



House of Commons  
Committee of Public Accounts

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# HM Revenue and Customs' 2009 – 10 Accounts

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**Eighteenth Report of Session 2010–  
11**

*Report, together with formal minutes, oral and  
written evidence*

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## The Committee of Public Accounts

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

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Eric Joyce (*Labour, Falkirk*)

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

### Publication

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

### Committee staff

The current staff of the Committee is Philip Aylett (Clerk), Lori Verwaerde (Senior Committee Assistant), Ian Blair and Michelle Garratty (Committee Assistants) and Alex Paterson (Media Officer).

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## Summary

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In 2009, HM Revenue and Customs' (the Department) implemented the new National Insurance and PAYE Service (NPS), the final phase of its project to modernise the collection of income tax through the Pay as You Earn (PAYE) system. The NPS brings together for the first time all of an individual's pay and tax details into a single record and offers the opportunity of increasing the accuracy of tax codes and reducing the likelihood of over and underpayments of tax.

The flawed implementation of the NPS in 2009-10 has resulted in lasting and costly losses for the Department and caused unacceptable uncertainty and inconvenience to the taxpayer. Software problems delayed the processing of 2008-09 PAYE returns until September 2010 – a year late - and data quality issues have further disrupted the issue of tax codes for 2010-11. The Department has failed to tackle a backlog of 18 million PAYE cases from 2007-08 and earlier, affecting an estimated 15 million taxpayers. The exact amounts of tax involved are not known, but estimates suggest £1.4 billion of tax was underpaid and there is £3.0 billion of overpaid tax to be refunded. The Department failed to understand the impact of the Finance Act 2008 on the deadlines for collecting tax, and so is now unable to collect any of the estimated £650 million underpaid in 2006-07 and earlier. The Department does deploy staff according to emerging problems and priorities; but it is not clear that the Department understands enough about the absolute and relative returns on investment from staff working on different tax streams in order to make decisions which maximise net returns to the Exchequer. As a result of its mismanagement of PAYE processing, the Department has not collected tax due from some individuals and has taken too much from others, causing both uncertainty and inequity in the system.

The Department has launched a programme to stabilise the NPS by 2012. It is vital that it demonstrates the ability of the system to process PAYE promptly, accurately and efficiently and restores customer confidence. In future, it should process everyone's PAYE within twelve months of the end of the tax year. It must also make sure it maximises the net revenue it collects before the deadline expires for 2007-08 underpayments of tax, and that it achieves its aim of processing 2008-09 and 2009-10 PAYE by the end of January 2011.

Based on early successes, the Department has extended its campaign-based approach to the recovery of 90% of tax debt. It is planning further improvements in its debt management capability, but these will not be delivered until October 2011.

The Department has increased its focus on preventing fraud and error in the tax credits system and is aiming to prevent £1.4 billion of error and fraud in awards for 2010-11. It is measuring its progress against a series of targets, which it is currently meeting.

The average taxpayer has a right to assurance that the Department has done all it can to maximise returns to the Exchequer when resolving disputes over large companies' tax liabilities. While we acknowledge the Department's legal duty to respect taxpayer confidentiality, we expect the Department to seriously consider the scope for greater transparency over its procedures for resolving such disputes, so that public confidence in the fairness of settlements with large companies is assured.

On the basis of a Report by the Comptroller and Auditor General,<sup>1</sup> we took evidence from the HM Revenue & Customs on the processing of PAYE, debt management and tax credits.

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1 Report by the Comptroller and Audit General on *HM Revenue & Customs' 2009-10 Accounts*, HC 299, Session 2010-11

## Conclusions and Recommendations

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1. **The Department has failed in its duty to process Pay As You Earn (PAYE) accurately and on time.** Problems in delivering the new National Insurance and PAYE Service (NPS) system delayed the processing of PAYE for 2008-09 by a year. The Department did not tell taxpayers of the delay promptly, causing uncertainty and worry for millions of people. The Department also failed to tackle a legacy of processing backlogs going back to 2004-05. It has now run out of time to collect all the tax due before April 2007, and has not yet repaid the millions of taxpayers who paid too much PAYE in these years. As a result, it has failed to collect tax that is properly due, caused uncertainty to taxpayers and treated them inequitably.

### Implementation of NPS

2. **The Department has not delivered an acceptable standard of service to PAYE taxpayers.** The Department knew in December 2009 that up to seven million people had over or underpaid tax in 2008-09, yet it did not take steps to identify and inform the individuals involved until September 2010 when it began reconciling PAYE for 2008-09 and 2009-10 combined. In January 2010 it began issuing 25 million coding notices for 2010-11, without first establishing why the number of coding notices was massively in excess of its forecast. It then stopped issuing notices when it realised belatedly the extent of errors in the tax codes. The Department must ensure that coding notices are subject to proper quality assurance before being issued, and that taxpayers are told of their individual under and overpayments as soon as practical.
3. **The Department failed to understand the risks of poor quality data, which undermined the effective operation of the NPS.** The Department plans to have stabilised the NPS and PAYE processing by 2012, and to have completed the 2008-09 and 2009-10 PAYE reconciliations by January 2011; but a key risk is the 10 million cases still outstanding where there are issues with data quality that require technical or manual intervention. We look to the Department to be able to clearly demonstrate that it has resolved systemic data quality issues by the end of 2011 and that NPS is delivering the benefits that it was intended to bring - including improved accuracy and speed of processing, and prompt processing of under and overpayments.
4. **To keep PAYE processing volumes manageable, the Department decided to raise the threshold for the recovery of underpayments from £50 to £300 for 2008-09 and 2009-10, foregoing £160 million in revenue.** This is inconsistent with the £50 threshold for those taxpayers underpaying in other years, and with, for example, tax credits debtors who do not automatically have debts under £300 written off. In making decisions on thresholds, the Department should consider both the narrow balance of cost and returns for a particular tax stream, but also, with a view to preserving equity between taxpayers, the broader consistency with the decisions it takes in other tax areas.
5. **We do not yet know the full cost of the problems with NPS implementation.** In its response to this Committee's recommendations, the Department should provide a comprehensive statement of the costs of the NPS, including the estimated cost to the

conclusion of the stabilisation programme. The statement should include the costs associated with recovering the processing of annual coding notices and end of year reconciliations exercise, and the revenue foregone as a result of the delays, and clearly set out the assumptions used in coming to these figures.

6. **The Department re-employed its Acting Chief Information Officer on a three months contract, equivalent to £600,000 per annum, around four times his previous salary.** This was after he had been unsuccessful in the competition for the permanent post. The Department should make succession plans for the replacement of senior staff well in advance of their departure dates, particularly when such dates are plainly known in advance due to fixed term contract arrangements, as was the case here.

### Backlog of Open Cases

7. **By allowing a backlog of 18 million PAYE cases affecting 15 million people to build up, the Department has delayed the repayment of overpaid tax and put at risk the recovery of an estimated £1.4 billion of underpaid tax.** It is unacceptable that so many people have had to wait so long for their tax affairs to be resolved. If the Department had processed PAYE promptly, it should have been able to collect nearly all of the estimated £650 million underpaid tax for 2004-05 to 2006-07. The Department should now set a clear operational standard to process all PAYE cases within 12 months of the end of the tax year.
8. **The Department failed to foresee the consequences of the changes in the statutory deadline for recovering underpayments of tax introduced in the Finance Act 2008.** The Department was aware that the change in the deadline would prevent it collecting underpaid tax for 2004-05 and 2005-06, estimated at £150 million. However, it failed to appreciate the impact of the deadline on the 1.9 million underpayments in 2006-07 and lost the chance to recover any of the £500 million tax owed. The Department should ensure that it does not miss the deadline for collecting revenue for 2007-08 and that its assessments of future legislative changes take full account of the operational impact.
9. **We are not convinced by the Department's explanation of how it decides to allocate resources to maximise the collection of PAYE.** It has assessed the amount of revenue brought in by staff working in some other parts of the Department, and concludes that they would bring in less working on PAYE. But the Department has not analysed whether employing additional staff on PAYE, rather than reallocating resources from elsewhere, would bring a net gain. The Department should assess the return on investment of having additional staff collecting PAYE and structure its staffing to maximise the net revenue collected.

### Corporation Tax

10. **There is little transparency for the taxpayer over the way that tax disputes with large companies are resolved.** While we recognise the Department's obligation to ensure taxpayer confidentiality, the Department should consider the scope for increasing transparency in the area of large and complex tax cases and for assuring



Parliament and the public that due process in the resolution of these cases is being followed. We look to the Department to cooperate fully with a National Audit Office review of its procedures for resolving tax disputes.

### Tax Credits

- 11. The Department has a target to reduce tax credits debt by £200 million by March 2011, but this target does not distinguish between debt that is collected and debt that is written off.** The Department should set separate performance indicators for the amount of tax credit debt it collected, and for identifying and writing off debt that is no longer recoverable.

# 1 Implementation of the National Insurance and PAYE Service

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1. The Department's implementation of the National Insurance and PAYE Service (NPS) is the final and most significant step in its programme to modernise the collection of income tax through PAYE. The NPS should allow the Department to combine the information it holds on individuals' employment and pension income into a single record allowing it to make a more accurate assessment of tax codes and reduce the likelihood of over and underpayments of tax.<sup>2</sup> The consolidation of this information from its former system of 12 regional databases, structured around employers, to a single national database structured around the individual, should also mean that the Department can deal with taxpayer enquiries at the first point of contact, and manage and prioritise its PAYE workload nationally, rather than by region.<sup>3</sup>

2. The implementation of the NPS was deferred twice and even then did not go smoothly.<sup>4</sup> Problems with the software and issues with data quality delayed the processing of 2008-09 PAYE returns by a year and resulted in large numbers of incorrect tax codes being issued.<sup>5</sup>

3. The Department had planned to use the NPS to process the 2008-09 PAYE returns in the summer of 2009, but software problems meant it could not enter the returns into the new system until mid-December 2009. An initial reconciliation of this data identified seven million potential overpayments and underpayments of tax.<sup>6</sup> The Department then decided to work these cases in April 2010 when the automated clearance facility in the NPS went live, but had to postpone this to deal with the data issues that emerged after its Annual Coding exercise.<sup>7</sup> It finally began processing the 2008-09 returns together with the 2009-10 returns in September 2010.

4. Despite knowing in December 2009 that it would be processing people's PAYE for 2008-09 much later than usual, the Department did not tell taxpayers of the delay until September 2010.<sup>8</sup> Taxpayers were therefore unaware that their tax for 2008-09 was not settled and that they might owe more tax or be due a repayment. The Department justifies the decision not to publicly announce the delay on the grounds that it would not be helpful because it could not tell people whether they personally would be affected.<sup>9</sup>

5. Problems with data severely disrupted the Annual Coding exercise. In January 2010, the Department used the NPS to generate the tax codes for 2010-11. The Department expected to issue about 13 million coding notices, 10% more than usual, but found it would be

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2 C&AG's Report, paragraphs 2.3 and 2.6

3 C&AG's Report, paragraph 2.6

4 Q3; C&AG's Report, para 2.9

5 Q 60; C&AG's Report, para 2.27

6 Q 49; C&AG's Report, paras 2.20 and 2.21

7 Qq 57, 74; C&AG's Report, para 2.21 and para 2.32

8 Qq 54 - 58

9 Q 58

issuing up to 25.8 million notices.<sup>10</sup> Although the Department knew that it had produced more coding notices than it had predicted, it did not realise that some of these were incorrect or duplicates until customers started to query their codes.<sup>11</sup> The Department launched a recovery programme to correct the data and to issue amended coding notices where necessary.<sup>12</sup>

6. The Department has undertaken a review of the implementation of the NPS to try to understand what went wrong.<sup>13</sup> It has yet to conclude that review, but attributes most of the problems to the quality of the data and the complexity of delivering a system with significantly higher levels of automation.<sup>14</sup> It also acknowledges that there was insufficient involvement of end users in the design and testing of the system at each stage of its development.<sup>15</sup> The Department told us that it had already applied the lessons learned from the annual coding exercise in its approach to end of year reconciliations.<sup>16</sup>

7. Following the problems with the Annual Coding exercise, the Department recognised that data inaccuracies would also affect the 2008-09 and 2009-10 end of year PAYE reconciliations. It delayed the processing of 2008-09 and 2009-10 reconciliations to give it time to amend data or isolate the cases affected by data problems. Out of the 45 million PAYE records to be reconciled for 2008-09 and 2009-10, it has identified 10 million cases which cannot be automatically reconciled and which require more work because of data inaccuracies.<sup>17</sup>

8. The Department has now begun to process the 2008-09 and 2009-10 PAYE cases, at the rate of 900,000 per day.<sup>18</sup> It will have processed the majority of the 45 million cases by Christmas and all of them by 31 January 2011.<sup>19</sup> Its latest estimate is that about 15% of the 38 million taxpayers involved will have an adjustment to their PAYE, with 4.3 million people found to have overpaid tax and 1.4 million to have underpaid.<sup>20</sup>

9. The Department will repay all overpaid tax but will not be able to recover all underpayments of tax. The Department estimates that it will find £2 billion of overpaid tax and £1.8 billion of underpaid tax as a result of the 2008-09 and 2009-10 reconciliations.<sup>21</sup> The £1.8 billion underpaid tax already excludes an estimated £160 million from 900,000 taxpayers as a result of the decision to raise the threshold for not reclaiming underpaid tax from £50 to £300.<sup>22</sup> The decision to raise the threshold was not based on a straight

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10 Q60; C&AG's Report, para 2.27

11 Q 48; C&AG's Report, para 2.28

12 C&AG's Report, para 2.29 – 2.31

13 Qq 61

14 Q 217

15 Qq 42, 43

16 Q 61

17 Qq 10-12; Ev 31

18 Q 23

19 Qq 18, 19; Ev 37

20 Qq 8, 9, 14-17

21 Q 28; Ev 37

22 Q 32-33

comparison of the costs of dealing with the cases and the revenue that could be collected, but rather on the Department's need to keep its workload to a manageable level at a time when it had to process two tax years at once.<sup>23</sup> It calculated that it could reduce the volume of cases by 40% and revenue by only 8%.<sup>24</sup> In addition, some taxpayers will apply to have their underpayment not collected under Extra Statutory Concession A19,<sup>25</sup> and a small number will be untraceable or unable to pay. The Department believes the effect of this will be small and hopes to collect more than £1.5 billion of the £1.8 billion underpaid.<sup>26</sup>

10. The Department has a programme in place to stabilise the NPS, and the system should be operating as intended by 2012.<sup>27</sup> To achieve this the Department will have cleaned the records it holds in NPS and successfully processed these through the key events in the PAYE business cycle, including Annual Coding and end of year reconciliation.<sup>28</sup> The Department plans to work with employers to ensure that the data it receives is accurate, which will in turn allow the Department to increase its accuracy rate.<sup>29</sup>

11. The Department does not know the full costs of the implementation of the NPS. At the time of the June 2009 implementation, the Department estimated the full cost of the system would be £389 million. This estimate includes the additional costs of £33 million, incurred as a result of deferring the implementation by a year, and £78 million for changes in the system requirements and implementation costs.<sup>30</sup> The delay in processing the 2008-09 cases and the problems with Annual Coding have resulted in additional costs and loss of revenue. The Department has estimated some elements of this, including the £160 million from the raised threshold, and informed us that the stabilisation will cost £7 million, but it needs to include the additional costs from the recovery exercises for Annual Coding and the end of year reconciliations, including the impact of diverting staff from other work to assist with this.<sup>31</sup>

12. The Department's temporary Chief Information Officer, Deepak Singh, was paid £160,000 per year under a three year contract which ended in June 2009 after he was unsuccessful in the open competition for the permanent position. He was then paid £150,000, equivalent to £600,000 per annum, to stay on for a further three months whilst his successor worked his notice period. The Department also incurred costs of £19,200 on outplacement services, helping Mr Singh to find another job. The Department justifies the decision to retain Mr Singh's services on the basis that they would otherwise either have had no Chief Information Officer or had to recruit an interim who had no knowledge of the complex IT programme they were trying to deliver.<sup>32</sup>

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23 Qq 17, 35, 37

24 Q 37, 95

25 Arrears of income tax may be given up where the Department fails to make proper and timely use of the information supplied to it.

26 Qq 28-31

27 Qq 6, 87

28 Q 218, 219

29 Qq 220-221

30 C&AG's Report, para 2.10

31 Qq 33, 36, 38-41

32 Q 84

## 2 The backlog of open Pay As You Earn cases

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13. Despite our previous recommendations,<sup>33</sup> the Department has made little progress in clearing the backlog of open PAYE cases from earlier tax years.<sup>34</sup> The limitations of the Department's previous PAYE system and the increasing complexity of modern working patterns have made it increasingly difficult for it to reconcile an individual's tax without clerical intervention.<sup>35</sup> These 'open cases' arise where the year end reconciliation of income and tax paid has identified a discrepancy, indicating a potential over or underpayment of tax.

14. At 31 March 2010, there was a backlog of 18 million cases from 2004-05 to 2007-08, affecting an estimated 15 million taxpayers.<sup>36</sup> The amounts of underpaid and overpaid tax cannot be known until these cases are worked, but analysis based on a sample of cases suggests that around £1.4 billion of tax has been underpaid and £3.0 billion tax overpaid.<sup>37</sup>

15. The Finance Act 2008 reduced the time limit for collecting tax from 6 years to 4 years.<sup>38</sup> The Department has forgone a significant amount of tax as a consequence of this change in the time limit for collection and its failure to process PAYE promptly. The Department knew that the 2008 Act removed its chance of collecting any underpayments of tax for 2004-05 and 2005-06, but failed to appreciate its impact on the collection of underpayments of tax for 2006-07 cases.<sup>39</sup> It estimates that up to £650 million of tax has been foregone because it did not process these cases promptly - £150 million in 2004-05 and 2005-06, and £500 million in 2006-07.<sup>40</sup>

16. The Department planned to work the 2006-07 cases in early 2010, but had to divert resources to deal with the problems in Annual Coding (paragraph 5 above).<sup>41</sup> It can take the Department more than three months to establish an enforceable debt once it has contacted the taxpayer with an income tax calculation.<sup>42</sup> Thus, to establish a debt for an underpayment of 2006-07 tax in advance of the April 2011 statutory deadline, the Department would have had to work the cases and contact the taxpayers concerned by November 2010. By the time the Department realised the necessary lead in times to the April 2011 deadline, it was already too late to act.

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33 Q 87; Public Accounts Committee, Second Report, of Session 2009-10, *HM Revenue and Customs: Improving the Processing and Collection of Tax: Income Tax, Corporation Tax, Stamp Duty Land Tax and Tax Credits*, HC 97

34 C&AG's Report, para 2.4

35 C&AG's Report, para 2.3

36 Qq 158; C&AG's Report, para 2.4

37 Qq 158, 191

38 Q 158; Ev 37

39 Qq 163-170, 183-185

40 Qq 160, 161

41 Q 185; Ev 37

42 Q 183

17. The Department calculates that, of the £500 million underpaid tax for 2006-07, only £25 million would be recoverable at October 2010, and concluded that it would not be cost effective to try to recover this.<sup>43</sup> It estimates that, of the £500 million underpaid tax for 2006-07, £100 million would have been recoverable had it processed these cases in April 2010 as originally planned.<sup>44</sup> However, as well as taking into account taxpayers applying for Extra Statutory Concession A19, and taxpayers that are not traceable, the reduction in collectible tax is also based on the assumption that the raised threshold for recovering underpaid tax would be applied to 2006-07.<sup>45</sup>

18. The Department intends to work all the overpayments cases for tax years 2004-05 to 2007-08 and repay the overpaid tax.<sup>46</sup> It has until November 2011 to reconcile underpayment cases for 2007-08 and contact the taxpayers concerned, the last of the backlog years for which it can still collect tax.<sup>47</sup> It has 250 people working on the backlog of cases and it plans to use an automated solution to improve its analysis of the backlog and accelerate the clearance process, including the prioritisation of which cases to work.<sup>48</sup> It aims to clear the backlog of over and underpayment cases by the end of 2012.<sup>49</sup> It was unable to give us an estimate of how much of the underpaid tax it would collect.<sup>50</sup> It has not yet decided whether the raised threshold for recovering underpayments will apply to 2007-08.<sup>51</sup>

19. The Department does not think it should redeploy staff to work on the 2007-08 cases. It has analysed the revenue collected per member of staff working on compliance or on debt collection, and assesses this to be lower than the revenue collected per member of staff working on PAYE.<sup>52</sup> On this basis, it judges that it does not make sense to move staff from these areas to work on PAYE cases.<sup>53</sup> It does not seem to have analysed whether bringing in additional temporary staff, rather than redeploying existing staff, would result in a net gain in revenue after taking into account the cost of the additional staff.<sup>54</sup>

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43 Q 205; Ev 37

44 Qq 158-160, 171; Ev 37

45 Q 206

46 Qq 177, 178; Ev 37

47 Q 187

48 Qq 193, 202, 213; Ev 35

49 Ev 35

50 Qq 186, 189;

51 Q 188

52 Qq 200, 202

53 Qq 172, 202

54 Qq 191, 201, 209-211

## 3 Tax disputes, Tax Credits, and debt management

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### *Tax Disputes*

20. The Department's Litigation and Settlement Strategy states that, where its legal advice is strong, it should not accept settlements for less than 100% of the tax and interest due.<sup>55</sup> The Department maintains that it does set out to prove the tax liability, serve its assessment and then collect what is due.<sup>56</sup> The Department told us that the final decision on how to resolve each tax dispute has to be taken by two Commissioners and must involve legal advice.<sup>57</sup>

21. The Department did not answer some of our specific questions on tax disputes on the grounds that it has a legal duty not to disclose taxpayer details, except in certain limited circumstances.<sup>58</sup> This applies to all taxpayers, whether they are an individual or a publicly quoted company. This inevitably makes it difficult to obtain assurance that the Department resolves tax disputes appropriately.

### *Debt Management*

22. The Department collected £67.9 billion of tax debt in 2009-10, £5.6 billion more than in 2008-09.<sup>59</sup> During 2009-10 it introduced a campaigns-based approach to the collection of debt across the major taxes. Its initial analysis shows that the campaigns approach has been cost effective, and it now applies this approach to collecting 90% of its debt.<sup>60</sup> To support the campaigns approach, it is enhancing its analytical capability by recruiting specialist staff and developing its IT capability. These measures have been delayed but should be in place by October 2011.<sup>61</sup>

23. The Department has been less successful in dealing with Tax Credits debt. The debts are often small, making them resource intensive to pursue, although where the Department can recover debts from ongoing awards, this is more successful.<sup>62</sup> The Department told us that it is on track to achieve its target of reducing the Tax Credits debt balance by £200 million to £4.3 billion by March 2011, although this will be partly achieved by writing off £461 million of uncollectible debt.<sup>63</sup>

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55 Q 260

56 Q 265, 266

57 Qq 264, 276; There are currently six Commissioners of HM Revenue and Customs who have responsibility for handling individual taxpayers' affairs impartially.

58 Q 247

59 C&AG's Report, para 3.4

60 Q 223

61 Qq 223, 224, 284, 285

62 Q 286

63 Qq 295-297,301

### *Tax Credits Error and Fraud*

24. The Department has a target to reduce Tax Credits error and fraud to no more than 5% of the value of finalised awards by March 2011. There is a time lag in measuring error and fraud in finalised awards, so the Department will have to wait until summer 2012 to know whether it has achieved its target.<sup>64</sup>

25. The Department's strategy for reducing tax credit error and fraud is increasing its focus on preventing error and fraud entering the system and it has changed its approach from 'pay now, check later' to 'check now, pay later'. It estimates that, whereas it used to prevent about £200 million of error and fraud per year, in the year to July 2010, it prevented £750 million and it plans to prevent £1.4 billion in the year to July 2011.<sup>65</sup> The Department believes it can reduce error and fraud losses by £2 billion in each year of the Comprehensive Spending Review.<sup>66</sup>

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64 Q292, C&AG's Report, para 20

65 Qq 293, 294; C&AG's Report, para 4.17

66 Q 292



# Formal Minutes

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**Tuesday 25 January 2011**

Members present:

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon

Mr Stephen Barclay

Jackie Doyle-Price

Dr Stella Creasy

Jo Johnson

Austin Mitchell

Nick Smith

Ian Swales

James Wharton

Draft Report (*HM Revenue and Customs' 2009-10 Accounts*) proposed by the Chair, brought up and read.

