House of Commons

Public Accounts Committee

HM Revenue and Customs: Improving the Processing and Collection of Tax: Income Tax, Corporation Tax, Stamp Duty Land Tax and Tax Credits

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Contents

Report

Page

Summary 3

Conclusions and recommendations 5
- Recovering Tax Debt 5
- Backlogs in Tax Processing 5
- Tackling Tax Avoidance 6
- Stamp Duty Land Tax 6
- Tax Credits 7

1 Recovering Tax Debt 9

2 Backlogs in Tax Processing 12
- Pay As You Earn 12
- Corporation Tax 12

3 Tackling Tax Avoidance 14

4 Stamp Duty Land Tax 16

5 Tax Credits 18
- Error and fraud 20

Formal Minutes 22

Witnesses 23

List of written evidence 23

List of Reports from the Committee of Public Accounts 2009–10 24

Summary

HM Revenue and Customs (the Department) is the engine room of public spending, collecting the income that finances the majority of services provided by government. In 2008–09, total taxes and duties collected and receivable were £436 billion, some £22 billion lower than in 2007–08. The £436 billion included £28 billion in tax debtors. The Department has made a provision for bad and doubtful debts of £11.2 billion, 40% of the total, and £3.3 billion more than in the previous year.

At a time when the public finances are under pressure, protecting tax revenues has never been more important. The recession presents a number of challenges for the Department and places the tax system under a great deal of stress. Taxpayers looking for support have been given more time to pay their tax liabilities. But while the Department is working to improve its debt recovery, its efforts are constrained by outdated systems and it has deferred plans to invest in them due to lack of funding. Better systems would help the Department improve tax recovery and reduce losses.

At the same time the Department has to ensure that it counters risks of non-compliance and deals with backlogs of processing from previous years. Delays in introducing new systems have contributed to processing backlogs and have led to staff resources being diverted at critical times. The Department cannot now begin to clear the backlog of 17 million PAYE cases until its new systems are fully operational in April 2010. Delays in introducing new computer systems and the loss of expertise following office closures led the Department to divert staff away from work to test compliance with Stamp Duty Land Tax, increasing the risk of lost revenue from non-compliance.

The absence of information on tax losses through non-compliance and avoidance makes it harder for the Department to analyse risk and to judge how to deploy its resources where they will have most beneficial impact. It has saved £11 billion in potential tax avoidance since 2005, but does not have an estimate of how much tax has been lost because of avoidance or of the cost of the resources it devotes to tackling avoidance.

In 2007–08 claimant error and fraud resulted in incorrect tax credits payments of between £1.58 billion and £1.84 billion, leading to the qualification of the Comptroller and Auditor General's opinion on the regularity of tax credits expenditure. The Department is looking to reduce claimant error by improving the guidance and support it gives to people at the time they need to report changes in their circumstances. It has a target to reduce claimant error and fraud to not more than 5% of the value of finalised awards by 2011.

On the basis of the Comptroller and Auditor General's report on HM Revenue and Customs 2008–09 Accounts, the Committee examined the Department on: how it is managing tax and tax credit debt; what it is doing to clear a backlog of PAYE and Corporation Tax settlements; how it is tackling tax avoidance; how it is improving the administration of Stamp Duty Land Tax; and how it is seeking to reduce tax credits error and fraud.[1]

1 C&AG's Report, *HM Revenue and Customs 2008–09 Accounts*, HC (2008–09) 464

Conclusions and recommendations

Recovering Tax Debt

1. **The Department estimates that £11.2 billion of the £27.7 billion of tax debt at the end of March 2009 is unlikely to be collected.** The percentage of debt where recovery is assessed as doubtful has risen to 40%, up from 23% in March 2006. This increase reflects the effect of the economic recession and a deteriorating trend in debt recovery from previous years. The Department needs to improve its performance in recovering tax debt as a matter of urgency. It is currently focusing on collecting debt earlier and prioritising its collection by risk. The Department should establish targets for the amount of debt it collects, including the recovery rate it expects to achieve, and should report its progress against these targets. It should also set out the actions it will take to reduce the levels of debt assessed as doubtful to below those of 2006 and the date by which it believes this will be achieved.

2. **Weaknesses in the Department's existing systems prevent it from analysing debts by age and value and from calculating a taxpayer's total debts across all taxes. The Department has deferred its plan to invest in a new debt management system because of other priorities.** An effective debt management system would improve the Department's ability to recover debt by providing a profile of debt across taxes by age, value and risk of recovery. With £11.2 billion at risk of non-recovery, the benefits of investment in a new system could easily outweigh its cost. There thus appears to be a very strong case for investment. The Department should re-evaluate the costs and benefits of investing in a system that would enable it to profile debt effectively.

3. **There is a risk that the wider economic benefits of investment in revenue systems are not realised where the Department has to prioritise investment decisions within the constraints of the funding limitations of its spending review settlement.** The Treasury should reconsider its approach to evaluating the economic case for investment in key revenue systems, and assess the costs of investment against its best estimate of the wider benefits to the public finances.

Backlogs in Tax Processing

4. **The backlog of unresolved Pay As You Earn (PAYE) cases awaiting processing stands at 17 million.** The elimination of this backlog is vitally important to taxpayers as it will identify who owes tax and who is entitled to a refund of tax. The Department can start clearing these cases in April 2010, when the final stage of its modernised PAYE system will be implemented. The Department should then clear this backlog as a matter of priority, focusing its effort on those cases which are likely to involve a refund or additional payment of tax. It should plan to clear the backlog by March 2011.

5. **At March 2009 Corporation Tax assessments amounting to over £10 billion, and in some cases over 16 years old, were 'postponed' awaiting resolution.** A postponement occurs when a company appeals against the Department's view of its tax liability, or when the Department expects that a company's tax assessment will be reduced. Cases can be complex and difficult to resolve and the Department is reviewing how it handles them. As part of this work, the Department should analyse and prioritise postponements to establish a clear action plan to resolve them. The action plan should include targets to allow the monitoring of progress in managing high value cases and reducing the existing volume of lower value cases.

Tackling Tax Avoidance

6. **The Department does not have an estimate of the total value of tax lost through tax avoidance or the number of staff it deploys on tax avoidance work.** Following the introduction of anti-avoidance legislation in 2004, the Department has collected £11 billion of revenue that may otherwise have been lost through tax avoidance. The Department's decisions about how to deploy its resources in tackling tax avoidance for 2010–11 and subsequent financial years should be informed by a full assessment of the revenue it is not receiving because of avoidance.

7. **The Department considers that general anti-avoidance rules as adopted in other jurisdictions may not work in the United Kingdom.** The Department should evaluate the relative merits of its existing anti-avoidance measures compared with the general anti-avoidance provisions adopted elsewhere, including the comparative cost of administering an effective general anti-avoidance rule.

Stamp Duty Land Tax

8. **The Department lost knowledge and expertise when it reduced its headcount and centralised its administration of Stamp Duty Land Tax (SDLT).** The Department has been successful in increasing online filing of SDLT, with 83% of returns now filed online, and has reduced the number of staff working on the tax from over 400 to around 135. However, the closure of the Bristol and Manchester offices and the centralisation of SDLT administration in Birmingham resulted in a loss of expertise. In future, the Department's plans for reducing or redeploying staff should identify how it will retain key knowledge and skills, particularly for jobs requiring specialist expertise, such as avoidance work.

9. **The Department's work to test taxpayers' compliance with the SDLT regime has been disrupted by delays in implementing the computer system and the effect of office closures.** In 2008–09, it only opened 203 enquiries on one million returns. Effective compliance work is essential to the successful operation of the tax, helping taxpayers to meet their obligations and deterring people from deliberately under-estimating the tax they owe. The taxpayer must know there is a possibility that any return could be subject to an enquiry. In deciding how much compliance work to undertake, the Department should estimate the volume of enquiries needed to provide an effective deterrent against non-compliance and should resource the work accordingly.

10. **The disclosure rules for SDLT did not require taxpayers to tell the Department when they were using an avoidance scheme, making it difficult to estimate the scale of avoidance.** The Department is extending the disclosure rules to residential property and requiring taxpayers to tell it when they use an avoidance scheme. The Department should use the additional information it gets on the use of avoidance schemes to improve its estimate of the tax it ultimately fails to collect and to direct its compliance resources to the areas of highest risk.

Tax Credits

11. **53%, or £2.3 billion, of the £4.4 billion debt arising from tax credits overpayments is unlikely to be collected.** The Department has already written off £1.3 billion of tax credits debt where it believes there is no possibility of recovery. It is reviewing its approach to tax credits debt, recognising that it has to reach a judgment as to whether the people it is pursuing are able to pay and whether collection is cost effective. As a priority, the Department should identify all debt that is either uncollectable or not cost effective to collect and decide by March 2010 what should be written-off. It should ensure that all tax credits debt remaining on its books at 31 March 2010 is being actively pursued and not ignored.

12. **The Department has been less successful in recovering overpayments directly from claimants where the award has ended. In 2008–09 it recovered £225 million of this type of debt, which grew from £1.8 billion to £2.1 billion.** It is examining new methods of recovery including recovery by adjusting income tax (for those in employment) and, working with the Department for Work and Pensions, by adjusting benefit payments (for those in the welfare system). The Department should set targets for implementing these recovery methods, and should aim to have them in place in time for the annual renewal of awards for 2010–11. It should extend the recovery of overpayments against ongoing awards to include any debts the claimant may have from previous awards.

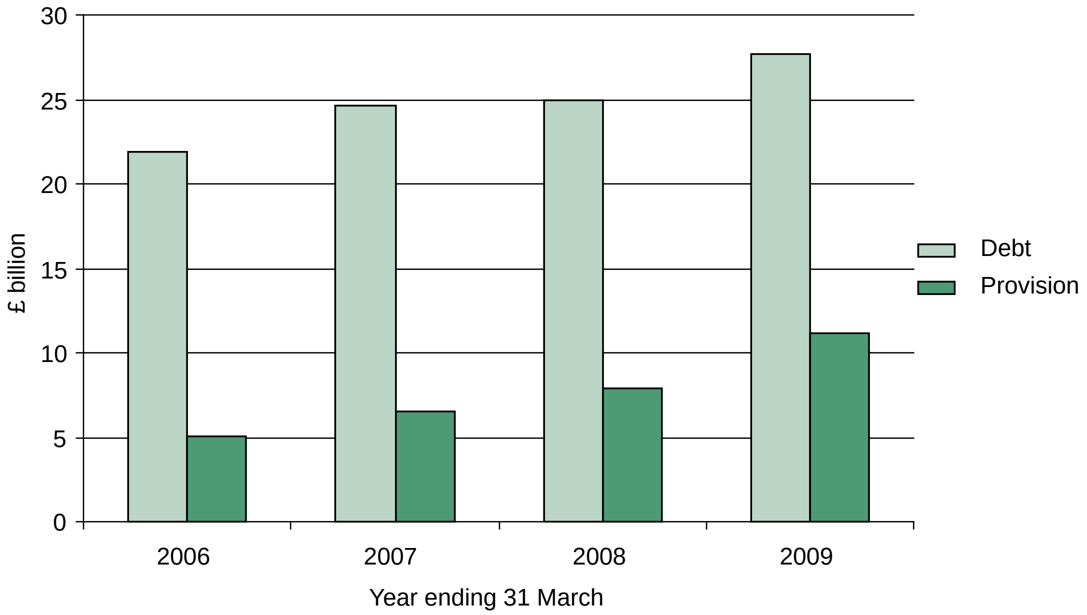
13. **The Department has implemented changes to improve the quality of its support to tax credit claimants, but its ability to improve its service is constrained by weaknesses in its computer system.** While the Department requires claimants to report changes in their circumstances as they occur, limitations in the computer system prevent the Department from telling the claimants when they contact the Department what the effect on their award will be. The Department should assess the costs and benefits of investing in an enhanced tax credits computer system that offers the flexibility to introduce service improvements promptly and to update claimant records in real time.

