House of Commons
Treasury Committee

The Merger of Customs & Excise and the Inland Revenue

Ninth Report of Session 2003–04

Report, together with formal minutes, oral and written evidence

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The Treasury Committee

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Introduction

1. The Treasury Committee established a Sub-committee in July 2001 to scrutinise the work of the various bodies for which Treasury Ministers are accountable. As part of this work we examine the activities of HM Customs and Excise and the Inland Revenue on a regular basis. On 2 July 2003 the Paymaster General told the Committee that the Chancellor was announcing a major review of the revenue departments to examine the “best organisational arrangements for delivering the Government’s tax objectives both now and into the future …”¹. The review, chaired by Mr Gus O’Donnell, Permanent Secretary to the Treasury, subsumed an earlier review—announced in response to the Committee’s report on the handling of the joint Inland Revenue/Customs and Excise STEPS PFI Project into the relationship between Treasury Ministers and the revenue departments—which had not reported.²

2. In March 2004, the report Financing Britain’s Future—Review of the Revenue Departments (the O’Donnell Report) was published.³ In his foreword to the report the Chancellor accepted the changes recommended in the report in full and announced the creation of a new department integrating the work of Customs and the Revenue.⁴ Subsequently, the Chancellor announced that, following the decision to merge Customs and Excise and the Inland Revenue, the new department would be called Her Majesty’s Revenue and Customs and that Mr David Varney would become the Executive Chairman of the new department.⁵

3. The Sub-committee announced, on 31 March 2004, an inquiry into the proposals to merge Customs and Excise and the Inland Revenue. We heard oral evidence from Mr O’Donnell and officials from the Treasury, Customs and Excise and the Inland Revenue on 28 April, from the Association of Chartered Certified Accountants, the Institute of Chartered Accountants in England and Wales, the Law Society, PricewaterhouseCoopers and the Chartered Institute of Taxation on 12 May, and from Mr David Varney, the Executive Chairman designate (and Chairman of both Customs and Excise and the Inland Revenue), and officials of both departments on 13 October 2004. We also received a number of written submissions, most of which we have published with this volume. We are grateful for all the evidence we have received, written and oral.

The case for merger

4. The O’Donnell report notes that the case for organisational change rests “on potential improvements in customer service, effectiveness and efficiency.”⁶ The report adds “It results from an analysis of:

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¹ Treasury Committee, Tenth Report of Session 2002–03, Inland Revenue Matters, para 64
² Ibid. paras 60, 61, 64
³ HM Treasury, Financing Britain’s Future—Review of the Revenue Departments, Cm 6163, hereafter referred to as “The O’Donnell Report”
⁴ The O’Donnell Report, page 1
⁵ “David Varney appointed executive chairman of new tax department”, Treasury Press Notice 47/04, 13 May 2004
⁶ The O’Donnell Report, para 1.17
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• international experience, which has shown that the current separation of direct and indirect taxes in the UK, as opposed to organising around functions and customers, is behind best practice;

• the functions of the revenue departments, which shows that there are benefits from bringing them together;

• the experience of closer working between the departments since 1994, which has produced promising but limited results; and

• the success of the creation of the Department for Work and Pensions, with the formation of several customer-oriented agencies, including the integration of benefits and employment advice in Jobcentre Plus, which has helped more people into work, and provided a better service for customers.97

5. Merging the revenue departments has been proposed several times before. Prior to 1833 the national revenue of the United Kingdom was collected by four boards: the Boards of Customs, Excise, Stamps and Taxes. In 1834 the Board of Stamps was merged with that of Taxes. In 1849 the Board of Stamps and Taxes was in turn amalgamated with the Board of Excise to form the Board of Inland Revenue. The present Customs and Excise Department was established in 1909, when Excise was removed from the aegis of the Board of Inland Revenue and amalgamated with the Customs under one Board.8

6. The amalgamation of the Inland Revenue and Customs was first considered in 1862 by a Select Committee appointed to “inquire whether it would be practical and advantageous to consolidate any of the establishments now governed by the Boards of Inland Revenue and Customs respectively.”9 The Inland Revenue Department, supported by Mr Gladstone, argued against amalgamation. Mr Gladstone is reported to have stated that “in the case of the Board of Inland Revenue, consolidation had been carried out to the very furthest point to which it was possible to carry it without great mischief to the Public Service.”10

7. More recently, our predecessors examined this subject. In a report on the Inland Revenue in May 1999 the Treasury Committee recommended that “the Government commission a study to assess the feasibility of merging the two departments, the potential for savings in public expenditure and in compliance costs as a result of merger, and an outline of how the merger might be planned.”11 The Government response noted that “…as the Paymaster General made clear in evidence to the Committee, the merger of the two departments is not something which has been ruled out indefinitely. However, the Government’s clear view is that it is preferable to proceed with the programme of closer working which we have in hand. We would not therefore see any advantage in the study which the Committee have recommended.”12

7 Ibid.
8 Committee on Enforcement Powers of the Revenue Departments, Report, Cmnd 8822, March 1983, page 786
9 Commons Journal, Session 1862–63, page 164
10 Committee on Enforcement Powers of the Revenue Departments, Report, Cmnd 8822, March 1983, page 786
8. The Committee returned to this subject in a report on Customs and Excise in April 2000, concluding “we believe that the merger of the Inland Revenue and Customs and Excise would improve compliance with taxation, reduce businesses’ compliance costs and reduce the Government’s revenue collection costs and we recommend that such a merger should proceed and that the Government should bring forward a plan for the merger in accordance with our conclusions and recommendations in this Report.” The Government rejected this recommendation on the grounds that the benefits of merger could be achieved through the closer working programme “without the risks, upfront and opportunity costs and structural upheaval which merger would inevitably entail.”

9. We asked Mr O’Donnell what had led the Government to change its mind on the benefits of merging the two departments since our report in 2000. He told us that:

“[…]The experience of having closer working, particularly things like Joint Shadow Economy Teams […] was they produced good benefits but they were in very limited areas. The closer working was because we were taking people from Revenue and Customs and getting them involved in joint projects. That was fine but the departments still had their own priorities and their own objectives. In order to make this bigger across the board it was quite clear to all of us in Treasury, Revenue and Customs that closer working whilst producing good results was not going to produce the really big benefits which you could get from a more radical change. At the same time we were having other machinery of Government changes, like DWP coming into existence, which taught us about a lot about merging organisations in the public sector. In general with the increasing strategic focus on delivery and efficiency that has led us to a situation where we have thought again.”

10. Our predecessors concluded in April 2000 that the merger of the Inland Revenue and Customs and Excise would “improve compliance with taxation, reduce businesses’ compliance costs and reduce the Government’s revenue collection costs” and recommended that such a merger should proceed. We are pleased to note that the Government have now accepted that recommendation.

**Expected costs and benefits**

11. The O’Donnell review examined a number of options for change but concluded that the creation of a new department offered the greatest net benefits, with improvements to:

- customer service and compliance costs, through coherent policy advice and service planning, customer education and advice, processes and systems, and compliance activity;
- effectiveness, through alignment of strategies, a coherent approach to information, new approaches to compliance, and flexible resource allocation. By helping to ensure that the right tax is paid by the right people, fairness would also be enhanced; and
efficiency, through economies of scale and the impetus of transformational change, particularly in transactional processes.\textsuperscript{16}

12. These potential benefits were recognised by most professionals in the tax field. PricewaterhouseCoopers noted that “in principle, we welcome the forthcoming merger of the Inland Revenue and Customs and Excise […] we believe that there are clear benefits to all parties – taxpayers, advisers and the government – from there being a single tax authority. It is a model that serves most EU and OECD countries well.”\textsuperscript{17} The Law Society welcomed the conclusions of the review and considered that the merger was “[…] long overdue.”\textsuperscript{18} The Chartered Institute of Taxation thought that the new revenue body could contribute to a better tax system and welcomed its establishment.\textsuperscript{19}

13. The Institute of Chartered Accountants of Scotland had mixed views. It told us:

“[…] the proposal to merge the Inland Revenue and Customs and Excise has met with a very mixed reception from the members of the Institute […]. Many believe that the development is logical and reflects the fact that in 1973 it would have been more sensible to give the responsibility for VAT to the Inland Revenue rather than Customs. This population believes that the merger proposal is logical and that there are obvious benefits in placing the responsibility for fiscal compliance on business taxes within the one organisation.

Others are very concerned that the proposed merger has the potential to cause difficulty to business, reducing the service which taxpayers have a right to expect and adding to costs. From past experience of the merger of the Inland Revenue and Contributions Agency, the proposal to merge the Revenue and Customs does not inspire confidence. As organisations, the Contributions Agency and the Inland Revenue had different computer systems and five years after the merger had been completed, they still have computer systems which cannot exchange information and accordingly duplicate enquiries and impose unnecessary additional costs on taxpayers in general.”\textsuperscript{20}

14. The O’Donnell review recognised that there were potentially significant human resources costs associated with the creation of a new department, and areas where there would be early priorities for investment before any savings were achieved (such as creating a common intranet for the new department). But the review considered that these costs should be viewed in the context of the potential efficiency savings.\textsuperscript{21} The O’Donnell report concluded “that on the basis of existing plans, reforms proposed by the Gershon [efficiency] review,\textsuperscript{22} and additional changes from integration, there could be scope for

\textsuperscript{16} The O’Donnell Report, para 1.20
\textsuperscript{17} Ev 45, paras 2, 3
\textsuperscript{18} Ev 58, para 1
\textsuperscript{19} Ev 40, para 2
\textsuperscript{20} Ev 44
\textsuperscript{21} The O’Donnell Report, para 1.22
\textsuperscript{22} The Chancellor announced that there would be an Efficiency Review covering the whole of public services in his budget speech in Spring 2003. The review, led by Sir Peter Gershon CBE, reported in July 2004.
overall efficiency savings equivalent to up to 14,000 jobs across the two departments by the end of 2007–08, the last year of the 2004 Spending Review period.”

15. The review noted that “risks are potentially more significant than direct financial costs. They could include risks to ‘business as usual’ (including tax collection) and the disruption of projects already planned.” But it considered that “strong management can mitigate the potential risks, with a focus on priority areas (much of the business would not be directly affected by the creation of a new department), and with a clear focus on delivery as the core business of the department, to ensure existing priorities are met and areas for change are identified.” The review concluded that “overall, the risks are outweighed by the potential long-term benefits of integration.”

16. In 2003–04 there were some 77,300 staff in the Inland Revenue and some 22,400 in Customs and Excise. The Treasury told us that the planned reduction in staffing of 14,000 was a gross figure, and that the net reduction would be 10,500 posts. The difference in these figures reflected spend to save decisions to increase the number of people working on compliance activities. The planned gross reduction of 14,000 staff comprised:

- 8,000 staff from the Inland Revenue and 3,000 from Customs and Excise as a result of existing plans and Gershon work (generally from making greater use of e-services, processes and e-filing); and

- 3,000 staff across both departments directly attributable to integration via the merger.

17. Subsequently, Mr Varney told us that the net reduction in the number of staff had increased from 10,500 to 12,500 “as a result of the Spending Review settlement and a look at […] what was expected out of the merger of the two departments.” Asked whether the 12,500 net job losses could be achieved without compulsory redundancies, Mr Varney noted that they could not be ruled out but they would try to avoid them.

18. We asked the Treasury whether they had quantified the expected costs and benefits of the merger. Mr O’Donnell told us:

“Both in terms of cost and benefit if you try to quantify them what you will find very quickly, what we did find, is that it depends very crucially on the sequencing. Precisely what those cost elements are is how quickly do you put these things together. You can go for a ‘big bang’ approach, which would bring the costs somewhat earlier and increase the risks, in my view, or you can phase it, which would phase them out over a different period. Those can give you different numbers in terms of cost. The risk implications are very different. When we come to an implementation plan which the new executive chairman and the new team will put

23 The O’Donnell Report, para 1.34
24 Ibid. para 1.23
25 Ibid.
26 Ibid.
27 Qq 44–63
28 Qq 241–243
29 Qq 246, 247
together to deliver what is purposely just a strategic goal that is laid out in the report, not a blueprint of how to do it, then will be the time to do a detailed risk analysis and quantify those risks for a particular different type of sequencing.”

19. We asked the executive chairman designate when he gave evidence to the Committee some six months later whether costs and savings had been quantified. Mr Varney noted that this had not been done as “one of the issues is the sheer size and complexity of the two organisations.”

20. Witnesses supported the proposed merger as a logical development that should in principle provide benefits to both taxpayers and the Government. We hope this proves to be the case in practice and that a detailed analysis quantifying the expected costs and benefits will be carried out as soon as practicable.

**Risks**

21. The O’Donnell review noted that “creating a new department is the most radical option, opening the way to transformational change in the way the revenue departments conduct their business. It would be a major challenge to continue effective implementation, while developing plans consistent with the vision set out in this review. It carries substantial transitional risks and costs, but also potentially the greatest rewards in terms of effective tax collection, customer service and greater efficiency, and the review assesses that the benefits significantly outweigh the risks and costs.”

22. Several witnesses were concerned about the risks posed by the merger. The Chartered Institute of Taxation expressed “some scepticism that staff reductions of the order outlined will result from using new technology, merging related functions (e.g. debt collection) and changing working practices (e.g. joint auditing) without affecting operational efficiency and customer service.” The Institute of Payroll and Pensions Management noted that “[…] it is the ‘business as usual’ approach that is vital. We have just begun the tax year that sees a significant change to PAYE, through the move to mandatory online filing for employers. We therefore need the Inland Revenue to continue to be outward looking even if it is facing huge internal reorganisation. Can one really believe that ‘much of the business would not be directly affected by the creation of a new department’ when 10,500 posts are to be lost with all the insecurity this entails?” The Institute also questioned whether the focus on priority areas would mean valuable projects were shelved.

23. The Public and Commercial Services Union (PCS) considered that for the new department to be successful “[…] it must deliver: additional yield for the Chancellor; improved support for business, employers and customers; a quality department, providing quality jobs; a national, accessible service for cities, towns and rural areas; [and] well paid, well motivated staff. PCS does not accept the proposed job losses as we believe that these

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30 Q 9
31 Q 206
32 The O’Donnell Report, para 3.116
33 Ev 41, para 11
34 Ev 50
35 Ibid.
objectives cannot be achieved with reduced staffing levels.”

The PCS acknowledged that the merger of the departments would inevitably bring rationalisation and change, but considered that “[…] ensuring that proper resources and processes are in place and involving the staff will be fundamental to the success of the new department. We believe that pre-emptive decisions and a tendency to move too fast, too soon will prove to have disastrous consequences. We therefore hope that the […] management board will take a measured and rational approach to change and to the delivery of effective public services.”

24. We asked Mr O’Donnell what assurances there were that the revenue departments could cope with the significant changes involved in the merger without disrupting tax collection and the level of service provided to taxpayers. Mr O’Donnell told us:

“I think everyone is clear both from the direction the Chancellor is giving and from the signals which we will set for the new management. They need to manage this risk of making sure that business as usual carries on in those specific mission critical projects like Tax Credit Renewal and they need that as their primary focus. It matters enormously to us that the revenue keeps coming in and Tax Credits keep being paid out. That is very much a focus. That is precisely why we are not trying to specify in this report a detailed blueprint of what they should do when. I had a personally very important and persuasive conversation with Howard Davies when I talked to him about setting up the FSA when he had the various different independent regulators and putting them into one. He said one of the things which was crucial in making a success of that is that people said to me, ‘these are the strategic objectives go and do it’. They did not say how because I actually wanted the freedom to ensure that regulation could work through that period and do it in a way which minimised the risk of a transformation when you are trying to carry on doing business as usual. That is very important and we will need to learn from successful integrations that have taken place in the public and private sector to make sure we do not let that happen. I agree that it is really important we focus on that.”

25. Mr Varney told us that ensuring tax gathering and service to the public was maintained was “very much the focus of our attention and that will be in our PSA targets and it is in the objectives we are trying to drive through. So we will be working extremely hard and diligently to make sure that happens.” The department has established a change management centre: to create the new organisation; to rationalise and prioritise the existing change programmes in each department to ensure they do not conflict and that they support the creation of the new department; and to focus performance on closing the tax gap, improving customer services and achieving efficiencies, particularly in the headcount. To ensure best practice is adopted, the department told us that it plans to establish “an advisory group where we will have individuals and organisations with direct relevant experience from both the private and the public sector and academia in this country and particularly in foreign financial services, and the tax authorities, who can give

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36 Ev 62, para 4
37 Ev 67
38 Q 28
39 Q 215
us the advice and can exchange information with us to make sure that we are picking up every trick that we should on the way.”

26. The revenue departments are among the most extensive users of information in the UK, and are heavily reliant on the IT platforms on which information is held. IT provision in the revenue departments is affected by their contractual arrangements with external suppliers. The Revenue and Customs use different models for IT provision based on their different needs, with Customs contracting with Fujitsu for infrastructure whilst outsourcing other work on a project basis or keeping it in house, while the Revenue act as an ‘intelligent client’ of a single strategic IT partner, bringing in co-partners as required. Both departments have sought to ensure flexibility within these contracts so far as is commercially realistic. Within the new department these arrangements will continue to support existing systems and services, as well as offering the option to migrate some service provision if required. In the longer term it would be possible to harmonise IT provision fully, though not without cost.

27. In January 2004, the Revenue signed the ‘Aspire’ contract with their new strategic partner Cap Gemini Ernst and Young, which will run from July 2004 to June 2014 (with the option to continue for a further eight years). The O’Donnell review noted that the Revenue “has robust plans in place to manage the supplier transition, and key stages should be completed before any new requirements from integration of the departments start to be felt. The Aspire bidding process also emphasised the capacity to support future business change. Differences in IT provision should not therefore present a barrier to integration of the revenue departments, though management will need to consider:

- their IT strategy, to what extent this will involve harmonisation of provision, and what underlying model will best serve the business needs; and
- how to ensure a collaborative approach to resolving any issues that arise, bringing in IT partners promptly, for example if there is a need to co-locate teams in offices that currently support only one department’s systems.”

28. We asked Mr Varney about the proposals for merging the departments’ IT systems. Mr Varney told us:

“[…] First of all, we are trying to bring the various IT arrangements that we have with the Inland Revenue and Customs and Excise into some coherence. We have the Aspire contract in the Inland Revenue with Cap Gemini, and in Customs & Excise we have the deal with Fujitsu. So we are talking, and I am hopeful that by the end of this year we will start the process of bringing them together. […] we have 250 major IT systems, and we have 3,000 staff, as I said, working [in IT]. It is a huge expenditure of money. We per year put out 170 million forms and we run 100 thousand desktops. So it is a big issue for us. I think what we are bringing in [in the recent recruitment of a Chief Information Officer] is expertise of somebody who has a track record of managing change in IT and delivering business benefits. We also

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40 Q 214
41 The O’Donnell Report, para 4.2 and Box 4.6
42 Ibid. Box 4.6
have to get smarter at our pre-risking and big risk minimisation projects, talking through both the IT risk and the operation.”

29. Asked when an integrated IT system was likely to be in place, Mr Varney said “it will take time, there is no getting away from that, and part of the modernisation of the PAYE system, for example, is critical to our achievement of the efficiency savings we have to make. So some of these projects are mission critical for both delivering cost and service objectives. I think we will bring what we want to bring because we bring the management potential and the discipline to the problem of investing in technology. What differentiates successful oil companies that use technology and those that are unsuccessful is essentially not the technology but the people and the attitudes.”

30. Whilst desirable in principle, merging the revenue departments is a major challenge involving significant change over a prolonged period. The Treasury and the revenue departments acknowledge that this process carries risks, but are confident they can be overcome. Other witnesses expressed doubts that existing levels of service could be maintained, particularly in view of the significant staff reductions that are planned. We note these differing views.

31. We consider that tax collection and customer service must remain the departments’ first priority during the merger process. We recommend that this be clearly articulated by Ministers and senior management to ensure that in the event of conflicting priorities it is clear which takes precedence.

Legislation: confidentiality and powers of the new department

32. The integration of the revenue departments into a single department will require primary legislation. The O’Donnell review considered that legislation, which should be brought forward when parliamentary time allows, should address the following issues:

- organisation and structure of the new department, to provide for its financing, and to define the relationship between the Treasury and the new department;
- information sharing within the revenue department, and between the new department and other bodies, subject to the need to preserve taxpayer confidentiality;
- powers of the new department to audit and investigate and to deal with non-compliance; and
- other synergies, such as an integrated debt collection facility.

33. The O’Donnell review noted that confidentiality requirements mean that disclosure of taxpayer or claimant data to other bodies, including between the revenue departments, must be legally justified—usually by a statutory gateway. The principal gateway between the revenue departments, Section 127 of the Finance Act 1972, is extensive, providing that Commissioners or authorised officers of the Revenue and Customs may disclose
information to one another and use information received from the other for the purpose of assisting them in the performance of their duties. This gateway allows officers of the revenue departments to share, for example, information relating to an individual case of fraud, or information to improve risk assessment on a specific business sector.⁴⁶

34. The review considered that:

“Although the existing gateway is extensive, the passage of legislation to create a new department […] will present an opportunity to consider how data can best be used to improve risk assessment, customer service, and policymaking. This would also present an opportunity to consider the gateways with other departments, such as DWP. […] The statutory rules in relation to particular taxes determine the obligations on customers to provide particular information at particular times, which in turn affects processes and the ways in which information can be used. For example, the Revenue may work with information from past accounting periods after the end of the three-year VAT enquiry window. Legislation also determines the departments’ powers to require information, gain access to premises and so on. For example, at present joint visits can require taxpayer consent since Customs has powers to enter premises that the Revenue does not have.

There are good reasons for different powers in some circumstances. However, the creation of an integrated department will allow an overview to be taken of powers, and their impact on information use. There is a balance to be struck between lowering compliance costs for customers, and ensuring that the right information is collected to inform future development and analysis. The right technical solutions and use of information, for example collecting basic data on a once-only basis and/or through electronic channels, can ensure that costs are lowered without leaving out data that may be important. There is therefore an important link between powers and information strategy, and the powers of the revenue department will need to be considered as part of the legislation to establish the new department […].

35. The Law Society was “pleased to see that the [O’Donnell] report recognises the legal differences between the taxes administered by the two departments, which will need to be addressed over time. As is acknowledged in [the report], there is good reason for the difference in powers. Any alignment of powers following the integration of the two departments should not result in an automatic levelling up of the powers to the highest level currently applied. The opportunity should be taken for a thorough review of all information gathering and enforcement powers. While there needs to be a credible enforcement regime with commensurate powers, the approach to be adopted should be to adopt powers which are tougher on those who are deliberately non-compliant with a lighter touch for those who are compliant.”⁴⁷

36. The Chairman of the Tax Law Committee at the Law Society also told us:

“I think the main concern, to take the criminal and civil powers, is that there should be consistency in the circumstances in which criminal powers are used across the

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⁴⁶ Ibid. para 4.20
⁴⁷ Ev 59, para 7
various categories of taxpayers, and the various taxes; that where criminal powers are to be used they are used properly—[that is] the process is human rights compliant, so that people are cautioned at the appropriate stage and have the opportunity to take advice, and this exercise seems to be a convenient opportunity to codify what the process should be, going forward. In terms of timescale […] if, as we understand it, the aim is to carry out the merger by early spring next year, then I think the review of the use of these powers will have to follow on behind, because I think it is important that the review is done properly, that there is proper consultation, and that is not going to happen in the time before next spring. So it needs to be a two-stage approach.”

37. We asked the Law Society whether any further specific safeguards on taxpayer confidentiality were needed in the forthcoming legislation. The Law Society thought that “there would be advantages in re-stating the Inland Revenue oath of confidentiality in the legislation, so it is clear on the face of the legislation that tax officials must keep […] taxpayer information [confidential].”

38. We asked the Treasury and the revenue departments what steps they were taking to review the legal powers the new department would need. The Treasury told us that it had set up a Bill unit:

“to look at all the issues relating to the new legislation that will be needed. It is a unit that will coordinate activity across the three departments to make sure that we come up with legislation that will then be put to parliament in the normal way. […] they are working very closely with colleagues in Revenue and Customs to look at the existing information legislation and what are the possible implications depending on how far one decides to go on information for the new department. These are all issues that we would just want to stress are being taken very seriously, both in terms of the potential benefits of sharing information and also the importance of preserving taxpayer confidentiality.”

39. The revenue departments noted that one of the questions they were considering was what powers were necessary for the new department to discharge its functions and whether they were proportionate and reasonable, and considered that that was what parliament would be asking itself.

40. The O’Donnell report recognised that “as a result of their different histories and tasks, Customs and the Revenue have distinct cultures. For example, Customs’ involvement in law enforcement activities has helped to condition its culture. VAT is collected in real time—this too has conditioned Customs’ culture. By way of contrast, the Revenue’s main taxes are retrospective. Whatever changes are made, it is important that the differences of the departments are recognised and their respective strengths celebrated.”

48 Q 165, 166
49 Q 135
50 Q 108
51 Q 110
52 The O’Donnell Report, Box 2.1
41. Other witnesses were concerned about the different approaches of the revenue departments and how this might impact on the new department. The Association of Chartered Certified Accountants questioned whether the contrasting cultures at the UK’s tax authorities lent themselves to a merger and considered that “the perceived problems here explained why a merger, while mooted for the last ten years or more, has never been contemplated until now.” The Association considered that:

“The Inland Revenue is more prepared to negotiate and has a more human face. By contrast, mention Customs investigators to accountants and businesspeople and exasperation sets in. Once the Revenue has made a ruling, it generally sticks to it. VAT offices change their minds more often—partly because they tend not to commit themselves in writing.

The historical background to Customs is that it was not set up as a tax collecting agency, chasing payments from people who are essentially honest. It was set up to chase smugglers. Some of that ethos persists—and it is this which needs to change if a merged entity is to operate as an effective public service agency.”

42. Mr John Whiting, Tax Partner, PricewaterhouseCoopers told us that the culture of the new department was:

“[… a] very big and major issue. I think, and the personal view of most of the practitioners that I represent would be, that we want a business-friendly, taxpayer-friendly approach, a ‘We’re all in this together, let’s cooperate’ sort of approach, because frankly that is what we as advisers and most taxpayers would want to do, rather than, [a] rather confrontational approach. How do you get that tone, assuming that is the agreed stance? Frankly, it has to come from the top, as with any organisation, therefore the new chief executive, say, must ripple down and set behaviours, and monitor it. There is a time, obviously, for hard behaviour. There is a time, if you are cracking down on drug smugglers, to take the police-type behaviour. That is fine. But for general taxpayer compliance we want to set a proper tone of ‘Let’s try and get it right together’; but if you go wrong, and deliberately wrong, obviously there is a bit of a mailed fist behind, but it is well behind, it is not the first step.”

43. We asked Mr Varney whether he accepted that a new culture was needed for the new department and what he thought that should be. Mr Varney told us:

“[…] My experience of managing the two departments is they have a range of cultures in them and there is a considerable overlap. The reason they have cultural differences is because they have got different tasks. I think one of the tricks for us is to be clear about why different cultures are appropriate in different situations. If you talk to the serious compliance people in the Inland Revenue you will find a much more law enforcement-type attitude. They may go about it in a very polite way but then they are not dealing with people who have got drugs in their possession or

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53 Ev 43
54 Ibid.
contraband cigarettes. The market gets the response which is likely to dissuade people from doing the activities that they are doing.”

44. On the question of powers for the new department, Mr Varney noted:

“Customs and Excise have come out of an environment and are part of a tax system where an entity is taxed in real time […] The Revenue has more time because they can do investigations and they can always reopen cases within a certain period of time. I think the proposition we will be putting, if the Bill is introduced, will be to keep the powers that each individual tax activity has in place and to accept that when [the new department] is up and running we will look again at the question of proportionality of powers in the context of broader institutions that exercise powers of enforcement.”

45. Merging the revenue departments to create Her Majesty’s Revenue and Customs requires legislation. It appears that a two-stage approach is to be adopted. The bill to create the new department will transfer the existing powers to require information, gain access to premises and so on unchanged. Consideration of what powers the new department needs to discharge its functions and whether they are proportionate and reasonable is to be delayed to a later date.

46. We recognise the pragmatic nature of such an approach to minimise any delays to the merger and to reaping the benefits that are expected from it. However, we are concerned that the powers the new department needs to discharge its functions should be subject to proper parliamentary scrutiny. We would therefore welcome a firm commitment from the Government to introducing ‘second stage’ legislation as soon as possible and recommend that this be in the form of a draft bill.

**Tax policy-making**

47. The O’Donnell review’s remit included examining “the most appropriate structure for providing policy advice to Ministers, currently spread across three departments and mainly based around individual taxes.” The review concluded that there should be a new division of work between the Treasury and the new department, designed to build upon their comparative advantages. The Treasury would lead on strategic work and policy development, and the new department would lead on policy maintenance and delivery. To ensure continued joining up and partnership working, both departments would assist the other in the discharge of its duties. As part of this, the Treasury’s capacity to advise on tax policy should be enhanced.

