



House of Commons
Committee of Public Accounts

Inland Revenue: Tax Credits and deleted tax cases

**Fifth Report of
Session 2005–06**

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

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The Committee of Public Accounts

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Summary

The Government replaced the Working Families and Disabled Person's Tax Credits with Child Tax Credit and Working Tax Credits (the New Tax Credits) in April 2003. Some 5.7 million families received Tax Credits in 2003–04 at a cost of £16 billion. In April 2004,¹ the Committee reported on the severe problems following the introduction of the New Tax Credits, which meant that several hundred thousand claimants were not paid on time.

The Government intended the New Tax Credits² to provide a system that was simple for people to understand and to administer. In practice many people have found the scheme difficult to understand. Many have complained to the Inland Revenue about the system and the frustration and misery it has caused to claimants. The administration of the schemes has also proved complex and HM Revenue and Customs (the Department) has not met its targets for the accuracy of processing and calculating awards.

Many people received overpayments of Tax Credits in 2003–04, some caused by software errors and Departmental mistakes. But the design of the system also results in other claimants being routinely overpaid Tax Credits, which the Department seeks to recover in future years. The overpayments and subsequent recovery make it difficult for claimants to plan their finances.

The Department's most recent estimates of fraud and error, published in 2003, indicated that overpayments were between 10% and 14% by value. The Department had suggested that with the introduction of New Tax Credits error rates would be half those of the previous system, but they have no evidence that this reduction has been achieved.³

Routine housekeeping software has been wrongly deleting taxpayer records for many years.⁴ As a result some taxpayers will not have received the repayment to which they were entitled, while others owe tax that will now not be collected. The Department estimates that almost one million records were wrongly deleted in the period 1997 to 2000.⁵

To deal with the Tax Credit problems the Department had to move staff from other tax work, which created backlogs of work on taxpayers cases and enquiries. The Department needs to recover from these backlogs.⁶

1 14th Report from the Committee of Public Accounts, *Inland Revenue: Tax Credits* (HC 89, Session 2003–04)

2 HM Treasury, *The Modernisation of Britain's Tax and Benefit System, Tackling Poverty and Making Work Pay – Tax Credits for the 21st Century*, March 2000

3 C&AG's Report, *Standard Report on the Accounts of the Inland Revenue 2003–04* (HC 1082, Session 2003–04), paras 2.24–2.26

4 *ibid*, para 1.16

5 Q 31

6 C&AG's Report, paras 2.34–2.36

Conclusions and recommendations

- 1. The operation of Tax Credits has proved unsatisfactory for a significant minority of claimants who were disadvantaged and who cannot understand how much they are due or why in so many cases such large overpayments have been made.** The Department does not have sufficient information about the claimant population to enable it to provide good service to the public and avoid disruption to its own main business of tax administration. The Department should review the information provided to claimants to enable them to understand their Tax Credit awards, and should develop as a matter of urgency the operational information needed to manage the Department's relationship with claimants and the effects upon them.
- 2. Members of Parliament have been inundated with distressing complaints from constituents whose lives have been affected by the Department's management of Tax Credits.** The Department has also received a large volume of complaints about Tax Credits, as have the Citizens Advice Bureaux. The current appeals and complaints procedures do not include any independent process, however, and the Department remains the final arbiter.
- 3. The scale of overpayments being recovered from claimants is much higher than envisaged when the Tax Credit scheme was designed.** Tax Credit initial awards are provisional and the final award for the year in question is often significantly reduced because the claimant's pay has increased by more than £2,500, which is disregarded. This leads to recovery of the overpayment. The Department published figures in June 2005⁷ showing that some 1.8 million (33%) of claimants had been overpaid in respect of 2003–04. The Department should review and report each year on the effect on claimants of the inbuilt overpayment and recovery of substantial sums of money so that Parliament can judge whether the consequences for claimants are compatible with its intentions in passing the legislation.
- 4. The Department cannot show whether error rates attributable to claimant error and fraud have halved as it predicted in December 2003.** The Department undertook to report on this issue by July 2005, by which time over £30 billion would have been spent on New Tax Credits. That report should quantify and analyse in detail the estimated overpayments due to fraud and error; set out targets for reducing overpayments and plans for achieving them; and show the performance indicators used by the Department to manage Tax Credits.
- 5. Schemes that are intrinsically complex carry the risk of being too difficult for the intended beneficiaries to understand and for departments to handle.** The Accounting Officer's ability to guard against fraud and error, and to secure economy, efficiency and effectiveness, may also be impaired by undue complexity. Accounting Officers should see that Ministers are made aware of the risks presented by unduly

7 HM Revenue and Customs: Tax Credits finalised awards 2003–04 (1 June 2005) www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-payments-0304.pdf

complex schemes, and if necessary be ready to seek a Ministerial direction where such schemes would be hard to implement to an acceptable standard.⁸

6. **The Department estimates that routine housekeeping software incorrectly deleted almost one million taxpayer records in the period 1997 to 2000, resulting in over 360,000 unidentifiable taxpayers not receiving repayments due and 22,000 others not paying tax that was due.** The Department needs to maintain reliable and comprehensive management information to monitor the operation of IT systems, including data that would enable unintentional record deletion or loss to be detected promptly.
7. **The problems in administering Tax Credits have entailed some impairment of the Inland Revenue's reputation for accuracy, fairness and proper handling of taxpayer affairs.** The Department's effectiveness in managing the tax system depends on maintaining public confidence in its administrative competence. It needs to demonstrate and convince taxpayers that it has resolved the problems caused by Tax Credits; caught up on the backlog of other work; and maintained its capacity for timely, fair and accurate processing of taxpayers' affairs.

8 A direction from the responsible Minister for the Accounting Officer to implement a course of action against which he or she has advised the Minister on either value for money or regularity and propriety grounds.

1 Administration, complexity and public understanding

1. The Government replaced the Working Families and Disabled Person's Tax credits with the Child Tax Credit and Working Tax Credit (New Tax Credits) in April 2003. Some 5.7 million families received New Tax Credits during 2003–04 at a cost of approximately £16 billion. Of these, several hundreds thousand claimants were overpaid New Tax Credits mainly because of the inherent design of the schemes, but also because of software errors.

2. The design of the system inevitably results in overpayments to many claimants. The Inland Revenue (the Department) makes provisional Tax Credit awards based on a claimant's income for an earlier year. The final award is assessed on actual income for the year. Tax Credit entitlement is reduced by 37p for every additional £1 of annual income over certain limits. Incomes tend to increase from year to year, so the final award is often lower than the provisional award. Except where caused by error, the extent of overpayments reflected claimants' improved economic circumstances.⁹ Software errors in the New Tax Credits system have resulted in overpayments of £174 million to 540,000 of the overall 1.8 million claimants overpaid.

3. The Department usually seeks recovery of overpayment from future Tax Credit awards in order to ensure that people get no more than they are entitled to. If repayment would cause the claimant hardship, the Department may waive all or part of an overpayment of Tax Credits, or allow more time to pay. But the Tax Credit IT system could not stop the recovery of overpayments while the staff considered hardship cases. The Department planned to start to change the system in the autumn of 2005 to prevent this automatic recovery of overpayments in some circumstances.¹⁰

4. The Department has written off amounts where the individual overpayment was £300 or less, and has sought recovery of amounts above £300. The Department writes off overpayments over £300 only where it considers that it was reasonable for a claimant to believe that their Tax Credit award was correct. It wrote off £37 million in 2003–04 and expected to write off similar amounts of overpayments in 2004–05.¹¹ The Department established the £300 threshold by reference to the costs of recovery. The Department is doing more work to improve its understanding of the administrative cost structure to see whether it should revise the write off limit.¹²

5. Members of Parliament and organisations such as the Citizens Advice Bureau have been inundated with complaints from claimants who have found the New Tax Credits scheme complex and who are unsure how much they are due. The situation has been exacerbated by departmental staff who have advised people to contact their Member of Parliament so

9 Q 3

10 Q 125

11 C&AG's Report, paras 2.10–2.13

12 Q 56

that their case would be considered more quickly.¹³ The Department considers it debateable whether these were typical of the wider story, but without being able to demonstrate that they were not.¹⁴

6. It believed that it needed to go through two or three annual cycles before making a judgement as to whether the system had met the expectations of Parliament.¹⁵

7. New Tax Credits have also proved complex and costly to administer. In 2003–04, the Department employed around 7,300 staff on New Tax Credits work and the full administrative cost was £403 million.¹⁶

8. The Department's target for the accuracy of processing and calculating Tax Credit awards was 90% in 2003–04.¹⁷ It failed to meet this target and the actual level of accuracy was only 78.6%. The results are worse than under the previous scheme.

9. The Department has received many more queries and complaints on New Tax Credits than it expected. The Inland Revenue told us that it had found many cases to be complicated and there were cases where it had struggled to decide on the appropriate response.¹⁸

10. Problems with New Tax Credits have adversely affected tax administration. The transfer of staff from other duties to deal with New Tax Credits problems, has created a backlog of work which the Department needs to clear. The diversion of resources also affected processing quality and accuracy, and the Department missed the Public Service Agreement target for the percentage of tax enquiries worked to a fully satisfactory standard.¹⁹ The Department is seeking to achieve major efficiency savings, including reducing staff numbers. The challenge is to make these reductions without customer service suffering.²⁰

11. The effectiveness of the Department in assessing and collecting taxes largely depends on its reputation for accuracy, fairness and proper handling of taxpayer affairs. The problems in administering Tax Credits have affected the public's perception of the Department, as it acknowledges.²¹

12. Claimants who have encountered problems can complain to the Department. By the end of 2003–04 there were 32,000 complaints in respect of Tax Credits and since then there have been tens of thousands more. The Department have tried to publicise the availability

13 Q 123

14 Q 133

15 Qq 4, 57

16 Inland Revenue Trust Statement 2003–04 Note (3(iv)), (HC 1062, Session 2003–04)

17 C&AG's Report, para 2.18

18 Q 15

19 C&AG's Report, para 2.35

20 Q 19

21 Q 114

of appeals and the opportunity that individuals have to complain, as well as the factors people can use in presenting an appeal.²² It provides claimants with details of the policy for handling complaints in the *Code of Practice 1, Putting Things Right* which the Department sends out with award notices. Claimants have no further appeal against the decision of the Department, whose judgement is final.²³

13. The Department pays compensation to people who have suffered most from the problems with New Tax Credits. These payments are made to claimants when Departmental mistakes and delays have caused people worry and distress or have resulted in claimants incurring additional costs. In 2003–04 an average of £34 was paid to 10,800 people.²⁴ Further compensation has been paid in 2004–05 and the average has almost doubled. The Department told us that the level of compensation paid was never adequate for the hardship and suffering which people had gone through, and that it was a way of saying sorry.²⁵

22 Q 105

23 Q 108

24 C&AG's Report, para 2.15

25 Q 139

2 Claimant error and fraud

14. Tax Credits carry the risk of fraud through claimants providing false information, for example understated or undeclared income, fictitious children or misrepresented childcare. The Department's most recent estimates of error and fraud by Tax Credits applicants were prepared in 2003. That work indicated an error rate of between 10 and 14% by value. The Department told us in December 2003 that it expected error rates to be halved by the introduction of New Tax Credits in April 2004.

15. Our predecessor Committee's Report of April 2004²⁶ concluded that the level of errors caused by claimant error and fraud in tax credit payments was unacceptable and recommended that the Department should take all necessary steps at least to halve the error rates. They recommended that the Department should make comprehensive cross checks to other departmental information sources, set quantified targets and timescales for further reductions and report performance against these targets.

16. At the Committee hearing on 24 January 2005 the Department could not provide any quantified estimate of the level of claimant error and fraud for New Tax Credits in 2003–04²⁷ and explained that it would not be able to do so before July 2005, after all claimants had confirmed their circumstances. The Department had undertaken some work on the provisional awards for 2003–04, but it could not make reliable quantified estimates from this work.²⁸

17. The Department said that in undertaking in December 2003 to halve error rates, it must have assumed that certain tools would be available which had not materialised.²⁹ The Department could not say whether it would ever get errors below 5%³⁰ but undertook to provide this Committee with an update on these issues by July 2005. That document is included in the written evidence with this Report.³¹

26 14th Report from the Committee of Public Accounts, *Inland Revenue: Tax Credits* (HC 89, Session 2003–04)

27 Qq 7–8, 10

28 C&AG's Report, para 2.25

29 Q 104

30 Q 12

31 Ev 23–26

3 Deleted tax cases and governance of IT projects

18. In 2003 the Department became aware that routine housekeeping software had wrongly deleted taxpayer records for many years. The software was intended to cleanse the databases of cases over three years old where the Department's work had been completed. But the software also deleted live cases. The Department discovered the problem in 2003 when it introduced a new information system that enabled monitoring of the system in question.

19. The Department estimates that almost one million records were incorrectly deleted in the period 1997 to 2000.³² The incorrect deletions mean that some taxpayers will not have received the repayment to which they were entitled and others owe tax that will now not be collected. The Department also estimates that, as a result of the deletions from 1997 to 2000, some 364,000 people have been underpaid by a total of £82 million (£226 average) and some 22,000 people overpaid by around £6 million (£259 average).³³

20. The software has also incorrectly deleted records for earlier years, but the number of cases involved was much smaller. Before 1997 the Department was clearing 99% of cases before they were three years old, but problems with the National Insurance Recording System (NIRS 2) resulted in a build up of open cases.³⁴

21. The Department has looked at its other systems and has tried to learn the lessons from the detection of the deleted tax cases. When it deletes taxpayer records now it stores them on a backup file, so that it can reconstitute the information if it is needed.³⁵

22. IT systems are essential for the administration and collection of taxes and the Department has suffered from high profile problems with its IT systems, mostly operated by private sector IT service providers. Problems with the IT systems when the New Tax Credits schemes went live in April 2003 resulted in several hundred thousand claimants receiving payments well after they fell due. The Department was also unable to reconcile payments made with amounts authorised.