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

Paragraphs 1 to 25 read and agreed to.

Conclusions and recommendations 1 to 11 read and agreed to.

*Resolved*, That the Report be the Eighteenth Report of the Committee to the House.

*Ordered*, That the Chair 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.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Wednesday 26 January at 3.00 pm]

## Witnesses

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### Tuesday 12 October 2010

Page

**Dame Lesley Strathie DCB**, Chief Executive and Permanent Secretary, **Sarah Walker**, Director, PAYE, Self Assessment and NI Contributions and **Jon Fundrey**, Financial Controller, HM Revenue and Customs

Ev 1

### Tuesday 16 November 2010

**Dame Lesley Strathie DCB**, Chief Executive and Permanent Secretary, **Sarah Walker**, Director, PAYE, Self Assessment and NI Contributions and **Jon Fundrey**, Financial Controller, HM Revenue and Customs

Ev 16

## List of printed written evidence

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# List of Reports from the Committee during the current Parliament

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

## Session 2010–11

First Report	Support to incapacity benefits claimants through Pathways to Work	HC 404
Second Report	Delivering Multi-Role Tanker Aircraft Capability	HC 425
Third Report	Tackling inequalities in life expectancy in areas with the worst health and deprivation	HC 470
Fourth Report	Progress with VFM savings and lessons for cost reduction programmes	HC 440
Fifth Report	Increasing Passenger Rail Capacity	HC 471
Sixth Report	Cafcass's response to increased demand for its services	HC 439
Seventh Report	Funding the development of renewable energy technologies	HC 538
Eighth Report	Customer First Programme: Delivery of Student Finance	HC 424
Ninth Report	Financing PFI projects in the credit crisis and the Treasury's response	HC 553
Tenth Report	Managing the defence budget and estate	HC 503
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Sixteenth Report	Ministry of Justice Financial Management	HC 574
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# Oral evidence

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## Taken before the Committee of Public Accounts

on Tuesday 12 October 2010

Members present:

Chair (Chair)

Richard Bacon	Anne McGuire
Stephen Barclay	Austin Mitchell
Jackie Doyle-Price	Nick Smith
Matthew Hancock	Ian Swales
Chris Heaton-Harris	James Wharton

**Amyas Morse**, Comptroller and Auditor General, **John Thorpe**, Director, NAO, **Gabrielle Cohen**, Assistant Auditor General, and **Paula Diggle**, Alternate Treasury Officer of Accounts, were in attendance.

### Examination of Witnesses

*Witnesses:* **Mr Jon Fundrey**, Financial Controller, **Ms Sarah Walker**, Director, PSN, and **Dame Lesley Strathie**, Chief Executive and Permanent Secretary gave evidence.

**Q1 Chair:** Welcome. This is the first time that the new Public Accounts Committee has met, so welcome and thank you for coming to give evidence this morning. A couple of things: we have a second evidence session this morning, so we are slightly worried that we will be time constrained and we will try and finish this one by 11.00. We don't think that we will cover everything that we need to cover, so if it is all right with you, we will ask you perhaps to return for a further session as soon as we can fix diaries to cover some of the areas. We will therefore focus this morning's evidence around the new PAYE system.

Can I just ask you one other question? The SRO on the new system is Bernadette Kenny, but she has not come with you as one of the people to give evidence this morning. We wondered why.

**Dame Lesley Strathie:** Good morning and thank you, Chair. In terms of the totality of the Standard Report, the Trust Statement and the SIC (Statement of Internal Control), and not being clear what the Committee wanted to discuss, I brought with me the Department's Financial Controller and Sarah Walker, who is the Director for PAYE Self Assessment and National Insurance, in terms of, between the three of us, hoping to cover as much of the ground of the report as we could.

**Q2 Chair:** Right. But if we do have a second session, it might be that the Committee would like to see Bernadette Kenny. If that were possible, we would be most grateful.

**Dame Lesley Strathie:** Yes, certainly.

**Q3 Chair:** We are going to concentrate on the implementation of the new system. You decided quite rightly to modernise your system, yet the history is poor. The system was introduced late, the costs associated with the introduction escalated. I think I calculated it as over a 40% increase in the actual costs of the new system. Despite deferring the implementation, you still found software problems;

the quality of the data led to massive inaccuracies; an enormous number of people—we will come to that in detail—were potential overpayers and underpayers, and there has been extensive delay in dealing with those reconciliations. The issuing of the PAYE codes was a fiasco and the inaccuracy rate was higher than under the previous system to date.

I have just picked out what struck me as being the principal things I read as I looked at the NAO Report and your report and accounts. All that has undermined the credibility and the reputation of HMRC, and we have 6 or 7 million taxpayers—we don't quite know—who are worried because they have either paid too little or they are owed some money by the Revenue. What on earth are you going to do to restore the credibility of the service that you lead, and how are you going to actually demonstrate improvements in the service?

**Dame Lesley Strathie:** Thank you, Chair. Let me first say that HMRC and I personally regret any anxiety that customers have suffered, and I will come to each of the points that you have made in terms of how many people have the right code and paid the right amount of tax in the totality of the system.

**Chair:** If I can interrupt you—we will come to the details. We will take those issue by issue as we go through.

**Dame Lesley Strathie:** Starting with the actual modernisation of the PAYE system, this was in gestation in 2003; a couple of years before HMRC was formed. It was formally launched in 2005. It was a massive programme to change PAYE, which I think we all know has served this country well for a very long time, but as people cease to live in a world where they have one job or one pension, it has become a bigger and bigger challenge to operate the system because of the movements of taxpayers and employees generally. It had two releases—the big one, known at the time as MPPC 3, was an enormous challenge for HMRC. The Department, as I understand it, accepted the NAO recommendation not once but twice to delay the introduction. The second

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time, I was very much aware of it because I was actually the SRO for the Employment and Support Allowance Programme in DWP and these two programmes were heading into collision, and we share the same system. There was a legislative need in the Employment Support Allowance and there was an organisational need in HMRC, but there were software issues at that time. So, it was delivered late. Not all the costs are associated with lateness; a huge amount of additional requirement was brought into this programme during its life, bearing in mind it had, I think, well over 3,000 requirements to start with. After the Child Benefit disk loss, which people will remember, a couple of years back, there was a huge programme of data security, an enforcement notice served on the Department and a lot of what came out of that data review meant that we had to strengthen our defences against a lot of risks on this programme, so we then introduced it in July 2009.

**Q4 Chair:** I am going to interrupt you, so I apologise for that. If I can focus you on the question. We have all read the NAO Report; we have also seen the proceedings of the Treasury Select Committee and we have read stuff in the newspapers, so what I really asked you is: it's a mess, right? There might be reasons for it, but it's a mess. What are you going to do to re-establish the credibility of HMRC and how are you going to demonstrate that? We will come back to what went wrong, but what are you now intending to do which will really improve matters from where we are?

**Dame Lesley Strathie:** Well, the key big building blocks for this include the reconciliation exercise that we are going through at the moment, which was well covered in the media, where we have many more people getting refunds of tax overpaid than we have of anybody being asked to repay tax. We should be through that exercise by Christmas and then we have those two years reconciled. We then have the annual coding exercise fast upon us because one of the problems with the entire PAYE system and process is that it has big business events to complete each year, and very narrow timeframes in which to do it. So, all the learning we had from the coding exercise last year is fed into our test and governance and assurance regimes for this year. We also have the open cases, which have been recorded in the accounts, the statement on internal control and the C&AG's report every year since the Department was created, and we have a plan—we are giving advice to Ministers now—for how we would automate the clearance of those cases, which go back some time, and we have a programme of work mapped out.

**Q5 Chair:** Is this the 10 million cases?

**Dame Lesley Strathie:** No. This is the 17.9 million.

**Q6 Chair:** The 18 million.

**Dame Lesley Strathie:** Yes. We would hope to have cleared them by the end of 2012 with commercial partners and with Ministers' agreement to do that. All that will put us in a much stronger state. We will be delivering PAYE cheaper; we will be delivering more accurate codes and, therefore, more people will be

paying the right amount of tax at the right time. The last thing I would say on reputation is that it is absolutely critical to us that we restore confidence in our payment-on-account system, and the customer's understanding of it, if we are to restore confidence in HMRC's reputation, but it is one big part of what we do. There are many other things that the Department is doing very successfully.

**Q7 Chair:** But it does impact on your reputation.

**Dame Lesley Strathie:** Yes, absolutely.

**Q8 Chair:** If we can focus first on the people who have not had their tax reconciled. There are various figures floating around here. As I understood it, you originally thought you had 7 million taxpayers who you thought had either overpaid or underpaid. You now believe you have 6 million who think they have overpaid or underpaid, but you have over 10 million taxpayers—if I read this right in the second memorandum—where you do not have sufficient information even to know whether they are in the 6 million or not. So, that figure could change when you look in detail at those 10 million plus taxpayers. Let me do it again: 45 million taxpayers; you originally said after 2008–09 7 million potential overpayers/underpayers; by adding in 2009–10 you came down to 6 million potential overpayers/underpayers, but of the 45 million there are 10 million you really do not know anything about, so that 6 million is a moving figure. Am I right about that?

**Dame Lesley Strathie:** Well, this is quite difficult because you are saying that the numbers will keep moving—and they will keep moving—as we apply the learning from the coding exercise. Each time we do another batch and test, we release 90,000 cases. We have made assumptions, based on the test run, about how many of those cases will produce an under or overpayment and how many will just go through as completely balanced and not produce either. Each time we run a batch, we test our assumptions against reality and judge what we think is in the rest of the mix. So 7 million came down to 6 million, came down to 5.9 million, and could even be 5.8 million.

**Q9 Chair:** What is it at the moment?

**Sarah Walker:** It's 5.7/5.8 million—that sort of number.

**Q10 Chair:** And how many of the 10 million have you established?

**Sarah Walker:** The 10 million cases are cases where we know we will have to do additional IT processes or clerical checking before that underpayment or overpayment can be established, but the estimate of the numbers within that 10 million is included in the 5.7 million.

**Q11 Chair:** But it could be completely wrong.

**Sarah Walker:** They are the same types of cases as the ones that we sampled to get the estimate that we have given, so there is no reason to think that looking at those 10 million will change that overall forecast.

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**Q12 Chair:** But there are 10 million at the moment you know nothing about.

**Sarah Walker:** Well, in the sense that they are cases we have not worked yet, but none of them have been worked. We are putting them through the system now. The figures we are giving you in terms of the numbers of overpayments and underpayments are estimates based on the sample. Until we work each of those cases and run it through the system, which we are now starting to do, we will not know the absolute number.

**Q13 Chair:** Okay. These are quite quick yes or no answers. You have said the overwhelming majority of PAYE customers have paid the right amount—that is in your letter to me of 1 October. That is not really true.

**Dame Lesley Strathie:** Well, it is in terms of anybody who is going to be asked for an under or overpayment. The numbers we are talking about here, like the 10 million, are those cases that are not completely straightforward, so they will not just reconcile in the system as it is. They are, if you like, sidelined until we go through the priority order. At the moment, our absolute priority is to pay back everyone for the last two tax years who have overpaid tax. Those are the 5.7, 8 to 5.9 million at the moment. The others are a number of different types of cases, different scenarios where we want to work them through one at a time. If you compare that with the P2—the annual coding notice—where everything went out and the customer then had to be the person to come back to the organisation and query the data we had on our systems versus what was correct, we are trying to make sure that, before anything is released into the system, we have accurate detail.

**Q14 Chair:** But all I am asking really of you on this one is, whether it is 5.7 or 5.8 million, that is a lot of people and it is wrong to say that the overwhelming majority of PAYE customers have paid the right amount. Yes or no? That's a lot of people.

**Dame Lesley Strathie:** I don't think it is wrong to say it.

**Sarah Walker:** I think that is out of 38 million.

**Q15 Chair:** Six million wrong is nothing to be worried about?

**Sarah Walker:** Of course it is.

**Q16 Chris Heaton-Harris:** That's 6 million people who have overpaid their tax?

**Sarah Walker:** No, 4.3 million have overpaid; 1.4 million have underpaid. That is our estimate.

**Chair:** I can't work out the percentages, but 6 million—that is a heck of a lot.

**Dame Lesley Strathie:** But I think, Chair, it is important to remember it is a payment on account system. Every change that an individual PAYE taxpayer has in the year is going to result in an under or an overpayment. So, if you are provided with a company car or you have some other benefit in kind or you move between tax brackets, then you need to tell us through your employer, your payroll provider or your pension provider. Some people do; some people do not. When we know in-year, we will adjust

the coding for the rest of the year, but the reconciliation takes place at the end of the year. In some cases, people do not always tell us or understand. We are never—I just really want to stress—we are never going to be in a system that is a payment on account where we do not have to reconcile what has happened during the year.

**Q17 Chair:** I do understand that. I would simply say to you that in my view 6 million either having overpaid or underpaid out of 38 million is a lot of people. Let me just put this to you: since 2008–09, 800,000 people have lost their jobs, have gone onto Jobseeker's Allowance or some sort of unemployment benefit. For those individuals, if they have underpaid, are you going to take account of their circumstances or expect them to pay it back? If they have overpaid, they are the ones who more than anyone will need the money owed to them quickly because they are in constrained financial circumstances. How are you responding to that?

**Dame Lesley Strathie:** Well, I think first and foremost, if people go onto Jobseeker's Allowance, that is a taxable benefit, which is addressed through the tax and benefit system. The commissioners took the decision on this double-year reconciliation not to ask for any underpayment of less than £300, so people are not being asked to repay that money. That is actually taken out of the system. We must also recognise that many of these cases would be subject to challenge—if the Department had all the information and failed to take the right action to recover it—so I think most people would be covered by that.

**Q18 Chair:** Yes, just I hope you would accept that those 800,000 people within that underpayment or overpayment group who have become unemployed since 2008–09 will suffer disproportionately because it will matter more to them. The only other thing I wanted to ask you and then I am going to turn to James is: in your letter, you say to me that the bulk—if we just talk about the 2008–09, 2009–10—will be reconciled by Christmas. What is “the bulk”? When will you actually complete the exercise?

**Dame Lesley Strathie:** Well, the 5.9 million figure that we were talking about earlier is the exercise that we absolutely expect to go through by Christmas.

**Q19 Chair:** So, all your 10 million that you have not touched yet—

**Sarah Walker:** Perhaps I can help. We expect the majority of those, including the 10 million, to be done by Christmas.

**Q20 Chair:** What's the majority? Define the majority.

**Sarah Walker:** At least 70%.

**Q21 Chair:** 70%?

**Sarah Walker:** The remainder will be done some time in January.

**Q22 Chair:** 70% by Christmas, 100% by 31 January.

**Sarah Walker:** Yes.

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*Dame Lesley Strathie:* 70% of the balance.

**Q23 Mrs McGuire:** What point in that target have you reached?

*Sarah Walker:* We have just started running the full output. We started, last week, by running 900,000 a night. So, we are right at the beginning of the process now.

**Q24 Chair:** Sorry, is it 70% of 38 million, 70% of 10 million or 70% of 6 million?

*Sarah Walker:* 70% of the 6 million we would expect to have processed.

**Q25 Chair:** But you do not know the 6 million because there are 10 million you do not know anything about.

*Sarah Walker:* No, but we will work through the 45 million records on the assumption that those 6 million are evenly spread through the population, which we would expect.

**Q26 Chair:** So, 70% of 45 million records will be checked by Christmas, which will generate 70% of your projected 6 million, which could be wrong because there are 10 million you do not know anything about?

*Sarah Walker:* We are confident in the 7 million prediction.

**Q27 Chair:** But am I right in what I have just said?

*Sarah Walker:* Yes.

**Chair:** So how many people does that leave? I can't work out these statistics.

**Nick Smith:** 70% of 6 million is 4.2 million.

**Chair:** Well, except it is not 6 million because 6 million might be wrong.

**Q28 James Wharton:** I just want to understand better the costs associated with this particular disaster and the decisions that have been taken throughout it, and the costs of those decisions as well. We have roughly 4.3 million people who are going to receive repayments—they have overpaid—and 1.4 million people who have underpaid are going to have to pay more in. My understanding is that you are looking to pay out about £2 billion and receive in £1.8 billion, so actually there should not be too much discrepancy—although, I suspect you will find it easier to pay money out than to get it back in. In terms of that £1.8 billion that you estimate you will get in at the end of this process, how solid is that figure? Looking at, for example, the extra-statutory concession, how much of that £1.8 billion do you expect to get back?

*Sarah Walker:* At the moment, only the minority of these underpayments are caused by Revenue error, which would make them eligible for writing off under the concession.

**Q29 James Wharton:** What does 'a minority' mean?

*Sarah Walker:* It is quite a small proportion.

**Q30 James Wharton:** What is it?

*Sarah Walker:* It is difficult to say, but I think we would say it is less than 20% and then, of those, a

proportion will claim the concession and we will then write it off. So, it is too early to say exactly what those numbers are likely to be.

**Q31 James Wharton:** So you might get £1.5 billion in, say, if you are talking 20%. There are question marks over some of those you might have to write off—some you will not be able to collect because people are not in work—but you would probably get about £1.5 billion or somewhere in that region.

*Sarah Walker:* I think we would expect to get a bit more than that.

**Q32 James Wharton:** Within that, the thing that strikes me is this seems to be a consistent type of error. You have thrown up 4.3 million people whom you need to pay back, whether you owe them £10 or £500—whatever it is—but only 1.4 million people who actually need to pay into the Revenue. How much of that is caused by the raising of this limit under which you do not actually try and claw it back from £50 to £300? How many people between zero and £300 could theoretically still owe money to the Revenue but you are deciding not to pursue?

*Sarah Walker:* There are 900,000 cases that are excluded by the increase in the tolerance.

**Q33 James Wharton:** And do we have an estimate of what the income from those would be? Is it relatively small?

*Sarah Walker:* The effect on the yield is roughly £160 million.

**Q34 James Wharton:** Right, and do we know what has been the cost to the Revenue of the exercise as a whole? The actual cost of implementing it, writing to all these people and chasing it up—have you done estimates of the overall net impact on the Revenue?

*Sarah Walker:* I do not think we have the cost of the current activity because that is still going on.

**Mr Bacon:** Mr Wharton is asking, I think—correct me if I am wrong—but I think he is asking about the cost of chasing those 900,000 who are excluded by the change in tolerance. Is that right?

**Q35 James Wharton:** We have had some mistakes and you owe some money to some people and some people owe money to you. Then you have made decisions about the way it is implemented and what I want to understand is, at the end of this process—wherever that end is—when this is all cleared up, how out of pocket is the Revenue going to be? How much of that is because of decisions that the Revenue has taken about the way it wants to pursue this and how much of that is just unavoidable because that was the mistake that was made? That is what I am trying to get at. So, do we have an estimate of the cost of pursuing those 900,000 people?

*Dame Lesley Strathie:* Yes, I think we can give you a note on that because it was a decision of the Commissioners of Revenue and Customs not to pursue and to increase temporarily the tolerance from £50 to £300. That was on a cost/benefit analysis of the cost of collection and the number of people who we potentially viewed would be able to challenge



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under ESC A19. So, we can give you the basis of that decision and the legal justification for it.

**Q36 Chair:** Can you also give us data on, if you had actually done the reconciliation of 2008–09 at the time you should have done, how much extra revenue we would have been able to collect?

**James Wharton:** Can I reiterate, the figure I really want to understand is, as I say, when we come to the end of this process and this is all done and dusted and you have collected what you needed to collect and paid out what you needed to pay, how much will this have cost that it would not have cost in terms of administration costs, the time costs and staffing costs—what is the cost of the mistake? If it had never happened, how much better off would the Revenue be? That is what I want to get at.

**Dame Lesley Strathie:** Yes, I can see why we are struggling to answer your question. This should cost considerably less than it has normally cost in other years. Bearing in mind what I have said, this reconciliation takes place every year and the vast majority of these cases have got to be worked manually according to resources available to work through them. It has always been part of it that we code this out when we send you what sometimes, when the information comes in, might be two years of a review. The big difference this year is that we have two years to do because reconciliation could not happen last year in introducing the new system, and the fact that it is an automated process rather than manual, so the end result of all of this ought to be that it costs less than it previously cost.

**Q37 James Wharton:** So you think even factoring in the cost of the errors that you are going to save money overall because of the changes you have made?

**Dame Lesley Strathie:** Yes.

**Amyas Morse:** Just for clarity, if you look at the supplementary memorandum paragraph 2.7, we pointed out that the level of tolerance that was determined by the Revenue was not based on a straight comparison of the costs of dealing with individual cases, but the need of the Department to take pressure off the system at a work peak. Is that a fair comment?

**Dame Lesley Strathie:** Yes.

**John Thorpe:** Our understanding is that there was not, as I say, a straight costing of that, but actually the wider issues of the impact on other areas of the Department's business, so the ability of the Department to deal with a peak in its workload at that time. That was a factor in that decision.

**Q38 Chair:** You are going to provide us with the details of that. I was asking a slightly different question: the fact that you failed to reconcile at the end of 2008–09 and have done a two-year exercise, that decision will have cost you a loss of revenue and I want to know what that is.

**Dame Lesley Strathie:** All the figures that we have, have the two years combined, but we can give you it on the basis of a broad half and half, and by the end of the process, because the answer to that question,

Chair, will lie in how many cases we remit from the challenge process and how many are actually accepted and coded out.

**Q39 Mr Bacon:** Do you have a ballpark figure for what number you are talking about?

**Sarah Walker:** We will be collecting the 2008–09 underpayments in exactly the same way as we collect the 2009–10 underpayments, and the bulk of them we will collect by adjusting people's codes in subsequent years.

**Q40 Mr Bacon:** Sorry, my question—it is really Mr Wharton's question—is how much has this cost? I have not heard a number yet and you can give us a note with an exact number, but roughly what is the number you carry around in your head of how much worse off you are because of all this?

**Dame Lesley Strathie:** Well, I would say, broadly, and looking at this from investment committee and the changes it brought about, that roughly around £7 million is the cost of stabilisation.

**Q41 Mr Bacon:** That is just the cost of stabilisation. The number we are trying to get is a really simple one. It is not complex at all. If this had all gone right—if everybody had been coded correctly, been sent the correct assessment and had paid the correct amount of tax—there would not have to be this enormous backing and filling and digging and scraping and blitzing, and everybody else going off and doing this one thing to the exclusion, by the way, of doing the job that they were supposed to do, because we know that basically everybody—the man and his dog and wastepaper basket—in HMRC were all put on this to help clear it. That is what we hear. That must have had an impact elsewhere in the organisation in terms of forgone revenue as well. If none of that had happened and you had ended up where you were supposed to be first time round, you would have had more money and you would have spent less. What we want to know is how much?