1 Recovering Tax Debt

1. In 2008–09, HM Revenue and Customs (the Department) collected tax revenues of £435.7 billion, £21.7 billion lower than in 2007–08. The main falls in tax yield were in Stamp Taxes (down by £6.1 billion, 45%), Corporation Tax (£5.0 billion, 11%), Value Added Tax (£6.4 billion, 8%) and Income Tax and National Insurance Contributions (£5.7 billion, 2%).[2] These were offset by increases in Capital Gains Tax (£2.7 billion) and Petroleum Revenue Tax (£0.9 billion).[3]

2. Much of the tax owed to the Department is not paid on time. Of the total tax take of almost £436 billion in 2008–09 some £100 billion was paid late.[4] The fall in tax revenues because of the recession has been accompanied by an increase in tax debt. At 31 March 2009, tax and tax credits debtors owed the Department £27.7 billion, £2.7 billion more than the previous year. The increase in debt is consistent with a trend that was seen before the recession. The Department has concentrated its resources on collecting very high value debt with the result that low value debt has been allowed to build up.[5] Based on the collection rate it is currently achieving across taxes and allowing for the effect of the recession, the Department has estimated that £11.2 billion of the debt held at 31 March 2009 is unlikely to be collected (**Figure 1**).[6]

Figure 1: Total debt and provision for debt for which collection is considered doubtful



Source: HM Revenue and Customs Trust Statements[7]

2 C&AG's Report, para 1.5

3 C&AG's Report, para 1.6

4 Q 4

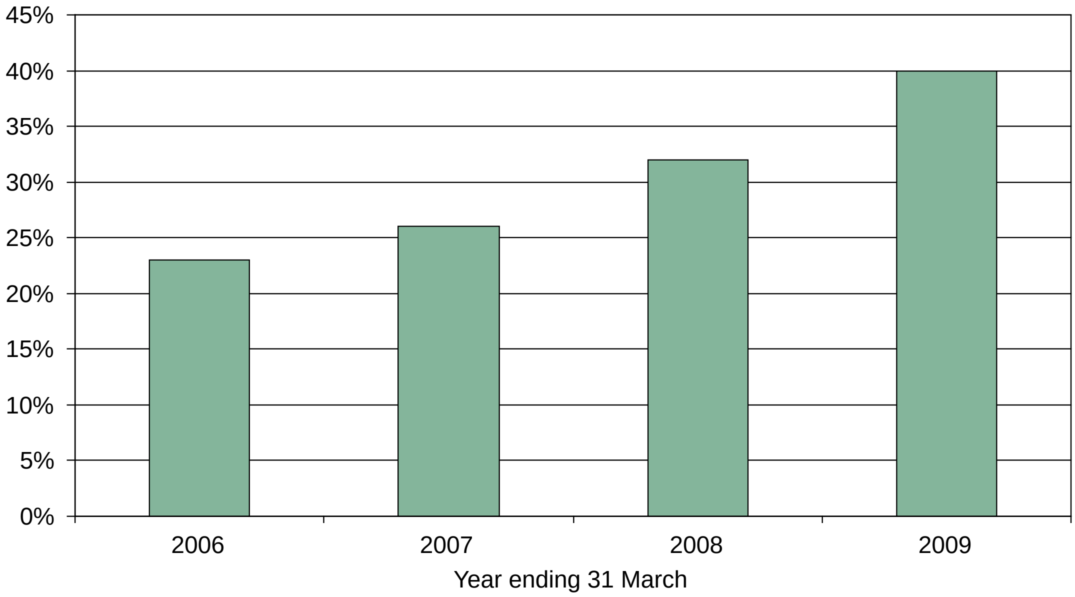
5 Committee of Public Accounts, Twenty-sixth Report of Session 2008–09, *HM Revenue and Customs: management of tax debt*, HC 216, para 9

6 C&AG's Report, Figure 2

7 *HM Revenue and Customs 2008–09 Accounts*, HC (2008–09) 464; *2007–08 Accounts* HC (2007–08) 674; *2006–07 Accounts*, HC (2006–07) 626; *2005–06 Accounts*, HC (2005–06) 1159

3. The amount of debt that the Department considers it is unlikely to recover has increased in recent years (**Figure 2**). At 40.2% of total debt, the provision for doubtful debt at 31 March 2009 is considerably higher than those included in previous years' accounts, and almost double the Department's estimate of 23% in March 2006.[8] This deterioration in the rate of debt recovery suggests that billions of tax debt that would have been considered collectable in previous years may not now be recovered. The Department ultimately writes this debt off where it concludes there is no possibility of getting it back, such as in a company insolvency, or if it cannot track taxpayers down.[9]

Figure 2: The percentage of total debt considered doubtful



Source: HM Revenue and Customs Trust Statements[10]

4. The Department considers that it is making progress in its management of debt. It has revised its debt strategy and is now focussing on collecting debt much earlier, and prioritising collection by risk rather than just value.[11] It is helping those taxpayers who are willing and able to pay their tax debt by introducing new payment methods, such as online payment, and allowing viable businesses suffering temporary financial difficulties more time to pay their tax debts.[12] The Department has also increased its productivity and managed to collect some £3.5 billion more in 2009 than the previous year.[13]

5. The Department is still faced with system weaknesses, particularly in its ability to profile debt by age and value quickly.[14] The Department had planned to invest in a single IT system for its debt management but decided to defer implementation because of other

8 Q 4

9 Q 14

10 *HM Revenue and Customs 2008–09 Accounts*, HC (2008–09) 464; *2007–08 Accounts*, HC (2007–08) 674; *2006–07 Accounts*, HC (2006–07) 626; *2005–06 Accounts*, HC (2005–06) 1159

11 Qq 4 and 25

12 Q 26

13 Qq 4 and 32

14 Q 32

funding priorities.[15] Without this investment, the Department's ability to tackle the problems it faces in getting to grips with tax debt is reduced. An effective debt management system would allow the Department to collect debt more quickly and reduce the amount of debt that cannot be recovered at all. Given that £11.2 billion of tax is at risk of being uncollectable, the benefits from investing in a debt management system could easily outweigh its cost.[16]

15 C&AG's Report, *HM Revenue and Customs: management of tax debt*, HC (2007–08) 1152, para 8e

16 Q 31

2 Backlogs in Tax Processing

Pay As You Earn

6. In March 2009, we expressed concern that the delays in transferring PAYE processing to the National Insurance Recording System would add to the backlog of PAYE cases that require manual working. The Department's systems identify these cases when the automated processing of employers' annual returns of pay and tax deductions from individuals raises doubts about whether the right amount of tax has been paid or there are difficulties matching information to a taxpayer's record. We recommended that the Department establish a strategy and a timetable to deal with, and eliminate, the backlog in PAYE cases awaiting checking.[17] The Department made the transfer to the National Insurance Recording System in June 2009. This has brought all the information on an individual's income together for the first time. This helps to ensure they are paying the correct amount of tax.[18]

7. During 2008–09, in preparation for this transfer, the Department reduced the number of cases requiring clerical intervention from 30 million to just under 17 million.[19] The Department will start clearing the backlog in April 2010, once the modernised PAYE system is fully functional. In some cases people will owe tax and in others people may be entitled to a refund of tax. The Department is working to identify these cases, and those which are cost effective to work manually and in what order.[20]

Corporation Tax

8. The Department also faces a build up of Corporation Tax 'postponements'. The calculation of a Corporation Tax liability can be postponed when a company appeals against the Department's view of its tax liability, or when the Department believes that a company's tax assessment will be reduced.[21] The value of postponements at the end of March 2009 was over £10 billion. £4.6 billion of postponements are over 10 years old, in some cases over 16 years old.[22] The Department has not actively monitored the high volume of low value cases and so these cases have built up over time.[23]

9. Postponements can be complex and difficult to resolve.[24] It is important that the Department puts in place effective case management, oversight and accounting processes to ensure that cases are settled, and companies given certainty about their tax affairs, on a timely basis. The Department has stated that, since early 2008, it has been reviewing its

17 Committee of Public Accounts Fourteenth Report of Session 2008–09, *HM Revenue and Customs: Tax Credits and Income Tax*, HC 311

18 C&AG's Report, para 1.20

19 Q 5

20 Q 6

21 C&AG's Report, paras 3.11 and 3.12

22 Q 10

23 C&AG's Report, para 3.30

24 Q 9

treatment of postponements and is developing a long term response but, over a year and a half later, this response remains unclear.[25]

25 C&AG's Report, para 3.30

3 Tackling Tax Avoidance

10. The Department estimates that its strategy for addressing tax avoidance has brought in £11 billion of revenue since 2005 that may otherwise have been foregone.[26] It also believes that good international cooperation has enabled it to make more progress in dealing with those who use tax havens.[27]

11. The Department examines each tax to assess the revenue it ultimately fails to collect as a consequence of taxpayer non-compliance and the impact of avoidance. The Department also assesses the nature of this 'tax gap' and the risks it needs to address.[28] It does not have an estimate of the total amount of revenue foregone through the use of avoidance schemes and cannot therefore assess whether increased use of these schemes has contributed to the recent fall in revenues.[29]

12. The Disclosure of Tax Avoidance Schemes (DOTAS) regime, introduced in August 2004, requires promoters of tax avoidance schemes to register them with the Department.[30] The disclosure regime applied initially to Income Tax, Corporation Tax and Capital Gains Tax. For most taxes, users of avoidance schemes are also required to tell the Department when they use a registered scheme.[31] The Department has identified what it believes are the indicators of avoidance as opposed to acceptable tax planning and publishes a list of factors that may indicate avoidance, such as transactions that have little or no economic substance.[32] There are penalties for failure to register schemes that meet the Department's criteria for disclosure.[33]

13. The Department uses the information from disclosures to assess whether avoidance schemes comply with existing legislation and challenges those schemes it believes do not. Where a scheme complies with legislation but is not consistent with the intention of tax policy, the Department considers the case for legislative action to stop the scheme.[34]

14. We asked the Department about the merits of introducing a general anti-avoidance rule that would make illegal any scheme devised just for tax avoidance purposes.[35] The Department considers that factors such as the ability of the taxpayer to move their residence or business overseas mean that introducing an anti-avoidance rule in the UK may not work. The Department has not evaluated whether it would need fewer people

26 Q 58

27 Q 59

28 Qq 62 and 66

29 Qq 60 and 62

30 Q 59; C&AG's Report, para 2.32

31 Q 64

32 Qq 95 and 97

33 Q 96

34 Qq 63 and 65

35 Qq 68–69

working to combat avoidance if it were to introduce a general anti-avoidance rule that was successful.[36]

15. The Department employs 17,000 tax professionals, but does not know how many staff it has working specifically on avoidance.[37] It believes it has enough well trained staff to undertake its anti-avoidance work and seeks to build its tax expertise through technical training and exchanges of staff with private sector accountancy firms.[38]

16. The Department acknowledges that it needs more capability to deal with the increase in evasion, avoidance and business failure that the economic downturn is likely to bring.[39] We note its intention to continue to reduce staff numbers and introduce better targeted risk-based approaches to combat avoidance.[40]

36 Q 81

37 Qq 70, 76–77

38 Qq 70 and 78

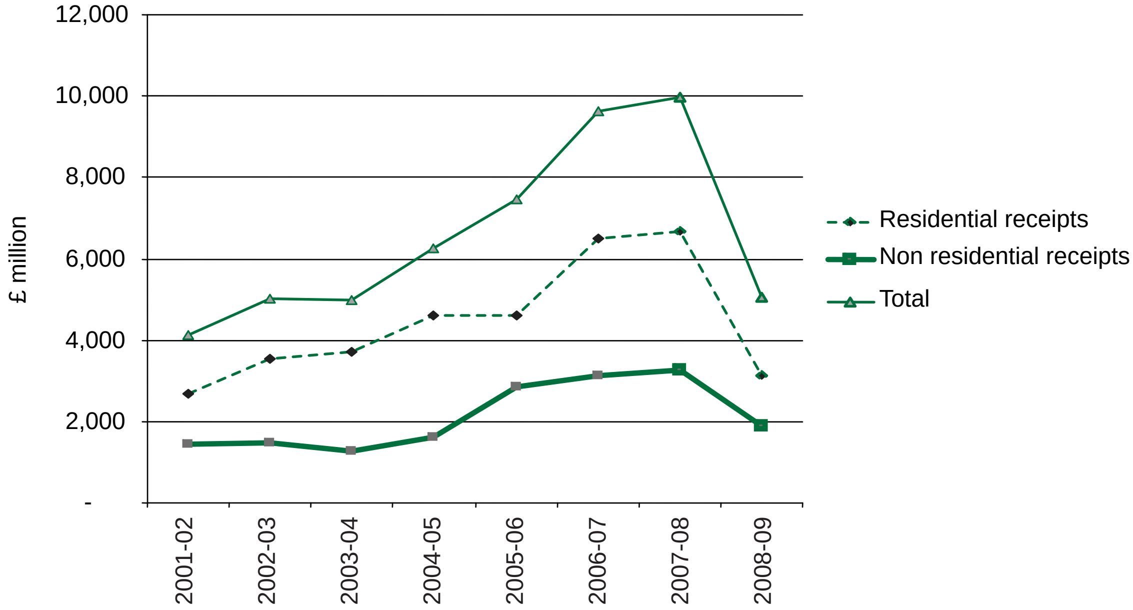
39 Q 73

40 Qq 76 and 78

4 Stamp Duty Land Tax

17. Stamp Duty Land Tax (SDLT) replaced stamp duty on land and buildings in 2003. SDLT revenues grew strongly following its introduction, rising to £10 billion in 2007–08, before falling sharply in 2008–09 to £4.9 billion (**Figure 3**). The Department attributes £3.5 billion of this decline to a fall in the number of property transactions, £1.3 billion to the fall in the value of properties, and the remaining £0.3 billion to policy changes (such as the raising of the threshold for the 1% band).[41]