48. On 11 October 2004 the Paymaster General announced that in line with the recommendations of the O’Donnell review the new arrangements separating the development from the maintenance of tax policy were now in operation. The Treasury had assumed responsibility for policy development, working very closely with the Inland...
Revenue and Customs and Excise. The new tax office in the Treasury has some 150 staff, about half of whom had transferred from Customs and Excise and the Inland Revenue.

49. There were concerns that these new arrangements would detach policymaking from implementation and operation. The Institute of Chartered Accountants in England and Wales noted:

“The O’Donnell Report proposes that the Treasury will be responsible for tax policy making and that the new merged Revenue Department will deal with policy implementation. Whilst we can see that this should lead to a wider strategic overview and to more joined-up tax policy making, which has been another of our concerns, there is a danger that this will widen the gulf which undoubtedly already exists between policy and operational issues.”

PricewaterhouseCoopers stated:

“We note the moves of the policy-making sections of the IR and C&E to the Treasury building. There are clear opportunities here in terms of ‘joined up’ policymaking. However, we do wonder how this will impact on the connection between policy and operations. In both the IR and C&E there can be times when policy is handed over to be implemented with operational staff seemingly under-prepared and under-supported (the recent introduction of Stamp Duty Land Tax is an example). There is a risk that the policymaking of the combined body becomes more detached from the implementation and operation, and indeed from practical experience. This is something to be guarded against: we hope that the policymaking groups will strive to maintain proper dialogue with users.”

50. In response to these concerns the Director of Tax Policy at the Treasury told us that they had considered moving tax policy-making to the Treasury in total, but had rejected that option because of concerns about “the potential that you would break up the link between policy and delivery” and because:

“[...] you would have real issues then about taxpayer confidentiality because to do detailed policy development and operational policy development you would need to go down to the records of individual businesses or potentially individual personal customers and, given that we do not want to go anywhere near undermining taxpayer confidentiality, that was another key argument for why we ruled out what might, on paper, look like a cleaner break. What we think we have got is something where we would be working in partnership to deliver on government objectives.”

59 Written Ministerial Statement, 11 October 2004
60 Q 269
61 Ev 52, para 13
62 Ev 45, para 9
63 Q 117
64 Ibid.
51. We asked Mr O’Donnell what impact the transfer of some responsibilities for tax policymaking to the Treasury would have on protecting taxpayer confidentiality. He told us that:

“[… ] maintaining taxpayer confidentiality is vital. The Chancellor made it absolutely clear to me at the start that under no circumstances should anything we do damage that. I think that is absolutely vital. You are absolutely right that we will be working more closely in partnership but that partnership only goes so far. When it comes to data sources, individual taxpayer records, individual company records there will be very clear firewalls, our computer systems will not be able to interact with their systems for that kind of data, hence when we looked at putting together a tax analysis group at one point we thought why do we not put this in the Treasury and we decided in the end it would be much better to be in the new integrated department precisely because of this data access point. It will be, if anything, strengthened and we will ensure that there is no access by Treasury officials or Treasury Ministers or special advisers to individual tax records.”65

52. The Treasury has assumed responsibility for tax policy development and has an additional 150 staff, half of whom have transferred from the revenue departments, for this work. We endorse steps to strengthen the Treasury’s capacity in this area, but note the concerns that the arrangements adopted may detach policy-making from implementation and operations.

53. The transfer of responsibility for tax policy development to the Treasury and the move of some Customs and Excise and Revenue staff to the Treasury building have raised concerns about confidentiality. We welcome the commitment given to maintaining taxpayer confidentiality and the assurance that there will be no access by Treasury officials or Treasury Ministers or special advisers to individual tax records and recommend that this principle be carried forward into the bill.

**Ministerial accountability**

54. The O’Donnell review noted that the creation of the new revenue department presents an opportunity to modernise the accountability arrangements, and to improve clarity about who is responsible to whom, for what. The review recommended that:

- “the new department should, like its predecessors, be a non-ministerial department, as an underpinning of customer confidentiality;

- each year the Chancellor should issue a Remit to the Executive Chairman outlining the new department’s main new and ongoing tasks. This should be focussed on what should be achieved, and why, rather than how, which should be a matter for the new department;

- a Framework Document setting out who is accountable to whom, for what, in the new department, should be published. The Framework will be an opportunity for Ministers to set out long-term principles to govern the work of the department; and
structures should be established to ensure that the Treasury and the new department have a close dialogue, developing a shared view of key issues, and agreeing advice to the Chancellor on the form of the annual Remit.\textsuperscript{66}

55. On 4 October it was announced that the Paymaster General would be the departmental minister for HM Revenue and Customs.\textsuperscript{67} According to an updated list of ministerial responsibilities on the Treasury website, the Paymaster General’s responsibilities also include “strategic oversight of the UK tax system as a whole including direct, indirect and corporate taxation, capital gains tax, inheritance tax and VAT.”\textsuperscript{68} The Economic Secretary’s responsibilities include “environmental issues including transport taxation and lorry-road user-charge”\textsuperscript{69} and “excise duties and gambling.”\textsuperscript{70} Mr Varney told us that he was accountable to three Ministers as, in addition to the Paymaster General and the Economic Secretary, he reported on some issues to the Financial Secretary.\textsuperscript{71}

56. We welcome steps to modernise the accountability arrangements that will apply to the new department. We support the introduction of a Framework Document setting out who is accountable to whom, for what, in the new department, and the proposal that the Chancellor issue an annual Remit to the Executive Chairman outlining the department’s main new and ongoing tasks.

57. However, we note that the Executive Chairman will be reporting to three Treasury Ministers on various aspects of the new department’s work, an arrangement which, at least in theory, appears cumbersome. We recommend that this aspect of the new arrangements be reviewed in the light of practice after the new department has been created.

\textsuperscript{66} The O’Donnell Report, page 111, and para 6.2
\textsuperscript{67} Written Answer, 4 October 2004
\textsuperscript{68} The website information is reproduced at Ev 68
\textsuperscript{69} Ibid.
\textsuperscript{70} Ibid.
\textsuperscript{71} Qq 273, 274
Conclusions and recommendations

The case for merger

1. Our predecessors concluded in April 2000 that the merger of the Inland Revenue and Customs and Excise would “improve compliance with taxation, reduce businesses’ compliance costs and reduce the Government’s revenue collection costs” and recommended that such a merger should proceed. We are pleased to note that the Government have now accepted that recommendation. (Paragraph 10)

Expected costs and benefits

2. Witnesses supported the proposed merger as a logical development that should in principle provide benefits to both taxpayers and the government. We hope this proves to be the case in practice and that a detailed analysis quantifying the expected costs and benefits will be carried out as soon as practicable. (Paragraph 20)

Risks

3. Whilst desirable in principle, merging the revenue departments is a major challenge involving significant change over a prolonged period. The Treasury and the revenue departments acknowledge that this process carries risks, but are confident they can be overcome. Other witnesses expressed doubts that existing levels of service could be maintained, particularly in view of the significant staff reductions that are planned. We note these differing views. (Paragraph 30)

4. We consider that tax collection and customer service must remain the departments’ first priority during the merger process. We recommend that this be clearly articulated by Ministers and senior management to ensure that in the event of conflicting priorities it is clear which takes precedence. (Paragraph 31)

Legislation: confidentiality and powers of the new department

5. Merging the revenue departments to create Her Majesty’s Revenue and Customs requires legislation. It appears that a two-stage approach is to be adopted. The bill to create the new department will transfer the existing powers to require information, gain access to premises and so on unchanged. Consideration of what powers the new department needs to discharge its functions and whether they are proportionate and reasonable is to be delayed to a later date. (Paragraph 45)

6. We recognise the pragmatic nature of such an approach to minimise any delays to the merger and to reaping the benefits that are expected from it. However, we are concerned that the powers the new department needs to discharge its functions should be subject to proper parliamentary scrutiny. We would therefore welcome a firm commitment from the Government to introducing ‘second stage’ legislation as soon as possible and recommend that this be in the form of a draft bill. (Paragraph 46)
Tax policy-making

7. The Treasury has assumed responsibility for tax policy development and has an additional 150 staff, half of whom have transferred from the revenue departments, for this work. We endorse steps to strengthen the Treasury’s capacity in this area, but note the concerns that the arrangements adopted may detach policy-making from implementation and operations. (Paragraph 52)

8. The transfer of responsibility for tax policy development to the Treasury and the move of some Customs and Excise and Revenue staff to the Treasury building have raised concerns about confidentiality. We welcome the commitment given to maintaining taxpayer confidentiality and the assurance that there will be no access by Treasury officials or Treasury Ministers or special advisers to individual tax records and recommend that this principle be carried forward into the bill. (Paragraph 53)

Ministerial accountability

9. We welcome steps to modernise the accountability arrangements that will apply to the new department. We support the introduction of a Framework Document setting out who is accountable to whom, for what, in the new department, and the proposal that the Chancellor issue an annual Remit to the Executive Chairman outlining the department’s main new and ongoing tasks. (Paragraph 56)

10. However, we note that the Executive Chairman will be reporting to three Treasury Ministers on various aspects of the new department’s work, an arrangement which, at least in theory, appears cumbersome. We recommend that this aspect of the new arrangements be reviewed in the light of practice after the new department has been created. (Paragraph 57)
Formal minutes of the Committee and the Sub-committee relating to the Report

Sub-committee

Wednesday 3 November 2004

Members present:

Mr Michael Fallon, in the Chair

Mr Nigel Beard  Mr John McFall
Mr Jim Cousins  John Mann
Angela Eagle  Mr James Plaskitt
Norman Lamb  Mr Robert Walter

The Sub-committee deliberated.

Draft Report (The Merger of Customs & Excise and the Inland Revenue), 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 57 read and agreed to.

Resolved, That the Report be the Third Report of the Sub-committee to the Committee.

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

Several papers were ordered to be appended to the Minutes of Evidence

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the Committee.—(The Chairman.)

[Adjourned till Wednesday 17 November at 2.15 pm]
Main Committee

Wednesday 3 November 2004

Members present:

Mr John McFall, in the Chair

Mr Nigel Beard  Mr Jim Cousins  Angela Eagle  Mr Michael Fallon
Norman Lamb  John Mann  Mr James Plaskitt  Mr Robert Walter

Draft Report from the Sub-committee (The Merger of Customs & Excise and the Inland Revenue), brought up and read.

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

Paragraphs 1 to 57 read and agreed to.

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

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

Ordered, That the Appendices to the Minutes of Evidence taken before the Sub-committee be reported to the House.—(The Chairman.)

[Adjourned till Tuesday 9 November at 9.15 am]
Witnesses

Wednesday 28 April 2004

Mr Gus O’Donnell CB, Permanent Secretary, and Mr Dave Ramsden, Director, Tax Policy, HM Treasury, Ms Helen Ghosh, Director General, Corporate Services, Inland Revenue and Mr Michael Hanson, Director General, Business Services and Taxes, HM Customs & Excise

Wednesday 12 May 2004

Mr Chas Roy-Chowdhury, Head of Taxation, Association of Chartered Certified Accountants, Mr Mark Lee, Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales, Mr Mike Hardwick, Chairman, Tax Law Committee, The Law Society, Mr John Whiting, Tax Partner, PricewaterhouseCoopers, Chairman, Tax Policy Sub-Committee and Past President of the Chartered Institute of Taxation

Wednesday 13 October 2004

Mr David Varney, Executive Chairman, Mr Paul Gray, Deputy Chairman, and Ms Ann Chant CB, Director General, Change Management Centre, HM Customs & Excise and the Inland Revenue
Written evidence

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* Government Responses are usually received in the same session as the Report was published. Accordingly, the HC number refers to that session unless otherwise indicated.
Oral evidence

Taken before the Treasury Sub-Committee

on Wednesday 28 April 2004

Members present:

Mr Michael Fallon, in the Chair

Mr Nigel Beard
Mr Jim Cousins
Angela Eagle
Mr David Heathcoat-Amory

Norman Lamb
Mr John McFall
Mr James Plaskitt

Witnesses: Mr Gus O’Donnell CB, Permanent Secretary, HM Treasury, Mr Dave Ramsden, Director, Tax Policy, HM Treasury, Ms Helen Ghosh, Director General, Corporate Services, Inland Revenue and Mr Michael Hanson, Director General, Business Services and Taxes, Customs & Excise, examined.

Q1 Chairman: Permanent Secretary, welcome back to the Committee, can you introduce yourself and your team formally, please?

Mr O’Donnell: I am Gus O’Donnell, I am the Permanent Secretary of Treasury and leader on this particular review. On my right is Dave Ramsden who is in charge of the review team and now a Director in Treasury’s Budget and Public Finance Directorate and deals with tax issues. On my left is Michael Hanson who is the Director General of Business Services and Taxes in Customs & Excise. On his left Helen Ghosh who is Director General of Corporate Services at the Inland Revenue. Helen and Mike can answer questions about the Department’s on-going work. We will happily talk about the Treasury end, the review, the tax policy and all of the rest of it. I would like to say at the start it is really nice to be here in front of the Committee where we are meeting a recommendation put forward by this Committee some four years ago. There was a recommendation by a select committee of the House 140 years ago which by a majority, not unanimously, suggested there should be merger. We got there in the end.

Q2 Chairman: We will come to our recommendations shortly and you will be able to explain why you turned it down four years ago. Perhaps we can begin with your response to our Committee’s report on some of the Inland Revenue problems last year when you said: “the initial conclusions from the review will be available at the time of the Pre-Budget Report so that the next steps can be considered”. In fact that did not happen. Why did it not happen and why was there not any consultation on this?

Mr O’Donnell: As we started work on this I had a very open mind about where we would go and I wanted to consult with a number of people informally as we went along. In fact we had very extensive discussions with the unions, with business groups, with IMF, with OECD. Very early on we decided we needed to look at international experience so we visited a number of countries, a number of different people and we had a number of workshops. There was a lot of work going on and we were basically not in a position to come up with anything very definitive at the PBR time. In particular it was becoming apparent that integration of the two departments was a very serious contender. What I wanted to do was make sure that we had some private sector input, some detailed private sector input for people to come in and look at emerging conclusions and say: “Is this a bunch of civil servants sitting down that are coming out with an answer without thinking about this in the way that the private sector would. Hence the use of external reviewers, people who had experience of integration in the private sector or someone like Martin Taylor who has a lot of private sector experience but had also worked with Customs and separately with Revenue on specific projects and knew the cultures and the ways of operating of the two departments, getting them to look at where we were coming out and give us an idea about whether what we were doing was workable or not. Hence we asked them to publish their letters to us and that is included in the review.

Q3 Chairman: That is not quite the point I was getting at. You implied there would be a document to consult at the time of the PBR but in fact you simply published your conclusions.

Mr O’Donnell: The general view of the Chancellor as I discussed this with him was it would be better for all concerned if we made it clear that there was a strategic decision by Government that this is the way they wanted to go and there would be consultation about the way in which we implemented that strategic conclusion.

Q4 Chairman: We recommended it back in April 2000 but you turned it down, you talked about the risks, the costs and upheaval which merger would inevitably entail and four years later you are in favour of it. What happened?

Mr O’Donnell: Like I say there is a long history to this, we could go back to the Royal Commission.
Q5 Chairman: Go back four years, why have you changed your mind in four years?
Mr O’Donnell: I wanted to bring in Gladstone who was very strongly in favour of bringing the two together.

Q6 Chairman: Why now?
Mr O’Donnell: In 2000 what we did was start a process of closer working between the Departments, this started back in 1994 and it was extended in 2000. The experience of having closer working, particularly things like Joint Shadow Economy Teams, JoSETs as they are known, was they produced good benefits but they were in very limited areas. The closer working was because we were taking people from Revenue and Customs and getting them involved in joint projects that was fine but the department still had their own priorities and their own objectives. In order to make this bigger across the board it was quite clear to all of us in Treasury, Revenue and Customs that closer working whilst producing good results was not going to produce the really big benefits which you could get from a more radical change. At the same time we were having other machinery of Government changes, like DWP coming into existence, which taught us about a lot about merging organisations in the public sector. In general with the increasing strategic focus on delivery and efficiency that has led us to a situation where we have thought again.

Q7 Chairman: When you turned it down you referred to the opportunity costs, just now you have said you have established big benefits, but there is nothing in this book of yours about the costs or the benefits that is quantifiable, why is there not?
Mr O’Donnell: Let us talk about the costs first of all, there may well be some transition costs in terms of some HR issues and the like, there may be some opportunity costs and management time devoted to some things rather than other things, these are relatively small numbers. When you look at the benefits, and I would pick out three areas, improved customer service, reducing the tax gap and increasing efficiency. When you look at the kind of numbers associated with those, particularly on the tax gap area, you get very, very large numbers. An old-fashioned cost benefit might have given you a number which gave you a very large big plus with the costs being earlier but the benefits being later and very large. However, what we have focused on here is once that becomes apparent you then focus on the risks and I think the risk element is really important in this because there are some issues to do with how you manage the risks to make sure that you deliver those benefits and you manage the risk that you will not keep your eye on the ball and there will be some questions about managing those critical projects which we have at the minute and how we can best manage those. We think that we can find ways of mitigating those risks. My general principle in these attitudes is that in the Civil Service we should not throw up our hands when people say there are risks, what we should do is manage those risks and do all we can to mitigate them.

Q8 Chairman: You cannot manage them without quantifying them. Which other Government department would you allow to merge two bodies without quantifying, even if they are miniscule, the costs and the benefits, even if they are large?
Mr O’Donnell: We have identified them.

Q9 Chairman: You have not quantified them.
Mr O’Donnell: Both in terms of cost and benefit if you try to quantify them what you will find very quickly, what we did find, is that it depends very crucially on the sequencing. Precisely what those cost elements are is how quickly do you put these things together. You can go for a “big bang” approach, which would bring the costs somewhat earlier and increase the risks, in my view, or you can phase it, which would phase them out over a different period. Those can give you different numbers in terms of cost. The risk implications are very different. When we come to an implementation plan which the new executive chairman and the new team will put together to deliver what is purposely just a strategic goal that is laid out in the report, not a blueprint of how to do it, then will be the time to do a detailed risk analysis and quantify those risks for a particular different type of sequencing.

Q10 Chairman: Can I ask you about confidentiality, there is a box in your Report where you say: “Because the Revenue departments are separate from the Treasury they are able to protect taxpayer confidentiality”. Now that you are merging them virtually into the Treasury and putting them in the same building as the Treasury, what steps are you taking to enhance confidentiality? What are you doing to stop a minister or a special adviser asking for a company’s or individual’s tax file?
Mr O’Donnell: I totally agree with you that maintaining taxpayer confidentiality is vital. The Chancellor made it absolutely clear to me at the start that under no circumstances should anything we do damage that. I think that is absolutely vital. You are absolutely right that we will be working more closely in partnership but that partnership only goes so far. When it comes to data sources, individual taxpayer records, individual company records there will be very clear firewalls, our computer systems will not be able to interact with their systems for that kind of data, hence when we looked at putting together a tax analysis group at one point we thought why do we not put this in the Treasury and we decided in the end it would be much better to be in the new integrated department precisely because of this data access point. It will be, if anything, strengthened and we will ensure that there is no access by Treasury officials or Treasury ministers or special advisers to individual tax records.

Q11 Chairman: How do you ensure that if they are in the same building using the same cafeteria, walking the same corridor? Is there a statutory safeguard?
Mr O’Donnell: I think there are statutory safeguards for confidentiality at the moment. At the moment the computer systems interact. For a computer being
in the other half of the building is not any different from where we are to Somerset House. That geographical proximity will not make any difference in that respect.

Q12 Chairman: There is a board, there is a separate department.
Mr O’Donnell: That will not change.

Q13 Chairman: That will not change?
Mr O’Donnell: No, absolutely not. There will be a separate board with the same juxtaposition vis-à-vis the Treasury, that will not change at all.

Ms Ghosh: The way we do it through our IT systems in the Inland Revenue, and I imagine it is the same is true within Customs, is to have firewalls. For example I personally as a board member could not go into our PAYE system or our Tax Credit system sitting at my desk. Only certain people have access to certain bits of data and that would persist through any new arrangements. We have practical operational safeguards against it happening.

Q14 Chairman: You do accept the need, given that everyone is going to be virtually in the same building, to give greater reassurance that politicians cannot look into people’s tax affairs?
Mr O’Donnell: Absolutely. I strongly support that and so does the Chancellor.
Chairman: Angela Eagle.

Q15 Angela Eagle: In your review you concentrate on three options, what you call the status quo plus, which is the series of change which is going on to implement the policies and accountability now. You also talked about a possible option of strategic alignment, which seems to me to be a slow motion merger over a longer time or the creation of a new department more immediately, what led you to conclude that this last one, the creation of a new department, was the right way to proceed?
Mr O’Donnell: In terms of status quo plus that would be seeing could we make closer working go further. All of the experience we had, and I think this is borne out in the workshops we had with Inland Revenue and Customs staff, this was limited, it was beneficial as far as it went but it was not going to make a significant difference. Strategic alignment was an interesting concept which was a bit of a halfway house and tried to get some of the benefits without going the full way to merger. The great problem with it was that it turned out to be the riskiest and the most uncertain of all outcomes because when we discussed this with people they said, “you are going to have a merger but you are going to do it on the quiet, you are going to start with this, lull us into a false sense of security and then move all of the way”.

We generally took the view that if we thought integration was the right thing to do then we should just move straight to it. All of the private sector reviewers that looked at the issue came to exactly the same position.

Q16 Angela Eagle: And a declaration at the beginning that was what your intent was.

Mr O’Donnell: It meant there were not disputes where some people would say, they have gone this way but let us try and ensure we go back to where we were, our comfort zone, this is all still to play for and you would have people trying to go for their specific desired outcome. I thought it was better to be very clear about the strategic directions.

Mr Ramsden: Can I add, there was also a point to do with accountability, we were worried that the strategic alignment option would not clarify accountability, which was a key element in the remit we had been given, you would have one body responsible for strategy and then two boards below it still responsible for the running of the individual departments.

Q17 Angela Eagle: A clean break with the past in that sense. You say in your Report there would be improvements to customer services for those that interact with the Revenue and Customs, that compliance costs for individuals will go down, there will greater effectiveness, it is a great story, can you give us some kind of vision about how you expect the arrows to be going up and down in that way in essence? What will it look like after the merger has been completed for an individual taxpayer or a business which might at the moment be interacting with both Customs & Excise and the Revenue? How will it look from the other end of the telescope?

Mr O’Donnell: Say it is a small business that is interacting, at the moment they will have to interact with Customs on VAT issues and give a whole amount of information on turnover, all sorts of issues to do with Customs. Then they will interact with Inland Revenue on the corporation tax or income tax. What you will find is they will have to repeat a lot of the same information, in some cases they may have to operate on paper, in other ways through the internet. If you imagine a system—let me give you a vision of where I would like us to be—where there is a one-stop-shop, a small business goes into the integrated department through e-mail that will make life much more efficient because the small business will have its accounts on its computer to start with, it will be able to fed directly in, there will be one set of information, they will have to give that information only once so the customer, the business, will gain. The integrated department will gain because it is much more efficient for them to deal with information which comes through “e” services rather than paper, so there will be an efficiency gain there. There is also a tax gain in that the information that they provide we will know is consistent between the information they provide on profits and turnover and that will allow us in our work on compliance to target work where some anomalies will appear but we will have all of that information and that will mean there are win/wins in this. That is what is so attractive about it.

Q18 Angela Eagle: What about the individual taxpayer?
Mr O’Donnell: Insofar as their activities cut across both areas that is a relatively small amount. I think individual taxpayers say with regard to their income
tax there are lots of potential gains along the way. The big growth in e-filing will help, the ability to contact the Inland Revenue by phone through contact centres. In one of the contact centres I visited as part of the review you can phone them and instead of having to write or wait for a reply and the reply may not cover everything you want you can phone them, they can get their get tax records up in front of them, they can answer your queries immediately, if there are any follow on queries you can ask them there and then and get it sorted out immediately. Those contact centres are up and running now and they will be improved. Last year the Inland Revenue took 36 million calls from tax payers. I think there will be gains from learning from the two different tax departments and the ways the used e-filing. Customs are some way ahead in certain respects.

Q19 Angela Eagle: Do you think the gains you are making here are all about e-filing and introducing that kind of access because that is what you seem to be hinting at in your answers?

Mr O'Donnell: That is one of the things. The other part to stress is there is information sharing, we have the ability to put that information together, which will be very good news for honest tax payers, that will increase efficiency, and it is extremely bad news for dishonest taxpayers because we will be able to catch them more easily. That good news will mean honest taxpayers have to pay less because dishonest tax payers will not be getting away with as much.

Q20 Mr Beard: One of your external examiners Martin Taylor said “there are three important prizes, reduction of the tax gap, better services to compliant taxpayers, particularly shared customers and cost reductions across the three departments. In the private sector the last of these would have often come first, here the reduction of the tax gap is by far the bigger prize and should be the priority rather than cost. If ministers decide for a new organisation this should be made clear to new management who should not be judged primarily on the attainment of secondary objectives”. Do you agree with that?

Mr O'Donnell: In essence we want all of those objectives because certainly in terms of the numbers I think when you talk about small changes in the tax gap those numbers in terms of hundreds of millions of pounds generated will be bigger than you will generate through efficiency savings. I think these things go together. When we establish the PSA targets, which we will do as part of the Spending Review in July, there will be targets which relate to all of these items.

Q21 Mr Beard: What is the tax gap in your estimation?

Mr O'Donnell: I can give you specific answers but let me give you the bit which is on the bottom of the cigarette packet first, a lot of work has been done in Customs to work out the VAT gap, the difference between what we collect and the theoretical yield. At the moment we are at something like 88% of the theoretical yield, we moved up from 86% on VAT. The 12% from 88 to 100 is 12 billion roughly. Big numbers.

Q22 Mr Beard: What about the Inland Revenue? Mr O'Donnell: When it comes to doing this for direct taxes it is rather more complicated. I stress working on these theoretical tax yields is difficult. In the Report we try to give some orders of magnitude. We know for the US their estimated tax gap is about 12.8%, for Sweden it is round 8% of total revenue and we have said for the United Kingdom it is broadly round the same magnitude.

Q23 Mr Beard: What is that in numbers? Mr O'Donnell: 8% of 325 billion is the answer—about 20 to 30 billion.

Q24 Mr Beard: Are you going to give the new organisation a target of what you expect them to make up in those tax gaps over a certain number of years? Mr O'Donnell: We are doing this already on the Customs side on VAT, that is part of the way that we do things. This is for consideration in the PSA target for this Spending Review as to whether we do this more generally.

Q25 Mr Beard: What sort of target do you have in mind? Mr O'Donnell: Looking at what we have done on the VAT side across taxes in general. I stress that is for decision as part of the Spending Review.

Q26 Mr Beard: When you say these three benefits will all have the same sort of priority, does that mean none of them will have any sort of priority? Mr O'Donnell: I do not think of them in the sense of trade offs against each other. When we do a lot of the e-transformation business that will help us with our compliance work hence reducing the tax gap and improving customer service. They all go together. Obviously the Chancellor will bear in mind when he thinks about how to allocate his resources the relative benefits from each of the different sources.

Q27 Mr Beard: You said in the Report: “The Revenue department have managed successfully a significant amount of change in recent year achieving better service to their customers, the introduction of several new services and more efficient administration”. How confident are you that both departments can cope with these significant changes you are proposing now? The record of IT projects is not encouraging and recently you have had difficulties with the Tax Credit system? Mr O'Donnell: Let us put it in context, if you think about IT and Government, who was first in getting into IT and delivering public services through the internet, it was the Inland Revenue. If you looked at the Report that the e-envoy gave, of the “e” transactions which were going through the Government internet service 98% of them were Inland Revenue, so they were there before anybody else. When you are first you are obviously going to
face some of the risks of being first and it is certainly true that there were problems with Tax Credits. The Department is very keen to learn the lessons of those and we are looking at Tax Credit renewals now and that is being managed. As you know the Revenue are going through a period now where they are moving their IT supplier away from EDS, things are changing. I think having been very early into this business they are in a position to learn from what went wrong and what did not in the past and move forward and develop these services more clearly.

**Q28 Mr Beard:** What assurances can you give this Committee that we will not be sitting here in twelve month’s time listening to a story of disrupted tax collection and poor service for the taxpayer arising out of this merger?

**Mr O’Donnell:** I think everyone is clear both from taxpayers you want a culture that is very customer-the direction the Chancellor is going and the new management. makes the whole transaction as straightforward and They need to manage this risk of making sure that that is being managed. As you know the Revenue are going through a period now where they are moving their IT supplier away from EDS, things are changing. I think having been very early into this business they are in a position to learn from what went wrong and what did not in the past and move forward and develop these services more clearly.

**Q29 Mr Heathcoat-Amory:** These are different taxes. Customs famously has greater enforcement powers going back to the days of smuggling brandy and all of the rest it being smuggled in. These are quite important. They are not both trying to do the same thing, they are dealing with different sorts of taxes and quite often dealing with different people. It may look fine from Whitehall to push all this together into one huge department, it always looks fine from the top. I want to get at what the driver of this is, you mentioned risks, are these risks for government or for the taxpayer? If there is a fiasco here it is taxpayers that are going to be jerked round and there will be nothing they can do about it. I am very worried, you say that you have identified risk, it is all about managing risk, what about quantifying the risk and in particular quantifying the risk for the taxpayer? What consultation have you carried out with those people who may be affected? Why did you not do this before you made the decision rather than make the best of it afterwards?