**Dame Lesley Strathie:** Well, I think we can absolutely give you what the additional costs to the MPPC business case have been for each of the business events that we have had to deal with since the implementation of the system—

**Mr Bacon:** And roughly what you think it is?

**Dame Lesley Strathie:** Yes, so we will give you that figure and...

**Mr Bacon:** Yes, but do you not have a figure in your head? I mean, I know roughly the defence budget: I used to think it was £32 billion and apparently it is now £38 billion. You carry numbers around in your head. What, roughly, is the number you carry around in your head for the cost of all this that you have incurred—the additional hit that you have had to take because of it? That is what Mr Wharton has been asking and we are yet to hear a number, roughly. We are not expecting you to sign your name in blood; when you send us the note you can sign your name in blood. I am just looking for a rough figure—is it £10 million, is it £50 million, is it £300 million? Is it £1.7 billion? Is it tuppence ha'penny? I just do not have any feel for how much this has cost you.

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**Jon Fundrey:** When this came back through our investment committee in July, we added in an extra £7 million for incremental costs associated with the stabilisation programme, so the hit to Department costs, if you like, is the extra £7 million.<sup>1</sup>

**Mr Bacon:** But, hang on, you have started a new stabilisation programme that is now going to take two years.

**Jon Fundrey:** Yes.

**Mr Bacon:** Are you saying that £7 million is for the two years going forward?

**Jon Fundrey:** Correct.

**Mr Bacon:** But what about the costs prior to starting the stabilisation programme?

**Jon Fundrey:** There is still a clear business case; the programme is still expected to generate savings of £535 million over the period.

**Mr Bacon:** Yes. With respect, my question was not about the savings that are generated. I am just after—as was Mr Wharton—

**Jon Fundrey:** Are you trying to get to the revenue forgone, if you like, or delayed, underlying that?

**Mr Bacon:** Yes. How much has this cost you? You have an in and you have an out and the out is higher and the in is lower. If you net it all off, how much worse off are you?

**Jon Fundrey:** So, the direct cost to the Department is £7 million. The Revenue number is—

**Sarah Walker:** £160 million.

**Mr Bacon:** £160 million—so if you add the two up it is £167 million, you think?

**Dame Lesley Strathie:** Yes, except we do not know until we get to the end of the process which cases will be challenged and which will go into—

**Mr Bacon:** No, I understand. You will say that all in your note and it will probably finesse up and down a bit.

**Dame Lesley Strathie:** Well, we don't know the answer, Mr Bacon, that's the truth and we will not know until the end of the process.

**Q42 Mr Bacon:** Okay. Could I ask you a broader question about the background to all this because in paragraph 2.9 onwards, headed up, “Delays in implementation”—this is in the C&AG's Report on page R21. It says in paragraph 2.11 that “following the second deferral, the Department... recruited a new programme director, introduced a new programme governance structure, changed the risk and stakeholder management processes, and appointed consultants to provide assurance on specific aspects of the new Service.” Now, that suggests that there was something wrong previously with the programme director, the programme governance structure and the risk and stakeholder management processes because if they had all been working swimmingly, you would not have needed to make those changes.

I have talked about this at length with the NAO, who are of the clear view that HMRC did not fully appreciate the risks of this and that your project management was not strong enough. Why not? This is obviously an enormously big project. The potential

risk is the tax take for UK plc—hundreds of billions of pounds. It is worth taking an enormous amount of care to get this right and there are shelf loads of advice on how to manage projects successfully. Not just one or two—dozens. I know because I collect them. Why was the project direction and management so weak? Why were the stakeholder management processes and the risk management processes inadequate and why was the governance structure inadequate? Why was this not set up properly in the first place, taking account of the risks?

**Dame Lesley Strathie:** Well, Mr Bacon, everything I tell you will be based on my own research, and probably an element of subjectivity, because as I said at the start, this programme goes back to 2003 in specifying its requirements and 2005 in launch. It had already delivered two major planks of success. I think if I say this in terms of my programme management experience, and I have managed some pretty big programmes, this is the biggest I have ever seen in my life. In terms of going from 12 regional databases with 45 million records on an employer-based system that has been there since 1944, and 1985 to the 12 regional databases, and actually to collapse all that into one and convert it into an individual customer account and clean up all that data for over the years, it was huge. The new governance, etc. was already in place when I arrived in the Department. I knew that the programme was in difficulty because it had been delayed twice and, indeed, from the first day that I was there it has been a major focus and a major priority to land, but it is huge. It was set up with the right governance at that point. It did have assurance processes. If I were to criticise the programme, I would say that the linkages between the programme and the business were not strong enough and, therefore, as we all know in delivering major change, unless you have the end user involved in the design and the testing at every stage you seldom end up with a programme delivering what you set out to do with it.

**Q43 Mr Bacon:** My question is, really, why were those linkages not strong enough? You have just said yourself, “As we all know”. Yes, we do all know because it should have been tattooed on the eyelids of everybody involved in spending public money and running a project for decades, because this issue about the end user not being sufficiently involved and about the connections between the business and the project not being strong enough has been repeated again and again and again. So why were those links not strong enough? Why did they not say right at the outset, “I know—we need really strong links between the projects and the business, because failure there is almost always failure of the project”? Why was that not done?

**Dame Lesley Strathie:** Well, I do not think I can answer you.

**Q44 Mr Bacon:** In that case, can I ask you to answer another question about this Chief Information Officer?

**Q45 Ian Swales:** Can I just ask a point on this point? This issue that Mr Bacon is talking about: the thing that disturbs me is whether your organisation is a

<sup>1</sup> The £7m cost relates to changes which will enable us to deliver all PAYE events going forward more effectively and not just End of Year Reconciliation.

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learning organisation. I actually, in a previous life, worked on the Self Assessment Online work in 2002. It was a deliberate decision by the Board of the Inland Revenue, as it was then, to do it in a different way with a small team of 50 people and do it in six months, and it worked. I just wonder why we have gone back to these massive projects. I can remember standing in Telford drawing the picture of how the project linkages should work. Why on earth do we keep having to go through the same learning again and again and again, even in your own organisation?

**Dame Lesley Strathie:** First of all, I would say I am very happy with where we have got to with our Self Assessment Online, but it did take about two years—in fact, nearly three years—of adjustment before we got to the stable state that we had last year.

**Q46 Ian Swales:** But I would argue that, in concept, that was more ambitious because we must not confuse complexity with volume. It is the same work to do a system for 100 taxpayers as for 10 million. You obviously have other aspects, in terms of hardware, communications and training and all the rest of it, but actually the software and the complexity is contained for one or two taxpayers; it does not matter how many there are. So, as I say, I would argue Self Assessment Online was actually more complex and was done very quickly with a small team.

**Dame Lesley Strathie:** I think where I would draw the distinction—we are very proud of our Self Assessment Online—is it is very much the part of the system that scoops up the additional tax due from those people who are in the system. I would accept any criticism as far as programme management is concerned, and clearly the Department recognised that and made the changes that you have stated, Mr Bacon. However, the PAYE system depends on the partnerships and working with employers. For everything to work to 100%, which it never will, it would mean every piece of information that we receive is accurate. The tolerance from taking all those years from 1985 and those databases, and bringing it together, it is absolutely clear that the quality of the data was very poor. The Department had definitely recognised that as something that had to be addressed before this introduction. It had also trialled different ways and set up a programme of data quality. What I do know is that there came a point where that was de-scoped from the programme and it was not formally picked up in the way that it should have been elsewhere. It was a critical dependency—

**Q47 Ian Swales:** The data quality issue was de-scoped?

**Dame Lesley Strathie:** Yes—and the data quality is at the heart of this. We will never reach a point, I cannot believe, where every employer, payroll provider and member of staff will get everything absolutely right. So, the challenge that we have going forward in this will remain working with all our partners to ensure that we have much higher standards of data quality and much better firebreaks from data that is not full standard going through the system. That is the big challenge.

**Chair:** We are going to come back to data soon. Matthew.

**Q48 Matthew Hancock:** I have a very specific set of questions about the delay in implementation of NPS and the consequent decision to send out the codes and communications around that. There was a delay in implementation of NPS that ran into being able to get the right codes ready for sending them out around the end of 2009–10. Is that right?

**Dame Lesley Strathie:** Yes.

**Matthew Hancock:** And the decision was taken to send out the codes knowing that there would be a large number of them that were wrong. Is that correct?

**Sarah Walker:** No, at the point when we started issuing codes at the beginning of this year, we knew that they were going to be a lot more than we had predicted, but we did not at all know that that was because they were going to be wrong. The first reason we had to know that there were wrong codes going out was when the customers contacted us.

**Q49 Matthew Hancock:** Okay. But it says in the Report on section 2.21, “When the Department was able to run the reconciliation ... in mid-December, it identified in excess of 7 million over and underpayments.” This is December 2009, correct?

**Sarah Walker:** That was the reconciliation of the 2008–09 cases, yes.

**Q50 Matthew Hancock:** And that there were 13 million coding notices that were expected to be wrong. That’s paragraph 2.27.

**Sarah Walker:** No, I don’t think so. We were expecting to issue 13 million.

**Q51 Matthew Hancock:** Okay. So, you took a decision to send out codes where you knew that you had identified in excess of 7 million over and underpayments.

**Sarah Walker:** Those over or underpayments did not necessarily affect the codes that we were sending out for 2010–11—that was a previous year.

**Q52 Matthew Hancock:** Okay, I get that. Turning to how a consumer sees this, if you know in advance that you are likely to have an underpayment and therefore face needing to pay back more in the future, it is much easier to manage that if you know in advance.

**Sarah Walker:** Of course.

**Matthew Hancock:** So why was this not made clear to people when you decided to defer the reconciliation in January 2010, as it says here in paragraph 2.21, that there would be these underpayments and overpayments?

**Sarah Walker:** I think it was a decision that was taken quite late in the day, but I think the real reason is that it is impossible for us to tell anybody that they are likely to have an over or underpayment.

**Q53 Matthew Hancock:** Who took the decision to cover up that there would be 7 million under and overpayments in January 2010?

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**Dame Lesley Strathie:** In January 2010 you would not know what that figure was because the reconciliation will not have been in place.

**Q54 Matthew Hancock:** No, that's not correct because it says in the Report that when the Department was able to run the reconciliation of 2008–09 in mid-December 2009, it identified in excess of 7 million over and underpayments. But you did not tell your customers at that point.

**Sarah Walker:** No, because they needed clerical work done to them in order for us to notify the customers of them.

**Q55 Matthew Hancock:** But you are still only just notifying, whereas in September this year you did tell everybody. We all saw it. It was all over the media. Why was that not explained before the election and why did you wait to tell a lot of people they would have to pay extra tax until September this year?

**Sarah Walker:** We were not able to do it. Because the 2008–09 data was not properly loaded on to the system until around the end of the year, we did not have the time to do the work that was needed to notify people of those over and underpayments.

**Q56 Matthew Hancock:** But you have not notified individuals of over and underpayments yet, correct? Except for a small number, right? So, you could have made the generic announcement that some people have had underpayments and overpayments when you found out about it in December 2009, but you did not. You only made this public in September 2010. Why?

**Chair:** No, we made it public with an NAO Report.

**Q57 Matthew Hancock:** So why was this information that there would be over and underpayments because of the delay to the system not made public to the taxpayers—to your customers—in December 2009 and why was it only made public in September 2010?

**Sarah Walker:** We expected to be able to work these cases in April, so the delay would not have been as long as we thought. In fact, it did turn out to be a little bit longer because we had to do extra checks. I think it is a question of whether a general announcement of that kind is actually a helpful thing to do.

**Q58 Matthew Hancock:** Well, the general announcement was made anyway, so I would put it to you that if you are a customer who is going, at some point in the future, to have to make an extra payment of tax, knowing as far in advance as possible is a beneficial thing, not an unhelpful thing.

**Sarah Walker:** Yes. And that is what we would have done; it would have been to notify those individual people by working it—

**Matthew Hancock:** No, I understand that you did not have that ready and you are just going through that now, but the generic announcement that there was a problem here was not made when you knew about it in mid-December 2009. Is that correct?

**Sarah Walker:** That's right.

**Matthew Hancock:** Why not?

**Sarah Walker:** We did not think it was—

**Matthew Hancock:** And who made the decision?

**Sarah Walker:** I can't remember.

**Dame Lesley Strathie:** Well, I am the accounting officer, so I think it is for me ultimately. First, we did not know who the people were, so it would have been a general announcement. What the programme had to consider and what the Board had to consider in all of this was that every time we send a communication out to our customer base, we get broadly a 40% movement upwards in calls and anxiety. We did not have the automation that we could just write to everybody else, so the choice here was, given we did not know who they were, we could have raised everyone's anxiety, against those customers who are pretty well used to this and get a reconciliation notice for one year or sometimes two years at a time. We felt we could not tell the people who they were because we were going to automate this so we would raise everyone's anxiety. We would not be able to deal with the volumes on our telephone lines, which would affect other customers getting through. We thought about—

**Matthew Hancock:** Hold on. This was going to happen at some point, and it did indeed happen. So, just because you did not want to tell everybody because you did not want to have made the mistake—I can understand, obviously, the increase in costs and all that—but that is not because of the communication; it is because of the mistake. You communicated the mistake eventually, so why not communicate it when it would have been more helpful to people, and why the delay?

**Dame Lesley Strathie:** Well, I am not sure that it would have been more helpful, given what we would have been able to say. We still had to get through all of the other events in the year, including the whole tax credits renewal, which is done on the telephone. We did share this information with all of our key partners in the process, all our agents of taxation including those who represent the vulnerable. We did tell Ministers in the previous Government that we would not be able to reconcile, and we took a view on balance that we should move ahead when we were clearer that we could tell people when we were going to solve the problem. The point at which this all hit the press in the way it did hit the press was when we had an absolute tested programme of work; a controlled ramp-up in which we did not go live until we had tested all of our assumptions through that process and started our communications with all our partners about what people could expect and when. As you know, that is not quite how the story played out in the media.

**Matthew Hancock:** Indeed.

**Dame Lesley Strathie:** But the way that it did play out in the media, as far as I am concerned, validates everything I have said about what happens when you are dealing with every single working person in the population.

**Q59 Matthew Hancock:** About why it is best not to have this sort of problem. On 26 January, *Computer Weekly* states that it asked the HMRC about the impact of the delay and the HMRC spokesman said that it was sending out more tax codes; this was a “natural

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feature of the new system.” *Computer Weekly* has called that a denial of there being a problem. So, you say that you knew that there was a problem—that is in the NAO Report—you have just said that Ministers were aware of the problem, yet HMRC denied that this would be anything unusual. Well, it certainly struck everybody as unusual when it came out.

**Dame Lesley Strathie:** I do not know what you have there, Mr Hancock, but reconciliation is a feature of PAYE, has always been a feature of PAYE. The only key difference—

**Matthew Hancock:** But not of this scale because of the delay. Not of the scale as it happened this time.

**Dame Lesley Strathie:** No, actually, I think that history will show that the volume of cases to be reconciled for two years here will be considerably less than has been the norm. It just does not have the focus because people receive the new coding telling them, “This live event happened during the year; that means you have now underpaid. Here is your reconciliation.” Under £2,000, we code out not even in that tax year, but the following one. It is a feature of the system.

**Chair:** Right. I am going to move on because there are a lot of people. Chris—if you can be quick because we only have until 11.00 on this.

**Q60 Chris Heaton-Harris:** Sorry. First I have to apologise to Mr Hancock because I shoved a statistic in his face mid-way through his presentation. Really, I just want to know if my tax code is going to be right this coming year. The paragraph I was trying to show Mr Hancock is 2.27 where it says you have geared up the new system; you are expecting to issue 13 million codes to individuals, 10% more than in previous years, and in the end found that you would be issuing up to 25.8 million coding notices. That is quite a big error, isn't it?

**Dame Lesley Strathie:** Yes.

**Q61 Chris Heaton-Harris:** Did you not see that coming and how is it going to look this year?

**Dame Lesley Strathie:** No. Well, I think it is absolutely right. We are conducting a full review of everything that happened in that programme and why our assumptions were so wrong in the production of the annual coding notice—and, indeed, when we identified there was an issue, the reasons why we continued to proceed. And, because inevitably there will be criticism in this Report and everybody involved in it as part of that process, all I can say to you is that what we know happened then, we have already taken the learning from and applied it in the way that we implement change in the future, and that is what we are going through at the moment in the reconciliation. However, it is absolutely clear that, with all the right governance, with all of the assurance, the assumptions were wrong, and the assurance process did not stop us implementing that.

**Q62 Chris Heaton-Harris:** And so for this coming year?

**Dame Lesley Strathie:** For this coming year, once we are through this reconciliation exercise, the next big business event for PAYE is the annual coding notice. I believe that the processes we put in place will allow

us to package the work in a way that we will get through it much better than we did last year. I actually think it will take us another year after that before I would see this as a stable system because we have just put new functionality in now, and everything we have put in we have to test that it works exactly as we expect.

**Q63 Nick Smith:** Chair, could I come in on that point? How quickly will the Department get to paying back overpaid tax to taxpayers? How quickly will people get their money back that has been overpaid, particularly pensioners?

**Dame Lesley Strathie:** The exercise we are doing at the moment—they are going out at the rate of 65,000 cheques a day at the moment, which is the limitation of our system in how many we can do. So, I know at the moment, well over 30,000 have already had theirs in cash from the initial run. We are monitoring that on a daily basis; generally it follows about five days after the notice.

**Q64 Nick Smith:** So, if you are a pensioner who has overpaid, when are you likely to get your money back by?

**Sarah Walker:** It depends. We are working on them between now and January. We will get the bulk of them done by Christmas. If you are due a refund, that refund will be a cheque and it will follow within a few days of your getting the notice.

**Q65 Ian Swales:** You have crashed ahead with a massive staff reduction programme all the way through this. I think what we are hearing—both today and I have also talked to people who work in a processing centre near me who are having to do things like enter data knowing them to be wrong, just to keep up the pace because they are not allowed to make phone calls—is that this feels like a Department that is overwhelmed. Do you regret the major staff reduction programme? Would you have retimed it? Is there a case for investing in people to sort out this mess? How do you assess that?

**Dame Lesley Strathie:** Anything I say suggests that I criticise everything that went before me as well as anything I might have done myself, but I think it is a huge challenge when you create a new Department and you have well over 200 big systems, about 900 systems and 100,000 people. I would say that the challenge is balancing the use of technology to make things more cost efficient to deliver with the human impact of that change. We try to balance the resources and balance those things. I think we have a terrible morale problem. I think the vast majority of people in HMRC want to do a good job—many of them are doing a good job—but we absolutely recognise that there are areas of the business where people feel that they are disempowered from doing the job well, and that is part of the transition. So, I very much hope when our spending review is settled, we will have a much clearer way forward for the Department. We are very fortunate that Ministers have already announced a £900 million investment in the Department and that is incredibly welcome because we recognise that we need that investment.

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**Q66 Ian Swales:** Your Department is unique in the Civil Service in that it is the one that brings the money in. So, to what extent do you have a business mind in bidding for resources? As you probably know, the civil service unions say that there is £40 billion plus out there waiting to be picked up. Meanwhile, numbers are crashing down and people do not have the time to do some of the things we have been talking about this morning. How is that assessed?

**Dame Lesley Strathie:** I am sure, as you can imagine, that all our planning for the spending review has been predicated on that very business case of how much more we could narrow the tax gap. I cannot tell you what the settled spending review is because it is not 20 October yet, but there is a difference between that £40 billion number of the theoretical tax gap, which is constantly adjusted, and our case for moving people from what I would regard as lower-value work, which will be replaced by greater automation, to investing in our compliance work with our evasion and our avoidance work.

**Q67 Ian Swales:** What do you internally, as the top team, think the tax gap is?

**Dame Lesley Strathie:** Well, we have published figures on what we think the tax gap is. The most recent figures showed the tax gap was £2 billion less than when it was last published, but that it had grown by £4 billion in the period, so we had an adjustment from the base.

**Q68 Chair:** What is it? What's the number?

**Dame Lesley Strathie:** £42 billion.

**Chair:** £42 billion.

**Q69 Ian Swales:** And your entire staff costs are less than £3 billion. Is that right?

**Dame Lesley Strathie:** The round costs for the Department, as in the accounts, is between £3 billion and £4 billion because there are some things that are funded by other Departments, so it—

**Q70 Ian Swales:** Okay. Including administration costs?

**Dame Lesley Strathie:** Yes, that's right. The majority of our costs are in people, estate and technology. That's the bulk of the cost for the Department, so whatever efficiency challenge that a Department has, it needs to come from those areas.

**Q71 Chair:** Can I just ask you on that—and I am taking the opportunity of being the Chair—you have had a 17.5% cut in your staff; you have already cut them by 17.5%. I want to ask you, firstly, was that too early and is that one of the reasons that you ended up with some of the problems that we are now trying to unravel? Secondly, we all know that the CSR will demand further cuts in staff from you between, I don't know—30% and 50%; what, in your view, would that do to your ability to run an efficient and effective tax assessment and collection system?

**Dame Lesley Strathie:** I think, first, if we look back at the history and the reductions, and the Department took every step to avoid redundancies, that often

meant not the people you might have wanted leaving the Department, or being in the place that they left.

**Q72 Chair:** So did you cut too much too soon?

**Dame Lesley Strathie:** Well, I think the Department cut in order to live within its balance, but I would say there is always a question mark over a programme that does not deliver to time and has a budget to be balanced. If the savings are going to come from staff reductions in the main, there is always a question over when the staff came out and when the functionality—

**Chair:** Did you cut too much too soon?

**Dame Lesley Strathie:** Well, I think we still have a lot more cutting to do, quite frankly.

**Chair:** So you did not cut too much too soon?

**Dame Lesley Strathie:** No, I don't think we did cut too much too soon, but that is not to say that necessarily we cut everything in the right place at the right time.

**Q73 Chair:** And if you lose 30 to 50% of your staffing?

**Dame Lesley Strathie:** Well, one of the steps that we have taken in our planning for the next four years is absolutely to protect our PAYE resource until we are through stabilisation. So, initial plans we had for efficiencies would have meant planning for more staff to come out of there now, whereas we have deferred that to later years and looked for efficiencies in other parts of the business.

**Q74 Austin Mitchell:** I take it that your answers here were an admission that it was a mistake to have a staff reduction programme at the same time as you are doing this massive transfer. Effectively, you said that. It does look like a mistake from the outside. I see in paragraph 2.13 that you had intended to set up a process to “manually work open cases relating to 2003/4 before the statutory deadline for their clearance passed.” Paragraph 2.21 states: “The Department had intended to work [reconciling cases] manually,” but found they were too large. In other words, the staff reduction prevented the manual reconciliation programme on the 2008–09 period. Is that correct?

**Dame Lesley Strathie:** No.

**Sarah Walker:** No. I think the reason why we were not able to reconcile the 2008–09 cases was that the computer functionality—the right bits of computer programme—were not available in time to allow us to get them onto the system and then work them in the time available. So it was actually IT delays that stopped us doing the work.

**Q75 Austin Mitchell:** But had you not had those IT delays, you would have had the staff to do it?

**Sarah Walker:** Yes.

**Q76 Austin Mitchell:** Okay. Well, in that case, was it too big a transfer to an IT system that could not cope? I see there are problems with the software for the NPS that meant you have to delay the processing the 2008–09 PAYE returns. You must have had, I presume, the advice of consultants on your IT systems

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and on your software, so who is responsible for the fact the system could not cope?

**Dame Lesley Strathie:** First and foremost, there are several suppliers. HMRC's IT is provided by Aspire, which is a partnership led by Capgemini, and then we have various other parties in different parts of the system. When you say the IT did not work: this is a massive programme with lots of different packages of software. The vast majority of the system works. It does what it was asked to do and, indeed, I was in Birmingham last week with lots of our staff who had nothing but praise for the system in terms of what it could do. However, there are two elements here: there are the bits that did not quite work the way we wanted them to; there were the bits that were coming in later releases and we have just released a lot of them this weekend; but also, you specify you want something back here in 2003, you have nearly 400 changes in that time and then you have delivery in 2009. So, sometimes you get what you ask for, but it is not necessarily exactly as you need it. There are very few programmes that I have known that cover a length of period and a scale like this where you get exactly what you set out to get first time.