Figure 3: Stamp Duty and Stamp Duty Land Tax receipts



Source: C&AG's Report

18. In introducing SDLT, the Government's objectives were to promote fairness by addressing stamp duty avoidance; support e-business through, for example, online filing; and to create a modern legal framework for stamp duty in line with other taxes.[42] The Department acknowledges that it did not implement this change well.[43] The computer system for processing the tax was not ready when the tax was introduced in 2003. This led to staff being diverted from other activities, such as compliance work, to process the SDLT returns.[44] The problems with the SDLT system have now been addressed and, with 83% of taxpayers filing on-line, the tax now has the greatest online take-up of any tax where electronic filing is not compulsory.[45]

19. As a self-assessed tax, the responsibility to calculate and pay the correct SDLT liability rests with the taxpayer. The introduction of self assessment and online filing, along with

41 C&AG's Report, para 2.7

42 C&AG's Report, para 2.1

43 Q 7

44 C&AG's Report, para 2.10

45 Q 7

the centralisation of SDLT administration in the Birmingham office, has enabled the Department to make savings, with the number of staff working on the tax reduced from over 400 to around 135.[46]

20. The Department undertakes enquiries into SDLT returns to assess how well taxpayers are complying with their obligations and makes its own assessment where it finds they have not paid the correct amount of tax.[47] This compliance work was disrupted on the introduction of SDLT in 2003 because of the diversion of staff to support processing, and again in 2007–08 when the Bristol and Manchester offices were closed and the administration of the tax centralised in Birmingham.[48] Only three staff transferred to the Birmingham office, resulting in a loss of cumulative expertise. New staff had to be trained and familiarise themselves with transferred enquiries. As a result, the compliance yield fell from £10.9 million in 2006–07 to £3.4 million in 2007–08.[49]

21. The compliance yield rose in 2008–09 to £13.3 million. The Department attributes this success to lower staff turnover in the compliance team and its greater focus on high yielding cases.[50] However, it only opened 203 enquiries in 2008–09, a tiny proportion of the one million returns received in the year.[51]

22. The Department believes that the main risk to SDLT is from avoidance, particularly in the commercial sector, but has found it difficult to estimate the scale of avoidance.[52] The Disclosure of Tax Avoidance Schemes regime was extended to SDLT in August 2005 and requires promoters of avoidance schemes to notify the Department of avoidance schemes only involving commercial property with a market value of over £5 million. Unlike for other taxes, the disclosure rules did not require users of SDLT avoidance schemes to tell the Department when they were using a scheme.[53] The Department is extending the disclosure rules to residential property and requiring users of avoidance schemes to tell it when they use a scheme.[54]

23. The Department does not have an estimate of the tax gap for SDLT.[55] In the absence of an estimate it is difficult for the Department to know whether it is doing enough work to tackle avoidance and non-compliance. It has a project underway to assess the scale and scope of avoidance, which it hopes will help it estimate the SDLT tax gap.[56]

46 Qq 8 and 75

47 C&AG's Report, para 2.16

48 Q 75

49 Q 74; C&AG's Report, para 2.20, Figure 7

50 C&AG's Report, para 2.21

51 Q 8; C&AG's Report, para 2.22

52 Q 90

53 C&AG's Report, para 2.33

54 Q 91; C&AG's Report, para 2.40

55 C&AG's Report, para 2.8

56 C&AG's Report, para 2.41

5 Tax Credits

24. The Department paid £24.1 billion to tax credits claimants in 2008–09.[57] It awards tax credits annually based on the income and family circumstances of claimants. Awards are adjusted where claimants' circumstances change and these are reported to the Department. After the year end, the Department reassesses awards after claimants have confirmed their circumstances and this can give rise to over and underpayments.[58]

25. Since the tax credits scheme was introduced in 2003, the Department has identified overpayments of £8.4 billion. By the end of March 2009 it had collected £2.7 billion of this debt and written off £1.3 billion. £4.4 billion of overpayments remain to be collected. Of this debt, the Department has identified £2.3 billion that it is unlikely to recover.[59]

26. Recoveries of overpayments may be made either by reducing future tax credits awards, or directly from the claimant where the award has ended.[60] At 31 March 2009, the tax credits debt to be recovered from ongoing awards was £1.4 billion. The Department is most successful in recovering tax credits debt where it can offer claimants the opportunity to pay off the debt by deductions from future payments.[61] In 2008–09, £417 million (63%) of debt recoveries were made this way.[62] The Department is less successful where it has to recover tax credits directly from claimants. In 2008–09 it recovered £225 million of debt directly, but by the end of the year debt for direct recovery had increased from £1.8 billion to £2.1 billion with a further £0.9 billion not being actively recovered, for example, where claimants dispute the overpayment.[63] The Department has focused on the recovery of higher value debt, meaning that much of the lower value tax credits debt has received little attention.[64] Some 26% of tax credit debts are less than £1,000 and some 15% are greater than £5,000 (**Figure 4**). Individual debts of £2,000 and below account for 50% of the total debt balance by value.[65]

27. People who receive tax credits quite often owe money to other agencies as well as the Department. The Department recognises that it needs to work more closely with claimants to help them find different ways to make their payments.[66] For those in employment, the Department is evaluating the effectiveness of adjusting PAYE codes to recover repayments directly from earnings. As part of a pilot exercise, 1,700 households with a debt less than

57 C&AG's Report, Figure 26

58 C&AG's Report, para 5.5

59 C&AG's Report, paras 5.10 and 5.16

60 C&AG's Report, para 5.10

61 Q 27

62 C&AG's Report, Figure 30

63 C&AG's Report, para 5.10

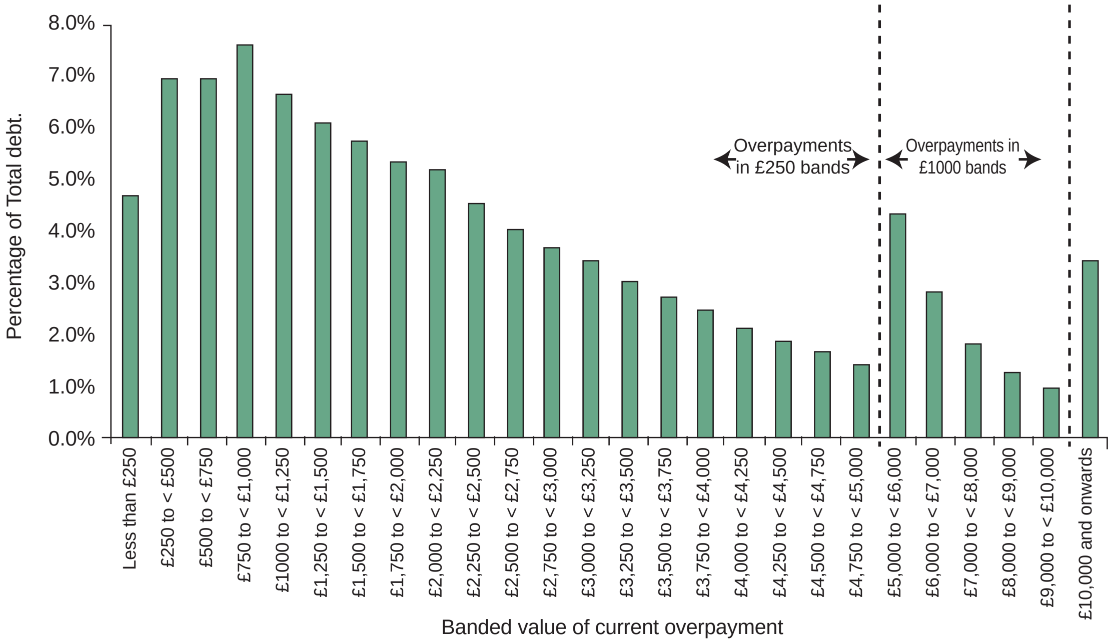
64 Q 27

65 Ev 13

66 Q 34

£2,000 are having their tax credits debt recovered through a PAYE adjustment. The Department plans to review the pilot at the end of the year.[67]

Figure 4: Percentage of Total Tax Credit Debt Outstanding at 20 October 2009 by value bands



Source: HM Revenue and Customs

28. For those in the welfare system, the Department is working with the Department for Work and Pensions (DWP) so that people can have their tax credits debts recovered directly from benefits on a voluntary basis.[68] Tax credits debts can be large when compared to many of the other welfare benefit debts. The Department recognises that it needs to work much more closely on tax credits debt with DWP to ensure that their joint resources are coordinated and applied to best effect.[69]

29. The £2.3 billion of tax credits debt unlikely to be recovered suggests that a large proportion of the debt will ultimately have to be written off. In general, the Department will only write off debt when it believes that there is no possibility of recovery.[70] It is reviewing its approach to tax credits debt, so that it can take a view on the cost-effectiveness of collection.[71] It recognises that it has to reach a judgment as to whether the people it is pursuing are simply refusing to pay or genuinely cannot pay. In deciding how it handles these cases, it recognises that it would be unfair on all of those people who have already repaid their debt not to pursue those who have so far failed to do so.[72]

67 Q 29

68 Q 11

69 Q 35

70 Qq 11 and 14

71 Q 39

72 Q 11

Error and fraud

30. Since the tax credits scheme was introduced it has suffered from high levels of error and fraud. The Department estimates that in 2007–08 error and fraud led to incorrect payments of between £1.58 billion and £1.84 billion, higher than in the previous year.[73] The C&AG qualified his opinion on the regularity of tax credits expenditure because of the probable level of overpayments of tax credits attributable to error and fraud.[74]

31. 90% of error and fraud is customer error, the vast majority of which is from people failing to tell the Department when their circumstances change. The Department has introduced a number of initiatives in an effort to improve the level of support to claimants and identify and correct these errors. The Department is improving its forms, notices, guidance and other support it gives to people. It has recently issued a new claims pack containing simpler guidance.[75] It has introduced a 'health check' which involves contacting claimants before they renew their claim to check if anything has changed in their circumstances.[76] It also contacts vulnerable claimants to ensure that they successfully complete the renewal process. The Department considers that the 2009 renewal process was its most successful yet.[77]

32. The Department has joined DWP's Jobcentre Plus 'rapid response' service to employers and employees where there are redundancies of over 20 employees. This is helping to identify those whose eligibility for tax credits will change and helping them get things right at the point where the claim is made.[78]

33. Weaknesses in the tax credits computer system continue to inhibit the Department's ability to improve communications with claimants. Some standard letters to claimants are automatically generated by the computer system which makes it more difficult and much more expensive to tailor communications to address the specific circumstances of individuals.[79] System limitations also prevent it from reassessing claimants' changes of circumstances and telling them what they are entitled to as soon as they report a change. The Department also recognises that errors have occurred because the computer scanning of forms has failed to recognise and take account of manuscript additions. It is now vetting claims forms to identify these instances and making sure that all relevant information is recognised. It is also looking at whether the process can be improved by increasing the scope for more manual intervention at the time the claim form is scanned and input to the computer system.[80]