**Mr O’Donnell:** If you go back to 1994, as you say it was a perfectly reasonable conclusion, it was the conclusion of the first Royal Commission in 1889 that closer working was the answer for the two boards and the reality is in some areas like the Joint Shadow Economy Teams it did very well but what that led me to believe is there are lots of potential gains here, particularly with information sharing. You talked about cultures, and I agree with you there is a culture issue here. If you think about it, what you need is an organisation which is capable of managing different cultures within itself. For honest taxpayers you want a culture that is very customer-friendly, which informs people what to do and makes the whole transaction as straightforward and efficient as possible. For dishonest taxpayers and where there is fraud going on you need a very tough, robust approach I think. The organisation needs to have that mix of cultures, it is not that you need one organisation with one culture and one with a different culture I think we need one organisation which has the capacity to deal with customers in a different way depending on where they come from.

If closer working had been a great success, and we talked to Revenue and Customs—and colleagues from Revenue and Customs might want to add to this—they were the ones who said, “this has gone well but it is really very limited because we each have our individual priorities set by our boards and closer working is not top of these priorities”.

**Q30 Mr Heathcoat-Amory:** These are different taxes. Customs famously has greater enforcement powers going back to the days of smuggling brandy and all of the rest it being smuggled in. These are quite important. They are not both trying to do the same thing, they are dealing with different sorts of taxes and quite often dealing with different people. It may look fine from Whitehall to push all this together into one huge department, it always looks fine from the top. I want to get at what the driver of this is, you mentioned risks, are these risks for government or for the taxpayer? If there is a fiasco here it is taxpayers that are going to be jerked round and there will be nothing they can do about it. I am very worried, you say that you have identified risk, it is all about managing risk, what about quantifying the risk and in particular quantifying the risk for the taxpayer? What consultation have you carried out with those people who may be affected? Why did you not do this before you made the decision rather than make the best of it afterwards?

**Mr O’Donnell:** We have talked to small business groups and to large business groups and in general the reaction of nearly all business groups has been strongly favourable. I can give you the quotes from the Institute of Directors, the CBI, from the tax accountants, the tax lawyers, a very widespread view that this is sensible. This is not a new view, if you go
back to 1863 the Mercantile witnesses, as they were referred to, were all strongly in favour of integration of the two departments, even then they thought it was very good for business. We focused on what is good for outcomes here and we believe that if you are a small business there are clear gains from not having to deal with two different organisations, and that is precisely what businesses said to us when we asked them about it. That is the feedback we got, they think that a merger will make their lives easier.

Q31 Mr Plaskitt: Mr O’Donnell the Revenue Departments between them spend £4.2 billion on administration, how much of that is the merger going to save?
Mr O’Donnell: We have not gone with specific function rather than by tax. The functions are ongoing to save? organising the new department by customer and by administration, how much of that is the merger than looking at it tax by tax, looking at it by Departments between them spend £4.2 billion on distribution of resources will be much more sensible

Ms Ghosh: The merger will be one element in it. A substantial element, which we might get on to later, is the efficiency savings which all departments are being asked to find following the Peter Gershon Efficiency Review.

Q32 Mr Plaskitt: I was going to come to those in the bit if you do not mind. You say in paragraph 1.13 that savings and administration costs will be large, so you have some idea of the sorts of figures we are talking about. Is there a percentage of that 4.2 billion which is likely to be saved that you have in mind?
Mr O’Donnell: The reason I am reluctant is that what I want is for the new management to specify their plans to deliver the PSA targets which will be set in July and these may well be associated with efficiency savings. What we know is in terms of fineness we have now set the finances for Inland Revenue and Customs & Excise for the period out to 2008. The Chancellor announced in the Budget they will be operating with flat cash. They will have to deliver their PSA targets with real reductions notice in their budgets. We can quantify how much those are, that goes into hundreds of millions.

Ms Ghosh: The people you are paying

Q33 Mr Plaskitt: Is that what larges means?
Mr O’Donnell: I call hundreds of millions large. Ms Ghosh: From the purpose of the two departments from our point of view the flat cash savings represent about £300 million a year by 2008 and for Customs it is about £150 million.

Q34 Mr Plaskitt: You are counting into the savings the no cash growth?
Ms Ghosh: Yes. In order to achieve no cash growth—

Q35 Mr Plaskitt: It is not administrative spending but it is going down in nominal terms as no cash growth. You are taking that as saving—
Ms Ghosh: Yes.

Q36 Mr Plaskitt: —but it is facilitated by the merger?
Ms Ghosh: Indeed.

Q37 Mr Plaskitt: You could not have done it without the merger?
Q45 Mr Plaskitt: Was that FTE or head count?
*Mr O’Donnell:* FTE.

Q46 Mr Plaskitt: So the FTE is 100,000?
*Mr O’Donnell:* Yes.

Q47 Mr Plaskitt: Of that you are suggesting that the efficiency savings will take out 14,000 of those jobs, that is 28 April 2004  The Merger of Customs & Excise and the Inland Revenue

Q48 Mr Plaskitt: Is that right?
*Mr O’Donnell:* Yes.

Q49 Mr Plaskitt: Gross reduction. So what would a net reduction be? If you roll forward and look at your anticipated head count in April 2008, what figure would be there as opposed to the 100,000 that is there now?
*Mr O’Donnell:* That would be the ten and a half thousand net change.

Q50 Mr Plaskitt: Downwards?
*Mr O’Donnell:* Yes.

Q51 Mr Plaskitt: So it would be down by 10%, the head count, roughly?
*Mr O’Donnell:* Yes. The distribution of that, of the 14,000, is 8,000 from Inland Revenue; those are the results of existing plans and Gershon work, 3,000 for Customs, and an estimate for 3,000 that is directly attributable to integration via merger.

Q52 Mr Plaskitt: Which departments will that final 3,000 come out of?
*Mr O’Donnell:* Across both.

Q53 Mr Plaskitt: Evenly across both or in ratio?
*Ms Ghosh:* It will be the new department by then so it is an artificial distinction to draw.

Q54 Mr Plaskitt: They were working in one of the two before, were they not?
*Ms Ghosh:* They were, but we will not by 2008 be defining people in those terms.

Q55 Mr Plaskitt: It is 48 months from now until the point when you have got those 10,000 out, so when does the process start of taking the numbers out, removing folk from jobs?
*Ms Ghosh:* Effectively it has started. If I could say a bit about the plans of the two departments?

Q56 Mr Plaskitt: Between now and 48 months’ time what is the approximate timetable for taking the 10,000 jobs out? Evenly across the period or in lumps at certain times?
*Ms Ghosh:* No. Inevitably the process will build up over time because of the way we will achieve the savings. For us—and I think it is a very similar pattern for Customs colleagues—the 8,000 savings that we are aiming to get are effectively the outcome of investments we are already making. So, for example, in our e programmes, our SA on line returns, and our modernising Pay As You Earn processes for customers project, which will require in the first instance large employers to send their end of year returns in on line, will both only start having an impact in reducing our processing work by about the middle of the PSA period. So as we begin to have a reduction in the processing requirement, then we will have to deal with the staff reduction issues. It will not be evenly over time because it requires our investment to come to fruition first.

Q57 Mr Plaskitt: There is quite a useful chart on page 25 of your report showing how the jobs are currently distributed in the two departments and, clearly in terms of Inland Revenue, data capture and processing is by far the largest category. That sits at around 37,000 people. In 48 months’ time, how many will there be in that bar chart?
*Ms Ghosh:* Precisely where the particular job reductions will fall is something that we have to build into our plans for the SR2004 period, but you would expect that to be the major area where jobs would fall.

Q58 Mr Plaskitt: I would. *Ms Ghosh:* Indeed, as Gus said, we would equally expect a proportion of those jobs for people who have the right skills and are re-deployable to be re-deployed into other areas of activity, such as improving our compliance activities.

Q59 Mr Plaskitt: So you are not sure how many people will be engaged in data capture and processing in 48 months’ time?
*Ms Ghosh:* Broadly speaking it will be 8,000 fewer people, but precisely where it will affect particular business units is the thing that will only become clear as the process rolls out.

Q60 Mr Plaskitt: All 8,000 are in that category?
*Ms Ghosh:* Because of the way we are making the savings, which is predominantly from an increase in e processing and data capture, the majority will be there. Clearly we are aiming even before integration and under the plans that Peter Gershon put forward, similarly to make savings in some of our corporate services and those areas of the department, which support the people who are doing the processing. If you have significantly fewer people doing the processing activities then there is a knock-on effect on your support staff, on your overheads and those sorts of jobs. So there will be an impact there but it is predominantly on processing.

Q61 Mr Plaskitt: If we strip out of the numbers those jobs that are being lost as a result of the switching to electronic processing, how many of the 14,000 jobs gross that are going are directly attributable to the merger of the two departments, as opposed to anything else?
Ms Ghosh: 3,000.

Q62 Mr Plaskitt: As opposed to anything else. That is the 3,000. In which categories on the chart on page 25 will those predominantly fall because it does not sound to me as though they will inevitably be largely in the data capture area?
Ms Ghosh: No, not at all.

Q63 Mr Plaskitt: So which areas will that show up in?
Ms Ghosh: We will only know where those savings will come from as we roll out the process of integration and our business planning and so on. So we cannot at this stage say precisely where that 3,000 will come from, but the experience, for example, of DWP, following the merger between DFES and the old DSS, demonstrated that across the department you would expect to get those sorts of savings.

Q64 Mr Plaskitt: Will there be many job savings in audit work? There are just as many taxpayers to be audited as before, are there not; just as many accounts?
Mr Ramsden: One point to make is when we were talking about the net figure being 10,500 rather than 14,000, a significant element in that is to reflect government decisions over the last couple of years in the areas of spend to save packages for both direct and indirect taxes, which have actually increased the numbers of people working on compliance activities.
Mr O’Donnell: That is the audit part.
Mr Ramsden: So in terms of our functional distinction that we use for the analysis and the review, that comes under audit investigation and work with Revenue and Customs. It is more difficult to come up with theoretical yields with the other taxes.

Q65 Mr Plaskitt: Should we expect to see job reductions in education and advice, another category that you indicate in the chart?
Mr Hanson: The two most likely areas to take these savings from will be transaction processing and probably corporate services.

Q66 Mr Plaskitt: Is that the one that is labelled “support” in this bar chart?
Mr Hanson: Yes.

Q67 Mr Plaskitt: So most of it is going to come in the data capture and processing?
Mr Hanson: Yes. Not front line is the key point.

Q68 Mr Plaskitt: The biggest contributor to that is the switch to electronic?
Mr Hanson: Yes.

Q69 Mr Plaskitt: Any compulsory redundancies in this 48-months programme?
Mr O’Donnell: We will try very hard to avoid compulsory redundancies.

Q70 Mr Plaskitt: You have not ruled them out?
Mr O’Donnell: As I say, we will do our very best to avoid them.

Q71 Mr Plaskitt: So you have not ruled them out?
Mr O’Donnell: As you say, we will do our very best to avoid compulsory redundancies.

Q72 Norman Lamb: Just finishing off on that subject, am I right in understanding that by far the most significant saving, efficiency savings, will come from the Gershon process and what is already underway rather than the merger of the two departments? More of the jobs are going as a result of the Gershon and existing processes rather than the merger; that is right, is it?
Mr O’Donnell: This is certainly true. It will be interesting, as the new management team get into precisely how they want to integrate the two departments. They may well find process ways of improving matters even further.

Q73 Norman Lamb: You are not making any great claims about enormous efficiency savings on head count from this merger?
Mr O’Donnell: No, but I think you should bear in mind that these are not operations that are operating very separately. Peter Gershon was on the steering group in the review team. Peter Gershon is doing the work with Revenue and Customs.

Q74 Norman Lamb: I was trying to identify where the savings are actually going to come from. Just going back very quickly to the tax gap point, you talked about an 11.9 billion gap on VAT, 12%, I think VAT is probably the worst in terms of the gap, is it not, of any of the taxes that are collected?
Mr O’Donnell: I wish I could confidently answer that. As I say, the reason that we are where we are on VAT, you will remember that period where we had a black hole on VAT and it did not come through, and, as a result, we had a report into that and we imposed quite a tough rule on making very cautious assumptions about the future relationship between VAT and consumption. It is more difficult to come up with theoretical yields with the other taxes because you get into behavioural effects and the like. So we will have to do quite a lot of work on that.

Q75 Norman Lamb: In terms of VAT I noticed that there are only three countries, according to the IMF, that administer their VAT through a Customs department: the UK, Malawi and Israel, and Israel is planning to change, which leaves us alone with Malawi. Is there any actual evidence from the international comparisons that the merger will in itself reduce the tax gap? What evidence do you have from other countries that they have a smaller tax gap with a merged department?
Mr O’Donnell: When you look at what Canada did, for example, and some work that happened in the US, there are some references in the report where this tended to increase the compliance rates, ie reduced tax gaps, somewhat.

Q76 Norman Lamb: So most of the countries that have merged revenue collection have a smaller tax gap than us; is that right?

Mr O’Donnell: No, that is a separate point. I was talking about ones where there has been a merger so you are able to see an effect of the change. If you were just to look at absolute size of tax gap—and we do not have any countries to compare now, because it would be a question of do we do better than Malawi, which might have more to do with the differences of UK and Malawi than to do with that specific institution.

Q77 Norman Lamb: That is just VAT. Just looking at the comparisons between countries that have a split and countries that do it with one single collection agency, is there any evidence that the single collection agency achieves a better return in terms of the tax gap?

Mr Ramsden: As Gus has said, it is very difficult to do cross country comparisons of that sort. No country gives you a straight answer on this, unfortunately, but Australia, for example, as we say in the report, introduced a VAT equivalent with the goods and services sales tax. They estimated that that improved direct tax yield by 1% because the information they got through the introduction of GST helped in their compliance activities on direct tax. That is obviously a different position than we are in, but we thought there was something in that. Similarly, as Gus was saying, in Canada there is evidence that joint audits have been very efficient and effective in raising revenues, but we certainly did not come across any evidence that answered your question as you have put it.

Mr O’Donnell: It is a very good question, and I wish we could answer it better, but most countries have not estimated tax gaps. I stress, it is quite a difficult matter.

Q78 Norman Lamb: I understand that. In terms of the savings that can be achieved, several people have expressed some doubts about the savings that you have estimated can be achieved, and the Chartered Institute of Taxation, to quote from them, have expressed “some scepticism that staff reductions of the order outlined will result from using new technology, merging related functions (eg debt collection) and changing working practices (eg joint auditing) without affecting operational efficiency and customer service.” How do you respond to those concerns?

Mr O’Donnell: I wonder if they were thinking at the time with reference to that about the 14,000 number. What we are saying is that 14,000 is the result of a number of investments that have already been made, computer services coming through, plus a modest amount that comes through efficiency savings as a direct result of integration of the two departments. So I think that when we talked to private sector people, who have actually gone through these sorts of integration processes, as to whether they thought the sorts of efficiency savings we were postulating were possible, most of them said they actually thought that we were being cautious about what could be achieved.

Q79 Norman Lamb: In determining the scope for staff cuts, what consideration have you given to deploying resources instead to tackling evasion avoidance, debt recovery, under spend to save initiatives, that you have talked about already? I suppose there is a concern expressed by unions and others that you would be better off transferring staff into those core areas, to cut the tax gap rather than by cutting staff?

Mr O’Donnell: I think that quite a lot of what will happen will be reallocation of resources towards audit work and the like, and the merger of the two departments will create opportunities, will give a better information base for audit work to be more effective, and there is certainly evidence elsewhere that that works. So I think that will happen and there may well be future spend to save packages, for example, in future budgets, that might want to exploit extra opportunities that arise then. Do you want to add anything?

Mr Hanson: That is probably exactly what will happen, but the point is that you would expect a business case for that, you would not just want it reallocated across the department willy-nilly; you would like to see a case.

Q80 Norman Lamb: So those will be developed in due course?

Mr Hanson: Yes.

Mr O’Donnell: When those spend to save packages come forward the only way in a budget we could actually score them is through an NAO audit.

Q81 Norman Lamb: What about location? There has been a lot of talk of Revenue and Customs being prime candidates for moving out of London. What is the plan for the merged department and the timescale for that? Does the relocation have to wait for the department to finally emerge or will it be happening anyway?

Mr O’Donnell: There are already plans in terms of the department’s response to Michael Lyons in his relocation report, which specifies some areas; but more detail will come through as the new management talk about their precise plan for implementation of the merger.

Ms Ghosh: Indeed. In fact I think there is a total of almost 2000 posts moving from the two departments out of London and the southeast.

Q82 Norman Lamb: That is a tiny percentage, is it not?

Ms Ghosh: But we have a tiny presence in comparison with other departments in London and the southeast because we are already highly regionalised departments. I think what we will need to do is to look at that set of propositions against the
impact on patterns of the distribution of our offices the rundown in processing and the impact of $e$ in where we need people. So I think the two processes will have to go hand in hand.

**Q83 Norman Lamb:** The two Revenue departments have come up with more offers to Lyons than the Treasury, is that right?

**Mr O'Donnell:** The Treasury is very focused on policy development. I am going to visit Liverpool soon, so I am looking forward to seeing potential locations.

**Q84 Norman Lamb:** Good. Have you personally been quite in favour of this all along?

**Mr O'Donnell:** No. I started off with a pretty open mind, to be honest. There are risks and what this will involve is being quite bold, accepting the fact that there are short-term costs and long-term benefits. As I went through it, it seemed to me that the scale of the long-term benefits are such that this was a very compelling case, for me, personally. I accept the fact that in five years I think it will be incredibly compelling, in ten years even more so. In the next two to three, when I personally will be here, it will not be so compelling, by definition.

**Q85 Mr Cousins:** Given, as has just been pointed out, that the Inland Revenue, partly because of the background of the old contributions agency, is already highly regionalised, is there not a danger in all of this that, despite the Lyons Review, there could be regions where a combination of the Lyons Review plus these changes minus result in a net negative impact on employment?

**Mr O'Donnell:** Net negative impact on employment nationally or regionally, do you mean?

**Q86 Mr Cousins:** Regionally.

**Mr O'Donnell:** I do not think you could rule out that there may be some regions where that happens, but the overall impact of Lyons is transferring jobs out; certainly there would be some reallocations because what is going on here.

**Q87 Mr Cousins:** The Inland Revenue employment base is very lumpy regionally and there is an obvious risk that in particular regions the balance of the two processes could result in a net reduction of employment.

**Mr O'Donnell:** One of the things that I discussed with Andrew Turnbull, when we were talking about Gershon and Lyons' combined impact, was a need to think about clearing houses where there are different effects going on from different government departments in their regional locations, and whether there were ways we could mitigate those sorts of problems, and in particular where you have, say, some moving out on the Revenue side but possibly some other part of the public sector increasing, then it makes a lot of sense for all of us to share that information and to try and manage those transfers because exits in the public service are actually quite expensive.

**Q88 Mr Cousins:** I am not clear what the cross government mechanisms are that could in fact carry out that kind of balancing exercise.

**Mr O'Donnell:** They are really about information sharing. There isn't something which will do it in a mechanical way, you are right; this is about giving people all the information and letting them know what the different plans are regionally.

**Q89 Mr Cousins:** The implication of future spend to save programmes, however, might serve to mitigate the net 10,500 figure still further, so that that net figure might reduce, given the impact of future spend to save programmes still to be identified.

**Mr O'Donnell:** Indeed it might, that is absolutely right.

**Q90 Mr Cousins:** There are some quite interesting figures in the report. For example, one additional compliance staff year in corporation tax produces over £800,000 in revenue. That is quite an extraordinary thought. Is some work going to be done, given the evidence that has been produced for this study, on focusing very particularly not just on the tax gap in general but in the areas that can now be identified as useful areas for focusing extra compliance work?

**Mr O'Donnell:** That is exactly right, and that is exactly why that chart in that report, this is work we have done, and why I think the committee was also right in their reference to strengthening tax policy function in the Treasury, to think very carefully how we think about policy and also how we coordinate with the collecting departments in terms of giving them the right incentives to get resources in the right places.

**Q91 Mr Cousins:** If you are going to re-deploy staff in that way then presumably their pay and rations and terms and conditions will have to be harmonised and there might even be the need for legislative change to make that possible, given the different legal statutory bases that Customs & Excise and the Inland Revenue have. Can we be sure that all of that will have been achieved?

**Mr O'Donnell:** We are hoping to get the necessary legislation in place—the phrase we have to use is "as soon as parliamentary time is available". I think it is very high priority to do that.

**Q92 Mr Cousins:** If parliamentary time is not available then the job losses will be higher because the capacity to re-deploy will be less.

**Mr Hanson:** The capacity exists now because we can advertise jobs across the departments.

**Ms Ghosh:** Exactly so, so even in that unlikely set of circumstances we could simply send staff across a boundary. In the same way, for example, our joint working team is made up of staff from both Departments. But there would be the disadvantages that Gus outlined in the sense that we would not be able to get the additional marginal gains from integrated activity.
Q93 Mr Cousins: One of the most telling cases for the merger—one that was predicted by this Committee way back in the year 2000—was that closer working did not work in some of these compliance and avoidance areas. The shadow economy teams are mentioned in this report as being the proof that you required full merger because the legislative statutory basis, the investigative powers that people had were not harmonised. So you will require legislation to overcome that.

Mr Ramsden: We are very clear in the penultimate paragraph of the main report, where we set out the scope of the legislation that will be required to deliver an integrated department.

Q94 Mr Cousins: What about the harmonisation of pay and rations, terms and conditions of employment which will also be required if you are to have flexibility in future?

Ms Ghosh: Indeed, and that is one of the first strands of work that the two departments are jointly setting in train. We have already started on that.

Mr O'Donnell: Perhaps it is worth explaining, and I should have said this earlier, that we have not just sat back, the two departments have had joint board meetings, I attended one of those; there are committees being set up to manage the bringing together. So a lot is happening already, and both Ann Chant and Mike Eland, the heads of the two organisations, really are working in an incredibly collaborative way, so I am really encouraged by what is happening at the moment. The point that we have a strategic decision made now means that everybody is getting on and saying, “Right, let us sort out how best to do it.” Of course, we need to get the new team appointed and that is important. The existing boards are getting on with things, they are not just sitting back.

Q95 Angela Eagle: When will that new team be in place if you want to get them appointed? When is this new management team going to be in place so that the merger can proceed pending that parliamentary legislation?

Mr O'Donnell: There is a lot that can be done, even without the legislation. As I say, the boards can get together. We have advertised for an Executive Chair; that process is in hand as we speak. The departments are advertising for a CIO (Chief Information Officer) because that is really crucial for the bringing together of these IT issues and the information sharing. Those things are in hand. Then once the Executive Chair is appointed he or she will need to sort out the top team.

Q96 Angela Eagle: So quite quickly really?

Mr O'Donnell: I hope so, yes.

Q97 Angela Eagle: You have mentioned IT and clearly the Inland Revenue has famously switched its IT provider and granted a contract to the Aspire Group, Cap Gemini Ernst and Young, which lasts ten years with another option of eight further years. The Customs & Excise presumably also have their own arrangements. How do you plan to integrate the IT, given that you have different suppliers and different commercial contracts over different times, no doubt containing different clauses and details, so that you can maximise some of the gains that you are talking about making from the merger?

Mr O'Donnell: Can I start off with that because as these new contracts were coming up I talked to Peter Gershon because at that point the review was ongoing, we were not sure where we would end up, but Peter was on the review and looking specifically at the chapter in here on information—he was central to that. I asked him to look at the contracts for both and tell me whether in his view they were flexible enough, had sufficient flexibility for him to manage whatever outcomes would come out of this review, including a merger as one. He did that and he said that in his view the flexibilities were there. That is not to say that it is going to be easy. I think one of the tasks for the new management and the new CIO will be to think about how they phase the integration of the systems. They are different; there are some gains, Fujitsu are involved with both providers so I think this is possible, but it is one of those areas that will require an enormous amount of managerial attention.

Q98 Angela Eagle: You say in your report that in the longer term you could harmonise IT provision fully but that this would not be without cost. Are you talking about at the end of the current contract, say in ten years’ time, and what sort of costs are you talking about?

Mr O'Donnell: You are getting into an area where I think that is uncertain. I think we would have to see. These needs evolve through time and we would have to see how the existing contracts work out and the new management will need to think about how well they can integrate them. The honest answer is I just do not know.

Ms Ghosh: As Gus said, the issue of integrating IT is one that we have already started to think about, it is another of our work strands under our integration project which we have set up. John Yard on our side and Len Morris on Customs’ side have begun to talk.

Q99 Angela Eagle: You cannot get your one-stop shop with all the tax information coming up and all that without integrated IT, can you?

Ms Ghosh: No. In fact you have answered the question for yourself. What we are very clear about is that we have to move to integration on the basis of a business case. So, for example, we need to look at our business plan, how we propose to achieve our PSAs and then look at where integration of our IT systems should first be put in place. For example, we might want to put more investment than we are proposing at the moment into the creation of a single customer view in our IT systems, because there are clearly big, both compliance and customer service gains from that. So that is the kind of issue that we want to look at, but it needs to be driven by the business need not by, “Let us just put the two systems together.” We are very conscious that at the moment we have a very small financial envelope in
which to operate. So we are not assuming lots of additional spending, it would be re-prioritisation of spending within our flat cash lines over this period.

**Q100 Angela Eagle:** Presumably this would be very front end based so that it would be the customer end rather than the back end systems that you would prioritise?

**Ms Ghosh:** Exactly.

**Q101 Angela Eagle:** As the DWP has done.

**Ms Ghosh:** But it has a double-whammy because it is good for compliance because our staff can look at the whole picture of the customer, and it is good for the customer because the customer can look in and see how much they owe us and how much we owe them. So that is the kind of area where early integration would be an excellent idea. Other things, we might say we never need to integrate—child benefit and frontiers, for example. What would be the point?

**Mr Ramsden:** Chart 4.2 sets out an illustrative example, page 80, of the kind of portal, the front end that Helen was talking about, where you get the benefits both in terms of the customer but also from the risk analysis and the compliance work that is going on behind the scenes.

**Q102 Mr Plaskitt:** Revenue is by far the bigger of the two departments at the moment; how are you persuading the staff in Customs that they are not being taken over?

**Mr Hanson:** They are not. It is the creation of a new department and they accept that. We have had a very intensive communications exercise over the past two or three months and we have carried people with us along the way, and I am personally surprised by how positive the reaction has been in Customs. There is some sadness, some people are unhappy at the disappearance of Customs, but most people are actually anxious to get on with it.

**Q103 Mr Plaskitt:** 150 local Inland Revenue offices at the moment. How many of those will survive the merger?

**Ms Ghosh:** Again, that is one of those issues that are very much to be developed as we develop our business plan towards 2008. What we are very clear about—and only yesterday the two boards got together and had a discussion about their vision for 2008—what we need to do in terms of local offices is be very clear that the services we retain in local offices are ones where there is real added value from local activity, for example in compliance or taking in money or whatever it may be, particularly given the fact that there is still quite a lot of processing and data correction going on in local offices. Local offices will undoubtedly look smaller by 2008. The Paymaster General, as you probably know, is absolutely committed to the fact that we need, in making our plans, to be clear that there should not be a reduction in the points of contact that people locally can have with, as it will be, the new Revenue department, but that might be in one-stop shops, it might be sharing premises in the Job Centre Plus, it might be going down to the town hall and all those sorts of ideas. So the local network will look very different but it will be a developing picture over time.

**Q104 Mr Plaskitt:** Mr O’Donnell earlier said the savings had been hundreds of millions when I was asking you about the staffing side of it. The bulk of the staffing reduction was coming in the process side of it, that is largely what goes on in the local offices. If that quantity of savings is to be achieved and that reduction in staff in those areas is going to be achieved, surely there will not still be 150 local offices in four years’ time?

**Ms Ghosh:** There may well not be, but that is exactly the kind of detailed planning we need to do over future years.

**Q105 Mr Plaskitt:** By what proportion would you expect that number to fall?

**Ms Ghosh:** One could not possibly say at this stage.

**Q106 Norman Lamb:** But are you not stuck with long-term commitments to a certain company called Mapeley STEPS, who you transferred them all to, where you have got serviced accommodation for the next donkeys’ years?

**Ms Ghosh:** I am happy to say that we built into our contract with Mapeley provisions for vacating premises. Indeed, a key part of the risk transfer for the purposes of the Mapeley contract, and one of the things that makes it very attractive, is that we are able to walk away from. I think, 15% of our core estate in one year and we can roll that forward and hand it over to Mapeley. So the risk, for example, of having a lease which you cannot sell on is transferred to Mapeley and is not our risk. We would also have a share in any increased development value that arose out of that. So the taxpayer gets money back, beyond the agreed 15% on flexibilities.

