the Department published guidance to pension providers which: "was not strictly in line with the PAYE regulations and processes". It goes on to say that the precise rationale for these instructions are now unclear and in paragraph 3.51 that: "the Department became aware of this issue in April 2005 and it changed its incorrect guidance but it did not explicitly notify the pension providers of the changes and they generally went unnoticed and were not implemented. Furthermore, the Department believes that some of its local offices agreed with pension providers to continue their previous local agreements when they queried the changed instructions." Obviously there was a problem that was caused in essence by HMRC and your proposal to deal with this is to not recover tax prior to 2006–07. What the Low Incomes Tax Reform Group is concerned about is that with that approach you can still find people who do not yet know that they have a liability and who will not find out that they have a liability until 2008–09 or even

2009–10 when they could suddenly find possibly a good chunk of the 420,000 pensions they estimate are affected will have this unexpected and unwelcome liability notified to them. Would it not be possible for you to do what they suggest, which is ask the pension providers for the names and addresses of those receiving annual payments of over £1,000 which would enable you to write to the people who are at the greatest risk, not in a year's time, so that people know now if they have a liability and can begin to make some adjustment for it rather than expecting in two years time them to adjust to what will by then be quite a big accrued debt?

Mr Gray: I will ask Mike Shipp to add to this in a minute if I may, but we have explored the possibility of writing to pension providers and we do not think that it would be possible actually to get complete coverage in doing that. The general approach we have taken on this—and you have summarised some of the history as set out in the NAO's Report—is that having fully established what the position is we have decided that it would not be appropriate to go back and seek to make recovery before the current year end, but having taken strict legal advice I believe the right cut-off point if you like is with effect from the current year. I know that the low income groups had concerns about this and indeed, just as I was discussing issues with Ann Abraham this week, I spoke with John Andrews the Chair of the LITRG on this very issue last week. The particular concern they have is whether by implementing this year rather than leaving it for another year or two, we might deprive people of the opportunity to make claims for adjustments to their Pension Credit entitlement from the DWP.

Q74 Mr Bacon: Yes, and he provides a worked example.

Mr Gray: We are in conversation with DWP about that and we think that actually in co-operation with them we can overcome that problem and that entitlement could be extended. The problem for me is if, having now fully established the scale of the problem and clearly identified that there is tax that should be being collected, which has not been collected in the past, then I do not think it would be the right thing for me as the Chairman of HMRC, particularly in light of legal and other advice I have had, to delay any longer putting matters on the right foot, and I would imagine the Committee and others might think it would be inappropriate for me to continue in full knowledge of the facts our failing to collect tax which is due.

Q75 Mr Bacon: Yes, I understand that and indeed the Low Incomes Tax Reform Group say that it may be that HMRC will say that they have to collect the outstanding liabilities in order to be fair to all taxpayers; who can disagree with that? The point is that the people who owe the money do not know and it is because of your earlier errors and you are not about to tell them for another couple of years. That surely is the point.

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Mr Gray: We will be aiming to tell them in the normal way that happens with all taxpayers, as soon as possible after the end of the year in question what their liability is, so as soon as possible after the end of 2007–08 when we have the end of year returns we will be notifying people. We do not envisage for most people seeking to collect any money that is due for 2007–08 onwards until we put it in their codings for 2009–10, so we are not going to suddenly turn round to a lot of relatively low income pensioners,

we are going to play it into their coding.**Q76 Mr**

Bacon: But they could have accrued quite a liability by the time that they know they owe anything, could they not?

Mr Gray: We are talking here by definition of relatively small pensions, so I think the likelihood of somebody building up a very large liability—

Q77 Mr Bacon: I am talking about relative to their total ability to pay it; it is a long time since I have been a poor student but I remember what it was like, nearly no money at all. It is precisely the people on the very low incomes who find this the most frightening, surely?

Mr Gray: I recognise what they are facing but we will be seeking to give them that clear notice in the way that we do. Mike, do you want to add anything on this?

Mr Shipp: Yes. It is relevant to what the Committee understands that we have given due consideration to how do we tackle this problem, and in order to do it in the way that the LITRG recommends would have required us to place upon all the pension providers effectively a voluntary requirement to give us data that they have got from their records, and that would have involved quite a burden on them, 6,000 pension providers, and we would then have needed to have compared that data to our tax records, taking into account the other income the pension has provided. One of the considerations that we were very conscious of and our lawyers were very conscious of was embarking on a process that was inevitably going to lead to an uneven effect on the pensioners; by that I mean there is little we could do to force the pension providers to give us that data so we would in effect be potentially going to those pensioners where their provider has given us the data whereas others would remain uncontacted by us because their pension provider had not given us that data. The lawyers were very assiduous in advising us that we need to be mindful of the impact on the pensioners themselves in just the way that you describe. So there were some practicality considerations here as well as even-handedness considerations.

Mr Bacon: I have run out of time, thank you for those answers.

Q78 Angela Browning: Mr Gray, could we look first at appendix A in Ann Abraham's latest report on page 46? It has been referred to this afternoon but I just think it is worth noting that although the overall number of cases referred to the Ombudsman may have dropped, the number of cases upheld is

extremely high, and particularly when you look at the number of cases in the year 06/07 that relate to overpayment there is an increase year on year to those cases that involved overpayment. Clearly, therefore, the overpayment problem is not being tackled and, also, the fact that the Ombudsman is upholding such a high percentage of those cases in the last year, 74%, leads me to believe, particularly from my own constituency experience, that you really are not tackling the overpayment problem. Can you give us just some feel this afternoon of how you are going to address this?

Mr Gray: I accept, as I said earlier, that the proportion of cases being upheld is too high—although it has dropped a bit it is still above the parliamentary average, and actually I regard the parliamentary average as far too high. The great majority of the cases that have gone through the various stages and got to the Ombudsman and settled by the Ombudsman relate to the early years of the operation of the system—I do not know if that is reflected in your own constituency experience—so to some extent the data we are getting recorded here, even though they are 06/07 cases as far as the Ombudsman is concerned, on average they are likely to be 04/05 cases in terms of when whatever difficulties have arisen arose. We are looking a little bit kind of through the rear window here, but what we are seeking to do and have been doing over the last two years is to put in place very significant improvements in the way in which we are administering the whole system and the overpayments. We have put in place since those first two years a large number of initiatives to seek to improve the flow of information that we give to claimants, for example by redesigning award notices, and a whole range of other things to try to make it easier for claimants to operate within the parameters of the system. The fact that overpayments are still a very large and increasing proportion of the caseload of the Ombudsman highlights the fact that a lot of the difficulties we had in the first year or two of the system we have substantially got on top of, but as I say I will not be satisfied if, in a year or two, I am in front of the Committee and we are still in a position in which such a large proportion of the cases going to the Ombudsman are being upheld because, clearly—and I have said this to your colleagues on the Public Administration Select Committee before now—an appropriate proportion of cases to be upheld by any independent adjudicator or ombudsman if it is higher than 20% or 30% then that says to me that there are issues that we still need to tackle within our systems.

Q79 Angela Browning: Of course, most of these cases referred to Ann Abraham have been cases that have been referred by Members of Parliament, so we have already, in handling casework and problems from our constituents, availed ourselves of the MPs' helpline, which is a dedicated phone number which we can refer our casework to, so in terms of being able to fast track a constituency case we are, I assume, getting a Rolls Royce service in trying to

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resolve the problems, yet still Members of Parliament are the people who are referring these cases to the Ombudsman. Why do you think that is?

Mr Gray: Because in those number of cases clearly you are not persuaded and when the Ombudsman has looked at a similar proportion of the cases she has not been persuaded that we handled them appropriately. Again, at the risk of sounding complacent, which I am not, the fact that we are talking here about a couple of hundred cases—which is clearly 200 cases too many, I do not want to under-estimate that—since we are dealing with 300,000 disputes of overpayments each year, the great majority of which are not getting this to this stage and are being satisfactorily dealt with, means we are dealing with a small proportion that are not being done properly. So it is a small proportion but we need to do even better.

Q80 Angela Browning: I would not want you to be complacent.

Mr Gray: I am not.

Q81 Angela Browning: What you should also consider is that these are people who actually take it upon themselves to contact a Member of Parliament in the first place, and I do not think any of us who deal with this casework on a day by day basis imagine that everybody is aware that if they do contact their Member of Parliament we can use the helpline and the facilities of the Ombudsman. I want to put to you one or two things that I think you should focus on and which I would like your response to because, for example, some of those cases that went to the Ombudsman certainly went from my office; in fact I handed in yet another case there this morning because of the mail strike. One of the problems of overpayment that I have had a lot of problems with is this astonishing situation where when, eventually, they say yes, we think we have sorted this out, the constituent nonetheless still gets direct payments into a bank account—and I have double-checked, there is no question there is any problem with the bank account receiving the payments—and some sort of paper, either a cheque or some sort of order, as well. I have to put a caveat on the bottom of every letter that I write, that even when you have sorted my constituent's problems out, please be aware that you should check your bank account as there may still be a duplicated payment. Surely that is not getting to grips with the problem, is it?