**Q77 Austin Mitchell:** Yes, we know it was a big job, but still there were software problems which delayed the reconciliation programme. Now, is anybody being held accountable for those mistakes?

**Dame Lesley Strathie:** Well, as far as the annual coding exercise and its relation to the overall programme, we are actually working through all of that at the moment. If there are mistakes there by any party, then they will be challenged on that.

**Q78 Chair:** Is Capgemini facing any detriment? Are you fining them or are you fining any of the partners who are part of this consortium, Aspire?

**Dame Lesley Strathie:** I don't have any evidence at the moment, as far as fining Capgemini.

**Chair:** BT, Fujitsu?

**Dame Lesley Strathie:** Aspire, as a partnership, is subject to breach under the terms on anything in terms of our live delivery.<sup>2</sup>

**Q79 Chair:** So it is not their fault?

**Dame Lesley Strathie:** As far as Aspire is concerned, they are the live service deliverer. On the build for MPPC, we have Fujitsu and software suppliers, we have Accenture in systems integration, so in terms of what went wrong, as I have said, we have not completed that review and it would be wrong for me to make judgments until we come to the end of that review in regard to who has any questions to answer in that.

**Q80 Chair:** And when are you completing the review?

**Dame Lesley Strathie:** Well, we are almost at the end of the findings, conclusions, etc, but that then means that where there are questions to answer for anybody, either in HMRC or anywhere in the entire partnership

for delivery, then we need to go through that process with them and give them the opportunity to respond.

**Chair:** There are a lot of people wanting to come in. Could you ask quickly on that?

**Q81 Ian Swales:** This contract to do this work: how much was it a fixed price contract and how competitive was the tendering process?

**Q82 Mr Bacon:** Can I add a supplementary there, because it is the same thing. When the Committee looked at Aspire originally, the NAO Report from whenever it was—four or five years ago—said that the cost was originally £2.3 billion and had risen, eventually, through mistakes up to £8.5 billion. Is the cost still £8.5 billion over 10 years or is it going higher?

**Dame Lesley Strathie:** I'm sorry. I cannot answer that.

**Q83 Mr Bacon:** You don't know how much the Aspire contract is costing you?

**Dame Lesley Strathie:** Well, you see, I think we are confusing two things here. Aspire is the partner who delivers our IT, so all our big systems, but we then offer contracts through a lengthy competitive tendering process for IT build, which is quite separate in the space. Then you have integration, so there are three parts to this. I just think that we are latching onto Aspire as the deliverer here when this is a system that has had many players over its life. So, the issue we had in software would not be an Aspire issue.

**Q84 Mr Bacon:** If Mr Swales permits, I would like to ask a narrow about one specific player, Deepak Singh, who was the Department's Chief Information Officer. Could you turn to page 30 of the main accounts, please? Do you see on the left there at the bottom, Dame Lesley, it says, "Deepak Singh to 18 June 2009" and then it says "45 to 50" and then in brackets, "£160,000 full-year equivalent". Are we on the same page?

**Dame Lesley Strathie:** Yes, we are.

**Mr Bacon:** Okay. Underneath at note 5, it says, "Deepak Singh was appointed on a three-year contract commencing on 19 June 2006." That was a fixed term, three-year contract. What that means is you knew in 2006 that three years later he would need to be replaced, and he became the Department's Director General and Chief Information Officer. Now, if you turn over the page, as it says he was appointed to a three-month contract and during this period Orwell Consulting was paid for his services, as detailed on page 32. If you turn over to page 32, at the bottom there it says, "For the period 19 June 2009 to 18 September 2009"—which is a total of 92 days, or 66 days excluding the Saturdays and Sundays—"£149,500 was paid to Orwell Consulting Ltd for the services of Deepak Singh." Now, Orwell Consulting was formed at Companies House on 28 May 2009 and then Mr Singh left HMRC three weeks later on 19 June—his contract came to an end—and he was then re-engaged on a three-month contract and the payments were made to Orwell Consulting. So, in sum, he was given a three-year contract of about

<sup>2</sup> Aspire, as a partnership contract, is subject to action if they are in breach on any aspect of our live services delivery.

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£160,000 a year. It came to an end; just before it came to an end he formed a company and you then paid him a further £150,000 for three months' work. Why?

**Dame Lesley Strathie:** Basically to de-risk the implementation of MPPC 3 and to deliver a large commercial renegotiation of our contract with Aspire. **Mr Bacon:** Why was it necessary to pay him an annual rate of £600,000 when you had known three years previously in June 2006 that he in three years' time would have a contract that would expire? Why wasn't something done way ahead of time to make sure that his services could be retained without having to pay him the equivalent of £600,000 a year?

**Dame Lesley Strathie:** First of all, he was recruited on a fixed-term contract and roughly halfway through that fixed-term contract he was temporarily promoted to Director General and Chief Information Officer in HMRC. When I arrived in HMRC, we had a number of changes to directors general and one of the competitions was to find a new Chief Information Officer. Mr Singh applied for that job; he was unsuccessful; it was a fair and open competition with one of our commissioners.<sup>3</sup>

**Mr Bacon:** When are we talking about now? Are you talking about when he was appointed temporarily?

**Dame Lesley Strathie:** No, I am saying when I went to the market for a Chief Information Officer—

**Mr Bacon:** Which was when?

**Dame Lesley Strathie:** I think competition would probably have started around January 2009 and Mr Singh was not successful. The process probably took about three to four months to find the Chief Information Officer. He was unsuccessful and the person who was successful was on a six-month release contract, so I had—

**Mr Bacon:** But Mr Singh had been the acting Chief Information Officer and Director General from October 2007, hadn't he?

**Dame Lesley Strathie:** Yes. But he was unsuccessful in applying for the job on a permanent basis. He was temporarily promoted to that job, we—

**Mr Bacon:** You were paying him £160,000 for a year's work. Why was it necessary to pay him £150,000 for a further three months' work at the end of his contract?

**Dame Lesley Strathie:** Very simply, he knew he was not getting the job. He knew there was a new CIO coming. We had this massive programme to land; we had the commercial negotiation. He was not interested in another short-term contract on the same basis. This was fairly unique and we did it within our rules. The balance, for me, was between being left without a CIO for that period or asking Mr Singh to strike a deal to cover the three-month period from when the contract ended, which would cover my negotiation and reduction in the six-month contract for his successor.

**Mr Bacon:** I just can't understand if he was not good enough to hire for the job permanently, how he could have been worth paying this enormous sum of money to keep him temporarily—but that's just a comment. I have one further question. If you look back on page 30, you will see in the second column it says £19,200 and if you turn over, under "Benefits in kind", the last

sentence says, "Deepak Singh was provided with a benefit in kind relating to outplacement services."

**Dame Lesley Strathie:** Yes.

**Mr Bacon:** Now, what does "outplacement services" mean?

**Dame Lesley Strathie:** Well this was part of a personal package, and we do not normally talk about people, individuals in this detail in open forum, but as the numbers are there—Mr Singh had the choice of just simply leaving in June and we would have had no CIO. I had the choice, as did the rest of the panel, as to whether Mr Singh had the job or whether the most successful candidate and the best person to take HMRC forward had the job. We then have to manage a risk, and the risk was that we did not have anybody at the helm. One of my choices would have been to go to market to try to find an interim; it would not have been any cheaper and, secondly, we would have been starting from a very low knowledge base of complexity.

**Mr Bacon:** So sorry, but there are other people who want to get in and I still don't—what is the answer to my question?

**Dame Lesley Strathie:** But, in answering the question—

**Mr Bacon:** What are the outplacement services?

**Dame Lesley Strathie:** The individual deal that we had was that he would have opportunity and support to find his next job, either an internal—

**Mr Bacon:** So you spent £20,000 of public funds in helping him find alternative employment?

**Dame Lesley Strathie:** We spent £11,000—

**Mr Bacon:** Is that right? Just counselling on finding—

**Dame Lesley Strathie:** And the Department paid the tax on his benefits in kind.

**Mr Bacon:** Sorry, I am just trying to get clear in my own mind because you still have not answered my question. "Outplacement services" means employment counselling, help with finding a job from consultants who provide that sort of service. Is that what it means?

**Dame Lesley Strathie:** Yes. It means that, indeed.

**Mr Bacon:** Right. So the company was paid £20,000 to help him find another job.

**Dame Lesley Strathie:** Yes.

**Mr Bacon:** Okay. Extraordinary.

**Q85 Stephen Barclay:** The Senior Responsible Owner on the project—that was Bernadette Kenny, was it?

**Dame Lesley Strathie:** That was from the 2008 governance.

**Stephen Barclay:** So she was appointed when?

**Dame Lesley Strathie:** You mean appointed as SRO? **Stephen Barclay:** Yes. When was the SRO appointed on this?

**Dame Lesley Strathie:** Well, there was a previous SRO—we are talking about when the governance that you started off with was changed in 2008. My understanding is Mrs Kenny became an SRO at that point.

**Stephen Barclay:** Okay. And she is paid the same amount as the Prime Minister?

**Dame Lesley Strathie:** Is she?

<sup>3</sup> For clarity, this refers to the Civil Service Commissioners.



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**Stephen Barclay:** Salary-wise. Well, I assume so, but I am asking is that the case? £145,000?

**Dame Lesley Strathie:** Well, the—no.

**Stephen Barclay:** So she is—

**Dame Lesley Strathie:** Well, the payments in there include any bonus payments, not the salary. I would say Mrs Kenny's salary is considerably below the Prime Minister's.

**Stephen Barclay:** Okay, salary is listed here for Bernadette Kenny as £140–145,000, so what does it entail?

**Dame Lesley Strathie:** That includes any financial bonus, which is then in-year.

**Q86 Stephen Barclay:** Sure. You mentioned doing a review because no one has been held accountable to date. Clearly, from the evidence we have heard, lots of things have gone wrong, but no one has been held accountable. When did you start your review?

**Dame Lesley Strathie:** Probably, I think, around June<sup>4</sup>.

**Stephen Barclay:** June? So, you did not actually start the review until the NAO were bringing their Report out?

**Dame Lesley Strathie:** Sorry, I do not recognise that as a cause. Any organisation that has a problem of the size that we had in the coding review, the first priority is to work out what went wrong and how we are going to put it right, and how we are going to manage all our customers and stakeholders, and then to be very clear, "Well, why did this happen?" This is a vast piece of work.

**Q87 Stephen Barclay:** Sure. Dame Lesley, you mentioned earlier in your evidence that it is critical to restore confidence and one of the difficulties I have is just looking at previous PAC Reports where many of these themes are evident and, in fact, there is a previous PAC Report into the 2008–09 HMRC accounts that said that a clear priority was to address the backlog of cases requiring refunds by March 2011. Now, I assume from your evidence today that you are not going to hit that clear priority set by this Committee at an earlier hearing?

**Dame Lesley Strathie:** Well, we absolutely are prioritising anyone who has overpaid tax and that is an NAO recommendation.

**Stephen Barclay:** Sure, but are you going to meet that target set by an earlier Committee? You are not going to meet it are you?

**Dame Lesley Strathie:** We will absolutely not be through what I consider to be all of our legacy issues in PAYE until the end of 2012 on current plans. Those plans are not finalised at the moment: they are the subject of Spending Review; they are the subject of current advice to ministers. However, in terms of dealing with the last two years and going into next year's annual coding and the clearance of all of those legacy cases, it will take us to 2012.

**Q88 Stephen Barclay:** Sure. When did you realise that you were not going to meet the clear priorities set by an earlier PAC?

**Dame Lesley Strathie:** I think you will have to clarify for me exactly which priority that was and which number we are talking about.

**Stephen Barclay:** Okay. Let me rephrase it: where previous PACs have set clear objectives for the Department, do you keep track as an audit finding in terms of your delivery against those? Who within the Department is held accountable?

**Dame Lesley Strathie:** Well, I was not quite aware that this Committee set objectives for the Department, Mr Barclay. I think everything that we have or have not done in terms of any of your recommendations is documented, followed through and reported if we have not. If you go through every set of accounts, statement on internal control, you will see that we declare exactly where we are at each year and what we plan to do about it. So, I am not quite clear what you are driving at that you think we might not have told you.

**Stephen Barclay:** I am not suggesting you have not told us. What I am driving at is that these same issues have been identified in earlier Committees and recommendations made to the Department. Those recommendations have not been addressed and yet, in your evidence today, you say, "Well, we cannot hold anyone accountable for that because we have not concluded the review."

**Dame Lesley Strathie:** Well, I said it would be wrong for me to hold anybody accountable when the review has yet to complete, and it would be absolutely wrong for me to judge before anyone who has either been overtly criticised or where criticism is implied has not had the opportunity to respond to that. That is part of the review process.

**Q89 Stephen Barclay:** Yes, but you yourself are saying it is critical to restore confidence. This is a programme launched in 2005; it has been repeatedly delayed. Millions of people in this country have had the distress of getting tax demands and no one has been held accountable.

**Dame Lesley Strathie:** Well, first, nobody has had tax demands. We have only just started the programme of roll-out of the reconciliation. What people get is the assessment in the same way as they would have had it. We do not demand the money there and then for most people and, indeed, we have put in place arrangements for those over £2,000 to have up to three years to pay it back.

**Stephen Barclay:** That comes from a different—

**Dame Lesley Strathie:** So, it is an assessment. It is not a demand in all of these cases.

**Q90 Stephen Barclay:** Could I ask in a slightly different way then please, Dame Lesley? Has anyone been held accountable on this project to date?

**Dame Lesley Strathie:** Well, we have a Senior Responsible Owner. We have a Programme Board. All the stages in leading up to the implementation of the programme and how we have done it so far are managed by the Executive Committee from the governance of that Board and through the HMRC Board in terms of decision.

**Stephen Barclay:** Is that a yes or a no, please?

<sup>4</sup> The review was commissioned at the end of February, 2010

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**Dame Lesley Strathie:** So, the Senior Responsible Owner will ultimately be the accountable individual.

**Stephen Barclay:** But she is paid a salary commensurate with the Prime—

**Dame Lesley Strathie:** That is why we have a Senior Responsible Owner.

**Q91 Stephen Barclay:** I guess what I am driving at is the SRO is paid a salary commensurate with the Prime Minister and is still in post; the head of IT is being paid at the rate as set out by Mr Bacon; and none of the third parties, as you said earlier in your evidence, you intend to take action against, in terms of Capgemini and other IT suppliers. So, it is very clear, not just in the evidence of this Report, but in the evidence of previous PAC Reports that there have been failings and yet I am struggling to understand whether anyone has been held accountable. If the answer to that is no then it is helpful to have that.

**Dame Lesley Strathie:** I have said to you that we have focused on everything that has gone wrong today. We have not focused on the many achievements and the fact that this was a very high-risk programme and we have, for the first time now, actually the opportunity to reconcile on an individual basis in-year. But I still go back to what I say—

**Stephen Barclay:** But you yourself said assumptions were wrong and when you—

**Dame Lesley Strathie:** I am the principal accounting officer and, therefore, I am ultimately accountable. There is a Senior Responsible Owner and if there is criticism at the end of this then that is the ultimate accountability. There was a programme director who is no longer with us, so I am not for one minute saying nobody is accountable, Mr Barclay, I am just saying we are not at the end of a process yet.

**Q92 Matthew Hancock:** But can you confirm that the SRO got a bonus?

**Dame Lesley Strathie:** Yes.

**Matthew Hancock:** Right. So she got a bonus despite—

**Dame Lesley Strathie:** Can I also confirm that the SRO is the Director General for Personal Tax and that being the SRO for this programme is one of her responsibilities.

**Q93 Ian Swales:** Can I just follow on from what Mr Barclay is saying and, as I am sure you are well aware and concerned about, the staff surveys within HMRC have placed HMRC 96<sup>th</sup> out of 96 civil service organisations and, specifically, 95<sup>th</sup> on leadership and managing change. So, that is what the people inside the organisation think. What are you doing about that specifically?

**Dame Lesley Strathie:** We have actually spent the last year on a programme of work with relatively junior staff, but staff from right across the organisation, getting in underneath that. There are five core areas, but I would still say that of all of them, if we could manage change really well, our staff would forgive us an awful lot, and I think that the staff who are in the organisation have gone through a huge amount since the Department was formed.

**Q94 Ian Swales:** But it connects to what Mr Barclay was asking. You clearly have a culture that the staff themselves are saying is poor on leadership and managing change. So, are careers being changed as a result of this? Are people being moved out? You obviously have a systemic problem.

**Dame Lesley Strathie:** Well, as we have already said, a lot of people have already gone from the organisation. We have been working on the deal that we want to strike going forward. In fact, if I were not here I would be dealing with our proposition for that at my Executive Committee this morning. I sat down with the Board and around 100 of our staff in Birmingham last week on a series of visits, and the biggest morale issue for people is the lack of progression. If you feel that because the organisation is constantly downsizing that there is no opportunity to progress, and then if you look upwards and you feel that you could do the job better than somebody else there, it is terribly demotivating. People have talked about morale and people have talked about engagement for a long time, but the issue is, my people tell me they want to have more power over their work; they want to be in a position where they can make progress, and that is going to take quite a bit of change over the next few years.

**Q95 Nick Smith:** A very quick question—a specific question on underpaid tax. Now, you decided to raise the threshold for not collecting underpaid tax from £50 to £300. I am interested in why you did take this decision because it affects, I understand, about 900,000 people. Can you tell us a bit more about that please?

**Dame Lesley Strathie:** Yes. Do you want to answer this one?

**Sarah Walker:** Yes, I think we realised that because we had two years' worth of reconciliations to do in one go, that would involve a much larger number of customers than we would otherwise have expected. We knew we were going to have to do that work in a relatively compressed period of time. We were concerned that we ought to be able to give people the right level of service: if they had enquiries they tried to phone us up; if they wrote to us, we needed to respond to their letters. Therefore, we were concerned that we could keep those volumes to a manageable level. We, therefore, looked at the trade-off between the numbers of cases and the size of those cases in monetary terms, and we realised that by setting a tolerance of £300 we could reduce the volume by around 40%, but the yield by about 8%. We thought that trade-off was reasonable and it would then allow us to continue to provide a good service to customers.

**Q96 Nick Smith:** How long is it going to stay at that number or is it going to come down? You did talk about it being temporary earlier on.

**Dame Lesley Strathie:** Yes, it is temporary. What we are working through at the moment—and advising Ministers about—is getting to a point where we know more about the open cases—the 17.9 million that are declared in the accounts; what we learned from the concessions that were given on a cost/benefit basis from this exercise, and could any of that apply when

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we go through the automated solution that we are hoping to bring for that? So, it is temporary until we get through this exercise, but it is important that we learn from that.

**Q97 Nick Smith:** And is there learning that is going to stay at that level or might it go up, or do you think it will come down?

**Dame Lesley Strathie:** Oh, no. I think it will come back to £50, but in terms of the programme of work through to 2012, we would want to look on the same basis as the open cases of identifying where we have overpayments of tax, and then prioritising any underpayment and looking at whether there are concessions, because the timeframe from the concession we talked about earlier will be another issue that we need to address on that. How many people, if they challenged, would actually have that remitted anyway?

**Q98 Chair:** We have not dealt with the 18 million pre 2008–09. It is one of the issues we need to come back to, but just a very quick yes or no and then the final one from Richard. What you are saying is the £300 limit will extend to the 18 million?

**Dame Lesley Strathie:** No, what we are saying is at the moment it only applies to this reconciliation exercise, but when we have more detail of what is in the 17.9 million—

**Chair:** It might?

**Dame Lesley Strathie:**—we will take everything we learned here and we will advise Ministers what we think is right.

**Q99 Chair:** I just want to get a yes or no on this. If you get staff cuts in the CSR, your commitment to deal with the 18 million pre 2008–09 cases will not be met by 2012. Is that yes or no?

**Dame Lesley Strathie:** No.

**Chair:** It will not be met?

**Dame Lesley Strathie:** It will not be because we are basing it on our current plans, and I keep going back to the fact that we are developing, and we think we have an automated solution for this, but we actually want to run them through a clone of the system, know exactly what is in it and then move on. But, as I said earlier, we want in all of our planning to protect PAYE

to do this. If we cannot protect PAYE, we cannot deliver.

**Chair:** Richard wants to ask you one more question.

**Q100 Mr Bacon:** Dame Lesley, I am keen to understand the timeline and the chronology of the head of the IT function because it looks to me like you, for a significant chunk of this period, did not have a permanent head of IT. Mr Singh, you said, was an acting Director General; he applied for the job eventually and did not get it. I remember Steve Lamey being Chief Information Officer some years ago. I notice he is still a member of the Board and, indeed, he has been a witness at this Committee some years ago. Could you send us a chronology showing a comprehensive timeline over the last 10 years of the person who was appointed head of the IT function, whether he was described as Director General or whether he was described as Chief Information Officer or whether he was both, or whether there were two people, and whether the person holding that function was acting or permanent, so we have a comprehensive history going back from the year 2000 to date. Can you do that?

**Dame Lesley Strathie:** Well, I can give you back to 2005–06 for HMRC because that is when it was formed.

**Mr Bacon:** All right.

**Dame Lesley Strathie:** We could do our best to go back to the two legacy or several legacy organisations because the—

**Mr Bacon:** If you could show us the prior years, it would be nice to see a narrative over 10 years and then what happened at merger and then after merger.

**Dame Lesley Strathie:** Yes.

**Chair:** Thank you very much. We are going to draw this session to close. We hope that you will be able to come back pretty soon. It will be really helpful to have the SRO in charge of this present next time, and there are some other issues that we will wish to cover. So, many thanks for the evidence you have given us this morning and I hope we can find a mutually convenient date soon. Thank you very much indeed.

**Dame Lesley Strathie:** Thank you very much, Chair. Thank you.<sup>5</sup>

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<sup>5</sup> Questions 101–103 were held in private.

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## Tuesday 16 November 2010

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon  
Stephen Barclay  
Stella Creasy  
Jackie Doyle-Price  
Matthew Hancock  
Chris Heaton-Harris

Joseph Johnson  
Mrs Anne McGuire  
Nick Smith  
Ian Swales  
James Wharton

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**Amyas Morse**, Comptroller and Auditor General, **Gabrielle Cohen**, Assistant Auditor General, **John Thorpe**, Director, National Audit Office.

### Examination of Witnesses

*Witnesses:* **Dame Lesley Strathie**, Permanent Secretary and Chief Executive, **Jon Fundrey**, Financial Controller, H M Revenue and Customs, HM Revenue and Customs, , and **Sarah Walker**, Director PSN, HM Revenue and Customs gave evidence.

**Q103 Chair:** Apologies to people who have been squashed in over there. We were just saying that we need a bigger room. This is where the Public Accounts Committee has always met so we shall have to have a think about that.

Thank you very much for returning for a second session. At the last session—if we can go straight in—you said that there were 18 million cases where you hadn't reconciled from 04–05 to 07–08. The estimate of the outstanding moneys owed to the taxpayer out of those 18 million was £1.4 billion. Last Friday, you wrote to me saying that you had, in effect, written off three out of those four years. What's the estimated loss to the taxpayer?

**Dame Lesley Strathie:** First, it is important to remember that the figure of £1.4 billion and the 17.9 million open cases is our best estimate of the notion of collectable revenue at that point. It is not revenue that has been brought to account. It is impossible to know accurately what is in those cases until they are actually worked.