34. Tax credits are subject to organised criminal attacks. In 2008–09, the Department identified but failed to prevent organised fraud amounting to £31.9 million.[81] It does not

73 C&AG's Report, para 5.20

74 C&AG's Report, para 5.21

75 Q 46

76 Q 21

77 Q 52

78 Q 47

79 Q 51

80 Q 46

81 C&AG's Report, para 5.22

have an estimate of the extent of undetected losses due to organised crime. The Department's response to the threat of organised criminal attack against the tax credits system is part of a wider response to combat serious organised crime. In its experience, threats do not generally affect one tax or one aspect of processing. Where its threat assessments have identified threats to tax credits it has been successful in shutting these down. Most of the recent attacks have focused on the self assessment system and on carbon credits fraud.[82]

82 Q 24

Formal Minutes

Monday 30 November 2009

Members present:

Mr Edward Leigh, in the Chair

Mr Paul Burstow
Mr Douglas Carswell
Rt Hon David Curry
Mr Ian Davidson
Nigel Griffiths
Rt Hon Keith Hill
Mr Austin Mitchell
Geraldine Smith
Rt Hon Alan Williams

Draft Report (*HM Revenue and Customs: Improving the Processing and Collection of Tax: Income Tax, Corporation Tax, Stamp Duty Land Tax and Tax Credits*), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 34 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Second 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 till Wednesday 2 December at 3.30 pm

Witnesses

Wednesday 14 October 2009	*Page*
Ms Lesley Strathie, Permanent Secretary and Chief Executive, **Mr Richard Summersgill CBE,** Director Benefits and Credits, and **Mr Jim Harra,** Director Corporation Tax and VAT, HM Revenue and Customs	Ev 1

List of written evidence

1	HM Revenue and Customs	Ev 13
2	Parliamentary and Health Service Ombudsman	Ev 14

List of Reports from the Committee of Public Accounts 2009–10

Second Report	HM Revenue and Customs: Improving the Processing and Collection of Tax: Income Tax, Corporation Tax, Stamp Duty, Land Tax and Tax Credits	HC 97

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 14 October 2009

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Dr John Pugh
Angela Browning	Don Touhig
Mr Austin Mitchell	Mr Alan Williams

Mr Amyas Morse, Comptroller and Auditor General, **Mr John Thorpe,** Director, and **Mr Stephen Ardron,** Director, National Audit Office, gave evidence.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, gave evidence.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HM REVENUE AND CUSTOMS 2008–09 ACCOUNTS

Witnesses: **Ms Lesley Strathie,** Permanent Secretary and Chief Executive, **Mr Richard Summersgill CBE,** Director Benefits and Credits, and **Mr Jim Harra,** Director Corporation Tax and VAT, HM Revenue and Customs, gave evidence.

Chairman: Good afternoon and welcome to the Committee of Public Accounts where we are bright and breezy in the new parliamentary session, the last before the general election. Today we have a very important hearing; we are considering the Comptroller and Auditor General's Report on *HM Revenue and Customs 2008–09 Accounts.* Before I introduce that may I just put on the record and welcome what I have read today on the Treasury website, and this is advice to ministers and civil servants but it is very helpful and so I would like to read it out and repeat it. It says here: "Witnesses to PAC hearings sometimes find that there is supplementary material which would be helpful to the Committee in addition to the NAO report. When this happens it is good practice to submit it to the Committee with adequate time to consider it, clearing it first with the NAO. If time does not permit this, witnesses or their representatives should discuss the best approach with the Clerk to the Committee." By the way, in that context I welcome our new and most gracious clerk, Sian Woodward.

Mr Bacon: Hear, hear!

Q1 Chairman: We put on record our obligation to Mark Everton, our previous clerk, who has gone on to work with the Journal Office. The Treasury also say here on their website, which is even more helpful, "After a PAC hearing witnesses and ministers are sometimes invited to comment publicly on the PAC's report. It is bad practice to do so immediately as the Committee finds this practice discourteous to parliament. The substantive response should instead be made in the Treasury minute published a few weeks after the PAC report. Accounting Officers should be aware that the PAC chairman is prepared to censure witnesses and ministers who do not observe this basic parliamentary convention." I have noticed that in recent years there has been increasing tendency for departments to comment on PAC reports and, as the Treasury's own website makes clear, this is bad practice because of course the Government replies to PAC reports in the Treasury minute, and we have got to try and maintain this convention. It is important because it does buttress the non-political nature of this Committee, that we do not get involved in policy, and if we start having a ding-dong between PAC reports and ministers it is not going to help the process. Our job is not to apportion blame, it is to try and cast light on the work of this Government. I am very pleased to have read this on the Treasury website. As I say, today we are considering the Comptroller and Auditor General's Report for *HM Revenue and Customs 2008–09 Accounts* and we welcome Lesley Strathie, the Chief Executive of HM Revenue and Customs. Obviously at a time of economic downturn and declining tax revenues the Department plays a crucial role in doing everything possible to maximise tax yield. This is the engine room, as the Comptroller and Auditor General has just reminded us, of government; for every pound that they spend they get £100 back so this is not some sort of dry subject, it is immensely important and lies at the heart of everything that we are trying to achieve in government, in other words maximising tax yield. Yet when we read this report we see serious weaknesses in information systems, skills and capacity which limit the Department's ability to operate effectively in such a complex environment. In taking evidence today on the issues covered by the C&AG's Report, in particular stamp duty, corporation tax and tax credits, I would like to focus on whether the Department has the knowledge and capability it needs to deploy its resources intelligently so that the risks are managed and the tax revenues are maximised at such a critical time. Before that may I say I am delighted to say a very happy birthday to Mr Alan Williams, who is 59 today and tomorrow will celebrate a magnificent 45

years in Parliament. Shall we give him a clap? That is the nice part of this. Ms Strathie, would you like to introduce your colleagues?
Ms Strathie: I would. On my right I have Richard Summersgill, Director for Benefits and Credits and on my left Jim Harra, Director for Corporation Tax and VAT.

Q2 Chairman: Okay. When we read this Report we see, Ms Strathie, that a massive £11.2 billion of the money owed to the Department by tax debtors has been assessed as "doubtful". This is a term of art but it means "unlikely to be collected". That is 40% of tax debt, so what are you doing about it?
Ms Strathie: Going to your opening statement we have been doing quite a lot about it since we very warmly welcomed the NAO's Report on debt. It is important to just put some context around that 40% which represents the provisions we have made in our account. The debt balance, when we laid the accounts on 31 March, which was £27.7 billion, is a snapshot, but there is a lot of volatility in those numbers because of the different tax regimes, but it is important to remember that it is a snapshot.

Q3 Chairman: You are not denying the figures that I have given you.
Ms Strathie: No, no.

Q4 Chairman: We are now talking about 40% of total debt is doubtful, unlikely to be collected. Two or three years ago it was 20% to 25%; this is worrying so let us not waste a lot of time, Ms Strathie, saying it is a snapshot. This is broadly correct; what steps are you taking to get the matter of tax debt under control? That is what I am asking.
Ms Strathie: I hear what you are asking, Chairman, but I still think it is really important to understand that we believe it is prudent to make that provision given the recession, given that we have seen an increase in debt, particularly since 2005. When we add the recession to that we think it is right to make that provision. What I also think it is important to understand is that all of that is not what we would consider to be fiscal risk; you do not have a direct read-across to what you would have in the private sector for example. Much of our debt is not paid on the right day and within that total tax take of almost £436 billion there is £100 billion which is paid late. We have completely revised our debt strategy and we are very, very keen to move our interventions with business upstream rather than compliance yield which very often becomes debt and is quite costly to chase down and in some cases can be written off. The intervention regime that we have is that we focus much, much earlier on the debt and, indeed, although debt is rising it is important to understand that this year alone we have actually collected almost £3.5 billion more this year than last year.

Q5 Chairman: Can I now turn to PAYE? You have transferred the processing of individuals' PAYE onto the national insurance reporting systems but we have got a backlog, have we not, of 20 million cases—how can you start to clear this backlog?
Ms Strathie: First of all I do think it is important to put in context HMRC's tremendous success in delivering this huge and fairly high risk modernisation which we did at the end of June, albeit we would have hoped to have delivered that programme sooner. In preparation for it we considerably reduced the number of open cases as part of our preparation, because we had an increase right up to 30 million. We managed to get that down to just under 17 million by March. We have another two releases to come, one in November and another in April for the modernisation programme. At that point we will then have the functionality to start reworking those old cases. In some cases people will owe tax and in others people may be entitled to a refund of tax.

Q6 Chairman: But as many as ten million of these cases may not be worth working on. I was hoping you were going to say you were going to concentrate on what you can actually achieve progress on.
Ms Strathie: We are actually working through with our own internal audit and with the National Audit Office at the moment to see of the remaining cases outstanding which may be much more appropriate and cost effective to write off and which cases have to be worked and in what order.

Q7 Chairman: Can I ask you about Stamp Duty Land Tax—time is moving on, I cannot ask a lot about this, but you are only now developing a strategy for compliance work. The tax was introduced in 2003; why have you waited so long?
Ms Strathie: The answer is that the Department did not wait so long. Looking back in the history, 2003 and what followed was probably not the Department's finest example of managing change. We did end up with huge resource implications because we did not have the technology to support. It now actually has the greatest take-up of any of our electronic channels which are not mandated, 83% file on-line.

Q8 Chairman: All these are excuses, Ms Strathie. I have been told that in 2008–09 there were one million transactions on SDLT and only 200 of those were subject to inquiry by you. This does not sound to me as though you have got a grip on this.
Ms Strathie: If you look at any of our compliance regimes—because this is self-assessment and file on-line and, as I say, 83% of people are filing on-line—what we have now is a really good centralised approach, a real productivity gain in terms of taking those numbers of people out and an increase in yield well beyond expectation. We are delivering against the objectives and we now need to be very clear about at what point you intervene in that process and, on a risk-based approach, what compliance activity we would want to take.

Q9 Chairman: I have got to move on very quickly now to corporation tax. Some of the assessments on corporation tax cases have been postponed for 16 years; what are you doing to resolve these very old cases, Ms Strathie?

Ms Strathie: Could I ask Mr Harra to answer that question? Thank you.
Mr Harra: The vast bulk of the postponements for the very oldest accounting periods relate to large businesses. We conducted an exercise in May of this year where we reviewed all of those largest cases and we found that all of them are actively working. It is the case that in some of the largest businesses we have got very complex matters under dispute, some of which have to go through litigation and it takes time to resolve those. It is also the case that we can assess where we discover suspected fraud or negligence many years after the end of the accounting period, so although a postponement may relate to an old accounting period that does not mean it is an old postponement, it may be on an assessment made much more recently.

Q10 Chairman: But £3.6 billion of this debt relates to 1993–99, already a long time ago; a further £1 billion is even older. You cannot tell me this is good management.
Mr Harra: Certainly if you look at the oldest ones there that you have mentioned,[1] we have reviewed those, and the amount that is in there that does not relate to a very small number of large businesses is negligible. All of those inquiries are being actively pursued but we have to go through the courts for most of those. For example, one of the oldest cases which represents half of all that stood-over tax from before 1993 is going through the French courts, and that is taking a very long time.

Q11 Chairman: Quickly on tax credits—this is one of the most difficult areas of all and we have reported many times on this. Ms Strathie, you have made no progress in the recovery of £4.4 billion tax credits overpayments; £2.3 billion of this is considered doubtful, in other words unlikely to be collected. How much debt do you expect to recover? How long will this take?
Ms Strathie: First to say there has been an increase in that and I will not bore you with all the reasons why, but the focus on recovery is one where we are trying to take some even-handed approach to those people who are finding quite a degree of difficulty in paying this back. One of the things we have done is arranged for people to have their PAYE codes adjusted so that we can take repayments there; we have also joint work that I co-chair with Sir Leigh Lewis in DWP. We are working with that Department so that on a voluntary basis people can have their tax credits recovered from DWP benefits when they are in those and there are a number of other ways where we have changed our approach to recover while people are in payment. There still is an issue about a large chunk of that debt which may be written off, but we have to strike a balance with all of those people who have paid back in how we handle those who have so far failed to do so.