23. The Department has been negotiating with EDS—its previous IT service provider—for compensation for unsatisfactory system performance. This process was facilitated by an independent arbiter, who has reported his findings but EDS has not accepted them. The Department is considering its legal options.³⁶

32 Q 31

33 Q 46

34 Q 29; 38th Report from the Committee of Public Accounts, *NIRS 2: Contract Extension* (HC 423, Session 2001–02)

35 Q 113

36 Q 17

24. Our predecessor Committee's Report in April 2004 noted that New Tax Credits was one in a series of major IT systems that had caused serious problems. It concluded that the Department should have been more cautious and realistic in fixing the timetable and assessing the resources needed. At the Committee's hearing on 24 January 2005 the Department stressed that it had learnt the lessons from previous problems. The contract with the Department's new IT provider, Capgemini, included a more severe penalty regime, though such clauses inevitably affected the 'price' of the contract.³⁷

Formal minutes

Monday 18 July 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mrs Angela Browning
Greg Clark
Helen Goodman
Ms Diana R Johnson

Mr Sadiq Khan
Sarah McCarthy Fry
Jon Trickett
Mr Alan Williams

Draft Report (Inland Revenue: Tax Credits and deleted tax cases), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 24 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

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

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

Ordered, That the provisions of Standing Order No. 134 (Select Committees (Reports)) be applied to the Report.

[Adjourned until Wednesday 12 October at 3.30 pm

Witnesses

Monday 24 January 2005

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Mr David Varney, Mr Paul Gray CB, and Mr David Hartnett CB, Inland Revenue

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Oral evidence

Taken before the Committee of Public Accounts

on Monday 24 January 2005

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Mrs Angela Browning
Mr David Curry
Mr Ian Davidson

Mr Frank Field
Jim Sheridan
Mr Gerry Steinberg
Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, National Audit Office, further examined.

Mr Brian Glicksman CB, Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

Standard Report 2003-04 (HC 1062)

Witnesses: **Mr David Varney**, Executive Chairman; **Mr Paul Gray CB**, Deputy Chairman, and **Mr David Hartnett CB**, Director General (Policy and Technical), Inland Revenue, examined.

Q1 Chairman: Good afternoon, and welcome to the Committee of Public Accounts, where today we are looking at Tax Credits, Stamp Duty, Land Tax and Deleted Tax Cases, and we are joined once again by Mr David Varney who is Executive Chairman of the Inland Revenue. Would you like to introduce your team?

Mr Varney: Paul Gray is Deputy Chairman of the Inland Revenue, responsible among other things for the business operations, and David Hartnett, who I think you have seen before is the Board Member responsible for the technical and policy issues.

Q2 Chairman: Thank you very much. Could I please ask you to look at the Comptroller and Auditor General's Standard Report, paragraph 2.7 on page 123. We know that we had the lengthy tax credit delays and we have already gone through that in some detail previously; we now have large demands for recovery of overpayments. Do you think this is the right way to treat vulnerable people?

Mr Varney: I think there is a very difficult choice to be made in terms of overpayment, which is the balance between compassion and compliance. What we try and do, and we have to do this on individual cases, is look at what the merits of the case are and of the number of overpayment cases we have had, which I want to deal with because they are caused by different reasons, of those which result from the computer errors we have looked at the cost of recovery of that set of overpayments as against the amount we are trying to reclaim and decided that in those cases which are under £300 of overpayment we will not pursue the reclaim of money. That has reduced significantly the number of cases affected. In the other cases we think there is a reasonable case for looking at recovering overpayment in general, though there will be particular case claims we will look at, but I think it is a very difficult area. Can I also make clear that in the design of tax credits it is

in the nature of the system that is relating payment to income and circumstance that there will be overpayments.

Q3 Chairman: I accept that referring to paragraph 2.4 on page 121 I just wonder whether it is administratively acceptable to design a system which generates large amounts of overpayments. We are talking about vulnerable and, by definition, poorer people; I just wondered whether MPs, when they voted for this to go through the House, would have done so if they had realised that the people in difficulties were, as a matter of course, being required to pay back money to the Inland Revenue. If you are on a low income this makes life very difficult indeed. I understand your point about them not having to pay if the overpayment is less than £300 but that, of course, may compound the problem. You are on a low income, you get a bill from you for several hundred pounds—which is not your fault as the person who may have a fairly modest wage—and you suddenly get a bill from the Inland Revenue for several hundred pounds, and you have designed the system in this way?

Mr Varney: I think what we are trying to do is operate the system which, as you rightly say, Parliament has set up. If I can put the computer errors to one side and just deal with the underlying issue, we dealt with the estimation of the benefit based on the income of 2001–02, and a number of people's economic circumstances have improved considerably during the period up until 2003–04, which is why there has been a generation of overpayments, and we obviously have set rules which are laid out in our code of practice which means that we do not recover the full amount if the person is in great hardship. There are rules in place to minimise the amount of recovery but to do it over a longer period of time, and we are clearly not trying to drive people who are already in difficult

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circumstances even more, but we also have to protect a system where people get what they are entitled to, not receive overpayments as a matter of course.

Q4 Chairman: You come with all your experience in the private sector, and this is now your second appearance before the Committee, and you have had a chance to look at this, I just wonder whether you think it is fair that people on lower incomes have been given this double whammy. First of all they have all these delays; now they have a system which generates overpayments. Are you entirely happy with this? Is there no way of redesigning the system?

Mr Varney: We need to go through two or three cycles. The renewal cycle we have just been through has operated much better than previously experienced—that is not to say it is trouble free and it is not to say there have not been people affected by error, in a system this size we are bound to have individual cases—but I do not think we are in a position to add anything more to the debate than Parliament itself did in terms of the experience of the operation of the system at this stage. I still think there is more work to be done.

Q5 Chairman: If we look at paragraph 2.10 and subsequent paragraphs on page 24, there were these two major systems errors which resulted in tax credit overpayments of £94 million and £80 million. Why were these errors not picked up during testing?

Mr Varney: Dealing with the first one, the £90 million, paragraph 2.10, the issue I think was discussed extensively with the Committee of Public Accounts last year and I think you were given a considerable amount of evidence why it was not picked up, and debated the testing period in volume testing, these are the group that we have looked at and I have spoken earlier about the balance between administrative cost and whether it is worth pursuing the smaller sums of money. On the £80 million, that is the other case which is the one I think I wrote to you about subsequent to the publication of the Committee's Report, that was an error which we picked up, we had not picked it up before, and we addressed it, made some changes to the system, and we have written to all the individuals that have been affected. In the majority of cases we are reclaiming the overpayment by moderating the amount that is paid over the balance of the financial year.

Q6 Chairman: Let's look at fraud and error now. By July 2005 you will have spent £30 billion on tax credits, is that right?

Mr Varney: About that, yes.

Q7 Chairman: So what interim estimates have you got on fraud and error bearing in mind the undertaking given by your predecessor? He told us that he was going to halve tax credit claimant errors to 5–7% by value. Are you generally meeting that commitment to this Committee?

Mr Hartnett: Chairman, I will pick that up, if I may. The first round, the 2003–04 year of tax credits, will not be finalised with investigations carried out until

probably July 2005. That is the first time we can get a reliable estimate through random inquiries of what the level of fraud and error might be. However, we did look at a sample of provisional claims, because they have to remain provisional, and looking at that sample it seemed that the error rate was below 10% and depending on groups somewhere between 6% and 10%, but that did not lend itself to a financial quantification.

Q8 Chairman: So what is the answer to my question? Are you meeting the commitment given by your predecessor to this Committee, Mr Varney?

Mr Varney: I think, as we are saying, we have not been able to measure the error rate.

Q9 Chairman: Then why did you give that commitment to us, if it is not measurable?

Mr Varney: I think you will have to ask him.

Q10 Chairman: We cannot ask him; you are now responsible. You are the Accounting Officer. A commitment was given to this Committee. We are talking about £30 billion spent on tax credits; a commitment was given to this Committee about fraud and error and we expect it to be met, and you are now saying "It is no good asking me, Guv; ask my predecessor".

Mr Varney: I will explain the reality which is that we have not yet completed the work on the errors.

Q11 Chairman: When will you complete it?

Mr Varney: I think some time around the middle of the year. We have also had a situation where we have stepped up the amount of work that we have been doing in terms of detecting fraud, and you can see this on stamp duty as well. When we introduce a new tax or benefit, we try to put all our effort into trying to explain to people how the system works, which we do because in the longer term it is in the best interests of maximising compliance. As we get clear evidence that people understand what the system is and the way it works we step up our efforts in terms of deterring non-compliance, and that is because we feel we have more people understanding the system. That is a balance issue, and so I am unable to give you an answer more than was said last time by the previous Accounting Officer.

Q12 Chairman: Will you ever get below 5%?

Mr Varney: I do not know.

Q13 Chairman: So it was unwise of your predecessor to give us the commitment that he did, then?

Mr Varney: I can only tell you the position I am in.

Q14 Chairman: Clearly it was because you are saying you are now unable to give any kind of prediction or commitment whatsoever?

Mr Varney: I am saying we will do the work and when I have done that it will inform the advice I can give.

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Q15 Jim Sheridan: Mr Varney, I am sure the frustration that this has caused among many of our constituents is not lost on you, and the additional workload it has caused to Members of Parliament. Starting with a clean sheet of paper and with the benefit of hindsight, what lessons, if any, have you learned from this debacle, and what advice would you give any other members in the Department embarking on such a programme?

Mr Varney: First, let me apologise for any failure on our part to reply to questions promptly and accurately and meet our obligations. You are right, we have been struggling, in the number of cases where people have been affected, to consider what is the appropriate response and many of these are quite complicated cases. I think there are lessons which came out of your last Report which we looked at in terms of large and complicated systems, and in terms of introducing them I think we have tried to apply those lessons, not least in stamp duty land tax but the way we go about big computer projects. There was a lot of discussion about being an intelligent customer and there is the major cultural challenge, which I think a lot of our people have risen to, of moving to a bigger tax collector and also of being a distributor of benefits. I think that has been a major challenge. On the size and scale of this operation I think there are some bits that have worked incredibly well. We have taken over the last 12 months 15 million phone calls which have been answered within 20 seconds which is a volume of telephone calls which is truly alarming, so lots of things that have gone well have been overshadowed by the problems in those areas which you know we have had.

Q16 Jim Sheridan: Did your Department have the technical expertise for this programme?

Mr Varney: We put a lot of faith in EDS' technical ability as part of the selection and that turned out to be misplaced. We have taken advice. As you know I have recruited a chief information officer from outside the public sector; I think we have reflected with colleagues in OGC and with colleagues in government the experience and are trying to learn from it.

Q17 Jim Sheridan: I assume that you are pursuing EDS for compensation. Where are we with that, and how much?

Mr Varney: We are pursuing them. We had, as is normal in these sorts of cases, a period of an independent specialist counsellor, I suppose is the best word, who was technically and legally qualified to whom both sides put their evidence; this was entirely voluntary, trying to resolve the impasse between us. The gentleman has reported; his report has not been accepted by EDS, and therefore we are considering our legal options, and I do not think I can really say more to the Committee without, in a sense, treading into territory which may lead the public purse to suffer in the event that we want to pursue this in a court case.

Q18 Jim Sheridan: Is there a timescale on this?

Mr Varney: I think in terms of the case itself, once it gets into the courts these things tend to take a number of years. If you look at most of the cases they tend to be settled some time during the court case by one side or the other, so I think we are doing all the steps we can now to prepare for a legal case.

Q19 Jim Sheridan: Given the announcement there will be thousands of civil servants losing their jobs, in any future thinning of the Inland Revenue, will that impact in any way on the progress you are making?

Mr Varney: I do not think so. I think our challenge is to make the reductions we have to make in ways where customer service does not suffer.

Q20 Jim Sheridan: On the question of claimants themselves, there is an awful lot that depends on the claimants themselves giving you accurate information. Is that right and proper, that you should be dependent on claimants giving you that information?

Mr Varney: This is a difficult question to answer, is it not? I think claimants have some responsibility. The judgement Parliament took is that there was a £2,500 dead zone in which changes on the income would have no impact on entitlement inside a year and there was the judgment that that £2,500 was a reasonable number, and not every single change had to be reported. Clearly there are other changes like the child, the state of the relationship, who has been claimed for, where it is right that claimants have some responsibility in the activity. I think that is fair.

Q21 Jim Sheridan: In circumstances where people's lives change, it is not a priority for them to automatically contact your Department to tell them that circumstances have changed, is it? Could it be that they forgot about it?

Mr Varney: We try, through newsletters and publicity, to make sure people understand, and when the Chairman asked me about the annularity of the awards, I will get more experience of how much people are learning and they do have a three-month window in which to notify us of some of the changes, like a child or a partner, but I think Parliament has really made a judgment which, as far as I can see, is still pretty reasonable. It passes the man on the Clapham omnibus test.

Q22 Jim Sheridan: Given that there are a large amounts of overpayments due, and as the Chairman has already identified a lot of these people are vulnerable, how do you intend claiming back the money that has been overpaid. Is it a one-off lump sum payment?

Mr Varney: No. We will obviously study those cases where people are claiming it is an official error and that we are responsible and they could not reasonably have known. We will not pursue them. But in those cases where we do want to pursue reclaiming the money individuals obviously have the right to appeal, if that is what they want to do; if we still get through and that is the right decision, then

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the amounts that we can reclaim are limited by our code of practice which is repeated by the Comptroller and Auditor General in his Report, so depending on family circumstance we would recover in a more delayed way, and people who are no longer receiving tax credits whom we want to recover the money from sometimes seek from us a timescale over which that can be done.

Q23 Jim Sheridan: And what happens if they refuse or cannot pay back?

Mr Varney: I think “refusal” is slightly different to “cannot”.

Q24 Jim Sheridan: What is the penalty if they refuse?

