House of Commons

Committee of Public Accounts

Inland Revenue: Tax Credits and tax debt management

Twenty-ninth Report of Session 2002–03

HC 332

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Report, together with formal minutes, oral and written evidence

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The Committee of Public Accounts

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Committee staff

The current staff of the Committee is Nick Wright (Clerk), Leslie Young (Committee Assistant) and Ronnie Jefferson (Secretary).

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Summary

In 2001–02, the Inland Revenue collected £148.7 billion in taxes and duties, and £65.3 billion in National Insurance contributions. They paid out £5.7 billion of Tax Credits. **Figure 1** shows receipts and Tax Credit payments over the last five years.

Figure 1: Inland Revenue net tax receipts and Tax Credits payments

	Net receipts (see note below) and Tax Credits				
£ billion	**1997–98**	**1998–99**	**1999–00**	**2000–01**	**2001–02**
Income tax	76.8	86.6	94.0	106.0	108.7
Payment of tax credit	-	-	(1.1)	(4.6)	(5.7)
Corporation tax	30.4	30.0	34.4	32.4	32.0
Capital gains tax	1.5	2.0	2.1	3.2	3.0
Inheritance tax	1.7	1.8	2.0	2.2	2.4
Stamp duty	3.4	4.6	6.9	8.2	7.0
Petroleum revenue tax	1.0	0.5	0.9	1.5	1.3
Windfall tax	2.6	2.6	-	-	-
Total tax receipts	**117.4**	**128.1**	**139.2**	**148.9**	**148.7**
Note: Figures are shown net after allowing for tax reliefs and allowances, and for repayments (2001–02 £13.2 billion).					

Source: National Audit Office analysis of Inland Revenue data

Each year, the Comptroller and Auditor General (C&AG) reports on his examination of the management of the tax system by the Inland Revenue (the Department). On the basis of his report on the 2001–02 accounts[1] and a supplementary note[2] from the Department, we examined the Department on:

- the control of Tax Credits,
- management of tax debt; and
- the need to improve management information for control over tax systems.

Tax Credits are available to people with children, or disabled people who work 16 or more hours a week. Working Families' and Disabled Person's Tax Credits in 2001–02 amounted to some £3.4 billion paid by credit transfer, order book or girocheque. A further £2.2 billion was paid by employers to their employees based on awards made by the Department, up from £1.3 billion in the previous year. Employers recouped these amounts

1 C&AG's Report, *Inland Revenue Resource Accounts 2001–02*, (HC 71, Session 2002–03)

2 Ev 1–2

from the tax and National Insurance contributions they collected.

The issues arising with the New Tax Credit schemes, which went live in April 2003, will be the subject of a further examination by the C&AG with a view to reporting later this year.

The management of tax debt is important for the Government's finances and central to the Department's work. For several years the C&AG has pointed to the need for improvements in management information for control over tax systems, and he identified again from his examination of the 2001–02 accounts areas where improvements were needed, notably for tax debt management.

In the light of our examination, we draw the following overall conclusions:

- The Department's special reconciliation of Tax Credit payments via employers to the amounts authorised for 2002–03 will need to demonstrate that payments made were in accordance with authorisations. From 2003–04 the Inland Revenue need to be able to reconcile automatically the total amount paid by each employer under the new Tax Credits systems with what the Department has authorised for their employees in total.

- The new Tax Credit schemes operating from April 2003 are very different in scale and scope from the previous schemes and the systems developed by the Department have been informed to an extent by the lessons of past schemes, including deficiencies pointed out by the C&AG. The Department are relying on more sophisticated risk management structures to minimise the errors and fraud that have characterised comparable benefit schemes in the past, and will need to demonstrate their effectiveness.

- The Department have had some early successes with their tax debt management initiatives but they still do not have routinely generated data on the level of debt for each tax stream to help manage the debt overall. Furthermore, the Department's target for half of employers to pay over to the Exchequer by the statutory date the tax they deduct from their employees' earnings is insufficiently challenging for a flow of funds amounting to two thirds of all Revenue tax receipts and National Insurance contributions.

1 Tax Credits

1. Tax Credits are part of the Government's programme of tax and benefit reforms to encourage people to work. The Credits are available to families and single parents with children, or disabled people who work at least 16 hours a week. In 2001–02 employers paid with wages some £2.2 billion in Tax Credits awarded by the Department. Employers then recouped the amount paid from the tax and National Insurance contributions they had collected from other employees, before paying the net sum over to the Department. [3]

2. The Department told us that the Tax Credit schemes to date had been in effect interim schemes from which they had learned many lessons. These included better targeting of information and publicity to increase take-up. They had also identified measures to ensure compliance with the regulations, and the use of risk factors as management tools, which were incorporated into the new Tax Credit schemes operating from April 2003. The new Tax Credit systems were purpose built with the risk factors built in so that there would be far more automatic selection of cases to help the targeting of Departmental inquiries. The Department had also steadily improved their strike rate with existing Tax Credits, by refining their risk indicators so that they hit the cases that were at risk.[4] With Child's Tax Credit from April 2003, there would be a direct link to Child Benefit, whereas under the former system there was no automatic verification that the child existed.[5]

3. The Department explained that they were looking at strengthening the checks which their compliance staff make when visiting selected employers, for example by looking at more than one month in which Tax Credits are in payment and possibly at more than one Tax Credit case at each employer.