Q12 Chairman: My last question really relates to the Treasury. It is clear to me that HMRC is stressed at the moment. What extra help have you given them in terms of helping them to manage this debt?
Ms Diggle: HMRC seem to be managing very well on fewer staff. They have managed to lower their number of staff quite successfully over the last few years; if they needed more staff I am sure they would tell us.

Q13 Chairman: The answer is you are not giving them extra help.
Ms Diggle: But we maintain a constant dialogue.
Chairman: Okay; thank you very much. Richard Bacon.

Q14 Mr Bacon: Ms Strathie, you said that you had to strike a balance between deciding to write off tax credit debt and having regard to those people who had done the right thing and paid back where they should have done. At what point do you decide that there is so little a chance realistically of getting back the debt that you choose to write it off?
Ms Strathie: We have done a reasonable analysis on this at the moment. Essentially HMRC recovers nearly all debt of any kind and that is our starting point. Generally we write off debt when we believe there is no possibility at all of getting it back, like in a company case when there is an insolvency or if we just cannot track clients down after a great length of time. Basically, therefore, writing off is not our starting position, but some of this is quite old and we feel on a cost-benefit analysis there is a question mark over some of it.

Q15 Mr Bacon: I noticed the Report says 94% of tax credit debt is less than £5,000 and 6% is less than £250; could you send us a breakdown, which probably would look neater than this, but something like that where you band it for us so that, for example, you would show less than £250 6%, and then the total in millions of pounds represented by that band.
Ms Strathie: Yes.

Q16 Mr Bacon: Then the £250 to £500 slug, what that represents in per cent in total and the number of millions of pounds, all the way up to £5,000 in £250 increments.
Ms Strathie: Yes.

Q17 Mr Bacon: Then presumably it is the bit from 94% to 100% that is over £5,000; can you do a detailed breakdown of that as well so we can see better where the debt lies. If you can find a way to factor into the same chart something about how old the debt is as well, I am really trying to understand—
Ms Strathie: Age and value.

Q18 Mr Bacon: Yes, the value and the proportion that is in each band, if you could do that.

[1] Note by witness: At 31 March 2009, £3.6 billion was recorded as postponed on the COTAX IT System for the years 1993–99. The further £1 billion mentioned relates to 949 Million recorded as postponed on other, legacy IT systems, of which £491 million was for the years 1993–99 and £458 million was for earlier years. Over half of this latter sum relates to the case which is going through the French courts.

Ms Strathie: We shall certainly take that request away and within the limitations of our system give you a written response.[2]

Q19 Mr Bacon: One of the things that concerns me about the entire tax credits system is that in the Annual Report and Accounts (not the C&AG's Report) in paragraph 6.15 you are still having 7.9% to 9.2% of the final value of tax credit awards classified as fraud and error. This is after many years of the tax credits system, during which you have paid out over £84 billion—I have just totted up the figures in the chart. The 7% to 9% of £84 billion in fraud and error is a lot.
Ms Strathie: Yes.

Q20 Mr Bacon: I know that organised fraud is categorised separately according to this paragraph; could you tell us what are the figures for fraud and error and organised fraud? You see, £1.58 billion and £1.84 billion in total—forgetting organised fraud for the minute—is fraud and error.
Ms Strathie: Yes.

Q21 Mr Bacon: How much of the £1.58 billion and £1.84 billion is fraud and how much of it is error?
Ms Strathie: Roughly 10% is fraud and the remainder is error and, as you say, that does not include the serious and organised criminal attacks on the system which are a bit more difficult to quantify. Our approach to fraud and error—and indeed this is something that the Chancellor has given us in his remit this year—has been to break down what is fraud and what is error, and indeed we have an aspiration to break that down further between our customers and our own people in the organisation. Basically you are looking at 90% customer error and if you want to look at that on another level, many of these errors are around child care costs and child care provision, so we are pretty clear on where things go wrong but the vast amount of customer error is because people fail to tell us that things change, that they have changed their circumstances. We have actually introduced quite a number of approaches, including a very proactive health check of contacting customers, just to check before renewals if anything has changed in their circumstances.

Q22 Mr Bacon: You mentioned that it was difficult to quantify the value in relation to organised criminal attack, but you presumably make some attempt to do that.
Ms Strathie: Yes.

Q23 Mr Bacon: What is the rough value that you have estimated?
Ms Strathie: I do not have the figure for that, do you?
Mr Summersgill: No. The last figure that was published was for 2007–08 and was in the order of £66 million. That was organised fraud prevented by our activities.

Q24 Mr Bacon: But you do not have the figure for organised fraud that was not prevented. Do you have no estimate of it? I am interested in this for two reasons; one generally because I do not like fraud against the taxes paid by my constituents and the second reason is that an HMRC civil servant leaked to me a dossier containing evidence of organised criminal attack. Fortunately I was not taken away by the police and arrested, but until recently until the arrest of my colleague I did actually have his mobile phone number on my BlackBerry—I can tell you it is not there now. He disclosed an organised criminal attack that was possibly involving tens maybe hundreds of million pounds where people came to this country from Eastern Europe, set up low paid jobs with British bank accounts so that they got tax credit payments, then went back home where, in Slovakia, they took the money out with a cash card, did not tell you about their change in circumstances and it was sometimes 12 months before you caught up with them, and £5,000 or £6,000 later they had enough money to buy a house. That was being done on a widespread scale, and after I publicised the fact of it and handed on the dossier I had received to the predecessor of the predecessor of the present C&AG it was closed down quite quickly; there was a lot of effort that was put into it. You must in that process have had some estimate, and in other similar attacks, of what the value was.
Ms Strathie: What we are saying is the last published figure is the one that Mr Summersgill told you about. It is really important when we look at our very serious and organised measures to understand that threats do not generally come under one single head of duty and one single line, nor does our intelligence come from any single source in HMRC. We are constantly reviewing the threat assessment; some of it is against tax credits and we were successful in shutting that down. More recent attacks have focused on the self assessment system and on carbon credits. Basically, the reason why things do not come necessarily in neat packages and it could only ever be an estimate of value is because generally these are interwoven into total loss. When people are serious and organised they are generally attacking or attempting to attack on several fronts.

Q25 Mr Bacon: The Report says you are increasingly prioritising debts by risk rather than by value, which one can see might make sense in some ways, especially if you assume that even a high value debt is likely to be repaid, but that must have some consequence for the recovery of large numbers of small debts, does it, and what do you do about it?
Ms Strathie: You are talking about debt generally, Mr Bacon, not just tax credit debt, yes?

Q26 Mr Bacon: Yes.
Ms Strathie: Where we saw that increase in debt that took us to around the £20 million pre-recession and then the further increase, a lot of that was because we were focusing on very, very high value debt. All of this is about prioritising resource and we had considerable success there, but we did see an increase in small debt rising over that period. Basically the

[2] Ev 13

revised strategy on our approach is to cover all of those areas. Basically we have debtors who can pay, are willing and able and just need some help to do it, so we have introduced new methods—people can pay on-line et cetera and there are time to pay arrangements. We have people who just need a bit of help to do it and we have introduced various different ways that people can pay. Then we have people who do not really want to pay but could pay.

Q27 Mr Bacon: Sure. Specifically on tax credit debt, low value tax credit debt, are there large numbers of small tax credit debts that have not been chased as vigorously as they might have been because you are placing emphasis on high value debt within the tax credit system?
Mr Summersgill: In the past there has been the possibility of that; clearly a lot of our focus in the Department has to be on the higher value debts. One of the things we have learnt is that the sooner we collect a debt, while it is young—as early as possible after the debt has crystallised following the finalisation process—and the more we can offer claimants the opportunity to pay off the debt by a debit against an ongoing payment then we are much more successful.

Q28 Mr Bacon: I noticed that from figure 30; does that mean you are going to be doing more of that recovery through ongoing awards?
Mr Summersgill: Yes. We are reviewing our whole approach in this area and, as Lesley mentioned earlier, a couple of things we are looking at are piloting the recovery of tax credit debts through as the pay-as-you-earn system.

Q29 Mr Bacon: I have run out of time so let me just ask you a question about PAYE and then you can answer it at as much length as you like. Very quickly, I was interested in that earlier answer from Ms Strathie; it is great that you are doing it through PAYE but what proportion of tax credit claimants are now having that recovery where it is required done through PAYE?
Mr Summersgill: It is a pilot so this year we offered it to a number of people with a debt less than £2,000 and within the pilot 1700 households are having a debt coded out. We will review how it has gone at the end of the year and then if it is successful we will look at the scope for rolling it out further.

Q30 Mr Bacon: Are you happy to take it over quite a few years in such a way that even a poor person might not notice £5 a month over three or four years—you could pay back a small debt that way.
Mr Summersgill: That is effectively the approach we take now in our time to pay arrangements. If it is not a debt we can collect from the ongoing tax credit award we will typically immediately allow a 12 months time to pay and we are always prepared to consider longer periods depending on individual circumstances.

Q31 Chairman: Thank you Mr Bacon. Ms Strathie talked about the limitations of the system, perhaps I could ask the Comptroller and Auditor General if he has any views on the systems of debt collection in HMRC?
Mr Morse: Thank you, Chairman. We think that HMRC is wrestling with an enormous issue, particularly following the consequences of the recession and we understood that there was intention to invest further in systems and to improve the systems infrastructure. I notice Ms Strathie mentioned the limitations of the system; we really feel that every £1 spent on improving this is about £100 yield in terms of what you can collect on behalf of the rest of the Government and it really is urgent that there should be investment in this area. We briefed the Committee on that before the hearing so I am glad to have a chance to testify to it on the record.

Q32 Chairman: Do you want to comment on that?
Ms Strathie: Yes, indeed. It is important that we understand how far HMRC has come in modernising a vast and complex business, and you cannot change every system overnight. If we had greater investment in this particular area then understanding very, very quickly the age and value of our debts would help, but secondly there is an opportunity for us to use more modern methods including debt collection agencies in some of this work. What we are seized of at the moment is you either reduce the head count in HMRC to free up the resources to do that or we strike some sort of agreement with our Treasury colleagues that we pay for that to an extent through the revenues that we collect. I know from all my experience of debt collection in DWP that the older a debt is the less likely you are to collect it, and therefore we feel that we have made incredible productivity gains in this area but we still have system limitations.
Chairman: Thank you. Don Touhig.

Q33 Don Touhig: Sticking with the question of tax credits do you believe that HMRC must try to recover overpayments to which claimants are not entitled—you must do it?
Ms Strathie: Yes, our starting position is that if the money is owed to the Exchequer, unless we believe there is no chance or it is so vastly expensive, then we should try to collect it.

Q34 Don Touhig: Is this objective pursued with a passion regardless of the consequences on the individual claimant?
Ms Strathie: I would like to think that in any service that I have delivered in government I start with the customer, and working with our customers generally speaking gives you the best dividend. We do need to understand that people who are in the tax credit regime are not always people who live organised lifestyles and quite often get themselves into debt with us and many other agencies that they owe money to. That is why we have tried to work on different ways to help people make those payments.

Q35 Don Touhig: I share that view very much, although a former Chancellor, Dennis Healey, once said there are two statements to treat with caution, the first one is "The cheque is in the post" and the second one is, "Hello, I am from the government, I am here to help". You told us in answer to earlier questions that you work closely with DWP in order to help recover money from people who have been overpaid, and you also in answer to questions from the Chairman said that there are some large organisations you have been seeking to recover money from for 16 years. Have you not just taken the soft option, let us pursue the little man and get the money back that he was overpaid and this multimillion pound corporation we will treat a bit differently?
Ms Strathie: In scale and context tax credit debts are relatively small if you compare them with many other tax debts; on the other hand they are pretty large compared to many of the other welfare benefit debts. I believe in a refreshed strategic approach; we need to work much more closely on tax credit debt within DWP's overall approach and use our resources equally to best effect rather than see the tax credit debt in the totality of everything else. I have been in HMRC 11 years and I have not come across one company yet or one chief finance officer who has told me we take a soft approach with them.

Q36 Don Touhig: How many overpayments are due to HMRC errors and how many are due to claimant errors, or do you assume all are claimant errors?
Ms Strathie: The way that error has been calculated and the business design process if you like, the customer journey to achieve tax credits and to renew tax credits, is one where there are lots of checks and balances in the system to help the customer get it right. One of the things that I feel quite strongly about looking forward is that we need to break that error figure down to address any potential error on the part of our staff. At the moment we have simply fraud and error combined of which we know broadly 10% is fraud and the rest is customer error. Like you I do not believe that every single person who works for me does everything perfectly every day.