Mr Varney: In the end we could seek to pursue recovery of the money through the courts.

Q25 Jim Sheridan: How much would that cost?

Mr Varney: We would have to make a judgment in each case. There is no point going through the courts if it is going to cost you more than the benefit you receive at the other end, but can we just be clear that refusal for no reason puts us in an incredibly difficult position. If someone has a hardship case our instructions are to examine that hardship case.

Q26 Jim Sheridan: But if some of the claimants know exactly what you have just said, that it is not worthwhile the Department pursuing them through the courts so just drop it, that is what they will do.

Mr Varney: That is not good either so we have to have the right balance between compassion and compliance.

Q27 Jim Sheridan: But what I am saying is that if someone knows that it is not going to be worthwhile the Department pursuing that claim because it is going to cost more to go to court than that is what some claimants will do. They just will not pay it.

Mr Varney: We have to make judgments. It depends on the case itself. It is very difficult to give a generalised view on this but if we decide that this is a vexatious refusal to pay which may have wider consequences then it is perfectly fair to pursue it through the courts.

Q28 Mr Bacon: Mr Varney, I would like to draw your attention to paragraph 1.16 on deleted taxpayer records. It states, “The Department became aware in the autumn of 2003 that a well established and accepted housekeeping routine on the PAYE computer databases had for a number of years deleted some records before the usual final review to check whether any tax remains overpaid or underpaid for the relevant year. This means that some customers will not have received the repayment to which they may have been entitled and others may owe tax which has not been collected. As the records have been deleted there is no way of identifying those whose records were open when the process was run.” Now since then you have written to me and it has been copied to the Committee stating that some 638,000 records, it is estimated, were deleted while still open for the years 1999–2000

and 1998–99. That is only for two years but in your letter you state also that the process, the function, the routine, is at least 10 years old, so firstly how many in total do you think had their records deleted, whether or not there is anything you can do about it now? Presumably that 638,000 is a small proportion of the total number of deleted records.

Mr Varney: We think not, but let me explain why. We think in the earlier years when the routine housekeeping was being done there were fewer problems with open cases—

Q29 Mr Bacon: You were clearing 99% of your cases before they became three years old?

Mr Varney: Yes. The issue really came with the NIRS 2 problem which led us to get behind on clearing up open cases, so we have an estimate of cases which we think were in 1997–98 which I think were about 275,000 which were deleted.

Q30 Mr Bacon: That is on top of the 638,000?

Mr Varney: Yes.

Q31 Mr Bacon: So that is already pushing up towards 900,000?

Mr Varney: Yes.

Q32 Mr Bacon: If you go back towards the 10 years that this function has been operating, what would it be in total?

Mr Varney: No, we do not think there would be many open cases because we were clearing open cases within three years.

Q33 Mr Bacon: Or 99% of them?

Mr Varney: Yes, so we think it is a very small number.

Q34 Mr Bacon: It says in your letter, “New management information systems . . . revealed that a function to cleanse the database of old redundant records was deleting cases that we did not want deleted”. I must say, you make it sound like Hal 9000 going off and doing its own thing completely independent of human hand but it strikes me if this new management information system revealed this, what else did it reveal? What else has it detected?

Mr Varney: One can never be quite sure but what we have done is, as a result of this, looked at our other systems. In almost all other cases we keep the data; what we were not doing in this particular case was backing up the data. The data has to be cleared in order to keep the PAYE database operable, and not loaded with cases which are finished.

Q35 Mr Bacon: It is not a philosophical question. I am asking you what else has been detected, if anything?

Mr Varney: Nothing else.

Q36 Mr Bacon: What I do not understand is how could a routine be created which deleted material it was not supposed to delete? We are talking here about your core data on taxpayers, people who owe you money and therefore owe the Exchequer money

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to pay for our public services, and people who are owed money, and before that was settled, whether they owed you or whether they were owed, it was deleted. How could a programme have existed for such a long time that allowed that to happen?

Mr Varney: I think it existed because the connection was not made between the build-up of open cases and the length of time and this routine, so this routine was seen separately from the build-up of the open cases.

Q37 Mr Bacon: I am still not clear that this is the answer because whether you have a build-up of open cases, whether you have 100,000 or a million open cases, or 25 open cases, surely to goodness any sensibly designed architectural system would say “This is an open case; it is a case that should not be deleted”, full stop, no matter the quantum.

Mr Varney: I think the system was designed on the basis that there were not open cases over three years old, and that was the assumption that had gone into it. It was clear that that was incorrect given that what was happening to the handling of—

Q38 Mr Bacon: This brings me to my next question because how much does the deletion affect your reported progress in clearing up the backlog of cases, because if you do not have the case then you do not appear to have a backlog, do you?

Mr Varney: It has about a 1% impact on the reported level of backlogs.

Q39 Mr Bacon: In your letter you also say, “Obviously we have to cleanse our databases regularly or the systems will become overloaded and would eventually break down.”¹ Anybody who has seen an ad for the Oxford English dictionary which is 20 volumes or an ad for Encyclopaedia Britannica, which is Lord knows how many more volumes, knows you can fit an awful lot of data on to one CD, so why have you written this sentence, “Obviously we have to cleanse our databases.” To most lay people it would not be obvious at all.

Mr Varney: When the programme was put in and with the background against which this was established, storing data was much more expensive. You are absolutely right; there are more options available now so we have changed the operating procedure so we keep data for six years, and what this episode has done is illuminated an area in which we have some historic decisions which have proved not to be correct when faced with the problems we have been dealing with, and therefore we have gone back and looked at it, and at some of our other storage information.

Q40 Mr Bacon: You say, “The function is at least 10 years old and was set up at a time when we were clearing around 99% of our open cases before they became three years old”. Why “at least”? Do you not know when this function was introduced? Thirty-three years old is also “at least 10 years old”. How old is this function?

Mr Varney: I do not know; I am quite happy to write to you. “At least 10 years old” was meant to convey it was a well-established process but I can find out and write to you².

Q41 Mr Bacon: It has been causing havoc for years, in other words?

Mr Varney: No. In the period of time in which it worked cases were closed within the three years.

Q42 Mr Bacon: 99% were.

Mr Varney: Well—

Q43 Mr Bacon: But even when it was only 1% it sounds to me like they were an inconvenience that was difficult to follow up so they were being struck off as if they did not exist any more.

Mr Varney: If it gives you that impression, that is the wrong one. We have revisited, as I said, the rules for holding information and we will now hold information for six years. We do not wish to see information disappear out of the system, for all the reasons you have identified.

Q44 Mr Bacon: In your letter you talk about the difficulty in contacting the people. You say you estimate you need to mailshot three million to get to the 638,000. How do you identify that it is three million? Who are they? And why three million to get to 638,000?

Mr Varney: We go through the process we use to get to the three million. It is basically a statistical judgment of, in order to get that number, what number do we need to mailshot? If we look at our last mailshot which we did to a million people, about 20% of people replied. The people who tend to reply are those whose affairs are in order, so we ended up with 1% getting an actual payment in settlement. So when we looked at the likely success rate of the mailshot it was clear it was going to cost us about £3 million to do the mailshot in order to distribute about a million pounds at most.

Q45 Mr Bacon: Because of the response rate you got?

Mr Varney: Yes.

Q46 Mr Bacon: Forgetting for a minute the response rate regardless of how many people would or would not contact you, what is your estimate of the total amount of payments that you have not made and the total amount of receipts you have not received?

Mr Varney: We estimate that the 364,000 people who are owed money have an average repayment due of £226, about £82 million overall, and we believe 22,000 people may have an underpayment of about £259, which means they owe us about £5.6 million.

¹ Ev 19

² Ev 22

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Q47 Mr Bacon: I can understand why you have difficulty in contacting them but can you not simply, when you send out tax forms, put a stamped message on the front effectively advertising to anybody without any additional cost?

Mr Varney: The problem is you would be hitting 30 million people and, as we know, any message that goes in is likely to cause confusion unless it is well-targeted. Also, individuals have their P45s, and those who think they have been affected have the data because they have gone off the system because we have not closed out their earnings.

Q48 Chairman: Thank you, Mr Bacon. The Committee owes a debt to Mr Bacon for flagging up to the media paragraph 1.16 and ensuring there has been a lot of public interest in this, but you are now giving the commitment, are you, that you have systems to spot these problems in future?

Mr Varney: I think so. We have looked at and I would be very disappointed if we fail to learn the lessons. That is what we have been trying to do. I am disappointed also in saying that we had the problem in the first place.

Q49 Mrs Browning: Mr Varney, the working families tax credit and the disabled persons credit were the predecessors to the tax credit systems you run at the moment. Am I right in recalling that they were administered through employers' payroll systems?

Mr Varney: Substantially.

Q50 Mrs Browning: Do you know what the incidence or aggregate amount of overpayment was when they were administered by employers?

Mr Hartnett: I am afraid I do not think we can break it down into the amount that was overpaid just through employers, but at a previous hearing, Sir Nicholas Montague explained there had been an extrapolation of the whole WFTC and disabled persons tax credit and that extrapolation amounted from memory to an overpayment of between £510 million and £700 million a year in the year in which it had been done.

Q51 Mrs Browning: What was the process, then, for recovery of those overpayments when it was run through the payroll?

Mr Hartnett: There was not a process because that was an extrapolation, and in order to identify individuals where money had to be repaid we would have had to review every single award of WFTC and DPTC, but what we have done is taken every opportunity where we have looked at a claim for any reason to see where there was an overpayment and, if so, pursue it.

Q52 Mrs Browning: So when you took over the working tax credit and the child tax credit through the Inland Revenue you were already alert to some of the problems which can occur with overpayment and reclaiming that overpayment from the claimants?

Mr Hartnett: We were alert because we had been the Department that brought in WFTC and DPTC in the first place and we knew the risk of overpayment; we discussed this with our colleagues in what is now the DWP as well so we were certainly alert to the risk, but the nature of WFTC and DPTC was such that as an interim tax credit they did not lend themselves to identification of individual cases.

Q53 Mrs Browning: Would you agree that there is obviously a possibility of over or underpayment when there is a key change in the family circumstances financially, but that in setting up this system and getting it under way with the IT systems you have procured there appears to have been very little in terms of lessons learned in the procurement of the IT systems which you now use which have caused a lot of the problems that we see identified on page 124 in figure 6?

Mr Varney: The IT systems have clearly played a role and we have discussed that with the Committee. The last release we did which was Release 4, which was a major release, went much more smoothly, and for the renewal process, although it is right to draw attention to this and it is absolutely clear that attention will need to be focused on under and overpayments of the annual system, the technology is functioning better than it was. There is no cause for complacency but it is moving in a better direction.

Q54 Mrs Browning: Mr Varney, can I just probe you on this question of the 82,000 where you are seeking to recover £57 million? We know that you are writing off cases below £300 although that aggregates to £37 million, a considerable shortfall to the Exchequer, but presumably the £300 threshold is because of the costs in actual recovery. It is nothing to do with the unfairness of what has happened to the individual families concerned.

Mr Varney: That is correct.

Q55 Mrs Browning: So may I bring you on then to these 82,000 people? You mentioned to us earlier about what was reasonable, a word that occurs in very frequently in the law courts, the interpretation of "reasonableness". If somebody is on lower incomes, and these credits are targeted to lower income families because of the recognition of their need of tax credit, if you had to recover £300 from them, hard as that would be, in terms of the hardship that recovery would cause an individual family, it is likely to be a lot less traumatic than some of the casework which my case worker deals with just in the constituency cases I deal with. How are you going to judge reasonableness without referral to the courts, because you obviously have access to income but do you make some form of assessment of capital or some assessment in terms of whether these people own their own homes? What is the process going to be? Are you going to get to the point where people are going to lose their homes in order to repay some of these larger sums?

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Mr Varney: I hope not. Can I just stand back—

Q56 Mrs Browning: Is that a policy or a hope?

Mr Varney: I think we tread seriously in trying to consider each case, and that does require making a judgment about where compassion is merited. Can I just stand back and talk a little about what you asked me to start with and see if I can give you an insight into the way we are thinking? When we were confronted with this problem, we tried to analyse what was the cost involved in the Department in recovering the amounts of money over the range of the overpayments, and that has proved to be quite difficult but we came to the conclusion that £300 was the right place to draw the line in terms of not pursuing. Given what we then understood about the costs in the Department and also about the reaction of claimants to pursuing overpayment, I have more work going on in the Department to improve our understanding of our cost structure and see whether I want to revise up the amount that I am prepared to write off because it is not in the interests of the Department and public expenditure to pursue it, so I will keep that under review, and that is a process where we are learning and asking much more of our cost information than ever before. As far as individual cases are concerned, we then under our code of practice are limited about how quickly we will recover the overpayment depending on the circumstances of the individual. Now if, having done that, somebody still thinks it is unfair then we will review it, and if they do not agree with the answer they can appeal. Many of the most difficult cases, as you say, come to your offices and your case workers. We put resources into improving our performance in answering your questions, but many of the cases you get are the most complicated and the most difficult and they come to me before I finally reply to you to try to make sure we have quality control over the judgments that are made, but these are difficult areas and sometimes we get it wrong.

Q57 Mrs Browning: They are difficult and my own quality control is that every case I get my case worker is required to pass to you via the Minister's office, because in terms of quality control in this place it is very important that ministers have a clear understanding of the on-going problems that Members of Parliament and their constituents are facing in this area. Given the complexity of tax credits, however, was it ever realistic to expect claimants to keep the Department updated of changes in their circumstances? It is not quite like somebody on income support who suddenly gets into employment and knows if he gets a job and he has been on unemployment benefits he really does have to let Jobcentre Plus know. That is fairly straightforward and reasonably understood, although it is subject to fraud and so on, but given the complexity of some of the significant changes that might happen within a family relationship and circumstances, is this really realistic?