**Q107 Mr Heathcoat-Amory:** Taxpayer confidentiality has been touched on but not really discussed. It is very important if people are to cooperate with the departments, in the knowledge that their disclosures will not be misused. This is governed by statute, the exchange between the two existing revenue departments. All that will of course go if it is just one big department. Therefore, what will replace it? I am thinking, for instance, of someone who imports a valuable picture, known to Customs but not to the Revenue, but the Revenue may be very interested for capital gains tax or inheritance tax purposes and might like to go on a fishing expedition down the list of people who have been importing valuable items. These safeguards will all disappear, surely, if it is just one big department sharing everything. So what confidence can the taxpayer have that it this is not just a huge increase in the power of the state?

**Mr Ramsden:** Can I just say that from the perspective of the review, when we were setting out the likely issues that the legislation was going to have to cover, we did highlight the issue of information sharing, and how the new legislation to cover information sharing and the existing legislation will
Q108 Mr Heathcoat-Amory: I do not just mean confidentiality vis-à-vis the revenue departments and the outside world, although I think that is an issue with the security services and the police, I think it is a continuing problem, the government just knows everything about everybody or wants to. I am talking about the sharing between existing separate departments and whether and how you can preserve that distinction by statute when it is all one department, one computer, one board, one set of staff. Has this been analysed? It is no good saying that this will be addressed by parliament at the time, what have you done to examine this now?

Mr Ramsden: I can say what we are doing at present, and then I will hand over to colleagues from the Revenue department. Within the Treasury we have set up a Bill unit to look at all the issues relating to the new legislation that will be needed. It is a unit that will coordinate activity across the three departments to make sure that we come up with legislation that will then be put to parliament in the normal way. So information is a key part of the deliberations and the work, the analysis that is being done by that unit, to take forward the implementation of the review, and they are working very closely with colleagues in Revenue and Customs to look at the existing information legislation and what are the possible implications depending on how far one decides to go on information for the new department. These are all issues that we would just want to stress are being taken very seriously, both in terms of the potential benefits of sharing information and also the importance of preserving taxpayer confidentiality.

Ms Ghosh: I think the key point is that it would not happen. The way you have described it, we create a new department and invisibly, and without anybody having spotted it, we have suddenly got each other’s powers. Again, back to our integration programme—another of our project strands which the two joint boards are supervising is precisely that legal issue. What we would need is legislation that says, “Here is a single Board, this is its relationship with the Treasury, this is the way we protect taxpayer confidentiality, and these are the powers that the new Board and department will have.” So it would be transparent and subject to parliamentary scrutiny; it would not happen sub rosa—is that the right term?

Q109 Mr Cousins: Just on that point, I am concerned myself about the existence of widespread evasion. I think the figures that you gave for the tax gap on VAT are very undermining to a small business that is playing by the rules. The same is true of organised crime and tax evasion, and you will recognise that the Inland Revenue has come under some criticism for not using its legal powers on tax evasion in the same robust way that Customs attempts to. I do think that the Committee wants some kind of assurance that this is going to be tackled, that the culture of the two organisations is going to be genuinely harmonised and that there will be across what were two big departments a robust attempt to break organised crime, to defend the person who is living their life playing by the rules, running their business according to the rules and not allowing them to feel cheated.

Mr O’Donnell: People have talked about Customs and Revenue having different cultures and attitudes to their powers. I very much hope that what we will get to is an individual department which has that set of cultures that I talked about earlier. The one you are referring to I completely agree with. For dishonest taxpayers, for fraud, that culture should be very tough, extremely robust. I totally agree with you.

Q110 Mr Heathcoat-Amory: The two departments have different legal powers, as we touched on earlier. Customs can enter premises without permission, the Revenue department by and large cannot. Is it intended to preserve this distinction or will it all level up to the level of the greater statutory powers? Governments love having more power, and so there will be an inevitable drift towards giving you all the powers of, in this case, the Customs & Excise. I think that ought to be resisted. Have you thought about this? What are your plans? Do you understand that there should be a prevailing pressure to limit by statute the rights of access for certain investigators if they are more allied to assisting Inland Revenue functions?

Mr Hanson: That is exactly why we have kicked off one of the work strands on this very issue, and one of the questions we are asking is what are the powers necessary for the new department to discharge its functions? Are they proportionate and reasonable? I imagine that is exactly what parliament will be asking itself.

Q111 Mr Heathcoat-Amory: When are we going to have the details on this? Yet again you are deciding on this merger without, in my view, either publishing or consulting on very important issues of concern, not to you but to the man, woman at the sharp end, who have to comply with your rules and who do not like having their door broken down at midnight by a whole lot of new officers who have inherited or assumed powers which at the minute are preserved only for certain eventualities.

Mr O’Donnell: One thing I would say is that we do care very much about the person at the front end, they are our customers, they are what we are here for. When it comes to sorting this out this will be a matter that goes to parliament and will be debated in full. There will be some recommendations that are put forward by the transition committees doing some work, when the Executive Chairman, he or she, is in place, and the new team makes some decisions in consultation with the Chancellor, and then that legislation will come forward as soon as parliamentary time permits.
Q112 Mr Beard: The review recommends a new division of work between the Treasury and the new department with the Treasury leading on strategic work and policy development, and the new department leading on policy maintenance and delivery. What is the distinction that is being made between policy development and policy maintenance?

Mr O'Donnell: There is a table that I would suggest you look at on page 95, which tries to break down the elements of policy and implementation to the different strands. There are four parts there, the strategic work in the top-left, as it were, and delivery bottom right. Those are the clear areas, the strategic policy, Treasury, delivery very much, for the delivery arm. The points you are talking about are maintenance and policy development. Mostly they will be allocated to the new department, not to the Treasury. There are some grey areas undoubtedly that will emerge between the two and, quite rightly, there should be strong contact between the Treasury in its function of deciding on tax policy and the delivery arm in telling us how easy it is in practice to implement that. So those are the areas that will be grey and they are in the boxes in the cross diagonal, as it were, bottom left and top right.

Q113 Mr Beard: When you were presenting the Treasury’s annual report I raised the question of whether your review would be considering bringing in some evaluation of tax for its operational implications, so that you knew the competitive impact on businesses, say, and the general impact on how businesses may operate if you change the tax system. Where would that sort of thing fit into this pattern?

Mr O'Donnell: Certainly there will be tax business units within the Treasury, and one of the gains we are trying to get here is to have an ability to look more coherently. So, for example, your issue about how businesses are affected by tax policy, the whole thing, if you are a business, you do not think of it, “That is what VAT is doing to me, that is what this tax, that tax,” so we want to be able to look across the board. Mr. Ramsden here will be in charge of doing a lot of that on the tax policy side for the Treasury. Certainly that will also be looked at in departments in terms of the practicability of what this means for businesses in terms of paying these taxes. Indeed, one of the suggestions that we put forward in the report is that the new department be organised much more on functional grounds, so that instead of having a VAT and a corporation tax there is a business approach to tax. So there will be a business directorate within the new department.

Q114 Mr Beard: This policy department, is that part of policy maintenance then?

Mr Ramsden: Could I just add, what we have ended up with is a model where we will still be very much in what we call a “policy partnership” with the Revenue department, although we are increasing quite significantly the Treasury’s capacity to think across the tax system strategically, but also to think about developments in particular areas. An example of this, as Gus was saying, we are going to be doing a lot more in the business area. Last week we advertised a new team leader post who will be leading a team working on SME taxation issues. We have also advertised publicly for a corporate tax team leader. So we are looking at tax from the perspective that the government thinks about tax, in terms of its objectives for enterprise or its objectives for UK competitiveness. So within that overall model we will have more expertise in the Treasury to do the kind of evidence gathering that you have been talking about—what we call a mixed economy, trying to bring in more external secondees; but we are going to be working in partnership with the Revenue department where there will still be a lot of operational policy work going on in the business tax area, and some more detailed policy development work.

Q115 Mr Beard: Who will have the lead on this sort of question, the Treasury or the Department?

Mr Ramsden: In terms of policy development work it will be the Treasury, but supported by the Revenue department.

Q116 Mr Beard: Who in these arrangements will be responsible for assessing the problems of compliance, whether the burdens of compliance are becoming onerous?

Mr Ramsden: I think it is fair to say that in terms of compliance and compliance costs, which we recognised throughout the review as being an issue, and being an issue as a lot of the evidence shows, particularly for small and medium-sized enterprises, that would partly come into the work of, to take that example, the new SME taxation team. Also, in terms of how policy is implemented and delivered, again they will be working very closely with the Revenue department, who will be closer to the front line, closer to the customer experience, as it were. So everything will be fed up from the operational side as well.

Q117 Mr Beard: This division between policy development and policy maintenance seems a bit fuzzy; it does not seem to be very clear-cut?

Mr Ramsden: I do not want to speak across Gus, but in chapter 5 of the review, where we assessed policy, we did look at various options and one of them was for a model that would give you a cleaner cut, which would have moved all of what we have described as policy making and what is depicted in chart 5.1 into the Treasury. In chapter 5 we raise a lot of the issues and concerns that we had with that, not least the potential that you would break up the link between policy and delivery. Also, you would have real issues then about taxpayer confidentiality because to do detailed policy development and operational policy development you would need to go down to the records of individual businesses or potentially individual personal customers and, given that we do not want to go anywhere near undermining taxpayer confidentiality, that was another key argument for
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why we ruled out what might, on paper, look like a cleaner break. What we think we have got is something where we would be working in partnership to deliver on government objectives.  

Mr O’Donnell: There is a broader aspect from a whole of Treasury point of view. Once you start getting into these areas there are large numbers of people working on policy maintenance and policy delivery. If you did transfer all of those you would then end up really changing the balance.

Q118 Mr Beard: If you transferred them to the Treasury?  
Mr O’Donnell: If you transferred them to the Treasury it would really change the balance of the people working in the Treasury. At the moment what we are talking is transfer of, let us say, around 150 for strategic tax policy work to the Treasury; the Treasury is around 1,000 staff. That you can see as being broadly comparable with a Treasury that wants to place more emphasis on tax policy, as you recommended we do and we agreed. If, on the other hand, you took the whole of policy, all of maintenance development, you would really rebalance the Treasury and it would be a tax part with little bits of other things added on, and I do not know where they would all go.

Q119 Mr Cousins: The 150 people that you are transferring to the Treasury will be useful to you precisely because of their background in more practical tax work.  
Mr O’Donnell: Yes.

Q120 Mr Cousins: How are you going to ensure that in the future you can get this use of talent and that you will not end up with the division between policy makers, the eggheads, and the doers and the breakers down of doors on the other hand?  
Mr O’Donnell: Absolutely. I think that is very important culturally. Two things that will happen there. What I am hoping for is that we establish a culture that says, for example, if you are a Treasury person you could have tax policy as an anchor, as a career anchor. At the moment, if you are a Treasury person you could do all sort of different things in the Treasury, and you might do that. What I am trying to get is the message across to Treasury staff that they need practical delivery experience.

Q121 Norman Lamb: Breaking down the doors.  
Mr O’Donnell: Not necessarily breaking down the doors, there are lots of other ways of delivering services to customers. We will get more interchange between the two and to get to the top in the Civil Service it is very important that people have a practical delivery aspect. Here we have this enormous delivery department on our doorstep, part of the Chancellor’s Departments, and I do not think that we in the Treasury are using that as well as we should, to get that experience, get people out there, get practical delivery experience, come back and that will help them and they can have a tax policy anchor, and spend some time on delivering business tax or personal tax, come back in and do some work on Treasury policy development. Also, I think do not underestimate geographical proximity. The fact that people who were previously in buildings some way away are now going to be in the front end of the Treasury building will mean that Treasury people will realise that you do not necessarily have two heads if you work in Inland Revenue or Customs, and actually that these are people who are trying to deliver many of the same outcomes as us, need the same skill sets as Treasury. I think it will be good for both sides. Also, if you take Inland Revenue and Customs, their policy people, who are doing policy development, get a chance to come in and work very closely with the Chancellor on direct tax policy issues. I think that is good too. So they will know about how that operation works.

Q122 Chairman: You have now paid attention to some of our reports; you will now that in successive reports that we have identified weak governance of both Customs and Revenue, and other issues. The small number of non-executive directors has been drawn attention to, failure to keep ministers informed at proper terms. How will this new Board be better than the two existing boards?  
Mr O’Donnell: Again, when the new management is place it will be encouraged to think about the structure of the Board, and I think what you say about choice of non-executive directors, the governance relationships between us and the Treasury, the fact that they will be very close and the relationships we are now developing—I am having regular meetings with Ann Chant and Mike Eland—we are developing close relationships with the teams between the Treasury and delivery arm, so I hope we will have established procedures, which ensure that it is clear that we are working together for mutual ends.

Q123 Chairman: It is precisely because you are working in the same building that you will also have to pay attention for the need to have a proper Board for the department rather than for the Treasury.  
Mr O’Donnell: Absolutely, and they will have their own Board, separate Board with their own non-execs, and I think that is really important and that needs to be a very strong Board.

Q124 Chairman: Finally from me—and we have talked about this all afternoon, and there is this long report—what are you calling this thing?  
Mr O’Donnell: There has been a great temptation, I can tell you, and the FT has indeed had competitions and all the rest of it. Much as I would love to have come out with a name—and you can imagine the temptations to really go for this—I actually think it is quite important that we do not come out with a name now. A name is an
important statement of values and what the organisation is about, and I think we should get in place the new Executive Chair. We can think about carefully launching this new organisation with its new name in its new premises, and I think let them do that big glitzy show and I will just do the technical evidence-based stuff.

Chairman: So we have to wait for that. Thank you very much for your attendance today. Let me assure you that this sub-committee will continue to keep an eye on this development and may indeed be recalling you and the other participants before or during the preparation of the Bill itself. In the meantime, thank you very much.
Wednesday 12 May 2004

Members present:
Mr Michael Fallon, in the Chair
Mr Nigel Beard
Mr David Heathcoat-Amory
Norman Lamb
Mr John McFall

Witnesses: Mr Chas Roy-Chowdhury, Head of Taxation, Association of Chartered Certified Accountants, Mr Mark Lee, Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales, Mr Mike Hardwick, Chairman, Tax Law Committee, The Law Society, Mr John Whiting, Tax Partner, PricewaterhouseCoopers, Chairman, Tax Policy Sub-Committee and Past President of the Chartered Institute of Taxation, examined.

Q125 Chairman: Mr Lee, can you introduce yourself and your colleagues to the Committee.
Mr Lee: My name is Mark Lee. I am the Chairman of the Tax Faculty of the Institute of Chartered Accountants in England and Wales. To my left is Chas Roy-Chowdhury.
Mr Roy-Chowdhury: My name is Chas Roy-Chowdhury, Head of Taxation at ACCA.
Mr Hardwick: Mike Hardwick, Chairman of the Tax Law Committee of The Law Society.

Q126 Chairman: Thank you very much, and welcome to the Sub-Committee. Mr Lee, I just want to get one thing straight about your own particular submission. Most of the other submissions we have support the idea of a merger. You do not seem to express a view in your submission. Are you in favour of it or not?
Mr Lee: We welcome it, but very cautiously. We would prefer to see step changes rather than a revolution.

Q127 Chairman: Would you rather this did not happen in this way?
Mr Lee: We are surprised it is being put forward without any reference back to the merger of the Contributions Agency with Inland Revenue five years ago. There does not appear to be any reference in the review to the lessons learned from that merger or indeed the lessons yet to be learned from it, and that surprises us somewhat.

Q128 Chairman: So how would you do it step by step? You would do it by bits of the department like closer working, would you?
Mr Lee: Closer working is not an example I would use. The review suggests a number of steps that could be taken, and a number of the anticipated benefits could be achieved through management changes and through closer working between Treasury, Customs and the Revenue. As I say, we would only be able to welcome the merger if we saw that there had been an adequate review of the previous merger five years ago. We are very concerned that the aspirational benefits in this review are not borne out by the alleged benefits that would come through from the Contributions Agency merger with Inland Revenue five years ago. Indeed—forgive me—I think it was your own Treasury Sub-Committee three years ago originally advocated a merger only after the Contributions Agency had been fully integrated with the Inland Revenue. At that time the Paymaster General, Dawn Primarolo, explicitly rejected the call for a merger on the basis that the merger would cost too much. Then given that you—I think it was your Committee—referred to that merger three years ago, it is surprising to us that this review makes no reference to it.

Q129 Chairman: Mr Roy-Chowdhury, what are the main benefits you see? Is merging the two departments the best way of actually getting those benefits?
Mr Roy-Chowdhury: I think on some things, as Mark has said, there are concerns, but what we would like to see is a one-stop shop that would help the taxpayer and businesses. The critical issue is whether or not they are trying to set up a Big Brother agency with all the draconian powers, so the worst and best powers, a cocktail mix of the past Customs & Excise worst search powers and Inland Revenue's mixed together. What we need is to focus on helping taxpayers comply with the complexities of the tax system. There may be issues that by a focus of government time and people's efforts being devoted to the merger, they may forget about tax simplification; but I think the reality is that what we need is a sea change in the view and the attitudes that taxpayers encounter within Customs & Excise and the Inland Revenue, one that needs to focus on the understanding that the tax system is highly complex. Small business and individuals who try to comply with the system who are not tax evaders, who are not fraudulent, who make genuine mistakes, need to be helped rather than penalised. The other area which the ACCA has advocated for a number of years is we would like to see a joined-up agency which can reschedule tax debt, so that perfectly good businesses can actually carry on with their cash flow enhanced.

Q130 Chairman: The kind of comfortable change you describe in your first answer, could that be obtained in any other way? Do you have to merge the two departments to get that?
Mr Roy-Chowdhury: I think the UK is out on a limb as far as countries are concerned in having lack of joined-up fiscal processing within its government departments; I think that is one area. Also in terms
of the cultural change issues, I think the Inland Revenue is much more accepted, it is far more willing to discuss, it has a structure of training which is recognised and is well thought through and balanced. I think a lot of those lessons could do with being filtered down to the joint merged agency, which is then what we will be hoping to feed that into. I think the template of the way that the Inland Revenue does business, while not perfect, will probably help in terms of feeding down into the ethos of the joint agency—or certainly that is the way we are looking at the merger. We are generally fairly positive about it, and certainly when I spoke to Gus O’Donnell, in meeting with him, we were very positive about doing it, as long as it is done in the “right way”, in inverted commas.

Q131 Chairman: Do you think this is the right way?  
Mr Roy-Chowdhury: The briefing I had with the Treasury is that there will be a Bill, probably in October this year, to try and zip together the two departments. Basically the powers that belong to VAT, the powers that belong to direct taxes, will just be downloaded, if you like, to the new department, and then those powers will be discussed and debated subsequently. I am concerned that, once those enhanced powers of the Customs & Excise are in the joint department, it will be very difficult to get rid of them; but I think, because we have the Contributions Agency example from March, there needs to be a much more quick solution, rather than having a drip-feed type approach that has happened with the Contributions Agency. I think probably what we need is for the joint departments to be brought together quickly and then for people to be brought in at the top to try and make it work. The concern I have and the feedback we are getting is that the way the merger was announced, with the 10,500 job losses net, is I do not think it has helped in terms of on-the-ground feeling that the department employees have. There is a lot of concern for their futures, and I think any private organisation which had announced job cuts in that way would be vilified. I do not think that has helped. Certainly I hope subsequently government and the people in charge of the merger will get together and actually bring it together in the best way possible.

Q132 Chairman: Mr Hardwick, obviously there is some disruption while you are merging these two departments. Do you see any other long-term disadvantages in having a single Revenue body?  
Mr Hardwick: I think the area where we are concerned that there could be disadvantages is from the split of policy from policy maintenance between the Treasury on the one hand and the Revenue department on the other hand. A lot depends on whether that is done well or not, and whether the two sides of the policy debate talk to one another. If they do, we can see considerable scope for considerable advantages; if they do not, then there is a risk of dislocation of policy which is not grounded in practice arising, and that would be very unfortunate. Otherwise, I do not think we see significant disadvantages in putting the two departments together. Like Chas, I think one needs to be a bit careful about the job losses and where they are going to fall, but there must be considerable scope for reducing overheads in related common functions, but it would be unfortunate if the jobs were to be the experts within the departments, because that might reduce the quality of service, and that I think would be unfortunate for everyone.

Q133 Chairman: You just said you do not see any significant long-term disadvantages. In your memorandum you say you accept that the existing barriers on the exchange of information would have to be dismantled. Does that mean you have concerns about taxpayer confidentiality resulting from the merger?  
Mr Hardwick: I think we have no difficulty with the idea that information that comes into the merged department in connection, say, with VAT affairs, should be available to those bits of the merged department which deal with direct taxes. That seems only right and sensible, because I would have thought it was part of the compliance checks which the new Revenue department would want to make, to make sure that direct tax and the VAT affairs of a taxpayer appear to be carried on consistently. The area where we think that care is needed is where information goes out of the Revenue department elsewhere within the government. We think it is important that it should go out in an anonymised form, and it should not be possible to relate information back to specific taxpayers. Also, in relation to exchange of information with other countries, the existing arrangements with other countries do enable information to be exchanged between the Inland Revenue and foreign tax authorities. As a result of this exercise there will be more information available to the merged Revenue authority and therefore more information could be exchanged with other tax authorities, and it is important that that should not disturb the balance between the two countries party to exchange of information treaties.

Q134 Chairman: These are in the double-taxation treaties?  
Mr Hardwick: That is right.

Q135 Chairman: Do you think in the forthcoming legislation we need get any further specific safeguards on taxpayer confidentiality, whether it is individuals or companies?  
Mr Hardwick: We think there would be advantages in re-stating the Inland Revenue oath of confidentiality in the legislation, so it is clear on the face of the legislation that tax officials must keep confidential taxpayer information.

Chairman: Thank you, John McFall?

Q136 Mr McFall: I look at the merger of Customs & Excise and the Inland Revenue. The government rejected the recommendation by this Committee, as you say, Mr Lee, in April 2000, that the revenue

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1 Ev 63—further details of the “oath”.

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Mr Whiting: Yes, I am sorry. John Whiting, representing PricewaterhouseCoopers and the Chartered Institute of Taxation. My apologies, Mr Chairman, for my late arrival, but I was repeatedly directed to the Thatcher Room, where various Commons officials insisted you were meeting, so I am afraid I have been there a few times. The first question that Mr McFall asked, I would say I have seen some small evidence of co-operation, some small evidence of better working, a little co-ordination. Frankly, mainly one is conscious that there has been more exchange of information. Better co-ordination of visits, almost certainly not. Clearly the Inland Revenue is now covering direct tax, PAYE and national insurance, so that is helping, and we are getting there; but co-ordination—particularly the burdens on small businesses—no. Co-ordination at a technical level, where one could imagine definitions being brought together, no, not yet. Is there scope for this? Yes, there is, and that is why generally one would support wholeheartedly the idea of the merger of the organisations.

Q141 Mr McFall: I get the feeling from your answers that the next few years, the short term, is a very, very sensitive time. If that is screwed up, as you say it could be, there are not going to be any long-term benefits, so the next few years are really, really crucial.

Mr Whiting: I would agree—

Q142 Mr McFall: We have to lay down exactly what we are wanting to achieve in the next few years. Mr Whiting: Yes; and I think it is not a quick fix, and it would be unrealistic to expect it. It is a long-term project. I think the gains are worth the pain, but we have to recognise that there will be some disruption. I think one of the great dangers would be going for a very quick bringing together, mashing together, streamlining, because one would lose customer service, one would lose the interface that the ordinary taxpayer, the adviser, has with the new body.

Q143 Mr McFall: From what you are suggesting to me, it would appear that maybe this Committee could perform a function by keeping an eye on this merger—

Mr Whiting: Yes.

Q144 Mr McFall: —at a regular period, whereas if we take a state-of-the-nation assessment after a few years, we would maybe not get an idea of exactly how it has been embedded as the months go past. Mr Roy-Chowdhury: Somebody needs to be the watchdog to see what is going on, and I think it is absolutely right that this Committee, which recommended the merger three or four years ago, should be the one which oversees what is going on.

Q145 Mr McFall: On the O’Donnell report it notes, and I quote, that “the new department should have clearer and greater discretion than at present, within the framework set by Government, to decide how to achieve the objectives set by Government”. These
are always good rhetorical statements, and at the end of the day we want to see them implemented. Would you agree that the departments need greater freedom on operational matters?

**Mr Roy-Chowdhury:** I have known this before. I absolutely echo what you say. I have difficulty understanding some of the jargon in this report, such as 1.37. What does it mean? I think what we would like to see, certainly from the ACCA’s point of view, is the merged department sectored into, say, small business, medium-sized business, large business, and that would be one way of perhaps looking at focusing much more in terms of what the taxpayer needs and being able to deliver for the government a more user-friendly interface in extracting the money from the taxpayer. Also, hopefully, knowing what the problems are going to be for a particular sector, ie SMEs, and the sort of problems they have in helping the small taxpayer. Then you have larger businesses which can be helped in that way, in the way that they need. Also, one thing that Gus O’Donnell mentioned two weeks ago is that he thinks the department can have a “good cop/bad cop” face, where they come down like a ton of bricks on the tax evader, and they are very supportive and helpful on the taxpayer who is trying to be compliant. I think the reality is—as I was saying at the beginning—what we want to avoid is the compliance costs, and the hope would be looked at is the compliance costs, and added. One thing I think which we would probably like—coming back to your earlier question—to give directions. They clearly need plenty of freedom of manoeuvre within this, so it is an overall direction which should be set. As you say, Mr McFall, I included some of the thoughts that I would like to see considered within the general operating aims of this new merged department.

**Q148 Mr McFall:** Yes. Other colleagues—

**Mr Lee:** I echo what John has said. Clearly there need to be yardsticks, and you get the results in business that you measure. What I am not sure is clear in connection with the framework document is the need for what we call “smart targets”—specific measurable, achievable, realistic timed targets—which your Committee, as part of the review process that you suggested earlier would have an opportunity to review against, rather than merely reviewing progress outside of any specific targets.

**Mr Hardwick:** I think one would expect a fair degree of consistency between the objectives from year to year, and that they would get fine-tuned as time goes by, and maybe occasionally new objectives would be added. One thing I think which we probably hope would be looked at is the compliance costs, and the balance between compliance costs and revenue raised, with a view to making the tax system more efficient.

**Q149 Mr McFall:** You are suggesting that the government would have to allow you to buy into these issues so that they could be monitored consistently over the years, and main targets not lost and then new ones coming in.

**Mr Lee:** One of the key concerns is that any such targets should be other than merely cost cutting. In other words, if one of the achievements that is measured is “Have we reduced the cost base within the new merged department? Have we consistently reduced the cost, and reduced the cost of collecting tax?”, that is not necessarily an appropriate objective or target of itself.

**Mr Roy-Chowdhury:** I think, Mr McFall, looking at your questions globally, it is very welcome that there will be much more overall parameters or overall remit set for the new department, and in lots of ways that actually harks back to something that the ACCA suggested a number of years ago, where there would be an MPC—Monetary Policy Committee—type remit on tax, where the government would actually set the overall high-level objectives, and then the body could get on and deliver those objectives. I think that is probably a much better, modern way of approaching. I agree it needs to be measured and it needs to be looked at over time, but instead of having the hands-on type situation we have had in the past in some areas, this would be a better way to better motivate the people inside the department, let them get on with things the way they can understand, because they are involved in tax, they can understand the best way to deal with these issues, and to actually deliver for the government the Exchequer results they are after.
Q150 Mr McFall: On the culture of the new department—I will make this one a larger question—we have had your submissions on that. Mr Chowdhury. You stated that “The Inland Revenue is more prepared to negotiate and has a more human face. By contrast, mention Customs investigators to accountants and businesspeople and exasperation sets in”, and Inland Revenue are more consistent, sticking to the rules. Mr Whiting, you say that the Inland Revenue is usually more understanding of business and more willing to be pragmatic. So how can we effect that change from one ethos to the other, which you describe. Mr Chowdhury, as saying that the Customs are chasing smugglers, to that of a tax collecting agency chasing payments from people who are essentially honest? How does that difference in attitude between the two revenue departments manifest itself now? How significant is it in practice, and how can it be changed? Mr Whiting in particular, the tone and the stance of the new body being an important issue, what sort of stance should the new body take, and how can that be achieved? It is all one issue.

Mr Whiting: It is a very big and major issue. I think, and the personal view of most of the practitioners that I represent would be, that we want a business-friendly, taxpayer-friendly approach, a “We’re all in this together, let’s co-operate” sort of approach, because frankly that is what we as advisers and most taxpayers would want to do, rather than, as Chas was alluding to, the rather confrontational approach. How do you get that tone, assuming that is the agreed stance? Frankly, it has to come from the top, as with any organisation, therefore the new chief executive, say, must ripple down and set behaviours, and monitor it. There is a time, obviously, for hard behaviour. There is a time, if you are cracking down on drug smugglers, to take the police-type behaviour. That is fine. But for general taxpayer compliance we want to set a proper tone of “Let’s try and get it right together”; but if you go wrong, and deliberately wrong, obviously there is a bit of a mailed fist behind, but it is well behind, it is not the first step.

Mr Ray-Chowdhury: I think that is absolutely correct. I endorse one hundred per cent everything that John has said. I think one of the key ways of bringing about the new ethos would be through better training because, as I mentioned earlier, I just do not think there has been the same unified approach to training in both departments as they now exist. I think one of the ways to deal with that is that you actually teach people “This is what it is like to run a business”, or “to be a taxpayer”, and you are not trying to evade tax, you are not trying to defraud the Inland Revenue or the joined-up agency, and you should be there first of all to help the taxpayer. That should be the underlying ethos which is hammermed into the people who work there; before anything else, they try and help the taxpayer. OK, the taxpayer may have got it wrong, but they are not crooks; they have just got it wrong because the tax system is highly complex.