Q37 Don Touhig: What you have just said is that it is customer error.
Ms Strathie: I am saying we are scoring customer error, we are not scoring our staff error. We have an accuracy measure in lots of our different regimes right across the Department and we collect together accuracy figures, but that is not then taken forward into one of our key measures and it is something that we are now looking at going forward as to how we work on that. I do not have a figure for staff error. Do you need to add to that?
Mr Summersgill: Could I just add to that? It is probably worth making a distinction between official error within the error and fraud statistics—which is actually very small and difficult to measure—and official error that leads to an overpayment. If official error leads to an overpayment then under the revised Code of Practice 26 if it was entirely down to us and there was no fault on the customer's side we would write that overpayment off.

Q38 Don Touhig: But is not the culture always to assume that it is the customer, the client, who is at fault?
Mr Summersgill: No, and indeed when a customer writes to us or you write on behalf of your constituents it will be looked into. Something that occasionally happens is that a customer will have notified a change of circumstances and for various reasons we may not have processed that timeously. We will listen to the phone conversation, which we record, and if we are satisfied that it is our error then we write the overpayment off.
Ms Strathie: I would have to say, Mr Touhig, that I deal with all these cases personally, the ones where you write to me on behalf of your constituents, and we are quite generous in accepting that we may have contributed to the error.

Q39 Don Touhig: I will pursue that further. We see at paragraph 5.14 that Mr Bacon has referred to that 6% of overpayments are less than £250 and the C&AG has told us that every pound you spend brings you back £100. Is it really cost-effective to pursue such small sums?
Ms Strathie: That goes back to what I said to Mr Bacon earlier; we are reviewing our approach on all of this. There are lots and lots of people who have paid back those sums and we have to reach a judgment as to whether the people we are pursuing can pay and will not pay or actually cannot pay and then take a view on the cost-effectiveness of collection.

Q40 Don Touhig: Those smaller amounts are roughly around 6%; with those smaller figures do you have a process whereby you make two or three attempts and then maybe say "We have spent hundreds of pounds in order to recover £250"?
Ms Strathie: At the moment we are separating this into those who are currently in award, in which case then we will pursue deduction from existing award, those who are out of award and how many of those are in gainful employment or how many of those are perhaps in the welfare system which is why we are looking across DWP as well.

Q41 Don Touhig: We also see in figure 30 that you are having more success recovering overpayments from ongoing awards. You are already setting that up, are you?
Ms Strathie: It is a lot easier for many of our customers that we take the money before they receive it.

Q42 Don Touhig: How many cases of overpayment where the claimant says it is your fault get referred to the Parliamentary Ombudsman?
Mr Summersgill: I am afraid I do not have that with me. It is a very small number indeed.

Q43 Don Touhig: Could you let us have that, please?
Mr Summersgill: I can let you have that, yes.[3]

Q44 Don Touhig: That would be very helpful indeed.
Ms Strathie: It is important to remember that we have the Adjudicator as the step in between which is why we have so few.

Q45 Don Touhig: You are on first name terms.
Ms Strathie: We are on first name terms, yes.

Q46 Don Touhig: We are constantly told that overpayments occur because claimants have failed to complete paperwork correctly, but have you looked at that from the point of view of trying to simplify the information? A case which you may be familiar with that I dealt with some while ago was where a constituent had to fill in the box that said "Are you in receipt of Income Support?" and the constituent had said, "Yes", but underneath had stated that this had ended on XYZ date, and your system could not scan that in, so we have ended up with a couple of years of correspondence because the system just was not capable of dealing with that.
Mr Summersgill: Through our tax credit transformation programme we are doing an awful lot to improve our forms, our public notices, our guidance and the help we give people, including looking at simplifying forms. Most recently we have issued a new form of claims pack with much more simple guidance in it. The specific problem to which you relate, it is still possible for that to occur because, as you say, the form is computer-scanned. What we are doing more routinely now is face vetting those claims to see if there are manuscript additions that we need to take account of and making sure that those are recognised. We are also looking at whether there are some opportunities to change the whole of that process and actually have more manual intervention at the time the claim form is scanned and input to the computer.
Don Touhig: Thank you for that.

Q47 Angela Browning: Could I just begin with tax credits? I see that you are recovering £413 million under time to pay arrangements; I wonder what analysis you have made—given that unemployment is rising—of the ability of people who come to those arrangements if their jobs finish. Have you made any analysis of the impact of unemployment on your debt in this area?
Ms Strathie: We have done quite a lot in terms of the effects of the recession. We have governance around trying to look ahead at different impacts and time to pay in all of our regimes has been focused on, understanding that it is a difficult time, a very difficult time in this particular type of recession and where it has started, and in bringing people into compliant regimes. That means having a conversation with customers about what the issues are. One of the things we have done very successfully in partnership with Jobcentre Plus is that in each redundancy situation where there are redundancies of over 20 Jobcentre Plus provides a rapid response service to the employer and the employees and HMRC has joined that rapid response force. There is opportunity there for people coming out of work who could fall into the category that you have talked about, but also for others who become eligible for credits. We are trying to work in a very proactive way to help people do things right.

Q48 Angela Browning: I know we have talked in this Committee before about tax credits, about the system as it is that you are working with and that you advertise and encourage people to make sure they are aware that on an annual basis they have to get in touch with you.
Ms Strathie: Yes.

Q49 Angela Browning: But of course the circumstances, which are many and varied, change throughout that tax year, and I would just like to clarify because it applies to some of the case work I am doing at the moment exactly how you handle the change of circumstances midway through the tax year. I can think of one case where I have notified your office that somebody had married, only for them to receive a letter saying that at the end of that year it would either be a plus or a minus situation. It does seem to me that you are storing up problems for yourself if, when there is a significant change of circumstance, which they have taken the trouble to notify you of, somehow a long period is going to pass before that is then assessed in terms of the reality of it. Why do you work to such a system, why can you not asses that change of circumstance at the time?
Mr Summersgill: When a change of circumstances is reported it will be processed and would immediately affect the award. I obviously do not know the circumstances but if by marrying two single households have become one then they would need to enter into a new claim with us so there would be a new award for the remainder of the year.

Q50 Angela Browning: Why have they been told that there will then be a plus or minus at the end of the year? It looked like a standard letter that had gone out.
Mr Summersgill: That sounds quite unusual. If you would like to send it up.

Q51 Angela Browning: I may well send it to you.
Ms Strathie: Please do. We all know the history of the tax credits system and the difficulties around it and one of the real challenges for us is that we have a system where the letters are hard-coded into the system which makes everything much more difficult to change and much more expensive to change. We take away the point that people should be able to tell us a change and we should be able to reassess them and tell them what they are entitled to, absolutely, and we will take that particular case away.

Q52 Angela Browning: That does seem to be a problem. Even so you mentioned to the Chairman that you were pleased that you had recovered more

[3] Ev 14

debt, but in terms of tax credits as of March 2009 you had £4.4 billion. It seems to be just flat-plaining, this ability to recover a debt.
Ms Strathie: That is absolutely right, we have seen a serious increase in tax credit debt which is part of the reason, but not all of it, why we have completely revamped our approach to recovery. Just to remind ourselves though, we have gone through a point where people were complaining that they could not get their tax credits, people had difficulty getting through to us. We have put in a number of steps that have allowed more people to receive their benefits and this year's renewal process during the summer was our most successful yet. Once you actually get on top of paying the money out and servicing your customers then you have to get back to the other things that perhaps were not at the top of the priority list whilst we brought that around.

Q53 Angela Browning: It is a lot of money, just not to be eating into, making any difference.
Ms Strathie: Yes, but there are limitations and in fact we do not use the same set of levers on tax credit debtors that we would on others—distraint, for example. We would not use the courts in the same way, we would not send the bailiffs in in the same way and I do not think that that is what people would want us to do.
Chairman: We will have to break for a division now I am afraid.

The Committee suspended from 4.21 pm to 4.28 pm for a division in the House.

Q54 Angela Browning: I just have two minutes, so perhaps we could have two quick questions and answers on income tax. There is an 82,000 backlog of cases where self-assessed taxpayers have appealed to the department. That trend seems to be going up. Is it the case that the word is getting around and people are working the system; in other words, that they are putting in more bogus appeals to delay the day of judgment?
Ms Strathie: I do not think we have evidence of that.
Mr Harra: I do not think there is evidence of that. It is unlikely, because if they postpone tax which ultimately they have to pay then they will have to pay interest on that. If they are in genuine difficulty and are unable to pay, it is much more beneficial for them to go to our business support service and get help that way.

Q55 Angela Browning: Finally, could you give us an update on the position as far as bringing together individual's employment and pension incomes. I declare an interest, Chairman, as I have both now. We understand from page R5, paragraph 1.2, that this is something that you were working towards. Could you tell us what the progress is? It is quite complex. People have different pots of money and they are dealing with the Revenue. I get three different codings at the beginning of the year before it finally all comes together in the melting pot. Surely that system drains your resources, does it not?
Ms Strathie: The issue is that people live very different lives from those of single employer straight over to single pension. We have worked with some customers on this—actually working with pensioners—and with our colleagues in DWP and with my people on processing at one of our largest sites in Cardiff, and we have redesigned the process. We have redesigned the help sheet, which we have tested with all of our pension customers, and it will now go on national roll-out. We have made it much easier for people there. We also mandated employers to provide occupational pension information and we are now working with DWP to look at creating a safe gateway to move information on state pensions between the departments. All of this in an effort so that we could efficiently and more speedily help people get the right coding. We do recognise that pension customers move in many cases from a very simple straightforward PAYE environment into a self-assessment environment and multiple occupational pensions, so it is an area of focus and will be for quite some time in how we can take the customer inside and make the whole process work better.

Q56 Angela Browning: This will continue. People do not work for one employer all their life and just end up with one pension.
Ms Strathie: No.

Q57 Angela Browning: It is complex.
Ms Strathie: It is very complex. It is complex for the customer and it is complex for us.
Chairman: Thank you very much. Austin Mitchell.

Q58 Mr Mitchell: Is there any estimate of the effect of greater use of tax avoidance schemes, many of them purchased from the big accountancy houses—say fiddling finance and profits through tax havens? How much of the fall in tax revenues is due to increased use of its schemes?
Ms Strathie: We have pretty comprehensive avoidance strategy which has brought in some £11 billion that would have been at risk otherwise, but I will bring in Mr Harra to talk more about this.

Q59 Mr Mitchell: Can you just talk about this comprehensive strategy. What is that? I have been going with delegations to the Revenue for many years saying that this is the amount of money being fiddled through tax havens, and they have all expressed great interest and nothing has happened. Why are you suddenly able to deal with?
Mr Harra: The department has a robust anti-avoidance strategy which includes a disclosure regime[4] requiring the scheme promoters to disclose the schemes to us. Since 2005, as Lesley says, that has protected revenues, we estimate, of £11 billion that might otherwise have been lost, so we believe that we are making good ground on that. As far as the use of

[4] Note by witness: The disclosure regime referred to is the Disclosure of Tax Avoidance Schemes (DOTAS) regime, which was introduced in 2004. HMRC has used information from these disclosures to block off over £11bn of avoidance opportunities.

tax havens is concerned, at the moment there is an environment where there is good international co-operation on that and, therefore, we are able to make a lot more headway than perhaps we have in the past. The story on avoidance is that we are pushing it back.

Q60 Mr Mitchell: But you do not have any estimate of how much has been lost through these schemes and through tax havens, do you?
Mr Harra: We do work to assess the gaps in all our taxes, and that includes—

Q61 Mr Mitchell: You cannot tell us what the gap is.
Mr Harra: We certainly publish results for our indirect taxes, where we have robust measures, and that includes avoidance as well as other types of non compliance.

Q62 Mr Mitchell: Can you tell us how much of the fall in revenues is due to an increased use of these schemes?
Mr Harra: We do not have a figure for use of avoidance schemes specifically. We look at all our heads of duty and try to learn as much as we can about how much the gap is on that head of duty and what the nature of the gap is in terms of the nature of the risk that we have to confront. But avoidance certainly is a big priority for us, hence the anti-avoidance strategy measure.