Mr Gray: That is an unsatisfactory situation, I quite accept.

Q82 Angela Browning: It is unacceptable; totally unacceptable.

Mr Gray: It results from a sequence of events in which, for a small proportion of cases, we are unable in the first instance to have the case operated automatically through the computer system in the way I was discussing earlier with Mr Curry. In those circumstances, in the interests of trying to provide as good a service as we can, we make alternative means of payment, either through giro or whatever, in rare

cases actually hand-collected cheques at our enquiry centres, so that the people who are entitled to the money get the money through an alternative source. What we say, and I say this quite often in letters when I write to you and your colleagues, and you are obviously the people pointing it out, we will then as quickly as possible try to sort out whatever the IT problem is that has affected that small group of cases. But once we have done that we know that because we have overridden the system in the first place to make a manual payment, it is likely that an automatic payment will be generated through the IT system, and we think that as long as we are up front about this—and we do seek to be upfront about this—in telling people we will try and sort out your problem as quickly as we can by finding a work-around, you may well then be in receipt of a duplicate payment, and we think it is appropriate to warn people that that will happen and to say in those circumstances that since we told you this may happen, if you get that double payment then we will seek to recover it from you.

Q83 Angela Browning: Let me give you an example. Last week I sent a case, not to the Ombudsman but directly to the minister, because we seem to have reached what I would regard as the reasonableness test, in other words the detail of the case had been explained and we had had an exchange of correspondence with your office, in exactly one of those situations where we had written in the caveat to the constituent, please be aware that although this is now resolved, we have agreed the appropriate amount, you may still get duplicated payments through a bank account and through a cheque. She understood that and then five months later she received, out of the blue, an enormous cheque, so she had to think does this relate back to the warning I gave her five months ago, so she phoned your helpline and said: "Look, I have got this large cheque, is this mine or not?" "Oh yes", said the helpline, "we have checked our records, that is fine." Two months later she gets a letter to say, "Oh no, it is not". In the exchange of correspondence I have had with your department we have ended up locked together, which is why I have sent it to the minister, because your department is insisting that the reasonableness test which you seem to apply would be that even though your helpline told her: "That is all right" and she took the trouble to check it, she still should not have spent the money anyway, even though she had taken those steps. I find this cloud-cuckoo land; who is going to advise these people? These are people on low incomes, these are people who have double-checked, these are people who have gone through their Member of Parliament. I really am not convinced that you have gripped the scale of the problem of overpayments, which is why I sent it to a minister.

Mr Gray: May I go back to the point I made earlier. In applying this reasonable belief test we are in the process of consulting on a way of amending that in a way which makes much clearer to people what we expect of them and what they can reasonably expect of us, so that in difficult cases of this sort we are

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relying less on what is inevitably at the margin a subjective assessment of what might or might not have been reasonable in the circumstances.

Q84 Angela Browning: It is an interesting word “reasonableness”, is it not?

Mr Gray: It is an interesting word. It is a word that has a long history in the traditions of the tax system, but in relation to the application of the world of Tax Credits we are now considering whether we should adopt an alternative approach and not use that word, although it is designed to deliver broadly the same sort of outcomes but through a more explicit set of expectations on the part of the claimants and ourselves.

Angela Browning: I often think it is rather like proportionality where a lot of very clever people could make a case, but those who are less able to make their own case would be totally swamped.

Mr Curry: I think it is not an appropriate word.

Q85 Angela Browning: Not an appropriate word, my colleague says. Thank you, I am grateful to you. Could I move on to something else. I do say that I think the MPs helpline is a very good resource, although I think we cynical old politicians understand why it has been provided for us, so that we phone your helpline and do not keep jumping up and down on the floor of the House of Commons embarrassing the Government. I am concerned that you do not provide such a facility to the Citizens Advice Bureau (CAB) because a lot of casework comes through to me from CAB offices. They are well trained people, they are not going to fill you up with frivolous casework, they will have a good understanding of what they are putting forward and of course, as MPs, we work in partnership with advisory bodies like the CAB. I know when I visited my own CAB in Devon they have been concerned that it takes quite a lot of time to get through to you in the same way that members of the public do and I wonder why you do not consider that as a useful way of helping to resolve some of these cases.

Mr Gray: We do, in fact, have such a system for the Citizens Advice Bureau. Some months ago now I spent a day in one of our Liverpool offices sitting with our staff operating exactly that dedicated line.

Q86 Angela Browning: Is that available throughout the country?

Mr Gray: I think it is for all CABs. It is not available for all the voluntary agencies which seek to support claimants. Perhaps I can make one other point here, that there is always a difficult trade-off to strike. Earlier on you referred to the MPs hotline as a Rolls Royce service, I hope it is a good service. Frankly, I do not aspire to it being absolutely Rolls Royce because, although we are keen to make sure that, as an important group, you have a special way to get through to us, there is always a trade-off. Once you start introducing specialist lines in any line of business, the more resource you put in and the more priority you give to specialist lines, other things being equal, you are having potentially a negative impact on other lines open to ordinary mortals, if I

can put it that way. Although we have got not only the MPs line but also a degree of dedicated support for Citizens Advice, just as in the tax paying world we are looking at special arrangements for tax agents to be able to contact us. I am always having to weigh what I think is quite a difficult balance between how much priority to give, given that the more resource I put into that, the less resource there is available for the generality.

Q87 Angela Browning: The reason I particularly raise the CAB is not only the fact that they would deal with tax credit cases but, of course, they are the major resource locally for dealing with the expanding problem of personal debt and there is a real read across when people suddenly find they are owing money that they had not anticipated they would owe. They are really at the heart of helping people who in my constituency earn not just less than the national average wage but less than the south-west average wage. Personal debt is a very, very big problem.

Mr Gray: I understand, which is why we have responded positively to exactly that idea.

Q88 Mr Mitchell: It is a great pleasure to welcome you back to this poor people’s court in your regular appearances here. First of all, a peripheral matter. I have got a series of letters and the last culminates in an email on 4 October from a David Piper of Rye—which I do not know and I do not represent but I am told it is almost as nice as Cleethorpes—saying that his company, which is called Future Gain 3000, applied for VAT registration in January this year and nothing has happened. He does not know why, he has had no explanation. I gather you know about the case because we have sent the material along to you. Why?

Mr Gray: We have been facing challenges with our VAT registration process. As the Committee knows from some of its earlier hearings, one of the biggest challenges we face as a department is the problem of carousel fraud in VAT. We have been relatively successful in bearing down on that multibillion problem over the last 18 months. A key requirement or a key aspect of carousel fraud in VAT is with people who obtain a VAT registration in the first place. Because that is a key problem, we have very consciously put extra compliance effort into ensuring that we are not providing VAT registrations to people who are at risk of then perpetrating a fraud.

Q89 Mr Mitchell: This is now ten months affecting business.

Mr Gray: This is ten months. In individual cases this can present us with a difficult dilemma. Only 5% of cases through our risk monitoring and risk targeting go through an extended check process. That has meant that there have been for straightforward traders longer delays than I would have liked. We are now progressively getting on top of that problem. This is not the only case.

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Q90 Mr Mitchell: You will deal with Mr Piper's case?

Mr Gray: We will deal with Mr Piper's case, along with the many thousands of other cases, but we will deal with it in a way in which I regard as incumbent on me to make sure we are doing the appropriate level of checks before we provide a VAT registration, which is a very valuable thing for anybody to have.

Q91 Mr Mitchell: I will stop you there because, as I say, it is a peripheral matter for us. Following on the point that Richard Bacon made, this representation we have had from the Low Incomes Tax Reform Group, a body from which Members of Parliament are excluded since our pay increase, about these backdated charges on small pensions, it seems daft you have not charged them for a long time and the costs of collecting are probably more than the revenue that you are going to get. It is going to hit people, I have seen after my conversation with the Prime Minister on Friday about the timing of the election, in 2008 and 2009, just when he will be going to the country. "The fair and reasonable approach", say the Tax Reform Group, "to this issue is to announce that no tax will be collected from a pensioner up to the point that HMRC write to them to tell them that they are one of the people affected". Why do you not work on that basis?

