



House of Commons  
Committee of Public Accounts

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**Tax Credits**

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**Twenty-second Report of  
Session 2006–07**

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

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to be printed 23 April 2007*

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## The Committee of Public Accounts

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### Committee staff

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## Summary

HM Revenue and Customs (the Department) has paid £47 billion under the current tax credit system in the first three years since it was introduced in 2003.<sup>1</sup> A tax credit award is based on the claimant's circumstances for the full tax year and payments are provisionally made on the basis of circumstances for the previous year. Final awards are based on actual circumstances and, because incomes tend to increase, many claimants have received overpayments, totalling around £5.8 billion in the first three years.

The Department seeks to recover these overpayments but cannot always do so and has so far written off over £500 million. It is unlikely to recover a further £1.4 billion of debt.<sup>2</sup> The recovery of these debts can cause hardship to claimants, and places an administrative burden on the Department.

The Government has made some recent changes to the scheme in an attempt to reduce overpayments. The most important change involves raising from £2,500 to £25,000 the threshold for increases in income in-year which are ignored when awards are finalised. This change will reduce the level of overpayments and increase the overall cost of the scheme by some £500 million each year. Despite asking for the cost of this measure in our last report, the Department did not provide it until the Committee's hearing. Meanwhile, the National Audit Office had separately estimated the cost of the change at between £400 and £600 million.

Tax credits suffer from the highest rates of error and fraud in government. In 2003–4 between £1.06 billion and £1.28 billion (8.8 to 10.6% by value) was incorrectly paid to claimants.<sup>3</sup> Despite these unacceptably high levels, the Department is not setting targets for reducing them until spring 2007, when it will have been able to calculate error rates for 2004–05.

The Department failed to ensure that its tax credit internet system complied with mandatory guidance issued by the e-envoy. Following attacks by organised criminals, it had to close the tax credits internet site in December 2005.

This is the Committee's fourth report on the current tax credits system.<sup>4</sup> Its cost in terms of the unforeseen level of overpayments and the scale of error and fraud continues to be significant and well beyond the levels that Parliament was led to expect. The Department is now taking steps to reduce the level of overpayments, at considerable cost to the taxpayer. But the Department has still not developed an adequate response to the unacceptable levels of error and fraud in the scheme.

1 C&AG's Standard Report on the Accounts of HMRC 2005–06, HC (2005–06) 1159, table 1

2 C&AG's Report, para 2.18

3 C&AG's Report, para 2.38

4 Committee of Public Accounts, Fourteenth Report of Session 2003–4, *Inland Revenue: Tax Credits*, HC 89; Fifth Report of Session 2005–06, *Inland Revenue: Tax Credits and deleted tax cases*, HC 412; Thirty-seventh Report of Session 2005–06, *Inland Revenue Standard Report: New Tax Credits*, HC 782

## Conclusions and recommendations

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- 1. £5.8 billion was overpaid to claimants in the first three years of the current tax credits scheme.** The Government has made changes to the scheme which it estimates will eventually reduce overpayments by one third. The Department does not have complete information on the causes of overpayments and is uncertain about how far each measure will reduce overpayments. The Department should include the actual cost and effect of these changes in its annual report to allow Parliament to evaluate their success.
- 2. In response to repeated questioning, the Department eventually told the Committee that increasing the income disregard to £25,000 would cost the Exchequer an additional £500 million each year.** The Committee requested information on the cost of the increased disregard shortly after the decision was first announced in the 2005 Pre-Budget Report. But the Department disclosed its estimate only during the Committee's most recent hearing and after the National Audit Office produced its own estimates of the potential cost. The Department said that greater confidence in its estimates had allowed it to release this information. But if it was confident enough to increase the disregard it should have been able to give an estimate of the cost when the decision was first announced.
- 3. Tax credits suffer from the highest rates of error and fraud in central government, undermining HMRC's reputation for accuracy, fairness and proper handling of taxpayers' affairs.** In 2005, the Committee concluded that the Department's effectiveness in managing the tax system depended on maintaining public confidence in its administrative competence. Yet the Department neither produces routine estimates for error and fraud nor sets targets for reducing levels. It needs to demonstrate to taxpayers that it maintains its capacity for the proper handling of their tax affairs by setting targets for reducing the level of error and fraud and producing routine estimates to validate its performance against the targets.
- 4. The Department does not have up to date information on levels of claimant error and fraud in tax credits.** In the absence of up to date information the Department cannot assess the effectiveness of its efforts to combat tax credit error and fraud. From 2007–08 most tax credits awards will now be finalised in the July following the year to which they relate. The Department should make earlier estimates of the overall levels of error and fraud and assess these as a basis for more timely and targeted action to bring the trend down.
- 5. The design of the internet system for tax credits was deficient from the outset and left it vulnerable to attack by organised criminals.** The system, which was opened in August 2002, did not conform to mandatory requirements on security set down by the Government's e-envoy. Only after sustained fraudulent attacks did the Department acknowledge that it could no longer manage the risks arising from the inadequate design, and it was forced to close the system in December 2005. The internet channel has been closed for well over a year and is unlikely to re-open before the summer of 2008.

- 6. The Department failed to design the tax credits scheme to give proper protection against error and fraud.** In its efforts to make the scheme accessible to claimants, it relied too much on detecting false claims after payment had been made. This approach of ‘pay now, check later’ left the scheme vulnerable to fraud. The Department is now increasing its testing of claims before they are paid, focussing on claims considered to present the highest risk. The effectiveness of this approach demands appropriate risk criteria, and the ability to identify emerging trends in the claimant population. It should supplement this work by testing a sample of claims below its risk threshold to confirm that its risk assessment criteria are soundly based.
- 7. The Department has increased the number of tax credits compliance staff from 1,200 to 1,400 in 2006/07, allowing it to examine a further 20,000 claims.** The increase in the number and the change in focus of compliance tests by HMRC in 2005-06 resulted in significantly increased yields. The Department should regularly reassess the resourcing of compliance work on tax credits against its effectiveness in helping to reduce the unacceptably high levels of incorrect claims.
- 8. The Department applies the same risk assessment process to all tax credit claimants, without distinct procedures for migrant workers.** Migrant workers do however present an additional risk of failing to notify the Department when they leave the United Kingdom and cease to be eligible for tax credits. The Department needs to manage the risk of making incorrect payments to claimants who have left the country permanently without telling it.
- 9. The Department does not have a gateway to request information held by the Home Office on migrant workers who are claiming tax credits.** This information would assist the Department in verifying information provided on income and circumstances. It should explore with the Home Office the scope for receiving information held on migrant workers.
- 10. The administration of tax credits has not been effective and Members of Parliament continue to receive too many complaints about the quality of service provided.** Administrative errors made by the Department continue to generate incorrect payments but it does not know how much is involved. This type of information is routinely prepared by the Department for Work and Pensions in connection with its administration of benefits. HM Revenue and Customs should calculate and publish information on the value of incorrect payments caused by administrative error.

# 1 Overpayments of Tax Credits

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1. Child Tax Credit and Working Tax Credit (tax credits) replaced the previous tax credits system in April 2003 as part of the Government's reforms of the tax and benefits system. The new arrangements were designed to help families with children and working people on low incomes. HM Revenue and Customs (the Department) paid some £47 billion of tax credits in the first three years of the scheme and it estimates that an average of 5.3 million families benefited in 2005–06.<sup>5</sup>

2. A tax credit award is provisionally based on a family's income and circumstances from the preceding tax year. The award is finalised after the end of the tax year when actual income and circumstances are known. The final award can differ from the provisional award, for example where incomes increase. A system of annual awards based on circumstances which often change inevitably results in a substantial amount of overpayments.<sup>6</sup>

3. There can be a number of reasons why a claimant is overpaid, but the tax credits computer system does not automatically generate information on the cause of overpayments for each award.<sup>7</sup> Nevertheless, the Department's analysis suggests that overpayments generally result from:<sup>8</sup>

- rises in income from one year to the next;
- families overestimating a fall in income when they seek additional support during the year;
- provisional payments made at the start of the tax year based on out of date information which the system is not designed to change until the award is finalised; and
- delays by families in reporting changes in personal circumstances to the Department.

4. Actual levels of overpayments have been much higher than the Department envisaged when the scheme was designed. It originally estimated that overpayments would be around £1 billion a year but in practice around £2 billion was overpaid in the first year.<sup>9</sup>

5. The Department seeks to recover overpayments wherever possible. It can only write-off the debt or restrict the rate of recovery if it considers that repayment would cause hardship. It can also write-off overpayments which result from official error or if it finds these are due to organised fraud.

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5 C&AG's Report, table 1

6 Q 205

7 Q 9

8 C&AG's Report, para 2.12

9 Q 205

6. In the first three years of the scheme the Department wrote off £557 million of overpayments. At the end of March 2006, a further £3.6 billion was outstanding,<sup>10</sup> of which the Department is unlikely to recover £1.4 billion, making a further write-off inevitable.

### Changes announced in the 2005 Pre-Budget Report

7. The December 2005 Pre-Budget Report announced changes to the tax credits scheme designed to provide greater certainty to claimants, particularly when the family income rises.<sup>11</sup> The package comprised five principal measures intended eventually to reduce overpayments by one third.<sup>12</sup>

8. The most important change raised from £2,500 to £25,000 increases in income which are disregarded when finalising awards. The effect is that from 2006–07 claimants will retain some of the amounts they would have been asked to repay in previous years.

9. The other changes affect the timing of payments and the recovery of overpayments, for example by reducing the build-up of overpayments that need to be subsequently recovered. These changes:

- place additional responsibilities on claimants to notify the Department promptly of changes in circumstances that affect their awards; with the aim of reducing overpayments caused by awards being based on out of date information;
- bring forward the deadline by which claimants need to finalise their awards from 30 September to 31 August;
- further shorten the period in the following year where payments continue to be made to claimants based on out of date information, by bringing the deadline forward from 30 August to 31 July;<sup>13</sup>
- will increase payments only for the remainder of the year when claimants report a fall in income during the year, with a further payment if appropriate when the award is finalised after the end of the year; and
- introduce automatic limits on the recovery of overpayments where awards are adjusted in year following a reported change of circumstance, with the aim of encouraging more families to report in-year changes of circumstances.

10. In the 2005 Pre-Budget Report, the Treasury estimated that the overall effect of the package would be a cash cost to the Exchequer of £100 million in 2006–07, followed by net savings of £200 million in 2007–08 and £50 million in 2008–09.<sup>14</sup>

11. We had previously asked about the underlying cost of each of the individual changes, and in particular the change in the disregard given the significance of its effect on the

10 HMRC Trust Statement 2005–06, Note 3.3

11 C&AG's Report, para 2.20

12 C&AG's Report, para 2.20.

13 This change starts with 2007–08 awards and was announced in the 2006 Pre-Budget Report.

14 C&AG's Report, para 2.21



underlying cost of the scheme to the taxpayer. The Treasury chose not to provide an estimate of the cost of the disregard when the changes were announced, and then took almost a further year to do so. Our previous Report<sup>15</sup> requested this information but the Treasury Minute response did not provide it.<sup>16</sup> The Department explained that it had information only for 2003–04 awards at the time of the Pre-Budget Report and that it did not have sufficient confidence in its estimates for them to be released until information on 2004–05 awards was available.<sup>17</sup> But if it was confident enough to increase the disregard it should have been able to give an estimate of the cost when the decision was first announced.

12. The Treasury eventually wrote to the Committee in October 2006 giving further information on the effect of the changes on Exchequer cash flows ('the Exchequer effect'), as shown in **Table 1**. From April 2006 the increase in the income disregard will result in a fall in cash inflows to the Exchequer, reflecting the foregone recovery of overpayments due to income rises. The cost and the timing of the Exchequer effect depends not only on the size of the overpayments that would have accrued had the higher disregard not been in place, but also on the profile of recovery of these overpayments. It can take HMRC several years to complete the recovery of overpayments. Thus, as Table 1 shows, the full cost of the increase in the income disregard in terms of its effect on the Exchequer can only begin to be seen after a period of time.

**Table 1: Exchequer Effect of the £25,000 disregard**

	2006-07	2007-08	2008-09	2009-10	2010-11
Annual cost of Income disregard of £25,000	£50 m	£100 m	£150 m	£250 m	£300 m

Source: HM Treasury

13. The Department told us that the full cost of the increase in the income disregard in terms of its effect on the claimants' entitlement would be around £500 million each year.<sup>18</sup> This is greater than the figure disclosed in Table 1 above, because the Department assumes that some of the overpayments that would have accrued in 2006–07 with the lower threshold for the income disregard would have been recovered in 2011–12 and beyond, and in some cases never recovered at all. The Department's figure is consistent with the National Audit Office's analysis, which suggested that increasing the disregard was likely to cost between £400 million to £600 million annually, depending on assumptions about the growth and distribution of income changes across the claimant population.<sup>19</sup>

14. As regards the cost of the other elements of the 2005 Pre-Budget Report package designed to reduce the build up of overpayments, the Department's estimates are imprecise. It estimates that the four elements of the package, described in paragraph 9,

15 Committee of Public Accounts, Thirty-seventh Report of Session 2005–06, *Inland Revenue Standard Report: New Tax Credits*, HC 782

16 *Treasury Minute on Thirty-fourth and Thirty-sixth to Thirty-ninth Reports on the Committee of Public Accounts 2005–2006*, Cm 6863

17 Qq 8, 33

18 Q 5

19 Q 6

which are designed to reduce overpayments could each bring an Exchequer benefit of up to £100 million a year when all the timing effects have worked through. These benefits will be partly offset by the application of automatic limits on in year recovery where awards are adjusted following a reported change. This measure will reduce the rate at which recoveries of overpayments are made, and the Department estimates that this could cost the Exchequer anything up to £100 million a year.

## 2 Error and Fraud in Tax Credits

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### Claimant error and fraud

15. Tax credits are vulnerable to fraud through applicants providing false information, for example understated or undeclared income, or by misrepresenting their circumstances, for example not declaring the existence of a partner. Claimants may also make genuine errors in their applications which result in incorrect awards.

16. The Department's effectiveness in managing the tax system depends on maintaining public confidence in its administrative competence, which is undermined by high levels of error and fraud. The Department has estimated that in 2003–04 claimant error and fraud led to incorrect payments to claimants of between £1.06 billion and £1.28 billion, some 8.8 to 10.6% of payments by value. The Comptroller and Auditor General qualified his audit opinion on HM Revenue and Customs' Trust Statement because of these losses.<sup>20</sup> The percentage levels are the highest for any government scheme providing means tested support, and the Department acknowledged that they were far too high.<sup>21</sup>

17. The Department explained that it was committed to reduce these levels substantially. But it did not know if error and fraud had in fact been reduced, because it only had information for 2003–04 awards.<sup>22</sup> The Department measures error and fraud by investigating a random sample of awards, but it cannot start an enquiry until the award has been finalised. Some 2004–05 awards were not finalised until January 2006, which meant the Department only started its investigations in February 2006. Given the time the Department takes to complete this work, it will only produce estimates of levels of error and fraud for 2004–05 awards in the spring of 2007.<sup>23</sup>

18. Despite the fact that the scheme has been in operation for four years, the Department still does not have a target for reducing error and fraud. It felt it needed data for 2004–05 to provide a reasonable baseline on which to set such targets.<sup>24</sup> The Committee expected the Department to have established a clear benchmark for managing the risk of error and fraud when the scheme was designed. The Department is only now starting to consider potential benchmarks, four years after the scheme was introduced.