Q63 Mr Mitchell: But it could be that a substantial proportion of a fall in tax revenues is due to big corporations getting wise, like News International or for that matter Google, and using these kinds of schemes to reduce their tax commitments, could it not?
Mr Harra: We do have a disclosure regime which makes it mandatory for us to be informed whether schemes of that nature are being used and, therefore, it gives us an opportunity to respond very, very rapidly to them; for example, by closing them down through legislation, as well as by tackling them case by case. There is clearly a risk there and it is a risk that we are absolutely on top of.

Q64 Mr Mitchell: We have these three accountancy houses selling schemes to companies and corporations how to pay less tax the easy way. Are they required to register those schemes when they devise them?
Mr Harra: Yes, the promoters of schemes are required to register them with us and tell us that they are promoting them, and then the users of those schemes are generally required to notify us when they make their tax return if they have used a registered scheme.

Q65 Mr Mitchell: So when a deviser of one of those brilliant schemes comes to you and says, "I have devised this and I want to register it with you", do you then crawl all over it to find out what you can do to stop it?
Mr Harra: Absolutely. The key step in our anti-avoidance strategy is to try to stop them upstream by taking rapid legislative action if that is what is required. If we believe a scheme does not work, we will publicly say, "If you use this scheme we will challenge it. We do not believe it works." But if we think that we can take immediate legislative action, then that is what we do.

Q66 Mr Mitchell: Are you expecting that you will be able to reduce the amount of revenue lost through the use of these schemes and the use of tax havens?
Mr Harra: Yes, that remains our priority.

Q67 Mr Mitchell: It may remain a priority but will you be able to do it?
Mr Harra: As I say, since 2005 we estimate we have already done that to the extent of £11 billion, and we will continue to focus on it.

Q68 Mr Mitchell: Would it be useful if we had something like the Australians have, a general avoidance rule, so that a scheme devised just to avoid taxes could be struck down?
Mr Harra: A general anti-avoidance rule is something that has been looked at from time to time and it is something that we keep under review, but it is not something that we—

Q69 Mr Mitchell: We keep lots of things under review. Is there any serious intention to produce such a general avoidance rule?
Mr Harra: There has been no announcement made that we are going to do that, and I would not be the person to make that announcement. But it is something that we keep under review, and if we think it is what we need in order to fight avoidance, then certainly that is what we would seek.

Q70 Mr Mitchell: I will keep that answer under review. Let us move on to something else. It strikes me that you must be losing the war against the big accountancy houses. They have lots of more highly-paid clever brains, some of them poached from the Revenue. Are you well enough staffed and are your staff well enough trained to attract the talent and the ability to increase the tax haul or to defeat these schemes?
Ms Strathie: HMRC works from the basis of the tax gap. That is what we are there for and we do that in a number of different ways. We have forecasts of expected tax from policy set by government and we focus on the gap. The forecast in revenues is lower for many obvious reasons of where we are. It is important that we start with tax as our business. We are the UK tax authority and therefore that is our primary core skill. One of the areas we have been focusing on in our own people strategy is building our tax professionalism. We do that in a number of ways, with very technical training but, also, by bringing people in from the private sector and having an exchange where people are going out, particularly with the big four companies. We have 17,000 tax professionals. I cannot say, amongst all of

the people-challenges and all of the challenges I face in HMRC, that attracting talent is one of my problems at the moment.

Q71 Mr Mitchell: You cannot, but is losing talent a problem?
Ms Strathie: No, it is not.

Q72 Mr Mitchell: Do you not think the big accountancy houses are better resourced with more highly paid staff than you are?
Ms Strathie: We have very different jobs. I have staff paid at all sorts of rates. But bear in mind where unemployment is at the moment, where we are in the recession. A brain drain from HMRC is not a current problem.

Q73 Mr Mitchell: Would I be right in saying that in times of recession you need more staff and more skilled staff because of problems of failure?—because of evasion and avoidance and general dodging, but problems of insolvency and failure.
Ms Strathie: You need more capability. You have more fronts to fight on. The capability does not always come in human form. Our approach is risk-based. We have developed many, many risk tools, and more are in development at the moment. Being clear about what the segmentation of our customers shows us allows us to work out how we intervene with those different groups, whether they are personal tax, business tax, benefits and credits. At the end of the day it does not all come down to people. We are still very much an in-sourced organisation and a very large battalion, but we would expect to continue to downsize, as we have been for the last few years.

Q74 Mr Mitchell: In this current situation—and I think the problem is going to get worse—why are you closing offices to make efficiency savings? I understand that paragraph 2.20 is an appalling story about the effect of the closures at Bristol and Manchester. Only three staff from Manchester and Bristol transferred to Birmingham. I can understand that. Who the hell would want to go to Birmingham? It has resulted in a loss of human experience, and then all the files have to be transferred and the staff in Birmingham had to familiarise themselves with the transferred inquiries. The time spent on inquires got longer and longer, so there was a disruption on compliance cases.
Ms Strathie: I go back to the challenge we face with modernising and delivering services, to the challenge of skill loss when you do it.

Q75 Mr Mitchell: If it ain't broke, don't fix it. You have a settled regime that is working in Manchester and you mess it up.
Ms Strathie: We have a finite pot of resources and we want to get best value for the taxpayer base at the end of the day. There are ongoing efficiencies to be made. I believe we will make them. If you are talking about the land tax centralisation there, that has in the end shown that we can deliver the service online. Customers like it because 83% of them file online—and they are not mandated to do so—and the staffing levels come down from over 400 to about 135. That is a challenge. It is very difficult when you have to move from locations, but offices are in the main no longer required for us to deliver the range of services we have with the telephone and the electronic channels.
Mr Mitchell: Thank you very much.
Chairman: The last question is from John Pugh.

Q76 Dr Pugh: I would like to follow through on a couple of things Mr Mitchell said. I have noted that he asked you whether you had enough people involved in anti-avoidance measures. I have tabled a question to the Treasury about this and they have answered rather blandly—possibly you have answered it for them—that these people are scattered all over departments and it is impossible to designate some people as anti-avoidance specialists. If somebody were to put to you that there are fewer now than ever or fewer now than last year, could you refute this? Presumably if you do not know how many people are involved in it, you cannot say there are fewer, can you?
Ms Strathie: I do not start with the point of view that this is all about the number of people you have. In the longer-term, we will demonstrate that we can do a lot more with less people because we deploy different techniques.

Q77 Dr Pugh: So you may have fewer people.
Ms Strathie: You said on a specific area. Avoidance is pretty broad. I am saying to you that this is not a case of me sitting here and saying, "In HMRC, in every area, people and more people is the answer." Some of our work is very labour intensive and we will never be able to do without people. Some of that is not even particularly highly skilled work; it is about those people who need help in order to comply.

Q78 Dr Pugh: To be fair, it is not putting to bed the suspicion that there are not enough people involved, is it? Nothing you have said so far and put on the record would remove that suspicion.
Ms Strathie: My straight answer to avoidance or any other area is that we have enough people in HMRC—indeed we probably have more people than you would ideally want because of the rate of change that we would need to effect as we reduce our workforce and bring onboard better targeted risk-based approaches.

Q79 Dr Pugh: Following through on Mr Harra's answer to Mr Mitchell on the anti-avoidance rule, you said you are helped by getting timely legislation. Legislation does not come around all that often really—even with this Government. Would it be the case that you would need fewer people if there were a general anti-avoidance law? You would not then need specialists to deal with the individual type and variation of avoidance, would you?
Mr Harra: As I say, it has been looked at before.

Q80 Dr Pugh: Did the assessment say you needed fewer or more people in that scenario?
Mr Harra: I think the assessment was that we have never introduced it because we have never concluded that—

Q81 Dr Pugh: You do not seem to know a great deal about it. I am merely asking you, if you had a general anti-avoidance rule, if you would need fewer people to stamp down on avoidance. It is a serious issue this.
Mr Harra: I cannot answer it because we would have to be sure that it worked. If it worked, you might need fewer people, but if it did not work, you would not.
Ms Strathie: You have to take a balanced risk of when avoidance is pushed towards evasion or the flexibility and mobility of the tax base to just up and leave the UK on that. Tax is global. A general rule in the UK does not take you very far.

Q82 Dr Pugh: Okay. In my notes here it says that the total taxes and duties collected and receivable were £435.7 billion. Collected and receivable presumably means what you expect to get in and identify. You cannot be absolutely certain what the figure is, can you, in any one year? In my notes it says "In 2008–09, total taxes and duties collected and receivable were £435.7 billion." I am really asking you what does that expression "collected and receivable" mean?
Mr Thorpe: We can help with that. Not all of that has been collected. That is an accruals-based measure. That is monies that are expected to be collected which relate to tax assessments which relate to 2008–09. Particularly on self-assessment and corporation tax, that is money yet to flow into the Exchequer.

Q83 Dr Pugh: Okay. Following through, the other figure given there is £27.7 billion tax debt. That is presumably money identified that you do not so far have.
Mr Harra: That is in the department's systems, yes. That is increasing debtors.

Q84 Dr Pugh: Of which £11.2 billion is going to be written off. At the end of the day, you are not going to get it. Have I understood that?
Mr Harra: That is a provision for doubtful collection, yes.

Q85 Dr Pugh: How does that compare with bad debt provision in other regimes, if I might put it like that, or in local authorities? Is it in percentage terms tolerable or higher than expected?
Mr Ardron: It is difficult to make an international comparison because the UK is one of the few countries that does produce the trust statements on an accruals basis. You can look at, say, the Republic of Ireland. The revenue commissioners there produce a kind of trust statement, but it is on a cash basis, and it will not disclose the debtors, creditors and accruals that you get in this financial reporting regime.

Q86 Dr Pugh: Presumably it excludes any sums not identified but due which you simply did not know about in the first place—stuff that is not objective successful tax evasion and so on. Do you have a figure or a guesstimate for that?
Mr Ardron: The tax gap? No. As Mr Harra said the Chancellor publishes estimates of tax losses for the tax gap as part of his Pre-Budget Statement. The department approves a volume which will give, in particular for the indirect taxes like excise, VAT and so on, accurate estimates for the tax losses. In the case of excise, those estimates are quite old because the data which is required to do that measurement is not readily available. For the direct taxes, I think Mr Harra has indicated that it is more difficult to do estimates.
Mr Harra: It is certainly our policy to publish tax gaps if we can come up with a robust measure of them. That is more difficult in the case of direct taxes than indirect taxes, although we do a lot of work in direct taxes.

Q87 Dr Pugh: Following through on that, to go to some specifics, on the hydrocarbons I noted the conclusion that the department is aiming at getting the illicit market share down to 4.4% and doing quite well. Is that job done? Is there very little you can practically do to get that any lower?
Mr Summersgill: It is a good job. There is more potentially that can be done, particularly through use of the latest technologies and so on, when it comes to road fuel testing and so on.

Q88 Dr Pugh: But the difference would be relatively small, would it not? This is actually quite successful.
Mr Summersgill: Yes. I think when you get to the departmental level there will be a question of where to put your bucks to get the best bang and diminishing marginal return, effectively.

Q89 Dr Pugh: The other thing I want to ask about is stamp duty land taxation. Obviously there are enormous variations within the housing market. I do get the impression there, though, that you have squeezed as hard as you can, except in the commercial sector. Am I right in assuming that?
Ms Strathie: I think we have. This has been quite a long and difficult journey, but I think that we have, notwithstanding that we see some change at the moment because of the recession.

Q90 Dr Pugh: On R11, at paragraph 2.21, mention is made of two large commercial transactions accounting for £8.6 million of the yield. Does that indicate that in fact the biggest problem with this particular form of taxation is in the commercial sector and with a few significant culprits?
Mr Harra: Yes, that is right. We believe the risk in relation to stamp duty land tax is largely avoidance, and has been largely in commercial property—although we are extending the anti-avoidance disclosure regime to very large residential property transactions as well after this year.