Mr Gray: We are trying to operate this on the basis we normally operate in the tax system, which is after the end of the year in question people's tax is brought to account and if there is a variation between the tax paid and the tax owed, then we seek to collect it, typically by putting that adjustment into a future year's coding and that is exactly what we are going to do here. We are not operating backdating. Very deliberately I took the decision that although this problem, which Mr Bacon described the sequencing of, has been clearly in place for a number of years, unfortunately and unsatisfactorily, we are not going to go back over those previous years but, having identified the problem when we have, during the course of 2007–08, having taken legal advice, I think the right thing is to start collecting it as we would normally do in relation to any other tax.

Q92 Mr Mitchell: The advice in local tax offices in many cases is that they are not liable and it has not been collected, so as you normally do does not apply.

Mr Gray: I think it is as we would normally do. If there is an adjustment that needs making we identify during one year, we bring it to account after the end of that year and then put it in a future year's tax code.

Q93 Mr Mitchell: Let us move on to the main issue, the Tax Credits. It does look from the evidence that the fact is that the computer system could not cope, so you are transferring it to the National Insurance computer system in 2008–09 and the fact that you did not have enough staff to select cases and deal with them as though it was introduced too fast. Would that be the case?

Mr Gray: It is actually not the tax credit system we are switching to the National Insurance recording system, that is the Pay As You Earn system which we are aligning with the National Insurance system. As far as Tax Credits is concerned, we are not doing that. We have a free-standing system over which, as you well know, we had difficulties in the early years, that is what has given rise to the issue *vis-à-vis* EDS, which I was discussing just now with Mr Bacon. Progressively over the years of implementation we, and our IT providers, have been steadily ironing out the difficulties within the system. Again, my predecessor and I have given evidence here that says we now believe that system is stable. It is a fragile system, it is very difficult to make further adjustments to, but we have got it to a stage of stability.

Q94 Mr Mitchell: Were ministers warned there would be difficulties in coping with the existing computer system and the existing staff numbers?

Mr Gray: When new Tax Credits were introduced, it was a new computer system that was introduced in order to deliver that system. New Tax Credits were designed on a completely different basis from their predecessor, social security benefits, which were fixed-term awards operated by computer systems, in what is now the DWP, used to that form of operation. With Tax Credits being designed on an annualised basis, we needed to have a new computer system, that was the one that was designed and which was available for implementation from 2003–04.

Q95 Mr Mitchell: My obvious problem is with pay now, check later, but you have raised the limit after April 2006 from £2,500 to £25,000 for variations in salary and wages in the back period.

Mr Gray: In relation to the year in question.

Q96 Mr Mitchell: Yes, that is right. That is a reasonable sum, but you are still expecting that will only lead to a one-third reduction in overpayment. Is it generous enough? Should you have raised it further? If it is necessary to raise it to £25,000, should it have been at that figure right from the start?

Mr Gray: Variations in income is only one of the reasons that generates overpayments. A number of the other measures introduced two years ago were looking at other aspects. One of the other main causes for overpayments is families overestimating the extent to which their income has fallen when they seek extra support during the year. We get delays in notification of changes of circumstance. There is also the point that Sarah Walker touched on earlier, that since this income disregard, as it is called, applies only to the year in question, as you move into the following financial year, the following April, we continue to make payments on a provisional basis in that year on the basis of the income information we have got until we go through the finalisation process. That means a significant part of the overpayment in the subsequent year reflects that lag in the system. There are a range of factors here underlying overpayments.

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Q97 Mr Mitchell: It is a joke. You say the computer system has now been reformed, revised, and can cope. You have diverted extra staff, but at what cost to the other aspect of your business, getting the money in, I do not know. You might like to tell us whether there have been any effects there on collecting money by diverting staff to recovering overpayments, but even with these changes and the big increase in the limit, £25,000 average is substantial, you are only expecting a one-third reduction in overpayments. There must be some endemic problem if all these steps are being taken and yet still are going to continue.

Mr Gray: I think the point is, going back to the point I made earlier, Mr Mitchell, the system was deliberately designed to be very flexible and to respond to people's changes in circumstance. From the word go the Government made clear the expectation that it would generate significant numbers of overpayments in any year which would then need to be adjusted and collected in future. What the various changes we have made have done is bring us much closer to the originally expected level of overpayments as a design feature in the system as the consequence of having a flexible system operated on an annualised basis. As far as your point about administration costs is concerned, yes, we have put more resource into Tax Credits.

Q98 Mr Mitchell: Is that extra resource or diverted resource?

Mr Gray: It is resource within a fixed overall envelope that I have at my disposal, so the number of staff went up from just under 9,000 in 2005–06 to just over 10,000 in 2006–07, although part of that was a statistical adjustment. There was an underlying increase of about half that amount. Part of my job is always trying to get the right margin of decisions on priorities for placing our staff and other resources. I felt that the judgments I have made in terms of putting relatively more resource into Tax Credits and inevitably, therefore, being able to be less generous in other bits of the Department have got the right overall balance.

Q99 Mr Mitchell: I hope so too because I have still got the grudging impression that you do not particularly want this, you do not like, as a department, handing out money instead of grabbing money off people. You have gone about it in a cack-handed way which builds up the sort of resentment that discredits a system which I strongly support.

Mr Gray: You have put that suggestion to me before which I do not agree with. I have got a really dedicated workforce in this area of the Department which is working incredibly hard, and I believe very effectively, to overcome some of the difficulties they face and they are amongst the most motivated staff that I have in the organisation. I am afraid I do not accept any implication that I have got a workforce that is grudgingly operating this policy.

Q100 Mr Mitchell: I only sought to say how strongly I support the system. Let us turn to the Ombudsman's Report, which is pretty damning but

it struck me in cases I have dealt with as a heavy booted way in which you demand money back from people who are not in a position to pay, working on fairly tight budgets and suddenly faced with a big bill which is going to be deducted from future payments. It is going to be crippling for them. She speaks of: "the unfair and inconsistent application of rules to claim back the money with distressing, devastating even, effects on families". It is too heavy-handed, is it not? Why not have a limit below which you do not claim the money back?

Mr Gray: I have accepted that there are those few cases she draws attention to which we have not handled appropriately. I do not accept your definition of "heavy booted" about the way in which we approach this.

Q101 Mr Mitchell: I have had people in tears in surgery faced with a bill and an unrelenting demand from your Department. It is not right, it damages the system. The CAB says that more than half of claimants would be less likely to claim their means-tested benefit as a result of their experience.

Mr Gray: I have obviously read that. Our data suggests that there is a very high rate of take-up still in Tax Credits by low income recipients. On your point about limits, for people who are still receiving Tax Credits we have very clearly laid down limits on the proportion that we can recover; for people on a maximum award we can only make a deduction of 10%, so it quite often takes a number of years to recover it. I do not regard that as heavy booted. For people who no longer have an entitlement to Tax Credits and from whom, therefore, we have to make direct recovery outside the system, we have very clear arrangements for operating principles around hardship. In the last two financial years we have made over half a million agreements with people to stagger the period over which they will repay us to take account of hardship that would occur if we did that more quickly. Indeed, over 80,000 of those agreements are giving people periods in excess of 12 months to make the recovery, so we are trying to be flexible. I do not deny there have been a few cases where we have not done it as well as we should have done and we need to get those right. I believe in the great majority of cases we are striking an appropriate balance.

Q102 Mr Mitchell: It could be more generous. You do not expect to recover £1.6 billion, which is a devastating figure. Why go on pretending, grinding these poor people? They are such a vulnerable section of society. Give up.

Mr Gray: Which is why in the great majority of cases we are seeking to do this sensitively and appropriately, but in the context of this is money that exceeds the amount to which people are entitled and, as a custodian of the taxpayer, it is my duty appropriately and sensitively to recover payments which were in excess of their entitlements.

Q103 Mr Dunne: Mr Gray, in response to Mr Mitchell just now you referred to the fact that there was an original design feature that there would be a

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substantial number of overpayments in the system. Could you tell us what was the assumed level of overpayments when the system was originally designed?

Mr Gray: Yes. I think in the initial documentation the Government produced when the policy was under consultation the suggestion was that in the first year the level of overpayments might be about £1 billion and on a continuing basis it might be about three-quarters of a billion.⁵

Q104 Mr Dunne: Affecting how many people, families?

Mr Gray: I am not sure whether a figure has been put on that. Sarah, I do not know if you know.

Q105 Mr Dunne: The original design of the policy was that there would be a very substantial amount of money affecting millions, one would presume. Would it be fair to say millions?

Mr Gray: Certainly hundreds of thousands, yes.