### Organised crime and the tax credits internet facility

19. Tax Credits have been targeted by organised criminals, and the Department identified incorrect payments by suspected organised fraudsters of £131 million in 2005–06.<sup>25</sup> These attacks forced the Department to close the tax credit internet channel (the e-portal) on 2 December 2005. The ability to claim tax credits through the e-portal was particularly

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20 C&AG's Report, para 2.38

21 Q 14

22 Q 84

23 Q 83

24 Q 11

25 C&AG's Report, para 2.33

appealing to organised criminals as it allowed them to submit multiple claims quickly with impunity.<sup>26</sup>

20. The facility to allow tax credits claimants to submit claims via the internet was introduced in August 2002. In September 2002 the e-envoy issued requirements on controls that should be built into systems where government services were provided electronically.<sup>27</sup> Central government departments and agencies were required to comply with these requirements. But the Department did not apply these to the tax credit system, despite the fact that they were mandatory.

21. In introducing the tax credits internet channel, the Department sought to strike a balance between accessibility for those who wished to use it and appropriate security.<sup>28</sup> But it failed to reassess the security of the internet channel at any point in the three years after the e-envoy's guidance was issued. It was only in December 2005, following a concerted attack by organised criminals, that the Department concluded the internet channel was not robust enough to withstand fraudulent attacks. It does not intend to re-introduce the internet channel until it is satisfied it fully meets current security requirements.<sup>29</sup> But this is unlikely to happen before the summer of 2008, some two and a half years after it was originally closed.<sup>30</sup>

## Compliance

22. Although aware of the risk of fraudulent tax credit claims, the Department initially placed the main emphasis of its compliance work on checking claims after they were in payment. It now gives much greater emphasis to checking claims before payment.<sup>31</sup> **Table 2** shows that the number of pre-payment checks increased in 2005–06, to almost half of all its checks. The value of incorrect payments identified by the Department's compliance work also increased in 2005–06. But in the absence of an overall measure of error and fraud, it is not clear if this increase is due to more effective compliance work or more attacks on the system.

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26 C&AG's Report, para 2.30

27 Office of the e-envoy: *Registration and Authentication: e-Government Strategy Framework Policy and Guidelines*, September 2002.

28 Q 40

29 Q 41

30 Oral evidence taken before the Treasury Sub-Committee on 14 March 2007, *The Administration of Tax Credits: Follow Up*, HC (2006–07) 382-I, Q 88

31 Q 17

**Table 2: HMRC's direct compliance checks**

	2004–05		2005–06	
<b>Checks on awards before payment</b>	17,000	16%	67,000	45%
<b>Checks on awards after payment</b>	91,000	84%	80,000	55%
<b>Value of incorrect payments identified by compliance checks</b>	£130 million		£528 million*	

\* This comprises incorrect payments prevented of £307 million and incorrect payments identified of £221 million. There is no corresponding breakdown of the figure for 2004–05.

23. In 2006–07 the Department has increased the number of tax credits compliance staff from 1,200 to 1,400.<sup>32</sup> HMRC made this decision on the basis that the additional staff will allow it to undertake an additional 20,000 investigations.<sup>33</sup>

24. HMRC's design of the tax credits scheme has failed to establish proper controls to prevent error and fraud from entering in to the system. In particular, the Departments approach of 'paying claims now, and checking later' failed to safeguard against fraudulent claims going directly into payment. As the Department's experience of the fraud committed through the e-portal shows, this failure in the design of controls is compounded where there are inadequate checks in place to establish the true identity of the claimant.

## Migrant workers

25. In May 2004 ten new countries joined the European Union, and many people from those countries have entered the UK to work. Subject to meeting certain conditions, migrant workers have the right to claim tax credits.

26. The Department applies the same risk assessment process to migrant workers as to other claimants.<sup>34</sup> It looked at the specific risks in this area, and concluded from the initial results of its work that the risk associated with migrant workers is no greater than that for other claimants.<sup>35</sup>

27. To be eligible for tax credits, claimants need to be present and ordinarily resident in the UK.<sup>36</sup> The Department therefore needs to know if migrant workers leave the country and continue to receive tax credits. Individuals are responsible for notifying the Department if they leave the UK and are no longer eligible for tax credits. But the Department did not consider there was a particular risk of non-compliance in this area.<sup>37</sup> It can charge penalties

32 Q 80

33 Footnote to Q 81

34 Q 49

35 Q 53

36 C&AG's Report, para 2.3

37 Q 54

where claimants do not notify it that they have left the United Kingdom for more than eight weeks, although it does not know how many penalties have been charged.

28. The Department also faces a risk in dealing with claimants who have previously lived abroad,<sup>38</sup> because it needs to verify incomes and circumstances before they came to the United Kingdom. Again, it does not have any distinct procedures to manage this risk.<sup>39</sup>

29. The Department provides tax credits information to assist the Home Office's work on Immigration and Terrorism. But it does not have any arrangements to request information held by the Home Office that could be used in its compliance work on tax credits.

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38 Q 50

39 Q 49

### 3 Customer service

30. The service provided to tax credit claimants has been poor. Members of Parliament continue to receive too many complaints from constituents about the administration of the scheme. The problems have been extremely time-consuming and frustrating for some people. Members have also had examples where the Department appeared not to have fully examined the case, or had placed the onus on the individual to provide detailed records in order to prove it had made a mistake. Our predecessor Committee's report of July 2005 noted that these problems have impaired the Department's reputation.<sup>40</sup>

31. The Department is taking steps to improve performance.<sup>41</sup> It writes off overpayments on the grounds of official error where it has made a mistake and the claimant could reasonably have thought the payment was correct. It has sought to clarify this test and has recently provided further guidance of what it means by "reasonable".<sup>42</sup>

32. Claimants can appeal to the Department if they dispute its decision to recover overpayments. The number of disputed overpayments grew significantly in 2005–06, as shown in **Table 3**. There was also a big increase in the number of overpayments written-off as a result of disputes, and in 2005–06 almost half of all disputes were resolved in the claimants favour.

**Table 3: Overpayments overturned on appeal**

	<b>Overpayments disputed</b>	<b>Overpayments written off as a result of the dispute</b>
2004–05	215,000	10,300 (5%)
2005–06	367,500	160,500 (44%)

Source: HMRC

33. If claimants are unhappy with the Department's decision on the recovery of overpayments, they can appeal to the Parliamentary Ombudsman. But the Department does not analyse how its decisions on overpayments are changed following intervention by the Ombudsman's office.<sup>43</sup>

34. The Department has improved the accuracy of its processing of information since the introduction of tax credits. But it does not know how much it has overpaid and underpaid through inaccurate processing.<sup>44</sup> To find out would require an examination of a large sample, which the Department considers would entail a disproportionate use of resources.

40 Committee of Public Accounts, Thirty-seventh Report of Session 2005–06, *Inland Revenue Standard Report: New Tax Credits*, HC 782

41 Q 108

42 C&AG's Report, para 2.17

43 Ev 24–25; Qq 148–149

44 C&AG report, para 2.41

## Software problems

35. The design of the tax credits system results in overpayments, but there have also been unforeseen overpayments due to software errors. In October 2005, there were still 199 known software errors in the tax credit computer system. The majority of these errors have since been resolved.<sup>45</sup>

36. The Department retains tax credit claims on its computer systems for six years. It reviews system capacity on a regular basis and is not aware of any claims that have been deleted because of capacity issues.<sup>46</sup>

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45 Ev 23–24; Q 77

46 Qq 125–129



# Formal Minutes

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**Monday 23 April 2007**

Mr Edward Leigh, in the Chair

Mr Ian Davidson

Mr Sadiq Khan

Mr Austin Mitchell

Mr Alan Williams

Mr Iain Wright

Derek Wyatt

## **Draft Report**

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

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

Paragraphs 1 to 36 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

*Resolved*, That the Report be the Twenty-second Report of the Committee to the House.

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

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

[Adjourned until Wednesday 25 April at 3.30 pm.]

## Witnesses

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### Monday 23 October 2006

**Mr Paul Gray CB**, Acting Chairman, **Mr Stephen Jones**, Finance Director, and **Mr Stuart Hartlib**, Director, National Compliance, HM Revenue & Customs.

Ev 1

## List of written evidence

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HM Revenue & Customs

Ev 22

## List of Reports from the Committee of Public Accounts Session 2006–07

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Second Report	Improving literacy and numeracy in schools (Northern Ireland)	HC 108 (Cm 7035)
Third Report	Collections Management in the National Museums and Galleries of Northern Ireland	HC 109 (Cm 7035)
Fourth Report	Gas distribution networks: Ofgem's role in their sale, restructuring and future regulation	HC 110 (Cm 7019)
Fifth Report	Postcomm and the quality of mail services	HC 111 (Cm 7018)
Sixth Report	Gaining and retaining a job: the Department for Work and Pensions support for disabled people	HC 112 (Cm 7019)
Seventh Report	Department for Work and Pensions: Using leaflets to communicate with the public about services and entitlements	HC 133 (Cm 7020)
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Twenty-first Report	Progress in Combat Identification	HC 486
Twenty-second Report	Tax Credits	HC 487

The reference number of the Treasury Minutes to each Report is printed in brackets after the HC printing number



# Oral evidence

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## Taken before the Committee of Public Accounts

on Monday 23 October 2006

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon  
Greg Clark  
Mr David Curry  
Mr Ian Davidson  
Mr Philip Dunne  
Helen Goodman

Sara McCarthy-Fry  
Mr Austin Mitchell  
Dr John Pugh  
Mr Don Touhig  
Mr Alan Williams

**Mr Tim Burr**, Deputy Comptroller and Auditor General, and **John Thorpe**, Director, National Audit Office, gave evidence.

**Ms Paula Diggle**, Treasury Officer of Accounts, HM Treasury, and **Mr Jonathan Athow**, Team Leader, Work Incentives and Poverty Analysis Team, HM Treasury, were in attendance and gave oral evidence.

### REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

#### STANDARD REPORT ON THE ACCOUNTS OF HM REVENUE AND CUSTOMS 2005–06 (HC 1159)

*Witnesses:* **Mr Paul Gray CB**, Acting Chairman, HM Revenue and Customs, **Mr Stephen Jones**, Finance Director, HM Revenue and Customs, and **Mr Stuart Hartlib**, Director, Risk and Intelligence, HM Revenue and Customs, gave evidence.

**Chairman:** Good afternoon. Welcome to the Public Accounts Committee, where today we are considering Part 2 of the Comptroller and Auditor General's Standard Report on Her Majesty's Revenue and Customs 2005–06, which deals with recent developments in Tax Credits. We welcome Mr Paul Gray, the Acting Chairman of HMRC. I think that this is the first time you have appeared in this capacity, Mr Gray.

**Mr Gray:** Yes, Chairman.

**Q1 Chairman:** Thank you. What is the cost of increasing the disregard to £25,000?

**Mr Gray:** The cost to the Exchequer will go up over time from roughly £50 million in the first year to about £300 million by 2010–11.

**Q2 Chairman:** The letter that I had from the Treasury on 18 October—have you seen it?

**Mr Gray:** Indeed, yes.

**Q3 Chairman:** As a matter of interest, why was it from the Treasury and not from you?

**Mr Gray:** On all these matters, HMRC and the Treasury work closely together, and in our earlier exchanges on the subject, Chairman, you may recall that the questioning was directed to both the HMRC and the Treasury.

**Q4 Chairman:** This letter does not give me the cost of increasing the disregard but the cash flow, does it?

**Mr Gray:** It gives you the Exchequer cost—the cost to the Exchequer—of increasing the disregard. It does not give the increase in entitlement for benefit recipients.

**Q5 Chairman:** May I have that information?

**Mr Gray:** Yes. The increase in entitlement will be roughly of the order of £500 million a year.

**Q6 Chairman:** I turn to the NAO representatives. You have estimated the cost of increased entitlement and, when you briefed me before the Committee, you told me that it would range from £300 million to £800 million. Would you please explain that? We have a low figure of £300 million, but it is a complex matter and it is important that members of the Committee realise exactly what is going on—the difference between the costs in any one year and the cash flow. We have your estimate but there is a danger of confusing the Committee. We want, with your help, to find out exactly what is going on. Will you tell us?

**Mr Thorpe:** Our purpose was first to see whether it was possible to produce an estimate. We used a rather simple model, which was based on 750 claimants. We then modelled a number of scenarios—nine in all—with different rates of income change. We then applied both the £2,500 disregard and the £25,000 disregard just to see what the financial impact would be. Across the nine scenarios, the lowest figure for the additional cost

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was £300 million, in the more extreme scenarios at the top of our range it was £800 million, but in the majority of the scenarios the costs were around £400 million to £600 million.

**Chairman:** That is a big variation. That is the difficulty that we are labouring under.

**Mr Thorpe:** The difficulty we had, and the reason we used scenarios, was that we did not know how income would change over time, or the distribution of those income changes over the population.

**Q7 Chairman:** You are happy that we now have a better appreciation of the cash flow and the cost? That is now clear, is it?

**Mr Thorpe:** Yes.

**Q8 Chairman:** My colleagues can come in on this. It is a complicated matter, but there is no point in pursuing it for the time being.

Why did we not have all this information before?

**Mr Gray:** When my predecessor and I last appeared before the Committee, Mr Clark asked me a number of questions on the subject. At the time, we felt that, as we had only one year's data on overpayments, for 2003–04, it did not give us sufficient data or information to provide a reliable breakdown of that component of the Pre-Budget Report (PBR) package. What the NAO said rather reinforces that point, given that in its estimate of the increase in entitlement it sought to use various scenarios drawing from the 2003–04 overpayment data. As you heard, a very wide range is generated.

What we were anxious to do before providing figures to the Committee was to have a firmer base for our estimate, and since our last discussions with the Committee we have had two further sources of data. The first is the second year of overpayment information in relation to 2004–05; secondly, in August we got some further information from the first stage of the finalisation process for awards in 2005–06. On the basis of that further data, we felt able to give a reasonable estimate of what we think the cost will be.

**Q9 Chairman:** Thank you for that answer. Obviously, overpayments are a feature of the scheme. Would you like to look at paragraph 2.12 of page 16? It tells us that, "The Tax Credits computer system does not automatically generate information on the underlying causes of overpayments". If overpayments are a feature of the scheme and there has been so much controversy about and comment on them, why do you not collect information on how they are caused? I should have thought that that was fairly basic.

**Mr Gray:** We do collect information. The problem is that a lot of overpayments can be generated by more than one of the underlying causes. As the Report brings out, at the top of the column next to the one to which you referred on page 16, four principal factors lie behind overpayments. In a large proportion of cases, more than one of those factors are in operation. Trying to disentangle unique proportions that apply to each one of those four causes is extremely difficult.

**Chairman:** But very useful, presumably.

**Mr Gray:** It would be very useful but if the overpayment is being generated simultaneously by more than one of those causes, it would be artificial to seek to break it down.

**Q10 Chairman:** Okay. In the PAC's final conclusion, we said that you should agree to publish targets for reducing claimant error and fraud. Do you remember that?

**Mr Gray:** Indeed I do.

**Q11 Chairman:** Have you done so; and if not, why not?

**Mr Gray:** We are progressively introducing targets for the management of fraud and error. I think that the Committee's specific recommendation was in relation to targeting the outcome of the random inquiry statistics for fraud and error. At this stage, we have not set a target for that particular measure. We are introducing a range of real-time targets to measure our interventions on the fraud side of the account. In relation to error, which accounts for more than 90% of the aggregate fraud and error estimate for 2003–04—by far the lion's share—we have only had the one year's data, from 2003–04, on error.

I am extremely keen to move to a position where we can set targets for that measure. My conclusion is that with just the one year's data from the first year of the scheme's operation, I would much prefer to have the data for the second year of 2004–05 to give a reasonable base line on which to provide targets.

**Q12 Chairman:** If we were to come up with another recommendation on those lines, we would be pushing on an open door. That is what you are telling us, is it not?

**Mr Gray:** Indeed; I am extremely keen to target reductions in fraud and error.

**Q13 Chairman:** We have levels of fraud and error in Tax Credits in excess of £1 billion—roughly 10%—have we not?

**Mr Gray:** Yes, those are the gross figures for overpayments, although that was offset to some extent by underpayments. The net figure is slightly less than that.