Mr Varney: I think the two areas where Parliament made a judgment was the £2,500 dead zone in which there would be no change if income improved and,

secondly, the three months' toleration of importing changes in the family. As I said earlier to the Chairman, I think I would like to have more experience of this system actually working before I express a view on whether the operational experience of the system had met the expectations of the Parliament in designing the system.

Q58 Mrs Browning: I think sometimes in this Committee it would be quite helpful if we had a Minister sitting where you are sitting today—and you need not comment on that!

Mr Varney: Thank you!

Q59 Mrs Browning:—but I would just say this: in a climate where, as Members of Parliament, we are concerned about people on lower incomes and the amount of indebtedness that families incur in those lower income ranges, it does seem to me that an experience like this compounds an awful lot of problems for people when they suddenly think they have some money, they spend it and then find they were not entitled to it in the first place, and I just wonder, and this is why the question perhaps should be more fairly put to a minister, when my constituents receive an overpayment from you in future, should I caution them to put it on deposit and for how long, until they can feel really confident it is theirs to spend?

Mr Varney: I could not possibly comment what the Minister might say but what I can say is that the briefing draws attention to the fact that there are millions of families up and down the country who have notified of changes in circumstance and are receiving the benefits neither with an overpayment or an underpayment.

Q60 Chairman: But ministers do not need to be involved in this; there should be some sort of health warning. People have to be aware of what is going on—that they are on low incomes already and there is a possibility this is going to be demanded back, and you are now in charge of this administration and you can make it easier for people to cope with this, can you not?

Mr Varney: I think we have tried in the code of practice to set out a set of rules which mean we will try not to inflict more damage than we need to in terms of recovery; we try to publicise also the availability of the appeals and the opportunity that individuals have to complain.

Q61 Mr Steinberg: How do the Inland Revenue collect taxes, and how did the Benefit Agency pay benefits before IT was introduced?

Mr Varney: Through lots of local offices, I suspect.

Q62 Mr Steinberg: Was it more successful?

Mr Varney: I doubt that we know what the error rates were.

Q63 Mr Steinberg: Certainly they would not write off a million cases, would they? Somebody would notice, I suspect.

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Mr Varney: I suspect that is right but I think you can have different sorts of errors and different sorts of problems.

Q64 Mr Steinberg: How does the Department continually justify these incompetent IT firms such as EDS and Capita? Why do they keep getting contracts? Do they have a monopoly?

Mr Varney: No, but I think—and I do not want to say anything that is going to be no longer in the Department's interests should we go to court—these are hugely complex systems in terms of challenges. We thought we had a contractor which had experience of managing big projects and I think, as my predecessor said, we were clearly disappointed that the system did not deliver.

Q65 Mr Steinberg: But it never delivers, does it?

Mr Varney: I think in private industry the success of big systems is about 25%, systems that deliver outcomes as prescribed, or that is what the American evidence is, so these big systems are really major issues about getting proper control systems—

Q66 Mr Steinberg: If that is the case, that it is 25% in the private sector and clearly not much better in the public sector, why do you not write in the contracts severe penalty clauses? Why do you have to tell us that it will take possibly a number of years to come to some sort of settlement through the courts? If you had some decent solicitors or barristers or lawyers working for you, presumably they would write into the contracts “If anything goes wrong you pay for it”?

Mr Varney: There is a more severe penalty regime in the new contract we have done—

Q67 Mr Steinberg: But why was it not in the old contract? I have sat here now since 1999, I suspect, and I have heard exactly the same excuse every time, “Ah, but this time we have made it much more difficult for them.”

Mr Varney: I was going on to say that there are penalties in the EDS contract, they are defined in terms of event and quantum and ability, so there is some financial penalty, but in the commercial world it is true that if you put extensive penalties in you end up in some way paying for it in the bidding system. There is not a group of people out there willing to offer you a payment of damages and not price it into their contract. So it will get priced into the contract, and I think what we have tried to do—

Q68 Mr Steinberg: But they are desperate for the work, are they not? They have a monopoly. There are so few of them that they are cutting each other's throats for the work, are they not? It amazes me that Capita seem to crop up virtually every time that we have a meeting, and EDS crops up every other time, and Siemens are another one, and I am at a loss to think of anybody else. There only seem to be the three of them, and they all fail.

Mr Varney: There are a small number of companies, that is correct. I think the response of the public sector is the right one which is to have a gateway

process, try and share experience and knowledge, and really there is not much more I can do than what I am doing at the moment which is to pursue EDS to a solution.

Q69 Mr Steinberg: Who is the new company? Capgemini. What confidence have you got in them to deliver?

Mr Varney: We went through a process which people said could not be done of swapping out our IT provider, and this is a large complex change and it addresses one of the issues you have raised in that we have switched from one of these companies to another, we ran a tender, we looked at the—

Q70 Mr Steinberg: And what guarantees have you got from Capgemini?

Mr Varney: We have penalties within the contract.

Q71 Mr Steinberg: This time.

Mr Varney: This time.

Q72 Mr Steinberg: Do you expect anything to go wrong?

Mr Varney: I am always expecting something to go wrong.

Q73 Mr Steinberg: So you are expecting something to go wrong?

Mr Varney: It is not just coming before this Committee but anybody who has 100,000 people dealing with 30 million—

Q74 Mr Steinberg: What could go wrong?

Mr Varney: Lots of things.

Q75 Mr Steinberg: Tell us, because they will be listening and then they will make sure it does not when you tell us what you expect to go wrong.

Mr Varney: That is one of the reasons we have a management process for managing IT and risk, which I think lies at the heart of how we are trying to manage this.

Q76 Mr Steinberg: EDS are going to pay compensation, we are told, and you say it is going to take a while before the court decides, and obviously it is not right for me to press you any further on that. I was going to but when I listened to you giving answers to Mr Sheridan I thought it was better not to, but in the Report I read somewhere that compensation could be expected of something like £34 on average per person who is going to be compensated. That does not seem very much to me, £34 per person?

Mr Varney: First of all, I am grateful for you not pursuing the EDS issue, but I think the compensation you are talking about is in terms of appeals³.

³ Note by witness Q76 and Q77: Correction: The Inland Revenue pays compensation under Code of Practice 1 when handling **complaint cases**, not appeals.

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Q77 Mr Steinberg: Yes.

Mr Varney: On the appeals in the first year that we dealt with them that was, indeed, the average that came out, £34. In the year to date we are roughly agreeing compensation at about the same percentage of cases, which is I think around 20%.

Q78 Mr Steinberg: So you are as tight-fisted as EDS, then?

Mr Varney: Hang on, I am trying not to make EDS tight-fisted but the level of compensation has almost doubled, which reflects the fact that many of the cases we are now dealing with have had longer periods of time where there has been worry and stress.

Q79 Mr Steinberg: Just going back to EDS, and I will not pursue the case any more, will they be considered for further contracts?

Mr Varney: I am sure they will be competing, and this will be part of their track record.

Q80 Mr Steinberg: Are other Permanent Secretaries aware of their track record?

Mr Varney: We have shared our experience with OGC but, as you said, there are a small number of companies and each of them has the distinguished past of at least one glorious problem.

Q81 Mr Steinberg: Were checks ever made on EDS at the time?

Mr Varney: Yes.

Q82 Mr Steinberg: So why were the problems not found out?

Mr Varney: I think that is the issue about which we are clearly right in the centre of the court case.

Q83 Mr Steinberg: Because I would have thought that there would have been tests taken and errors found which could have been put right at the time. It seems strange to me that this continuously went on and mistakes were being made and made and nobody seemed to pick them up, but you are saying they were picked up. If they were, why were they not put right?

Mr Varney: I think we had quite an extensive discussion last year with—

Q84 Mr Steinberg: What I am saying is there was £94 million worth of errors and my view is that if £94 million worth were being made 30 years ago somebody would have said “Wait a minute, I think there is £94 million worth of errors being made here”, and nobody seems to be doing that.

Mr Varney: As I say, we are pursuing them in the courts.

Mr Steinberg: I have a load of questions here on EDS so I will have to miss them out.

Q85 Chairman: So you are not prepared to say any more on EDS?

Mr Varney: I do not think it would be helpful.

Q86 Mr Steinberg: Does the new partner, Capgemini, expect to be able to recover overpayments? Will it be doing that?

Mr Varney: No. The systems they are running will be used by us to pursue the overpayments, and we think some of them will be recovered. Some of them are being.

Q87 Mr Steinberg: How much?

Mr Varney: Too early to say, really.

Q88 Mr Steinberg: So what do you reckon the loss to the taxpayer is going to be as a whole, or is it “too early to say”?

Mr Varney: Yes, but I will be back.

Q89 Mr Steinberg: A number of members have mentioned, I think the Chairman did and I think Angela mentioned it as well, that basically the people who receive tax credits to begin with are also those who are the least fortunate in society and are usually the poorest anyway, and Angela asked whether she should tell her constituents to bank some of the money just in case it was going to be overpaid. I do not think that would be a good idea because the very fact they are getting tax credit is basically because they desperately need to spend that money so when they receive a Giro or cheque for it they are hardly going to consider banking some of it because they need to spend it. So how do you expect the poorest people in society to pay back money that is overpaid? The system is inherently wrong, is it not?

Mr Varney: The code of practice lays out what we will do in terms of the recovery rate, but the reason there is an overpayment is because circumstances have changed. One of the reasons is that people’s economic circumstances are much better than we anticipated when we did the award.

Q90 Mr Steinberg: Yes, but they do not change that much, do they? A few quid here or there puts them under benefit or not under benefit

Mr Varney: By more than £2,500 because that is the dead zone that Parliament has discussed, but there is clearly a very delicate section of the population which is absolutely captured by this, and we need to handle them appropriately with kid gloves thinking our way through it, but there are also other people who, quite legitimately, have much better economic circumstances and who owe us money.

Q91 Mr Steinberg: Very quickly, what do you think, and this is going to be a guesstimate obviously, the actual overpayment through errors of fraud is going to be this year?

Mr Varney: I do not know.

Mr Hartnett: We will not know, Mr Steinberg, until we get through to about July, when awards for 2003–04 will have been finalised, we will have carried out investigations, in particular random sum investigations, which will give us an indicative figure for fraud and error.

Q92 Mr Williams: What is the largest amount that up to now you have tried to reclaim?

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Mr Varney: £19,500.

Q93 Mr Williams: That is a lot of money, is it not? It would be a shock to 90% of the population, and possibly more, to get a demand for that?

Mr Varney: But you would notice that you had received it.

Q94 Mr Williams: Sorry?

Mr Varney: You would notice that you had received it.

Q95 Mr Williams: Yes, but if you are reclaiming it—

Mr Varney: No, but I think you would ask yourself, “£19,500 is quite a lot of money. Is this really what I am entitled to?” Your reaction as MPs has been very clear. You would say to yourselves, “This is a large sum of money”.

Q96 Mr Williams: Yes. On the other hand people submit the information and they expect to get the right answers from you, and they take it for granted that if they get a letter or an indication from you that they are in conformity with their annual tax requirements that is correct?

Mr Varney: Besides the areas where there are computer errors, which I have said is a separate case, if on the information we have made the right assessment and the information was incorrect, then they have received the wrong entitlement.

Q97 Mr Field: But they never know that.

Mr Varney: That is an issue where we have tried with the design of forms to give feedback. I do not think you can say in every case they will not know, but what you can do is say “We are going through each case to see what we were told, when we were told it, and whether, on the basis of the information we were given, we made the right decision but the information was wrong”.

Q98 Mr Williams: In the context of tax credit situations the biggest error is going to be with people on the lowest income, is it not?

Mr Varney: We do not know enough yet to be able to say “yes” to that. Errors are spread over, we think, a variety of incomes.

Q99 Mr Williams: But the likelihood statistically, since this is not necessarily related to the individual income of the people who have been overpaid or underpaid, is that this is something that could occur to anyone in any part of the spectrum, therefore one would expect, if there are more people on low income, the likelihood is there are more people on low income who are now being asked to pay it back.

Mr Hartnett: David is right in that we do not know yet, but one of the errors—

Q100 Mr Williams: But the trouble is because of the six year limit people need clarity from you and we need to know fairly soon.

Mr Hartnett: Can I pick up your point, if I may, on the issue of poorer people? One of the errors deleted income and so made it look as though people had

less household income than they otherwise had. Now, that tended to happen further up the income scale within tax credits rather than at the bottom or near the bottom, and that is one of the reasons why at the minute we cannot give you a full response to what the spread is. We understand the spread of overpayments in particular circumstances, but not yet what the demographic or financial segmentation is.

Q101 Mr Williams: How soon are you likely to be able to give us clarification for that?

Mr Varney: July.

Q102 Mr Williams: You will submit a document to us in July by the NAO giving us an update on the information?

Mr Varney: Certainly, we will try our best. If everything runs according to plan we will do it in July.⁴

Q103 Mr Williams: I was slightly puzzled when the Chairman asked you a question earlier about the time of your predecessor and you said you could not answer that. Does that not suggest to you that it would be logical for us to have your predecessor sitting alongside you to deal with this questioning?

Mr Varney: You asked me a question—obviously these are questions for you—about what I thought and I told you the basis on which I thought I could make an informed judgment.

Q104 Mr Williams: No, as I recollect the Chairman asked you a question about your predecessor and because it was your predecessor, you said you were unable to answer it. Generally, the practice of this Committee is, and the practice within the Civil Service has been, to presume that the new Accounting Officer is like the Queen when the King is dead: “God save the King”, “The Accounting Officer is dead, “best of luck with the next one”. What you are saying is you are unwilling to accept that you should be able to answer in the way which your predecessor would be able to, which to us means it would be logical, therefore, to consider having your predecessor called in.

Mr Varney: I do not think my predecessor would be able to answer either. When he spoke to you he was expecting a number of tools to develop and approaches which would illuminate the answer and would work in the direction he was forecasting. I think the direction there might be some reduction is one I hope we will be able to live up to, but today I know those tools will not provide the sort of answer which he gave. I am saying to you, my position is I am going to wait until I have done all the work and then I can make a sensible assessment.