Q106 Mr Dunne: Hundreds of thousands of families would be receiving the wrong payment.

Mr Gray: In the interest of trying to have a flexible system that responded to their changes in circumstance, then they would receive in a period more than they were entitled and that would then be adjusted in subsequent periods.

Q107 Mr Dunne: You are accepting this was a Treasury policy at the time the scheme was introduced?

Mr Gray: I am describing to you the documents that were produced at the time.

Q108 Mr Dunne: In our Report, the 22nd Report of this Committee, we concluded that the Department's effectiveness in managing the tax system depended on maintaining public confidence in its administrative competence and you responded to that, as did the Treasury. Are you able to update us with figures for the number of families affected by overpayment and underpayment? The figures that we have only refer to the tax year ending April 2006.

Mr Gray: I am afraid I cannot. The figures are produced under normal National Statistics conventions. It is in May of next year, if I am right, that the data for 2006–07 will be available. I cannot give you any figures beyond the ones—

Q109 Mr Dunne: Available publicly. Do you have that information?

Mr Gray: No, because, as they are National Statistics and published under those conventions, I do not have access to that data.

Q110 Mr Dunne: You have a responsibility for managing the Department and presumably you have your own management figures of how many underpayments and overpayments there are in place from month to month, do you not?

Mr Gray: I have that management data, yes, but at a particular point in the year, in order to respect the National Statistics conventions, I cannot draw on the emerging aggregate data.

Q111 Mr Dunne: Can you tell us directionally whether there are currently more or less families who are in receipt of overpayments than the £1.9 million at April 2006 and underpayments of £900,000 at April 2006?

Mr Gray: Sarah might want to add to this in a minute, but directionally those numbers are going down. Others of your colleagues have asked me questions about the impact of various changes that were announced in the Pre-Budget Report two years ago, those are being implemented on a staggered basis. The first of them, the income disregard, which Mr Mitchell referred to, came into effect in 2006–07, so when the 2006–07 data is available, since that was the first of the measures introduced and unambiguously that will reduce levels and numbers of overpayments, we would expect them to be coming down broadly in line with the estimates that were made at the time.

Ms Walker: I could perhaps help about why it takes so long to publish the figures on overpayments. You cannot establish an overpayment until entitlement is finalised for a year. We finalise entitlement when we get renewal data from the customer. The deadline for sending in renewals this year was the end of July for people with employment income; people with self-employment income, because of the self-assessment timetable, will have until January to give us the final details of their income. We then need to process that and that is why it takes until probably June next year to get the final statistical figures for overpayments for 2006–07.

Q112 Mr Dunne: Thank you. Take us on then to the issue you have just been touching on, the income disregard. The Parliamentary Ombudsman in paragraph 3.3 of her Report referred to the 363,000 awards of overpayments to households where the income was less than £10,000, so people on very low incomes indeed. Is it the case that anybody whose income is less than £25,000 where there has been an overpayment under the new regime will not be pursued for that overpayment?

Mr Gray: No.

Ms Walker: No. As I think Paul explained earlier, there are a lot of different reasons for overpayments to occur and not all of them are about in-year increases in income. Where there is an in-year increase in income of less than £25,000 that will not create an overpayment, but there are other reasons why overpayments might arise for people, whatever the level of income.

⁵ *Note by witnesses:* The figures given are inaccurate as the Government did not publish a forecast of monetary amounts but in fact gave estimates of the expected number of overpayments. In 2002 the Government expected around 1 million awards to be reassessed as a result of income rises in the first year of tax credits, compared to around 750,000 in subsequent years (paragraph 4.47 The Child and Working Tax Credits. The Modernisation of Britain's Tax and Benefit. Number Ten April 2002 published at Budget 2002).

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Q113 Mr Dunne: Where there has been an error by the Department, mis-transcribing income data, would that then be disregarded?

Ms Walker: We will write off overpayments caused by error in most circumstances, although we do expect people to check and notify us. If there is an obvious error they have not notified us of, then we will seek to recover that. There are also other examples where people delay in notifying us of other changes, for instance where their child leaves school, or something like that, and they have not told us in time, we will sometimes get an overpayment created for that.

Q114 Mr Dunne: Could I pick up the point about the staffing levels. You have just told us that the current number of staff are of the order of 10,000 in the tax credit team as whole and that has increased from, I think, 7,300 in 2003–04. There is a very interesting table on page 24 of the Ombudsman's Report which shows that the number of staff who are authorised to process overpayments, A grade full-time equivalent staff, has fallen from the third quarter of 2005 of 964 to the fourth quarter of 2006 to 601. What is the current number of people who are authorised to process overpayments?

Mr Gray: I do not have a precise figure with me. I think it may have gone up slightly since that period. We are right in the middle of a process at the moment where we are integrating together the staff in both the categories set out in that page 24 which you have referred to. Up to this point we have had staff in the complaints teams, the upper table on that page, organised separately from those authorising overpayments. We are just introducing a reorganisation in which we are bringing those teams together as part of our programme of trying to provide more effective service, picking up Ms Browning's point, since the great majority of complaints we encounter, as well as those that Members of Parliament put through to the Ombudsman, concern overpayments. That is the dominant issue that causes people to complain. We are integrating those two processes in order to get a more consistent and more effective handling of both the complaints and the formal overpayments process.

Q115 Mr Dunne: Is this team going to be subject to Gershon efficiency saving targets within the Department?

Mr Gray: Not explicitly. I do not adopt an approach where I apply a uniform staffing squeeze to everybody. What I am looking to do, and part of the redesign process for these teams, is we are implementing under our Pace Setter Programme lean management techniques which we are applying increasingly through the Department, where results so far are showing we get both increases in productivity and very significant increases in the quality of the work done. I will be looking to that team to raise its effectiveness and performance but, given the priority of this area of work, I will make sure there is adequate staffing to meet the workload.

Q116 Mr Dunne: I am very pleased to hear that because it does not look to me from the research that the Parliamentary Ombudsman has undertaken whether you had given it that priority. If you add the two tables together, there is still a decline in personnel employed in resolving complaints about this and the 37.5 % of the families who are in receipt of Tax Credits who get the wrong money paid into their account. This should be the top priority of this entire Department.

Mr Gray: You are looking at, I think, the second half of those tables rather than the full run of it. During the course of 2005 particularly, we built up very substantially indeed the numbers of staff who are dealing particularly with overpayments because we faced a particular backlog at that time. I made commitments, and the then Paymaster General made commitments, that we would get on top of that backlog and we would ensure that overpayment issues were addressed within four weeks. It was dealing with that backlog that was a very significant part of the build-up of resources in 2005–06. Having got on top of that backlog, the fact that the numbers have gone down does not mean it is less of an ongoing priority for me, it means that we had successfully tackled a particular backlog problem.

Q117 Mr Dunne: Do the local tax office staff have a role to play in helping to resolve this or do people who are in serious trouble have to have the wit about them to contact their MP altogether?

Mr Gray: Our local staff in our enquiry centres do not play a formal part in decisions on overpayments.

Q118 Mr Dunne: Could they be helpful in processing claims?

Mr Gray: They can be very helpful if somebody wishes to go into one of our offices, they can talk to our staff who can help them in the process, but the formal processing and handling of overpayments is done by specialist staff in the tax credit office, and, as I was discussing with Mr Curry, in the contact centres.

Q119 Mr Dunne: Mr Gray, I am afraid that you have the dubious distinction of being, I think, the second most frequent of my correspondents because I refer cases to you. I thought your answers at the beginning of the session to Mr Williams, when you talked about the number of complaints getting through to the Parliamentary Ombudsman being the tip of the iceberg, did sound somewhat complacent because people who choose to complain to their MP are clearly a very small proportion of people who are in difficulty. If on average there are 10,000 claimants per constituency and 37 % of them are wrong, that is between 3,000 and 4,000 families per constituency which have got cause to complain or wrong payments. I find it frankly somewhat bewildering that you are not throwing more resource into sorting out this problem which is the biggest in your Department, I would assume.

Mr Gray: As I think I have sought to explain to you and Mr Mitchell, at a time during which over the last two years the total amount of staff in the

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Department has fallen from 100,000 to 86,000 I have increased in absolute terms, let alone in relative terms, the proportion of resource that addresses this problem. I am sorry if I sounded complacent, I was at pains to stress that I am not complacent and I certainly am not.