**Q14 Chairman:** So you are now in the unenviable position of being the worst performer in Whitehall—worse even than the Department for Work and Pensions. Is it not a matter of shame that somebody who reports to the Chancellor of the Exchequer should now be responsible for the worst levels of fraud and error in Whitehall?

**Mr Gray:** I am extremely keen to reduce the levels of fraud and error.

**Chairman:** I did not ask you that. I said that you speak for the Inland Revenue and are responsible for the worst levels of fraud and error in Whitehall. The Inland Revenue has had a reputation second to none in Whitehall for efficiency.

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**Mr Gray:** In the first year—2003–04—levels were slightly less than they were under the Working Families Tax Credit. They are clearly far too high, and I am committed to looking to reduce them very substantially.

**Q15 Chairman:** You are now performing worse than the Department for Work and Pensions, are you not?

**Mr Gray:** We are performing at about the same level in the first year of any scheme—

**Chairman:** That is very reassuring.

**Mr Gray:**—as was the Department for Work and Pensions when Income Support was introduced.

**Q16 Chairman:** Let us look at page 22 figure 8, which deals with HMRC's direct compliance checks. You can see that in that first line are volume checks: pre and post payment checks and pre-payment checks going up in 2004–05 from 16% to 45%. Do you see that?

**Mr Gray:** Yes.

**Q17 Chairman:** Why did it take you so long to realise that a greater number of risky claims needed to be checked before they were paid? Is that not rather basic?

**Mr Gray:** In the first year, we took a view about what was the appropriate balance between the two. In the light of experience we have concluded that it is right to increase the proportion of pre-payment checks.

**Q18 Chairman:** How much did you lose because of the failure to perform such checking?

**Mr Gray:** It is extremely difficult to give—

**Q19 Chairman:** If you cannot answer now, can you give us a note?<sup>1</sup>

**Mr Gray:** I shall certainly try to do so, yes.

**Chairman:** But you are saying that it is too difficult to tell us how much you have lost because of this abject failure.

**Mr Gray:** The central point is that since we did not have the data that would have been generated by a different proportion in that year, it is difficult to reconstruct now what the position would have been.

**Q20 Chairman:** Interesting as the subject is, I shall have to end soon to let others come in. There was a massive internet fraud against Tax Credits in December 2005, was there not?

**Mr Gray:** Yes.

**Q21 Chairman:** And some £55 million was lost. Do you want to tell us more about that and why you of all people could not design a secure internet system?

**Mr Gray:** We had a long discussion on the subject at the Committee's previous hearing. As explained on that occasion, we were carefully monitoring the position during the latter part of 2005. We faced a dilemma between the weight to be attached to ensuring reasonable access to Tax Credits and countering fraud.

**Q22 Chairman:** £55 million was lost. Do we know more? Was one group of people involved or was there widespread fraud? Were hundreds, thousands or scores of people involved?

**Mr Gray:** Some of this is still under investigation and it is difficult for me to talk openly about it, but we know that we were dealing with a major programme of organised fraud.

**Chairman:** And they got away with £55 million. You of all people—an organisation that regularly deals with fraud—were unaware of the potential for criminal attacks on your tax credits system. You allowed somebody to get away with £55 million at our expense.

**Mr Gray:** We were not unaware of the risks. What we are seeking to do is ensure that we strike the right balance between access to this credit and minimising the fraud threat. We have always known that in this project, as in all similar areas, there is a significant fraud threat.

**Q23 Chairman:** And has anyone been arrested or charged yet?

**Mr Hartlib:** One person has been charged, convicted and sentenced to imprisonment for offences connected with this case.

**Q24 Chairman:** And is the investigation ongoing?

**Mr Hartlib:** It is a very complicated investigation.

**Q25 Greg Clark:** It is great news that after a year we have finally managed to hunt down the figure for the increase—we have Mr Burr and his colleagues at the NAO to thank for that. Your estimate produced a range of £300 million to £800 million. That is a big sum. The context is that, even if we take the Treasury and HMRC's estimate of an entitlement of £500 million, by my calculation the policy change costs the equivalent of £20 for every household in the country. So, the use of the money is clearly important. Has the NAO shared the methodology used with the Treasury and HMRC?

**Mr Thorpe:** We have shared our workings with HMRC.

**Q26 Greg Clark:** When did you do that?

**Mr Thorpe:** I cannot give you the precise date, but it was about three weeks ago.

**Q27 Greg Clark:** And have you had any comments or an appraisal back?

**Mr Thorpe:** We have not had detailed comments back. We have had a discussion with analysts in the Department, but not detailed comments on our methodology.

<sup>1</sup> *Note by witness:* It is not possible to determine what the yield would have been if the balance of checks between pre and post award cases had been different in the first year. Risks change over time and the Department responds accordingly (as evidence of threats emerge). PBR 2005 announced that HMRC has doubled the number of pre payment checks, including the number of checks on an undeclared partner.

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**Q28 Greg Clark:** And has the Treasury and HMRC—I heard Mr Gray’s response to the Chairman that they are as one in this—shared their methodology with you, so that you could audit it, as it were, before this hearing?

**Mr Thorpe:** We have not looked at those figures and we have not looked at the background.

**Q29 Greg Clark:** Is it that you have not looked at those figures or have you not been provided with the methodology?

**Mr Thorpe:** No, we received the letter on Thursday, but we have not had the opportunity to speak to the Department or the Treasury about those numbers.

**Q30 Greg Clark:** So, it is something of a coincidence that, having drawn a blank for the best part of a year, the NAO helpfully produces some estimates and miraculously, with five days to go before the hearing, the Treasury pulls the rabbit out of the hat. I assume that this was a coincidence.

I am interested, Mr Gray, in the process. I heard what you told the Chairman about how original estimates might have been unreliable, but the questions that you were asked at the previous hearing do not correspond with the answer that you gave. The questions that were asked on 14 December last year were to do with looking into the assessment that was made in deciding on the policy—in other words, the assessment that already had been made and that was lodged in your files, as it were. Just to remind you, this is what I asked you at that time: “part of that assessment must have been an idea of what the pure fiscal effect was of increasing the disregard? . . . That work must have been done; you will confirm that?” You answered: “I believe it has been done.” I asked, “Since that information is available would you write to me through the Committee giving . . . the pure component of increasing the disregard?” You replied, “Certainly”, and that you would provide that information. That was historical, factual information but the trouble was that after the hearing we were never provided with it. We were provided with an answer that said that estimates were unreliable, but you promised the Committee that you would give a factual piece of information.

Again, we know that that information existed because the Institute for Fiscal Studies made a Freedom of Information request to HMRC, which said in rejecting that request, “You requested information . . . In this case, we have concluded that the public interest in withholding the information outweighs the public interest in disclosing it.” It is a matter of concern to me that you were able to conclude that it was not in the public interest to disclose that information to the IFS, and in particular that you withheld it from this Committee when you were clearly asked to do so. Is there any reason why you were not able to supply the Committee with the factual figure that you had in your files?

**Mr Gray:** The answers that the NAO has given today help to illuminate that. The difficulty that we faced in using just the information from the 2004–05 overpayments was that it was impossible to give anything like a reliable estimate. As the NAO has said, it has come up with a range using the same data—

**Q31 Greg Clark:** But surely, Mr Gray, that is for us to judge. We asked you what you had in your files. You could have commented on the reliability of the information, but we asked for that information and you refused to give it to us. I do not understand why.

**Mr Gray:** For two reasons. The first is the reason that I have just given, which is that the range was extremely wide. In relation to your earlier comment, Mr Clark, in terms of judging the affordability of the package that was announced in last year’s Pre-Budget Report, as we discussed in the last hearing, this measure was not merely introduced in isolation.

**Q32 Greg Clark:** You will be aware, Mr Gray, that we were interested in going beyond or below the package and looking at the components of it. That was absolutely clear from the transcript. But we now have some information, and you have given us more information today that £500 million is the entitlement cost. I was interested by the Treasury letter, which I assume that you stand by and which stated: “This additional information has not led the Government to change the costing of the disregard”. So, from that we are to assume that the £500 million is the same as the estimate that you made at the time of the PBR, which you would not disclose to us. Is that correct?

**Mr Gray:** What we are clear about is that the overall size of the package, taking all the components together, has not been affected.

**Q33 Greg Clark:** No, that is not what I am asking. You addressed this. The letter from the Treasury states that, “This additional information has not led the Government to change the costing of the disregard or the package as a whole.” So the letter is making the claim that both the component and the package as a whole have not been changed in response to the new information. In other words, the component that we were interested in last year is the same as the £500 million that has been cited. Is that correct?

**Mr Gray:** I said to you last December, when you were pressing me on the subject, that the figure was likely to be measured in hundreds of millions. As the NAO has said today, using the information available at the time generated ranges that went from the low hundreds of millions to the high hundreds of millions. In that sense, although the position has not changed, using the further information that we received from the two additional sources we have now felt able to have greater confidence in giving a single figure rather than that extremely wide range.



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**Q34 Greg Clark:** So, the range has not changed. Has the median changed?

**Mr Gray:** I have given you a figure of £500 million in relation to the NAO's range of £300 million to £800 million, so that is not a million miles away.

**Q35 Greg Clark:** Will you now write to the Committee and clear this up once and for all? Will you let us know, now that you have given a cost in which you have some confidence, what that figure was at the time of the Pre-Budget Report? What was the range and what was the median? That exists; you can promise the Committee that, I hope.<sup>2</sup>

**Mr Gray:** I will certainly seek to explain—

**Q36 Greg Clark:** No, will you give me the figures—the range and the median?

**Mr Gray:** I will certainly give you a range. Whether we had at that time estimated a precise median, I honestly cannot remember, but I will check that.

**Q37 Greg Clark:** Will you give me all the figures that you had?

**Mr Gray:** Yes, certainly.

**Q38 Greg Clark:** Through you, Chairman, can I ask the National Audit Office also to verify that information and to check that that statement is accurate and that the additional information has not led the Government to change the costing of the disregard or the package as a whole? That would close that sorry chapter in the proceedings. In terms of assessing the value for money of the £500 million cost of this policy change, did you make an assessment of alternatives for dealing with overpayments—for example, perhaps moving to quarterly assessments of awards rather than increasing the limit to £25,000?

**Mr Gray:** During policy discussions and deliberations, my Treasury colleagues considered a wide-range of policy adjustments. What resulted—as we discussed last December—was this package of a range of measures, which have a broadly neutral overall cost impact.

**Q39 Greg Clark:** So, you did look at alternatives and this was the best value for money alternative?

**Mr Gray:** This was a package that after consideration, was felt to represent the best package of changes for introducing improvement in the overall overpayment situation and as explained at the time of the Pre-Budget Report, was estimated overall to generate a reduction of about one third in the level of overpayments.

**Q40 Greg Clark:** May I ask you one last question about a different subject? It relates to the e-portal you introduced. Paragraph 2.35 of the Report says that the e-portal, “was introduced in 2002”—as we know. That paragraph goes on to talk about “subsequent guidance issued by the Office of the e-Envoy”—that is, subsequent to the e-portal going

live. In fact, that guidance was issued in September 2002, only a month after the e-portal went live and when it was already version 3.

I have a copy of the e-Envoy's guidance from that time and it is absolutely clear that the guidance that came in September 2002 said, “central government departments and agencies must comply”—“must comply” is in bold, which is the emphasis in the guidance—“with this framework when installing and operating electronic business services”. Yet, the report goes on to say, “the HMRC first became aware that attempted fraud through the e-portal was an emerging problem . . . at the end of 2004”. It also says that the peak was November 2005 and that the e-portal was not closed until 2 December 2005. In other words, three years and three months since the e-Envoy's report said that you were under an obligation to comply with its guidance, you finally closed the portal. During three years and three months there was a positive obligation in bold in the e-Envoy's report, yet nothing was done. Who is responsible for that?

**Mr Gray:** The Department is responsible for that. What we were seeking to do during that period, as I sought to say in my earlier answer to the Chairman, was to strike the appropriate balance between accessibility and the use of the e-portal for those who wished to use it, and ensure appropriate security.

**Q41 Greg Clark:** What is the point in having an e-Envoy that gives unambiguous guidance that central Government Departments and agencies must comply with, if agencies decide themselves rather airily to strike a balance between convenience and those injunctions?

**Mr Gray:** I understand what you are saying, Mr Clark. We reached that decision in December 2005 and we are now absolutely clear that we will not reintroduce the portal until we are satisfied it meets absolutely full and current security requirements.

**Q42 Mr Davidson:** May I start by asking about the extent to which you share information on the income of individuals and families with other Departments? Do you have access, for example, to information supplied to sections of the Home Office?

**Mr Gray:** We exchange information with other Departments where there is an appropriate gateway.

**Q43 Mr Davidson:** Is there an appropriate gateway with the Immigration and Nationality Directorate?

**Mr Gray:** Yes. There are certainly some gateways. I am afraid I do not have in my head precisely what the elements are that we can exchange.

**Q44 Mr Davidson:** Okay. I have a case arising in my constituency concerning an overstayer seeking indefinite leave to remain on the basis of marriage. Obviously they want to declare that they have enough income to support themselves and the figure for income that they have produced in relation to that is vastly different from the figure they have declared for Tax Credits. Indeed, the figure declared to the Home Office could be up to £48,000 per year,

<sup>2</sup> Ev 22–23

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whereas the 2005–06 Tax Credits award notice could show both husband and wife as having a nil income. Would that be picked up?

**Mr Gray:** I am not sure whether there is an appropriate gateway for those two sources of information. I could certainly look at the details of that case, if you want to let me have them.

**Q45 Mr Davidson:** I think that we would want not only that case reviewed, Chairman. Perhaps we could have a response that indicates whether there is a gateway, and, if there is not, what is being done to create one.<sup>3</sup>

Does the risk assessment process address any specific difficulties around migrant workers?

**Mr Gray:** Yes, it does. I might ask Mr Hartlib to add to this answer. As part of our risk assessment processes, we have undertaken to look at some categories of migrant workers, in particular those employed by gangmasters. The results of that work so far suggest that there are no significant risk differences between migrant workers and others, but Mr Hartlib might want to add a bit on the detail of that work.

**Mr Hartlib:** Yes, the same risk assessments that are applied to Tax Credit claimants generally apply to migrant workers. In addition, as Mr Gray said, we have recently been carrying out a project to look at specific risks, as we recognise that there is anecdotal evidence that migrant workers are a particularly risky community.

**Q46 Mr Davidson:** Okay, can I clarify whether children who are the subject of Tax Credit claims are required to be in the United Kingdom?

**Mr Gray:** It is a rather complicated position.

**Mr Davidson:** A simple yes or no would be sufficient.

**Mr Gray:** The answer is not a simple yes or no. In some cases, they are required to be present, but in other circumstances—if the main earner is working, has a right to work and is present in the UK—they are not required to be present.

<sup>3</sup> *Note by witness:* There are two statutory gateways for HMRC to pass Tax Credits information to the Home Office. Section 130 Nationality, Immigration and Asylum Act 2002 provides lawful authority for information to be disclosed on Tax Credits and other former Inland Revenue functions when the Home Office:

- suspects that a person does not have leave to enter or remain in the UK, or work in the UK;
- suspects that a person has undertaken employment in the UK in breach of restrictions or conditions imposed on them;
- is determining whether an applicant for British Citizenship is of good character, or
- is applying rules relating to maintenance and accommodation to an applicant for entry clearance (eg does a sponsor of someone applying to come to the UK have sufficient income to support the applicant).

Information may also be disclosed under Section 19 of the Anti Terrorism Crime and Security Act 2001 to the Home Office if the information would assist them in any criminal investigation or prosecution. There is also a gateway to allow information held for former HM Customs & Excise functions to be disclosed for the Home Office's immigration functions at Section 20 Immigration and Asylum Act 1999.

**Q47 Mr Davidson:** In circumstances where it is not necessary for the children to be in the UK, what steps are taken to verify that they actually exist?