**Chair:** I think we all accept it's an estimate.

**Dame Lesley Strathie:** It is an estimate, but it is important because it is estimated at a point. The ability to collect deteriorates rapidly every day thereafter. As far as we're concerned, what I've just written to you about concerns 06–07 because the law changed in the Finance Act 2008. That means that the 06–07 cases are time-bound when we get to April 2011. In order to have an enforceable debt, we would have to work the cases and have that debt in play, which really means that, by mid-November, we have had no realistic opportunity of doing so, or the cost of trying to collect that money would outweigh doing so. As far as 06–07 is concerned, we estimate that if we had been able to work those cases in April, around £100 million of revenue might have been collected. We estimate now that were we to try to work those cases, within any time at all, the notional revenue forgone would be £25 million.

**Q104 Chair:** £500 million?

**Dame Lesley Strathie:** £25 million.

**Q105 Chair:** Hang on a minute. Can I just take you through some of these figures? There is quite a lot I would like to come back to on that. First, you may have estimated that you could only get £100 million, but what was said last week was that your estimate of the revenue that ought to have been paid over 06–07 was £500 million. Is that right?

**Dame Lesley Strathie:** £500 million is the notional revenue, if we had been able to work it at that time back in 06–07.

**Q106 Chair:** So, £500 million is the notional amount, which is a lot of money. What you haven't told us about is 04–05 and 05–06. What was the estimated loss to the taxpayer? I understand all the stuff about it being estimates.

**Dame Lesley Strathie:** £150 million.

**Q107 Chair:** So we have so far lost to the taxpayer, £650 million potential. Is that a yes or no?

**Dame Lesley Strathie:** Potential, from this strand of work, yes.

**Q108 Chair:** Can I also ask you why you didn't tell us at the hearing in October that you would not be able to pursue 04–05 and 05–06? You knew the details of the Finance Act 2008 then. It was clear in October that we had already run out of the four-year time frame for those two financial years. Why did you lead us to believe in the October hearing that there was still a potential for pursuing those debts, or those underpayments?

**Dame Lesley Strathie:** There are two issues here. First—I am not trying to be clever here—we did not actually have the hearing that we came to have. It was indeed I, at the end of the hearing, who drew your attention to the open cases, because they are a statement of public record and have been in every set of accounts since the Department was formed. I was drawing attention to the fact, in response to a question on another matter to do with reconciliation, when one of the Committee Members said, "So when you've done this, that's it up to date", that in fact we still had this huge legacy.

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The earlier years you are referring to effectively went out of date in terms of potential underpayments when the Finance Act 2008 came in.

**Q109 Chair:** I understand that, which is why the question is why on earth were we ever led to believe something, in both the NAO Report and in the last session? I certainly sat here thinking there were 18 million people who could have underpaid from '04 through to '08 and you were going to pursue them by 2012. Why did you lead us to believe that when we all knew the Finance Act 2008 was in?

**Dame Lesley Strathie:** I don't think I did lead you to believe that. I was required when I did the accounts and laid them, to categorise all that we had, because we hadn't been through any formal clearance process of those cases. We still have to go through them to identify anyone who has overpaid, and that is what we intend to do.

**Q110 Chair:** I understand all that, but did you know at the last hearing that because we had run out of time we would not be pursuing the 04–05, 05–06? Did you know that?

**Dame Lesley Strathie:** Did I know that we had to have an enforceable debt in place, that realistically the last point for doing that would be around mid-November, and that the cost of pursuing of them would outweigh it? No, I did not.

**Q111 Matthew Hancock:** That is for 06–07. What about for 04–05 and 05–06?

**Dame Lesley Strathie:** Those were regarded, in relation to any underpayment.

**Q112 Matthew Hancock:** I understand that it is important to make sure that we still give overpayments back, but were underpayments still being pursued?

**Chair:** They couldn't.

**Q113 Matthew Hancock:** At the last hearing, you gave the impression that underpayments were still being pursued from those two years, 04–05 and 05–06. Did you know at the time that they couldn't be pursued?

**Dame Lesley Strathie:** No. I did not and I do not think that that is what I explained either. I was very clear that we had cases numbered for each of the years. I was clear that when the previous Government made the decision to introduce that change and bring us into line with other tax authorities, it was recognised that we would be forgoing the potential underpayments for those years. Given that I was not part of the history of this at the time, I wasn't conscious of all the detail, as we worked through the legacy of these open cases to understand what's in them, I understood then that we don't have any potential for underpayments in those years. We will still work those cases when we have the solution to find anybody whom we owe money to.

**Q114 Matthew Hancock:** So when did that specific detail come to your attention?

**Dame Lesley Strathie:** Probably about two to three weeks ago.

**Q115 Chair:** Perhaps Sarah Walker or one of you should have known, and we should have been told, that 04–05 and 05–06 were uncollectable under the Finance Act 2008. I think that is the point that we are making. We are disappointed that that was not made clear to us in evidence. I accept that you might not have known—should you have done? Somebody on the table answering questions to the Committee should have told us that.

**Dame Lesley Strathie:** I absolutely accept that we should have known. I would also accept that, when the law was changed and the impact changed, we should have advised the Committee of that.

**Q116 Chair:** Can we go to 06–07? Last Thursday or Friday, you wrote to me writing that off. You knew that that was under constraints of time. If you had started work on trying to pursue the people who have underpaid, even as late as June of this year—a few months ago—you might have saved the taxpayer at least £100 million, if not more, given that the total estimated underpayment is £500 million.

**Dame Lesley Strathie:** Absolutely, but I implore the Committee to put this in the context of the choices that HMRC has to make in where it deploys its resources against maximising revenue and reducing risk. While we have had to introduce the new system, and while we have had to deal with all the legacy issues, it is important to note those numbers in the context of the £435 billion that we collected and also to note that, in the same time that we forwent that and used our resources on intervention yield, we actually moved from £7 billion to £11 billion in intervention yield. So it is a resource deployment issue.

**Q117 Chair:** This is all well and good. I was just thinking as you were replying that my last ministerial job was in the Department for Culture, Media and Sport, and £500 million in that Department would have made a fantastic difference to the arts organisations, and even £100 million would have made an incredible difference, and Government would have forgone an estimated £500 million or, on your more conservative estimate, £100 million. I just think that somewhere in your massive system of officials somebody should have said, in June, "Hang on a minute. We've got the Finance Act. We've got to start pursuing the 06–07 underpayers quickly to get that money into Government."

**Dame Lesley Strathie:** I absolutely accept that it's a big number. Our job is to maximise the receipts for the Revenue, but I still say that even if we had had those choices—bearing in mind we would have had to work these cases manually, because we are reconciling the later years—we would have had to take people off debt collection and intervention yield, and, as I say, during this same period, through from 05–06 onwards, we have actually increased that by £4 billion. So, £500 million is a big number and £100 million is a big number, but, taking your example of your previous Department, £4 billion would be a big

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number for the Government not to have on their receipts.

**Q118 Matthew Hancock:** Can I come back on this resource question? If you didn't know that you couldn't collect from 04–05 and 05–06, would you not have put fewer resources into trying to collect from 04–05 and 05–06?

**Dame Lesley Strathie:** I would always put my resources into trying to collect the most current money, because that is the greatest return for the Revenue.

**Q119 Matthew Hancock:** So how many resources did you direct at trying to collect from 04–05 and 05–06 during the period that you did not know that it was not possible?

**Dame Lesley Strathie:** None.

**Q120 Matthew Hancock:** Good. Just one final thing, you were told only two to three weeks ago that it's not possible for HMRC to collect from 04–05 and 05–06. Who should have told you?

**Dame Lesley Strathie:** Any number of people.

**Q121 Matthew Hancock:** Who is responsible for that? Who reports to you? Who should have told you that?

**Dame Lesley Strathie:** The Director General for personal tax is the next in the line of accountability to me. There is the Permanent Secretary for Tax, who is my second permanent secretary. We have a central policy function, which maps those changes over a period of time. There are any number of people who should and could have known, and we are very conscious of that. The personal tax part of the business had a plan at the start of the year for working those cases. When we hit the reconciliation exercise, we absolutely had to sort that out and we had to deploy our efforts towards it. I think it is fair to say that somebody lost sight of that somewhere in the window between dealing with the annual coding exercise and my determination to clear all of those cases by 2012. We have started to work through the content of those cases.

**Q122 Ian Swales:** There is a real question about how in touch the management are with the ground. This is a transcript of a teleconference between you and your own staff on 21 October: "Our AOs here have been reviewing cases for the years 2004–05 since June." Another comment: "If the cases for 2005–06 don't count because the number of years that we can now review has reduced from six to four, why are we spending so much resource looking at them, when we could perhaps be dealing with more customer correspondence?" Those are from your own staff to you just a few weeks ago. So even your own staff are asking what's going on.

**Dame Lesley Strathie:** That is a perfect example of the ability that staff have in the organisation to raise such issues. We did act on the back of that. We have 1,000 telephone lines open every month for the staff to ring me and the rest of the executive team to raise those very issues. We were following three NAO

recommendations, and I feel very strongly that if people have overpaid tax, they deserve it back. We have people in various parts of the organisation working on such cases. It was that telephone call, and another issue when the board visited a number of our sites in Birmingham, that prompted us to look at the translation of what we were asking people to do versus what was happening on the ground.

**Q123 Chair:** It is absolutely vital that people who have overpaid get their money back, but, equally, people who have underpaid are either going to cost the taxpayer more, because we are going to have to get the revenue from somewhere else, or services will suffer, because there is less money to spend on them. Both sides of that equation matter.

**Dame Lesley Strathie:** I accept that, Chair. I still go back to my point that that is a notional amount of money. It is not an amount of money that could ever stand an accountancy test, or come on to our balance sheet and, therefore, be written off. That is quite important.

**Q124 Ian Swales:** My next question is about the write-offs. When the original Report was published, *The Observer* stated that £40 billion had been written off in the past five years. Is that a number that you recognise, £40 billion in tax? The description was, "£40bn it had expected to collect during the past five years."

**Dame Lesley Strathie:** I think that the article refers to the tax gap figure. Without the article, I don't know, but the only figure that I recognise for that is our tax gap estimates, which we have published.

**Chair:** Your colleague has something.

**Jon Fundrey:** In the trust statement for last year, the number given for losses was £6.4 billion.

**Q125 Ian Swales:** That is one year. This £40 billion is over a period of five years, but you are saying that £6.4 billion is for one year.

**Jon Fundrey:** It was £6.4 billion last year, and £4.6 billion the previous year. I don't have the data available for the previous three years for a five-year history.

**Q126 Ian Swales:** I think we established at the previous hearing that both of those figures are more than your entire costs for people and administration, so what do you say to the Chartered Institute of Taxation, which blames all this on repeated staffing cuts? Are you satisfied that you are managing your staff numbers appropriately given the scale of those problems?

**Jon Fundrey:** There is an underlying reason for those particular cases. Last year, for example, we undertook an exercise to look at MTIC fraud, and a reasonable proportion is specifically attributable to that. There is also a general background. Some 90% is due to company insolvencies, and in such cases we cannot pursue the debt any further. I think that those are the underlying factors for that loss figure, rather than the staffing issue.

**Dame Lesley Strathie:** Could I also respond? It is the tax gap. We have got to remember that the tax gap is

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the best estimate and we have a strong record in this country. Not every tax authority measures its tax gap. This is the difference between the tax that the policy was designed to deliver and the tax that flows in. That includes all fraud, evasion, organised criminals and everyone who does not pay their tax through evasion or avoidance.

**Q127 Ian Swales:** That is the figure that is £40 billion each year, isn't it?

**Dame Lesley Strathie:** We publish figures when we believe that they are robust enough to be published. The gap was published at £42 billion and then revised to £38 billion, before increasing by £2 billion to £40 billion. Those are the numbers over the last couple of years.

**Q128 Mrs McGuire:** I am frankly astonished that nobody in the Treasury was keeping an eye on the legislative process and the changes that were made to the back-claiming of tax, given that the Inland Revenue, when the boot is on the other foot, will say to an individual taxpayer that ignorance of the regulations is no excuse for underpayment. I have certainly had constituency cases in which quite deep regulations have not been fully understood. What are you now doing to ensure that HMRC looks at legislation that is passing through? I cannot get my head around the fact that a piece of legislation was passed, called the Finance Act, which obviously impacted to a certain extent, if not to a great extent, on HMRC, and nobody clocked the bit about the change in the regulations.

**Dame Lesley Strathie:** If I have given that impression, I must correct it, Mrs McGuire. We knew that the Finance Act had changed our ability to do underpayments from six to four years, and brought the taxes in line. The bit that failed in our system was to recognise that the deadline we were working to was not April '11, but realistically November '10. The fact is that you have to have an enforceable debt in place, and that takes more than three months, depending on the response from the customer. It wasn't that we didn't know the change, but that we didn't understand that we ran out of road in mid-November.

**Q129 Chair:** Hang on a minute, let's be clear. November '10 is just for 06–07. For 04–06, you'd run out.

**Dame Lesley Strathie:** The Finance Act was done knowing that those years were gone. There was no desire to mislead, but simply a recognition that that was in history. We have always declared what is in the system. We would still have to work those cases to find overpayments.

**Q130 Mrs McGuire:** But that is almost as bad as not knowing, because you didn't then make a realistic assessment of the impact of that change. To put it in your phrase, you would run out of road by November.

**Dame Lesley Strathie:** No, I think when Ministers made the decision to change the law and understood what would be the notional foregone figure for the earlier years, they had every right to expect HMRC to deal with the 06–07 cases. Indeed, there was a plan to

work and prioritise the highest value cases. Resources were then diverted to the P2 issue. We owe it to be clear on the record about Ministers' expectations of HMRC at the time when they made that change. We failed to deliver on those.

**Q131 Mrs McGuire:** Right. Can I then take us on to 2007–08? What is your best estimate of how much of that tax overpayment will now be recovered?

**Sarah Walker:** We don't have a figure yet. We need to work out how we can prioritise the highest value cases and work them on the basis of the best value for money. We are also in the process of discussing with our suppliers an IT solution that will allow us automatically to sort, identify and crystallise the amounts owing, and then put them into tax codes where we can. It is too early to say how much of the 07–08 money we will be able to collect.

**Q132 Mrs McGuire:** So when will you run out of road for 07–08?

**Sarah Walker:** This time next year.

**Mrs McGuire:** So we have a full year for you to do all those things.

**Q133 Ian Swales:** Is that achievable?

**Dame Lesley Strathie:** We have to understand that we have all these years of legacy issues. We haven't made decisions, and the commissioners haven't taken any decision, on 07–08. We will have to take decisions and ask Ministers to support them. I say that because we genuinely haven't worked through. There is much more notional revenue in those cases and clearly more opportunity to collect, but we have to look at fairness and at the concessions that we have allowed in the 08–09 and 09–10 reconciliation exercise. We raised the threshold for PAYE from £50 to £300. We then have the ECS A19 concessions, according to which, if HMRC had all the information somewhere in its system but failed to deal with it, people can legally challenge whether they pay the debt. We now know what happened in each of those earlier years and what we are doing in the future years, and we have 07–08 in between.

**Q134 Chair:** Just to be clear, the estimate is £900 million, which is nearly £1 billion. Given all that, are you telling us that it is likely to be well under 50% of that?

**Dame Lesley Strathie:** I am telling you that I don't know the answer, but when looking at deploying resource to get the best return, it is always going to be in the most current cases, because that is where you bring it to account. When we consider 07–08, we will consider how much resource it will take to get how much revenue.

**Q135 Chair:** Well let me just put this to you: in 06–07 the original figure was £500 million, of which you said £100 million was possibly collectable, and £25 million was what you got in. If you take that forward into 07–08, £1 billion will end up probably with not more than £50 million. Is that right?

**Dame Lesley Strathie:** It's absolutely possible, but it depends on what is in the cases and on their value. If

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the analysis showed that the average debt was well above £300, we would work out the returns we would get from that. If we do not give any concessions for that year, in the way we have done with others, that will lead to a different result. I am saying that 07–08 is the last of the legacy years that we have to tackle. We have already diverted resource to that and have prioritised it to the highest value.

**Q136 Ian Swales:** I will quote figures from the original Report—I know that it is now out of date. Page R20 states that, “early analysis by the Department suggests that around half of all these cases are likely to involve an over or underpayment of tax and in aggregate these may lead to repayments and recoveries of the order of £3.0 billion and £1.4 billion respectively.” Some £0.4 billion seems to have gone already. I suppose my question is a straightforward business one: if there is £1 billion out there to be collected, how much would it cost to go and collect it? It is very simple. Some £1 billion of public money is waiting to be collected, and you are saying that it is more important that people do PAYE coding or something like that. Doesn’t it seem that we should be going for it, and if it takes temporary resource or systems or whatever, why wouldn’t we do that?

**Dame Lesley Strathie:** I don’t accept that there is £1 billion to go and collect, which is the whole premise. We never know what is in a case until it has been worked. All the numbers in our analysis are based on our best sampling, supported by HMRC and Treasury analysts. The NAO has agreed that, although not perfect, it is the best we have got. As I have already pointed out, the older a debt is, the less chance there is that it will ever be collected, as people just became uncontactable. I cannot accept that that is anything more than a notional sum at this time.

**Q137 Ian Swales:** This is something that’s baffled me since the first hearing, thinking about it.

If you’re doing the work to establish an overpayment, you must be getting to the point in a case where you know what a number is for that person. I would have thought that if you sent a letter at that point to somebody saying, “You owe us £100,” you’d actually get most of it, and it would only take a letter. How difficult can it be to collect a certain slice, anyway, of the money that’s outstanding? You make it sound like some enormous task, whereas we’re talking about PAYE differences of probably a few hundred pounds, in many cases. Okay, yes, some people would have moved, but a lot wouldn’t. They’ll still be in the same jobs, and they’ll still have the same tax codes. How hard can it be to at least get some of it?

**Sarah Walker:** These cases are quite difficult to work. By definition, these are the cases that were left over after we’d done the normal processing in these past years, so you do have to do additional work in order to establish—

**Q138 Ian Swales:** But my point is, aren’t you doing that work anyway in order to establish if they’ve overpaid? How can you know until you do the work?

**Sarah Walker:** No. We’re able to do some computer analysis that will separate out the cases that are likely to be overpaid or underpaid.

**Q139 Chair:** So you’re not prioritising underpayment cases in 2007–08? Are you not prioritising them?

**Sarah Walker:** Within underpayment cases, yes, we are.

**Q140 Chair:** You’ve written it all off before. We’re now at 2007–08, which Anne has moved us to. If there is nearly £1 billion estimated income to come out of those 2007–08 cases, wouldn’t it be logical in that year to prioritise underpayment?

**Sarah Walker:** We have a commitment that we will—

**Q141 Chair:** Are you prioritising underpayment?

**Sarah Walker:** We are not prioritising underpayments over overpayments at the moment, though we—

**Q142 Chair:** Are you prioritising overpayments over underpayments in 2007–08?

**Sarah Walker:** We are working both at the moment.

**Q143 Stella Creasy:** I am trying to get my head around your business model and how you’re dealing with these cases, because it feels to me like that’s one of the issues here. Can I start by asking you what analysis you’ve done on the return on investment of each member of staff on the amount that you can recover?

**Dame Lesley Strathie:** On the specific area—

**Q144 Stella Creasy:** You’ve made a lot of talk about it. I understand that you have a limited number of people, and that therefore you have to, as you’re saying, deploy resources. What work have you done on the return on investment of deploying a member of staff to the recovery that you can do?

**Sarah Walker:** We understand that it costs a lot more, in terms of staff costs, to work an older case than it does to work a current case.

**Q145 Stella Creasy:** No, in terms of this type of work. You’ve talked about the trade-off. You mentioned debt collection and intervention work. What work have you done on the return between moving people to do this kind of work?

**Sarah Walker:** The return on this kind of work is a lot lower than the intervention yield or debt collection, because you’ve got to work through a lot of cases in order to find the ones that—

**Q146 Stella Creasy:** Okay. How does that compare with the amount of money that you could recover if you were to put people into this work? If we’re talking about there being up to £1 billion of money to recover, what’s the analysis you’ve done of the cost of, as Ian has mentioned, bringing in temporary people to work on this, in comparison to the work you can do on debt collection? If you’ve made that trade-off internally between different forms of collection, what about the different costs to the taxpayer of the money that you don’t collect? What work have you done on that?



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*Sarah Walker:* I'm not sure I've understood. I think it's the same—

**Q147 Stella Creasy:** There's a return on investment on the number of people you put into this work, yes?

*Dame Lesley Strathie:* We have done that work. I can't lay my hands on the figures at the moment, but we have done the work in terms of what the intervention yield is per person in our compliance effort plus the intervention yield on our debt. If we were to move the resource now to work all these cases manually, given what I've said about notional through to what's actually collected, we would lose considerably more for the Exchequer while we worked on these cases. What we are hoping to do, when we have the technical solution, is to be able to put all the cases through and immediately know the priority order and get them into codes for the next—

**Q148 Stella Creasy:** So that would imply that it would actually cost you £1 billion in staffing to recoup £1 billion?

*Dame Lesley Strathie:* We'll never recoup £1 billion. I keep saying that. That is just not a figure that is ever going to materialise into returns for the Exchequer, because of the concessions that are already there. If HMRC had all the information and has not used it, the customer has a right to challenge us—

**Q149 Stella Creasy:** I appreciate that, but how can you have done that sum? How can you have worked out that it is not in the taxpayer's interest to prioritise other forms of debt intervention if you don't have an accurate figure for the amount that you can recoup?

*Dame Lesley Strathie:* We have done the work from a notional sum. If everything had been perfect at the time and everybody had paid their tax at the time, I can work that bit by bit through the organisation to see what the returns are. That is how we arrived at the £25 million from the £500 million, and we need to do the same for each. You have to take when an assessment is made, when it is brought to fruition, how much is not and our ability to do these things.

**Q150 Stella Creasy:** So you're saying that out of all the figures that are being bandied around, even if you had the staff, you could recover only £25 million?

*Dame Lesley Strathie:* For 06–07, yes.

**Q151 Ian Swales:** Why don't you talk about the rules that are in place. One of them you decided yourself in order to make life easier. You cut the number of cases from 1.9 million to half a million by introducing this £300 tolerance—by going from £50 to £300. According to your letter, "The number of underpayment cases was 1.92 million."

*Dame Lesley Strathie:* For 06–07.

**Ian Swales:** Yes, for 06–07. The letter continues, "If we applied the same £300 tolerance, we estimate the number of underpayments would fall to less than half a million." That's 1.5 million people you've taken out of the system because of a rule that you've put in yourself. You say that that money can't be recovered, but it's your own rule that's making it unrecoverable to make life easier, isn't it? Am I right?

*Dame Lesley Strathie:* There is the cost of administration and collection. If you recall, Ministers asked us in the reconciliation exercise to raise that threshold. At one time, the threshold was much higher than £50. It then went back to £50. We had to raise it to £300 for the purposes of that exercise, because of all that we had to get through and on a value-for-money basis. We were then asked—by this Committee as well as by the Treasury Committee—to look at applying the same tolerances. We should bear in mind the fairness of people who thought their tax was reconciled a long time ago suddenly having those bills, and that was my point about 07–08.

**Q152 Matthew Hancock:** Can I try asking Stella's question a different way round? Do you think, on the current arrangements, that you will maximise the net tax take—net of costs—given the existing tax structure?

*Dame Lesley Strathie:* Sorry, are we talking about 06–07?

**Matthew Hancock:** I am talking about 07–08 and all the back payments. You have the gross costs, and there are taxpayers' gross outstanding liabilities to you. Do you think that the current structures and the number of employees, for example, maximise the net tax take—net of the cost of collection?

*Dame Lesley Strathie:* For the legacy years?

**Matthew Hancock:** Yes. The legacy years right up to last year.

*Dame Lesley Strathie:* I am still not clear. I am clear about all the figures that I have given you for 06–07 and the earlier years. I am clear that for 07–08, our notional numbers are much greater, and we are in slightly earlier terrain.