Q120 Mr Bacon: I have a couple of other questions. One is about the penalties which have been issued to employers for on-line filing. On 24 September you issued 202,000 penalties but several thousand of them were wrong. My information is that it was much less than eight % were wrong and you have corrected that to six %, but it is still over 12,000. This is the third year in a row in which there have been thousands of incorrect penalties levied on employers, perhaps representing hundreds of thousands of employees. Will your Department publish lessons learned from IT-related failure document following the example of the Identity and Passport Service Operations Director, Bernard Herdan, who not only did that for the Passport Service but challenged other departments to do the same?

Mr Gray: The latest position on the issue you are referring to is that 11,000 penalty notices have been issued incorrectly.

Q121 Mr Bacon: Incorrectly?

Mr Gray: Incorrectly, 5.4 % of the total. This actually was not what you would regard as a pure IT problem, it was a process problem. We have already put in place a remedy for this. We are able to identify the employers who have been sent the incorrect penalties. We have written to them; I am conscious they may not yet all have received their letters because of the postal difficulties. We have put information on our website to indicate that those employers need take no further action and those incorrect penalties will be automatically cancelled. Obviously when a mistake like this occurs, we look at it and we seek to draw lessons from it.

Q122 Mr Bacon: Do you think there is any purpose in doing what Bernard Herdan of the Passport Service suggested in publishing a lessons learned document, especially as this is several years in a row?

Mr Gray: In relation to this particular issue, I am not sure but we will certainly be doing a lessons learned exercise. Whether it is appropriate to do a formal publication, it is certainly something I am more than happy to share with the Committee, if that would be helpful, what lessons we do draw.⁶

Q123 Mr Bacon: I would like to ask you also two more questions. One is about migrant workers because there was an issue with Tax Credits where migrant workers came to this country, set up jobs which entitled them to Tax Credits, started to receive them into a bank account and then left the country. Indeed, this Committee said in an earlier Report that there is an additional risk where migrants fail to notify the Department, leave the United Kingdom

and fail to cease receiving Tax Credits. There were cases of people in Slovakia going home and withdrawing money from a British bank account using cashpoint cards in Slovakia and other Eastern European countries. I know about this because some of your employees in your organisation have come to tell me about it. I am wondering what is the current position because you said in the Treasury minutes: "The Department continues to evaluate the amount of risk". I was wondering where things stood. Are things getting better in this respect or not?

Mr Gray: We are keeping the situation under close review. It is clearly a risk. It is not just a risk that arises in relation to A8 countries, it is a risk that relates to anybody going to another country, whether they originally lived in the UK or have come into the UK. We do not actually think that the risk is particularly large. Such evidence as we have got suggests there is not a major problem here, but we are seeking to keep a very close eye on it. If we did identify, which we have not at this point, that there is a particular problem in relation to any particular country or nationality, then we will put in place measures to seek to deal with that.

Q124 Mr Bacon: The last question is about Sir John Bourn's qualification of your accounts, which I think is the fourth or fifth. Sir John will perhaps correct me if I am wrong, is this five years in a row now your accounts have been qualified?

Mr Thorpe: It is five years, yes.

Q125 Mr Bacon: We are familiar with the European Union accounts, and not comparing their record yet and indeed the Department for Work and Pensions' record, but for a body that collects the money not being able to account accurately to Parliament how the money is spent and for the Comptroller and Auditor General to have to write in his trust statement that: "I have concluded that the payments arising from erroneous and fraudulent tax credit payments", this is on page 83 of this document, AHC 626, the accounts for the HMRC, "are not in conformity with the authorities which govern them and not are applied to the purposes intended by Parliament. I therefore qualify my opinion on irregularities in income and expenditure on the Department's trust statements for 2006-07 because of the probable levels of claimant error and fraud in the Tax Credits". For several years in a row it means that you, as Accounting Officer, are placed in the invidious position of failing in your basic duty to Parliament as accounting officer of accounting to Parliament for how you handle this spend, which is your primary lawful duty as accounting officer. At what point are you going to turn around to your masters and say, "The policy you are asking me to implement causes me to fail in my duty to Parliament to account for how I spend the money that Parliament owns", because that is what is happening, is it not?

Mr Gray: As you read out there, the qualification of the trust accounts relates explicitly to one issue, not to the generality of our accounts, I am pleased to say.

⁶ Ev 23-24

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Q126 Mr Bacon: No, of course. Could I ask a supplementary. It is the case that Tax Credits itself means that you have the highest rate of fraud and error of any central Government department, is it not?

Mr Gray: The figures in those first two years, 2003 and 2004, were at a relatively high level, 8.7 % in 2004–05. Those figures were somewhat lower than the rates of fraud and error at similar points in the introduction of major social security benefits, such as income support. We talked earlier about the clear intention to introduce targets for the reduction of tax credit error and fraud, which we will be doing early next year. Within that context I will be looking to get into a position in which there is a substantial improvement and I can get towards a position of non-qualification. The fact is, of course, that I am not unique in having my accounts qualified in relation to this broad type of expenditure. At the DWP which operates those other benefits I have been talking about, they have their accounts qualified by Sir John in the same way and he has set a particular value on fraud and error that he regards as a target one needs to get to for non-qualification.

Q127 Mr Dunne: I have one constituency issue which is a problem I meant to raise earlier. I received a letter which was forwarded to you last week from a constituent of mine who filled in an application form for working Tax Credits on 8 June using his wife's National Insurance number as a temporary number. He repeatedly contacted the helpline and was told that he would have no difficulty in processing the claim using that temporary number. Eight weeks later he was given contrary information that actually she needed a permanent number which she then sought and reapplied. He has been chasing the helpline on a weekly basis and he is currently told that the claim is being processed and nobody is able to find where it is in the chain. It does suggest that there is a major problem with new applicants coming on to the register where your computer processing intake procedures do not work. It is four months since he applied so I imagine he is eligible for hardship, which you referred to earlier. I would be grateful if you could comment, first of all, on the processing issue and, secondly, how he should apply for hardship.

Mr Gray: Although you have written to me, and no doubt the case will land on my desk soon, I am afraid it has not yet so I cannot really talk about the details of that. I do not know if Sarah wants to add anything about the temporary *vis-à-vis* the permanent National Insurance point in a minute. Once we have an application in place we do seek to process it as soon as we can. There are provisions for backdating for up to three months to allow for the possibility of delays. I think you may have misunderstood what I was saying about hardship. I was talking there about special arrangements we can make in situations in which

we are recovering overpayments as distinct from the issue of hardship during the claim. Sarah, is there anything you want to add to that?

Ms Walker: I do not think I can help you on the specific case. I know we are able to pay Tax Credits where both claimants do not have a proper National Insurance number, but I cannot tell you what has happened in this case.

Mr Gray: Certainly I will personally look into the case and write to you, if I may.

Q128 Mr Mitchell: Given the fact that immigration is now running on such a big scale and you will have claims whether from Eastern Europe or outside the European Union for Tax Credits, how do you check up whether the kids claimed for actually exist or are dead? Do you endlessly go around and knock on the door and demand to see the children? How do you know these children actually exist? Is it easier or more difficult to recover an overpayment from immigrant workers than from British workers? Do you keep your figures by place of origin or immigration? Can you tell us what the figures are for immigrants?

Mr Gray: To a degree I can. The position on your first question is that we require proof of identity for a child.

Q129 Mr Mitchell: Is that a birth certificate?

Mr Gray: A birth certificate. We require the relevant national birth certificate.

Q130 Mr Mitchell: You do not know if the child is dead, do you?

Mr Gray: No more than actually in relation to wherever a child is presented from. I do not think that presents a risk that is specific to the country of origin, so we require that documentation. We have regular liaison with our counterpart organisations in the other countries, for example in Poland, which is the A8 country from which the largest numbers of claimants come, we have a close relationship with the relevant authority there. We request them and they comply to make checks for us on occasions and 99 % of those checks carried out prove to be satisfactory. In terms of numbers, the Home Office data and workers registration scheme shows that there are now nearly 700,000 people in this country through the accession monitoring report who meet the entitlement conditions of being present, ordinarily resident and have a right to reside in the UK. That is the entitlement condition for both child benefit and child tax credit. Out of those 700,000 the number of tax credit payments we are currently making to A8 nationals is 40,000, 40,000 in relation to a total number of 700,000.⁷

⁷ *Note by witness:* Over the period March 2004 to June 2007 around 683,000 applicants have applied to register on the Workers Registration Scheme of which 656,000 have been approved. Over the same period there have been around 38,500 applications approved for tax credits from A8 countries.

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Q131 Mr Mitchell: How many of those kids are now in Britain and how many in Poland?