Mr Hardwick: I think other ways in which you could harmonise the approach to taxpayers would be through joint audits, say you get one person going along to look at the VAT compliance of the taxpayer, and at the same time someone looks at the direct tax.

Mr Lee: I am sorry—I apologise for cutting across you—I believe, the Institute of Chartered Accountants believes, that this is a fallacy that is suggested in a number of places, and this is the fact that visits from Customs & Excise are designed to focus on current information, what is happening at the moment, and the current periods, whereas visits from the Inland Revenue are looking at historical information and what happened in the past. There may be occasions when it is useful for joint visits to occur, but equally it could create a much greater burden by requiring much more information to be brought together all at once.

Q151 Mr McFall: We are talking of culture here, and maybe what comes to mind is to have management training approaches which are consistent, and perhaps both personnel to have secondments in different departments so they can understand the culture at the start.

Mr Hardwick: Once they are within the same organisation it may well be that you could get that.

Q152 Mr Heathcoat-Amory: I am slightly surprised at the comment that the prime task of the Revenue department is to help business; surely the prime task is to raise money for the government? I think that is compatible with a good working relationship with people who pay their taxes. Are we not slipping into an assumption here that it is all is about being business friendly—

Mr Whiting: I am sorry, I would like to be able to correct—

Q153 Mr Heathcoat-Amory: —and not to do what parliament tells them to, which is to raise money.

Mr Whiting: I take that as read, that the overriding objective is of course that they collect money, but in a business-taxpayer-friendly way. So I certainly take the correction.

Q154 Mr Heathcoat-Amory: Secondly, could I just explore this—and I do apologise for being late—that this difference in culture does arise from a difference in the taxes that they enforce. One is a transaction-based approach—VAT, by and large, or Customs—and the other looks at the record of transactions over a period of time. This has up to now been a reason for keeping the departments rather distinct. So are we not in danger here of forcing together not just two different historical departments but two different functions and forcing them into one, on the assumption that that will bring a whole range of economies, when in fact we are glossing over the good reasons for having two different sets of people doing rather different things?

Mr Lee: I think that is absolutely right, to a degree. The historical reasons for the two departments—one growing out of Customs, with the addition of VAT—as part of our original representations the Institute of Chartered Accountants back in 2003, I think we did suggest that the Customs side of
Customs & Excise be maintained separately to the VAT side, which could potentially be merged successfully with the Inland Revenue’s functions. I mentioned, I think before you arrived, that the long-term benefits are without doubt; the short-term pain, cost and difficulties I believe have been underestimated. Certainly at the meeting that I attended with others representing professional bodies and advisers, at Downing Street on 18 March, the day after the Budget, there was a very clear insinuation from Gus O’Donnell that the business benefits—the benefits to business—one of the three or four key objectives, were unlikely to come through for five to ten years.

Mr Heathcoat-Amory: What I would like to say, Mr Heathcoat-Amory, in 1909 I understand Customs & Excise merged—the Board merged back at that time—and clearly we have now a unified department there. We have the experience, as Mark has said, about the Contributions Agency problem. But more up to date, we have the instance of GST being introduced in Australia—Goods & Services Tax—where it is only introduced within the single fiscal department in Australia. I think actually there have been a lot of benefits to the way that has been handled, and I think if VAT had been introduced through the Inland Revenue when it was in 1972 or 1973, then that would have been accepted that it would have been there and it would have been fine. For example in France, it is all within the same fiscal department, and most other countries in the world. I think it is a concern; we have got two different types of taxes; but then I do not see, with the IT systems, if they can be made to meld together suitably, that there are any obstacles that will not be overcome.

We are looking at the possibility of a one-stop shop for businesses by the two merging successfully. I certainly do not advocate in terms of promoting a business-friendly culture, with these departments looking at some sort of hippy culture with people going with whatever tax they want to pay. They need to pay the right amount of tax, but there are different ways to actually get people on your side. As John was saying, the “We’re all in it together” type of approach—I think people are much more willing to pay the tax they are meant to say, and accept where they are told “No, sorry, you’ve done that wrong. This is the right way to do it, and can you do it the next time”.

Mr Whiting: Can I just add a brief comment. We acknowledge that the taxes are different, but we have I think something like 25 different taxes in the UK, if you add them up. Many of them are different, but most of them are paid by the same taxpayers, so this is where I come back to. I accept, as we have, that the main objective is to raise the money, but in the Colbert’s term, it is all the feathers coming out of the same goose, and can we please make sure the plucking is as efficient and painless as possible, bearing in mind the needs of the goose as well as—

Mr Lee: Yes, indeed. There is of course one specific benefit that should be gone into quite early, which could benefit business, and that is the joined-up provision of information to businesses about both how to register the fact that they are starting a business, and the information they require on an ongoing basis, although it is interesting to note that the trial as regards new businesses registering using a combined form to cover income tax, national insurance and VAT, is not working, because the form needs to be sent to three different places within the UK, and does not always make it to the third place, which is Customs & Excise. Unfortunately it is only a duplicated form.

Chairman: Let us move on. Nigel Beard?

Q156 Mr Beard: All this mention of the culture of this new organisation: Gus O’Donnell told us that what was needed was an organisation which is capable of managing different cultures within itself, one for honest taxpayers that is very customer-friendly, and one for dishonest taxpayers which has a very tough, ruthless approach. Do you agree with that aim, and is it practicable?

Mr Lee: I think it is an old school concept. I think there are good guys and bad guys on both sides, and what is required is a new culture whilst drawing on the benefits and history of both that exist at the moment.

Mr Roy-Chowdhury: I think, as I said at the beginning, at the meeting with Gus two weeks ago, he believes that there can be a good cop/bad cop in the same organisation, but my concern is it would be mainly the bad cop—the one which considers every taxpayer is sitting on tax they should be paying—I think that is the culture that we need to have at the very end of the road where it is quite clear that there is fraud, there is tax evasion going on. I think we need to have the right kind of training, the right kind of approach from the top down, to make sure that if there is to be a bad cop—which there has to be; I admit there has to be enforcement, there needs to be somebody who lays down the law when there is somebody who is taking the revenue authorities for a ride—but it needs to be done in an appropriate way. I think merging the two departments together, you are not starting with a clean slate, but you have that opportunity of trying to instil a better culture within that joined-up organisation. I think that needs to happen from day one, that that is going to be the culture, where the taxpayer is presumed innocent until shown to be otherwise.

Mr Hardwick: I think there is a lot in what Gus O'Donnell was saying. I think the hope is that the new organisation gets to know its taxpayers, and to know whether the taxpayer it is dealing with is more likely to be someone who is basically trying to comply with the system, or someone who is trying to exploit or evade the system. The approach to the different taxpayers I think needs to be different. Inevitably, you have to look at the guy who is trying to exploit the system far more rigorously than the person who is trying to comply with it.

Q155 Mr Heathcoat-Amory: He would rather be plucked once than twice?
Q157 Mr Beard: Can they do that within the same organisation?
Mr Hardwick: I do not see why not.
Mr Whiting: I would echo what Mike is saying. It is basically the customer focus, which I think is the consistent message that we are saying: one recognises that some people are going to try and stretch the system or evade, frankly, and that they need to receive a certain approach. Go back a few years, when I was starting out in tax, the Inland Revenue had a generally friendly attitude, but we all knew that if you fell into the hands of the Enquiry branch or the back duty people, you had potentially got a bit of a problem on your hands. That was at the time a perfectly successful approach. Life moves on and things change, but that worked perfectly well in the same organisation. I feel it can now.

Q158 Mr Beard: Mr Whiting, the Chartered Institute of Taxation has expressed some scepticism that the planned staff reductions of 14,000 by the end of 2007–08 can be made without affecting operational efficiency and customer service. While there may be some risks attached, do you accept that with the introduction of e-processing there should be scope for significant savings in staff engaged in data capture and processing and that this should have a knock-on effect on support staff as well?
Mr Whiting: Yes, we do, and there should be, because as any process gets more efficient—one looks at business, look at all the organisations that we deal with—we all know that things become more efficient, things can be processed more quickly; if one brings two processes together there must be some savings. Whether this amounts to 14,000 and whether this is actually new numbers or repetition of some existing numbers, that is where we get a little sceptical.

Q159 Mr Beard: What grounds for scepticism?
Mr Whiting: It is a very large number, a large proportion of the existing people, and also bearing in mind it is at a time when, despite all of our efforts, the system is getting more complicated, and more things are coming in, and more things are going to have to be run. In the past few years we have seen tax credits coming in—a major addition to the burden of Inland Revenue. We just wonder whether this staff level reduction is achievable. It harks back to something we were saying earlier, that we would not like the whole thing to be driven by “We must achieve X per cent staff reductions or cost savings”, because surely that is not what it is all about? It might be a useful by-product, but it should not be the overall aim.
Mr Lee: If we come back to Mr Heathcoat-Amory's point earlier about the primary objective of the revenue bodies being to collect tax, I would expect the Sub-Committee to be concerned at the reduction in time and effort that the Inland Revenue have been able to devote to inquiries under the self-assessment system since it was introduced in 1997–98. The consequence that has had is that there are fewer stories from the man in the pub, the club, or wherever, of being turned over by the Revenue, and this is not just because the Revenue are being nice and sweet and kind; it is because they just do not have the time to undertake the enquiries that were targeted which ought to have been undertaken. As a result there is the possibility that more people may be less compliant than they otherwise would be, because there is less of a concern that they are going to get caught. One of the primary reasons for that in the last couple of years has been the introduction of the tax credit system, with a lot of staff who would otherwise have been undertaking enquiries being diverted to try and deal with tax credits at short notice. If that is any form of example of how the merged body will operate when there are new things to be done, it does not set a very good example.

Q160 Mr Beard: They did say to us in giving evidence that although there could be two objectives—one is cost saving, and the other the reduction of the taxation gap—they were definitely going for a reduction of the taxation gap.
Mr Lee: It is difficult to see how they could achieve that with fewer staff.
Mr Roy-Chowdhury: I think Gus O'Donnell was really saying that in reality a lot of the reduction may be through natural wastage, when he gave his evidence. I certainly agree with what Mark was saying. I think self-assessment was a case where the Inland Revenue tried to take advantage by cutting some of the people who knew, the people who had been in the Revenue for quite some time, back in 1997, before the benefits of the new system came in. I think the last thing that needs to happen is job cuts, or reductions in the staff in the joined-up department, before we know how the system is going to work, how the new department is going to work. I do not think the job cuts should have been announced at all in the way they were, as I said at the beginning, but that should be the last item on the list—not in terms of the reason for the merger, but in terms of the timing—that the last thing you actually do is reduce the numbers in the joined-up department, once you see the IT systems are working, once you see the Exchequer is getting in the cash it is meant to, once you see the taxpayers are complying and everything is working all right.
Mr Hardwick: I do not have a difficulty with the idea of job cuts as such, but I think you have to be very careful where the job cuts are going to fall, inevitably.

Q161 Mr Beard: They are not just talking in broad terms about job cuts; they are the result of a particular examination, are they not?
Mr Hardwick: Yes.

Q162 Mr Beard: The O'Donnell report notes that the tax service might be organised not on the basis of individual taxes but around three main areas: strategy and change management is one; customer service and compliance is another; and law enforcement is a third. Does this sort of organisation seem sensible, reasonable and helpful?
Mr Roy-Chowdhury: What does it mean? This is what I said earlier. I do not actually understand what the language means. What I would say is that there should be a segregated—I agree there should be division within the organisation; it is far too large to be the fiscal body, and that is it; but it should be on the basis of the business sectors in terms of size of the business: SMEs, medium-sized businesses, maybe partnerships, maybe something else—large businesses. But I honestly do not understand what this jargon here means in paragraph 1.37.

Q163 Mr Beard: The first, strategy of change management, means policy, does it not? Customer service and compliance means taking money out of people’s pockets; and law enforcement means getting it up to a proper level.

Mr Roy-Chowdhury: I appreciate there needs to be a law enforcement arm, clearly, which deals with evasion, fraud, all that sort of thing; but I think the way I would look at it, or the way I understand the simple language, is that you would go by business size or sector in terms of the organisation of the new department. Clearly it needs to be segmented, otherwise it would be too big to work.

Mr Lee: I think I can follow the logic of the distinction there. On the first hand it is talking about policy, which will reside in the Treasury. The second is dealing with the compliant taxpayer, and the third is dealing with the non-compliant taxpayer—and that distinction does make sense to me. However, the concern that the Institute of Chartered Accountants has is the potential problems of divorcing policy from practice and operational matters. The Working Together group, which contains representatives of the professional bodies working together with the Inland Revenue, has made enormous strides in terms of trying to achieve some recognition of what happens in practice to make it easier for everybody to comply effectively, and for the Inland Revenue to reflect feedback that they receive. There are suggestions that policy will be set without having due regard to what will happen on the ground, but reflecting afterwards—

Q164 Mr Beard: But they are saying they divide the policy function too. One will be policy formation, and that will be in the Treasury, and the other will be policy maintenance, and that will be the new organisation.

Mr Lee: I am sorry, that is precisely my point, that they will only be reflecting on how things are working after policy has been introduced, as opposed to taking into account operational issues before policy is finalised.

Mr Whiting: I think one of my great concerns in the organisation—it is very difficult, of course the organisation has to be split, and it is always possible to do it that way, that way, or all sorts of ways; but one of the connections I want to be convinced about is that there is a good connection between the day-to-day operations dealing with the taxpayer, and policy, such that policy is not set in isolation and there is a good interlinking between the two, so if it is not working on the ground, that filters back to policy. If policy thinks of something, then the people who are to operate it are well trained and disciplined. The only other sort of point I would make in terms of this strategy—and it may be seen as a detailed point—is I was not clear where the international links, which are obviously very important to the revenue function, fit in. It may fit in all of them. That would just be one of the queries that I would put.

Q165 Mr Beard: Mr Hardwick, you note in your memorandum that the Law Society has, you say, “in the past expressed concerns at the way Revenue departments have operated, for example, the inappropriate use of PACE powers, the mixed use of criminal and civil powers and in the use of regulations and guidance”, and consider that the merger should be taken as an opportunity to clarify many outstanding issues and to introduce improvements. What are your main concerns in this area, and is the uniform approach possible or appropriate?

Mr Hardwick: I think the main concern, to take the criminal and civil powers, is that there should be consistency in the circumstances in which criminal powers are used across the various categories of taxpayers, and the various taxes; that where criminal powers are to be used they are used properly—

Q166 Mr Beard: What does “properly” mean?

Mr Hardwick: The process is human rights compliant, so that people are cautioned at the appropriate stage and have the opportunity to take advice, and this exercise seems to be a convenient opportunity to codify what the process should be, going forward. In terms of timescale, since we sent in the evidence we have had a better understanding of the timescale for the merger. If, as we understand it, the aim is to carry out the merger by early spring next year, then I think the review of the use of these powers will have to follow on behind, because I think it is important that the review is done properly, that there is proper consultation, and that is not going to happen in the time before next spring. So it needs to be a two-stage approach.

Q167 Mr Beard: Has the Law Society said this to the Treasury?

Mr Hardwick: We would accept—we did indicate when we saw the Treasury that we would be happy for that to be done in more than one stage.

Q169 Mr Beard: But did they agree with the main point you are making?

Mr Hardwick: Yes, I think they did.

Q169 Mr Beard: Lastly, Mr Hardwick, in relation to the departments’ powers to require information, gain access to premises, and so on, you say that “any alignment of powers following the integration of the two departments should not result in an automatic levelling up of the powers to the highest level currently applied”, and that “the opportunity should be taken for a thorough review of all information gathering and enforcement powers”. 
What are your particular concerns in this area? Do you believe there is a case for maintaining these legal differences in some areas?

Mr Hardwick: I think there is a strong case for treating differently those taxpayers who you suspect of trying to evade tax from those taxpayers who you think are basically compliant. The powers of Customs are much wider than the powers of the Revenue, and I think that is driven partly from the history of the two organisations.

Q170 Mr Beard: Yes.

Mr Hardwick: If you put the two organisations into one body, then it seems more logical to draw a distinction between those taxpayers who are compliant and those taxpayers who are criminal, than to draw a distinction between the taxes.

Q171 Mr Beard: Could that not come out of the review you were talking about a moment ago?

Mr Hardwick: Yes, it could, yes. I think the right approach for a merger on the currently-envisioned timetable is to look at alignment of the powers after the merger and not try to do it in a hurry before the merger.

Q172 Mr Beard: So let us be clear, Mr Hardwick: you are saying that these powers should not differ according to different taxation, but according to the different type of—

Mr Hardwick: Taxpayer behaviour.

Q173 Mr Beard: Taxpayer behaviour?

Mr Hardwick: Yes.

Mr Beard: Thank you.

Chairman: Norman Lamb?

Q174 Norman Lamb: Mr Whiting, you said from the point of view of the compliant taxpayer the benefits of a merger are likely to be marginal, and that the real focus should be on simpler taxes, more clearly understood, and so forth. Is there a risk that the merger could divert attention away from what you clearly see as the greater objective of reform to simplify the tax system?

Mr Whiting: Yes. I think any merger gives the danger of a change of direction of the organisation, or a good degree of introspection whilst it is sorted out exactly where the organisation is going—a certain amount of doubling up, a certain amount of concentration as to how we should do things, rather than necessarily continuing in the way we should. As some may know, I speak as a partner in an organisation that has been through a merger, so I have some experience in this.

Q175 Norman Lamb: We are talking about a quite long-drawn-out process here, are we not?

Mr Whiting: It could be. I think is the answer. We talked before about how this will take time to deliver benefits, so it could take a while to really see the benefits flowing. Again, I think I have to come back to the tone and direction set by the chief executive, set by the strategic remit and framework documents, that if those are set in the right direction, and the direction is set fairly clearly, the right tone is set, so we know which direction we are going, then people can work in that direction and conform to that, even if there are an awful lot of I's to be dotted and T's to be crossed as you develop.

Q176 Norman Lamb: Now that the strategic decision has been taken, do you think there is a strong case to be made for real priorities to be given for getting on with this and the process of merger quickly, rather than dragging on for some considerable time?

Mr Whiting: I think basically yes, because the decision has been taken, and I am quite sure that the people working in the departments would welcome to know who is the chief executive going to be, what are we going to be called, what is our direction. There is a lot of uncertainty.

Q177 Norman Lamb: At the moment we have two acting chairmen, do we not?

Mr Whiting: Yes.

Q178 Norman Lamb: There is clearly a risk of drift, is there not, in this interim period?

Mr Whiting: Indeed; and this is, I think, why we do need to a degree to crack on and get on with it, and give people the impetus so they know who they are going to be led by and in what direction they are going.

Mr Hardwick: It is very important. I think, just to echo what John was saying, to get on with it quickly and minimise the uncertainty that staff will be feeling as to what it means for their careers, and indeed, given the scale of the job losses, whether their job is at risk.

Q179 Norman Lamb: Also in terms of not diverting for too long from the other priorities that we were talking about.

Mr Whiting: Inevitably you talk, as one does socially, to people at any level in either organisation, and one of the topics is of course “Well, who’s it going to be? Where are we going? Is my job safe?” They are only human, so it is detracting from morale.

Q180 Norman Lamb: When we took evidence from Gus O’Donnell he talked about the tax gap and he talked in particular about VAT and £12.8 billion or something like that as the tax gap. He made some play of the fact that the merger, streamlining of processes, and so forth, would be a big opportunity to reduce that tax gap, and the review document says there are actually only three countries—I think it is Malawi, Israel and the UK—where VAT is collected on a different type of—going.
12 May 2004  The Merger of Customs & Excise and the Inland Revenue

greater commonality in policing the evaders and catching them and bringing more taxes in, then yes; that is certainly one of the by-products of the merger, that taxes potentially will be collected more efficiently from those who do not wish to pay. Will that close the gap? Yes, it will. Is the gap 12.8 billion? I do not know.

Mr Roy-Chowdhury: I endorse what John says. I think the concern is that 12.8 billion—I am not sure how it is calculated—my concern is that the joined-up department and the 3,000 who are going to be redeployed, between the 14,000 and the 10,500, they expect to save, to try and recoup some of this tax gap—they are going to go after soft targets, people who actually are known already to the fiscal authorities, those who are already registered for VAT, those who already pay tax, whereas I think the real loss, the real tax gap, the loss to tax evasion, is in the shadow economy. When are we going to see concerted action there? That is where we need the bad cop strategy to work, rather than going after those people who are within the economy now.

Q181 Norman Lamb: Your view is that it is wholly inadequate at the moment, and much more attention needs to be given to that sort of evasion?

Mr Roy-Chowdhury: Yes. I think that those people who are registered, who are recognised on the system, who are taxpayers who the fiscal authorities understand, who are there doing trade, who have a PAYE reference or a national insurance reference, they are the people who are at the moment being targeted, by and large. I think it is those people who are outside the knowledge base at the moment who the joined-up fiscal authority needs to go after.

Q182 Mr Heathcoat-Amory: We have talked a lot about administration and enforcement, but all this is about unified tax systems, and I just want to get back to that for a minute. Do our witnesses think that the prospect of a simpler tax system, whereby taxes are lower, simpler and properly enforced, will be enhanced by the merger, given that the Revenue branch have no obvious interest in simplification or doing away with taxes. Bluntly, more complexity, more jobs, so will this merger with a large self-confident Revenue department actually perhaps put back the prospect of this Holy Grail, a simpler system?

Mr Whiting: Of course many people say that we sat here have a great interest vested in a complex tax system—

Q183 Mr Heathcoat-Amory: I could not possibly say that myself; I am a chartered accountant!

Mr Whiting: I think we would make it on your behalf, as it were, and I think we would all subscribe to it, but actually in reality we have an interest in a simpler tax system, because that is better overall for our work, our clients and everything else. Yours is a fair challenge. I think. What I would say is we are not really making a lot of progress on a simpler tax system as we stand. Putting the two organisations together does at least give greater scope for it. Whether you are talking about common definitions, eg groups of companies where the VAT, the indirect tax definition, differs widely from the direct tax, or common procedures, or spotting that there is scope for streamlining definitions—there are papers flying around on that—it can only help, I think, in the quest for a generally simpler system. Are we ever going to get to it? Despite what I would like to achieve, and what I have argued for in things like my ideas of a tax practice committee and various things, I fear it is going to be a very long haul, and it may be our successors who see it.

Mr Hardwick: By overhauling the way in which policy is made, I think there is the opportunity to look at things in a rather wider way than maybe has been done today. My understanding is that the Treasury are looking to look at the impact of tax on business sectors. That sort of approach may help them to look at broader ideas for reforming the tax system in a way that raises money, but raises money in a simpler way, and with fewer complexities which could be exploited at the side. So I think there is the chance that the system could produce a simpler tax system. Whether it will do so remains to be seen.

Mr Lee: It is certainly true that simplicity is only one of the objectives that should be set. Paragraph 1.25 of the report sets out five objectives for policy making from a tax perspective. The Institute of Chartered Accountants Tax Faculty produced the Ten Tenets for a Better Tax System back about five years ago now—a number of you may have had copies of this at the time. We identified ten tenets that should be identified, and against which the tax system and developments in the tax system should be challenged and checked. Simplicity was only one of those ten. There are a number of overlaps with the five policy objectives set out in the report. One of the constraints, however, we have come to realise in recent years, is actually the way in which the parliamentary draughtsmen prepare the legislation, making it that much more complex than either the Revenue or the profession or indeed taxpayers would like it to be, because there seems to be a rather historical system that nobody is able to change in the way that the legislation is drafted. It would be a great step forward if the merged body was able as a result of the change to introduce some changes into the way the tax legislation is drafted, in order to achieve both simplicity and some of the other tenets that we have identified.

Chairman: Let us move on. Norman Lamb?

Q184 Norman Lamb: The O’Donnell report referred to the potential risks of the merger, and they refer in particular to risks to businesses in collection of tax, and disruption of projects already planned. Do you share that concern that those risks exist, and do you think it is possible to achieve the merger without those risks materialising?

Mr Whiting: I do share that. Those are risks. It is the general disruption, disruption of the service, be it in terms of collecting the money or the service to the taxpayer. The first step is to recognise that they are risks, and to try and take action to circumvent them,
stop them actually becoming a major problem, which is back to our discussion about direction, tone.

Q185 Norman Lamb: Gus O’Donnell has made it clear that there would be a consultation process once the strategic decision has been taken. Have you yet been informed of this consultation, what the timescale will be, what it will involve, and so forth?

Mr Roy-Chowdhury: Certainly we had a Treasury briefing last week, I think, the other bodies here, some of us also had a briefing. Basically the simple answer is “yes”, we have been told—

Q186 Norman Lamb: This is a written briefing you were sent?

Mr Roy-Chowdhury: No, just in terms of the Act being tabled in October, and the new body coming into being next year, and consultation on the actual powers within the body, and various other aspects of the zipped-together body.

Q187 Norman Lamb: Can I move on to tax-making policy. You talked earlier, Mr Whiting, about concern about separation. We understand that policy is going to be focused very much within the Treasury, with implementation in the department. Is there a risk that that separation will reinforce the concerns that you have about separation between the two?

Mr Whiting: It is a point that we have made. It is a point that I think can be made already in terms of the way the departments are organised; it is a concern that I made certainly, and my body made, in submissions to the O’Donnell review, and I think one has to put it up as still a risk, that policy gets set in isolation. Coming back to earlier points, you have to split this department and the whole organisation of our tax system in some direction. I understand why policy is split off from operations, if we call it that, but there need to be good connections and good links between them, so policy is not set in isolation. One of the tenets, if you like, to borrow Mark’s term, I would like to see is that it is imbued that consultation always takes place on any policy change, to make sure that the policy setters are in touch with people like ourselves and taxpayers; that in effect consultation is compulsory, because one recognises that this split does have the danger of policy being set in a slightly theoretical, rarefied place.

Mr Roy-Chowdhury: I echo everything John says. I think also, going back to Mr Heathcoat-Amory’s point about where the two departments merging together is going to detract from simplification of the tax system, what we advocate at ACCA is that there should be a tax policy committee, such as the Bank of England’s monthly policy committee where the government actually sets the overall framework, and then tax policy is set within that framework without this constant political tinkering. I think one of the reasons we have a problem with the tax system being so complex in the UK is because there is a lot of political tinkering that is going on, and we need to try and move away from that, as we have for interest rate setting.

Mr Hardwick: It may be that it would help if policy is set on a slightly slower timescale, so that there is space for greater consultation and consideration—both consultation by the Treasury with the tax authorities about the practicalities, and consultation with outside stakeholders. I think one of the problems in the past has been that we have tended to rush into things, and then discover that they had effects that we did not expect, so we had to fine-tune.

Mr Lee: Tax credits might be a good example.

Mr Roy-Chowdhury: Zero-rated corporation tax.

Mr Whiting: Zero-rated corporation tax, yes. I completely endorse what Mike has said. You can sometimes get there faster by going more slowly.

Chairman: We will have to leave it there. Thank you all very much indeed.
Wednesday 13 October 2004

Members present:

Mr Michael Fallon, in the Chair

Mr Nigel Beard  John Mann
Mr Jim Cousins  Mr John McFall
Angela Eagle  Mr George Mudie
Norman Lamb  Mr James Plaskitt

Witnesses: Mr David Varney, Chairman, HM Customs & Excise and the Inland Revenue, Mr Paul Gray, Deputy Chairman, HM Customs & Excise and the Inland Revenue and Ms Ann Chant CB, Director General, Change Management Centre, examined.

Q188 Chairman: Mr Varney, can I welcome you to the Sub-Committee. Could you formally identify yourself and your colleagues, please? Mr Varney: My name is David Varney, I am Chairman of Her Majesty’s Customs & Excise and Inland Revenue, and Chairman Designate of Her Majesty’s Revenue and Customs. On my right is Mr Paul Gray, who is Deputy Chairman of Her Majesty’s Customs & Excise and Deputy Chairman of Inland Revenue, and Deputy Chairman Designate of Her Majesty’s Revenue and Customs. On my left is Ms Ann Chant, who is Director for our Change Management Centre.