**Q153 Matthew Hancock:** Your notional what are much greater?

*Dame Lesley Strathie:* The notional revenue is much greater than the—

**Q154 Matthew Hancock:** But I am asking about the interaction between your resources and the tax out there that is owed to the public purse. Given the management difficulties, lags and what have you, I would have thought that it would be reasonable to try to get to a position where, if you hired one more person and put them into the programme, you would not get any more net tax after cost. So long as there is stuff out there that it costs less to collect than you get from collecting it, you should be putting more resource into it. I was asking about the net tax take.

*Dame Lesley Strathie:* For example, I have seen many cases myself, where people were working on them only to discover that the debt was £3.

**Q155 Matthew Hancock:** Exactly. That is a net cost, but an anecdote is no answer, because you have to average things out over all the cases. Do you think that you have put the right amount of resources in to maximise the net tax take from this process.

*Dame Lesley Strathie:* I believe that if we take more resources and work all of these manually, and we now move significant resource into that work—

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**Q156 Matthew Hancock:** What about marginal resource? One more resource?

**Dame Lesley Strathie:** No. One more is not going to make very much difference at all.

I am convinced that if we took our staff from elsewhere in the organisation, then we would clearly maximise the return on 07–08. What we would put in jeopardy is maximising the return from much more current work and from much higher dividends.

**Q157 Stephen Barclay:** Just on that 07–08 figure, Dame Lesley, how much are you spending on staff to collect that figure? I appreciate that you would not actually get the billion pounds even if you had unlimited staff going after it, but how much are you spending on staff to go after that 07–08 figure?

**Q158 Chair:** Or how many people?

**Dame Lesley Strathie:** At the moment, we have 250 people working these cases, plus we are working overtime on the cases.

**Q159 Stephen Barclay:** How much are they costing—as a ballpark figure?

**Dame Lesley Strathie:** I can't give you it.

**Q160 Stephen Barclay:** Because I think that what is coming from these questions is how much are we spending? We have 12 months left, before the cut-off deadline for going after that money, which is anything up to a billion; obviously, in practice significantly less will be realised. But in order to go after that money, how much are we actually spending up front over the next 12 months?

**Dame Lesley Strathie:** I can tell you that we had 750 resources allocated to this work at the start of the year. We had to divert 500 of those to work on the annual coding notice, which we had to do before we could reconcile, and we have had 250 plus overtime working on the 07–08 figure.

As I say, I do have the numbers on the staff. This is not unskilled work, so we actually looked at recruiting more people to go on it. But we can only use the resources once and if we take them from higher-value work, the return to the Exchequer will be much lower.

**Q161 Chair:** Can we move it on a bit, because otherwise we will get stuck on this? I think it would be helpful, Lesley, if we had a note from you on the number of people in or the amount of money in, and the anticipated tax take-out.

Can I move you on, because the reason that you had to move people off was that the IT system failed you? So, as I understand it, in the CSR you were given another £100 million to do further modifications to the software. Is that right?

**Dame Lesley Strathie:** No. That's for real-time information.

**Q162 Chair:** So, is the software—let's leave real-time information aside, because we'll get muddled otherwise—now in a fit state to deliver what you wanted of it?

**Dame Lesley Strathie:** Can I just be clear that our issues with the annual coding notice are much more to

do with the quality of data going through the system, bearing in mind that we had 12 regional systems and 12 separate databases? Yes, there are software problems and, yes, we are improving our software all the time, but that is not the main issue in the coding notice.

One issue was that the standard or bar was so high that the level of rejection and duplication caused us issues. So, I use the analogy of a motorway. If you think of lorries or cars coming on to it, the real benefits from the new NPS system is automation. So, we have all the feed-in from employers, payroll providers, customers, others and agencies, and you want to automate as much of that as possible, rather than it all having to be manually worked. At the moment, we have to park that information in lay-bys, while we consider if it is right to go through the system for total automation or if there is more that needs to be done to it. So that is the approach—we know that the annual cycle and all the business events for PAYE mean you have a very defined period in which you can do it.

**Q163 Chair:** So when will the data be accurate? When? What time frame are you working to on that?

**Dame Lesley Strathie:** We have done about 75% of legacy data, but what I need to make clear is that we can clean up everybody's record and there is now an individual tax record for everybody, whereas we worked in the past on an employer basis, but we rely on everybody to give us the correct information.

**Q164 Chair:** When is your bit of it correct? Obviously you rely on people, so when are you clear that your data systems—

**Dame Lesley Strathie:** I will only regard it as up to date and where we would want to be by 2012 when we have gone through all of the history and all of the business events for PAYE reconciliation, and tackled our legacy open cases.

**Q165 Chair:** Your accuracy rate in 09–10 meant that one in 20 accounts were wrong. In 10–11, are we still going to see one in 20 being wrong?

**Dame Lesley Strathie:** Absolutely not, as far as history is concerned. This is an enormous undertaking. Those databases have been there since 1985.

**Q166 Chair:** So what will the accuracy level be for 10–11, do you reckon?

**Dame Lesley Strathie:** I reckon that we should be well up into the 90s in terms of what we hold in our systems, but this relies on every employer and everybody who works for an employer giving us accurate information. We have to develop in the system an intervention that deals with errors, and I would say that historically HMRC and the Inland Revenue have been very tolerant of the quality of information that comes into the system. Under this system we need to work with 4.5 million businesses and payroll providers to get better standards.

**Q167 Chair:** The only point I would make is that one in 20 is not a tolerable level. What you are really saying to us is that by 2012 you might reach a

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tolerable level. From your point of view, I think this should be 100%. Any bank would expect it to be 100%.

**Dame Lesley Strathie:** One thing I would not like us to lose sight of here is the customer benefit. We now have a system where a customer can ring up and be answered by any contact centre agent, who now has their tax record to hand in one system and can handle their issues there and then.

**Chair:** But you can do that with a bank.

**Q168 Nick Smith:** We know that proactive campaigning works, and in the NAO report—paragraph 3.16—you were planning to extend campaigns to all taxes by October of this year. What is your progress with this?

**Jon Fundrey:** Currently about 90% of our debt goes through the campaign approach, and we are intending to increase that still further. There are a couple of recommendations from the NAO that support that. One is to increase our analytical capability, so we are in the process of recruiting a team of analysts to focus on that. There was a slight delay as a result of the recruitment moratorium post the election. We also need to make some IT changes to aid that analysis, and that should be in place by October next year, I believe.

**Q169 Nick Smith:** But you said that would be done by October this year, so there is a year delay.

**Jon Fundrey:** We have continued to work on the IT solution, but it has been slightly held up by the current moratorium on significant ICT spend. Similarly with the recruitment, but the recruitment is also under way. There has been some delay, but it is currently under way.

**Q170 Nick Smith:** So a six-month moratorium has led to a year's delay on recruitment and IT?

**Jon Fundrey:** Not necessarily, I think. Presumably, we took a while to put the recruitment in place. I know it is under way at the moment.

**Q171 Mr Bacon:** Can I stick on this issue of IT? I take your point about data quality being a central issue, but it can't have helped that the IT management function was not being adequately performed. We know it wasn't being adequately performed because the acting chief information officer, who applied for the job of permanent chief information officer, didn't get the job. We were discussing this last time; you then had to pay him £50,000 a month to stay around for three months. He was succeeded by Phil Pavitt who had been at Transport for London before he came to HMRC. Could you say whether Phil Pavitt or his family gained financially from his undertakings as a senior public servant while he was at Transport for London, for example by employing contractors through a company in which his partner had a financial interest?

**Dame Lesley Strathie:** I don't think it is appropriate for me to answer that question, but I am sure that Mr Pavitt and Transport for London would be very happy to answer it.

**Q172 Mr Bacon:** Were you aware of the claims made by the London *Evening Standard* before you appointed Mr Pavitt?

**Dame Lesley Strathie:** Yes, I was.

**Q173 Mr Bacon:** You were. And what investigations did HMRC carry out to verify that Mr Pavitt had not acted unprofessionally?

**Dame Lesley Strathie:** Absolutely everything that was appropriate.

**Q174 Mr Bacon:** Did you speak to Transport for London?

**Dame Lesley Strathie:** Yes, I did.

**Q175 Mr Bacon:** You did. You investigated it with Transport for London.

**Dame Lesley Strathie:** I went through everything in connection with all the candidates who I was considering for appointment, and the company of headhunters that was responsible for the recruitment also did due diligence on this.

**Q176 Mr Bacon:** Did you pursue the matter with the Metropolitan Police?

**Dame Lesley Strathie:** I had no occasion to pursue anything with the Metropolitan Police.

**Q177 Mr Bacon:** Were you aware at the time of Mr Pavitt's appointment of the ongoing investigation that the Metropolitan police and internal fraud at Transport for London were undertaking?

**Dame Lesley Strathie:** I didn't know anything about the detail of any of that, Mr Bacon.

**Q178 Mr Bacon:** Are you saying that you were unaware of the claims of fraud just before Mr Pavitt was appointed?

**Dame Lesley Strathie:** I was absolutely aware of allegations that were made. I was also aware that there was no case proven.

**Q179 Mr Bacon:** If you didn't talk to both Transport for London and the Metropolitan Police, who were involved in an investigation during the time before Mr Pavitt's appointment, how could you have verified to an acceptable level of satisfaction that there was no case to answer?

**Dame Lesley Strathie:** Mr Pavitt himself was very clear on all of that. I also spoke to his boss at Transport for London, and I employed my HR function and the headhunters to do due diligence on that. I am very happy to say that I have absolutely no cause for concern whatsoever.

**Q180 Mr Bacon:** How many associates or former associates of Mr Pavitt have been employed on temporary or permanent contracts by HMRC?

**Dame Lesley Strathie:** I know of only two people in the organisation who have previously worked in one guise or another with Mr Pavitt, and neither of them is in his direct command.

**Q181 Mr Bacon:** If you could amplify that answer in a note, that would be very helpful.

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**Dame Lesley Strathie:** Absolutely. I would be very happy to do that.

**Q182 Matthew Hancock:** I want to come back to the question of data quality. You said that one of the reasons for the delay in improving the situation on underpayments and overpayments is reconciling the data quality. You listed some of the organisations and people who have to give you the data that go into the system, and I entirely recognise the old nature of a lot of the stock of data. What progress are you making on delivering real-time information?

**Dame Lesley Strathie:** Advice has gone to Ministers about the basis of the next level of consultation on real-time, so there is quite a way to go on that.

**Q183 Matthew Hancock:** And how seriously do you think that will be able to improve the information that you get?

**Dame Lesley Strathie:** There are two issues. The first, we have to say, is that real-time is the next big leap, because the sooner we have the information, the sooner it can be corrected or acted on. However, notwithstanding everything I have said about data quality, real-time will never be designed for 100% of the population—that is impossible. I believe that building the technology will be the lesser of all the challenges. I believe that we need to work with businesses for probably about two years and have a plan incrementally to bring them on board this system, if we want to do it well.

**Q184 Matthew Hancock:** So why do you think that DWP's approach, which is to bring in real-time information on a much faster basis than that, is appropriate for it, but not for you?

**Dame Lesley Strathie:** The DWP will not build in real-time information. It will be relying on HMRC building a real-time information system for PAYE. There will be a reliance on sharing that data.

**Q185 Matthew Hancock:** But that is inconsistent with the statement by the Secretary of State for Work and Pensions on the universal benefit, which will be based on real-time information.

**Dame Lesley Strathie:** Yes, the universal credit. We will have to share the same information.

**Q186 Matthew Hancock:** The DWP will be using real-time payments information in order to deliver the universal credit within two years, but you are saying that over those two years is when you will start to talk to people.

**Dame Lesley Strathie:** No. As I said, we have put out advice on the basis on which we would bring this next change on board, and consultation has yet to take place. In fact, Ministers have yet to decide on our advice on that, but the universal credit programme, in its infancy or pre-programme state, will require DWP to extract that information from HMRC. So the speed at which we have to build the technology and start this process is, to a large extent, determined by the welfare reform needs. We would want to do this anyway. We would want to move to real time to make it better, but there is an imperative. We have a big job

to do and DWP has a big, hard dependency on HMRC.

**Q187 Matthew Hancock:** You said you want to do it eventually. How quickly do you think you will be able to fully integrate real-time information into the PAYE system?

**Sarah Walker:** The idea is that the IT for real-time information should be in place by April 2012.

**Q188 Matthew Hancock:** In HMRC as well as DWP?

**Sarah Walker:** In HMRC. But we won't put all employers straight on to it at that point. There will be a period over which we will gradually bring employers on to it and make sure that it is working and testing it. The information will then be available and can be used by DWP and can be used by the PAYE system. There is then a phased period during which we will start to use that information to change tax codes. So although it will be coming in from employers, the timing with which we make use of it in PAYE will be flexible and phased in.

**Q189 Mrs McGuire:** Does that mean that the DWP time frame is predicated on HMRC getting its act together? The Secretary of State says that he has a two-year time frame for introducing something. I am just getting the impression that that cannot be introduced unless HMRC gets the foundation stones laid and the building halfway built.

**Dame Lesley Strathie:** I think it is important that I don't answer for DWP any longer.

**Q190 Mrs McGuire:** But you have sown a seed of doubt in terms of the time scale.

**Chair:** DWP is dependent on HMRC, and HMRC cannot deliver in a time frame to enable DWP to do it within two years.

**Dame Lesley Strathie:** No. We are planning to deliver to support universal credit. Let me reassure you. Last week, Sir Leigh Lewis and I chaired the joint work programme, which we have had in place for the last three years because we share systems and customers, and took stock of the whole universal credit and what DWP has to do on the whole of real time and the joint fraud and error strategy, where HMRC is expecting to reduce losses in tax credits by £2 billion a year for each of the years of the spending review. Those three big pieces of work are being overseen by me and the permanent secretary at DWP at the moment. I can't answer what DWP would do if HMRC failed to deliver. I just know that we are hard-wired into the programme and we will work as part of a joint programme.

**Chair:** We will watch that with interest. I want to move us on to something else.

**Q191 Nick Smith:** Very quickly on that. How will you support employers to provide that information for real time?

**Dame Lesley Strathie:** That is exactly my point. This will have to be an incremental programme to bring employers on board. That is the basis on which we go out to consult now.

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**Q192 Chair:** I'm going to move us on to something else. We understand that you have to keep personal tax information confidential, but the tax affairs of companies, particularly publicly quoted companies, are available, one assumes, to their shareholders. I therefore have a slight question about why we cannot discuss them here. It is a question of principle. I am not trying to trip you up on this one, Lesley. I can understand that you don't want to talk about my tax affairs to the Committee, but I cannot understand why we cannot have an open discussion about the tax affairs of a publicly quoted company in this Committee.

**Dame Lesley Strathie:** We went through this with your predecessor.

**Chair:** I know you did. I am quoting from a letter he got.

**Dame Lesley Strathie:** It is quite important in terms of working with companies to crystallise liabilities and to bring tax in. It is for the companies themselves to discuss whatever they choose to discuss, but it is inappropriate for HMRC—

**Q193 Chair:** But they do disclose them to their shareholders, publicly. All companies do.

**Dame Lesley Strathie:** But would they disclose the details of the settlement, or would they disclose to their shareholders what the number in their accounts was?

**Q194 Mr Bacon:** In the case of Vodafone, it disclosed to its shareholders that following the agreement that it had reached with HMRC it was not expecting to be affected into the future by tax in the particular matter of a controlled foreign corporation. So, it did go beyond the number, didn't it, in the public domain?

**Dame Lesley Strathie:** But that's for Vodafone. We did make a statement to which Vodafone gave us permission to add, which I can read if you want, but it has already been in the press.

**Chair:** I think that we've all seen that—it's been in the debate. I don't think that it will help us, given that we're running out of time.

**Dame Lesley Strathie:** I would just like to reassure the Committee though, that ultimately the commissioners have to make decisions, and I am satisfied as the accounting officer that the proper processes took place here. I think that in the Court of Appeal this was a huge success for HMRC; this is revenue that could potentially have been forgone.

**Chair:** You're discussing the individual case there. Ultimately, our understanding is that the accounts could be qualified by the National Audit Office if it found that there was a question mark over whether sufficient revenue was collected from Vodafone.

**Q195 Chris Heaton-Harris:** I was wondering whether you could extrapolate "crystallised liability" for me. I thought that if you were a corporation and you did something that was liable for tax you'd probably end up paying it. So, is it just an aspiration of HMRC to get that tax? Do you immediately start in a negotiating position? I'm slightly worried by the phrase "crystallised liability."

**Dame Lesley Strathie:** What I was referring to was not the detail of the Vodafone case. The Court of Appeal decision last year confirming the compatibility of a controlled foreign company's rules with EU law was an important success for HMRC. It paved the way for the settlement—that was the point that I was making—and it will pave the way for other settlements.

**Q196 Chair:** You can't let us know the details of the Vodafone negotiations, but can you let us know how many companies you're currently discussing—

**Chris Heaton-Harris:** Crystallising.

**Chair:** Crystallising, sorry—disputed outstanding tax with, where the sum exceeds £250 million?

**Jon Fundrey:** We intend to disclose in next year's set of accounts significant litigation in cases that we're going through, and we're working with the NAO on what form of disclosure we can make.

**Q197 Chair:** How many? Can you tell us? They might not be in litigation. I never know. You might be negotiating outside litigation. How many companies are there that HMRC views at present as owing more than £250 million, and with which you're in discussions through to litigation. How many?

**Jon Fundrey:** I don't have that information to hand. I'm not sure that it would be appropriate for us to start disclosing the nature of that kind of case, but we are certainly—

**Chair:** No, we're asking for numbers. We're asking for numbers.

**Jon Fundrey:** But we certainly intend to disclose in next year's accounts cases of more than £50 million that we're currently going—

**Q198 Chair:** Well, can you let us have that figure now? No one is saying, "Vodafone, Vodafone, Vodafone," but they are asking, "With how many companies are you in negotiation?"

**Dame Lesley Strathie:** I can offer the Committee a note in relation to that. We will give you the information that we can in terms of litigation strategy and the cases that we have in the pipeline. We'll give you as much information as we can.

**Q199 Chair:** And can you also give us the information as to the quantity?

**Dame Lesley Strathie:** Yes.

**Q200 Chair:** Can I ask you one final question? Do you think that it's appropriate that someone who left HMRC in 2007 should, within a couple of years, be negotiating with an ex-colleague to settle a dispute about debt? As the boss of HMRC, are you happy with that situation?

**Dame Lesley Strathie:** I'm not sure what you're referring to.

**Mr Bacon:** John Connors. He was an HMRC director, and he now works for Vodafone on tax matters and was negotiating with HMRC about Vodafone's tax liability, was he not?

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**Q201 Chair:** Do you think that that's appropriate?

**Dame Lesley Strathie:** I don't know anything about that and it would be inappropriate for me to comment. I am very happy, if there are any issues on process, to take them back to the commissioners who dealt with this, and to our legal team.

**Q202 Chair:** I don't think I am asking you a question completely out of the way. I don't know a lot about it either. I just read what I read in the press. What hit me in the face was that in my view it is completely inappropriate to have a negotiation of quite a sizeable potential outstanding debt between somebody who was working for HMRC, who has now gone to work for the company, negotiating with an ex-colleague within two years. Ministers wouldn't be allowed to do that.

**Dame Lesley Strathie:** All I can say is there has been a lot in printed media on this that is inaccurate. I can't comment on that.

**Amyas Morse:** Before you pass on, the Chair very kindly paraphrased something that I said quite carefully, qualifiedly, earlier on. Since you said it on the record, Chair, I can't let it go by. What I said was that there might be a case for qualifying on grounds of irregularity if it was seen that a decision had been made unreasonably. I did warn that I thought that that wasn't very likely. I think I am repeating myself fairly accurately. Thank you.

**Q203 Mr Bacon:** Dame Lesley, may I just pursue this point? You raised the issue of the Court of Appeal case and the fact that that was a great success for HMRC, because it meant that your approach was compatible with European law and you could therefore continue to pursue people whom you deemed had a liability. Your litigation and settlement strategy is clear on that. Where you have a strong case you should seek full value from the settlement or take the matter to litigation. Where you have disputes that are of an all-or-nothing character—that is to say, it is merely a question of whether the law applies or not—such disputes should be settled on all-or-nothing terms. It goes on to say, “Do not split the difference or offer any discount for an agreement not to litigate.” Your own controlled foreign corporation specialists believed in the case of Vodafone that the absolute minimum that HMRC should settle for was £2.4 billion. You have referred a number of times to the issue of process. The process that concerns me and may concern others is that, instead of the HMRC's specialist in controlled foreign corporation law being consulted on the terms of a deal, it is done in private between your permanent secretary for tax, Mr Hartnett, and the company concerned—in this case, Vodafone—without the proper checks and balances that you would expect to see, or to ensure that the right advice from within HMRC, from those who knew about the details of controlled foreign corporation law was taken. That is the problem.

**Dame Lesley Strathie:** I don't confirm any of that, Mr Bacon. I think it is quite important and I don't believe that any decision was taken in private. There comes a point when the commissioners have to decide what the right course of action is in the circumstances that

they are in. The director general for business tax was the accountable commissioner in the first instance here, and the business tax senior management team. The permanent secretary for tax is the second commissioner. Then we have counsel, overseen by our senior legal team. It would be absolutely wrong to suggest in any way that the permanent secretary for tax did some deal in private.

**Q204 Mr Bacon:** If I may continue for a minute. Going back to your point about processes, the issue is whether the people who knew what they were talking about with HMRC were consulted on the terms of the deal. That is a process point. It is a fact that the people who knew what they were talking about were not consulted on the terms of the deal.

**Dame Lesley Strathie:** You are now getting into detail. I would only say in a general manner: there is a huge tendency when people have worked on something for a very long time to hope that they will finally have their day in court. There are many cases that have gone back for years and years, where they have still delivered nothing. Eventually they are part of a settlement strategy.

**Q205 Mr Bacon:** Going back to your point, it is your settlement strategy that I was reading. It says: “Such disputes should be settled on all or nothing terms.” It is your settlement strategy that says on avoidance cases, “If our legal advice is strong, do not accept settlements for less than 100% of the tax and interest due.”

**Dame Lesley Strathie:** But wouldn't that suggest to you that there was a number that was the tax liability due? That's the last word that I'm going to say on the subject, or I am absolutely in danger of breaking taxpayer confidentiality.

**Q206 Mr Bacon:** I wanted to ask you about David Cruickshank from Deloitte. Who brought him in—HMRC, or Vodafone?

**Dame Lesley Strathie:** You read that in the papers. Again, I said you shouldn't believe everything that you read in the press, Mr Bacon.

**Q207 Mr Bacon:** Who brought him in?

**Dame Lesley Strathie:** I don't know that anybody brought him in.

**Q208 Mr Bacon:** It was Mr Hartnett who brought him in, wasn't it?

**Dame Lesley Strathie:** I don't know that he was brought in.

**Q209 Ian Swales:** My question is an extension of that one. It is to do with the control mechanisms. Who authorises such arrangements, especially the ones that fall between the public assessment, if you like, or the clear assessment that the staff would make, and litigation? In other words, what about those cases that fall in between? Incidentally, the Chair was asking for some data. I think it would be important to try and divide that between those cases greater than £250 million, where we think that there is litigation, and

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those greater than £250 million where we are in the period between assessment and potential litigation.

My real question is about the control system. Who can agree to those huge sums of money going up or down? What is the management control?

**Dame Lesley Strathie:** This is for the director general, business tax, and the senior management team. There then has to be another commissioner and we have to have legal advice. There is a considerable amount of process before we would ever get to an end result.