Mr Gray: I have not got the precise figures for that but some certainly are in line with the EU entitlement conditions resident in a country of origin as well as here, but we go through those checking processes I described in order to seek to deter any fraud. Were we to find, but we have not found yet, that there were any particular risks more prevalent in any particular nationality, then we would take specific intervention action. We have not identified any such risk, therefore, we adopt the same antifraud mechanisms for A8 migrant claimants as well as people who have been resident in the UK throughout, but we keep that position under very close review.

Mr Williams: Thank you for that. You had a request to go into private session briefly on one particular issue, so could I ask those who are not directly involved with the members and witnesses, please, to leave.

Mr Williams: Richard?

Q132 Mr Bacon: If you are able, Mr Gray, to give us a brief summary of the position. Just to remind the members, the original deal cut with EDS, if that is the right word, was a settlement payment of £71 million following a claim by HMRC of £209 million. The settlement of £71 million was reached by mutual agreement and involved £44 million of payments initially and I think it was 26.5 or 26.4 million of payments would be staggered in quarterly payments over a number of years in the future and—this was the key point—to come out of future revenues of EDS from new contracts with Government, new public sector work they received and not from any existing work. I think I am right in saying that was December 2005 that deal was agreed to. It is how many quarterly payments have there been since, of how much and how much is left still to pay?

Mr Gray: As on previous occasions, I am very happy to give that evidence in private. Mr Williams, since I am bound by a confidentiality provision on this, I would formally ask the Committee to observe that and not to make the figures publicly known, but of course I am happy to share them with you privately.

Q133 Mr Williams: I am sure all Members understand that.

Mr Gray: Thank you very much. As you said, Mr Bacon, following those large initial payments, the balance due from early 2006 was £26.5 million. I will not give it you to the last penny, I hope that is sufficiently accurate. We have now had six instalment payments under the formula that you are aware of, which have totalled a little under * pounds, so the total balance due is now fractionally over *. It is in that context and applying my own arithmetic of the sort you took me through on previous occasions.

Q134 Mr Bacon: Did you work out how many years it would take? It came to 106.

Mr Gray: No, because it is not going to take that long!

Q135 Mr Bacon: You just do not want to be asked questions in 85 years!

Mr Gray: This is a rate that is well below that necessary to make the repayment within broadly the three years that we are envisaging and that is the reason I am taking what was intended to sound like the rather more assertive, if not aggressive, action that I described earlier.

Q136 Mr Bacon: This is obviously on the basis of legal advice, but presumably if you were to go back to court that would be contested in an open court case where witnesses would be called and so on.

Mr Gray: Indeed.

Q137 Mr Bacon: Are you expecting that now may have to happen?

Mr Gray: I hope not. I am very determined about this. The company, having agreed the overall settlement in the first place, is party to that agreement. The only issue there is the speed over which the agreed debt is repaid.

Q138 Mr Bacon: Since the speed is so plainly unsatisfactory, what is your own personal idea of a sensible timetable for resolving this completely?

Mr Gray: My predecessor's expectation at the time the agreement was reached was that we were looking at a period of around three years, two years of that have now elapsed, so I am still looking towards the end of 2008 as a period in which I would hope the matter is resolved. I am a realist, but I hope a very tough realist in these circumstances, and what matters to me is clear action during the course of next year that demonstrates a willingness to deliver in something like that timescale. I am not, frankly, going to adopt a position that says I have an absolutely precise date by which I must have the whole lot repaid, but I am taking a very tough attitude on this.

Q139 Mr Bacon: It is fair to say by December 2008 if this will have gone up by a few hundred thousands pounds more that, as bunnies go, you would be a pretty unhappy one?

Mr Gray: Yes, and I think I will be quite an active one.

Q140 Mr Bacon: Can we quote you on that, the HMRC's Chairman is to become an active bunny?

Mr Gray: The words I used in the open session were carefully chosen and, as you may have seen, I was referring to my notes at times and I am more than happy that they will be in the public transcript and you may wish to refer to them.

Q141 Mr Bacon: Thank you very much. I hope that we will resolve this and you will be unsurprised if I keep returning to it.

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Mr Gray: I would be disappointed if you did not.

Q142 Mr Williams: Thank you, Mr Gray. You will understand from the tone of the hearing that it is likely to be a critical report, it is not a critical report of you personally, you are always very open with

us, but it is a situation that many of us are finding constituents facing very severe hardship. Thank you for your attendance and we look forward to seeing you next time.

Mr Gray: I think we will be meeting again in a few weeks on another topic.

Letter from Chairman, HM Revenue and Customs to Committee Chairman

TAX CREDIT ADMINISTRATION

I thought it would be helpful, prior to my appearance before the Committee on 10 October, if I provided some further background to the review by HMRC of some older tax credits awards that the Financial Secretary referred to in her statement to the House of 25 July (copy attached).

Tax credits work on an annual cycle. The initial award at the start of the year is based on a family's latest known circumstances and is calculated on the income they received in the previous tax year. At the end of the tax year, during the renewals process, HMRC seek confirmation of the actual income and the family's circumstances. Based on that information, they issue a final award for the tax year just ceased. For the purposes of this note, I will refer to this as a section 18 decision in acknowledgement to the relevant section in the Tax Credits Act 2002.

Parliament wanted to provide finality and certainty to customers and the Act sets out the circumstances and manner in which a section 18 decision can be re-opened. As the Financial Secretary's statement confirms, officials did not follow the correct procedures when reopening some of these cases.

Although the revised award was an accurate reflection of the households' new circumstances, the process by which HMRC took new information into account was not correctly followed in all cases. HMRC should have notified recipients in writing at the time, that it was examining the award after finalisation, using our powers under sections 19, 20 or 21 of the Tax Credits Act, but did not do so in certain cases.

I have outlined below a couple of examples with some of the common reasons for re-opening a finalised award that we have seen in practice.

(i) A customer tells HMRC that their income for the preceding year was £1,800. HMRC finalises the award (make a section 18 decision) on that basis, the customer does not appeal and gets a large lump sum payment in respect of arrears. After the customer has returned their annual renewals pack, confirming that the details of their circumstances were correct, the customer gets in touch to say the family's income figure should be £18,000.

What HMRC have done is amend the records without opening an enquiry and re-finalised the award, creating and seeking to collect back the overpayment. This is the right amount in terms of the money the claimant should actually end up with, but our actions to achieve that result were wrong. The error arose because HMRC failed to notify the claimant in writing at the time.

(ii) In another example, when finalising their 2006–07 award, the customer gets in touch to say they have just realised they had never told us that one of their three children left school in July 2005. They forgot to put this information when returning their annual renewals pack in May 2006 when they were finalising 2005–06.

What HMRC have done is amend the records and re-finalised the award.

What HMRC should have done is open a section 19 enquiry within the period beginning immediately after the award is finalised and ending one year after the reply date of their annual review notice, (or made a section 20 adjustment within five years of the award year end) under the Tax Credits Act 2002 to correct the award and recover the overpaid money. It should also have notified the claimant in writing of its action. HMRC will now need to review the case, either within section 19 or section 20, to confirm the award, and correctly keep the overpayment we have recovered.

It might help if I explain how the problem came to light. From spring 2006, a small number of cases came to the attention of our technical team which had been re-opened after finalisation without the necessary legislative steps being followed. Examples of the incorrect procedures were found in a few appeal and complaint cases, and the conclusion drawn at the time was that the problem was small-scale and localised. In each case, the technical team gave advice on how the case should be correctly handled.

Part of the remit of the technical team is to monitor information from operational staff and claims that are referred to them and take a view of how policy and legislation are working in operational practice, in this instance a small number of cases continued to emerge over the summer. Therefore guidance to staff was strengthened to emphasise the correct processes that should be followed if a finalised award needed to be

re-opened. In addition, training sessions were held between September and November with staff from a range of tax credits operational areas. Feedback from these sessions indicated that a number of staff were unclear or uncertain about the correct procedures.

We analysed this feedback, which suggested that the problem could have been more widespread than first thought, and, in early 2007, steps were taken to gauge the scope of the issue. This was a major task with a population of six million families who reported just over seven million changes in circumstances in 2006–07. In addition, many of the cases re-opened after a section 18 awards, had been handled following the correct procedures.

We also took legal advice on the status of the actions that had been taken. By July 2007 we had firm legal advice from Counsel. We were then in a position to provide full advice to the Financial Secretary in July. The Financial Secretary thought it appropriate to bring the issue immediately to the attention of the House. This she did through her statement of 25 July and in an individual letter sent to all Members. HMRC also notified the Chairman of the Committee of Public Accounts and the National Audit Office at the time; and have kept the voluntary organisations informed.

We informed the NAO of this issue in July 2007 once we had received firm legal advice from Counsel. We have subsequently provided various background papers to the NAO and they have met with HMRC officials to discuss the nature and implications of this issue. We will continue to keep them updated on our work in this area.