**Mr Gray:** The claim would go through all our normal risk assessment processes in relation to children. I do not know whether Mr Hartlib can add anything.

**Mr Hartlib:** Nothing further at this stage.

**Mr Davidson:** Can you repeat that?

**Mr Hartlib:** I have nothing to add to what Mr Gray said.

**Mr Davidson:** But he referred the matter to you.

**Mr Hartlib:** He asked if I had anything further to add.

**Q48 Mr Davidson:** I think that that is sufficiently clear.

Do Tax Credit claims for children require the same level of proof as Child Benefit claims?

**Mr Gray:** Yes, they do. Indeed, we operate data matching arrangements between the two benefits to seek to add to the verification that is part of the verification procedures that I referred to earlier.

**Q49 Mr Davidson:** My understanding is slightly different. Perhaps that could be pursued subsequently.

Can I clarify what steps are taken to verify details of a claimant's income and circumstances in a previous period when they lived outside the UK? If Tax Credits are based on someone's previous income, what steps are taken in the case of migrant workers to ensure that the stated circumstances and income are correct?

**Mr Gray:** We would operate the normal procedures for all claimants in relation to verification of income, and if the risk factors suggested a high-risk case into which we ought to look more deeply, we would make further inquiries. But we do not operate a distinct regime for migrant workers because nationality is not a primary consideration for us.

**Q50 Mr Davidson:** I understand about nationality, but someone who has lived abroad and produced details of previous income and circumstances that cannot be verified would seem to be fairly high risk. I am disappointed that they are not checked.

**Mr Gray:** Obviously, we face that risk factor in dealing with UK nationals who might previously have lived abroad.

**Q51 Mr Davidson:** That is right, but I suspect that there are not quite as many of them as there are migrant workers who have come here recently.

**Mr Gray:** I do not have the precise figures in my head for UK nationals, but it is worth saying that the number of claims that we have accepted for child Tax Credit from migrant workers, based on the Home Office data published last August, is about 14,000. That compares with more than 430,000 migrant workers who are registered under the workers registration scheme, so it is important to bear in mind the context.

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**Mr Davidson:** That is right.

**Mr Gray:** A rather small proportion of the claims that we have accepted for Child Tax Credit are from migrant workers. Indeed, there are a number that we have not accepted.

**Q52 Mr Davidson:** Can you clarify how many you have not accepted?

**Mr Gray:** I think we have had claims for about 21,000, and 14,000 have been accepted.

**Q53 Mr Davidson:** So a third of the claims made have been false?

**Mr Gray:** No, a third have not been accepted. A number may still be being reviewed.

**Mr Davidson:** Indeed, but 7,000 of 21,000 have not been accepted at the moment, although they might be in future. That seems to me to be a fairly high proportion.

**Mr Gray:** It also indicates, in relation to your earlier questions, that we are going through fairly rigorous procedures in reviewing these applications when they come in.

**Mr Hartlib:** Mr Davidson, I do not know whether it would help if I go back to the project that I mentioned. We thought that this was potentially a higher-risk area and we wanted to carry out research and investigation to find out whether that was the case. The project is not yet complete, but the emerging findings are that the risk associated with migrant workers is no different from and is at a level comparable to that for other Tax Credit claimants.

**Q54 Mr Davidson:** I find that surprising, because it does not gel with the information that I have been given, but can we clarify what systems you have in place for circumstances in which someone is awarded Tax Credit, leaves the country and then comes back again? As I understand it, there is no mechanism that would automatically pick that up. The allegation that I have is that that has been quite widespread.

**Mr Gray:** There is a general arrangement that people leaving the country, if that exceeds either eight or 12 weeks depending on the circumstances, are no longer entitled. We make it clear to people, whether they are migrant workers or UK nationals going abroad, that that is the position. We are obviously aware of press stories and other things that suggest there has been a problem of the sort that you are referring to, but the investigations that we have done—again, this relates to the work Mr Hartlib described—have not led us to conclude that there is a particular issue here.

**Mr Davidson:** Okay.

**Mr Gray:** But we obviously continue to be vigilant in this area and would take action if we thought there was an issue.

**Q55 Mr Davidson:** Yes, how many penalties have you charged where people have left the UK and not told you?<sup>4</sup>

**Mr Gray:** I am afraid I have not got that figure in my head. I can—

**Q56 Mr Davidson:** Okay, perhaps we could have that. What action is taken if a member of the public or someone working for a personnel agency reports to you that a migrant worker is making a false claim?

**Mr Gray:** If we got specific information of that sort, it would be passed to our compliance teams and, depending on the nature of the information we are given, we would consider it for investigation.

**Q57 Mr Davidson:** Would it surprise you to be told that a member of staff in a personnel agency in my constituency reported on repeated occasions to the Revenue office in East Kilbride that false claims were being made and was told that that was not the responsibility of the people with whom she was dealing; their responsibility was to get the payments made, irrespective of whether the claims were false, because their targets were all about getting the payments out? Repeated complaints of that sort were made, to no avail.

**Mr Gray:** I would be disappointed if that were the case and I would very much wish to know about those circumstances and look into them.

**Q58 Mr Davidson:** I think that will undoubtedly happen. Can you clarify what training is provided to local staff who are administering Tax Credits in, say, East Kilbride about exactly who can and cannot claim Tax Credits? Do you believe that the training they are provided with is sufficient?

**Mr Gray:** A general level of background training is provided. What is most relevant in that context is that all claims are subjected to risk assessment criteria; for the majority of staff who are dealing with claims, that will be after the point at which the risk assessment process has been undertaken.

**Q59 Mr Davidson:** Would it surprise you to be told that the staff of the personnel agency with whom I have been dealing frequently have to draw the rules to the attention of the staff in East Kilbride? The staff of the personnel agency know more about the rules than the people who administer them.

**Mr Gray:** Again, that would surprise and disappoint me, but if that is the position, Mr Davidson, I would very much encourage you to let me know personally, so that I can look into it.

**Q60 Mr Williams:** Mr Gray, did I hear the figures correctly when you referred to the disregard? Did you say that in the first year the cost to the Exchequer would be £50 million and that it would be £300 million by 2010?

**Mr Gray:** Yes, I did.

**Q61 Mr Williams:** Which is the first year?

**Mr Gray:** It is 2006–07.

**Q62 Mr Williams:** You also said that the extra entitlement would be £500 million year by year?

<sup>4</sup> Note by witness: We do not hold that information.

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**Mr Gray:** Yes, the entitlement would come into effect more or less straight away. The Exchequer cost builds up gradually over a number of years.

**Q63 Mr Williams:** So the total in year one would be about £550 million—the £50 million and the £500 million combined.

**Mr Gray:** I do not think that it is appropriate to add the two together; they are alternative measures of different things. The increase in entitlement—

**Q64 Mr Williams:** No; the £50 million is a cost, is it not?

**Mr Gray:** The £50 million is a separate cost.

**Mr Williams:** It is a separate cost from the entitlement.

**Mr Gray:** But the entitlement is not a cost to the Exchequer; the £50 million is the only cost.

**Q65 Mr Williams:** With respect, it is a cost to the Exchequer in one way or another, is it not?

**Mr Gray:** I do not think it is.

**Mr Williams:** It represents something that has been foregone, for understandable reasons, but it is a cost.

**Mr Gray:** What we are trying to measure in the figures described in the letter as Exchequer costs is the extent to which, as a result of the increased disregard, overpayments that would otherwise have been recovered are not recovered. And the cost of that, which is the only cost to the Exchequer in the first year, is £50 million.

**Q66 Mr Williams:** Yes, but the cost of overcoming the fact that administrative impossibilities are facing you in relation to the second figure does not alter the fact that it is a cost. It is therefore £550 million in year one; and the £300 million and £500 million in 2010 comes to £800 million.

**Mr Gray:** I honestly do not think, Mr Williams, that it is a cost to the Exchequer. The Exchequer cost figures capture the whole cost to the Exchequer; the £500 million is measuring a different thing, which is the increase in entitlement.

**Q67 Mr Williams:** Okay, we disagree on that. Perhaps you will let me have a further note on the subject.<sup>5</sup>

Greg Clark followed up on the question of the e-Envoy. Who was responsible for ensuring that the e-Envoy's guidance was observed? Who ultimately was responsible for that?

**Mr Gray:** I would regard the senior management of my Department as being responsible and accountable for that.

**Q68 Mr Williams:** How did they explain the fact that they ignored it?

**Mr Gray:** For the reason that I sought to explain to Mr Clark—that a judgment was being taken, which seemed appropriate at the time, to seek to balance the issues of accessibility and of security.

**Q69 Mr Williams:** Despite the fact that, as Mr Clark emphasised, it said that it must be observed. That is not optional, is it? It is an imperative. Did the person in charge—say, the Permanent Secretary—consult about whether he was entitled to override the e-Envoy's advice?

**Mr Gray:** I am honestly not sure what particular exchanges took place.

**Q70 Mr Williams:** I would have thought that you would want to know about that. It is not an insignificant thing, is it, when you get mandatory advice, which I think that was, and when you or your Department choose to ignore it? I would have thought that someone would follow up to see quite how it had happened. Was any action taken against anyone for ignoring it?

**Mr Gray:** I understand the point that you are making. The fact that the portal for Tax Credits had been introduced before that guidance was issued clearly had an influence on the situation. I have sought to explain to Mr Clark and now to you the balance being—

**Q71 Mr Williams:** But do we understand that ultimately no one had to accept any responsibility or admonition for having ignored mandatory advice?

**Mr Gray:** I have sought to explain to you the basis on which a decision is taken. We now, after November last year, are in a different position, where we have closed the portal.

**Q72 Mr Williams:** Yes, but that is not what I am asking about. I am asking about what happened there. It seems that you do not run a very tight ship, does it not?

I switch again to the software errors. We are told that 199 software errors are still not remedied. That sounds to me like a lot. Who supplied the software?

**Mr Gray:** The majority of the software would have been supplied under the Inland Revenue's former contract with EDS—

**Mr Williams:** Sorry, can you speak up slightly?

**Mr Gray:** Sorry. The majority of that would have been supplied under the Department's previous IT contract with EDS.

**Q73 Mr Williams:** EDS? Is that why it is your former, and not your current, supplier?

**Mr Gray:** As has been discussed with the Committee before, there are a number of reasons why a change of supplier was made. As you know, a new supplier was introduced in July 2004.

**Q74 Mr Williams:** How long have the software errors been identified but not remedied?

**Mr Gray:** They were progressively identified over the first two or three years of the operation of Tax Credits.

**Q75 Mr Williams:** So how many were in total there originally, then?

**Mr Gray:** There were significantly more than that originally, but I am afraid I do not—

<sup>5</sup> Ev 22–23

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**Q76 Mr Williams:** There must have been, if it took three or four years, but how many? You know that there are 199 outstanding; how many have been dealt with?

**Mr Gray:** Quite a large number—

**Mr Williams:** No, not “quite a large number”. “Quite a large number” is an insignificant answer. How many errors have been addressed?

**Mr Gray:** I cannot give you a precise figure. I can certainly let you have that figure separately. What we have done very deliberately in the early years of the system is to seek to address those errors that were having the biggest impact in the system. That might have been a relatively small number of errors but they were having the most significant impact on the operation of the system.

**Q77 Mr Williams:** I would like a note off you giving a precise indication of what errors have been dealt with, in addition to those that have not been. Having identified them all—you do not remember a grand total at all—was any penalty clause invoked against the supplier?<sup>6</sup>

**Mr Gray:** Well, I think—

**Mr Williams:** Other than saying, “Come and put it right”?

**Mr Gray:** As you are aware from an earlier hearing, Mr Williams, we have reached a settlement with EDS in relation to errors in the initial building of the Tax Credits computer system and it is in the process of paying us total compensation of £71.25 million.

**Mr Williams:** £71 million.

**Mr Gray:** £71.25 million.

**Q78 Mr Williams:** Out of a total contract price of?

**Mr Gray:** Sorry. Again, I do not have that figure, but I can let you have it.<sup>7</sup>

**Q79 Mr Williams:** Okay. Finally, your compliance teams have been getting improved returns. How many compliance teams do you have?

**Mr Gray:** Do you mean how many staff are there in total?

**Q80 Mr Williams:** Well, it says “teams” in our briefing. I am not sure whether that is a correct definition of how you work. Is it just an overall group?

**Mr Gray:** I mean, would it be more helpful to give you a total number of the staff engaged, which I am sure Mr Hartlib can give you?

**Mr Williams:** Okay, give me the total number of staff.

**Mr Hartlib:** We are increasing the number of Tax Credit compliance staff from 1,200 to 1,400.

**Mr Williams:** Yes, that is where I am going next.

**Mr Hartlib:** The position is complicated, given that we are in the middle of a planned restructuring, as the organisation was very dispersed, although I shall not bother the Committee by going through the history.

**Q81 Mr Williams:** With respect, that is not what I am asking you. You gave the information that I wanted, but have you worked out the marginal benefit of the increase in the size of the compliance teams? Are you just saying, “We’ll increase the number by 200”, or have you arrived at that figure by working out what you might get for employing 10, 20, 30, 40 or 50 extra people?

**Mr Hartlib:** Yes, there is a cost-yield ratio that can be derived from our compliance effort. Arriving at the figure of 200 meant taking into account the marginal benefit from increasing the staff engaged on the work.

**Mr Williams:** Perhaps you will give us a further note on that as well.<sup>8</sup>

**Q82 Mr Bacon:** Mr Gray, I am looking at the trust statement in the certificate by Sir John Bourn to the House, which says: “claimant error and fraud accounted for incorrect payments in claimants favour of between £1.06 billion and £1.28 billion (8.8% to 10.6% of finalised entitlement). The Department currently has no estimate of the total level of claimant error and fraud in the Tax Credit awards made since 2003–04.” Is that still the case?

**Mr Gray:** That is still the case.

**Q83 Mr Bacon:** Are you planning to get an estimate?

**Mr Gray:** We are certainly planning to get an estimate. We plan to produce those figures annually. We will produce the estimate for 2004–05 in the spring of 2007.

**Mr Bacon:** Right, so next spring?

**Mr Gray:** Next spring.

**Q84 Mr Bacon:** What do you think the figure is roughly, without signing your name in blood?

**Mr Gray:** I do not know, which lies behind my initial answer to the Chairman that I wished to see what the error figure was in year two of the operation before reaching a view on whether it was sensible to target particular reductions in the years beyond that.

**Q85 Mr Bacon:** What is your target date for producing a set of accounts that are not qualified because of fraud?

**Mr Gray:** I do not have a precise target for that, but I am extremely keen to get to that position as soon as we can.

**Q86 Mr Bacon:** And you are unable at the moment to account to Parliament for how the moneys that Parliament voted for you are spent, are you not? You are failing in your duty to Parliament, basically.

<sup>6</sup> Ev 23–24

<sup>7</sup> *Note by witness:* The EDS contract ran for 10 years and the total revenues under it were of the order of £2,500 million as was explained at the Committee’s hearing in December 2005 (Q212–213) in the 15 months to 30 June 2004 EDS earned revenue of £504.6 million from the contract and this gave rise to a profit of £121.3 million.

<sup>8</sup> *Note by witness:* The additional staff will allow us to action an additional 20,000 compliance interventions.

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**Mr Gray:** In respect of Tax Credits—although not in other aspects of the trust account—we indeed have a qualified account.

**Q87 Mr Bacon:** Why do you think you are failing in your duty to Parliament?

**Mr Gray:** Because we have not yet reached a position where we have driven down error and fraud to a satisfactory level.

**Q88 Mr Bacon:** As you know, this Committee does not look at policy, but there is always a wafer-thin membrane at certain points, where the policy comes under scrutiny because it appears to be the cause of your being unable to account to Parliament for how money is spent. Although it is distributing thousands of millions of pounds, it could be that it is the policy itself and its complexity that causes you, as the chairman of HMRC, to be unable to account to Parliament for how money is spent and whether it is spent effectively, efficiently and economically. Would you agree with that?