Q189 Chairman: Thank you. Before we come to the main topic today, I want to ask you about the letter you wrote on 29 September to the Chairman of the main Committee, John McFall, about London City Bond, and you reported that some 20 retired or serving Customs officials have now been named as under investigation in the Fourth Impact Assessment into that affair, including two very senior officials, one of whom I think appeared before this Committee, and who are the Director General of Law Enforcement and indeed the Solicitor. Can you add to that and tell us what is going on? Mr Varney: I can tell you something, but clearly it is a matter of a police investigation, which is continuing, and I would not want to say anything that prejudices the inquiry. The police have taken up an investigation which began in November 2002. From time to time they provided us with an Impact Report, which enables us to meet our obligations to the courts in the various cases that come before the courts. As you have referred to the letter, the letter spells out that in that Impact Report the police recorded certain allegations against 20 individuals. I will say these are allegations; they are not proven, they are not fact, and we have to act on that basis. I have considered very carefully what I should do in an employment context: what was my duty to the employees, my duty to the institution and to the law enforcement task we are trusting in. I came to the conclusion on the basis of advice from the Internal Investigations Division and following consultation with the Attorney General and the Treasury Solicitors that it would not be possible for the two senior individuals to remain in post. I then pursued the option of whether there was alternative employment and by the nature of the tasks and their seniority that proved not possible. So with great reluctance I came to the conclusion that they had to be suspended. So that has been done. The police inquiry is continuing and we are encouraging the Police Commissioner of the Metropolitan Police to move as expeditiously as he can to bring his investigations to a conclusion. We also felt that this was the right time also to make an announcement on what we were doing both in the short-term in dealing with the police inquiry, and I have got Perry Nove, who was the Commissioner of the City Police advising me on the handling of interface with the police, and Bill Taylor, who was Her Majesty’s Inspector of Constabulary in Scotland, is working with ourselves and the Serious Organised Crime Agency to develop the framework both for professional accreditation of investigators and accountability when there are complaints against the enforcement institutions.

Q190 Chairman: When do you expect the whole affair to be resolved? Mr Varney: I have written to the Metropolitan Police Commissioner asking for it to be expedited and I am awaiting a reply.

Q191 Chairman: When do you expect the whole affair to be resolved? Mr Varney: I am not privy to the police investigation in its totality, and I have recently referred another matter to the police to investigate.

Q192 Norman Lamb: An absolutely key issue in the London City Bond case was the question of Alfred Allington’s status as a registered informant. The Butterfield inquiry concluded that he had never been registered as an informant. Customs & Excise knew before John Healey made his statement to Parliament that he had been registered. Yet I am told in parliamentary answers that John Healey only found out that information in January of this year, several months afterwards. The result is that he gave an incomplete statement to Parliament. Why is it that the Customs & Excise did not provide all the necessary crucial information to the minister before his statement to Parliament?
Mr Varney: What you are addressing are matters which are directly—

Q193 Norman Lamb: That is not a police matter.
Mr Varney: It is directly part of the police investigation and is involved in this. You have written, as I understand it, to the Economic Secretary, who I understand has replied.

Q194 Norman Lamb: He has refused to reply to the question.
Mr Varney: I think you may find that there is a reply winging its way at this very moment.

Q195 Mr Beard: Does this position arise because you, in your new role, have reviewed the case, and if that is not the case why did these names not arise in the initial investigations?
Mr Varney: I have not sought to, in a sense, revisit the police investigation. I have taken steps to assure myself that the police investigation that was provided to me can be relied upon as a piece of my own qualifications? The advert for your post asked

Mr Varney: I think that is correct.

Q196 Mr Beard: So these names had not arisen in the earlier part of the investigation?
Mr Varney: They were not in the First Impact, the Second or the Third Impact before.

Q197 Mr Cousins: I have two questions for you. One is, as I am sure you will be aware, that there is a name being put into the public domain by a national newspaper within the last week or two, suggesting that Sir Richard Broadbent, a former Chair of Customs, is facing police questions as a result of the case that you have referred to. It would be useful for you to confirm, if that is untrue, that it is untrue.

Mr Varney: The police may or may not choose to interview these individuals. The state of the Impact Report is that they will pursue and investigate these allegations, and I repeat that this is not a proof of guilt, it is that there is an allegation been made. Let me just answer your question. I can confirm that Sir Richard Broadbent was one of the people we advised of the report.

Q198 Mr Cousins: My other question really relates to the quite important remark you made about bringing the Serious Organised Crime Agency in to advise of your own internal procedures, because can you confirm that in this chain of cases that led up to the London City Bond case that there are quite senior members of Customs & Excise investigation teams who have now been suspended for periods up to six and a half years?

Q199 Mr Cousins: Of course. I understood.
Mr Varney: I think you are referring to the Branfield case, which did take six years.

Q200 Mr Cousins: Yes.
Mr Varney: And three officers have been charged and will come before the courts.

Q201 Mr Cousins: Is it correct that one officer has been suspended for a period of six and a half years?
Mr Varney: I think that is correct.

Q202 Chairman: We are going to turn back to the merger now between the Customs and the Inland Revenue. Mr Varney, if we could start with your own qualifications? The advert for your post asked for “a broad understanding of the challenges of working in the public sector”. Most of your background and experience seems to be in the private sector. Do you think that is going to be an advantage or a disadvantage?

Mr Varney: I suspect that it will be a mixed blessing. I think there are advantages obviously coming from the private sector, having dealt with large-scale change. It is not an accident that my deputy is from the public sector, and I suspect he will come with pluses and minuses too, and hopefully the two of us working together will reduce each other’s deficits.

Q203 Chairman: Specifically in the private sector you presided over the de-merger of the exploration side of British Gas from the gas pipelines operation and the de-merger of MM02 from BT. The Daily Mail profile said that you were “well-versed in breaking things up, but less practised in putting them back together.”

Mr Varney: If just shows how careful you have to be when you read newspapers, does it not? The 02 basis, it is correct that it was de-merged from BT but what was de-merged were four separate operating companies with individual identities that were, for example, BT Cellnet in this country and a variety of brands overseas, which had to be crafted into what is now the 02 brand and turned into a successful company. So I think I would argue that I have had some experience of putting things together but I agree that my popular image is rather more of taking things apart.

Q204 Chairman: Have you firmed up a timescale of the merger itself? When do you expect the process to be completed?
Mr Varney: Let us start with what we need to get the merger underway. We need obviously a Bill to be included in the lists of proposed legislation because without the Bill there are a lot of things we cannot
do. We have tried information sharing, that will get us some of the way; but we will need to get the Bill and the framework document agreed with the Treasury. We are clearly moving two departments. The thinking parts of the two departments will move into the other part of the Treasury building when it is finished, which is, we anticipate, in November, and we will occupy the Treasury. That will take in 1,575 people in Revenue and Customs, and that will help with the relationship with the Treasury. So the refurbishment of that part of the building, which is 1 Parliament Square, is on budget and two months early and will come in at something like £181.687 million in March 2002 prices, and we will occupy that paying an annual rent of something like £17.1 million, again in 2002 money. The aim obviously is to get the organisation in shape, and if everything finds favour with Parliament it will come into existence on 1 April next year. By then we can start the organisation moving together. We have a series of targets over the 2004 settlement, where we have got to produce efficiencies of 507 million cumulatively and save 12,500 jobs net and make an impact on the tax gap, and what we will be doing is tuning the organisation over that period of time. It is unlikely that on day one we will have an absolutely perfect organisation. If we look at what the Australians, the Canadians and the Americans have all done, they have made major organisational shifts and then they have done some fine-tuning. What we have also been doing is talking to staff because these are hugely complex outfits, as you would well know.

Q205 Chairman: We will come to head count a little later on. When would your customers start to see the benefits of merger?

Mr Varney: In various groups. One of the things we have done is put together the large business organisation and the large business group 1, respectively the Inland Revenue and Customs & Excise, into a large business system to create one interface with the larger businesses. That will take some time to get the benefit from, but we think that with sector specialists being employed we will be a better and smarter department. On the electronic agenda we have, for example, an electronic self-assessment. At the moment we are running so far this year at about 500,000 hits, mainly by agents. In the same period last year we were running 250,000. So pushing out the E agenda will be helpful. I think one of the big challenge areas for us is what is the right structure, framework, to interface with very small businesses and then the bigger smaller part of the business world.

Q206 Chairman: The O’Donnell Review was not able to quantify the actual costs and savings because the report said that that depended crucially on the sequencing of the merger. Now that you are into this process have you got that information and are you able to share that with us?

1 Note from Witness: This is the large business service.

Mr Varney: No. If it had been a six-week job I think O’Donnell would have probably got to the bottom of it. I think one of the issues is the sheer size and complexity of the two organisations. If you have 98,000 full-time employees, equivalent, which is actually 106,000 people on 1 April, spread over 300 locations, of which 93 are in common; 24 locations have more than 1000 staff, that is 65% of the staff; you get to 40 locations you get to 75% of the staff; 170 locations have less than 100 staff and they are 8% of our staff in total; and 24% of our staff is in London and the south-east. If you then interact, and we interact with 30 million people, two million companies, what we have been doing—and what Paul and I did on our first two days—is sit down with the Treasury. We are clearly moving two departments. The thinking parts of the two departments will move into the other part of the Treasury building when it is finished, which is, we anticipate, in November, and we will occupy the Treasury. That will take in 1,575 people in Revenue and Customs, and that will help with the relationship with the Treasury. So the refurbishment of that part of the building, which is 1 Parliament Square, is on budget and two months early and will come in at something like £181.687 million in March 2002 prices, and we will occupy that paying an annual rent of something like £17.1 million, again in 2002 money. The aim obviously is to get the organisation in shape, and if everything finds favour with Parliament it will come into existence on 1 April next year. By then we can start the organisation moving together. We have a series of targets over the 2004 settlement, where we have got to produce efficiencies of 507 million cumulatively and save 12,500 jobs net and make an impact on the tax gap, and what we will be doing is tuning the organisation over that period of time. It is unlikely that on day one we will have an absolutely perfect organisation. If we look at what the Australians, the Canadians and the Americans have all done, they have made major organisational shifts and then they have done some fine-tuning. What we have also been doing is talking to staff because these are hugely complex outfits, as you would well know.

Q207 Chairman: But you would not in the private sector be merging two big organisations without having some idea of the costs and savings you want to achieve by the end of year one, the end of year two and the end of year three—you would be flying blind otherwise.

Mr Varney: No, but then we would not be going to Parliament to seek agreement of the Bill. We would have also been doing is talking to staff because these are hugely complex outfits, as you would well know.

Q208 Chairman: But you still have no real idea of whether this is all going to cost us more money in the long-term or whether it is going to save money? You have no quantifiable idea?

Mr Varney: I was at dinner last night, we brought together the personnel people from South Africa—the FISCS, the Fiscal Authorities in South Africa, the United States, Netherlands, Ireland, and all of them who have done it are very enthusiastic that it makes you more efficient and gives you a better input. I think we believe that we can see some advantages. We have a new Chief Information Officer who we have just appointed and he sees opportunities, so I think we are quietly optimistic.

Chairman: You think there are going to be savings.

Q209 Mr Mudie: In your remarks, you seem to have increased your staff by 7,000 from the 3,000-4,000 figure. We have somewhere the figure of 99,000 and you have gone up to 106,000. Is that full-time equivalent?
Mr Varney: No, 98,000 full-time equivalent, but with part time people; if everybody who works part-time is treated as an employee it would be 106.

Q210 Mr Mudie: Following on from what the Chairman was dealing with, you are down as saying, “to keep a long-term focus on the effectiveness prizes and not fall prey to the temptation to substitute short-term cost reduction objectives”. What are these “effectiveness prizes” you refer to?

Mr Varney: You are very much geared of course with investment and technology, for it to be enabled; what is the right balance of the investment in electronic infrastructure in a world in which more organisations are really enabled? It is also to keep a rigorous focus on making sure that processes really do work well. If there is one lesson from National Savings and from Unipart, it is continuing to fine-tune processes, particularly when you are dealing with as many people and as many different places as we are. That is a major target for us. There is always a temptation to succumb to the short-term pressure to cut costs a little bit more and not do a real trade-off, which is what we are doing to close the tax gap.

Q211 Mr Mudie: But those statements there, do you think that they are long-term or something that you should be doing anyway?

Mr Varney: I think we are in the business of continuing improvement, as much as we are in the business of change.

Q212 Mr Mudie: You deliberately, I presume, use the word “substitute”, but I would have thought you would be doing those things anyway as a matter of course as part and parcel of what you were about, and you might have some reduction of cost objectives as part of it, and not see it as necessarily a substitute.

Mr Varney: I do not think it is necessarily a substitute but there can be occasions on which managers and directors take pride in cutting their costs and then wake up to the fact that the market position has disappeared. I can think of one or two supermarkets—

Q213 Mr Mudie: I do not think the market position for tax will disappear; I think you are assured that that will continue into the future.

Mr Varney: We have to do a better job obviously in reducing the gap; that is common ground.

Q214 Mr Beard: In your comments on the Gus O’Donnell report you noted, “if a single department is established it would have a huge risk management task . . . relating to revenue streams as well as IT projects”. Then you went on to say, “an absolute requirement for the new organisation will be good processes to deal with those risks—particularly on IT.” What are you doing to meet that requirement?

Mr Varney: I feel hoisted by my own petard! Let me deal with the IT one. We have gone out to recruit a Chief Information Officer, which we have done so. We have had an outside competition and Steve Lamey from BG—who I have never worked with, let us be very clear, I left BG before he arrived, and Paul was on the recruiting panel—we have chosen him as our Chief Information Officer. He is coming in and he has already focused on how can we take the 3,000 people we have in IT plus the contracts that we have, to make them work for us. We have had two organisational shifts, which is that Paul and I both attend the management meetings of Customs & Excise and the Revenue, and we have focused those on delivering performance. We have created EXCOM, which is essentially looking at design and risk, and Ann Chant heads up the Change Management Directorate, which is in a sense where our change management is overviewed, and we have a classic change management view point through internal audit. Ann, maybe you would like to say a little more about your contribution?

Ms Chant: Yes, our change management function has to fulfill three objectives. Broadly, the one that we have sort of touched on, creating the new organisation from existing departments, having it up and running well and getting increasingly better whenever we come into being. Both organisations already have major change programmes to improve their own handling of their business as usual. So those are things that have already been put into train and are running. Those two programmes have to be brought together, rationalised, prioritised, and we have to make sure that they do not conflict and in fact support creating the new department. That is the second element. The third element is that, as we have touched on, there are three areas we have to start performing against straight away: closing the tax gap, improving customer services and achieving significant efficiencies, particularly in our head count. So those are three different responsibilities which comprise the change management programme. We have set up a small change management centre to oversee that and clearly the oversight, the handling of risk in both departments and the creation of the new department is a vital responsibility therein. We already have well-established risk tracking control programmes but we have to bring those together and add in this new dimension monitoring and driving forward and assisting and stimulating and checking. That whole programme is the responsibility of this discrete change management centre. I would add one more thing. Apart from all contacts and networks we have established within the two departments I am going to set up an advisory group where we will have individuals and organisations with direct relevant experience from both the private and the public sector and academia in this country and particularly in foreign tax authorities, who can give us the advice and can exchange information with us to make sure that we are picking up every trick that we should on the way.

Q215 Mr Beard: What reassurance can you give that during this period, which is bound to be an upheaval, that tax gathering will be maintained and service to the public will be maintained?
Mr Varney: That is very much the focus of our attention and that will be in our PSA targets and it is in the objectives we are trying to drive through. So will be working extremely hard and diligently to make sure that happens.

Ms Chant: It is the second element of that risk factor. It is looking at the change programmes and the improvement programmes of the two existing departments, to strengthen the performance of business as usual. So it is absolutely essential.

Q216 Mr Beard: Your answer, Mr Varney, is aspiration. What confidence do you have that you can achieve it?

Mr Varney: I would not have taken the job if I did not think there was a fair chance that we could achieve it; we would be struggling hard to do it.

Q217 Mr Beard: On the IT side of things, the public sector has had a very chequered history with regard to IT projects, and no doubt that is going to be a central nervous system of the new organisation and a very important element of the changes you are bringing about, particularly on the IT side of things. How are you going to avoid some of the obvious mistakes that have been made in the past? Particularly, for instance, as this Committee has revealed, putting too many eggs in one basket by getting too involved with one contractor?

Mr Varney: I wish I could say that the private sector was incredibly better. The evidence in the US is that about 25% of the IT projects deliver value. In Europe we think it might even be slightly less. First of all, we are trying to bring the various IT arrangements that we have with the Inland Revenue and Customs & Excise into some coherence. We have The Aspire contract in the Inland Revenue with Cap Gemini, and in Customs & Excise we have the deal with Fujitsu. So we are talking, and I am hopeful that by the end of this year we will start the process of bringing them together. You are absolutely right, we have 250 major IT systems, and we have 3,000 staff, as I said, working. It is a huge expenditure of money. We per year put out 170 million forms and we run 100 thousand desktops. So it is a big issue for us. I think what we are bringing in is expertise of somebody who has a track record of managing change in IT and delivering business benefits. We also have to get smarter at our pre-risking and big risk minimisation projects, talking through both the IT risk and the operation.

Q218 Mr Beard: How do you believe that with a combined organisation you are going to avoid the sort of problems that affected tax credits when they were introduced?

Mr Varney: The first one is by learning all the lessons that we can about what went well and what went badly with tax credits. Organisations learn, in my experience, when they confront their past, the good news and the bad news, and where they are anxious also to benchmark with other organisations. So talking to other Revenues around the world is a very important thing to do. I do not think that we have to invent everything here; I am quite happy to be Robin Hood, and if one of the other Revenues has got a better answer we will take it.

Q219 Mr Beard: Is the problem at a conceptual level, where you are talking with other Revenues, or is it more at the detailed management level and control level of these contracts?

Mr Varney: I think a lot is inadequate specification or over elaborate specification and not re-checking it, and also many of us have learned to try to create the framework in which the people who are going to have to operate the kit, whatever it is, have a chance to test it before it is live. There are no silver bullets. What we need is a culture that is relentlessly saying, “Are we learning all the lessons? Are we checking this?” There is a new procedure in government, which is about as good as anything I have seen outside in terms of its academic structure, of gateway reviews and peer challenge. I certainly do not feel a great sense of adventure in IT, particularly if something runs all the way through and is key to our modernisation agenda and what we want to achieve.

Q220 Mr Beard: What you have just described is quite a menagerie of various systems. How long is it going to be before we have an integrated IT system?

Mr Varney: It will take time, there is no getting away from that, and part of the modernisation of the PAYE system, for example, is critical to our achievement of the efficiency savings we have to make. So some of these projects are mission critical for both delivering cost and service objectives. I think we will bring what we want to bring because we bring the management potential and the discipline to the problem of investing in technology. What differentiates successful oil companies that use technology and those that are unsuccessful is essentially not the technology but the people and the attitudes.

Q221 Mr Beard: But they could have said that ten years ago, so how do you know?

Mr Varney: They probably did. All I can do is to say, look at my record.

Q222 Angela Eagle: I think the most comforting thing I have heard is that you do not want to do dramatic and exciting things with the IT quickly, you just want to make steady progress. I think that is already a sign that you are more likely to succeed than somebody who has very ambitious approaches to it. 250 major systems. The Aspire contract is only just essentially gearing up and therefore there will be a transition from the old EDS contract, plus some way then of attempting to somehow combine that with the Fujitsu contract, which is completely different in structure and form. So you have different structures, a transition from one to another in one of the systems, and all the time the day job going on. I do not know what you are paying your new IT manager, but presumably quite a lot of money. That is a complex picture, is it not?

Mr Varney: Yes.
Q223 Angela Eagle: Yet it is absolutely critical to what both the Revenue and Customs—particularly the Revenue—do day to day, and the impact that that has on tax payers and customers. 

Mr Varney: That is absolutely right. He has been engaged, almost as soon as he was appointed—he has not actually taken up full-time engagement—seeing the IT community, talking to customers, and he and Paul were sitting down the other day and talking about how do we get the alignment between Cap Gemini and Fujitsu? And you are right, they are different contracts, but it is in both parties’ interests to believe that HMRC is, without presuming on Parliament, going to be a reality, and a satisfied or what is the right mixture or encouragement and enforcement.

Q224 Angela Eagle: Do you have any sign that they are looking at the small print in their contracts and waiting to take you on for compensation, or do you think that they are enthusiastically engaged in trying to make this work? 

Mr Varney: The word “enthusiastic” I would need to think about very carefully, but I think there is a recognition that it is in both their interests to make this work. I think the Aspire contract changeover was one of the biggest changeovers I have seen from one computer contractor to another, and I do not minimise the sense of achievement in doing that. I think we have a platform and we have to move forward. I have to take it at face value, but the people I have met from both sides, of Cap Gemini and Fujitsu, are expressing to me that they will work together in the interests of their client.

Q225 Angela Eagle: The transition between the EDS and the Aspire has been going on with no obvious disruption to the day job that I have come across. You are touching wood. You do not only have to do that, do you, you also have to make qualitative increases in service in order to achieve your significant savings—half a billion pounds of savings cumulative—and roll out your E agenda and all of those things. Do you think it is possible to do that kind of consolidation at the same time as moving forward? The risk management there must be huge; there must be a big chance it is all going to collapse. 

Mr Varney: It is a bit like driving Formula I cars—rather better to drive it for your hope rather than your fears, or you will drive yourself into the wall. But a sensible management looks at what those risks are. The Aspire contract has been switched over, EDS are out, Cap Gemini are now in. The Revenue got advice beforehand that this was an extremely difficult and dangerous thing to do. It has been done and it reflects great credit on those who were involved. I think it is about the attitude of mind to delivery performance, and seeing all the technology as part of the context in which it will work. I think there is another issue, if I can move on slightly, which is the issue of the extent to which we encourage people to use electronic communications with us, and the extent to which we mandate, and that is an issue on which we are starting to find what is the right basis because there is a real dilemma when we build an electronic infrastructure which brings with it great benefits for the benefits of all tax payers in the end in terms of the service. What do you do, do you encourage or mandate people?

Q226 Angela Eagle: You are talking about compulsory electronic filing. 

Mr Varney: Yes.

Q227 Chairman: For businesses or individuals? 

Mr Varney: I think it is a debate where we are going to have to talk about if we can provide services which use electronic interchange, what is the right balance, or what is the right mixture or encouragement and enforcement.

Q228 Angela Eagle: But you can see that becoming an issue once you have got yourself sorted? 

Mr Varney: Yes.

Q229 Angela Eagle: Requiring electronic filing. Would that be businesses first and individuals to follow? 

Mr Varney: I do not know whether it would follow, but I think at each stage we will have a debate, and no doubt this Committee will want to exercise its view and contribute to the debate.

Q230 Angela Eagle: Finally, what is the biggest risk that kept you awake at night that you are all managing at the moment in this huge change management process? Perhaps each of you could say which one you are most focused on? 

Mr Varney: It is a lady’s privilege to go first! Ms Chant: May I say that I am not actually being kept awake at night at the moment, which is good I would say from creating the Change Management Centre it is energising and involving, getting the commitment and understanding of both departments of the common objectives, and I think if we get that right the enormous power that that unleashes should, with the appropriate controls, see us through, if we can pull that off.

Q231 Angela Eagle: So your biggest worry is that you will not do it? 

Ms Chant: Yes. However, we have already started working hard to do just that. It is the appropriate expertise within different parts of the department, as well as the combined initiative and imagination of the staff and managers concerned. If they can get behind what they understand to be the key objectives for a new organisation, that should give us the go ahead. 

Mr Gray: I am also sleeping pretty well. I should tell you.

Q232 Angela Eagle: You all look pretty relaxed! 

Mr Gray: My main issue is one that has already been touched on, which is setting the right balance between keeping people focused on current performance, delivering the day job, delivering performance that was touched on and freeing up the right amount of resource, frankly not too much, for planning and developing the further benefits that
we can yield from the merger, and getting that balance right is essentially a people and focus issue. All the enabling of the infrastructure is of course hugely important, but that for me is the biggest thing—it is people rather than systems.

**Mr Varney:** I too sleep well, so I think it is a combination of a people issue that Paul mentioned, and is my Bill going to be there on 1 April? Because I could have a group of people willing and ready to go and wanting to get on with this, but will they have the tools to be able to do it? And getting the right relationship with the Treasury, so that Gus O’Donnell and I are setting a tone at the top, and the cooperation, working together, will produce better results than living in silos.

**Q233 John Mann:** I was interested in the talk of electronic filing. Do you file your tax returns electronically?

**Mr Varney:** My agent does, I think.

**Q234 John Mann:** In terms of the organisation, the O’Donnell report noted that the tax service might be organised around three main areas. Is that the sort of organisation you are aiming for?

**Mr Varney:** I have read O’Donnell, I have been looking at the way that other tax authorities are organisation. We have been working at the moment, we had seven transition streams which predated my appointment, which have led us to, for example, the appointment of Helen Ghosh as a Corporate Service Director in both the Revenue and Customs and there we are looking for the right structures for personnel, finance and logistics. Really we are bringing together a large business group. We are trying to bring together knowledge, analysis and data, and we are currently looking for a head of knowledge, analysis and data. So we are trying at the moment to get the building blocks from below of the organisation. Mike Eland is looking at the whole way we do law enforcement across both the Inland Revenue and Customs & Excise and pulling those together. We have this executive committee for designing the organisation. I think it makes more sense to design the organisation in a sense from the bottom up rather than the top down. I have the advantage of having O’Donnell’s report with a top down suggestion, which I can benchmark my structure against.

**Q235 John Mann:** Is there any danger of the law enforcement becoming the poorer partner?

**Mr Varney:** No. Let us be clear, those who want to serve their returns, pay their taxes, our job is to make it as easy as possible, and if they are getting credits to make that as easy as we can. For those who are lost or do not understand we have to help them. For those who do not want to do it we have to relentlessly seek them out.

**Q236 John Mann:** In terms of the style of the change you want to be implemented, last month the Department of Work and Pensions moved—some would say speedily, some would say hastily—to announce the closure of lots of offices. Are you under similar pressure to get quick costs savings?

**Mr Varney:** I am under a pressure to deliver efficiency and I have a Spending Review in which to do that, and we will think about what is the sensible way to proceed in delivering those efficiency savings. The first people to know will be the people who are affected.

**Q237 John Mann:** Some people are suggesting—and it is inevitable in a time of change and job losses—that senior Civil Servants in senior management are overpaid. At the same time there have been some ideas circulating that Senior Civil Servants are underpaid. Look at the change of process you are going through, would you say that your senior management are now overpaid or underpaid?

**Mr Varney:** I find myself in a bit of an odd position of having negotiated a salary reduction to take this job, so I think that there is a real issue about if we are having an open structure in which people move through the private and public sector, there is going to be pressure at all levels, not just at the top level, of having salaries. Clearly the salaries in the private sector are much higher and would not be reflected in the public sector. I do not think with the change process which we have, the debate we want to have about salary levels is different in the change process. The change process we are engaged in—and I think this is common ground between ourselves and the Unions—is to produce jobs which are more challenging, more stretching and more rewarding. That is a continual process of technology and modernisation, that is going to take out jobs which are more challenging and produce ones which are more challenging, and maybe a smaller workforce.

**Q238 John Mann:** Presumably also in relationship to the Unions they are suggesting that lower down the skills if they are more rewarding, better rewarded.

**Mr Varney:** You would not be surprised to find that they have made many such suggestions.

**Q239 Mr Plaskitt:** Mr Varney, you have just told us that you have negotiated your salary down. Did you get it down from an “attractive” six-figure salary as in the advert to an “unattractive” six-figure salary?

**Mr Varney:** Clearly it was not unattractive because I am doing the job.

**Q240 Mr Plaskitt:** I just wondered what an unattractive six-figure salary looked like.

**Mr Varney:** I might be able to give you some advice later!

**Q241 John Mann:** In an earlier answer you suggested that you were looking to save 12,500 jobs; is that a gross figure or net?

**Mr Varney:** That is net.
Q242 John Mann: A net saving of 12,500 jobs. When we took evidence from Mr O’Donnell in April he said that the net job reduction figure to be anticipated was 10,500, so have you now got 2,000 more redundancies on the list?  
Mr Varney: Yes.

Q243 Mr Plaskitt: Why is that?  
Mr Varney: As a result of the Spending Review settlement and a look at what is the broad shape, what was expected out of the merger of the two departments. So of some of these reductions that we have, we have what I would call are very draft plans of seeing the direction in which we can move; in others we have a lot of work to do.

Q244 Mr Plaskitt: How many of the 12,500 net job reductions, in your view, would come about directly as a result of the merging of the two departments?  
Mr Varney: The number we have is 3,500.

Q245 Mr Plaskitt: So that has gone up by 500 from what Mr O’Donnell told us in April because he then said it was 3,000; you have increased that, have you?  
Mr Varney: Yes, I have a number which is running, 3,200; these numbers move around. The point I think I made to the Committee is that we do not have today a plan which I am prepared to die for, which I have worked all the way through, otherwise I would have talked to the employers who would be affected. We have been going through a process of getting an allocation of money and numbers; it is not unusual in a plc—and in my experience I have done it frequently—of the business saying what it can do and the finance department saying, “We need more than that and here is the spec.” That is in the nature of the debate.

Q246 Mr Plaskitt: Are you going to be able to achieve the 12,500 net losses and avoid compulsory redundancies?  
Mr Varney: I hope so, but let us be clear that they are job reductions and we have a buoyant economy at the moment—I think we reported today the greatest number of people in work—so we are going to have labour turnover. Nobody wants to go for compulsory redundancies unless it is absolutely avoidable. I am not ruling it out, but I am not seeking it.

Q247 Mr Plaskitt: You cannot rule it out but you would try to avoid it?  
Mr Varney: Yes.