We have now finalised the mechanics of the review. We are anticipating that HMRC will incur administrative costs of around £10 million to complete the review. In addition to these there will be the cost of handling any additional appeals or complaints which we are not yet in a position to assess.

I can give my assurance that the vast majority of those affected by this issue will not see any impact on their tax credit award and no one will be worse off. However HMRC expect that around 20,000 households may receive a repayment to the total value of around £20 million. Those cases will date from 2003–04 or 2004–05, where the amendment to the award was made to correct an error made by HMRC, rather than new information from the customer. An example of such a case is:

a claimant told HMRC that their income for 2004–05 was £20,000. When HMRC were inputting income, details of £2,000 were inadvertently entered and the section 18 decision is made on that basis. After the award was finalised, HMRC are contacted by the claimant alerting them of the error.

HMRC amended the records and re-finalised the award, and sought to collect the overpayment without opening a s19 enquiry.

When this case is reviewed HMRC will not be able to open a section 19 enquiry as they are outside the time limits and Section 20 cannot be applied as the error was made by HMRC and did not result from any negligence on the claimant's part. Hence this case cannot be put on a correct legal footing and the overpayment that has been collected will be repaid to the claimant.

If a customer's tax credit award is being reviewed as part of this exercise they will have been sent a letter from HMRC. Unless individuals receive a letter, they have not been affected by this issue.

HMRC is about to start the planned programme of work to review the tax credit awards that may be affected. It will be completed in three years. The time span reflects the need to put these cases on a sound footing as soon as practicable, whilst ensuring that HMRC continues to improve the service it provides to tax credit claimants. The plans include ensuring that those cases where the overpayment is greatest will be reviewed first, and priority will also be given to those where there is an outstanding query about the overpayment.

Since the Financial Secretary's written statement HMRC have done further work to refine their initial estimates of the number of affected cases. Although the total number affected has not changed, HMRC now estimate that as a result of this issue around 100,000 cases relating to 2003–04 will be need to reviewed and 75,000 cases relating to 2004–04 and 75,000 cases relating to 2005–06 awards. Revised procedures have now been put in place and no awards for future years will be impacted by this issue. This should be seen in the context of the six million households that are benefiting from tax credits.

3 October 2007

Memorandum submitted by the Low Incomes Tax Reform Group

1. The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation to give a voice to the unrepresented in the tax system. The Group aims to help people on low incomes to cope with their tax affairs and campaigns for a simpler and more accessible tax and benefits system.

2. We would like to draw the Committee's attention to an issue raised in the Comptroller and Auditor General's Standard Report at paragraphs 3.47 to 3.53. This identifies that some 420,000, as yet unidentified, pensioners are going to be thrown into debt due to HMRC error.

3. We believe that the remedial action proposed by HMRC to correct a series of its own failings will bear particularly harshly upon those pensioners with lower or modest incomes. We also believe that the administrative effort required to make the retrospective corrections proposed is disproportionate to the amount of tax loss.

4. The series of administrative failings by HMRC leading to the current position is outlined in paragraphs 3.47 to 3.51.

5. In paragraph 3.52 remedial action is proposed which consists in writing off any tax arising before 6 April 2007. This would have been necessary in any event as customers of HMRC would have almost certainly had a right to remission of this tax under the terms of Extra-Statutory Concession A19. Our concern is for those low-income pensioners (probably the vast majority within the estimated population of 420,000) who will have an unexpected and unwelcome debt notified to them some time in 2008–09 (or even 2009–10).

6. The debt will have been accruing since 6 April 2007 and is likely to accrue until April 2009 when it will be included as an underpayment in the codings of the pensioners. This will, of course, coincide with accurate collection of the additional liability for 2009–10.

7. It is of course possible, with a diversion of resources by HMRC, to ascertain from the major pension providers the identities of the pensioners involved and to warn them appropriately in the current tax year. Instead we have an accruing debt position hanging over an unnamed group which will cause worry and distress to an even wider group wondering if it applies to them.

8. The fair and reasonable approach to this issue is to announce that no tax will be collected from a pensioner up to the point that HMRC write to them to tell them that they are one of the people affected. From that point on the pensioner will, in any event, have to consider an adjustment to their lifestyle to cope with the future additional tax liability.

9. It is likely that the amounts individually will be small in terms of the administrative effort required to correct matters. It will be an extremely time-consuming manual process to identify the different categories of pensioner involved:

- Some will be non-taxpayers and will remain so after investigation, but may need a home visit from HMRC in order to ascertain their position.
- Others will have additional liabilities which will then be the subject of a backdated claim to the Department for Work & Pensions for their existing Pension Credit (tax being deductible in arriving at income for Pension Credit purposes). The liability will be collected by one government department and repaid by another.
- Others will, for the first time, be eligible to claim Pension Credit because of this new tax liability which will reduce their income below the Pension Credit threshold.
- Some pensioners will already have disclosed this income on Self Assessment returns; but, because this particular source of pension may have been amalgamated already with other pension sources on those returns, a detailed enquiry will be necessary.

10. If HMRC feel that some significant pensions may be being paid without tax deduction, then an immediate request in October 2007 to the pension payers to notify the names and addresses of those receiving annual payments over £1,000 (£220 of tax at risk) would enable the greatest risks to be addressed today and not in a year's time.

11. At the end of this submission, we have provided a hypothetical, but not untypical, example of the types of problem which will be uncovered by the HMRC approach and the efforts that will be required by multiple government agencies, the taxpayer concerned and the voluntary sector. Whenever problems of this magnitude emerge the hard-pressed voluntary sector has a surge of pensioners wanting independent advice.

12. It may be that HMRC will say that they have to collect the outstanding liabilities in order to be fair to all taxpayers under their collection and management responsibilities. The riposte to this is that they should have due regard to the worry and distress brought to a particularly vulnerable section of society and the high costs of collection. Materiality is an important part of HMRC's duty of collection and management.

13. If HMRC wish to see a precedent for writing off liabilities they should look no further than the amounts of tax credits they are writing off due to official errors.

14. If HMRC wish to see how other government departments deal with their most vulnerable customers they could take a leaf out of the DWP's book who in July conceded that they had failed to match records appropriately for recipients of incapacity benefit. The DWP commented:

“These awards have been made, and payments received, in good faith. People will have made their retirement plans on the expectation of this level of income. For state pension the regulations will ensure that state pension will continue at the existing level and any subsequent benefit awarded to a surviving spouse or civil partner, based on the deceased's contribution record, will also be protected. No recovery will be sought for past periods.”

15. We have been authorised by Age Concern, Help the Aged and TaxHelp for Older People to say that they have considered this memorandum and are in agreement with its recommendation.

John Andrews OBE
Chairman
Low Incomes Tax Reform Group
 October 2007

ILLUSTRATIVE EXAMPLE

Susan Smith is a widow aged 62. She has a basic State Pension and income from a small part-time job. She pays tax at a top rate of 10%. She has been receiving a small pension of £10 a week which has been paid tax free (in error, but authorised by HMRC). She has disclosed this pension to the DWP and to her local authority for the purposes of her claims to Council Tax Benefit and Housing Benefit. The DWP have told her that her income is just too high for her to claim Pension Credit.

This pension will now generate an additional tax liability of £52 for the current tax year and potentially a higher liability in 2008–09 when the 10% lower rate band is abolished and she becomes liable at 20%. She will not find this out until some time in 2008.

When Susan finds out that HMRC have given her a tax debt for the first time in her life she will also find that this is just the start of her troubles. HMRC will attempt to collect the debts for 2007–08 and 2008–09 from her part-time job income in 2009–10 (should she still be working then).

The tax liability for 2007–08 reduces her income for Pension Credit purposes in that year and makes her entitled to the benefit. So in 2008 she will have to approach the DWP with a back-dated claim for Pension Credit which will require her to obtain from HMRC a certificate indicating that Susan did indeed have a tax liability for 2007–08 (even though it was going to be collected in 2009–10).

Susan will then complete an appropriate Pension Credit claim form and the DWP will then make to Susan a retrospective payment of Pension Credit for 2007–08. At the same time this receipt of Pension Credit will, under the passporting rules mean that Susan is entitled to enhanced awards of both Housing Benefit and Council Tax Benefit, together with a range of other benefits, such as free dental checks. She will have to approach her Local Authority for retrospective claims and HMRC may have to provide appropriate certification of the tax paid and the DWP of entitlement to Pension Credit.

Susan's position will have to be re-evaluated for both 2008–09 and 2009–10.