**Mr Gray:** As you say, there is a wafer-thin issue, but I do not think that I am here to account to you for the policy. I am here to account for my administration of the policy. I am committed to getting into a position where we substantially drive down the level of error and fraud, within the context of the current policy.

**Q89 Mr Bacon:** Even if you do not have a specific date for producing a set of clean accounts, what might be a reasonable time horizon within which to do so?

**Mr Gray:** We are in a difficulty over time lags. We are halfway through 2006–07. Because of the inevitable lags, given the nature of the system, at this stage we have only the fraud and error estimate for 2003–04. We will have an estimate for 2004 next spring. As I said earlier, at that point, I want to consider carefully whether we will then be in a position, having had two years of figures as well as all the other intermediate targets we are adopting, to set targets going forward that have a reasonable basis and which may provide a point of reference for our discussions with the NAO about a reasonable timetable for us getting the accounts to a non-qualified basis.

**Q90 Mr Bacon:** How many HMRC employees are currently under criminal investigation?

**Mr Gray:** I do not have that figure with me at the moment. I do not know if Mr Hartlib can help.

**Mr Hartlib:** Do you mean in relation to all potential areas of criminal investigation?

**Q91 Mr Bacon:** How many HMRC employees are currently under criminal investigation? It could be for murdering their colleagues. I am not distinguishing—

**Mr Gray:** So you are not just talking about anything in relation to Tax Credits?

**Q92 Mr Bacon:** I am actually talking about in relation to their duties as HMRC employees, for the purposes of this question, although, obviously, an HMRC employee is capable of stealing a car just like anybody else, but that is not really what I am referring to.

**Mr Gray:** No, I am just seeking to clarify if you are asking a broader question than about Tax Credits, which I think you are.

**Mr Hartlib:** Since 2003, there have been 11 cases of Tax Credit fraud involving HMRC employees.<sup>9</sup>

**Q93 Mr Bacon:** Eleven; and how many other cases? I remember that when we were looking at hydrocarbon oils fraud and tobacco smuggling there were HMRC, or Revenue and Customs, as it then was, employees involved. How many other employees, apart from the 11 specifically in Tax Credits?

**Mr Hartlib:** I am afraid that I only have the information relating to Tax Credits.

**Mr Bacon:** But it is 11 relating specifically to Tax Credits?

**Mr Hartlib:** Since 2003.

**Q94 Mr Bacon:** Have they all been prosecuted?

**Mr Hartlib:** These are the people going through prosecution, yes.

**Mr Bacon:** I am sorry.

**Mr Hartlib:** Yes.

**Q95 Mr Bacon:** Is it possible that you could write to us with a note setting out the offences they were charged with, what has happened to those people and what convictions they have been given?<sup>10</sup>

**Mr Hartlib:** Some may be going through the court process, and so it would be extremely difficult in those cases for obvious reasons.

**Mr Gray:** I think that in relation to cases that are completely finalised, we can certainly do that.

**Q96 Mr Bacon:** Well, if you can do that, and then put an addendum saying that there are five other cases, or whatever the number is, still going through. Did any of them involve the issue that you were talking about earlier, Mr Hartlib, which Mr Davidson was asking about: migrant workers?

**Mr Hartlib:** Not that I am aware of.

**Q97 Mr Bacon:** You said earlier that you had looked at the category of migrant workers. When did that work start?

**Mr Hartlib:** In August of this year.

**Q98 Mr Bacon:** Was it in response to all the press coverage that you mentioned?

**Mr Hartlib:** Obviously we take note of any evidence in areas that are likely to indicate risk. That is why we started that in August of this year.

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<sup>9</sup> *Note by witness:* Since 2003 there have in fact been 12 investigations of Tax Credit fraud involving HMRC employees, including current investigations, those in the prosecution process and two successful prosecutions.

<sup>10</sup> Ev 24–25

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**Q99 Mr Bacon:** Was it a response to press coverage or to your own internal compliance systems?

**Mr Hartlib:** We get information from all sources—members of the public and elsewhere—and it was a combination of all these factors that led us to take a closer look at migrant workers.

**Q100 Mr Bacon:** You did say earlier that you thought that the profile of migrants and their propensity to commit fraud was the same as for everybody else and that there was not a particular issue there—

**Mr Hartlib:** I said that that is the emerging finding of this project, which is not yet complete.

**Q101 Mr Bacon:** HMRC employees have told me—and, it appears from what he was saying, Mr Davidson, although I am not privy to the conversations that he has had—that people were coming to this country from abroad, getting “jobs”, setting up a Tax Credit payment and then going home and continuing to draw the Tax Credit payment. Are you saying that that is not happening?

**Mr Hartlib:** That is one area that we are looking at—for example, if somebody leaving the country who has paid tax here can claim a repayment of that tax. We have looked at all instances, with this particular segment in the project that we are conducting, to the extent that that has happened, and we have not found one case. That is just one example.

**Q102 Mr Bacon:** Sir John Bourn wrote to me on 1 June about the investigation by the Organised Tax Credit Fraud Strategy Board into 40 separate organised Tax Credit fraud cases, the majority of which involve multiple claims based on hijacked or false identities. He said then that the Department could not give a precise figure, but that initial indications were that half of the cases involved sums in excess of £250,000 each, which would make at least that chunk worth £5 million and the rest presumably less. Six or seven weeks later, by 11 July when this report was published, the sentence said, “initial indications are that the total losses . . . were £26 million”. What is the latest estimate?

**Mr Hartlib:** The latest figures for those particular activities that I have seen recently are that there are now 48 cases—

**Mr Bacon:** Forty-eight cases?

**Mr Hartlib:** Yes, and the amount is still in the region of £26 million.

**Q103 Mr Bacon:** Do you expect it to go higher?

**Mr Hartlib:** We will not know until the investigation is complete.

**Q104 Mr Bacon:** How long do you expect it to take to complete the investigation?

**Mr Hartlib:** It is impossible to give a figure in investigations of this size and complexity in terms of when they will be completed.

**Q105 Mr Bacon:** The £131 million in paragraph 2.33, which the Report says is the estimate of loss due to organised fraud—is that separate from the £26 million, or is the £26 million part of that £131 million?

**Mr Hartlib:** That £131 million is the amount that was paid out in respect of organised fraud during 2005–06. The 40-odd cases that we have been speaking of cover a different period or a period wider than 2005–06.

**Q106 Mr Bacon:** Do you mean a period that might go both beyond and before, as it were?

**Mr Hartlib:** Yes.

**Q107 Mr Bacon:** Is there an element of double counting, or are they actually two? Should one add them together to get to the total?

**Mr Hartlib:** No, there is not an element of double counting. The £26 million would be subsumed in the £131 million or its equivalent in other years, because the £131 million is in respect of cases that we disrupt, where we stop the payments from taking place. Some of those cases will not result in a criminal prosecution, but it is a technique common with other law enforcement agencies that disruption is a weapon to defeat organised crime just as much as prosecution is.

**Q108 Mr Touhig:** Mr Gray, Tax Credits are one of the most popular initiatives that this Government have introduced, but your incompetence and mismanagement have brought it into disrepute. Do you agree?

**Mr Gray:** I do not agree with the second element of that statement. I recognise that the administration of Tax Credits has not been as good as it should have been, and I am committed to putting in place measures that improve its performance.

**Q109 Mr Touhig:** How do you treat complaints from Members of Parliament about the operation of the Tax Credit system?

**Mr Gray:** I hope, carefully and diligently. Since I became Chairman, I personally have assumed responsibility for signing a good number of letters to you and your colleagues. My policy is that letters from Members of Parliament should be treated fully and fairly, and an appropriate response given.

**Q110 Mr Touhig:** Are you always up front when you reply to Members’ complaints and queries?

**Mr Gray:** I try to be, yes.

**Q111 Mr Touhig:** And your Department?

**Mr Gray:** I certainly hope so. Whether we are perfect in this regard, I am not sure. Perhaps you are about to give me some information suggesting that we are not.

**Q112 Mr Touhig:** I have a case of a constituent who completed a return on the previous year’s income and who ticked the box to say yes, she had had Income Support, but who wrote underneath that she was not claiming it now. You continued to pay that

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constituent as though she were receiving Income Support, despite repeated telephone calls and other messages to you. I wrote several times and got nowhere, and eventually referred it to the Ombudsman. The Ombudsman said in a report that in letters to me and the constituent, you—the Revenue—had unequivocally stated the reason that income had been incorrectly registered was due to technical errors. The ombudsman was then advised that in fact there were no technical errors, and no excuse or explanation were given. I was lied to, wasn't I?

**Mr Gray:** I do not have the precise details on that, but it clearly does not sound as though that particular complaint was handled or solved satisfactorily, no.

**Q113 Mr Touhig:** Do you think that truth is very important in such things?

**Mr Gray:** Yes.

**Q114 Mr Touhig:** Yes, so do I. I think of truth as like a lady being pregnant. Either you are pregnant or you are not: there is no in between. Yet it seems to me that you deliberately practised a deceit upon me and my constituent, and I think that the ombudsman shares that view.

**Mr Gray:** On the basis of that case as you have described it, it seems to me to fall well short of the standards that I aspire to.

**Q115 Mr Touhig:** I should think so. Very often when I write I give details of a particular complaint or an issue and I get a letter saying that it is being looked into, but inevitably the reply comes back that the person must still repay an overpayment and so on. Perhaps other colleagues have the same response. Is that a standard brush-off to Members of Parliament in these cases?

**Mr Gray:** No, there is not a standard brush-off. We are seeking to operate the policy as it has been laid down, which was reviewed and stated in our code of practice 26 arrangements earlier this year. We operate what has become known as the reasonable belief test whereby if there has been an official error but we think it is reasonable for the claimant to have known that it was an error, we do not write off the overpayments. If, however, we believe that it was reasonable for them to believe that they had been paid correctly, we do write off the overpayments.

**Q116 Mr Touhig:** That is perfectly reasonable and fair, although I must tell you that the times I write to your office giving evidence where I believe the overpayment was your responsibility, rarely, if ever, do you come back and say that you agree.

I have another constituent whom you told in a letter she received on 30 August that she had been overpaid £2,778. On 5 September, you paid £551 into her bank account. Why did you do that?

**Mr Gray:** It is a little difficult for me to comment on the precise details of that case.

**Q117 Mr Touhig:** It is typical of the cases I am handling, though. When I pressed your officials about this particular case you eventually came back to me and said, "Oh dear. We haven't overpaid her £2,778. In fact we've overpaid her £129.80." That is some difference, is it not?

**Mr Gray:** In that case, it certainly was a big difference.

**Mr Touhig:** It must make you feel ashamed presiding over such a shambles.

**Mr Gray:** I am not remotely proud of any case where we have difficulties of this sort. As I said earlier, I am committed to seeking to drive down the number of those cases and to get to a position where you and your colleagues are not able to quote any examples of that sort to me.

**Q118 Mr Touhig:** I have another case of a constituent whom you said had been overpaid £4,953. Her marriage broke up; she advised you the next day that her husband had left and that she was now a single-person family, yet you continued to pay her despite all her efforts. Only because of the fact that she kept every single record, even records of telephone calls, did we manage to convince you at the end of the day that she should not have to pay back that money. The error was yours, was it not?

**Mr Gray:** It sounds from your description, if I heard you right, that we have accepted that in that case the error was ours and the reasonableness test was met to justify a write-off.

**Q119 Mr Touhig:** It just takes so long to persuade you of these things. Sometimes when I am writing back and forward to you, I think I will see the second coming before I get a resolution to some of the cases I raise.

I tabled down some questions to the Paymaster General, especially about the operation of your computer systems. In response on 17 October, I was told:

"In the event of a system failure the system and its data can be recovered to the point of failure as back up copies of data are kept as part of the design of the system. Data and information is fully backed up on a daily basis and securely stored off site. The system supporting these credits has not overloaded and there have been no system failures caused by an overload in the period referred to."—[*Official Report*, 17 October 2006; Vol. 450, c. 1107W.] I fully accept that answer given by my ministerial colleague. I am told by people who work for you that if the system goes down and a client telephones, the only way to record that information is to take notes, and if the opportunity arises when the system is back up and running, then to enter that information. Is that a common occurrence?

**Mr Gray:** If the system is not operating when there is a telephone call, clearly it is not possible simultaneously to input it into the system.

**Q120 Mr Touhig:** No. But if a member of your staff then takes notes, what procedure is in place to ensure that those notes are entered on to that person's file when the system is back up and running?



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**Mr Gray:** Well, during any such downtime we seek to ensure that those notes are duly entered when the system is up and running again.

**Q121 Mr Touhig:** I am told it is hit and miss. Am I wrong?

**Mr Gray:** I hope you are wrong. Whether there has never been an error or an oversight in this respect it would be rash of me to commit to, but certainly the intention is to ensure that we get the records brought up to date.

**Q122 Mr Touhig:** Would you say that the events in the tale I just related to you are not widespread then?

**Mr Gray:** I do not think that they are the general rule, but, clearly, you described a case in which we failed to meet the standards that we aspire to.

**Q123 Mr Touhig:** Do you issue guidelines to staff on how they record information and what they should do with it when the system is down?

**Mr Gray:** Yes, I believe we do.

**Mr Touhig:** You believe you do, but you do not know.

**Mr Gray:** I do not have in my head a precise recollection of the guidance, but we certainly have general guidance of that sort.

**Q124 Mr Touhig:** Mr Williams made some points earlier about the quality of your system and so on. I noticed that you moved from EDS to—what is it?

**Mr Gray:** CapGemini.

**Q125 Mr Touhig:** CapGemini. Is the system often down? I am told that it is, and that when you have problems with capacity you erase files from two or three years back in order to enter new bits of data on new cases. Is that the case?

**Mr Gray:** I do not think that the system is often down. The amount of downtime has progressively reduced. System availability was well over 99% during the course of the year. That does not mean that there is never any downtime, but “over 99%” does not quite accord with “often down”.

On your second point about past data, it certainly would not be our practice to erase data that it is important for us to maintain on the system.

**Q126 Mr Touhig:** So you do not erase data.

**Mr Gray:** I am not saying that we do not erase any data, but we seek to ensure that all data that it is important to retain for the ongoing continuity of the system is retained.

**Q127 Mr Touhig:** So data on current cases are definitely retained—they are not erased in order to create more capacity for new cases coming in?

**Mr Gray:** That is certainly not the general policy. Again, if you have a particular case, I would appreciate it if you would refer it to me.

**Q128 Mr Touhig:** I appreciate that it may not be general policy, but does it happen?

**Mr Gray:** I am not aware of that happening, but if you have any information—

**Q129 Mr Touhig:** Could you write to us and confirm the guidelines that you issue?<sup>11</sup>

**Mr Gray:** Certainly.

**Q130 Mr Mitchell:** Don made his position on the Tax Credit system clear, so I will do the same. I think that it is a brilliant system, and it is an important weapon in redistribution. What is the view on Tax Credits of the top people at the Revenue?

**Mr Gray:** In what respect, Mr Mitchell?

**Q131 Mr Mitchell:** Do they like it or dislike it?

**Mr Gray:** I think that the great majority of staff working on Tax Credits find it a very rewarding role.

**Q132 Mr Mitchell:** But do they like or dislike the scheme? It asks the Department to change its attitude: instead of taking in money, it becomes Lady Largsesse. That involves a different habit of mind and a different approach. Are staff happy with it?

**Mr Gray:** I think that the great majority of staff are very happy to operate in that environment. Indeed, quite a number of them were inherited from the Department for Work and Pensions, where they had been used to that role.

**Mr Mitchell:** Experience tells me that if the civil service does not like a scheme—for instance, the poll tax—it administrates it in such a way as to screw it up totally and make it unpopular. All the indications are that that has been happening in this instance.