Q248 Mr Plaskitt: Mr O’Donnell also told us that there would be consultation about the way the merger was going to be implemented. Can you tell us what sort of consultation processes are running with all the staff involved?  
Mr Varney: We have met the two Unions teams and we are also getting input from outside—various bodies have written to me with advice. Paul and I met the two Unions teams separately and they are coming together to reflect HM Revenue and Customs and we will continue to talk to them and see them, as we have done historically, as a valuable partner.

Q249 Mr Plaskitt: How have the Unions reacted to the job reduction figure going up?  
Mr Varney: They were concerned, but they were more concentrated on some of the issues that Mr Mann identified in terms of their aspirations and what would a settlement that was successful look like for them.

Q250 Mr Plaskitt: And the time frame on achieving that 12,500 reduction? When will that be done by?  
Mr Varney: That all has to be done by the end of 2008. There is a gradual build-up, so if you exclude the 3,200 which come from the merger, we have something—and I am rounding the figures because I think that is a sensible way of doing it—and we have about 2,000 in the first year, 04/05, and then a gradual build-up until we get to about 13,000, which we have identified at the moment in draft, in 2007–08.

Q251 Mr Plaskitt: Out of this process and all the job shedding, what would you say would be the concrete benefits for the staff arising out of all of this?  
Mr Varney: It is going to have to continuously improve, we are not going to arrive at Nirvana, but it is an organisation which has greater customer satisfaction, it is working to reduce the tax gap and it has a sense of a purpose about the agenda it wants to drive forward in the next Spending Review.

Q252 Mr Plaskitt: Are those concrete benefits for the staff? I can see why they might be a mission for the whole department.  
Mr Varney: I do not think there is much fun working in a department which is not well regarded, well received and playing a useful role as a public service.

Q253 Mr Plaskitt: That is how you see the benefits to the staff?  
Mr Varney: Yes. As I said, the Unions and ourselves want to see jobs which are more interesting and stretching, and it will be our success in up rating and training our staff.

Q254 Mr Cousins: Working to reduce a tax gap may in fact involve more staff.  
Mr Varney: I think working smart. There is a real choice. I have seen a number of papers which say that if you have ten more staff and the average staff generates 100, by getting ten extra staff you get an extra thousand on top, so that is worth doing. Unfortunately in the business I suspect it is not like that. We are dealing with people on the gap side who are often quite smart and are revolting, so being smart and seeing where we can apply resources sensibly is the thing we have to do, and we have to make choices of risks.

Q255 Mr Cousins: One of the things that the Committee has explored already is the presence of Customs’ staff at ports and airports of entry, and
Mr Varney: Yes.

Q257 Mr Cousins: told the Committee something about that. who would have to change their approach if a

Mr Varney: Let me take the general point. I think the real issue is—and it is an issue for us—that whatever budget we are given we have to make a risk assessment of how do you deploy whatever that resource is as the most deterrent effect? You can never have 100% presence; nobody could ever afford that, nor would they defend it. So every government that is doing manning borders has to have a measure of, where are the risks, where is the deterrent effect, how much would we need? That is the judgment we are involved in. If you had at the moment 98,000 full-time employees how would you deploy them in order to get the best outcome for the public purse? I am always going to be taking risks; I am in the risk management business. I am trying to get smarter at it, better at it. The number of people I have is, in the end, a judgment. So one of the debates I will be having, no doubt with ministers, I will be saying, “Here are the resources I have, here is how I see the risks, here is what I am doing.”

Q256 Mr Cousins: One of the important factors here is relocation from London. Could we end up with a situation in which relatively low paid workers are brought under immense pressure to relocate from London while people higher up the food chain of authority are all looking forward to hunkering down in these wonderful new offices you are going to have, shared with the Treasury, at a cost, you have just told us, of £17 million a year. Will the relocations from London be people high up the food chain or will it be a question of pressure on lower paid staff to move?

Mr Varney: We are looking at what makes sense to relocate both in terms of cost efficiency of the task and also where the customer groups are. For example, I could put my large company group in the Shetlands, but most of the large corporates they deal with are in the south. So there is a real issue of looking where the customers are. On the private sector, private individuals, customers want face to face, and we agree with that, we think it is the sensible way, and what can we do remotely? I have got the 1,575 people I am moving into the Treasury and moving in because they work within the area which has a very close impact and working relationship with the Treasury. I know there are some plans in some quarters to send the Treasury to Liverpool. If that were to happen no doubt we would go with them.

Q257 Mr Cousins: I wonder if I could just ask you, as part of the relocation that may mean modifying the number of offices you have got, and you have just told the Committee something about that.

Mr Varney: Yes.

Q258 Mr Cousins: Under the agreement with Mapeley there is a cap on the amount of square footage each year that you can surrender. Is that a difficulty for you?

Mr Varney: I think it is an advantage actually. That is one feature of the Mapeley deal which is better than what we had before. What we had before was if we were going to adjust property we would have had to have taken all the cost on our own account. You are right, there is a cap and we will have to be an intelligent reconstructor about real estate distribution with one eye to what our interests are vis-à-vis Mapeley.

Q259 Mr Cousins: Under that contract there is a limit on the number of square footage of offices you can surrender during the course of the year.

Mr Varney: Yes, there is. Under the agreement with Mapeley there is a cap on the amount of square footage you can surrender each year. The sooner you yourselves can clarify this from within your organisation or decisions imposition from above you?

Mr Varney: I think it is a continuing challenge and it has got to be a challenge. Nobody likes the uncertainty. We do not like it because we would like to know where it is coming from, the staff are not keen on it because they want to know whether it affects them or not, so I do not think anybody is under any illusion that the sooner we can clarify this the better, but we want to make decisions which are good quality decisions and robust and well considered.

Q260 Norman Lamb: On the job issue, Mr Varney, you have talked about the risk assessment that you carried out. Having done that for the 14,000 jobs that you are going to lose, do you end up with any concerns about the implications of that or are you entirely confident that you can maintain the performance, working smarter as you say, or do you have continuing concerns?

Mr Varney: I think it is a continuing challenge and it has got to be a challenge. Nobody likes the uncertainty. We do not like it because we would like to know where it is coming from, the staff are not keen on it because they want to know whether it affects them or not, so I do not think anybody is under any illusion that the sooner we can clarify this the better, but we want to make decisions which are good quality decisions and robust and well considered.

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Q262 Norman Lamb: You anticipate that you will emerge from that with those 14,000 job reductions confirmed and achievable?

Mr Varney: I have committed to 12,500 now. I do not want to offer any more up at the moment.

Q263 Norman Lamb: On the culture of the new department, the O’Donnell review recognised the distinct cultures of Customs and Excise on the one hand and Inland Revenue on the other and talked about Customs’ activities relating to compliance and the focus on risk assessment whereas the Revenue are more engaged in the processing activities. ACCA told us that the Revenue is “more prepared to negotiate and has a more human face than Customs who would have to change their approach if a merged department is to work effectively”. Do you
accept that a new culture will be necessary for the new department? At which end of the spectrum will it be?

**Mr Varney:** I think I am going to dissent from the analysis that the two organisations have distinct and individual personalities quite as clear as that. My experience of managing the two departments is they have a range of cultures in them and there is a considerable overlap. The reason they have cultural differences is because they have got different tasks. I think one of the tricks for us is to be clear about why different cultures are appropriate in different situations. If you talk to the serious compliance people in the Inland Revenue you will find a much more law enforcement-type attitude. They may go about it in a very polite way but then they are not dealing with people who have got drugs in their possession or contraband cigarettes. The market gets the response which is likely to dissuade people from doing the activities that they are doing.

**Q264 Norman Lamb:** Though the dishonesty and the loss to the Exchequer can be just as great through losses on the Revenue side as Customs and Excise.

**Mr Varney:** Yes.

**Q265 Norman Lamb:** Yet the powers on the Customs’ side are in some cases very draconian. You are being challenged at the moment by the European Commission over your powers of seizure because it has asserted that they are unlawful under European law. What is your response to that? Are you comfortable with the extent of the draconian nature of those powers?

**Mr Varney:** Let me give a general answer. Customs and Excise have come out of an environment and are part of a tax system where an entity is taxed in real time and if you do not stop it, it disappears. The Revenue has more time because they can do investigations and they can always reopen cases within a certain period of time. I think the proposition we will be putting, if the Bill is introduced, will be to keep the powers that each individual tax activity has in place and to accept that when HMRC is up and running we will look again at the question of proportionality of powers in the context of broader institutions that exercise powers of enforcement.

**Q266 Norman Lamb:** Gus O’Donnell, in his evidence to us, talked about an approach with honest, law-abiding taxpayers and the approach being customer-friendly and so forth, and this is rather what you are talking about on different activities, and then he says a rather different approach for the dishonest taxpayers which has to be a very tough, ruthless approach. The Butterfield review concluded that it was not only tough and ruthless but that it was unlawful as well in some respects and continuing over quite a period of time. Are you concerned that the culture of Customs and Excise has changed sufficiently? Many would say that it is rotten at least in part; some would say it is rotten to the core. How do you feel about the culture of Customs moving into this new organisation?

**Mr Varney:** I think it is absolutely outrageous if people are saying that. These are 8,000 people, public servants, working in a difficult situation. There are a small number of cases and I have referred them to the police in order for them to investigate. That is what a law enforcement agency does when it has serious investigations. It would be an absolute scandal if an efficient law enforcement organisation was besmirched by the possible—just the possible, not proven, not tried in the courts—

**Q267 Norman Lamb:** Butterfield has already concluded.

**Mr Varney:** Butterfield said there were some individual cases, which he drew to our attention, and he made some suggestions about both enforcement of standards in law enforcement and in terms of inspection, and those I have implemented. He made a suggestion that we split off the prosecution of the Customs and Excise and it was announced yesterday, I think, by the Attorney General that we are also going to do that with the Inland Revenue.

**Q268 Norman Lamb:** Are you satisfied with the recommendations in Butterfield? You talked about some of them but are you satisfied that on the whole the recommendations are being implemented?

**Mr Varney:** I think that we are going through, as we should do regularly, asking ourselves, as any law enforcement agency has got to keep asking itself, “Are we doing the task appropriately, discharging it professionally and responsibly?” and if there are allegations we deal with them toughly, openly, quickly and proportionately. These are rotten decisions to have to make but they have been made.

**Q269 Chairman:** Finally, can we turn to your relationship with the Treasury. You said that you were moving into the Treasury building. The Paymaster General announced on Monday that the new arrangements for the development and maintenance of tax policy are now in operation, which presumably means a piece of your Department has moved across to the Treasury. How many staff have moved?

**Mr Varney:** The new tax office in the Treasury has got about 150 people, or will have when it is fully fleshed out in its final form. We have provided about half. I think.

**Mr Gray:** Just under half.

**Mr Varney:** From both Customs and Excise and Inland Revenue. I think there are two points to make. We will still have people of a similar ilk to the policy—are I use the term—works in the Treasury. We will have people of that tribe who will be practising their wonking in an operational context and may, over their careers, go into the Treasury and come back. We will also have, and I think this is true of many other situations I have been involved in, people who, if you are developing policy, you want to talk to because they have got operational experience at the cutting edge of some particular tax. They will tend to be in the operational activity. They will know what is going on in terms of avoidance and they will know what is going on in terms of difficult
issues. The fact that we are in the same building should really make sure that we meet the work together. I know that Dave Hartnett, who is leading up the policy side, has spent a lot of time thinking about how we review regularly the process of working together, and I have accepted Gus O’Donnell’s invitation to be a non-exec on the Treasury Management Board as another way of showing that we are really keen to work together.

Q270 Chairman: Some of the evidence that we have taken during our inquiry into the merger, for example from the chartered accountants, has drawn our attention to the danger that this will widen the gulf that already exists between policy issues and operational issues.

Mr Varney: I think it would be very disappointing if it does. It is clearly a danger but the move was motivated by almost an absence of policy making for tax in the Treasury armoury and I think we have got to correct that. I have got some really good policy people who are going to work with operational people on thinking about what is the best way of improving the framework of law so that it operates more effectively and efficiently.

Q271 Mr Beard: Those people who are doing that tax policy, how are you going to make sure that their analysis gets through before the tax is actually formulated rather than afterwards?

Mr Varney: Obviously one is my relationship with both the Paymaster General and the Chancellor, to whom I am accountable. The benefit of the merger comes from us having a place at the table and articulating an operational viewpoint. If that is not listened to then I think this Committee will be asking why these operational mistakes have occurred.

Q272 Mr Beard: We have asked in the past why these have occurred and we were told by Mr O’Donnell when he was doing his review that this would all be sorted by the new arrangement, that was why I was asking you the question.

Mr Varney: I think we are both working towards trying to make the situation into the future much better than it has been in the past.

Q273 Chairman: Can you clarify for us the position so far as accountability to ministers is concerned. According to the announcement on Monday, the Paymaster General will be the Departmental Minister responsible for Revenue and Customs, however the website still lists the Economic Secretary as retaining responsibility for excise duties. Can you help us with that?

Mr Varney: That was in the announcement, that he has still got that responsibility.

Q274 Chairman: So you will still be accountable to two ministers?

Mr Varney: For various aspects and, in fact, three because there are some things that I report to the Financial Secretary on. There are issues to do with the City, various things that come across my desk, that will go to the Financial Secretary.²

Q275 Norman Lamb: Why the divide? Why have one minister responsible for excise duty and gambling? If you are merging the two departments, surely it would make sense to have one minister responsible?

Mr Varney: With great respect, I think I am probably not able to give you the sort of quality answer you could get from some other people in the Department.

Q276 Chairman: You mean you are as mystified as we are?

Mr Varney: You might say that, I could not possibly comment.

Q277 Chairman: We will ask elsewhere. How do you respond to the other criticism that moving your Department into the Treasury itself actually reduces the gap between ministers and their advisers and people closer to politics and the independent tax collection that has always been protected by that geographical distance, indeed by various oaths and declarations that you have to undertake?

Mr Varney: We have still undertaken the oaths and we will be on a separate computer system and all individual taxpayers' data will remain private to us, it will not be shared with the Treasury. I am not convinced that the geographic co-location is actually a major issue, it is an issue of attitude and training, and we have got very clear responsibilities under the Finance Act for the protection of the confidentiality of data, which I think is key to confidence in us and confidence in the tax system as a whole.

Q278 Chairman: So there is no danger of a minister or adviser meeting your officials in the cafeteria and asking for a file or anything like that?

Mr Varney: Everyone is trained to be absolutely crystal clear that that is private information that is not passed.

Q279 Chairman: Have you made a statutory declaration yourself?

Mr Varney: I have.

Q280 Mr Cousins: One of the questions that we asked your predecessor about was the creation of specialist teams to deal with quite special areas of difficulty about tax collection and in a piece of correspondence that the Committee has received we were told that as a result of the spend to save programmes, in 2003 a National Avoidance Unit was created and in 2004 an Avoidance Intelligence Unit was created, both with very substantial responsibilities. In one case it is seven people, that is the National Avoidance Unit, and in the other case, the Avoidance Intelligence Unit, which has got massive responsibilities, including co-operation with

² Ev 68
the American agencies who are concerned about tax evasion on a massive scale, that consists of ten people. Now, smart government is fine but is this not quite inadequate to the task of closing the tax gap that you have set yourself?

**Mr Varney:** Ann, you were there.

**Ms Chant:** Yes. Could I perhaps explain that those units are the ones that deal with the discussion, the strategy, the understanding, the intelligence and the theoretical analysis of the problem. What they come up with will then be translated into operational activity which will be carried out by thousands of people, which is one possibility or, of course, another obvious output of theirs is proposed legislation to close tax gaps. They are not personally the only people doing that, they are, if you like, the brain that is putting that together to come up with the strategy and the tactics and the legislation to stop avoidance. They are mirrored exactly by some of the teams from the opposite authorities.

**Q281 Mr Cousins:** But, Ann, even if we were to accept that—Sorry, that was overly familiar because of our Newcastle connection.

**Mr Varney:** There is a more serious problem than I thought!

**Ms Chant:** There is that line about “when you are in a hole...”

**Q282 Mr Cousins:** Even if we were to take that answer purely on its merits, and I am not sure about it, the Chairman has just referred to the enormous intellectual firepower of what he called—now I am in another hole—the art of wonking, but a unit of ten people, a unit of seven people, are they going to have the intellectual firepower to deal with the practicalities alongside the Treasury with its massive numbers of people?

**Ms Chant:** Can I give you another example. We talked about setting up a very small change management centre that I head. We have not quite fixed the figures yet but, roughly speaking, we are talking about 30 people. Nobody is assuming that 30 of us are actually going to do it all, it is where you identify what needs to be done, where you refine your strategy. Going back to your original point, by the time 30 people from three different countries come together and apply their brain to one particular internationally common tax avoidance or evasion scheme, you do not need big numbers there, you need analysis and understanding. What they then come up with is either operational instructions or changes to legislation or intelligence guidance to the law enforcement people. I think that is the difference. There is no question that they are the only ones who are doing it.

**Q283 Chairman:** We are going to leave it there. We shall be reporting on the merger shortly and then we will expect to see you early in the New Year to hear how everything is going.

**Mr Varney:** I shall look forward to it.

**Chairman:** Thank you very much indeed.
Written evidence

Memorandum submitted by the Chartered Institute of Taxation

MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE

INTRODUCTION

1. In his Budget speech, the Chancellor of the Exchequer accepted the recommendation of Mr Gus O’Donnell in Financing Britain’s Future: Review of the Revenue Departments (Cm 6163) (“the Report”) and announced a merger of HM Customs and Excise and the Inland Revenue.

2. As the leading UK body concerned solely with taxation, the aim of the Chartered Institute of Taxation is primarily to work for a better tax system—better, that is, for all interested parties. We think that the new revenue body can contribute to this and we welcome its establishment.

3. The Report, the Chancellor’s Budget Speech and the Economic and Fiscal Strategy Report (“EFSR”) suggest four areas of concern:

   — Moving policymaking from the revenue departments to HM Treasury.
   — Independence of the new revenue department.
   — Staffing the new revenue department.
   — Taxpayer benefits.

4. Our comments on these matters are set out below. We conclude with some remarks on the need for tax simplification.

POLICYMAKING

5. Chapters 5 and 6 of the Report recommend a radical shift in the responsibilities for tax policymaking. In brief (para 5.47), the Report recommends:

   — “[T]he Treasury should have lead responsibility and accountability for tax policy, with support from the new department.”
   — “[T]he new department should lead on policy maintenance, with support from the Treasury.”

6. There is clearly an argument for moving major policy issues to the Treasury to help implement the Government’s policies. Equally, however, there is argument for leaving technical policy issues to the new department, which will have the technical expertise and operational experience to make the necessary judgements. The key is to ensure:

   — proper resources are put into policymaking
   — the policymaking is evidence-based and does not become a theoretical exercise
   — opportunities are taken for harmonised, connected policymaking across multiple taxes
   — the centralisation of policymaking does not lead to an unwillingness to consult
   — there is proper connection between the policymaking and the operational side of the tax body.

It is the last two issues that are of more concern to us than the location or constitution of the policy section.

INDEPENDENCE OF THE NEW REVENUE DEPARTMENT

7. The Report recommends that the new department should have “greater discretion than at present . . . to decide how to achieve the objectives set by Ministers” (para 7.27). We agree that the new department should have responsibility and accountability for the day-to-day implementation of tax policy, running of the department and non-revenue tasks (see para 6.23). We note, however, that the new department will be subject to Treasury direction by means of:

   — The Chancellor’s Annual Strategic Remit (“ASR”)
   — A “Framework Document”.

8. The Report recommends that the new department’s priorities will be set out in the ASR. This would take the form of a letter from the Chancellor to the departmental chairman. It would be published alongside the Budget documents (see paras 6.30 to 6.33). We welcome the proposed publication of the ASR. As regards substance, we note that changed priorities lead to a redirection of resources. It seems clear that additional resources must be made available to meet new requirements if operational efficiency is to be maintained.

9. The report sees “an opportunity to set out longer-term principles in relation to running the department in [a] Framework Document” (see para 6.33). It has a number of things to say (in the context of policymaking) that could usefully be enshrined in this document. For example:
— “External stakeholders should be consulted where possible” (para 5.18). We prefer the Code of Practice on Consultation that consultation should take place unless there is a good reason for not doing so.

— “[P]lans [should be] adjusted in the light of new evidence [arising from consultation]” (para 5.18). This means that policymakers must listen, keep an open mind, and be prepared to abandon ill-conceived proposals.

— “Compliance costs must be factored in [to policymaking] particularly for small businesses” (para 5.18). The “investment to understand a new set of rules . . . is a proportionately greater burden [for small businesses] than for larger companies” (para 5.20).

— “[T]he Government must take into account the effects on behaviour that any tax will have” (para 5.19). This means listening to outside experts: cutting the starter rate of corporation tax to nil in 2002 led to an increase in company registrations for the sole purpose of benefiting from the nil rate band of corporation tax (as forecast by many commentators) and consequent measures announced in the 2004 Budget.

— “[L]egislation must be both precise and comprehensive” (para 5.20). Tax legislation should be finite in scope, say what it means and mean what it says.

— “Stability is important in the tax regime, particularly for small firms” (para 5.20). Policymakers should avoid tinkering with the legislation in dribs and drabs. Whole chunks should be looked at with a view to rationalisation, modernisation and simplicity.

— “[T]ax policy [must be] anchored in the real world” (para 5.21). It must also be firmly based on what taxpayers actually do. Tax legislation all too frequently “deems” that taxpayers have done something that they have not actually done (para 5.21).

— Policy [must] “pick up early warnings of problems on the ground” (para 5.21). It must clearly address “areas where tax is being lost”. It must also address areas where issues of unfairness, anomaly or ambiguity come to light, perhaps as a result of litigation. It must also result in action being taken.

Staffing the New Revenue Department

10. The Chancellor announced that past investments in new technology “can make large savings in back office costs”, and announced a significant overall staff reduction. We have concerns if cost-cutting is one of the main motives of the merger.

11. The Report indicates that the revenue departments currently employ 90,300 staff (in terms of full-time equivalents), or approximately 100,000 in actual numbers (see para 2.6). We express some scepticism that staff reductions of the order outlined will result from using new technology, merging related functions (eg debt collection) and changing working practices (eg joint auditing) without affecting operational efficiency and customer service.

12. The report recommends that the new revenue department should develop “strong career paths to provide experience across the new department” (see para 3.117). This gives rise to both problems and opportunities:

— Cost-efficient control of small businesses suggests a need for generalists who can cover the whole range of a taxpayer’s tax affairs. Thus, in relation to a sole trader, for example, a tax officer would need to have some level of expertise in income tax, PAYE and VAT. It is not unreasonable to expect the officer to have this expertise (after all, all Chartered Tax Advisers have such knowledge and a good number of our members can be found within the tax authorities). The taxpayer is required to possess it (and much more besides) in order to comply with his legal obligations.

— The tax system is notoriously complex. This has led to increasing specialisation amongst tax advisers over the last thirty years. This is a matter of necessity: there is simply too much legislation, case law and guidance for an individual tax adviser to give expert advice on everything. Thus, it will be necessary for the new department to invest heavily in staff training.

— A simpler tax system would have many benefits for the new department. Tax officers could cover a wider field in greater depth with less training. They would find it easier to detect technical errors in the application of the law and generally apply the tax law with an efficient touch.

13. We conclude that tax simplification is a necessity if the new department is to function efficiently with fewer tax officers.

Taxpayer Benefits

14. The Economic and Fiscal Strategy report indicates that the merged department “will improve tax collection from the non-compliant and reduce costs for the compliant, helping to improve the fairness of the tax system”. The new department will be “customer-focused” and make “better use of the information that taxpayers provide” (para 5.80).
15. Compliant taxpayers will gain only a marginal benefit from merger. It is true that they may benefit from a “one stop shop” for tax. However, what taxpayers in general, and small business in particular, need is fewer tax obligations and a tax system that—at least insofar as it affects them—they can understand and can therefore comply with. The new body does have the opportunity to work towards this end.

16. Providing better information and increasing taxpayer support is only a palliative. The real solution is a simpler tax system. Given that most tax is now collected by self assessment and that most taxpayers have relatively straightforward tax affairs, they both need and deserve a tax system designed for the modern world. There should be no need for them to require professional help in order to comply with their statutory duties.

TAX SIMPLIFICATION

17. The Report indicates that the Government’s tax objective is “to create a fair and efficient tax system with incentives to work, save and invest” (para 5.9). We regret the omission of simplicity as a specific objective:

— Using the tax system to introduce “incentives”, “address environmental externalities” and “promote economic growth and efficiency” necessarily leads to a more complex tax system.

— Most taxes are now self-assessed. This means that taxpayers must understand their tax obligations in order to comply with them.

— Increasing complexity can reduce levels of compliance (because taxpayers cannot understand what it is they have to do), increase compliance costs (because it is necessary to employ a tax adviser) and expand the shadow economy (as a means of escaping onerous compliance burdens or professional fees that taxpayers cannot afford).

18. Simplicity cannot be left out of the equation.

19. The Report has nothing to say about tax reform (in the sense of improving or modernising the legislation giving effect to existing policies). We consider that the establishment of a new department is an ideal time to consider the antiquated machinery for changing the law. We have long argued for a twin-track approach to tax legislation:

— An annual Finance Bill giving effect to new policies introduced shortly after the annual Budget. This would be the responsibility of the Treasury (assisted by the new revenue department).

— An annual “tax reform” Bill concerned with what are essentially nuts-and-bolts issues introduced early in the Parliamentary session so as to receive Royal Assent by the beginning of the new tax year on 6 April. This would be the responsibility of the new revenue department (subject to oversight by the Treasury).

If a move to a twin-track basis of tax law change remains impossible, we do think there must be a real commitment to a proper process of change, involving full and timely consultation.

20. One reform that is both necessary and desirable is an alignment of tax management provisions (eg assessments, penalties, registration, interest on overdue tax, repayment supplement, debt collection, etc). The present situation is a mess. For example, there is separate legislation (drawn in broadly similar but not identical terms) for each of the taxes and levies under the care and management of Customs and Excise, and different provisions for customs and excise duties. The legislation for taxes under the care and management of the Inland Revenue is more closely harmonised. However, it has little in common with the Customs and Excise legislation, although it deals with the same subjects.

21. In more general terms:

— It is desirable to harmonise terminology and tax treatment for direct and indirect tax purposes. For example, taxpayers can account for tax on a cash basis for VAT purposes but not for income tax purposes.

— It is desirable to look holistically at a special regime for small businesses. For example, one of the advantages of the VAT flat rate scheme is that small businesses do not have to keep certain records. However, they still need to keep them in order to comply with direct tax requirements.

— Merger should not be used as an excuse to increase burdens on taxpayers. Thus, the lighter burden should be chosen when deciding which of the two revenue department approaches to follow.

14 April 2004
Memorandum submitted by the Association of Chartered Certified Accountants

WOULD A MERGER BETWEEN CUSTOMS AND THE REVENUE WORK?

More than a year ago Dawn Primarolo, the paymaster-general, announced a major review of both the Inland Revenue and Customs & Excise, after a series of high-profile problems at both agencies, embarrassment in the episodes such as the Mapeley Steps affair, where the two agencies transferred their properties to a Bermuda tax haven and the general implementation problems with the new tax credits system.

Gus O’Donnell, in my view, has produced a very useful report which has hit most of the nails on the head in most respects.

But would, or could, a merger work in practice?

The UK is unusual in having a split tax regime. Customs’ VAT responsibilities have always sat uneasily with its fight against drug smuggling. So, in theory at least, a merger could mean VAT collection being subsumed into the Revenue to form one general tax function, leaving a Customs Authority to chase drug traffickers.

A general tax agency could provide businesses with consolidated tax demands covering PAYE, Working Families Tax Credit, VAT, Customs Duties and Corporation Tax. Local offices could help taxpayers with enquiries on everything from Inheritance Tax to capital gains. Administration could be simplified.

Time could also be saved when a tax inquiry is launched. Currently, a VAT investigation is often followed by a Revenue inquiry with consequent doubling of disruption to a business’ affairs. One agency doing one inquiry would make some sense, but the danger is a much more in-depth investigation, with more issues to examine. And inspectors may find themselves under more pressure—real or perceived—to “find” results to justify the costs of combined inquiries.

But the $64,000 question is: do the very different cultures at the UK’s tax authorities lend themselves to a merger? The perceived problems here explain why a merger, while mooted for the last ten years or more, has never been contemplated until now.

The Inland Revenue is more prepared to negotiate and has a more human face. By contrast, mention Customs investigators to accountants and businesspeople and exasperation sets in. Once the Revenue has made a ruling, it generally sticks to it. VAT offices change their minds more often—partly because they tend not to commit themselves in writing.

The historical background to Customs is that it was not set up as a tax collecting agency, chasing payments from people who are essentially honest. It was set up to chase smugglers. Some of that ethos persists—and it is this which needs to change if a merged entity is to operate as an effective public service agency.

ACCA as a WATCH DOG—POWERS OF THE NEW AGENCY

But my concern is that, in a merged tax authority, Customs’ approach—and powers—would prevail. Customs has far greater powers of investigation and entry—greater than the police in some cases. If a merged tax authority takes on such characteristics, the ‘bad cop’ would sideline the “good cop”.