Q105 Mr Williams: Social security has its own definitions of hardship. You said you may take into account hardship when you are making a request for a refund. How do you decide what is and is not a hardship case?

⁴ Ev 23–26

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Mr Varney: Included in the Report we have got our code of practice which tries to spell out the factors we will take into account on page 135. What we have tried to do is make as explicit as we can the factors which people, who are wishing to appeal, can use in putting their case together.

Q106 Mr Williams: Is there any appeal against you?
Mr Varney: Yes.

Q107 Mr Williams: Who do they appeal to?
Mr Varney: They appeal to us. I think we have had about 37,000 cases⁵.

Mr Field: It is not an appeal though.

Q108 Mr Williams: There is no appeal outside your organisation?

Mr Varney: There is not. Obviously, some cases come through MPs who raise their issues.

Q109 Mr Williams: But you are the final arbiter?

Mr Varney: In hardship, yes.

Q110 Mr Williams: Can you give us any idea how many hardship cases you have had put to you and how many you have accepted and turned down?

Mr Varney: I think we have given you the statistics about the appeals; how many people got money as compensation or redress for stress, strain and hardship, but the actual number of hardship cases, I am quite happy to write to the Committee and say: "Here is the number we have dealt with and here is the number we have not"⁶.

Q111 Mr Williams: I think it is possible that there may be a helpful memory jogger coming up.

Mr Varney: There is a memory jogger which is reminding me of something I said previously.

Q112 Mr Williams: It is reminding you not to tell us any more.

Mr Varney: It is not helping me answer your question which I am quite prepared to write to the Committee on.

Q113 Mr Williams: I understand that but I would have thought you might have anticipated this is the sort of question we would ask you. If you can let us have that information. Coming back to the system, I do not want to get into the legalities, but what I cannot understand is what it says in your letter to Mr Bacon—who was very astute in noting the importance of this issue—is that a function to cleanse the database of all records was deleting cases we did not want deleted, and this was put down to a capacity problem. Was there a specification of any capacity in the original contract, the memory capacity for this particular area of a system?

⁵ *Note by witness:* The 37,000 figure relates to the approximate number of tax credit complaint cases received from claimants in 2004–05 (as at 31 December 2004), not the number of appeals. Tax credit claimants can appeal against our decisions on their tax credit entitlement only, not against our decision about recovering an overpayment. (See also Q110.)

⁶ Ev 22

Mr Varney: No. What has happened is, I think we hold about 16 million records in Pay As You Earn⁷ and if we do not cleanse the system regularly the capacity of the system gets eaten up with information we are not using. What we will do now when we delete cases is we will delete them to a backup file. We can hold them on the backup file and reconstitute the information if we need it again, it will not be deleted.

Q114 Mr Field: I apologise for not being here for most of the meeting. I hope I am not going over grounds which other members have gone over. I want to ask you some questions about my constituents who do not recognise the service you have been describing which I have been hearing for the time I have been here. Do you accept that your disappointment with administering tax credit is beginning to change the public's perception of how the Revenue runs?

Mr Varney: I think there is a change in perception, I accept that. I think where payments have been made successfully and in the right amounts to the right families, that tends to be taken for granted. In those areas where there have been mistakes and they get highlighted, that gives an overall impression of the system which I think does have an impact on reputation.

Mr Field: Generally speaking, given that my constituents think you are all rather clever—

Q115 Chairman: We think you are rather clever.

Mr Varney: I will take that as a compliment.

Q116 Mr Field:—and that they ought to be careful in making their tax returns, my guess is now people have seen how you have performed the tax credit, they do not think you are as good as they thought you were. Therefore, in that sense the public perception of this service is changing.

Mr Varney: It has been interesting. On the forms we have been seeing how well people understand and asking people how well they think they understand the system. We are getting higher levels of people saying they think they understand the system and the way it works. I accept fully that we are going through a difficult process of introducing annularity relating benefit to income on a delayed basis on the tax system. As I said to the Chairman right at the beginning, I think in the couple of years' time we will be able to give a considered view of some of the challenges and difficulties of a system like this.

Q117 Mr Field: If people are filling in their forms, thinking they are getting greater understanding of the system, I think they are either fooling themselves or you. I doubt whether most MPs understand it, it is immensely complicated. One of the problems is when the cheques come through there is no way my constituents can understand whether you have paid

⁷ *Note by witness:* Correction—PAYE databases hold about 40 million (not 16 million) records.

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them the right money or not. Then they find, arbitrarily, you grab most of it back, their living standards are massively reduced as a consequence and then being normal Brits they think they might appeal. You talked to Alan Williams about an appeal, they do not have an appeal, they are talking to the people who made the mistake. There is no outside body, is there, to whom they can appeal who can judge whether you have behaved properly?

Mr Varney: Some of the cases do end up with MPs in Parliament.

Q118 Mr Field: Indeed mine are.

Mr Varney: You have asked me about the general ones, but you get very quickly to the specific case. Performing a judgment is a process which is quite time consuming. We have had correspondence with yourself on some of the cases you brought and normally a file arrives on my desk with all the considerations we made before I signed the letter to you. It is a change. I said earlier, which I think is correct, that we have only just gone through the first cycle of renewals. Certainly, that has gone much better than the general publicity we suggested about tax credits and the system is performing better than it was.

Q119 Mr Field: One of my constituents had 15 forms from you telling her different amounts of tax credits but the onus is on her, if she is going to have the debt wiped off, to show that she understood she had been paid the wrong amount, is that not the rule?

Mr Varney: As I said, in the code of practice we have set out in quite a lot of detail that if there are circumstances of hardship how we are going to delay recovery but, also, the factors we would take into account in considering whether to pursue an over-recovery. We are trying to meet the requirements of last year and clearly lay out clearly our processes and procedures.

Q120 Mr Field: Mr Varney, when you say you have delayed the claw back, it may be that they are all so happy they do not come and see me. I have not had one constituent where it has been delayed, often they find out because the money has stopped that you have made a claw back.

Mr Varney: If people are receiving the benefits then, as we have said, subject to the requirements in the code of practice, we can moderate repayments over the balance of the year to ensure they get their entitlement. If there was an overpayment, which they reasonably could have thought was their just deserts, then that is grounds for us not recovering the money.

Q121 Mr Field: One constituent whose wife becomes ill, who has £100 withdrawal of tax benefits, now has so little money he has to walk three miles to the hospital and to work because you claim, rightly, he has had this income as an overpayment. He does not even have the option of going unemployed to get a larger income because when he turns up to the Jobcentre Plus, his entitlement is computed on the basis that he possesses this income which you have

overpaid him and which you are clawing back. Now he has to continue working to a degree where they have got £40 to pay all the bills after rent and council tax with a sick wife, with two children and not being able to have the bus fare to work. We are still waiting to see whether there is a hardship payment. Even if you come up with £30 or £60, what is that to someone you have taken £3,000 off because you claim there has been an overpayment?

Mr Varney: I cannot answer individual cases unless you give me the identity and the name.

Q122 Mr Field: I thought you had it.

Mr Varney: Not all of the cases, but if this is a case which you feel I have not dealt with appropriately, I will look at it again.

Q123 Mr Field: I feel strongly about all of them. When they go down to the local office now your officers say: "We do not understand it, but your MP does, he will queue jump for you, get on to him". Now you are pushing your work on to me.

Mr Varney: I read what you said to *The Financial Times* in your letter. Our view is that is not appropriate advice to give, no matter how clever your MP is, it is not the right advice. One thing we are working on is at the moment we have not got the IT functionality to stop recovery if we have a hardship discussion going on. That is what we are trying to build into the next set of releases.

Q124 Mr Field: Mr Varney, I have not had one case where hardship has not been caused other than you already doing the claw-back. Often you tell the people later, after their bank statements have changed, that you are in the process of clawing back.

Mr Varney: That is an IT functionality. We have not got the functionality to be able to do that and that is why we are building that into the next set of releases.

Q125 Mr Field: When will that occur?

Mr Varney: Autumn through to April.

Q126 Mr Field: We have got half of this financial year plus all the other back-payments. We have established today there is not an independent appeal system, the appeal is down to people making a mistake, and maybe other members have already asked you this, but how many individuals have you written off the overpayments for?

Mr Varney: In terms of the overpayment, we have written off about 375,000 cases.

Q127 Mr Field: You have written them off?

Mr Varney: Cases with under £300. We had a long discussion about this earlier.

Q128 Mr Field: The bigger the overpayment the less chance of a write-off?

Mr Varney: Yes, that is not surprising. Again, I am looking at what it costs the Department to recover the money as against the sum which is being recovered.

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Q129 Mr Field: Mr Varney, I know you are running a system which you inherited and, I tried not to give vent to my anger about this because, in a sense, although you are responsible for it now it is other people who are at fault for this. I do want to leave on record my sense of despair of not being able to rescue my constituents from the utter chaos that their lives are in. When Alan Williams said: "Why should they know that £19,000 was an overpayment?", the Government keeps trumpeting on that it pays to work. You get more money, why should you know, when there is no clear wage-slip coming with these benefits, that they are being overpaid? The whole Government propaganda is you will be substantially better off if you work, but how do any of my constituents know what substantial means? They think: "God, how wonderful, the Government is delivering on its promise. I have got some money to buy some shoes and some food and I can make up the rent which is in arrears". They are not in a position to know that. In a way, it is a measure which, although about empowerment, destroys the sense of empowerment for my constituents. I have tried to give you some sense of their anger about all this.

Mr Varney: Certainly, you have done that. Also, my in-tray is full of others of your colleagues who have written about individual cases. Also, there is a group who are receiving what they are entitled to, fulfilling their obligations. It is important we grow the size of that group, we do that by trying to communicate and where there are problems, we try and handle them as sensitively as we can. We are not perfect and we do make mistakes.

Q130 Mr Field: We hope those who are not making any complaints are getting what they are entitled to.

Mr Varney: We do also.

Mr Field: My constituents who have come up against your errors now say: "I wish I had never heard of tax credits", their life has been plunged into such chaos.

Q131 Mr Davidson: First of all, I apologise in case any of the points I want to raise have been touched on already as I had to go out during the meeting. I wonder if I can pick up on an issue about the culture of your organisation. I have a lot of cases also from yourselves, but I have also a lot of cases from the CSA. There is a substantial difference from the CSA because the CSA in trying to help appear not to be capable, but your people do not even try and help, and do not provide much assistance. I have got reports from the CAB and from my own staff indicating how unhelpful your organisation is. Do you think that comes because of your background as tax collectors? Why is it that you are so unhelpful compared with people like the CSA who genuinely appear to try?

Mr Varney: I would be very disappointed if that was a widely shared view. I think the staff have done a

fantastic job, faced with the difficulties of the computer system and faced with trying to introduce a new tax regime. Not everybody is going to be as sympathetic, I accept that, but we have put an awful lot of work into this.

Q132 Mr Davidson: I received a letter from the Citizens' Advice Bureau in my constituency, which I was involved in setting up to deal with issues like this. They tell me the CAB advisers are supposed to have a special helpline number, not available to the public, in order that they can assist clients and advise when they call the Bureau. In practice, our advisers found that tax credit officers refuse to give out any information over the phone, routinely insist that they put their enquiries in writing, they have offered to fax through consent forms there and then to enable the enquiry to be dealt with but this has been refused; obtaining information by post is extremely difficult *et cetera*. What is the point in having a helpline if you do not deal with people over it?

Mr Varney: There is no point in having a helpline if you do not help people. We have gone out and consulted with groups around the country and the general picture is not at all the way your CAB is describing it. If you would like to pass the details of that to me, I will get one of our senior officers to see what is going on in the particular situation in your constituency because that is not mirrored in the advice we get elsewhere.

Q133 Mr Davidson: That is helpful. I want to continue with the mail, they are advised to write. They are saying here, the standard pattern is they write to you, they hear nothing, they send reminder letters, they get a standard acknowledgement which tells them to wait another six to eight weeks for a response. They have given a particular case: they enquired on 6 July, they sent two reminder letters, nothing happened, they complained to the Edinburgh office, who replied promptly, who sent them back to the office. They wrote a complaint to the office on 1 November, they still have not had a reply to the complaint, however, they got a response to the original reply on 15 November, that was unsatisfactory. They wanted further details on 24 November, they sent a reminder on 16 December. They got sent back a standard response telling them to wait six to eight weeks for a reply. They sent me that one as being a typical example of dealing with yourselves. Can you understand why people are frustrated?

Mr Varney: Certainly, I would be more than prepared to look at the case. Whether it is typical or not is a matter of debate.

Q134 Mr Davidson: Can you confirm one point: my staff have been told that where there seems to be a case going into review, there seems to be a glitch in the system whereby everything has to go back to be checked manually right from the very beginning?

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Mr Varney: Not that I know of. Can you give me the case?

Q135 Mr Davidson: I will give you the case later on. I have another case where a Citizens Advice client was told she had been overpaid tax credits, the CAB asked for a breakdown of the calculation as the client wished to dispute, as you can imagine. After four months the tax credit office replied to say: "It is not possible to give an explanation of how the awards are calculated".

Mr Varney: We know there have been a small number of cases like that, if this is one of them we will get on the case and resolve it.

Q136 Mr Davidson: Another one is where somebody had an award, the circumstances changed, they were then told it would take two months for the new award to be processed, the old one was stopped, so they were left with at least a two month period receiving nothing at all from yourselves and that was over the Christmas period.

Mr Varney: That should not happen.

Q137 Mr Davidson: That should not happen either. The point I made about where somebody phones in to discuss a claim and the tax credit office refuses to discuss it over the phone, they offer to fax in a consent form there and then to allow it to be discussed over the phone and you still refuse to discuss it and say: "It cannot be dealt with until the next convenient date at the very earliest", is that standard practice?

Mr Varney: No, I thought we accepted faxes from the CAB.