**Mr Gray:** I do not accept that, Mr Mitchell. I think that the Department and its staff have done their level best to operate the system to the best of their ability. In fact, the significant improvements that have been introduced over the past year or 18 months are a huge tribute to the staff in my Department who have done a fantastic job in delivering improvements. However, I accept that there is still a lot more to be done.

**Q133 Mr Mitchell:** Don gave some telling instances of failure. I talk to my staff not about specific instances but about the general attitudes and the general position, and they have found the Revenue as difficult to deal with in this instance as the child support system, which is really saying something. May I try you on the points that they have made? One, the rules are not clear, simple and straightforward. They are opaque and, perhaps, written defensively. It is difficult for ordinary mortals who are not accountants or whatever to understand them. Do you accept that criticism?

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<sup>11</sup> *Note by witness:* Tax Credit claims are kept on the IT system for six years (in line with data on our other systems). No claims have been deleted, by accident or design, because of any system capacity problems. The current Tax Credit IT system is sized to cater for all recipients of Working Tax Credit and Child Tax Credit, and for records of past recipients. System capacity is reviewed regularly. The ability of the system to meet its predicted load is thoroughly tested in the period leading up to each six monthly software release, and is tested to worst case scenarios for the lifespan of the software being released. New storage is added as required.

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**Mr Gray:** I do not accept it as a criticism of the scheme. Certainly, I spend a lot of time going round the Department talking to my staff. I spent a lot of time last autumn and winter particularly on Tax Credits. Sometimes they will explain to me points that they think do cause some degree of difficulty, and we will feed back our comments on that, but as a general rule I find people in my Department are perfectly happy operating the system.

**Q134 Mr Mitchell:** But do you find that the public understand the rules?

**Mr Gray:** In the majority of cases yes. In the most difficult cases we have problems, but I think it is important to recognise there are now more than 6 million families in receipt of Tax Credits and even though, regrettable though it is, every Member of this Committee and other Members of the House will have some cases where people are facing difficulties, the very great majority, in my view, of the 6 million on our case load are now being operated perfectly satisfactorily.

**Q135 Mr Mitchell:** Okay. The second criticism again comes from staff in Grimsby, who are smarter, more intelligent and more concerned than their MP, who does not deal with the detailed thing. The second criticism they make is that in the overwhelming majority of cases where there are problems it is the fault of the Revenue rather than the claimant. It is either a computer problem, and we have had some instances of that, or a staffing problem—that is, you are understaffed in this area; or the confusion is caused by the fact that people have sent in the information on time and accurately, but it has not been received, or it has been lost, or it has not been dealt with quickly. Now, do you accept that the onus in that case is on the Department, rather than the people?

**Mr Gray:** I think that where errors are being made in the Department, and they certainly have been made in the Department, it is our responsibility to drive those errors out of the system, but we have acknowledged in the early years of the operation that the Department has made errors and, in some cases, it has been appropriate to write off the resulting overpayments.

**Q136 Mr Mitchell:** Okay. It is a minority of cases where you have actually written them off and accepted it is your responsibility.

The third criticism put forward is that, where there is an error, even if it is your fault, the Revenue always shifts the blame back on to the claimant. You get endless quibbles, arguments and delays and it then becomes a detailed argument in which the Revenue is trying constantly to shift the onus of the problem back to the claimant.

**Mr Gray:** As I said in response to Mr Touhig, we operate and have sought to clarify the so-called reasonable belief test.

**Q137 Mr Mitchell:** I just wonder whether you have got the mentality of tax collectors rather than of beneficent advocates of social change. You have all

got stern unbending expressions today. The first time you smiled was about a quarter of an hour into this session. Now, I would not care to face any of you on a tax case—particularly my own—but will those attitudes transfer over to this very different operation?

**Mr Gray:** I recognise the cultural point you are making. We are seeking to do our level best to make sure that our staff do operate the system in an appropriate and a fair way, but we are operating the reasonable belief test in the same way as we do in the rest of the tax system. There are certainly cases—although perhaps none have crossed your desk recently—where we do accept not only that the cause of the error is official but that we should also write off overpayments.

**Q138 Mr Mitchell:** But this question of attitude does transfer to the Comptroller and Auditor General's Report, because that says, at paragraph 2.12, "HMRC's analysis of overpayments suggests that they result from a number of factors"—all of which are somebody else's responsibility, rather than the Revenue's. You give four: delays in reporting changes, provisional payments based on out-of-date information, families overestimating, and income rises from one year to the next. All these are somebody else's fault, not yours.

**Mr Gray:** I am not sure that all four are, but we certainly do accept that we need progressively to adapt the system so that we make it far easier for claimants to get the right information, and we are piloting a number of different ways of operating. We are taking the initiative much more as an organisation to contact people and ensure that their circumstances are up to date. For example, in our contact centres, rather than merely dealing with whatever query someone calls in about—

**Q139 Mr Mitchell:** But that same paragraph says that you do not have the staff resources to examine every award to determine why an overpayment occurred. How can you pronounce on whose fault it is unless you have examined each individual case?

**Mr Gray:** We do examine each individual case where there is a dispute. We are seeking to get increasingly into a position where we are getting more and more of the cases right in the first place, so that we are doing more prevention and have less curing to do when a problem arises.

**Q140 Mr Mitchell:** Why did the number of families affected by underpayments increase in 2004–05? We are just getting tougher on things?

**Mr Gray:** I do not know whether I can point to a particular factor. You are certainly right; there was a relatively small increase between 2003–04 and 2004–05, where the number of underpayments went up slightly and the overpayments came down somewhat. However, the number of underpayments is substantially less than the number of overpayments.

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**Q141 Mr Mitchell:** One final question, on fraud. I found the answers about the delay in catching up with the fraud issues somewhat difficult to believe. The Government are banging on about identity fraud and what a monstrous thing it is, and how we are all under threat and so we need identity cards to prove who we are—but never mind, I will not go into the psychology of that. Just a few years back, there was a fraud when passengers on the Heathrow Express had their Barclaycard details stolen by the people who took the tickets. Barclaycard caught up with that very quickly; why were you so slow when the Government are so stern on identity fraud, when it is such an issue and when the possibilities are so enormous? When the staff of Network Rail and the benefits Department had their identities stolen, why were you so slow to catch up with it and so lax about the possibilities of fraud?

**Mr Gray:** In relation to those identity thefts and fraud thefts, we would obviously have liked to have anticipated them or got on top of them more quickly. Actually, there was a relatively short delay between the point at which those identities were stolen and the point at which we intercepted the fraud.

**Q142 Sarah McCarthy-Fry:** Like Mr Touhig and Mr Mitchell, I talk a lot with my constituents about Tax Credits. The overwhelming feeling from the constituents I speak to is the huge benefit that Tax Credits have given them, particularly when it comes to the ability to go to work. I am talking in particular about women with children and their ability to work, and they really think that the credits are a good thing. However, we all have problems when system goes wrong and they are giving it a bad name. It seems to come down to errors in your Department.

In the past 18 months, I have seen 23 such cases, 14 of which involve overpayments. The distress that it causes to my constituents when those overpayments come to be clawed back is incalculable. I, too, have a case ongoing at the moment—I do not want to go into too much detail, because it is with the ombudsman—where there is a catalogue of errors from start to finish. It was not that my constituent did not give you the information—she did—but the problem was what your Department did with it. As Mr Touhig said, it is like getting blood from a stone. The amount was £6,500, and £2,500 has been written off, but it comes down to the question of what is reasonable, which was the point that you made.

I was interested by the remark you made to Mr Mitchell: that you apply the same test as in the rest of the tax system. Do you accept that this is not the same as the rest of the tax system? Most people in the tax system are on Pay-As-You-Earn, so they never get involved and their employer does it. You are asking people to look at complex award notices themselves. Do you think that it is fair to apply the same reasonableness test?

**Mr Gray:** I think that it is fair, in the context of the tax system, for us to apply a parallel approach. From what you and other members of the Committee have said, I accept that it is incumbent on us to do all that

we can to make it easier for people to provide us with the information. We have put in place quite a lot of measures to make the award notices simpler; we introduced a new award notice in April and we are introducing a number of other initiatives. All of those are particularly geared to making sure that we give extra help and support to those who find things most difficult. I was quite interested to hear that you had had 23 cases in your constituency. I in no way want to minimise the importance of getting those cases right, but with 6 million cases in operation—

**Sarah McCarthy-Fry:** There are not 6 million in my constituency.

**Mr Gray:** No, but the average constituency will have in the order of 10,000 claimants. I am not pleased that you have had 23 constituents who have found things difficult and I wish to get to a position where that figure is as near to nought as possible.

**Q143 Sarah McCarthy-Fry:** If 23 come to me when they have got to the end of the line, there are probably a lot more than that. The point that I am trying to clarify is whether this reasonableness business is a subjective or an objective test. Is it a tick-box test, or do you look at each case on its merits to see whether some person could have considered what happened to be reasonable?

**Mr Gray:** We look at things case by case. In April, we produced a revised version of our code of practice 26 note, which sought to make clearer the steps that we go through. We quite accepted that the earlier version was perhaps not as clear as it should have been. We worked in close conjunction with voluntary sector organisations and others to see whether we could make the explanation of the test and the way in which we applied it clearer and more straightforward. Those are some of the changes that we have introduced to meet the points that you and others are making.

**Q144 Sarah McCarthy-Fry:** So do you think that it is acceptable to demand on three separate occasions that somebody who is probably on a low income pay back an overpayment within 30 days, without telling them that there are ways of finding a longer time to pay?

**Mr Gray:** I would be very disappointed if there were cases of that sort. Certainly, we seek to make it clear that there is a range of options for people who want to enter into time-to-pay arrangements. For anybody who has an ongoing Tax Credit entitlement, that is of course automatic, and various rules operate there. For people who cease to be claimants, we seek to make it clear that we can enter into time-to-pay agreements if they do not feel able to pay the whole amount. Indeed, during the past year, we have entered into more than 300,000 time-to-pay arrangements on those hardship grounds.

**Q145 Sarah McCarthy-Fry:** But is that routinely offered or do people have to ask?

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**Mr Gray:** We seek to make it clear that people have the right to ask us to consider such an arrangement. If there are cases in which we have not done that satisfactorily, I would, again, be very pleased to know about them.

**Q146 Sarah McCarthy-Fry:** Okay. From April 2006, we have had the £25,000 disregard if people's income has changed.

**Mr Gray:** Within the current year.

**Sarah McCarthy-Fry:** Within the current year. What would happen if someone's income had not changed, but you made an error—they gave you the correct information, and their income had been the same all year, but your calculation was incorrect—and they had not noticed that the award was incorrect? I am trying to think of cases going forward. Does the £25,000 disregard apply only where somebody's income has changed, or does it apply where there have been errors that the claimant should have noticed?

**Mr Gray:** I think that we are talking about £25,000 in relation to the actual income, pre and post.

**Q147 Sarah McCarthy-Fry:** Only when income has changed. So that is not going to help in the cases of some of our constituents, where it comes down to the issue of reasonableness.

There are a lot of organisations out there, and a lot of the people who have contacted me want an amnesty for overpayments. Has any costing been made of an amnesty, should anyone go down that route?

**Mr Gray:** Certainly, consideration was given to that proposal; indeed, it was one of the recommendations in the ombudsman's report 18 months ago. It is the only one of her 12 recommendations that the Government did not accept. Her proposal was an amnesty on all overpayments in relation to the first two years of the system. Overpayments in those two years were £2.2 billion and £1.8 billion respectively, so a total amnesty on all of those would have a cost that ran into billions of pounds.

**Q148 Sarah McCarthy-Fry:** Do you have any analysis of overpayments that are overturned on appeal to you and overpayments that are overturned on appeal to the ombudsman? Have you an analysis of the percentages involved?

**Mr Gray:** Yes, I think that we have, although I do not have all the figures in my head.

**Q149 Sarah McCarthy-Fry:** Could you send me a note?<sup>12</sup>

**Mr Gray:** We could certainly do that, yes.

**Q150 Sarah McCarthy-Fry:** I would like to move on to staffing. Again, a lot of the concern is that when people ring up they certainly do not get the same person and the advice differs. Is there any opportunity for people to discuss face to face with anybody or is it purely by telephone?

**Mr Gray:** It is certainly possible for people to go into one of our face-to-face enquiry centres to discuss a case if that is the channel that they wish to use.

**Q151 Sarah McCarthy-Fry:** I do not know whether everybody received a note from the Public and Commercial Services Union, but I certainly did so. It says that "there is still a massive reliance on fixed-term appointees and huge amounts of overtime." Do you agree with that analysis?

**Mr Gray:** We have certainly been making use of fixed-term employees to seek to manage particular peaks of work and that seems to me an appropriate way of doing things. I do not recognise a reference to huge amounts of overtime. Certainly, there has been some degree of overtime work, but I would not describe it as huge.

**Q152 Sarah McCarthy-Fry:** Do you think that if you were not offering fixed-term appointments but had permanent employees, there would be a better continuity of service and you would then be able to offer a better service to clients?

**Mr Gray:** The great majority of our staff are permanent employees. We have more than 8,000 staff engaged in one way or another on Tax Credit work. The number of fixed-term appointments is measured in a few hundred. So they make up quite a small proportion and we have deliberately concentrated their work not on the front-line contact centres or enquiry centres but in parts of the back end processing.

**Q153 Sarah McCarthy-Fry:** Paragraph 2.27 of the report states: "In 2006–07, HMRC plans to dedicate at least a further 200 staff to its Tax Credit compliance teams." Do you know what percentage of total staff that is?

**Mr Gray:** In relation to the proportion of compliance staff?

**Sarah McCarthy-Fry:** In relation to the compliance teams, yes.

**Mr Gray:** I think that Mr Hartlib gave the answer to that earlier. The 200 is in addition to the 1,200.

**Mr Hartlib:** It is in addition to the 1,200, yes.

**Q154 Sarah McCarthy-Fry:** That is, additional employment? You are not moving people around?

**Mr Hartlib:** No, they are additional, full-time staff equivalents.<sup>13</sup>

**Q155 Helen Goodman:** Mr Gray, you have said already that the levels of official error and fraud are unacceptable. You have also said that the Department has made great strides forward in the past year to 18 months. You have been in your current role for only six weeks. How much of your time on a day-to-day basis is taken up with thinking about Tax Credits and Tax Credit problems?

**Mr Gray:** In my current role in the past six weeks? Probably between 10 and 20% of my time.

<sup>13</sup> *Note by witness:* These are additional posts to Tax Credit compliance. They are being funded from a reduction in posts from the Risk workstream arising from a restructuring and the streamlining of processes.

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**Q156 Helen Goodman:** And during your previous role as Deputy Chairman of HMRC?

**Mr Gray:** At the end of 2005 I spent a period of three months in which I was probably spending 90% of my time on Tax Credits. My predecessor explained in an earlier hearing of this Committee that he and I had agreed that I would dedicate a very large proportion of my time to them during that period.

**Helen Goodman:** The original Tax Credit scheme was introduced in 1999. At that time you were in the DSS at the Department for Work and Pensions.

**Mr Gray:** Indeed.

**Q157 Helen Goodman:** Do you think that there is a problem with the institutional memory of the Inland Revenue?

**Mr Gray:** I think there are always challenges in any organisation, whether or not work is transferred between Departments, in ensuring that you keep the institutional memory up to date. The fact of the matter is that in 1998–99, when the work that was originally Family Credits was moved to the then Inland Revenue, the majority of the staff working on it within the Inland Revenue were former Department of Social Security officials, so it was not a matter of completely new people dealing with the new regime.

**Q158 Helen Goodman:** Was that staff at the operational level or those involved in design and policy work?

**Mr Gray:** Certainly at the operational level and at the design level, there was very close co-operation and involvement between the two then Departments.

**Q159 Helen Goodman:** Thinking back over the past year or so, and to recent policy developments such as the introduction of the £25,000 disregard, were the operational people involved in the redesign when Ministers were being advised on making the changes?