**Q210 Ian Swales:** So if you were in a discussion about potentially settling a case—I am not talking about this case, it could be any case—and a figure of £100 million was being bandied around at a meeting, who would ultimately say, “Okay, settle for that £100 million”? Would it happen before the settlement was made?

**Dame Lesley Strathie:** I wouldn’t use those words. If we are having a hypothetical case, then you are striving for the liability. What is the proven liability? Then you might settle for 100% of it.

**Q211 Ian Swales:** That would be the normal process. So you are saying that there are no cases that are settled differently? What Mr Bacon read out is the process—it is the liability or it is litigation. Is that the case?

**Dame Lesley Strathie:** Our job is to prove the liability, to serve that assessment and to collect the money.

**Q212 Mrs McGuire:** Do you feel that sometimes, the bigger the organisation and the bigger the company, the more opportunity they have to negotiate? My experience in some situations has been that HMRC is pretty unforgiving when it comes to smaller organisations and companies in pulling back tax or national insurance.

**Dame Lesley Strathie:** I think we have the same job to do for every customer—large or small business, or individual. I think that global taxation, particularly for foreign companies, is very complex. A huge amount of our work is in nailing down what we believe the law was intended to do and what applies for the UK to protect the UK tax base, versus what other people would contend. That is the huge challenge. Our job is to protect the United Kingdom’s tax base. Clearly, companies will have other drivers.

**Q213 Mrs McGuire:** So you don’t think that those who have privileged access, whether they are dealing with a national taxation issue or an international one, have greater opportunities to come to an arrangement, whereas smaller companies that find themselves in difficulty find it almost impossible to negotiate with HMRC in how they pay back money?

**Dame Lesley Strathie:** We have absolutely proven, with the introduction of the business payment support service during the recession, that provided people came to us and told us that they had a difficulty, we would put in place time-to-pay arrangements. We have demonstrated that, and we have greater compliance. We are keeping the business payment support service, now that we are out of recession, because it allowed

many more companies to come into a compliance regime and be given time to pay. The return on that has been very high.

We have also demonstrated it in the PAYE reconciliation, where people had debts of more than £2,000. Provided that they come to us on receipt of that assessment we will give them up to three years to pay. We are applying the same for individuals and business customers. I don’t believe that anybody, just because they’re a large corporate, has the opportunity to come to an arrangement so far as liability is concerned. Any arrangement is around time to pay.

**Jon Fundrey:** To give you some sense of scale, we have in place 371,000 time-to-pay arrangements covering £6.4 billion<sup>1</sup>, and 90% of them are paying.

**Chair:** Will you say that again?

**Jon Fundrey:** We currently have 371,000 businesses in our time-to-pay arrangements, covering £6.4 billion. They have time to pay, but we are also collecting in excess of 90% of that at the current rate. I am using those figures to demonstrate that we also look after the other end of the market.

**Q214 Mr Bacon:** Dame Lesley, you said that your job was to prove liability. Indeed, you had a Court of Appeal case that helped you in that. My belief is that having got that case on your side, you did not pursue things as strongly as you should have done.

**Dame Lesley Strathie:** On what basis do you say make that assertion?

**Q215 Mr Bacon:** On the basis that your CFC specialists believed that you could get more money than you did. My question is about forward agreements on tax treatment. They are unlawful, aren’t they?

**Dame Lesley Strathie:** I’m sorry, but I am not a tax specialist.

**Q216 Mr Bacon:** You can’t tell me if forward agreements on tax are unlawful?

**Dame Lesley Strathie:** No, but I would be very happy to find the information for you.

**Q217 Mr Bacon:** Sarah Walker, can you tell me if forward agreements on tax are unlawful?

**Sarah Walker:** I think you are talking about the sort of arrangement that Mr al-Fayed had?

**Q218 Mr Bacon:** Yes, that kind of arrangement.

**Sarah Walker:** Those were found to be unlawful.

**Q219 Mr Bacon:** Why are you still doing them with other companies?

**Sarah Walker:** That’s not my area; I am sorry I can’t answer that.

**Mr Bacon:** Mr Fundrey?

**Jon Fundrey:** Also not my area.

**Q220 Mr Bacon:** Vodafone said in its press release that it is not likely that CFC liabilities will arise in future, as a consequence of the likely reform of CFC

<sup>1</sup> Between November 2008 and September 2010, HMRC granted 371,000 ‘time to pay’ arrangements, covering £6.4bn.

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rules due to the facts established in the agreement. My question is how can they arise now?

**Dame Lesley Strathie:** Perhaps you should ask Vodafone what it meant by its statement.

**Mr Bacon:** Perhaps we will.

**Q221 Stephen Barclay:** Following on from that, where there is a legal process, who has the authority to vary it? We heard from Richard about the Department's guidelines. Who has the authority to vary them? Does it require your authority?

**Dame Lesley Strathie:** I go back to the point about the commissioners. There are six commissioners in Revenue and Customs, and they cover different areas, but on any decision there will be a minimum of two commissioners. We will ensure independence and governance of that. I would never personally be involved in any of these decisions. It would come up the line with the permanent secretary for tax.

**Q222 Stephen Barclay:** Sure, but we had an exchange at our last meeting about the vagaries of how accountability works and the role of the accounting officer. I want to clarify whether, as the accountable officer, you have to agree to variations.

**Dame Lesley Strathie:** My job as principal accounting officer is to account for decisions that are made and who made them. It is not for me to make those decisions. Why would I? I'm not a tax professional.

**Q223 Stephen Barclay:** So you don't have to sign them off?

**Dame Lesley Strathie:** No.

**Q224 Stephen Barclay:** And how do you get oversight of potential conflicts of interest?

**Dame Lesley Strathie:** Well, I very much hope, first and foremost, that if there was a conflict it would be self-declared and, if not, that our legal team and our governance would pick that up.

**Q225 Stephen Barclay:** Right. That's not something you would actually look at. You rely on people self-declaring conflicts of interest.

**Dame Lesley Strathie:** I have told you already that I have no role in the settlement of tax cases. Therefore, my job is to make sure that there is a process and that the process is governed. I expect the NAO to oversee that process also. I expect anyone in the permanent secretary or tax line to be working with the NAO on any of our approaches for that. In an organisation the size of mine, I can't do everything personally.

**Q226 Stephen Barclay:** I appreciate that. One final thing. In terms of these firms always being major employers, one would understand there being other factors considered in terms of whether to pursue an aggressive strategy. Are you satisfied that this case was judged solely on the legal issues in dispute?

**Dame Lesley Strathie:** I have absolutely no reason to doubt that proper process was followed in this case.

**Q227 Chair:** It was followed?

**Dame Lesley Strathie:** Yes. I have no reason to doubt that at all.

**Q228 Stephen Barclay:** Were there no discussions with the company about impacts on jobs or other factors?

**Dame Lesley Strathie:** I am not privy to that. I am protected from the taxpayer's confidentiality as well—just as Ministers are. The detail and the discussions are not something that I am privy to.

**Q229 Chair:** I am going to move us on. There are two other issues we need to take—I don't know if Members want to raise them. One is debt, which is a much better story you have to tell in your Report. I just wanted to know—we have talked a little about the campaigns and things—in the original NAO Report, you agreed that there would be an October deadline, so you would be able to use campaigns right across all types of debt. Have you stuck to that?

**Jon Fundrey:** As I referred to earlier, we have currently got 90% of our debt activity going, following through the campaign approach. The further work on the analytics, *etc.*, and the IT capability that we were referring to earlier—we will continue to enhance that. We anticipate the IT capability being in place from October 2011.

**Q230 Chair:** Okay. Have you done any evaluation? Everyone thinks this system works. Have you done any evaluation to look at whether it is really cost-effective?

**Jon Fundrey:** Yes, we have, and it is proving to be.

**Chair:** Is the rest of the Committee happy on the debt issue? Anyone want to ask anything on tax credits?

**Q231 Jackie Doyle-Price:** If you look at the NAO Report, it shows that at the beginning there was quite a lot of overpayment, which you gradually got down. Obviously, those overpayments need to be recovered. The story on that isn't quite so good. I suppose that brings us back to where we started in terms of chasing unpaid taxes. Could you perhaps tell us a little about how you are going to tackle that outstanding overpayment issue?

**Jon Fundrey:** Perhaps I can cover that and then Sarah can fill in a bit.

Tax credit debt has a different characteristic really to the other debt that we face—it is typically small, with 55% of it currently under £500, for example, so it is a lot more resource intensive to pursue. We have successfully trialled debt collection agencies in a number of areas. It would be our intention to use those in the future—looking at tax credit debt as well. Tax credit debt is quite well recovered when we recover it from ongoing payments. Where it is prohibitive under the legislation—for example, when doing it across awards, because we can only recover in a particular award—we have a number of issues on tax credit debt. But the current strategy, which is to focus on the renewals process and bring forward the work, is actually starting to show dividends in terms of preventing the debt occurring at the back end of the process.

**Q232 Chair:** Can I just ask something arising out of that? On the PAYE underpayment, you write off



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anything under £300—why are you not doing that on tax credit?

**Dame Lesley Strathie:** The PAYE threshold is a temporary rise, first and foremost. A lot of tax credit debt has indeed been written off. Our strategy on tax credit debt is to pursue payment where payment can be made, so we have written off debt in hardship cases.

**Q233 Chair:** I'll tell you why I ask the question. From my constituency case load, my view is that, on the whole, it is poor people who may mistakenly not tell you in time of a change in circumstance, or you may not have adjusted their tax credits in the appropriate time. On the whole, it is people who can't afford to pay back £200 or £300. It seems to be outrageous, if I may say so, Dame Lesley, that people who pay PAYE get their debt written off if it is under £300, but people who are on tax credit debt, who are the poorest, still may have to meet that repayment. It seems to me to be inequitable.

**Dame Lesley Strathie:** Some people would argue about whether they are the poorest or not. The issue remains the same: we don't write off debt while there is an opportunity to pursue it. On tax credit debt, we accept that some of it is very old and we have written off considerable amounts of it. We will write off more debt. The balance we have to strike in terms of what's fair, is between those who repay their debts and those who don't. But, in general, we have fewer levers open to us in collecting this debt. We know the older debt becomes, the less likely that is. As we've gone through cleansing the debt generally, we've tackled tax credit debt. We have written off quite a large amount. Equally, we have talked to a lot of customers who have responded to the campaign. The average debt is less than £500.

**Jon Fundrey:** We wrote off £146 million last year. If we extrapolate that forward, it's likely to be in the order of £460 million this year.

**Q234 Mrs McGuire:** What general principles did you put in place to write off that £146 million?

**Jon Fundrey:** Underpinning that is a view of collectability. Also there are circumstances in which we might actually be at fault, and we are therefore correcting that. There's a whole varied list of reasons.

**Q235 Mrs McGuire:** How do you distinguish between fraud and error? I think that this is what the Chair was also alluding to. There are some individuals who, if they receive notification from HMRC that this is what they're getting in terms of tax credit, take it as gospel—maybe they shouldn't but, frankly, often they do. They can find themselves, at the back end of the year, with an outstanding debt. Frankly, some of the debts I've seen in child tax credit are significantly more than £500, mainly, although not exclusively, through no fault of the individual concerned. How do you distinguish between what is a genuine error and someone trying to play the system? Do you give them the same sort of sympathy we have been talking about over the last week while in relation to larger companies?

**Sarah Walker:** There are a couple of things happening here. There is genuine error, where somebody has given us some wrong information.

**Jackie Doyle-Price:** Or you interpret it wrongly.

**Sarah Walker:** I want to go through this, if I may. Somebody may give us—either by mistake or sometimes deliberately—wrong information that we've based an award on. There are other cases where an overpayment arises not because someone has made a mistake, but because they haven't notified us of a change that is relevant to their award, so that at the end of the year they've had too much money because we weren't aware of a change in their circumstance. Where there is an error—there might be an error by HMRC clearly in calculating the award—we don't expect people to be able to understand exactly the calculation of their awards because that can be very complex. Where there is an HMRC error that they couldn't reasonably have been able to spot, we don't expect them to pay back any overpayment that results from that. But it is the nature of the tax credit system that there will be overpayments and underpayments because it is a system of payments on account, which need to be corrected at the end of the year.

**Q236 Mrs McGuire:** Will your new system be more sensitive to those changes? Will the new IT—PAYE—system be more sensitive to some of the changes?

**Sarah Walker:** Tax credits aren't paid through that.

**Mrs McGuire:** Sorry. My fault.

**Dame Lesley Strathie:** It will eventually be replaced by universal credit.

**Mrs McGuire:** I was thinking of situations that I have had to deal with where, for administrative ease, the local authority has paid six weeks' salary to school dinners personnel and others who are off school for six weeks. That knocks the whole tax credit system to pot. They effectively get a six-week payment in one salary month, instead of it being scheduled out. Fortunately, we have managed to sort that out with the local authority, but not without a lot of anguish among people who receive credits.

**Q237 Ian Swales:** I have a question on this. On error and fraud, figure 11 of the Report talks about roughly 9% and £2 billion of overpayments. That has actually got worse since the two years before. You have a target for that to be 5% by March 2011, which is only four months away. How is it going?

**Dame Lesley Strathie:** Any of the figures that are in the public domain at the moment, because of the time lag in this, are from before the error and fraud strategy was introduced. You will have to wait some time before you know. However, we are confident that the proxy measures and the interventions that we have brought on board will get us on track. What has been yielded by the work that we have done over the last year and the current year makes us believe that we can reduce losses by something in the region of £2 billion in each year of the spending review. The increase is directly related to much more money being

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spent on the tax credit system, more families being helped and more generosity in the system than previously.

**Q238 Ian Swales:** So what percentage is it? Obviously, as you say, it takes time before you know, but you must have some management information. What running rate do you think you are at now in terms of error and fraud in the system?

**Dame Lesley Strathie:** I have to be careful here because we do not have figures that are in the public domain yet. As soon as I say something in this Committee, it will become a statistic. Looking at the past, we were probably in the region of identifying £200 million in this area. I believe that, last year, the figures will probably show about £750 million. I believe that by the time we get to this year it will be about £1.4 billion. I am confident that all of the work we are doing is delivering on proxy management measures.

**Q239 Ian Swales:** Sorry, what was that stream of figures?

**Dame Lesley Strathie:** Those were the amounts of money that we are actually protecting and identifying. We've moved from "pay now, check later" to "check now, pay later". We are trying to take out error and potential fraud at the front end of the system.

**John Thorpe:** Can I help the Committee? That stream of numbers is set out in paragraph 4.17 of the Report.

**Q240 Matthew Hancock:** I think we can all agree that the tax credit system has at times been shambolic. We don't need to go over that. In terms of the future, you have prepared a tax credits tactical delivery plan to reduce tax credit debt. It says that by March 2011, you should reduce the debt by £200 million to £4.3 billion. Are you going to hit that?

**Dame Lesley Strathie:** Sorry, could you tell me which paragraph that is in?

**Matthew Hancock:** Paragraph 4.32 on page R47 states: "In 2009–10, the Department prepared a Tax Credits Debt Tactical Delivery Plan, which was designed to reduce tax credits debt. The plan included objectives to reduce the amount of tax credits debt by £0.2 billion to £4.3 billion by March 2011".

**Dame Lesley Strathie:** In the first four months of 2010–11, we estimate that we prevented another £17 million in overpayments entering the system.

**Q241 Matthew Hancock:** Hold on. The question is about debt; it isn't about overpayments.

**Dame Lesley Strathie:** We wrote off £146 million in 2009–10 and plan to write off a further £461 million in 2010–11.

**Q242 Matthew Hancock:** I'm reading again: "The plan included objectives to reduce the amount of tax credits debt by £0.2 billion to £4.3 billion by March 2011". Is that on track?

**Dame Lesley Strathie:** That is on track, yes<sup>2</sup>.

**Q243 Matthew Hancock:** Great. The second question is that given the history of this and the difficulties, including with the people who you deal with in the tax credit system, do you think, looking to the long-term future, that this problem will go away when the system is completely reformed?

**Dame Lesley Strathie:** Tax credit as we know it, the White Paper says, will disappear. DWP will be administering all of the welfare system apart from child benefit, as I understand it, for the moment. What I'm not clear on is the time frame. Clearly there will be an introduction of universal credit, but massive programmes like this generally have a long roll-out.

**Chair:** Richard will ask a question, then I think we'll draw to a close.

**Q244 Mr Bacon:** One quick one. Could you say how many forms P800—these are the statements of reconciliation for overpayment and underpayment of income tax—HMRC has issued in the last five years? You may write with a note if you want. How many have you issued in the last five years, and how many are you anticipating issuing between the beginning of September and Christmas this year?

**Dame Lesley Strathie:** I'll certainly be able to tell you what we have already issued in the reconciliation exercise for two years and what we anticipate by the end of the year. I shall have to go back and research what the old system could tell us.

**Q245 Jackie Doyle-Price:** Just to clarify and be explicit, of the reduction in debt by £0.2 billion, what proportion of that has been achieved by writing off uneconomic debts?

**Dame Lesley Strathie:** On the forecast by 2010–11?

**Jackie Doyle-Price:** Yes.

**Dame Lesley Strathie:** Of course, I can't tell you exactly what we're going to do in the future. We have a target. Are you asking me what we've done this year so far?

**Q246 Jackie Doyle-Price:** You've said to the Committee that you're on course to meet that target by reducing the amount of debt by £0.2 billion. I just want to be clear in my mind how much of that's been achieved by writing off uneconomic debt, as opposed to collection.

**Jon Fundrey:** As I said earlier, last year we wrote off £146 million. If we continue going forward this year, our forecast is that we'll be writing off approximately £460 million.

**Q247 Chair:** I just wanted to conclude with this observation. I think this has been a difficult year, which is why we've had to have two sessions as we've talked about your accounts. I want to put something to you, Dame Lesley. You've had your first two years in post. A lot of this stuff is legacy that you've inherited, and I think we all understand that. As you move forward into the next year—when we come to do this exercise next year—are you confident that

<sup>2</sup> The Tax Credit debt balance was £4.5bn at 31.3.10, but we expect it to be higher by 31.3.11. The current forecast is £4.8bn

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having sorted out the PAYE, you will be in a better position to tell us a better story, or are there other things looming on the horizon which could prove disastrous for the taxpayer or for individuals?

**Dame Lesley Strathie:** I absolutely believe that we'll be in a better place when we lay the accounts this year, but to go back to what I said, clearing all the legacy issues will take us through to 2012. We'll be giving you a progress report. I absolutely need to be clear that we record in our Annual Report on accounts and my statement of internal control any other legacy issues that we have.

**Q248 Chair:** And there's nothing there on the horizon—we're halfway through this year now—that is going to prove yet another disaster area?

**Dame Lesley Strathie:** We've focused very much on PAYE. It is an incredibly important system—it is the aorta, and it delivers the money through business, so it's incredibly important—but we are a huge organisation that still manages to bring in £435 billion a year and protect much more. There are many successes that the Department has, as well as the challenges it has from the past.

**Chair:** Thank you very much indeed.

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## Written evidence from the National Audit Office

### THE COLLECTION OF PAYE

#### 1. PURPOSE

1.1 Part 2 of the Comptroller and Auditor General's July 2010 Report on the HM Revenue and Customs Accounts for 2009–10 reported on the implementation of the National Insurance and Pay as You Earn Service (NPS) and the consequences for processing Pay As You Earn (PAYE)<sup>1</sup>. Since then the Department has started the PAYE end of year reconciliation process for the 2008–09 and 2009–10 tax years. This process has been widely reported in the media.

1.2 This memorandum is intended to bring the Committee up to date with the Department's progress with the 2008–09 and 2009–10 Pay As You Earn (PAYE) end of year reconciliation, its proposals for addressing the backlog of open cases relating to the 2007–08 and previous tax years, and its plan to stabilise the NPS.

#### 2. END OF YEAR RECONCILIATION

2.1 Reconciling individuals' tax after the end of the year is a normal part of the PAYE process. In previous years, this has largely been a manual process undertaken by the Department's staff. NPS now automatically reconciles all but the most complex cases and determines whether an individual has paid the correct tax. Where NPS identifies an over or underpayment it automatically issues a tax calculation (Form P800) to the taxpayer. The tax calculation is based upon information the Department holds. The taxpayer is advised to contact the Department if he or she thinks the information held and therefore the calculation is incorrect.

2.2 Problems with the loading and reconciling of end of year returns have delayed the processing of over and underpayments of tax for the 2008–09 tax year. As a consequence, in January 2010, the Department decided to defer the reconciliation of these items until the automatic clearance capability was available. The Department planned to begin processing these reconciliations from August 2010 once the full NPS end of year reconciliation functionality had been tested. This meant that it would effectively be reconciling the 2008–09 and 2009–10 tax years together.

2.3 The full NPS end of year reconciliation functionality was included in the final software release in April 2010. The Department has taken a number of steps to assure itself that the end of year functionality was operating as intended before it entered live service in September. Part of its "controlled go-live" process involved processing a sample of live records and checking the results to confirm that the system is operating as intended. This was followed by running initial batches of live cases through the end of year reconciliation functionality and the issue of P800 calculations to taxpayers. It has used these initial batches to test its planning assumptions on resultant customer contact levels and the quality of its guidance. The Department wrote to the Committee on 1 October 2010 to inform it of the outcome of this test process and its decision to start the full live running of the end of year reconciliation process.

2.4 The Department plans to complete the bulk of the 2008–09 and 2009–10 end of year reconciliations for 45 million customer records (38 million individuals) by the end of 2010. It expects to run daily batches of some 700,000 PAYE records through the reconciliation process each day, which will result in an average daily output of some 90,000 P800 notices. The size of the daily reconciliation batches reflects the capacity of the Department's systems to issue repayments (it has undertaken to issue payments within 14 working days of the repayment notice being issued) and the need to manage the overall level of customer contact.

2.5 Some PAYE records on NPS are currently set aside from the end of year reconciliation process. At the time of our report the Department had identified two million records where a risk of data inaccuracy could potentially impact on the end of year reconciliation process. Further scans of the NPS database have identified a total of 10.6 million cases which may fall into one or more at risk scenarios and these have been

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<sup>1</sup> HM Revenue & Customs 2009–10 Accounts: Report by the Comptroller and Auditor General HC299, Session 2009–10

temporarily set aside from the reconciliation process on a precautionary basis. The Department has launched a project to check these records using automated processes and, for the more complex cases, manual intervention.

*Increase in underpayment threshold to £300*

2.6 Normally, underpayments of £50 and below identified by the end of year reconciliation process are not pursued. The Commissioners have used their Collection and Management powers to approve a temporary increase to £300 in the tolerance for underpayments arising during the PAYE end of year reconciliation work for the years 2008–09 and 2009–10.

2.7 The level of the tolerance is not based on a straight comparison of the cost of dealing with the individual cases and the yield at stake, but the need for the Department to deal with an exceptional peak of work in a limited time. This option was expected to save the Department having to issue around 900,000 P800 outputs and thus reduce customer contacts by 40% while reducing tax yield by only 8%—an estimated Exchequer impact of around £160 million.

2.8 After allowing for the increase in the threshold, the Department estimated that 4.3 million taxpayers will receive repayments, while 1.4 million will be sent letters explaining that they have underpaid. The total underpayments are worth in the region of £2.0 billion while the overpayments are worth about £1.8 billion.

2.9 The Department has put in place a new process for people with 2008–09 and 2009–10 PAYE underpayments (generally over £2,000) that cannot automatically be paid through their salary deductions. They will be offered at least the same length of time to pay as those with smaller underpayments and not face interest provided they engage with the Department and agree to pay their underpayment.