Of course, if HMRC only started to collect the liability from the time that Susan is notified none of this complexity caused by arrears would occur.

Supplementary memorandum submitted by HM Revenue and Customs

Question 122 (Mr Richard Bacon): *Lessons learned*

What happened:

- Each employer on PAYE is required to submit a return on form P35 annually.
- Before issuing any penalties HMRC checked for forms P35 that had been received but not processed. These employers were inhibited from the interim penalty process and no penalty notices were issued; the estimated number in this category for 2006–07 was 32,000.
- Following the issue of penalty notices, there was a high level of customer contact. Our IT Partners, ASPIRE, found that not all employers had been identified and penalties inhibited. A further 15,000 forms P35 had been received and, of these, over 10,000 had been issued with an interim penalty notice in error.
- A large majority of these cases were received on 17 May 2007.

Action Taken:

- The majority of the “missing cases” were immediately reprocessed.
- An apology letter was issued to employers where penalty notices had been issued in error.
- A process was developed to prevent any further action being taken to recover the penalties by automatically discharging them.

Next Steps:

- Analysis of the problem has not yet established the root cause and investigations continue. However HMRC has introduced the following to ensure this does not happen again.
- A scan will be run on a regular basis to an agreed schedule and in particular prior to the issue of Penalty Notices to highlight any problems.
- When peak processing commences for 2007–08 (April 2008) the process will be reviewed daily to detect any record of IT issues.

Lessons Learned:

- HMRC and ASPIRE will carry out a comprehensive review of all scans carried out between systems to identify employers that should be inhibited from the penalty run. This will ensure the correct scans are produced at the correct time in future.
- We aim to improve problem management and problem management governance by addressing the issue of how low priority Reports are consolidated and escalated.
- We will obtain more rigorous and formal assurance from business partners that all employers for whom a penalty notice should have been inhibited are identified.

ADDITIONAL QUESTIONS FROM MR BACON AND COMMENTS FROM LITRG

We provide replies to Mr Bacon's supplementary questions below and, in addition, have noted Mr Andrew's (LITRG) annotations to the transcript of the hearing.

Our broad solution to this issue is to let normal PAYE processes apply with the minimum of delay, bearing in mind that many of the existing PAYE processes are set to be improved or automated following significant improvements to the IT support for PAYE (Modernising PAYE Process for Customers) in 2008.

THE PAYE RESIDUAL FILE

The "Residual File" is subset of all end of year returns for employees received by HMRC each year. It contains details for all ongoing employments at the previous 5 April which could not be automatically matched to a corresponding taxpayer record on HMRC's database. Forms will fail to match for a variety of reasons, with the most common being incorrect reference numbers or where we had no prior knowledge of the taxpayer, normally because the P45/46 process for employee movements had broken down.

We keep the current residual file on-line as it is used throughout the year by HMRC staff as they reconcile customer records. Typically, this will involve matching an end of year return for an employee in the Residual File with a corresponding taxpayer record, calculating the overall tax due on the consolidated income, comparing that with the tax paid under PAYE and taking corrective action either to collect any underpayment or refund any overpayment. At the same time, prospective changes are made to avoid a recurrence in future years, typically by updating employee data and adjusting the taxpayer's code number for each employment.

At the end of the year, cases remaining on the Residual File are archived and a new on-line Residual File is created from the most recent employer returns.

ANSWERS TO MR BACON'S SPECIFIC QUESTIONS

1. *"How many forms P14 were held by HMRC in the residual file for the years ending 5 April 2003 to 5 April 2007 inclusive from pension payers where the income was £1,500 or less?"*

HMRC has not analysed the detailed files for all of these years. We have analysed 2005–06 and this shows that the residual file held approximately two million P14s from pension providers where the income was £1,500 or less. The average amount of pension income on these P14s was just over £500.

2. *"Given that pensions providers are legally bound to provide details of pensions paid to all their pensioners annually, why is HMRC not in a position to identify the individuals referred to in the Low Incomes Tax Reform Group brief prepared for the PAC on 10 October without imposing an unnecessary burden on pensions providers?"*

We fully understand LITRG's concern that HMRC should notify pensioners of any new or increased tax liabilities as soon as possible.

Whilst an approach to all pension providers during 2007–08 would have allowed us to identify affected cases early and engage in earlier communications, we nonetheless discounted it on three main grounds:

- The administrative costs to some 6,000 pension providers and their agents in providing informal, in-year returns (notwithstanding that they are legally bound to provide details of pensions paid to all their pensioners annually). The providers would have to make judgements about a range of circumstances in which tax may or may not be correctly deducted from small pensions.
- Our inability to enforce provision of the information in the event that the return was not forthcoming from the pension provider.
- The likelihood that the timescale for obtaining, matching and processing the information would extend beyond April 2008.

3. *Why does HMRC delete the contents of residual file records each year, given that they contain potentially valuable information?*

In order to save on-line storage space and to keep the file to a manageable size, the residual file is closed each year end and a new residual file created from the most recent employer returns.

A separate archive of every P14 sent to HMRC is retained for six years so no P14 data is actually deleted.

4. *Why did HMRC take the view that it was acceptable to introduce arrangements and staff instructions which involved the removal/deletion of an individual's PAYE computer record when the individual had income which was subject to taxation, albeit that no tax was due and payable in a given year?*

The National Audit Office's Report explains that the precise rationale for this range of formal and informal practices which attached to the non-taxation of small pensions is now unclear. There was a combination of incorrect central guidance, inappropriate local agreements and failures by local offices to implement agreed procedures, and it is likely that decisions were taken because staff did not consider the effect material against the administrative savings for the Department and pension payers. The Department has now corrected our guidance to staff and begun a systematic programme of work to put all pensions on a proper footing but does not intend to recover tax which was not deducted earlier than 2007–08.

Supplementary memorandum submitted by the Low Incomes Tax Reform Group

The LITRG have provided the following comments on the oral evidence given by HM Revenue and Customs. The comments relate to questions 75, 77 and 91.

QUESTION 75

In effect Mr Gray states that three years liability on this unknown amount will be collected in one tax year (2009–10) and pensioners may not be told about it until close to the start of that year. That is not normal for people on very low incomes. HMRC should, at the very least, have regard to the financial capabilities and the personal circumstances of each of these pensioners and undertake liaison with the relevant DWP/Local authority colleagues. Armed with this information a customer-focused response can be taken.

QUESTION 77

We did not ask that the HMRC action should be to obtain the information in the current year. We merely anticipated that HMRC would say that they were powerless to do anything about it. This would not have been correct as it is merely reflects how many resources HMRC were prepared to put into the problem in the current year.

The Low Incomes Tax Reform Group asked to see the legal advice which Mr Shipp mentions but this request was denied. We assume because they were not confident that it would hold up to scrutiny.

Mr Shipp refers to wanting to be even-handed to pensioners. If HMRC are going to let the debt accumulate that is not being even-handed to those pensioners who are going to be thrown into debt.

We do not believe that HMRC will get simple processes in place before next year between themselves and the DWP to deal with the knock-on effects of these errors.

Firstly the DWP operate strict backdating rules and we do not believe that these will be set totally aside for this cohort of HMRC customers.

Secondly when Pension Credit was introduced in 2003 it was accompanied by the introduction of Assessed Income Periods, being five years of fixed awards. These expire next year and the DWP are gearing up to ask pensioners if anything has changed in their financial situation, so new fixed awards may be given. It will be a lottery whether pensioners will have heard from HMRC or not by the time the DWP write to these pensioners.

Finally we are not convinced that HMRC are being even-handed or fair to this low-income pensioner population when we have numerous examples of tax credit debt being written off of much greater magnitude than is likely to occur here. Tax credit claimants have longer periods ahead of them to recover the lost finances and the ability to work to replace the debt. These, often very elderly, pensioners will not have that opportunity. What is fair about that?

I think HMRC should be asked how many P14s they have already received from pension providers which are sitting in their “residual files” (a large electronic in-tray) and which therefore disclose the amounts already paid to pensioners for 2006–07. This would obviate the need to “trouble” the pension providers if the reality is that HMRC have nearly all of this information already as to who these people are and the pensions paid are not going to vary significantly or at all between years.

QUESTION 91

It is not correct to say that this problem was identified in 2007–08 as was shown in the NAO Report it was identified in April 2005. LITRG was aware of it in 2005.

This whole exercise will require hundreds of HMRC staff to be involved with knock-on effects across to other government departments and the already over-stretched voluntary sector. Bearing in mind the associated distress to low income pensioners, many of whom after examination will be shown not be taxpayers, we cannot accept that this is a good use of HMRC’s scarce resources.