**Mr Gray:** Yes. I was extremely keen to ensure that although the lead on policy advice on these issues clearly falls to the Treasury, it was very important that the operational implications of any changes were carefully considered. It would be fair to say that the time scale given for the implementation of the five or six measures announced in the last pre-Budget report—they were not all simultaneous, but were at various dates over the course of two or three years—reflected the strong input from HMRC on the operational deliverability of those changes.

**Q160 Helen Goodman:** Good. Do you think that the operational input and the need to take account of the capacity of the organisation may be part of the reason why the policy has had to be significantly redesigned so many times during the past seven years?

**Mr Gray:** I do not think I am in the best position to comment on that. I am sure that when looking back, people can always see scope for improvement. What is most important to me is that, as we move forward,

we should ensure that we have the right degree of co-operation between the Treasury and HMRC. As I said, I am very happy with the co-operation that there has been—for example, around the last Pre-Budget Report—and I am confident that that will continue.

**Q161 Helen Goodman:** You are lucky, Mr Hartlib, in that you rejoice in the title Director of Intelligence. I am envious. Would you say that the compliance issues on Tax Credits were significantly different from other tax issues that you have had to deal with in HMRC and, before that, in the Revenue?

**Mr Hartlib:** The organised crime and the attacks that we experienced towards the end of 2005 are different from the main stream of tax compliance work that the former Inland Revenue had to deal with in its day-to-day compliance activities. As for claimant compliance, it is about giving the correct information on a range of items; you are obliged to give correct information, whether it be the level of your income, the amount of hours that you work or other such matters.

**Q162 Helen Goodman:** Yes, but was it not predictable that such a scheme would be a target for organised crime?

**Mr Hartlib:** Any system that pays out money is likely to be a target; that is why, from the beginning, we had in place verification and risk rules to identify those instances. You will see from the Report that the majority of the attempts were stopped before the money was paid out.

**Helen Goodman:** Well, yes, although you will agree that the level of fraud is completely unacceptable, even if the attempts were—

**Mr Hartlib:** Yes, there were certainly lessons to be learned from what happened at the tail end of last year, and we are learning them in the plans that we have in place to make our systems more secure against the attacks that we saw then.

**Q163 Helen Goodman:** Where would you say there was a similar compliance problem in Government? Does a similar compliance issue arise anywhere else?

**Mr Hartlib:** In terms of identity theft or in terms of criminal attacks?

**Helen Goodman:** Identity theft or organised attempts to defraud big systems.

**Mr Hartlib:** It is not just Governments who are susceptible to identity theft. Every day, we see reports about identity theft being a problem that is prevalent across the financial sector.

**Q164 Helen Goodman:** What I am wondering therefore is whether or not you brought in the appropriate skills at the design phase of the Tax Credits to deal with this predictable problem.

**Mr Hartlib:** We had people with compliance experience involved in the design of the system, but as time passes, as you would expect, we learn from instances and we improve the systems. We are going

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through that sort of process now to ensure that when the e-portal is brought back into operation it is secure from these sorts of attacks.

**Q165 Helen Goodman:** Does the Inland Revenue have any input into the policy work on identity cards?

**Mr Gray:** We are certainly engaged in that.

**Q166 Helen Goodman:** Do you think that that will make a significant difference to the level of fraud on Tax Credits?

**Mr Gray:** Sorry, will what make a difference?

**Helen Goodman:** The introduction of ID cards.

**Mr Gray:** At the margin, I think it might, but the issues that we are addressing are largely specific to Tax Credits. A lot of the lessons that we need to learn are, as Mr Hartlib has said, from reading across to, and liaising with, the experience of the private financial sector. We also need to learn lessons elsewhere within our own Department's work in respect of other areas in which we are paying out money.

**Q167 Helen Goodman:** Is there any way in which the lessons that you have learned on these identity and compliance issues are being shared with other Departments?

**Mr Gray:** We are certainly looking, over time, to get better still at sharing that.

**Mr Hartlib:** We are sharing this experience with the financial institutions as well.

**Helen Goodman:** Thank you.

**Mr Hartlib:** May I just clarify a comment I made about the additional 200 staff? They will be engaged on compliance work; some 190 will be directly engaged on front-line activities and 10 on improving our intelligence.

**Q168 Chairman:** Mr Gray, you were asked a specific question by Mrs. Goodman about whether the introduction of identity cards would help the administration of Tax Credits, and you gave a long discursive response that did not answer her question. Would you like to try again to give a direct answer to a direct question: will the introduction of identity cards significantly help you in the administration of Tax Credits, yes or no?

**Mr Gray:** I think that it would be helpful, but there are a lot of other things that we need to do as well.

**Q169 Dr Pugh:** I want to go back over some of the points raised by Mr Williams. It is established, is it not, that there were 199 known software errors in October 2005? Presumably there are considerably less now. Do you know, broadly speaking, how many fewer software errors there are in the software you are using? Are any that still exist major glitches?

**Mr Gray:** I think it would be fair to say that none of the errors that are left are major glitches, as I was trying to say in response to the earlier questions on this. We have sought to prioritise action so that we resolve the issues that are causing the biggest problems.

**Q170 Dr Pugh:** So broadly how many minor glitches are there left in the program?

**Mr Gray:** I think that we probably still have in excess of 100, but I can let you have the precise figure.<sup>14</sup>

**Q171 Dr Pugh:** Okay. You settled with the provider of much of this software—EDS—and I think that the figure you quoted was £71,250,000 in settlement. £26.5 million of that is dependent on it receiving further procurement, is it not?

**Mr Gray:** Yes.

**Q172 Dr Pugh:** This Committee said: "Government should not be placed in the invidious position of having to commission further work from a contractor in order to recover compensation for underperformance." Do you agree?

**Mr Gray:** As my predecessor made clear in previous evidence sittings, we believe that the settlement that we reached was the most appropriate one in all the circumstances, and maximised the return to the Exchequer.

**Q173 Dr Pugh:** Of that slice of £26.5 million—about a third of £71 million—have you got any?

**Mr Gray:** We have. We have had two payments from EDS, and we expect a third shortly.

**Q174 Dr Pugh:** About how much?

**Mr Gray:** Dr Pugh, and Mr Chairman, I would prefer not to give those figures in public session. As a result of the earlier hearings, there is public knowledge of the fact that a ratio of 4.5% of new business will be paid to us. I do not think that it is appropriate for me to give a figure in a public forum, as it would be possible to deduce—

**Q175 Dr Pugh:** Okay. You are not going to give the figure. You are aware that this Committee said that "Confidentiality arrangements should not be accepted where they will impair accountability for public money. Contractors need to accept that, if they do business in the public sector, the terms of such settlements should be in the public domain." Do you agree?

**Mr Gray:** I do. The answer I just gave was that I did not think it was appropriate to give you the information that you had requested in a public forum.

**Dr Pugh:** Well—

**Mr Gray:** I did not say that it was inappropriate to give the information to the Committee. In the last hearing, my predecessor sought your agreement for certain evidence on the matter to be given in private.

<sup>14</sup> *Note by witness:* As the C&AG's Report notes, at the end of October 2005 there were 199 software errors which potentially caused errors in payments. The majority of these errors have been solved. As set out in the written statement by the Paymaster General on the 6th December, maintaining stability of the Tax Credit IT system remains a key priority for HMRC and is subject to continuous and ongoing improvement.

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**Q176 Dr Pugh:** So when the Treasury responded by saying that the deal was unusual in so far as it “includes unusual features of permitting the Department to disclose details to all bodies necessary to satisfy public scrutiny and accountability requirements”, the term “all bodies” includes the Public Accounts Committee? You are perfectly happy for us to find out about the EDS deal.

**Mr Gray:** Certainly.

**Q177 Dr Pugh:** Okay. I received a letter in March from Sir David Varney which explained why EDS wanted confidentiality in the first place. It did not want the structure of the deal to be known to its competitors. Why did the Government want confidentiality for the settlement? Or rather, why did the Department want it?

**Mr Gray:** The Department wanted to secure the best possible deal for the Exchequer. In any negotiation, the various parties bring their own particular requirements. The judgment that we reached was that that deal—that figure, with that particular confidentiality arrangement—offered the best deal. However, the deal provides that if we cannot secure the whole of the remaining £26.5 million, our rights to pursue legal action remain completely unfettered. I remain confident that we will secure the proceeds as set out in the agreement. However, if there is any question of us not doing that, we shall not hesitate to take the appropriate legal action to secure it.

**Q178 Dr Pugh:** Did EDS ever point out, when the system was first introduced, that the system was not mature or capable enough at that stage, and that it needed more time before introduction? Is there any minute from EDS indicating that to you, or to Sir David Varney your predecessor?

**Mr Gray:** I am honestly not sure. Neither Sir David nor I were in the Department then, so I am afraid I do not have the answer.

**Q179 Dr Pugh:** Well, in the Department’s memory, is there any recollection on the part of any of your officials that EDS ever said, “We are not ready to go, the system should be held back”? That would explain why some of the computer problems occurred.

**Mr Gray:** My recollection is that in evidence that was presented jointly between the Government and EDS, EDS indicated a willingness to go ahead with implementation at the point of implementation.

**Q180 Dr Pugh:** EDS never thought there would be any problems at all following from the introduction of the software? There were substantial problems because clearly you had substantial problems.

**Mr Gray:** EDS confirmed to us, before go-live, that the system was fit for live operation.

**Dr Pugh:** Fit for live operation?

**Mr Gray:** Yes.

**Chairman:** Mr Gray, we have been going for one hour and 50 minutes. Can you please raise your voice?

**Mr Gray:** I am sorry.

**Chairman:** Thank you.

**Mr Gray:** Would you like me to repeat that last point?

**Chairman:** No, just keep your voice loud and clear and the answers crisp.

**Mr Gray:** I will drink some more water and then shout.

**Chairman:** You can drink plenty of water. I know this is hard work for you.

**Mr Gray:** I entirely understand and I apologise.

**Q181 Dr Pugh:** Let us look back over the history. A system is introduced whereby you have no debate over disputed payments; that is then abandoned. The system does not identify or quantify reasons for overpayment and it cannot perform daily reconciliation of payments made against payments authorised. If EDS did not tell you that was ready to go or even if EDS told you it was ready to go, should you not have had some reservations yourself, because the software system was clearly not fit for purpose?

**Mr Gray:** Hindsight is a wonderful thing. With the benefit of hindsight, we can say that maybe it would have been better if some things had been better equipped. What we are seeking to do—

**Q182 Dr Pugh:** It does not take a lot of hindsight to say that not having a daily reconciliation of payments made and payments authorised is a snag, a weakness, does it?

**Mr Gray:** It is a snag and one that, since live operation, we have been seeking to remedy.

**Q183 Dr Pugh:** Okay. Clearly, you are bold people when venturing forth with any computer programme. May I briefly touch finally on the e-portal? We know you did not take the advice of the e-envoy; you worked to your own standards and your own advice. Did you take anybody’s advice? Did you look at the commercial sector? Did you call in consultants? Or did you just go ahead, thinking the security of your system was good enough if you judged it so to be?

**Mr Gray:** We had launched the system, as was brought out through the earlier questions, in August 2002 on the basis of what seemed appropriate at that time. We were then reviewing whether to maintain it. I do not think I can add much to what I said earlier.

**Q184 Dr Pugh:** You took no advice apart from your own?

**Mr Gray:** I am not aware of particular conversations on that point, no.

**Dr Pugh:** Okay.

**Chairman:** Mr Gray, your last questioner, you will be relieved to hear, is Mr Dunne.

**Q185 Mr Dunne:** Thank you, Chairman. I would like to take us back to the income disregard, which was raised originally by Mr Clark. I am struggling to reconcile the statements made in the NAO Report at paragraph 2.20 with the letter to the Chairman of the Committee from the Treasury. In paragraph 2.20,

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the NAO set out the various components of the package, most of which go to reducing overpayments. Some will increase the cost to the Exchequer and some will reduce the cost to the Exchequer, so they go both ways. In paragraph 2.21, an estimate is made, which I think was included in the pre-Budget report, of the net cost to the Exchequer over three years.

If you compare that with the figures given to us in the letter from Mr Orhniaal to the Chairman, it suggests—this relates specifically to the income disregard—that the difference varies quite dramatically on that issue, so for example in the current year there is a net cost to the Exchequer, as per paragraph 2.21, of £100 million, of which £50 million comes from the income disregard. That seems to be the conclusion you can draw from the letter from the Treasury. However, in the following year—next year—there is due to be a net saving to the Exchequer of £200 million, whereas the income disregard widens to a cost of £100 million, which suggests that there is £300 million of savings from the other elements of the package. Let us compare that to the following year, 2008–09, in which the saving reduces significantly to £50 million, yet the cost of the income disregard expands to £150 million.

There may be a logic to that that I cannot see at first sight. If you could explain it to us, that would be helpful. If you cannot, I ask you to write to explain it to us and, ideally, break down the components of the package so that it is clear for all to see.

**Mr Gray:** I am not sure I can completely answer all points immediately. Certainly in relation to the second-year effect, a number of the other measures that were part of that package were being introduced at a later date than the income disregard, so it is not surprising that you see that phenomenon.

**Mr Athow:** There are two elements that affect that second year, both of which reduce overpayments and Exchequer costs. The first one was shortening the renewal window. In the first and second year people had until the end of September to renew their claims. For this year, which will affect overpayments for 2006–07 and therefore any moneys that might be reclaimed in 2007–08, the renewal window was shortened by a month, so it was five months instead of six. That reduces the time period during which people may be overpaid because HMRC would be using out-of-date information.

The second element that reduces overpayments and Exchequer cost, which was introduced in that year, is withholding accrued underpayments. These are lump-sum underpayments that may arise during the course of a year and if someone has overestimated the extent of an income fall that could turn into an overpayment at the end of the year. So both of those are being introduced in that year.

**Q186 Mr Dunne:** These are all referred to in the NAO Report as elements that comprise the package but the scale of each of those elements is not clear. It would be helpful, Mr Gray, if you could write to us

explaining each component of the package so that we can understand how they all add up. Can you do that?<sup>15</sup>

**Mr Gray:** I have certainly undertaken, in response to Mr Clark, to write further on this. I will see what we can do on that issue.

**Q187 Mr Dunne:** Thank you. One of the consequences of this increased disregard will clearly be to have an impact on people's attitude to prior overpayments where you are seeking recovery. On page 18, table 6 refers to £2.6 billion of debts due to be recovered and a provision for doubtful debts for the two years of £900 million, of which £400 million was written off last year. Are you anticipating your provisions to increase in the current year as a result of the increased disregard?

**Mr Gray:** We have made a provision for the current year of £400 million—

**Q188 Mr Dunne:** Sorry, that was for last year, was it not?

**Mr Gray:** That was for last year but there was also a similar amount for 2005–06. Those are, of course, provisions, not write-offs and we have deliberately sought to adopt prudent assumptions there. The fact that we made such a provision in line with normal accounting practice does not mean that that is the amount we will write off. We hope to be able to write off significantly smaller amounts than that. Up to this point, as you see at the top of that table 6, the total amount we have written off in relation to 2003–04 currently stands at only £300 million.

**Q189 Mr Dunne:** Do you not anticipate an element of fairness applying here? If the Government have made a policy change that it was unfair to have an income disregard of such a low level hitherto and that has given rise to large quantities of overpayments as a result of, in many cases, your error, do you anticipate it being more difficult to recover overpayments going forward now that the disregard has been increased tenfold?

**Mr Gray:** No, I do not think that I do. Particular rules are applying in particular years. Up to this year, the disregard is £2,500. I see it as our job to implement and operate that policy, applying the appropriate parameters year by year.

**Q190 Mr Dunne:** We all have examples of constituents who have problems. It is the problems of overpayment and recovery of overpayment that are mainly brought to my surgeries. Can you explain the policy that you apply and at what point you decide that a debt should be written off or provided for? Is that clearly spelt out somewhere?