*Extra Statutory Concession (ESC A19)*

2.10 The Department does not expect to recover all of the estimated £2.0 billion of underpayments. Under an Extra Statutory Concession (ESC A19), the Department may agree in certain circumstances not to collect the tax where taxpayers can show that the Department already had the relevant information to allow it to collect the tax but it had failed or delayed to use the information and the taxpayer believed their tax affairs were in order. The Department has introduced a new web page which provides customers with information about Extra Statutory Concession A19 and has simplified the process under which claims are considered.

**3. CLEARANCE OF OPEN CASES FROM EARLIER YEARS**

3.1 The phased release of NPS also meant that the functionality to support the automated reconciliation of individuals' PAYE records was not available to the Department between July 2009 and April 2010. Although it set up a process to manually work some open cases, it was not able to work the bulk of the backlog of 18.2 million un-reconciled cases from 2007–08 and previous tax years affecting around 15 million people. Since June 2010, the Department has cleared a further 300,000 cases through manual working.

3.2 The Department wrote to the Committee on 30 September to outline its proposals for clearing the backlog. It is now considering the option of using the NPS end of year functionality to process the residual population of 17.9 million cases. This would allow it to fully assess the composition of the open case population including those cases that are untraceable or otherwise unworkable, those that balance, and the remaining over and underpayment cases. It hopes to process the majority of the over and underpayment cases automatically using the NPS functionality. The new functionality should also provide the Department with more accurate data to support decisions on the prioritisation of cases for manual working.

3.3 The Department aims to have a more complete picture of the composition of the open case population by April 2011, and to complete the reconciliation of the majority of over and underpayment reconciliations using the NPS automated process. It plans to clerically work the remaining cases which are too complex to clear through the automated process. The Department has committed to completing clearance of all outstanding legacy cases by the end of 2012.

4 October 2010

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**Written evidence from HM Revenue and Customs**

*Questions 34–41 (James Wharton, Mr Bacon): The Committee was keen to understand fully the cost of delaying the running of the 2008–09 PAYE reconciliation.*

If reconciliation had taken place in 2008–09, HMRC would have incurred the expected annual administrative costs in handling these cases. In undertaking reconciliation for 2008–09 and 2009–10 in the current financial year, there are additional costs over and above the expected annual administrative costs which amount to a total of revenue forgone of £190 million.

These additional costs are due to the increase in the PAYE underpayment collection tolerance from £50 to £300 (which accounts for £160 million of the costs), and some of the 2008-09 debt being harder to collect because it is more prone to write-off (accounting for £30 million of the costs).

#### INCREASING THE TOLERANCE

The deferment of the reconciliation for 2008–09 means that the Department has to reconcile two years instead of one. As a result, the Department has to handle the contact resulting from two years' worth of reconciliation over a relatively short timescale.

The temporary increase in the level of the tolerance was not based on a straight comparison of the cost of dealing with the individual cases and the yield at stake. It was taken because of the need for the Department to deal with an exceptional peak of work in a relatively limited time. Increasing the tolerance to £300 is expected to save the Department having to issue about 900,000 tax calculations to taxpayers with an underpayment and dealing with the bulk of them over a period of three months. It is expected to reduce customer contacts as result of this exercise by 40% while reducing tax yield by only 8%, an estimated exchequer impact of about £160 million.

#### HARDER DEBT TO COLLECT

In addition, as the underpayment is a year older then some of it becomes harder to collect. In particular, there is an increased likelihood of Extra Statutory Concession A19 applying. It is difficult to estimate this cost with any precision but our assessment of it is of the order of £30 million.

#### OTHER ISSUES

We announced a new process on 15 September 2010 for people with 2008–09 and 2009–10 underpayments that cannot automatically be paid through their salary deductions. Individuals in this position will not be charged interest on underpayments provided they agree to pay their underpayment.

The reduction in interest and penalties for the two years resulting from this new arrangement has been estimated to be less than £10 million. This has not been included in the calculations because it is expected to be a relatively low figure, and one that is difficult to quantify.

There is a notional resource saving as a result of the Department no longer having to do further work on the 900,000 cases which have been excluded because of the increase in the PAYE tolerance. Not doing this work does not, however, produce an actual saving. HMRC staff are still deployed to manage the contact and additional work generated by the reconciliation exercise.

*Question 100 (Mr Bacon): Dame Lesley, I am keen to understand the timeline and the chronology of the head of the IT function because it looks to me like you, for a significant chunk of this period, did not have a permanent head of IT. Mr Singh, you said, was an acting Director General; he applied for the job eventually and did not get it. I remember Steve Lamey being Chief Information Officer some years ago. I notice he is still a member of the Board and, indeed, he has been a witness at this Committee some years ago. Could you send us a chronology showing a comprehensive timeline over the last 10 years of the person who was appointed head of the IT function, whether he was described as Director General or whether he was described as Chief Information Officer or whether he was both, or whether there were two people, and whether the person holding that function was acting or permanent, so we have a comprehensive history going back from the year 2000 to date. Can you do that?*

#### HMRC CHIEF INFORMATION OFFICER

**September 2009 to present:** Phil Pavitt was appointed Chief Information Officer on 2 September 2009 on a three year contract.

**June 2009 to September 2009:** Deepak Singh was appointed interim Chief Information Officer on a three month contract, with key deliverables, whilst the Department awaited the arrival of new CIO (designate).

**October 2007 to June 2009:** Deepak Singh was appointed Acting Chief Information Officer 12 months into a three-year contract.

**October 2004 to October 2007:** Steve Lamey was appointed Chief Information Officer for both Inland Revenue and HM Customs & Excise on a four year contract. Three years into this contract, in October 2007, he was appointed Chief Operating Officer and in October 2008 he was appointed Director General of Benefits and Credits, HMRC.

#### FORMER DEPARTMENTS' CIOS OR EQUIVALENT

##### *Inland Revenue*

**April 2003 to October 2004:** Helen Ghosh, Director General, with responsibility for Corporate Services, including e-business and information resources.

**1999 to April 2003:** Tim Flesher was Deputy Chairman with responsibility for Corporate Services, including e-business and information resources.

*Customs & Excise*

**October 2003 to October 2004:** Len Morris became Director of Information and e-Services on 13 October 2003 and Acting Chief Information Officer from April 2004. He became Acting CIO for both C&E and IR from July 2004 until October 2004; working to Helen Ghosh.

**January 2003 to October 2003:** In January 2003, Information and e-Services became a separate Directorate headed by David Garlick (Acting Director).

**July 2000 to January 2003:** Alex Fraser was appointed as Director Logistics in July 2000 and left the Department in April 2003.

*October 2010*

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**Supplementary written evidence from HM Revenue & Customs**

1. Questions 212–216: *The Committee wanted to know how much HMRC is spending on staff resource to deal with the open cases from 2007–08 and an estimate of the amounts of tax involved.*

From more recent sampling we now believe that the notional value of 2007–08 underpayments is around £780 million, but we know that because of elapsed time significant numbers of cases will prove unworkable or untraceable, and in addition there will be ESC A19 concessions, so the net amount finally recoverable is expected to reduce to a range £100 million to £200 million. We estimate the costs of recovery to be around £30 million, but with increasing cost and diminishing rate of return as the value of worked cases falls.

2. Q235 Mr Bacon: *“How many associates or former associates of Mr Pavitt have been employed on temporary or permanent contracts by HMRC?”*

HMRC employs one person who is a previous associate of Mr Pavitt. This person was appointed by the Chief Finance Officer in December 2009 on a fixed term contract until November 2011 and reported to the Chief Finance Officer. Following a recent restructuring of the role and the IT organisation, the line management has changed to become a dual reporting line to the Chief Finance Officer and the Chief Information Officer.

3. Q252: Margaret Hodge: *“How many companies are there that HMRC views at present as owing more than £250 million, and with which you’re in discussions through to litigation?”*

As at 31 October 2010, there were in HMRC as a whole, 22 businesses where the total value of tax under consideration in respect of all issues on those businesses, was greater than £250 million. All of these are businesses dealt with by the Large Business Service.

NOTES:

1. It is important to note that the tax under consideration for a specific issue does not necessarily reflect HMRC’s final view of a customer’s liability. Initially, it will represent the maximum amount of tax potentially at risk from the issue in dispute, making no allowance for losses, reliefs or different legal interpretations. The tax under consideration can and does change as the facts of the issue are discussed with the customer and the legal issues are examined;
2. the businesses referred to above are at different stages in the process of reaching resolution. Some are at the early fact finding stages while others are closer to final resolution. Some of the issues are in litigation;
3. the total value of the tax under consideration for the 22 businesses, referred to above, is £14.9 billion, of which, £10.2 billion relates to 371 issues that are not in litigation and where we have not yet reached a final view of the correct tax liability. Of the remainder, £4.7 billion relates to 89 issues that are in the litigation process, or where the issue in dispute is the same as one of the issues currently in litigation, and where we expect the court’s decisions to determine the outcomes;
4. the majority of disputes that do arise are resolved by agreement between HMRC and the taxpayer, rather than through the courts, as the most effective way of ensuring that tax due under the law is established and paid. Around 90% of issues relating to the largest businesses are settled in this way. HMRC’s approach to the resolution of civil tax disputes, whether by agreement with the taxpayer or through litigation in the courts, was published on HMRC’s website in 2007 as the Litigation and Settlement Strategy (LSS). The LSS is presently under review but the basic principles will not change;
5. for the largest businesses decisions on matters where the tax under consideration is greater than £100 million or where the issue is otherwise significant are generally made by the High Risk Corporates Programme Board. This is chaired by the Director of the Large Business Service and

includes Directors of the main business areas, tax regime owners, and Solicitors. For all cases where the tax under consideration is more than £250 million, settlement proposals are required to be agreed by two Commissioners;

6. this data is extracted from HMRC's management information systems as at 31 October 2010.

4. Q299: Mr Bacon: *Could you say how many forms P800, these are the statements of reconciliation for overpayment and underpayment of Income tax, HMRC has issued in the last five years?* . . . *How many have you issued in the last five years, and how many are you anticipating issuing between the beginning of September and Christmas this year?*

#### THE NUMBERS OF FORM P800 ISSUED IN THE LAST 5 YEARS

<i>Estimated number of P800s*</i>	
<i>Year **</i>	<i>Number (millions)</i>
2005–06	3.2
2006–07	4.0
2007–08	3.8
2008–09	3.2
2009–10***	1.4

#### *Notes*

\* measured by number of mailings to customers, including copies to their agents. Numbers do not therefore equate to the number of individuals whose accounts are reconciled with an under or overpayment.

\*\* Number issued in the relevant year. These can be in respect of a number of previous tax years.

\*\*\* There was no end of year reconciliation exercise during 2009–10.

September to December 2010–11:

We estimate that we will issue notices about under or overpayments to around 5.7 million people by the end of March 2011 as part of the current exercise covering 2008–09 and 2009–10, completing 90% (c.5.1 million) by the end of December. Taking into account copies for Agents and that some people receive more than one notice, we expect to have mailed 6.3 million P800s by the end of December. As at 12 November we have mailed 3.9 million.

5. Q270: Mr Bacon: *“On the basis that your CFC specialists believed that you could get more money than you did. My question is about forward agreements on tax treatment. They are unlawful, aren't they?”*

Mr Bacon asked whether HMRC enters into forward agreements of the sort held to be unlawful in the Al Fayed case. In particular, he referred to Vodafone's press release which he seemed to suggest indicated that such an agreement was entered into as part of the recent settlement. It would not be appropriate to comment any further on Vodafone itself. However, the Committee can be reassured that it is not HMRC policy to enter into agreements of this kind, which would preclude the Department from taking account of material changes to relevant facts.

*November 2010*

#### **Supplementary written evidence from HM Customs and Revenue**

I wanted to write to *you* in *your* new role as Chair of the Committee of Public Accounts and congratulate *you* on *your* appointment.

As Principal Accounting Officer for HM Revenue & Customs (HMRC), I will be giving evidence to the Committee at fairly regular Intervals. HMRC is unique in collecting large amounts of tax revenues and each year the National Audit Office (NAO) examines our activities and principal tax streams to check our overall management of the tax systems. This results in the publication of the C&AG's report alongside the Trust Statement and Resource Accounts and an additional PAC Hearing; this year scheduled for 12 October.

I thought it would be helpful in advance of this Hearing to provide you with an update on developments to improve our contact centre performance and our plans to clear outstanding PAVE open cases.



#### CONTACT CENTRE PERFORMANCE

In response to the Committee's 24th Report on HMRC: Handling Telephone Enquiries, we have continued with our programme to improve performance:

- in the first quarter of 2010–11 we have reduced sickness absence;
- we have increased staff utilisation;
- information is available in large print, audio tape and Braille formats;
- type Talk service prefix number-18001; and
- we have significantly increased the use of IVR (interactive voice response) messaging.

The Department's planning assumption was that caller demand would reduce by 10% by 2010–11, due to the success of our demand reduction activity in 2009–10, and our planned resourcing and reduction in contact centre staff numbers was in line with this. In fact the number of daily callers has increased by 15% in the first quarter of the year and this has continued into the second quarter. As a consequence, performance in call attempts answered fell to 43% in quarter one of 2010–11 compared to 75% in the same period in 2009–10.

We are reviewing the range of reasons for this increase and the consequent impact on performance. There were more PAVE callers than expected during the period when we were issuing coding notices earlier this year. This period stretched into our high peak of demand during the Tax Credits renewals contact peak. In addition there was a 5% increase in the number of Tax Credit claimants needing to renew their claims; and a significant increase in the number of calls on the VAT helpline from customers for a variety of reasons such as giving traders help with moving to online filing and payment.

In addition, the introduction of a new caller authentication and verification service for Tax Credits which, although providing a much improved level of protection against identity theft, increased Tax Credits call handling time.

We are doing all we can to mitigate this increase in demand. We will be moving advisers between different lines in our contact centres to help handle the calls arising from this exercise and also have a contingency plan to bring in extra staff from the wider Department should they be needed. We are also developing further plans to improve long term performance. We are currently reviewing our forecast for the full year but we will not now meet the output we achieved in 2009–10.

#### LEGACY OPEN CASES

When I appeared before the Treasury Select Committee on 15 September I explained that we are currently working through plans on how to clear each open case, and we have an ambition to clear them by 2012. I have also considered the Report by the Comptroller and Auditor General on HMRC's 2009-10 Accounts and specifically the recommendation that the Department should:

- prioritise the clearance of open cases where it believes the taxpayer has overpaid tax;
- examine the scope for accelerating the clearance of the backlog through the use of automated software rather than manual working; and
- re-assess the scope to identify and exclude underpayments of tax where recovery is unlikely to represent value for money.

We are committed to completing clearance of all 17.9m outstanding legacy open cases by the end of 2012 and have set up a programme to complete this clearance through the use of automated software, with manual clearance following only on an exceptions basis.

An experienced programme director has been appointed to lead the work, the first stage of which will be to work with our supplier to design the technical solution. The next step will be to analyse all the cases to identify precise volumes of over and underpaid cases and the values associated with each case. Once we have this information, we will consider what scope there is to identify and exclude underpayments of tax where recovery is unlikely to represent value for money. We will also review what action we can take in respect of any case which may be unworkable, such as where the taxpayer is untraceable, regardless of whether it is an underpayment or an overpayment case. In the light of any such decision the open cases will then be processed and any overpayment repaid and any underpayment collected. As part of this work we will also take account of any relevant lessons learned from the current End of Year Reconciliation exercise.

In summary our approach will be to:

- develop and test the technical auto clearance functionality;
- run all outstanding cases through the solution to establish the tax effect;
- take decisions after consultation with Ministers and HM Treasury on thresholds and the approach to concessions;

- run the reconciliation process to give effect to those decisions; and
- clerically correct the cases that fall to auto-clear and either resolve them manually or re-run them through the system.

We are confident that we will be able to run this process without interfering with live operations.

*30 September 2010*

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**Supplementary written evidence from HM Revenue and Customs**

**END OF Year RECONCILIATION 2008–09 AND 2009–10**

You may have seen coverage from my recent appearance at the Treasury Select Committee on 15 September. Following this I am writing to let you know about our work to reconcile PAYE cases for the years 2008–09 and 2009–10. This is a normal part of the PAYE process, but this is the first time we are doing the reconciliation using the new National Insurance and PAYE Service (NPS) IT system, and we are doing two years at once as we were unable to do it last year. The overwhelming majority of PAYE customers have paid the right amount of tax, so their accounts will reconcile as balanced when we run this process. But for a minority there will be an over or underpayment which we must now put right.

At the start of September, we tested the process using 475,000 customer records which produced underpayment notices for some 11,000 customers, and overpayments for around 42,000. The objective of this exercise was two-fold: to act as a final test of the IT in the live environment, and to assess our operational readiness to deal with the customer response.

You will be aware that there was a huge response in the media to our decision to send out these notices, much of it focussing on the underpayments, and suggesting that it was all down to HMRC error. This is not the case—underpayments and overpayments arise for a variety of reasons, often linked to a change in a customer's circumstances during the year (for example. Changing jobs, receiving a new benefit in kind—such as a car—receiving a new source of income). As a result a minority of customers will find that they have paid too much or too little tax at the end of the year.

I am pleased to report that the test was successful. We are confident that the system is in as good a shape as it can be. Our analysis indicates that we have a 95% confidence of an error rate of 2% or less. Contact volumes have been within our forecast range, and many customers have been able to get the information they needed (especially those chasing refunds) by listening to our recorded message service.

As a result I am satisfied that we are now in a position to move to full live running of the EOYR process, and I have agreed it should start from 1 October. We expect to issue around 90,000 notices a day and hope to have completed the bulk of this exercises before Christmas.

Our forecast is that, in total, around 4.3 million taxpayers will receive repayments, while an estimated 1.4 million will be sent letters telling them they have underpaid along with an explanation of the calculation and how it can be reviewed. The total underpayments are worth about £2 billion while the overpayments are worth about £1.8 billion.

We have put in place a number of measures to ensure that we maintain effective levels of customer service during what will be a very busy time. These include improvements to the explanatory note accompanying the notices, and new guidance on the internet. You will also recall that the Commissioners took the decision not to collect smaller underpayments of tax and increased the tolerance level for underpayments to £300.

I hope this is helpful.

*1 October 2010*

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**Supplementary written evidence from HM Revenue and Customs (06)**

Following my letter dated 28 October, in which I responded to a number of issues raised at the Committee of Public Accounts hearing on 12th October, and our subsequent telephone conversation, I am writing to offer some additional information about our legacy open cases.

At the hearing on 12 October 2010 you questioned me on the impact of the Spending Review on my undertaking of clearing open cases by 2012. Following the Chancellor's spending review announcements on 20th October, we are working through the details of the settlement. I can confirm that it is still my intention to have cleared the open cases by the end of 2012, subject to the successful implementation of a technical IT solution that I also mentioned at the hearing which will allow a substantial amount of the work to be done automatically.

As the Committee is aware, the cases go back a number of years and we intend to repay all cases where there is an overpayment of tax and to date we have been prioritising these cases. However, I have to take a view now on what underpayments to prioritise and there are time limits in collecting tax from previous years. Finance Act 2008 reduced the relevant time limit from six years to four years as part of a wider alignment

of time limits across all the taxes which aimed to simplify the system and reduce customer burdens. This took effect from April 2010 which meant that income tax due for 2004–05 and 2005–06 became uncollectible at that point although even without the deadline in practice very little would have been recoverable.

The deadline for working the underpayment cases for 2006–07 is 5 April 2011, but in practice we do not have that length of time or resources to establish a legally enforceable debt. We are therefore continuing to prioritise our resources to work overpayments, but we have decided that, in relation to end of year reconciliation work, we will devote our remaining available resources to recovering 2007–08 underpayments, to maximise the return to the Exchequer. We intend to focus first on the higher value cases by working these clerically, again to maximise the return to the Exchequer.

For the tax year 2006–07 the estimated number of underpayment cases was 1.92 million. If we applied the same £300 tolerance as we have applied to the current reconciliation exercise we estimate that the number of underpayments would fall to less than half a million. After taking into account those who would be impossible to trace and those who are likely to be entitled to the benefit of the extra statutory concession A19 this estimate falls to around 170,000.

Had we been able to start working these cases in April 2010, the maximum amount we might have recovered would have been less than £100 million. However, as we have already discussed with you we had diverted staff to the annual coding exercise and we also prioritised repayments. We think the amount now recoverable from an estimated notional value of £500 million at April 2007 would have been around £25 million. This is very much a legacy issue. For 2008–09 and later years the NPS system will be able to do the reconciliation exercise automatically for the vast majority of the cases. It is that functionality we will also be utilising to clear the remaining open cases once we have implemented the technical solution.

The end of year exercise for 2008–09 and 2009–10 continues to progress well. I can give an up to date position at the hearing if that would be helpful. I am of course happy to answer any questions you may have in advance of hearing and we will continue to keep the Committee updated on our progress.

*12 November 2010*

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**Supplementary written evidence from HM Revenue and Customs**

**COMMITTEE OF PUBLIC ACCOUNTS HEARING ON HMRC 2009–10 ACCOUNTS AND  
C&AG'S REPORT**

Following my letter dated 12 November, in which I provided some additional information about our legacy Pay As You Earn (PAYE) open cases, I am writing to offer a further update about the approach we plan to take in order to secure the best value for the taxpayer in our collection of underpayments for the year 2007–08. This letter is also to tell you about how we have managed an issue concerning pensioners and the application of extra statutory concession (ESC) A19.

At the Committee of Public Accounts Hearing on 16 November, you asked me how much of the value of the PAYE underpayments for that year might be recovered. I reserved my answer, as we needed to conduct a proper analysis of what would give us the best return for the taxpayer given the resources available and the trade off with other priorities. In particular I was mindful of the fact that we get a much better return when we collect more recent debt than when we go after older debt, and that our focus in recent months has been the running of the end of year reconciliation (EoYR) exercise for the years 2008–09 and 2009–10.

Our analysis shows that the best and most reliable way of recovering underpayments of less than £2,000 is to collect the money through PAYE. The collect 2007–08 underpayments by adjusting the tax code which will apply for the tax year 2011–12, we need to process these cases now as we only have until late March to do this work. We will prioritise cases which represent larger amounts to maximise value for money given our limited resources.

As the Committee is aware, we decided not to collect underpayments of less than £300 to deal with the operational impact of the 2008–09 and 2009–10 EOYR exercise. This allowed us to remove high volumes of customers with lower value underpayments from the process, thereby protecting service levels for customers generally, with minimum impact on revenue foregone.

For 2007–08, concentrating on cases worth £300 or more leaves in scope around 25% of the cases to deal with by volume, but those contain around 80% of the value. The Commissioners of HMRC have therefore decided, using our Collection and Management powers, that the £300 tolerance should also apply to the 2007–08 year in order to allow the work to get the underpayments into codes to start as soon as possible.

I wanted also to update you on a decision the commissioners have taken concerning the application of extra statutory concession (ESC) A19 to some pensioner cases as part of the EoYR exercise for 2008–09. In about 250,000 cases the customer had received state pension but that had not been included in their tax code for 2008–09 and 2009–10, and because they have other income this is likely to result in an underpayment of tax. These cases may have built up over several years and only surfaced now because national Insurance and PAYE System (NPS) allows us to pick up cases where an individual is over state pension age and does not have that state pension income included on their NPS record.

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Of this population of 250,000 who might have been liable, we considered most would have a good claim for the tax to be foregone by HMRC under the terms of ESC A19. Without issuing notices of underpayment to each relevant customer we cannot identify in advance which of these customers would be eligible for ESC A19 to be applied. On the basis that the vast majority would, if they contacted us, be eligible for concession the Commissioners have therefore decided that the department should not seek individual claims.

Finally I am pleased to report that by the end of the calendar year we completed 90% of the cases where HMRC had received all the relevant information for the years 2008–09 and 2009–10. We are now working hard to complete the process for the remaining cases.

*January 2011*

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