4. Under the new Tax Credits regime the Department expected more prosecutions and would be tough on fraud as a great many people would be coming into the new Tax Credit net. They were to have 83 new criminal investigators to cope with Tax Credit fraud and the policing of the system would be much tighter than at present.[6] There would be additional safeguards, including greater reconciliation of data between the Inland Revenue and the Department of Work and Pensions, and better matching with data on employee earnings.[7]

5. The Department told us that much of the new Tax Credit was intended to be paid to recipients' bank accounts, including the new Universal Bank Accounts which would not be fully operational by April. The Department wanted gradually to build up the number of customers paid in that way, though they would not impose it until the Post Office Card Account was introduced, which they expected to be within a few months. In the meantime customers would be paid by Girocheque.[8]

3 C&AG's Report, paras 3.3–3.15
4 Q 13
5 Q 75
6 Q 15
7 Q 45
8 Qq 106–108

6. The Department considered that Tax Credits had been successful in lifting people out of poverty. Take-up has been much higher among lower earners, and more people who did not claim their entitlement to Family Credit have been claiming the new Tax Credits than before.[9]

9 Qq 53–54

2 Tax debt management

7. The Department's Receivables Management Service was created in April 2001 to combine tax collection and debt management services within the Department. The new Service is responsible for collecting and accounting for debt legally due and payable, and also for collecting tax returns from individuals and companies.[10]

8. Despite recent initiatives to improve the collection of taxes and returns, there is very little management information on levels of debt against which to measure the success of these initiatives and the Department's performance, or to help target Departmental resources.[11]

9. Existing systems were not designed to generate accounting information routinely, and so could not total the individual debts recorded. Instead, dedicated queries had to be run to generate such information. The Department acknowledged that it would be important to provide tax debt information routinely, and in time to support accruals based Whole of Government Accounts. But they had not allocated specific personal responsibility for ensuring proper control over the totality of debt for each tax stream.[12]

10. No system can ensure that all taxpayers and potential taxpayers comply with their obligations.[13] But the Department have not sought to quantify the levels of fraud, evasion and avoidance, whereas HM Customs and Excise have published their estimates of fraud including some £358 million lost to the hidden economy, in their Annual Report.[14] The Department recognised that they needed to do more work in this area given the estimates of the tax gap provided by HM Customs and Excise; the work being undertaken in Australia; and the forthcoming requirement for Whole of Government Accounts to report on taxes due.[15]

11. Only half of employers make payments of PAYE and National Insurance contributions by the statutory due date each month. The Department's Joint Employer Remittance Initiative over a six-month period, encouraging large employers to meet their obligations, has increased significantly the collection of revenue, worth some £2 million in interest,[16] and at a cost of only some £60,000. The Department had now extended this initiative, both across all employers, and to corporation tax and the self-employed.[17]

10 C&AG's Report, paras 4.37–4.39
11 *ibid*, paras 4.12–4.13
12 Qq 85, 82
13 C&AG's Report, para 3
14 Q 122
15 Q 124
16 C&AG's Report, 4.29–4.30
17 Qq 95–96

3 Management information

12. Deficiencies in management information to support controls and strategic or operational decision-making has been a recurring theme in the C&AG's reports over several years. The Department acknowledged that when systems were being developed in the past, management information had not always been afforded the priority to ensure that it was not sacrificed if delivery and cost pressures arose.[18] They said that this was no longer the case, and management information systems would be mandatory for all new systems. The Department will spend £31 million on the development of management information between April 2003 and 2007, in part to provide a cohesive performance indicator framework.[19]

4 Tax simplification

13. On tax simplification the Department said that many features of the tax system were matters of policy and therefore for Ministers rather than the Accounting Officer. As an indication of their efforts to simplify the administration of the tax system, the Department aimed to be more active in direct help, for example targeting small business and those likely to have most difficulty with tax. They were also trying from April 2003 a shortened version of the self-assessment return for people with relatively simple affairs. They had a "Working Together" initiative with taxpayer representatives to help to identify how to make things easier, and a project to rewrite tax law. IT and internet technology were being used to help taxpayers and to enable the Department to bring together information from separate, older tax systems so that however complex the underlying system, taxpayers would find it simpler at the point where they deal with the Department.[20]

5 Unauthorised access to taxpayer data

14. The Department had disciplined 205 people in 2002 for all types of computer misuse, not just unauthorised browsing of tax records. The Chairman of the Board recently issued a strongly worded note to all Departmental staff making it clear that computer misuse was a serious offence, ultimately punishable by dismissal. There had been only two instances, dating back to 1994 and 1996, where Departmental staff had sold information. In each case the offender was dismissed and imprisoned for a year. The Department's information technology could trace who accessed which records and the system itself checked where people accessed tax records outside their immediate areas of responsibility.[21]

18 C&AG's Report, para 2.16
19 Q 73
20 Q 17
21 Qq 18, 22, 27, 29

Conclusions and recommendations

On Tax Credits

1. The Department should state in their Annual Report the effectiveness of employer compliance checks for new Tax Credits in terms of the numbers of checks on Tax Credits carried out at employer visits and the proportion of such visits that include checks on Tax Credits.