**Mr Gray:** Yes, I think it relates to my discussion with Helen Goodman earlier. We have a clear procedure if people wish to dispute their overpayments, in which we invite them to provide all the relevant information. Using the revised code of practice 26, to which I referred earlier, our staff implement that policy case by case.

<sup>15</sup> Ev 22–23



## HM Revenue and Customs

In correspondence with other Members of the House I quite often make the point that if there is further information that people wish to make available, we obviously bring that into account in the decision making.

**Q191 Mr Dunne:** I have two other quick points. We have touched on the number of staff increasing in order to deal with these problems. How does that relate to your Gershon targets?

**Mr Gray:** Obviously it has to be compatible with those overall targets, so although we are making additional staff available in the areas that we have described, that has to come within the overall envelope for staff numbers that we have agreed. We are almost bang-on target for the targets for overall staff reduction that we have agreed up to 2008—if anything, we are slightly ahead of the required reduction curve.

**Q192 Mr Dunne:** My final question relates to the impact of the policy on families. How did you react to the article in *The Times* earlier this year, which picked up on a Reform policy document that calculated that on average a married couple with two children pays £5,000 more in tax than it receives in benefits, whereas if the same couple split up, they would receive £7,000 more in benefits than they would pay in tax?

**Mr Gray:** I am not sure that I reacted in any particular way.

**Q193 Mr Dunne:** Do you recognise the validity of that analysis?

**Mr Gray:** I honestly do not have that analysis in my head, but if it was written in such an eminent newspaper as *The Times*, I am sure that one should treat the figures with respect.

**Chairman:** We have a couple of supplementary questions from Mr Mitchell, Mr Clark and Mr Bacon. They are going to be very brisk.

**Q194 Mr Mitchell:** I just wondered how identity cards are going to be useful, when you did not ask for passports or other forms of identification for entry to the e-portal. What is an identity card going to tell you about my 50 offspring back home in Romania, when I am working as a self-employed Romanian plumber?

**Mr Gray:** I am not sure it is going to tell you anything there. The Chairman put me on the spot in relation to that issue. I said that I thought that identity cards would be helpful, but that there was an awful lot else that we needed to do and that our main issues around tackling fraud in the Tax Credit system will still rely on us getting our own systems and procedures in place.

**Q195 Greg Clark:** I shall be brief. We give Mr Gray a hard time in this Committee. It is true to say that some of the communications that our constituents receive leave a lot to be desired, but over the past six weeks I have referred several cases to Mr Gray and the answers that I have received have been comprehensive and very helpful.

**Mr Gray:** Thank you—I trust that will be retained in the record, Chairman.

**Q196 Mr Bacon:** On the basis of that I shall of course expect a comprehensive and full reply to my question. This might be a question for Mr Hartlib, but you say that there are now 48 separate organised fraud investigations. I take it that that is not 48 separate cases of fraud but, because they are organised frauds, you have bracketed or brigaded them by the type of fraud. In other words, there are 48 different kinds of case going on.

**Mr Hartlib:** By the similarity or common route to the fraud.

**Q197 Mr Bacon:** Yes. How many different employers have been targeted, and how much of the £26 million is accounted for by how many large employers?

**Mr Hartlib:** We have not had any large employers since the DWP and Network Rail cases. The fraudsters go about things in other ways, getting identities from a number of sources.

**Q198 Mr Bacon:** So there were no large private sector employers? You have just mentioned the DWP and Network Rail, which I have to say I did not mention.

**Mr Hartlib:** It is in the public domain.

**Q199 Mr Bacon:** I was not talking about public or private. I was simply talking about large employers. Is it true that there were some private sector employers at the time?

**Mr Hartlib:** In the past there have been some private sector employers.

**Q200 Mr Bacon:** How many large companies were targeted?

**Mr Hartlib:** A handful. I have not got the figures to hand, but I can let you have a note on them.

**Mr Bacon:** Okay. If you could let me have a note that would be great.<sup>16</sup>

**Chairman:** I think Mr Athow from the Treasury would like to add something.

**Mr Athow:** No.

**Chairman:** Well, it is always nice to hear from them.

**Q201 Mr Bacon:** Do not go to an auction, Mr Athow—that is my advice.

I have one final question about EDS. How many quarterly payments have you received so far? The deal involved a netting off of the amount that was owed in one lump and then a quarterly payment from future revenues. How many quarterly payments have been received? Mr Jones is nodding. As the Finance Director, perhaps you should answer.

**Mr Jones:** We have received two quarterly payments so far. We are in discussion on the third.

**Q202 Mr Bacon:** Can you tell me when those quarterly payments were received? I do not have my

<sup>16</sup> Ev 24–25

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papers with me relating to that, but from memory the agreement was December 2005. I remember thinking that by 31 March 2006, you should have had your first quarterly payment. Is that right?

**Mr Jones:** No that is not right.

**Q203 Mr Bacon:** When was the first quarterly payment made?

**Mr Jones:** The procedure is that after the end of a quarter, EDS give us an account of how much new business they have written and we then invoice them for the amount that we are due to receive. I can give you the dates of receipt.<sup>17</sup>

**Q204 Chairman:** Send us a note.

A final, easy question from me, Mr Gray. Is it possible to design a Tax Credit system that does not generate over payments?

**Mr Gray:** I do not think it is possible to design one that does not generate any overpayments.

<sup>17</sup> Note by witness: Payments were received on 6 June and 9 September 2006.

**Q205 Chairman:** How about the significant overpayments that cause distress to our constituents?

**Mr Gray:** A Tax Credit system based on an annual basis, as this one is, as was made clear from the word go will inevitably involve a substantial amount of overpayments. It was estimated initially, which proved to be an underestimate, that we would be talking in the order of £1 billion: it proved to be £2 billion in the first year.

**Q206 Chairman:** Is it possible to design a Tax Credit system that is so easy to administer that one can keep fraud and error down to the levels historically associated with your Department?

**Mr Gray:** Yes, I believe it is.

**Q207 Chairman:** You are giving us a commitment that you are aiming to achieve that?

**Mr Gray:** That is what I am aiming to achieve, as I sought to make clear earlier.

**Chairman:** That is a positive note to end on. Thank you.

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 Supplementary memorandum submitted by HM Revenue & Customs
 

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QUESTIONS 35–37 (MR GREG CLARK), QUESTIONS 185–186 (MR PHILIP DUNNE) AND QUESTION 67 (MR ALAN WILLIAMS)

The Committee asked for information on the range and median of the cost of increasing the income disregard as calculated at the time of the 2005 pre-Budget report, and the cost of each component of the PBR changes, showing how they interact with each other to produce the overall cost/savings profile.

The Committee asked for a note explaining why the £500 million increase in entitlement for tax credit recipients is not a cost to the Exchequer.

## COSTS AND ENTITLEMENT

It is worth reiterating that costs for Tax Credits are scored on the National Accounts basis. This means that cost is scored in the year money goes out, and yield is scored in the year money comes in. Consequently overpayments incurred in a given year score as a cost. Recovery of overpayments over future years, scores as a yield in those future years. The main cost of the disregard is therefore composed of the foregone yield in each year that would be expected from the recovery of overpayments caused by income rises over the current disregard.

As the Treasury explained in their previous letter on this subject, the change in entitlement, is the increase in the amount claimants are entitled to receive, all other things being equal, if their change in income is great enough for them to benefit from the increase in the disregard introduced from April. A change in a claimant's entitlement does not always affect the amount they actually receive—whether or not it does depends on when the claimant notifies HMRC about their changed income. So, for example, before April 2006, if claimants did not inform HMRC of an income rise above £2,500 they would continue to receive the same amount of tax credits as they would have received before the income rise, some of which would be recovered as an overpayment in future years.

As the Treasury's previous letter set out, the new information we have received since the PBR 2005 costing has substantially increased the Government's confidence in the underlying basis of the costing and, in particular, it's costing of the disregard change, rather than causing it to amend any of its costings. That is why the costing for the disregard provided in the Treasury letter of 18 October 2006 was the same as the costing that was made in the 2005 Pre-Budget Report.

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## THE PROFILE OF THE OVERALL COSTING

The Committee were also interested in the other elements of the PBR package. This included a range of measures to make the tax credits system work better for families, providing more certainty over their tax credit award while maintaining flexibility to respond to falls in income and changes in circumstances, namely:

1. an increase in the income disregard from £2,500–£25,000, ensuring that almost all families with increasing incomes will not have their tax credit entitlement reduced in the first year of the increase, further boosting work incentives;
2. automatic limits on recovery of excess amounts paid where awards are adjusted in-year following a reported change, to reduce the effect of the change on continuing payments;
3. to tackle the problems associated with families overestimating falls in income, when claimants report a fall in income during the year, their tax credit payments will be adjusted for the rest of the year to reflect their new income level, but will not include a one-off payment for the earlier part of the year;
4. a reduction in the time allowed to report a change that reduces tax credit entitlement from three to one month, shortening the time when people are potentially paid too much;
5. bringing forward the deadline for the return of end-of-year information from the end of September to the end of August, reducing the time that recipients are being paid on the basis of information rolled forward from the previous tax year, which is often out of date; and
6. HMRC will contact key groups of tax credit recipients to collect up-to-date information before the start of the new tax year, allowing provisional payments made up to the time of renewal to be set more accurately, helping to reduce overpayments.

As the Paymaster General has set out previously, income rises from one year to the next are only one of four main causes of overpayments—the others are families over estimating the extent to which their income has fallen when they seek extra support during the year; provisional payments made at the start of the tax year, based on out of date information that is subsequently updated when the award is renewed; and delays in reporting changes of circumstances to HMRC.

As we've explained previously, a number of elements of the package are expected to reduce future overpayments by preventing money from being paid out that is at risk of becoming an overpayment. For example, shortening the renewal window; adjusting future payments when an estimate of lower current year income is reported, but not making a one-off payment for the earlier part of the year; reducing the time claimants have to report a change that reduces tax credit entitlement and making it mandatory to report more changes in circumstances; collecting income estimates for provisional payments; and contacting key groups of tax credit recipients to collect up-to-date income information before the start of the new tax year. Overall those elements of the package that reduce expenditure, each bring an exchequer benefit of 0–£100 million a year in a steady state—that is when all the timing effects have worked through.

Applying automatic limits on in year recovery where awards are adjusted following a reported change will, like the increase in the disregard, have a cost. Again looking at the effect of this in a steady state, the exchequer cost is expected to be of the order of 0–£100 million a year. So the overall impact of the non-disregard elements of last year's PBR package is broadly to benefit the exchequer, mitigating the £300 million a year cost of the disregard.

The phased introduction of these different elements and their differential effect on overpayments explains why the overall cost of the package has its particular shape over time. For example, shortening the renewal window will reduce overpayments by reducing the length of time that tax credit awards are based on previous year's income.

Similarly, from 2007–08 HMRC will adjust future payments when an estimate of lower current year income is reported but not make a one-off payment for the earlier part of the year. When the award is finalised, any necessary adjustments to payments will be made. This will give families a buffer against any overpayment they might build up later in the year. The main impact of this measure is expected in 2007–08, the year it is introduced.

**Question 77: (Mr Williams):** *How many IT software errors have been resolved and how many not yet dealt with?*

As the C&AG's Report notes, at the end of October 2005 there were 199 software errors which potentially caused errors in payments. The majority of these errors have been resolved. As set out in the written statement by the Paymaster General on 6 December, maintaining stability of the Tax Credit IT system remains a key priority for HMRC and is subject to continuous and ongoing improvement.

In relation to information about the Settlement Agreement with EDS, by the terms of that agreement HMRC is legally obliged to notify the Committee that such information is subject to confidentiality obligations between HMRC and EDS. As we have previously informed the Committee, the Settlement Agreement confidentiality restrictions do not, of course, restrict in any way disclosure of information by

HMRC to the Committee, the National Audit Office or any other statutory, legal or parliamentary body charged with scrutiny of HMRC or its actions. However, we are legally required to inform the Committee of these confidentiality terms and request that the Committee takes them into account in its deliberations as to what use will be made of information and, in particular, what will be published—relating to the Settlement Agreement.

Questions 91–95: (Mr Richard Bacon): *How many HMRC employees are subject to a criminal investigation in respect of their HMRC duties? What are the charges, how many are ongoing investigations, and what has happened to those where the investigation is concluded?*

The following figures refer to cross-departmental criminal investigations. They include all prosecutions since HMRC was formed, and all current investigations.

Figures in the public domain constitute those that are, or have been, in the court process (bullet points 2, 3, 4 and 6). Figures not in the public domain constitute current investigations (bullet points 1 and 5).

#### INTERNAL CRIMINAL INVESTIGATIONS

- 21 officers are currently under criminal investigation (including five cases referred for prosecution but not yet in court.
- Nine officers have been charged and are going through the court process (charges are: 3x Tax Credit Fraud; 3x Conspiracy to Defraud; 1x Contrary to Public Bodies Corrupt Practices Act (Scottish case); 1x Common Law Cheat; 1x False Accounting.
- 12 HMRC officers have been charged and convicted. (Convictions were: 3 x Tax Credit Fraud; 2x Corruption; 3x Common Law Cheat and 2x fraudulent evasion of VAT; 1x Conspiracy to Defraud; 1x Conspiring to Import Class A Drugs.) The sentences ranged from a four month suspended prison sentence to 15 years in prison.
- One officer has been charged and found not guilty (Offence of Conspiracy to Cheat).

#### EXTERNAL CRIMINAL INVESTIGATIONS (POLICE AND IPCC INVESTIGATIONS)

- 12 current serving officers subject to criminal investigation.
- Three officers (1x serving at the time; 2x former) charged and convicted (convictions were 3x Misfeasance in Public Office) The sentences were all suspended prison sentences (ranging from three to six months).

Questions 148–149: (Sarah McCarthy-Fry): *Analysis of the number of overpayments overturned on appeal to HMRC and on appeal to the Ombudsman*

The Government has published much of the information already requested by the Committee in the answer to Parliamentary questions. These can be summarised in the following table:

	<i>Overpayments disputed</i>	<i>Overpayments written off as a result of the dispute</i>
2004–05*	215,000	10,300
2005–06	367,500	160,500

\*End of year adjustments only start after the end of the tax year so there were no disputed overpayments in 2003–04. Renewal packs were first sent out from April 2004 and data was first recorded from May 2004.

The amounts written off are on the basis of the criteria set out in Code of Practice 26.

We do not keep information on the number of overpayments that are changed following intervention by the Ombudsman’s office. However, the Ombudsman’s Annual Report for 2005–06 to Parliament (HC 1363) suggests that she upheld or partially held around 270 disputed overpayments for tax credits as a whole.

Question 200: (Mr Richard Bacon): *How many large employers (private or public sector) have been targeted by tax credit identity fraud?*

Two large employers have been the target of Tax Credit identity fraud.

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#### IDENTIFYING CAUSES OF OVERPAYMENTS

The Committee also raised the issue that the Tax Credits computer system does not report on the causes of overpayments. This is not so much a computing issue as a reflection of the fact that it is often not clear what the exact causes of the overpayments are, particularly where there is more than one change during the year.

Overpayments can result from a number of factors and it is often impossible to disentangle the precise impact of each. Take the following stylised example of a two child family earning £22,000 under the 2005–06 system (ie with a £2,500 disregard). They will be entitled to tax credit payments of around £1,600 per annum. If this family experiences a rise in income of £5,000 and, six months into the year, one child leaves full time education this would have reduced their entitlement to tax credits to £545. If these changes had not been reported to HMRC this would produce an end of year overpayment of £1,055. However if we look separately at the impact of the two different measures this would sum to more than the total impact (the income rise would reduce entitlement by around £925 and the child leaving full-time education would reduce entitlement by around £840). Therefore there is no objective way of disaggregating the overall overpayment between that arising from an income rise and that from changes in circumstances. I hope that this provides a helpful explanation of why it can be difficult to disentangle the precise impact of different causes of overpayments.

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