Q138 Mr Davidson: They tell me here that they do not. Again, there are other ones about not replying to letters and all the rest. My own office tells me when they deal with these cases you refuse to give out any information because they quote constantly the Data Protection Act and say it prohibits them giving out any information to anybody other than the client. We have gone through a whole rigmarole, that you pass it to the office, to the office, to the office and we have offered to give you code words. If the IRA can provide code words and it can be taken as valid by the appropriate authorities, I would have thought you should be able to work out some mechanism whereby if somebody comes into your office and are sitting there with a member of my staff, they are able to discuss details.

Mr Varney: We have got a helpline for MPs which has been well used. As far as I am concerned we talk on a regular basis to people in your office dealing with cases, trying to resolve them. The line is quite heavily used.

Mr Field: It is shocking that you have a line for MPs. It is a second rate service for our constituents.

Mr Steinburg: No, it is not.

Q139 Mr Davidson: This point about repayments of overpayments, I am genuinely perplexed—and I am sorry if this was touched on earlier—how you expect some of the people in my area involved with an

overpayment to genuinely repay the amounts involved. There are a number of cases which can be provided where there are quite substantial sums and where the people involved thought Christmas had arrived, have sought to clarify whether or not this was in fact incorrect and were told, no, it was absolutely right—how that gels with the point earlier on, it is not possible to explain how calculations are arrived at, I will let that pass—then they went ahead, spent the money and were told there was an overpayment and are now being pressed quite hard for the repayment of substantial sums. The money in those circumstances is simply not there. Then to hear the average compensation is only £34 going up to £68 does not seem to be an adequate grasp of reality. Coming back to the very first point I made about the culture of the organisation, while I appreciate they are dealing with an immensely complex set of issues, and I appreciate that the vast majority of staff are working hard, you do not seem to have got all of this right, do you?

Mr Varney: We have set out a very clear code of practice in trying to deal with the hardship cases. In the circumstance you have described where there is an official error and they reasonably could have thought that was the right answer, we will not pursue the overpayments. The compensation, which you have drawn attention to, is never going to be adequate for the hardship and suffering which people go through, it is a way of saying sorry. I know of no system where when people suffer you get the exact financial compensation, it is a gesture. While you were out of the room, I said the amount we are paying this year is double the—

Q140 Mr Davidson: I heard that. Can I pick up on the point you made there, the question of it being reasonable to assume it was a valid payment. We have had cases where initially people did not believe it and came back on to your office and had it confirmed to them that yes, it was right. Clearly they went off and spent it and said: "Christmas has arrived early" and then found they were asked to repay the amount.

Mr Varney: I have explained that we are guided by this code of practice. If we have said that and we can prove that has happened, then that is a case for official error.

Q141 Mr Davidson: Can I clarify the point about proving this has happened. Many of these people's lives are less than completely ordered and they are not necessarily going to have taken notes of times and exact conversations.

Mr Varney: We tape all calls.

Q142 Mr Davidson: None of these has been wiped?

Mr Varney: No.

Q143 Mr Davidson: That is helpful because they are findable, are they? If someone comes along and says: "I phoned up ages ago", they are able to find these particular conversations?

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Mr Varney: We hope so.

Q144 Jim Sheridan: Unless they have been wiped clean.

Mr Varney: They have not been wiped clean.

Q145 Mr Bacon: Mr Varney, a lot of these problems are to do with IT systems. You are merging with Customs and Excise now. You are the Chairman of both organisations. We spoke about this briefly the last time you were before us. The system you are keeping is the Capgemini system for Inland Revenue and not the Fujitsu system which Customs have, is that correct?

Mr Varney: No, we are keeping both.

Q146 Mr Bacon: Why are you keeping both? Is not one of the recommendations of the Gershon Review to stop having duplication of systems especially when they are doing one function, such as collecting revenue?

Mr Varney: I think collecting revenue is a very high level of the structure. These systems are being modelled on individual taxes and individual events. Given where we are, which is that we have not been able to spend money on the merger in any large amount until the Second Reading and we cannot spend money on the core of HMRC until after it is established by Parliament, which is happening at the moment, I think it makes sense that what we do is we are going to run the systems we have got.

Q147 Mr Bacon: In parallel?

Mr Varney: They do different things. Then we will converge over time.

Q148 Mr Bacon: How much time?

Mr Varney: I have not done the studies, so it is very hard to give you an estimate.

Q149 Mr Bacon: The Fujitsu contract is a PFI contract, is it not?

Mr Varney: These are all partly of a PFI nature. The real issue is what we will be doing, first of all, is to seek to get functionality of data, not the fundamental systems and, able to integrate the information so we can get that to an integrated department and then look at what is sensible to do with the systems.

Q150 Mr Bacon: Who owns the intellectual property of the Customs' Fujitsu systems?

Mr Varney: I would think it is us, but let me come back to you⁸.

Q151 Mr Bacon: Are you sure?

Mr Varney: No, I said I will come back to you.

Q152 Mr Bacon: As I understand it, there is a PFI contract whereby essentially Fujitsu supplies you with a service and they own the intellectual property.

We have had this problem in Norfolk with Jarvis because they own the designs of the schools except they are not capable of fulfilling them.

Mr Varney: Let me not guess, I will come back to you absolutely clearly on who owns it. It is a much more complicated question than at first sight.

Q153 Mr Bacon: Have you examined the possibility of paying Fujitsu compensation for the Customs contract and discovered it was too expensive?

Mr Varney: Certainly, I know it is expensive.

Q154 Mr Bacon: You have examined the possibility of paying them compensation?

Mr Varney: What Capgemini and Fujitsu said to me was they would find ways of working together.

Q155 Mr Bacon: Have you examined the possibility of initiating compensation?

Mr Varney: Obviously I have looked at what the alternatives are in terms of terminating the contract.

Q156 Mr Bacon: How much would it cost for you to terminate the contract?

Mr Varney: It is not something we are going to do at this stage.

Q157 Mr Bacon: How much would it cost?

Mr Varney: It is quite substantial.

Q158 Mr Bacon: How much?

Mr Varney: I think we are talking tens of millions.

Q159 Mr Bacon: Only tens of millions, not hundreds of millions?

Mr Varney: Tens of millions.

Q160 Mr Bacon: You think it is less than £100 million?

Mr Varney: Yes.

Q161 Mr Bacon: You are an Accounting Officer and, therefore, you are responsible to Parliament for how public money is spent. The C&AG said in his Report that last year he qualified the accounts because there was a 10%–14% by value error rate and although the Department believes it might be half that now, the C&AG says the Department has not estimated the level of financial error on New Tax Credits and I quote: "I have no evidence that error has yet been reduced significantly to enable me to give an unqualified audit opinion. I therefore have qualified my audit opinion on the 2003–04 trust statement in respect of the New Tax Credit payment". Obviously you are failing in your duty to Parliament to account for how public money is spent efficiently, effectively and economically if the accounts are qualified, which they are. This is a discussion which does not just affect your Department, it is a discussion we have had with Sir Richard Mottram concerning the DWP, do you think that officials who are Accounting Officers and those who work for them

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have a responsibility to ministers to advise them to design systems which are as simple as they can be, to have as little complexity as possible, on the basis that complexity itself inhibits the efficient economic and effective spending of public money? In other words, the policy itself inhibits your ability to do your job as an Accounting Officer and account accurately to Parliament for the monies which Parliament votes for you.

Mr Varney: Let me try and separate that because there are quite a lot of things in there which I do not find myself in agreement with. As an Accounting Officer, in all the areas, one tries to make sure we are discharging our duties of Parliament. The Auditor General has quite rightly drawn attention to the fact that we cannot quantify the errors in New Tax Credits and, therefore, qualified the accounts. We will have to work to get a set of accounts which are unqualified. In the formation of HMRC, which you know, our previous policy work has gone across to the Treasury. Our role in discussion about the policy is the experience which comes from operating systems and the advantages and disadvantages of different approaches, and that is the advice which will be giving to Ministers.

Q162 Mr Steinberg: Listening to Ian Davidson and the mistakes which are made, if you turn to page 126, figure seven, does this not sum it all up and it is the cause of all the problems, the fact that the New Tax Credits, the Accuracy of Processing and Calculating Awards is 78% correct against a target accuracy of 90%, whereas the old tax credits were in some cases 98% right and at the worst 85% right. Surely that is the solution to the problem or the reason for the problem is the staff are making so many mistakes.

Mr Varney: Clearly it is something we need to improve. I think the Committee will be probably glad to hear that in 2004–05 it is improving and moving up. Clearly it is an issue in the system.

Q163 Mr Steinberg: If they are making so many errors no wonder there are so many overpayments.

Mr Varney: There are overpayments in the system in part because of the design of the system. If you focus on the overpayment issue, the overpayment issue comes about in part because there are errors. Another part is the change of economic outlook of individuals, which is much better than we thought it was and, therefore, they are entitled to less credit or there is a change in their family circumstance which means they have got a lesser entitlement.

Mr Steinberg: Finally, the point Mr Davidson made, for goodness sake do not take any notice of him as far as hotlines are concerned because when I have somebody screaming at my secretary that it is her fault they are not getting the tax credits—and that happens, our secretaries and our staff tend to get the blame: “You have not paid me my correct tax credits”—at least they have the advantage of being able to go home and sort it out over the hotline. If the hotline was not there, in many cases sometimes

you would have to call the police, to be quite honest, to get them out of the office. Do not get rid of the hotline for goodness sake.

Q164 Jim Sheridan: Just to clarify the position, Mr Steinberg has raised it already, the MPs’ hotline, is that still available? I think Mr Davidson identified situations where your staff are quoting the Data Protection Act and refuse to discuss cases. Would you clarify what the position is?

Mr Varney: The hotline is available. We changed the number of the hotline and we advised you. The reason for that is the lady sitting on that number was receiving harassment calls⁹.

Q165 Jim Sheridan: From MPs?

Mr Varney: From outside.

Q166 Jim Sheridan: Harassment calls from MPs?

Mr Varney: No, no.

Q167 Mr Field: That is just how we feel.

Mr Varney: No, from an outside individual in which the police are involved now.

Q168 Jim Sheridan: MPs can still use a hotline?

Mr Varney: There is still a number and it is still to be used by MPs and their officers in order to process cases of the type that Mr Steinberg has described.

Q169 Mr Field: On the qualification of your accounts: were the accounts of the Revenue ever qualified by the Comptroller before you had to run these tax benefits?

Mr Varney: No.

Q170 Mr Field: There might be a lesson there, might there not?

Mr Varney: That is the reason they have been qualified.

Q171 Mr Field: Going back to the earlier questions, there is a culture in that there is one department of government which understands about paying out money and the other one has quite a good record in collecting it in. They are different activities.

Mr Varney: I think we go back to the issue of the annularity. As I said, I think after two or three years we will be able to talk to you about what our experience is of the new system. We are in the very early stages of the new system.

Q172 Mr Field: When do you think you will get your accounts back not being qualified?

Mr Varney: I am working hard to do that. I do not like having accounts qualified. It is the first time it has ever happened to me so I am working hard. As you have pointed out, and I think that is right, in the

⁹ *Note by witness:* Correction: the telephone number that was changed was that of the Complaints Co-ordinator in the Chairman’s Private Office and not the MP’s Tax Credit Helpline.

Inland Revenue

system of benefits, there has been a feature of those accounts. It is a challenge for us.

Mr Varney: Of course¹⁰.

Q173 Mr Field: Will it be in the next financial year?

Mr Varney: I am not going to give you a forecast, you will only be inviting me back after I have retired!

Q175 Chairman: There is no time to deal with it now. Thank you very much, gentlemen. We will be issuing our Report and seeking to help you resolve the public's dent of confidence in the Inland Revenue as a result of what has been going on in tax credits.

Q174 Chairman: Could we have a note please on paragraphs 3.18 to 3.20 on the avoidance opportunities in stamp duty and land tax?

Mr Varney: Thank you very much.

¹⁰ Ev 22

Memorandum submitted by the Inland Revenue

I thought it might be helpful if I provided you with some more recent information relating to particular tax credits issues in advance of the hearing on 24 January.

Key developments since the period covered by the Comptroller and Auditor General's Report are:

EDS COMPENSATION [STANDARD REPORT 2.9]

The structured negotiations, facilitated by a neutral arbiter, have now come to an end to be replaced by direct negotiations between IR and EDS. These are continuing at present but it is far from certain that litigation will be avoided.

INCORRECT AWARD CALCULATIONS [STANDARD REPORT 2.10]

In addition to the software error referred to in the C&AG's Report, an isolated system problem which meant some income figures were erroneously omitted from entitlement calculations resulted in some 60,000 households receiving incorrect (higher) payments for 2003–04 or 2004–05 or for both years in some instances. The system problem has been fixed successfully and no new cases have arisen.

The overpayments total some £80 million.

We are asking for repayment of the overpayment, although we expect some claimants will be able to show that they should not have to repay their overpayment, in accordance with our Code of Practice 26, *What happens if we have paid you too much tax credit?*

FURTHER WRITE-OFFS

The C&AG's Standard Report mentioned that we have written off £37 million in respect of low value payments made in error to some claimants in the Spring of 2003. The Report also advised that further write-offs would be made as claims for official error relief are agreed.

Whilst the exact figures are difficult to quantify at this stage, it looks likely that we will make some further write-offs in respect of payments made during 2003–04. These relate to manual payments made during that year where it was not possible to record some payments on the records of the recipients due to processing delays. There will also be some further amounts to be written off when official error relief is granted in cases other than those mentioned in the Standard Report.

ACCOUNTING AND RECONCILIATION [STANDARD REPORT 2.17]

As trailed in the C&AG's Standard Report, we introduced a further interim reconciliation mechanism in August 2004. This still involves considerable clerical input, but is working as planned, providing an early identification of any payment problems that might occur. We expect to introduce an automated arrangement, allowing quicker reconciliation in the autumn of 2005. We are bringing the reconciliation for 2004–05 up to date by May 2005 to ensure that all payments made in the year are taken into account when the awards for that year are finalised.