Q91 Dr Pugh: But they are not obliged, are they, to tell you in advance of an avoidance technique for this form of taxation?
Mr Harra: The promoters of avoidance schemes for commercial property have been obliged for several years now to notify us of the schemes that they are marketing, and that is being extended now to expensive residential properties as well.
Chairman: Richard Bacon has a supplementary question.
Mr Bacon: I would like to pursue further, really for my own edification, this question of evasion and avoidance. We talked earlier, and you just then, Mr Harra, about avoidance and anti-avoidance schemes. Ms Strathie referred to the fact that one would somehow tend toward evasion. When I was a schoolboy and about to join the Conservative Party in the mid 1970s I thought I understood clearly the difference between evasion and avoidance. I remember the *Rossminster* case in 1976.
Chairman: You took an interest in this when you were a schoolboy!

Q92 Mr Bacon: I am afraid I did. I was clear about the distinction: evasion was a criminal offence and avoidance was permissible. Indeed, the judge was very clear in that very famous case, that companies had no duty so to arrange their affairs to maximise their tax liability. I seem to remember being on the Finance Bill when the anti-avoidance legislation as far as schemes were concerned was pushed through. Mr Harra you said you then take rapid legislative action to spot an error. We are saying that you, the Government (that is to say the HMRC and ministers together), come up with the policy and the law, and that is it. People try to work within that, then you find you do not like what they are doing and so take, in your words, "rapid legislative action". Where do you draw the line between legitimate avoidance and what you have called the kind of avoidance that you want to get at through anti-avoidance schemes? Because a large corporate is going to have a large complex business and is going to have at any one time a variety of options available to it, with the limited resources that it has, and it will say: "Option 1, 2 and 3 will have the following consequences in marketing terms, in growth in business terms, in risk terms and in tax terms" and it will be one of the considerations that they use. They might quite plausibly say, "We'll go for option 2, because although we like option 3 in a number of respects, it will cause us to pay more tax." At that point they are engaged, plainly, in tax avoidance, are they not?
Ms Strathie: Yes.

Q93 Mr Bacon: Where does the line get drawn?
Mr Harra: Debating societies could probably endlessly debate where the boundary between tax planning and tax avoidance is. I perhaps shortcut it when I said that we could instantly introduce legislation, because, needless to say, we advise ministers and ministers decide whether they wish to or whether they do not.

Q94 Mr Bacon: You did not say instantly, you said—
Mr Harra: Rapid.

Q95 Mr Bacon: — "rapid legislative change".
Mr Harra: In the case of the anti-avoidance disclosure scheme, we have identified what we believe are the badges of avoidance as opposed to acceptable tax planning. That is for the purposes of ensuring that promoters notify us of those schemes. We then consider (i) do they work under the existing legislation and—if we believe that they may—(ii) is it within the policy intent of the legislation or is it frustrating the policy intent? Then we advise ministers, "Do you want to do anything about this?" Thanks to that disclosure scheme, we have the ability, where we need to respond, to do so very rapidly, before large numbers of users use the scheme and we end up fighting them through the courts—which is very expensive.

Q96 Mr Bacon: If you were a person interested in avoiding tax in the way that you describe, you would not "buy" a scheme and the so-called promoter of the schemes would not "sell" it to you. You would, as the would-be user of such a scheme, find out all about it and then go and use it, avoiding the registration on both sides that you talked about, would you not? Would that not be the obvious reaction to your regime?
Mr Harra: There are quite stiff penalties if anyone tries to do that. It is mandatory to register these schemes and if a promoter fails to do so then—

Q97 Mr Bacon: I am sorry to go on about this, but how do you show that they have used one of "these schemes" if they have done something that is quite similar to what a scheme would have done without ever having registered it?
Mr Harra: I cannot give a detailed answer to that. I repeat what I said: we have published what we regard as the badges of schemes that need to be registered—features which, if they are present in what you are doing, mean that you need to register what you are doing with us.

Q98 Chairman: Thank you. That concludes our hearing. Obviously the figures we are talking about here are enormous. As John Pugh has reminded us, in 2008–09, total taxes and duties collected and receivable were £435 thousand million. That is some £21 billion lower than in 2007–08. The £435 billion includes £27 billion in tax debtors; that is £2.7 billion (11% higher) than the previous year. Of the £27 billion HMRC has made a provision for bad and doubtful debts of £11 billion, which is up £3.3 million on the previous year and an equivalent to 40% of tax debtors. This is at a time when enormous new liabilities have been taken on from government. As the Comptroller and Auditor General says, this is the engine room of government. One does not need to use emotive terms like "crisis". This system is clearly under a great deal of stress. In the very first question I asked you, Ms Strathie, about this 40% of total debt unlikely to be collected, I asked you what steps you are taking to get your management of tax debt under control. I am not convinced that you have given us sufficiently robust answers in the hour and a half of this session, so we will now go away and, with the help of the National Audit Office, write our report and try to help you resolve this very serious problem. Do you wish to make a final comment?

Ms Strathie: Yes, I do. I still go back to what I have said, that at the end of the day HMRC does recover almost all debt. We write off less than 1% at the end of it, and whilst we have made that provision in our accounts because there is a recession and we think it is prudent to do so, we do not believe that that figure is a total fiscal risk. We believe that there is much more to do in debt collection. We believe we can build on what we have done and we do believe that if we do not take the steps we are, that debt will increase significantly during the recession.

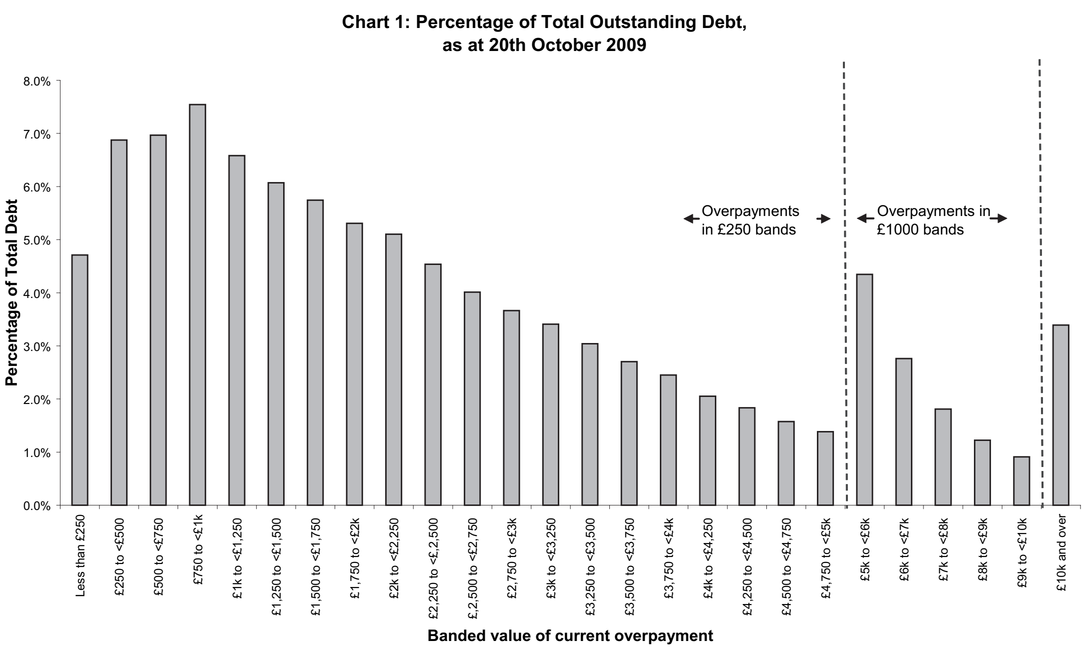
Chairman: Thank you very much. That concludes our hearing.

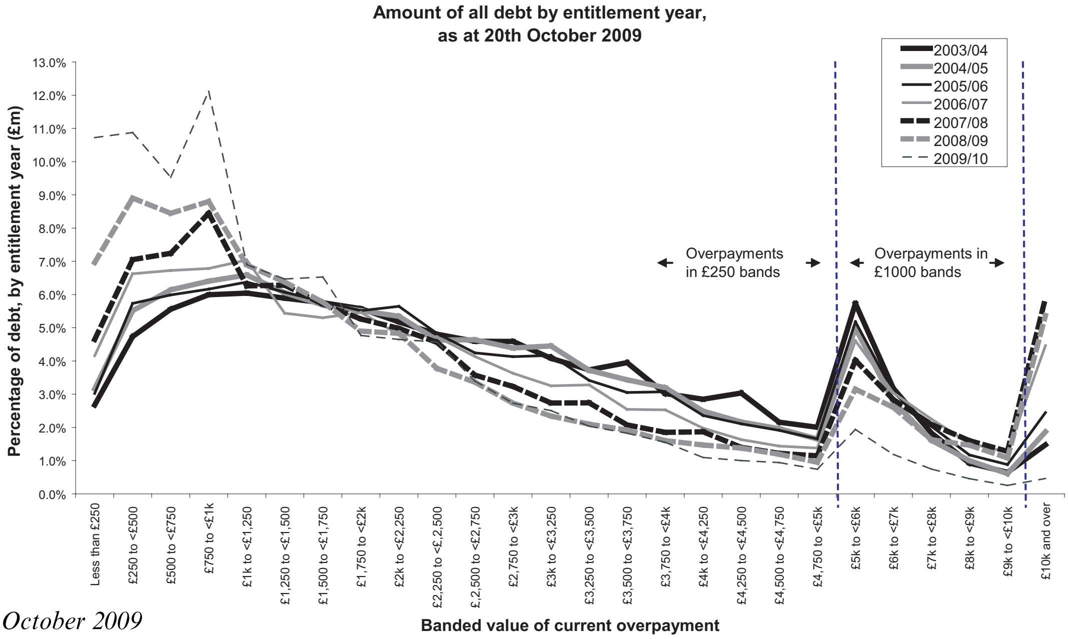
Supplementary memorandum from HM Revenue and Customs

QUESTIONS 15–18 (MR BACON): TAX CREDITS DEBT

Additional charts were requested analysing debt by age and value. Chart 1 gives an analysis of total debt by the requested value bands and Chart 2 gives a more detailed analysis by year of entitlement. Debt includes all debt (including debt being recovered from on-going awards, direct recovery and debt not subject to active recovery).

HMRC normally seeks to recover all tax credit overpayments, but to do so in a way that does not create financial hardship. It will also write off overpayments where there has been a mistake by HMRC and the customer has met their responsibilities. Further information on HMRC's practice in this area is available at: http://www.hmrc.gov.uk/leaflets/cop26.pdf.





28 October 2009

Memorandum from the Parliamentary and Health Service Ombudsman

I have been informed by HM Revenue and Customs (HMRC) that the Rt Hon Don Touhig MP asked Richard Summersgill, Director Benefits and Credits Delivery, a question on 14 October regarding the number of cases that had been referred to my Office concerning overpayments of Tax Credits.

Although we do not hold our data in a format that would allow us to easily check how many cases specifically related to overpayments, I am happy to share with you how many complaints my Office has received about Tax Credits, and to put those figures into context.

In 2008–09, my Office received 1,161 complaints regarding Tax Credits. 985 of these were against HMRC, 24 were jointly against HMRC and the Adjudicator, and 152 were solely against the Adjudicator. I am confident that the vast majority of these cases will refer to overpayments.

In 2008–09, my Office accepted 2 of those cases for investigation. Both were against HMRC.

In 2008–09 my Office reported on 51 Tax Credit investigations. A breakdown of the outcome of those investigations is shown in the table below.

	Fully upheld	Partly upheld	Not upheld	Total
HMRC	3	5	2	10
Both HMRC and the Adjudicator	1	22	16	39
Adjudicator	0	0	2	2

As you will no doubt be aware, I have produced two reports on the administration of Child and Working Tax Credits, in June 2005, entitled, *Tax credits: putting things right and in October 2007, Tax Credits: Getting it wrong?*

I have, of course, kept a close eye on HMRC's progress in taking forward my recommendations, and I received a progress update from Lesley Strathie, Chief Executive of HMRC, this summer.

By way of interest I can tell you that I saw a significant decrease in the number of complaints about tax credits coming to my Office in 2008–09 compared with in 2007–08 and I made reference to this in my Annual Report for 2008–09 which was laid before Parliament in July 2009. That is not to say that there is not more work to do; there do, undoubtedly, remain problems. My Office will continue to monitor closely the effectiveness and impact of the implementation of my recommendations, and analyse any further trends arising from the complaints which come to me. If I consider that further action on my part is necessary, I will not hesitate to intervene again in whatever way I believe to be most appropriate.

23 October 2009

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