2. For the interim period at the start of 2003–04, when payment through the Universal Banking Service are not available for all new Tax Credits, the Department needs to provide sound alternative reconciliations for payment streams and checks for payment diversion, and report material errors and losses.

3. The Departments should compare the levels and types of fraud in Tax Credits with more traditional benefits to see whether there are patterns and trends—for example by region or employment sector—which might provide useful information and suggest guidance for protective measures.

4. The Department should each year secure reliable and comprehensive evidence of the overall eligibility for Tax Credits, including Family Resource Survey data, against which to judge take-up and to thereby assess and report upon their effectiveness in getting Tax Credits to those entitled to them.

On Tax Debt Management

5. The Department should aim higher than their current target of half of employers paying over to the Exchequer by the statutory date the tax and National Insurance deducted from their employees each month.

On Management Information

6. The Department have earmarked £31 million to improve management information from 2003–2007 and to provide a cohesive performance indicator framework. Designers of new systems and system enhancements should incorporate good quality management information, and existing systems should be improved to generate the management information needed for effective control over the operation of those systems.

7. To maintain the confidence of taxpayers, the treatment of unauthorised staff access to taxpayer information as a disciplinary offence should be upheld, taking account of changing risks and challenges posed by changes in information technology.

Formal minutes

Monday 16 June 2003

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Mr Brian Jenkins
Mr Ian Davidson	Mr David Rendel
Geraint Davies	Mr Gerry Steinberg
Mr Nick Gibb	Jon Trickett
Mr George Howarth	Mr Alan Williams

The Committee deliberated.

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

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

Paragraphs 1 to 14 read and agreed to.

Conclusions and recommendations read and agreed to.

Summary read and agreed to.

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

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

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

Adjourned until Wednesday 18 June at 4.30 pm

Witnesses

Monday 20 January 2003 *Page*

Sir Nicholas Montagu KCB, Mr David Hartnett CB, and **Mr Steve Heminsley,** Inland Revenue Ev 3

List of written evidence

1 Letter to the Chairman of the Committee from the Chairman of the Board of Inland Revenue Ev 1

2 Inland Revenue Ev 17

List of Reports from the Committee of Public Accounts Session 2002–03

First Report	Collecting the television licence fee	HC 118 *(Cm 5770)*
Second Report	Dealing with pollution from ships	HC 119 *(Cm 5770)*
Third Report	Tobacco Smuggling	HC 143 *(Cm 5770)*
Fourth Report	Private Finance Initiative: redevelopment of MOD Main Building	HC 298 *(Cm 5789)*
Fifth Report	The 2001 outbreak of Foot and Mouth Disease	HC 487 *(Cm 5801)*
Sixth Report	Ministry of Defence: Exercise Saif Sareea II	HC 502 *(Cm 5801)*
Seventh Report	Excess Votes 2001–02	HC 503 *(N/A)*
Eighth Report	Excess Votes (Northern Ireland) 2001–02	HC 504 *(N/A)*
Ninth Report	The Office for National Statistics: outsourcing the 2001 Census	HC 543 *(Cm 5801)*
Tenth Report	Individual Learning Accounts	HC 544 *(Cm 5802)*
Eleventh Report	Facing the challenge: NHS emergency planning in England	HC 545 *(Cm 5802)*
Twelfth Report	Tackling pensioner poverty: encouraging take-up of entitlements	HC 565 *(Cm 5802)*
Thirteenth Report	Ministry of Defence: progress in reducing stocks	HC 566
Fourteenth Report	Royal Mint Trading Fund 2001–02 Accounts	HC 588 *(Cm 5802)*
Fifteenth Report	Opra: tackling the risks to pension scheme members	HC 589 *(Cm 5802)*
Sixteenth Report	Improving public services through innovation: the Invest to Save Budget	HC 170
Seventeenth Report	Helping victims and witnesses: the work of Victim Support	HC 635
Eighteenth Report	Reaping the rewards of agricultural research	HC 414
Nineteenth Report	The PFI contract for the redevelopment of West Middlesex University Hospital	HC 155
Twentieth Report	Better public services through call centres	HC 373
Twenty-first Report	The operations of HM Customs and Excise in 2001–02	HC 398
Twenty-second Report	PFI refinancing update	HC 203
Twenty-third Report	Innovation in the NHS—the acquisition of the Heart Hospital	HC 299
Twenty-fourth Report	Community Legal Service: the introduction of contracting	HC 185
Twenty-fifth Report	Protecting the public from waste	HC 352
Twenty-sixth Report	Safety, quality, efficacy: regulating medicines in the UK	HC 505

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

Twenty-seventh Report	The management of substitution cover for teachers	HC 473
Twenty-eighth Report	Delivering better value for money from the Private Finance Initiative	HC 764
Twenty-ninth Report	Inland Revenue: Tax Credits and tax debt management	HC 332

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