PROCESSING ACCURACY [STANDARD REPORT 2.19]

In 2003–04, we accurately processed 78.6% of new claims and changes of circumstances against a target of 90%. That target was challenging, and remains so for this year, which includes renewals for the first time. However we have been working very hard to improve performance against our accuracy target. Checking undertaken so far this year indicates that a significant improvement has been achieved, although we are still likely to fall short of the target over the year as a whole.

To make further improvements we are:

- Reviewing once more those cases where we had made a processing error in 2003–04 to see what the final financial effect was following finalisation of the case (we expect that the renewals process will have repaired a number of the errors).
- Piloting a new method of checking processing accuracy in 2004–05, including the financial effect of processing errors (with a view to adopting the new method in 2005–06 in place of our existing checking regime).

ORGANISED FRAUD [STANDARD REPORT 2.20]

We are aware of the potential attractions tax credits hold for organised fraudsters. We have detected some activity to target tax credits and have taken action to prevent further loss. We are keeping current procedures under constant review to ensure, by identifying suspicious activity at an early stage, that we can continue to deter and detect attempts to defraud the system.

SOFTWARE RELEASES 6 AND 7 [STANDARD REPORT 2.27]

Release 6 (April 2005) is planned to include some essential improvements to the annual renewals process, including an adaptation of the Annual Declaration form to handle customers who need to declare two years' income.

There will also be a new version of the claim form to include an ethnicity survey. (Currently this is only included on the Annual Declaration form, which does not need to be completed in some one-third of renewals cases.)

The functionality enhancements planned for Release 7 (October 2005) will enable us to take account of civil partnerships and gender recognition issues, improve the clarity of the Award Notice and facilitate payment reconciliation at customer account level.

RENEWALS [STANDARD REPORT 2.30]

The renewals process has been going well and the vast majority of claimants have successfully renewed their awards.

We stopped making payments to a total of 200,000 households who were previously receiving tax credits. These are the people who either failed to return the renewals notice or failed to report details of a change of circumstances they had indicated had occurred when they sent their renewal back.

PAYMENT VIA EMPLOYER (PVE) [STANDARD REPORT 2.33]

The Chancellor announced in Budget 2004 that payment of Working Tax Credit via employers (PVE) would in due course be phased out and replaced by direct payment by the Revenue. PVE has been a success in reinforcing the message that work pays more than welfare. However, the Government accepts that the benefits to business now justify moving to direct payment in due course, thus reducing the cost of payroll administration and addressing a key area of business concern.

We are consulting representatives of employers and other interested parties on the detail of implementation. In particular, we want to ensure that claimants are well prepared for the change in payment method and that mechanisms are in place to show that the Government is still supporting those in low-paid work.

IS/JSA MIGRATION

In a statement on 22 October, the Paymaster General announced that the phased transfer on to Child Tax Credit (CTC) of the remaining families with children in receipt of Income Support/Job Seekers Allowance, planned to begin from October 2004 would be deferred until 2005. This is to allow a full cycle of tax credits activity to be completed before these families are transferred in.

David Varney
Chief Executive

20 December 2004

Letter from the Chief Executive of the Inland Revenue to Mr Richard Bacon MP

Sir John Bourn has asked me to write to you to set out the position in relation to PAYE Open Cases.

In the Inland Revenue's Annual Report and Accounts for the year ended 31 March 2004 we reported that a well established housekeeping routine on our computer databases had deleted some records before the usual final review to check whether any tax remained overpaid or underpaid for the relevant year. I am sorry that this has happened and I am writing now to give some more detail in advance of the PAC Hearing on the Accounts.

The final review referred to takes place after the end of tax year to check that people have paid the right amount of tax and NIC under PAYE. Details of pay and tax, provided by employers as part of their end of year returns, are compared with our records. Where the correct amount of tax has been paid no further work is required. However, the amount of tax paid may be incorrect for a variety of reasons—for example, the PAYE code may have been changed too late in the tax year for the employer to operate it, or gaps may have occurred in employment and an emergency code has had to be operated. Also, some cases may have failed to match up with a taxpayer record (for example, because the NINO is incorrect). Both types of case are marked as “open cases” and listed for clerical review.

New management information systems (set up to monitor the extra effort we have been putting into reducing arrears of PAYE open cases) revealed that a function to cleanse the database of old redundant records was deleting cases that we did not want deleted. The function clears three year old cases where the customer has left employment and has not recommenced either at that employment or somewhere else. We found, though, that it was not distinguishing between three year old cases which had been given their final review by Revenue operators and those which had not yet been given that review. Consequently, the process has deleted some cases that had not yet been reviewed. The function is at least 10 years old and was set up at a time when we were clearing around 99% of our open cases before they became three years old.

Obviously we have to cleanse our databases regularly or the systems will become overloaded and would eventually break down. When the process was first brought in it operated effectively to cleanse our databases. But as the numbers of three-year-old cases still open grew it became inappropriate. As it was running behind the scenes it was not visible until revealed by our increased, and largely successful, focus on dealing with arrears of open cases.

As soon as the issue emerged the function was changed to ensure that such cases are not deleted without the final review being carried out. Cases relating to customers who left their final employment in 2001–02 or later are therefore not affected.

For customers who left employment in 2000–01, we are seeking to reinstate the records from back up tapes so that the cases can be worked normally.

For customers who left employment in 1999–2000 or earlier, we are unable to reinstate the records. We have been trying to determine the numbers involved and the amounts of tax that might have been overpaid and underpaid. We have also been considering whether there is any cost effective action we could take, without a high risk of error, to deal with the cases in some way. However, as the records have been deleted and cannot be reinstated we cannot precisely identify the cases concerned, so our options are limited. We have looked at a mailshot and general advertising.

We estimate that we would need to mailshot 3.04 million people using information from our NIRS database in order to reach an estimated 638,000k whose records were deleted while still open for 1999–2000 and 1998–99. Information from a similar exercise we undertook three years ago suggests that we would get a 20% response but end up repaying only 1.3%. Based on these figures we could end up repaying as few as 6,000 people. Costs of the exercise would be over £3 million in terms of direct costs and staff displacement and in total we would be likely to repay less than that.

Unless we were to mount a very large advertising campaign on the lines of the current SA and NTC campaigns the response to general advertising is also likely to be poor and create a very large number of extra contacts for us but again with very little outcome. We estimate the response would be no better than for a mailshot and could even be lower.

The Department as steward of public money has a duty to strike a balance in not incurring massive costs in fulfilling to the letter a statutory function, if doing so will only deliver minimal benefit securely to a relatively small number of people. Here the equation is £3 million plus of cost for benefit of less than that sum to around 6,000 people. Significant numbers of staff would have to be displaced to deal with largely unproductive customer contacts. There would also be considerable worries over whether that benefit is at risk of significant error and fraud given the long period that has elapsed since the customer left their final employment, and because we will be unable to undertake all our usual checks. We have therefore reluctantly come to the conclusion that we should take no further action in respect of these two years.

Of course, the position remains that a customer wishing to claim a repayment can still contact the Revenue in the usual way with their supporting evidence. We will then examine the documentation and repay where a repayment is due.

All of the customers whose records were deleted would have received a form P45(3) from their employer on leaving that employment. This form invites them to claim a refund if they feel they have overpaid tax. It sets out clearly what they should do. So they have had the opportunity to claim repayment of any tax overpaid. It is just the final manual review that has not been done.

Years prior to 1998–99 are, on legal advice, time barred for us to take any action to repay tax overpaid or recover tax underpaid.

We told NAO about the issue in good time for the NAO to include it in their Standard Report on the Revenue's accounts and the Revenue disclosed the issue in their annual accounts. As soon as we spotted what was happening we corrected it and have disclosed the issue at the proper time and in the proper way. There is no question of the matter being concealed.

David Varney
Chief Executive

18 November 2004

Memorandum submitted by the Citizen's Advice Bureaux

TAX CREDIT OVERPAYMENTS AND RECOVERY

Citizens Advice Bureaux (CABx) across England, Wales and Northern Ireland dealt with 134,000 tax credit enquiries in their first year of operation (2003–04). The two most frequent tax credit problems reported by CABx relate to general poor administration by the Inland Revenue and to problems associated with overpayments and their recovery. Citizens Advice currently receives approximately 300 reports about overpayments and recovery every month.

Members of the Committee will have received a letter on behalf of a number of organisations including Citizens Advice,¹ expressing our concern about the harsh recovery of overpayments that have resulted from mistakes made by the Inland Revenue. In this briefing we would like to provide Members with a few examples that illustrate the unreasonable hardship, confusion and anxiety experienced by CAB clients who find themselves in overpayment situations.

We are concerned about what CAB evidence suggests is the thousands of overpayments that have resulted from mistakes by the Inland Revenue or as a result of the Revenue failing to respond to claimants reports of changes to their circumstances. Once made, it is the claimant's responsibility to spot errors. If unable to spot them, they will later need prove that it was *reasonable* for them to have believed their award was correct if the overpayment is to be written off.² This is very difficult for claimants who commonly struggle to understand their entitlement in a system that is new and using award notices that contain inadequate information. In many of the cases reported by CABx it is unclear how overpayments have arisen and claimants do not understand by how much their future payments will be reduced to recover these overpayments.

We believe that a more sympathetic approach is needed in dealing with recovery of overpayments. Where claimants are disputing recovery on official error grounds, we are not confident that the current decisions are being made fairly and would like to see an independent audit of Inland Revenue decisions that apply the *reasonableness* test.

SPECIFIC ERRORS AND POOR DECISION MAKING

In addition to the specific computer error that in April and May 2003 caused 450,000 households to be overpaid a total of £94 million,³ there has been an error that has caused the income of one partner in a couple to be lost from the records. Many CABx have seen clients who did not notice the deletion of the income figure and in some cases the income correctly appeared on the award, but had not been used in the calculation. The error only came to light when their payments were suddenly cut and they were informed that they had been overpaid.

A CAB in Staffordshire reported that their client had been informed of an overpayment but did not know why this had arisen. The helpline advised that their information showed that the client worked 40 hours a week but had no income. The client had not spotted this error and he found it difficult to believe that the computer system had not rejected the information as contradictory.

A Sussex CAB client had been informed that they had been overpaid over £4,000 as a result of an IR error. The husband's income was recorded as nil even though he was recorded as working 37 hours a week. The letter from the Inland Revenue stated that "We have decided that although the overpayment was a result

¹ Letter dated 14 January from John Andrews of the Low Incomes Tax Reform Group on behalf of the Chartered Institute of Taxation, Child Poverty Action Group, Citizens Advice, the Institute of Chartered Accountants in England & Wales, Low Incomes Tax Reform Group, One Parent Families and TaxAid.

² Code of Practice 26, *What happens if we have paid you too much tax credit.*

³ Inland Revenue Annual Report 2003–04.

of a mistake on our part it was not *reasonable* for you to believe that your award and subsequent payments were correct.” In order to recover the overpayment the Revenue will simply not pay them for the next eight years (assuming entitlement remains the same).

Claimants with overpayments resulting from this error received letters from the Tax Credit Office informing them of the overpayment, apologising for the error and advising of how it will be recovered. For example:

“I am writing to let you know that your tax credits have been overpaid since April because we calculated your award incorrectly, to apologise for our mistake and to explain the arrangements for repaying this money.

We estimate that the incorrect payments currently amount to £4,293.19”.

A Sussex CAB client received a letter from the Inland Revenue dated 27 August stating that they had overpaid tax credits approximately £600 for 2003–04 and £2,200 for 2004–05. The letter stated that they had incorrectly calculated the clients’ award and apologised for the mistake. The client was alarmed by the huge debt they suddenly found themselves with as she said she had always informed the Inland Revenue of any changes to her family’s financial circumstances.

Official figures indicate that by the end of November 2004 67,000 requests for the recovery of overpayments to be reconsidered on the grounds of official error, but only about 1,100 families had had them written off.⁴ This seems a very small proportion of cases given that the poor quality of award notices in this first year of operation has meant that errors are very difficult to spot and entitlement very difficult to understand.

From the CAB cases we have seen, responses to requests are in fairly standard letters where it is difficult to be confident that all the information needed to make a fair decision is taken into account in the first instance. The client who had received the letter, whose extract is quoted above, was told it was not reasonable for her to have believed her award was correct. No full explanation was given and the decision seemed to be based largely on the fact that the amount was so large. The claimant had continually kept the Inland Revenue up to date with her changes of circumstances even though she’d had a nil award for most of the year. A change in May had generated the lump sum back-payment and an award for the current year. Her award notice showed the correct household income and the amount she received matched the amounts listed. With no information on how awards are calculated, it does not seem reasonable to have expected the claimant to know that this was wrong.

LUMP SUMS PAID IN ERROR

It may be reasonable to expect claimants to be able to spot large sums paid in error, but CABx have reported cases where claimants have been uncertain about monies paid, queried it with and received reassurances from the helpline, only to be later asked for the money back. It is important that when the Revenue makes decisions about whether claimants’ overpayments should be recovered that they take account of what advice they have received from the helpline.

A Midlands CAB reported couple with two children who had been paid a lump sum of £3,500 by the Inland Revenue in the spring of 2004. She returned the money as didn’t believe she’d been underpaid. The Revenue insisted it was due and paid it a second time. When she returned it a second time the Revenue contacted her insisting it was hers and paid it a third time. A couple of months later she was notified that she had been overpaid by £4,900. During 2003–04 a CAB client in Wiltshire had received a lump sum payment into her account around the time when her hours had decreased from 40 a week to 30. It appeared to be a duplicate payment as her working tax credits were normally paid through her wages. She queried it with the helpline several times but was assured that it was hers and she should spend it. Early in the new tax year, she was informed that she had been overpaid and it would be recovered from her future payments.

Citizens Advice believes that the way that the Inland Revenue are applying the “reasonableness” test as set out in Code of Practice 26, is itself unreasonable. It requires a degree of knowledge and understanding of the tax credits system, which is unreasonable for the vast majority of claimants. We would like to see an independent audit of Inland Revenue decisions which apply the reasonableness test.

OVERPAYMENTS NOT CONNECTED TO OFFICIAL ERROR

We are also concerned about the number of overpayments that, whilst not originating from Revenue error, have nevertheless come as a shock to claimants who didn’t fully understand the new system or their award notices. Claimants can find themselves with overpayments as a result of an increase in income above £2,500 that they haven’t reported during the tax year, or as a result of changes to their personal circumstances that they did not report immediately.

During this first year of operation it looks likely that a large number of overpayments have resulted from these factors. We do not believe that the Inland Revenue succeeded in adequately highlighting the fact that awards were only provisional, based on circumstances remaining as initially reported. CAB evidence

⁴ HC Deb, 15 December 2004, c. 1087W

suggests that claimants found it difficult to understand their entitlement and how their changes of circumstances would affect their awards. This has not been helped by the lack of relevant information on award notices.

Supplementary memorandum submitted by the Inland Revenue

Question 40 (Mr Bacon): How old is this function?

The function to automatically delete redundant records which are over three years old was introduced in April 1992.

Questions 110–113 (Mr Williams): Can you give us any idea how many hardship cases you have had put to you and how many you have accepted and how many you have turned down?

BACKGROUND

Our Code of Practice 26, What happens if we have paid you too much tax credit? explains:

- the Department's approach to recovering overpayments,
- that there are limits by which continuing payments can be adjusted to recover overpayments from the previous year, and
- the circumstances in which we can make additional payments.

Tax credits payments may be adjusted during the year following a change in a claimant's circumstances. If, as a result, the claimant was paid too much in the earlier part of the year, their payments will be reduced.

HARDSHIP CASES

We ask claimants to contact us if the reduced payments cause them or their families hardship. We will consider whether to increase their payments for the rest of the year. If we do, the claimant will pay off some of the amount they owe during the year and will be expected to pay back the rest after the end of the year.

In 2003–04 we received around 43,500 requests for additional payments of which some 32,500 were accepted. In the first 10 months of 2004–05 we have identified some 11,500 requests for additional payments. Around 4,200 have been accepted, 6,200 rejected and some are still under consideration.

Where there is no award in the current year, the customer will receive a Notice to Pay, and can pay back the overpayment in 12 monthly instalments if they wish.

Exceptionally, if payment would cause hardship, we may decide not to collect all or part of an overpayment, or allow more time to pay. In the first 10 months of 2004–05, some 42,500 requests for time to pay were received by our Receivables Management Section. Approximately 42,000 requests have been accepted, eight have been rejected and others are under consideration.

Question 150 (Mr Bacon): Who owns the intellectual property of Customs' Fujitsu systems?

Under the terms of the Infrastructure Services Agreement (ISA) that Customs have with Fujitsu, the Department holds Intellectual Property Rights unless specifically agreed otherwise. This applies to all applications and software developed at our request. Fujitsu retain the rights for any systems that they have previously developed and brought with them. For any work done outside of the ISA, Customs follow Office of Government Commerce guidelines on the ownership of Intellectual Property Rights. The broad policy is to achieve best value for money for the Department. The main principle is that the rights should be held by the party best able to exploit them. Work is currently being done to review the best commercial model for HM Revenue and Customs.

Question 174 (Chairman): Could we have a note please on paragraphs 3.18 to 3.20 on the avoidance opportunities in stamp duty land tax?

What is the current estimate of the "tax gap"?

The NAO Report refers to the "tax gap". In this context the "tax gap" means the amount of extra tax we estimated would have been payable if:

- (a) payment of stamp duty had been compulsory, and
- (b) it had been payable on all land transactions.

The estimated yield from the measures in table A2.1 of Budget 2003 was £350 million. This included reform of the charge on new leases and other reforms so the strict yield from anti-avoidance measures was £210 million. Of this £210 million, £130 million came from measures in Finance Act 2002.

It is not possible to identify the increase in yield that has occurred as a result of the anti-avoidance measures alone, and therefore the current size of the “tax gap” is uncertain. However, the overall increase in yield observed between 2003–04 and 2004–05 is consistent with the £210 million increase forecast at Budget 2003, after making allowance for forecast price inflation, growth in transaction volumes, and usage of Disadvantaged Areas Relief.

What plans do we have to further reduce the “tax gap”?

As the “tax gap” (as defined above) is structural it can only be reduced further by legislation. We cannot anticipate what announcements in this respect might be made by the Chancellor in his Budget.

We will use the new compliance powers available under SDLT to detect and counter non-compliance in order to minimise the gap between the amount due under SDLT and the amount we collect and to inform our compliance strategy.

Has the introduction of SDLT reduced the use of special purpose vehicles?

We have no way of monitoring the use of special purpose vehicles incorporated offshore, since transactions in the shares of such vehicles are not reported to us. Special purpose vehicles have many advantages, not just tax advantages, and there is no reason to suppose that their use will have decreased. However the introduction of SDLT has made the avoidance of SDLT using special purpose vehicles more difficult.

Supplementary memorandum from HM Revenue and Customs

At the PAC meeting on 24 January 2005 in respect of the C&AG’s 2003–04 Inland Revenue Standard Reporting featuring Tax Credits I agreed to provide the Committee with a note this month on the demographics of the Tax Credit claimants with overpayments and errors. I would also like to inform you of some indicative findings about the level of Tax Credit claimant compliance.

DEMOGRAPHICS OF OVERPAYMENTS

The Committee asked for a note outlining the groups of people who have been most affected by overpayments and errors and the demographic analysis of these groups.

The analysis below shows families with overpaid awards. The first column covers all overpayments, whether caused by official error or by changes in income or other circumstances. In respect of errors, there are limits to the types of error that we can clearly identify. In particular, no demographic analysis is available of the 455,000 families affected by the computer system fault described at paragraph 2.10 of the C&AG’s 2003–04 Inland Revenue Standard Report. We have, however, been able to identify families affected by certain other known computer system errors. The figures cannot be added together as some families can appear in more than one column.

- A Families for which the computer based the award calculation on less than their full income due to a system error, whether or not they disputed the overpayment later;
- B Families who reported their annual incomes when renewing their awards but this income was incorrectly disregarded for subsequent years, leading to under or overpayments. Includes all such families, whether or not they became aware of the error or contacted us;
- C Families where there has been a system error identifying the amount of overpayment recovered from the next year’s payments. Includes all such families, whether or not they became aware of the error or contacted us.

		<i>Thousands of families experiencing certain types of system error</i>			
		<i>Overpaid in 2003–04*</i>	<i>Income incorrectly handled</i>	<i>Renewal income disregarded</i>	<i>Cross-year recovery error</i>
		*	<i>A</i>	<i>B</i>	<i>C</i>
Total		1,879	63	36	63
Split by income level					
2003–04	Up to £5k	134	5	2	8
	£5–10k	249	6	14	12
	£10–15k	294	8	9	11

	<i>Thousands of families experiencing certain types of system error</i>			
	<i>Overpaid in 2003–04 *</i>	<i>Income incorrectly handled</i>	<i>Renewal income disregarded</i>	<i>Cross-year recovery error</i>
		<i>A</i>	<i>B</i>	<i>C</i>
£15–20k	279	8	5	11
£20–30k	454	17	4	14
£30–40k	149	11	1	4
£40–50k	40	5	–	1
Over £50k	129	3	–	1
Not known	153	–	–	–
Split by number of Children (at 5 April 2004)				
No children **	232	8	7	5
1 child	640	23	16	21
2 children	677	24	10	24
3 children	246	7	3	10
4+ children	84	2	1	4
Split by type of household (at 5 April 2004)				
Single no children **	127	1	5	2
Single with children	465	2	26	20
Couple no children **	105	6	2	3
Couple with children	1,182	54	4	38

*Strictly speaking, these are counts of overpaid awards, not families.

**Includes awards for families that had qualifying children earlier in the year but, for example, the last child had left full time non-advanced education during the year.

NB some figures have been rounded, therefore some columns do not add up.

CLAIMANT COMPLIANCE

You will recall that to measure the general level of compliance in tax credits we are carrying out an annual programme of random enquiries on a statistically representative sample of finalised claims across the tax credit population. As with other “random enquiry” exercises, its main purpose is to:

- measure the proportion of claimants that are non-compliant;
- measure the financial consequences of non-compliance;
- measure the effectiveness of our automated risk assessing processes ie factors, or combinations of factors, in a claim that denote a high risk of non-compliance; and
- use the results to help to refine our risk assessment processes for the future by developing new ways to identify high risk claims.

We randomly selected a sample of about 4,700 awards. Because of the size and diversity of the claimant population, and the possible variations of compliance risk, we stratified the sample by type of claim so that we could measure the level of compliance for various claimant groups, as well as for claimants as a whole. The sample was designed to achieve an overall precision of $\pm 1.4\%$ at worst (with 95% confidence) in the resulting estimate of the proportion of compliant cases. This was based on a set of assumptions about the proportions of non-compliance that would be found in each stratum.

We are carrying out a full check on each claim in the selected sample to establish whether there was any non-compliance, and where we identify some, we are measuring the financial consequences of that non-compliance. The random enquiry programme could not start until recipients had provided the Department with details of their final 2003–04 incomes, which meant that we were unable to start work on some cases until after 31 January 2005.

Due to the time needed to complete these investigations, particularly when the claimant is self employed (we need to tie in this investigation with a check of their income reported on their Income Tax Self Assessment), we do not expect to publish final results for 2003–04 until Spring 2006. Whilst some investigations can be dealt with relatively quickly, ie claimants on PAYE where income can easily be cross checked, some will take longer to resolve, especially when we need to obtain information from third parties

eg childcare providers. But we now have indicative findings. These come with a strong warning that they are subject to a wide margin of error. This is because they are only based on the subset of the sample cases where a full enquiry had been completed by mid-May 2005. It is likely that these cases were the more straightforward (and probably more compliant, or at least less likely to be deliberately non-compliant) ones. This means the full results are likely to see an increase in the proportion of non-compliant cases and the financial consequences estimates. The deliberate error proportion and associated financial cost estimate are also likely to rise.

INDICATIVE RESULTS

The 1,385 cases where the checks had been completed by 15 May 2005 provide the basis of the indicative results. This represents only about 29.6% of the total sample. After grossing the sample up to the tax credits population, we estimate that 13.1% of the overall population of some 5.3 million awards (excluding out of work cases) are non-compliant. The associated financial consequence of this non-compliance is £460 million per annum, some 3.4% by value.

Where it was established that the claim was wrong, tax credit compliance officers were asked to indicate whether the non-compliance was due to a deliberate attempt by the claimant to receive tax credits to which they were not entitled or due to errors in the claim that that were not deliberate. In only 0.3% of awards examined and closed to date was the error deemed to be deliberate. The financial cost associated with this is estimated to be £30 million. The remainder is due to other errors on the part of the claimant. We would expect the relative proportions to change by the time the exercise is completed as these results are only indicative and because the cases that are taking longer to complete may fall into different categories. It is reasonable to assume that cases settling quicker tend to be more straightforward so the proportion of cases that are not compliant is likely to rise when the full data is available.

As this is the first random enquiry exercise on tax credits, we cannot use the results from previous exercises to forecast what these results might be once the full sample has been worked.

FINAL REPORT

We are aiming to complete the investigation of all cases within the sample as soon as possible and we expect the 2003–04 random enquiry program to be completed in January 2006. Quality checking and full analysis of the final data will take time to complete so we expect to produce a final report by Spring 2006. Once we have established a baseline figure for the level of non-compliance in tax credits, our intention is to target year on year a reduction in this figure beginning in 2006–07.

OTHER COMPLIANCE RISK MONITORING WORK

As well as putting in place the random enquiry programme, there was a clear business need to obtain evidence about the types of non-compliance and the effectiveness of our risk assessment system before July 2005. To that end, we carried out an exercise designed to inform our risk assessment process by:

- looking at the effectiveness of the risk rules which have been developed to support tax credits and protect the system from abuse;
- provide an indication of the level and type of non-compliance around claimant circumstances; and
- support and inform the compliance regime for tax credits.

The research involved reviewing a small statistically valid sample of 1,000 provisional (not final) awards for 2003–04. As these claims were provisional, we could not use our random investigation powers, so where we were unable to identify a risk from the original claims they were not investigated. We then carried out examinations on those claims where we had identified a risk. But as the sample cases were provisional awards, and overpayments are a normal part of the tax credits system (eg arising from changes in income and circumstances that claimants are not required to report until the end of the year), the results could not, nor were intended to, provide a robust, comprehensive measure of the levels of claimant error or the financial impact of those errors. The random enquiry programme was designed to do this.

The main risk areas confirmed by that research related to incorrect childcare costs, undeclared partners and income discrepancies. The work confirmed that our risk scoring system is effective in identifying these risk areas and differentiating between high and low risk claims. This confirmed our view that the risk scoring system is working as planned and proving valuable in targeting investigative activity by our compliance teams on the most appropriate cases.

The research found that the proportion of non-compliant claimants lay in the range 5%–11%. Where it was established that the claim was wrong and that the error arose from non-compliance, the reason for the error was recorded as either deliberate error or negligence. Only 2.2% of the cases deemed non compliant was due to deliberate error.

COMPARISONS OF LEVELS OF NON COMPLIANCE IN WFTC/DPTC AND CTC/WTC

Child and Working Tax Credits (CTC/WTC) are very different in scale and scope compared to their predecessors, Working Families' Tax Credit (WFTC) and Disabled Persons Tax Credit (DPTC) because of the annual nature of awards and because they are designed to react to any changes in personal circumstances during the period of an award. Also, significantly more families benefit from them, including a large proportion that are only receiving the family element. These fundamental differences do not lend themselves to direct comparison of levels of non-compliance between the two schemes.

David Varney
Chairman

18 July 2005