Nor should it be forgotten that VAT and corporation tax are two very different animals. VAT is charged on a transaction basis and Customs’ IT system is set up for regular payments over time. A lot of Customs’ time is spent out in the field checking that retailers and traders have systems that will adequately account for VAT—an activity that contributes to the authority’s rather fearsome reputation.

The Revenue’s infrastructure, meanwhile, is geared to deal with annual or quarterly deadlines—so the risk is that there will be a hiatus of payments, which are processed and ideally cleared in time for the next deadline. The cost of bringing together two such disparate systems would be high indeed.

The different cultures also have major implications for staffing and training. The Revenue is geared towards professional qualifications and has a structure of tax exams. Customs, by contrast, is much more experience-driven. Although there has been a recent emphasis on professional training with adoption of ACCA qualification being promoted as an example.

To sum up, I would say the problems of a merger between two such distinct bodies give little grounds for confidence that it would succeed. But the string of disasters we have had recently—from the Revenue’s family tax credit debacle and ceasing of reminders to people to pay enough NICs for a decent state pension, to Customs’ failures in £billion fraud cases—means there might just be a sufficient head of steam now for this long-mooted merger to move from theory to practice.

CONCLUDING COMMENT

The key concerns are:

(i) The merger actually adds genuine value to businesses and taxpayers.

(ii) The IT systems of the joint department upon which so much of the potential savings are dependent function effectively.
(iii) It needs to be ensured that the merger is not largely a smoke screen to bring about a “Big Brother” department with worst powers of both the existing agencies.

(iv) The opportunity needs to be seized in the merged department to create a user focused, transparent and less fearsome face of Government ie it is an opportunity for the joint agency to re-invent itself.

April 2004

Memorandum submitted by The Institute of Chartered Accountants of Scotland

MERGER OF INLAND REVENUE AND CUSTOM & EXCISE

The proposal to merge the Inland Revenue and Customs & Excise has met with a very mixed reception from the members of the Institute of Chartered Accountants of Scotland. Many believe that the development is logical and reflects the fact that in 1973 it would have been more sensible to give the responsibility for VAT to the Inland Revenue rather than Customs. This population believes that the merger proposal is logical and that there are obvious benefits in placing the responsibility for fiscal compliance on business taxes within the one organisation.

Others are very concerned that the proposed merger has the potential to cause difficulty to business, reducing the service which taxpayers have a right to expect and adding to costs. From past experience of the merger of the Inland Revenue and Contributions Agency, the proposal to merge the Revenue and Customs does not inspire confidence. As organisations, the Contributions Agency and the Inland Revenue had different computer systems and five years after the merger had been completed, they still have computer systems which cannot exchange information and accordingly duplicate enquiries and impose unnecessary additional costs on taxpayers in general.

Over the years fiscal legislation has evolved to meet the different objectives and time requirements of the different taxes. For example, personal tax is reported in arrears by an annual tax return and a filing requirement which allows the individual some 10 months after the end of the fiscal year in which to gather together the information, complete the return and submit this to the Revenue. There is then a 12 month window period which enables the Inland Revenue to seek clarification on any issues.

Political reasons have led to an inability to merge NIC and tax. Although taxpayers and business in particular would welcome the merger of tax and NIC, it is politically expedient to retain the distinction. The fact that there are different measures of income or profit, different time frames and of course different reporting requirements all leads to cost which in many instances could be reduced if the system was rationalised.

The reporting requirement for VAT is normally on a quarterly basis but for small businesses there are elective options for annual accounting and for very large businesses there is a mandatory monthly payment regime. Pay As You Earn compliance has another different set of reporting requirements and timescales. The cumulative effect of all these reporting requirements is that information is sometimes gathered piecemeal rather than in a co-ordinated manner. Such piecemeal enquiries can add to cost yet there is a clear right to privacy and a balance must be struck.

The Inland Revenue is also responsible for the tax credit regime and there is concern that this is a major problem area demanding resource and creating processing bottlenecks within the organisation. Customs & Excise have major concerns about potential fraud arising from missing traders and this creates bottlenecks in the process of registration, often making it an expensive and time consuming process for a new business to obtain its registration number.

In general, the proposed merger of the Inland Revenue and Customs & Excise is an area of concern. If it is managed efficiently it is accepted that there will be opportunities to achieve economies of scale and a reduction in total staff numbers. However there is concern that the past performance of mergers has not inspired confidence and there is concern that unless computer systems are designed to be able to exchange information that additional costs may be imposed on business. In addition, there is concern that the culture of the two organisations is substantially different and that it will take a considerable period of time to overcome the cultural difficulties which would be necessary to achieve a merger.

The absence of proper consultation is regrettable. In the absence of detailed merger proposals, the invitation to comment seems premature. On behalf of the public interest element and on behalf of the Institute’s members, we shall be keeping a watching brief on how the merger proposals develop.

9 April 2004
Memorandum submitted by PricewaterhouseCoopers

MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE

INTRODUCTION

1. PricewaterhouseCoopers, as the largest tax practice in the UK, has extensive dealings with both the Inland Revenue (IR) and Customs & Excise (C&E). These occur on a daily basis, at all levels and gives us a real interest in the planned merger of the two bodies.

2. In principle, we welcome the forthcoming merger of the IR and C&E and the Chancellor’s acceptance of the recent O’Donnell report. In this short memorandum we outline our views on the benefits, risks and opportunities the merger presents.

BENEFITS OF THE MERGER

3. We believe that there are clear benefits to all parties—taxpayers, advisers and the government—from there being a single tax authority. It is a model that serves most EU and OECD countries well.

4. The main benefits that we foresee are:
   — better co-ordination of the demands placed on taxpayers, especially small business, by the tax authorities
   — bringing into line definitions (for example groups of companies)
   — more effective policing of evasion due to improved information exchange
   — generally building on best fiscal practice and joining up tax policymaking

RISKS

5. We note that there are expectations of significant staff cuts in due course, thanks to a combination of the merger and investment in technology. Whilst all taxpayers would welcome lower costs of tax collection, we do have a concern that the pursuit of cost savings could damage service to the departments’ customers.

6. Thus we would hope that the maintenance of customer service—and by implication the flow of funds efficiently into the Exchequer—would be a clear objective in the transitional period. Cost savings should follow, rather than drive, the merger.

7. The IR and C&E have traditionally had rather different stances towards taxpayers. C&E have tended to be more confrontational, probably influenced by their responsibilities for quasi-policing in some areas; the IR is usually more understanding of business and more willing to be pragmatic. Obviously this is a generalisation but the tone/stance of the new body is an important matter. We would hope that it sets out to be co-operative, sensitive to business needs and priorities, rather than a “super policeman”.

8. In saying this we are not in any way advocating a softening of attitudes towards evasion but a recognition that the efficient running of the UK’s tax system depends on the co-operation of all involved. Advisers such as PwC, and our clients, want to work together with the tax authorities to minimise burdens on all concerned, but we do expect a similar attitude from the authorities.

9. We note the moves of the policy-making sections of the IR and C&E to the Treasury building. There are clear opportunities here in terms of “joined up” policymaking. However, we do wonder how this will impact on the connection between policy and operations. In both the IR and C&E there can be times when policy is handed over to be implemented with operational staff seemingly under-prepared and under-supported (the recent introduction of Stamp Duty Land Tax is an example). There is a risk that the policymaking of the combined body becomes more detached from the implementation and operation, and indeed from practical experience. This is something to be guarded against: we hope that the policymaking groups will strive to maintain proper dialogue with users.

OPPORTUNITIES

10. There is an interesting question to be answered in terms of the control and general standing of the combined tax body. There will of course be responsible Ministers; but at the same time the tax authority needs to have its degree of independence. The plan to have
   — an Annual Strategic Remit (ASR)
   — a Framework Document (FD)

is promising, particularly the publishing of these documents. This allows for all interested parties to be clear about the overriding aims of our tax system and (presumably) be able to contribute suggestions to its evolution.

11. There are certain key attributes that are important to the maintenance of confidence in the tax system. It would be appropriate for the new combined body to quickly set out (perhaps in its ASR or FD) its commitment to:
— simplification of the tax system;
— consultation over changes to the tax system;
— improving the way tax law is changed.

12. We would also suggest that there is scope for review and potential streamlining of tax management provisions, particularly for indirect taxes. Although not strictly part of the tax authorities remit, the development of a common Tax Tribunal route for appeals is to be welcomed.

13. All of this would be with the aim of making the tax system more accessible and comprehensible for the unrepresented taxpayer, more efficient for those who use advisers and the advisers themselves, and more effective for government. That, surely, is what this merger is all about.

April 2004

Memorandum submitted by the British International Freight Association

MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE

The British International Freight Association (BIFA) is the representative body of the freight forwarding industry, which supplies British business with the international supply-chain management and cargo movement expertise, across all transport modes, by which Britain exports and imports. BIFA comprises in excess of 1,200 British-based corporate members, responsible for 80% of British freight forwarding business.

The interest of BIFA in this subject stems from HM Customs & Excise being the regulatory authority that has most impact on the business of our members and that of their clients. Our sector, in common with much of the wider business community, is naturally apprehensive about this merger. However it is recognised that if, as we are led to believe in the report on the “Review of the Revenue Departments”, this merger is about more than merely saving money, there is potential for some real positive outcomes for all concerned. Among these, that of making the integrated HM Customs & Excise more accountable for its policy and more focused on the users of its services. The test of the effectiveness of the new Revenue Department, for BIFA members, is whether or not it will serve to enhance the UK’s attractiveness as a location for cargo services and the companies which use them, in terms of the better facilitation of international trade.

Our members have been increasingly concerned in recent years at the way H.M. Customs & Excise, at the behest of the Treasury, has sought to make savings on its budget year on year, without any real reference to the bigger picture of their likely impact on Britain’s wider international competitiveness, particularly as regards exporting. The cumulative effects of each incremental rationalisation by the Department (including its current [Customs] Entry Processing Unit “Modernisation” Programme), on the competitiveness of British exports, and on Britain as a location for cargo services, should not be underestimated in today’s globalised economy.

In the cargo movement sector, this has contributed to the loss of cargo servicing business to continental sea and air ports, a tendency we would like to see reversed, by greater focus on the part of the relevant British regulatory authorities, on trade facilitation, as opposed to “trade frustration”. Currently therefore, rather perversely, HM Customs & Excise policy, driven by the constraints of year on year Treasury budgetary cuts, often has the unintended effect of shifting economic activity in our sector to the near continent, eroding the very tax base relied on by the Government to finance its broader political objectives.

With the aforementioned in mind, at this stage of the Inland Revenue–HM Customs & Excise integration process, BIFA would like to emphasise the importance we, together with other related business sectors, attach to having a properly resourced “Customs and International Trade” (CIT) division within the new Revenue Department. Furthermore Business recognises that Customs is aware of the need to change the way it administers its various international trade related regimes, and that to this end, Customs has embarked upon a business change programme, known as the “blueprint (vision)”,1 with the support of Business. We strongly urge that this programme and its consultation process be safeguarded within the new Revenue Department, and would invite assurances from Mr Gus O’Donnell, Permanent Secretary, HM Treasury, to this effect.

We hope the Committee will find the points raised in this brief of interest to its examination of this subject.

15 April 2004

1 Not printed.
Memorandum submitted by the Institute of Payroll and Pensions Management

BACKGROUND

The Institute of Payroll and Pensions Management (IPPM) is the leading representative body for payroll and public sector pension professionals in the UK. We have around 10,000 members across all industry sectors including a large number of student members studying for the industry’s benchmark qualifications.

Relevance

The IPPM is actively involved in both working with, and lobbying, many government departments, but primarily the Inland Revenue. We assist in both developing new, and refining existing, legislation that will impact upon employers and their employees. Our strong working relationship with the Inland Revenue at both HO and local level has, we believe, been extremely beneficial to both our profession and the department, and gives us a valuable perspective on the O’Donnell proposals.

A “CUSTOMER CENTRIC DEPARTMENT”

We take heart from the fact that in his foreword to the report Gordon Brown mentions the word “customer” at least three times. He sees that the new department must have the “best possible customer understanding” and that removing the departmental silos will allow, “focusing on the customer”. However it is perhaps the definition of customer that we need to challenge. Much is made throughout the report of the successful creation of the Department of Work and Pensions and its customer focus. From our perspective the formation of DWP has not been truly customer centric. Whilst the Pensions Service is clear that it serves pensioners and Jobcentreplus the working age population, the needs of employers as customers have been completely overlooked. We have consistently struggled to engage with DWP in matters affecting our employees and given our role in providing information for means tested benefits this is disappointing. We therefore need to ensure that the new taxation department sees business and all employers as key stakeholders, and more importantly not just the high profile areas of Corporation Tax and VAT but employment taxes too, which after all brings £175 billion into the Treasury coffers.

REDUCED COMPLIANCE COSTS

Lower compliance costs are an objective that O’Donnell expects to flow from integration, both in terms of coordinated policy advice and education and joint compliance visits. However the latter must be a long-term objective, as one can’t envisage that ex-Revenue compliance officers, already challenged keeping up to date with tax and NICs developments, could become VAT experts overnight or vice versa. We have been involved in a project over the last year to increase IR Large Business Office compliance teams’ “commercial awareness” of payroll issues in the round. This has been acknowledged as a success by LBO senior and local office staff, but is indicative that there is insufficient resource currently to allow Revenue compliance staff to be upskilled to the level that they need to cope with both the development of technology in the PAYE world and also the vast array of legislation that employers must comply with.

IR LBO is taking significant steps to become more enabling, customer focused and effective by introducing Risk Based Systems Audit, Customer Account Managers and computer audit tools. We would hope that the merger process would not derail these positive developments. We do however have concerns about the current two-tier compliance regime. LBO serves a client base where total employee numbers exceed 1,000. For employers with 999 or fewer employees compliance work is carried out by the local office network. The two structures do not appear to be moving forward at the same pace, and given that employers should expect the same service regardless of their size, this needs to be addressed as part of any reorganisation.

EDUCATION AND ADVICE

The review expects the new department to be able to offer employers “improvements to customer education and advice”. Employers currently have a number of avenues, which offer education and advice:

— The Employer Helpline
— Printed or online guidance
— Business Support teams
— Revenue contact centres and Area Management

The Employer Helpline is acknowledged by employers as first rate, however it too can struggle with new legislative developments—tax credits being a case in point. This was demonstrated vividly over the last year when on several occasions our members were told that if we had given them advice on the tax credits’ PVE process it was more likely to be correct than that provided by the helpline staff! If the Helpline is to be expected to cover the full remit of the new department then it must offer credible advice from day one in order to avoid employers “answer shopping” across various IR and professional sources.
Printed guidance is being reviewed as part of the Better Guidance Project and the rebadging by Marketing and Communications. There is always a tension providing written guidance that can be understood by the smallest employers with little/limited technical knowledge versus the needs of larger employers and payroll specialists. Any move to bring together the Revenue and C&E guidance into one format must be co-ordinated, and opportunities taken to update old and out of date guidance, not simply reproduce it. The number of areas within the Revenue which are responsible for guidance at present means that key changes can easily be overlooked, or are not detailed in a consistent manner in guidance eg the change to under deducted NI which came into effect from 6 April this year. Within the new structure some central control over all printed/online material must be established, this centralised department should also receive information from all policy development to ensure it is up to date at all times and not playing catch up. Poor guidance means poor compliance and frustration experienced by employers, advisors and other customers.

The Business Support teams were established to support new and small employers with their PAYE obligations. Their free workshops are well received by employers. We are not aware that a similar structure exists within C&E and would urge that the Revenue model is retained. Again however there is the caveat that the Business Advisers are often given insufficient training on new legislative developments resulting in their employers’ workshops being delivered too close (or even after implementation) eg new statutory Payments in April 2003. Very often the Business Support Team advisors are reassigned to cover operational work when resource is stretched eg during the introduction of New Tax Credits in April 2003.

The move to 71 areas and away from the many hundreds of independent local offices has been challenging for employers. We are currently working with the Revenue area management team to review employer feedback on the success of the new structure. Concerns abound around the three levels of telephony service provided during the transition phase (which has been going on for three years now), lack of knowledgeable staff at the contact centres and delays in postal and normal transactional processing. A local service already under pressure to meet targets, and in the midst of a reorganisation not due to be complete until the end of 2005, does not seem best placed to face the transition to a new department without a detrimental impact on customer service. Local Offices are already telling employers to be sympathetic to them, as many of the local staff will be losing their jobs—unless some local office closures are already agreed as part of area management this sort of message will begin alarm bells ringing amongst employers already concerned about area management.

Our views were sought as part of the development of the channel strategy, interestingly by a member of C&E seconded to the Revenue but we have seen no outcomes. It is disappointing when asked to be involved in an initiative that should deliver benefits to our members that we are not provided with any follow up as to conclusions. The obvious, and easy to make assumption, is that the channel strategy was left to wither in its silo. We hope that its mention in the review indicates this is not so and will be interested to see how this fits in with Better Guidance and Area Management. There is a real sense at the moment of the Revenue trying to achieve so much on many fronts that it can lose sight of the how all these projects interact with each other and of course with stakeholders. Our concern is that this would be an even greater risk in a much larger department.

**Transactional Processes and Systems**

We are encouraged that the review looks to rationalising processes and improved use of online communication. As a body representing mainly large employers our members are well placed to handle the Revenue’s aggressive stance on the use of the E channel compared to other government departments. This year sees a sea change for large employers who become obliged to send year-end returns online. It is worrying that the review says, “E-programmes will need to be redesigned to take account of new circumstances”. The current E channel is a result of intense customer feedback; this input must not be lost in any reorganisation.

For SMEs the view may be different with perhaps a concern that the review will seek to make daily online transactions mandatory rather than year-end returns as is currently due to be the case by 2009–10.

We hope that the review will give impetus to the Modernising Payroll Processes for Customers Programme (MPPC) to deliver real improvements for employers; we are encouraged it is noted as a “key project”.

At present there is still far too much unnecessary paper exchanged all of which needs extensive employer intervention. We would press for a real departmental (nay governmental review) of outdated and “rogue” forms.

A key area in terms of customer buy in will be whether new/integrated systems can deliver win-win situations, for example this April’s move to mandatory e-payment is one way only, with large employers compelled to pay electronically but the Revenue not similarly obliged to pay monies due to employers in the same way.


**POLICY CENTRALISATION**

However from an influence perspective we are concerned that the review champions a move to take all policy development away from the Inland Revenue to the Treasury. This would leave the new department with a policy maintenance and delivery role. We believe that our involvement in the many consultative fora on which we sit has led to better policy development that it is simpler to implement. We are naturally concerned that this valuable input could be lost within the new structure and so take comfort from the suggestions made within the review that more external secondees will be sought and that there will be improved contact with stakeholders—"listening to what customers have to say", after all the customers are the ones that have the business experience that civil servants so often lack. Our suggestion would be that some external secondees are sought from what we would refer to as the sharp end of business ie the operators—the IPPM would be very interested in assisting with this.

Splitting policy development away from implementation has been spectacularly unsuccessful already for employers. When the Revenue and the Contributions Agency merged the policy development for statutory payments was left with the DWP whilst implementation went to the Revenue. This has led to inertia in terms of reviewing the policy for both SSP and SMP, two of the biggest burdens for business in terms of payroll processing. The Revenue are keen, as are employers, to review this area in its entirety, whilst DWP do not see it as a priority as they of course do not have to deal with the compliance burden it presents. We feel similar tensions could be inherent in the new structure.

In our submission to the Cabinet Office Code of Practice on consultation we commented how consultation invariably begins too late, and that all too often it feels that there is already an end game and what people are trying to do is find a path to get to that end game and are not truly looking for consultation which may not provide the same end result. If there are constraints and limitations to what can be influenced during consultation then the expectations of the Representative bodies should be managed at the outset. Through treating Representative bodies as confidential partners they can assist policy makers to get the rights answers for both parties, with far less energy being used to influence areas where "final" decisions have already been made.

O’Donnell notes a frustration that often surfaces for business. Officials have a single tax view of compliance and business whilst business has to be expert in the intricacies of all government compliance—if it’s a tall order for an official why is it any easier for customers who are incidentally trying to run their businesses as well as comply.

**NEW NATIONAL SERVICES**

We have seen the creation of several new business streams in the Revenue over the last few years, some more successful than others. The review alludes to perhaps three areas where this may offer opportunities

- Payment and Debt Recovery
- Large Business compliance
- The local office network

We would simply remark that bigger is not necessarily better and that customer buy-in and benefits will be key to any development in these areas.

**INFORMATION SHARING**

A thorny subject which has of course the legal requirements of Human Rights and Data Protection legislation as a backdrop. As employers we feel frustrated that we supply the same information many times over to various government departments who cannot share basic data about our employees. We are therefore very supportive of the plans to share data across the new department as this may remove one barrier, we hope that ID cards and the Citizen Information Project may also go a long way to getting this resolved. It is absolutely certain that current data sharing failures whether they are cultural, legal or technological lead to inefficiency for both employers and the Revenue.

“Strengthening links to DWP, ONS and external organisations” will be a major step forward. Where cross-departmental working has been used for example in the Employment Act 2002 changes (involving a range of government departments and interested parties) this worked well and better legislation was the result. It is noticeable how few issues there have been with the implementation of the new statutory payments in April 2003, which must be testament to this approach working well. We would agree with the statement in the review that “each department separately considers the compliance costs it imposes on business and changes are considered which take into account the full picture”. This is, we believe, the case across government with no overall view of the cumulative cost of legislative change at any one time. This is coupled with poorly researched RIAs and few post-implementation reviews.
“BUSINESS AS USUAL”

Finally it is the “business as usual” approach that is vital. We have just begun the tax year that sees a significant change to PAYE, through the move to mandatory online filing for employers. We therefore need the Inland Revenue to continue to be outward looking even if it is facing huge internal reorganisation. Can one really believe that “much of the business would not be directly affected by the creation of a new department” when 10,500 posts are to be lost with all the insecurity this entails. Will the “focus on priority areas” mean valuable projects are shelved?

The review sees the greatest risk in areas where there is “significant overlap or synergy”. Given that the local office network and debt management are just such an area of overlap, and the ones that have the highest volume of business and taxpayer interaction, this risk must be not be underestimated.

CONCLUSION

We are encouraged that Gus O’Donnell sees PAYE as an area where compliance will continue to be high and that it is not an area where there is wilful non-compliance. However, the desire of employers, to meet their obligations must not be taken for granted. PAYE brings £175 billion into the Treasury, a not insignificant amount, and all of this collected very efficiently by the UK’s “army of unofficial tax collectors”, ie its 1.6 million employers.

Finally we concur that the statement in 4.15 is key to the success of the merger from the customer’s perspective “taking a whole customer view requires a succession of steps amounting to radical change”. The evidence we have from our work with the Revenue is that the senior team are prepared for this change and we are keen to work with them to deliver it.

April 2004

Memorandum submitted by the Tobacco Manufacturers’ Association

MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE

This submission by the Tobacco Manufacturers’ Association (TMA) represents the views of its principal member companies who are responsible for the collection of £8 billion in excise duties each year. The regime in place to do this is efficient and effective and is favoured by both HM Customs & Excise (HMC&E) and the UK tobacco companies. However, the smuggling of both genuine and counterfeit tobacco products into the UK and the growing level of crossborder shopping are of huge concern to the TMA and its member companies.

SMUGGLING AND CROSSBORDER SHOPPING

We trust that the new organisation will maintain the efforts of HMC&E in the fight against tobacco smuggling, but more resources must be allocated to this task. The TMA and its member companies have a long established commitment to assist HMC&E in its efforts to eliminate the black market in tobacco products. This assistance will, of course, be extended to the new organisation.

As well as securing additional resources to tackle tobacco smuggling we believe that it is crucial that the new organisation be able to “fight its corner” with regard to setting levels of tobacco tax. We maintain the view that enforcement alone cannot outweigh the economic conditions that create the incentives for smuggling. In the past our attempts to engage HMC&E on the issue of tax levels has been met with the response “the Treasury sets the tax rates”. The Government’s Tackling Tobacco Smuggling (TTS) strategy announced in March 2000 set out a wide range of measures to reduce smuggling; tax was not one of these.

The current levels of tobacco tax have created an environment in which, according to HMC&E, 18% of cigarettes and 51% of handrolling tobacco (HRT) smoked in the UK is smuggled, losing revenue of around £3 billion. HMC&E report that 41% of cigarette seizures are counterfeit. Since the first estimates of revenue lost were made in 1996 more than £15 billion has been lost. We believe this clearly demonstrates that HMC&E is unable to enforce the tax rates set by the Treasury.

Quite apart from the loss of revenue, smuggling also represents a loss of sales to the UK retail sector and our member companies. It is also a law and order problem. The supply of smuggled tobacco products in the UK is, in the main, controlled by organised crime. As the Home Secretary recently noted organised crime “corrupts society and spreads fear and intimidation”.

2 British American Tobacco, Gallaher Ltd and Imperial Tobacco Ltd.
4 Hansard, 29 March 2004, Col 1277.
The UK’s high tax levels have also led to a revenue loss of £1.4 billion from legitimate crossborder purchases of tobacco products by UK citizens in other Member States, and over £4 billion since 1996. According to HMC&E estimates, it currently accounts for 9% of cigarette and 18% of HRT consumption. Although this trade is an integral part of the Single Market it has caused huge problems for HMC&E as it is they who must establish if someone is a smuggler or someone exercising their rights as a consumer. This difficulty has seen HMC&E fall foul of the European Commission.

We believe that by looking at tax and enforcement policy together the new organisation can oversee a regime that can successfully tackle smuggling, reduce the revenue lost through crossborder shopping and return the bulk of non-UK duty paid consumption to the duty paid market.

**Policy Development and Implementation**

As there are only a small number of tobacco companies operating in the UK, responsible for the collection of £8 billion in excise duties each year, we believe that the tobacco sector should be treated separately from the other excise regimes by the new organisation.

With regard to the implementing of policy or new legislation the tobacco regime is quite different from that of the alcohol sector. Recent examples of diversion fraud in the alcohol sector do not occur in tobacco products due to the existing high levels of control achieved in the existing tobacco regime.

In forums such as the Joint Alcohol and Tobacco Consultation Group (JATCG) the opportunity for the tobacco sector to contribute is limited as changes to the alcohol regime are often irrelevant to our industry.

When consultation has been on a one-to-one basis the TMA and its member companies have been instrumental in helping HMC&E successfully introduce the fiscal mark on tobacco products and a protocol to limit the effects of forestalling. As with the issue of smuggling the Industry is ready to work with the new organisation on the development of policy that will meet its needs and those of industry.

*16 April 2004*

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**Memorandum submitted by the Institute of Chartered Accountants in England and Wales**

**MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE**

**Introduction**

1. We write in response to the Press Release issued on 31 March 2004 by the Treasury Sub-committee of the House of Commons. This invites written evidence on the merger of Customs & Excise and the Inland Revenue, prior to the oral evidence session on 28 April which Mr Gus O’Donnell is to attend.

2. In October 2003 we submitted a paper to the Treasury, containing detailed comments and suggestions for the Review of Inland Revenue and HM Customs & Excise. We attach a copy of this paper—TAXREP 39/03. The majority of the comments in it are still relevant in the context of the proposals in HM Treasury’s March 2004 report *Financing Britain’s Future: Review of the Revenue Departments* (which we will refer to as “the O’Donnell Report”).

3. The intention of this memorandum is to update our October 2003 representations and draw out some key points of relevance to the proposals to merge and reorganise the revenue departments. For the present purpose, we are not aiming to provide a comprehensive analysis of the O’Donnell Report.

4. The ICAEW would be pleased to take part in any future consultations on this issue.

**Who We Are**

5. The Institute of Chartered Accountants in England & Wales is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

6. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

7. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter TAXline to more than 11,000 members who pay an additional subscription.

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5 Annex A
THE TAX FACULTY’S OCTOBER 2003 REPRESENTATIONS

8. In the representations we made to the Treasury in October (TAXREP 39/03) we said (at paragraph 8) that we did not necessarily believe that a structural reform, integrating tax policy formulation within the Treasury, would overcome the weaknesses we had identified in the area of tax policy making. These weaknesses chiefly stemmed from inadequate communication and a failure to give proper consideration to operational issues at an early stage. We are concerned that the restructuring of the departments, proposed by the O’Donnell Report, should be done in a way which tackles these weaknesses—and which does not make the situation worse. We comment on this further below under “Key Issues for the Merger of the Revenue Departments”.

9. Since we prepared our paper in October, there have been developments in a number of the areas we highlighted. Updates on these are set out below:

- In paragraph 14 we discussed Regulatory Impact Assessments. We are aware that the Regulatory Impact Unit of the Inland Revenue is aiming to do more monitoring and follow-up of policies post-implementation, and to form links with their colleagues on the operations side such as the Working Together team. We applaud this and hope that adequate resources will be allocated to it, both now and in the merged department.

- In paragraph 24, we refer to the Code of Practice on Consultations, the new version of which has now been published. Although we welcome this, there are still instances where informal consultations offer inadequate turnaround time for us to formulate our comments or for the Revenue to implement suggestions.

- The Inland Revenue’s website (see paragraph 29) has now been re-launched in a new format. Although better in some respects it has not been an unqualified success—a common reaction from users is that it is often harder to find things on the new site compared with the old. And the important point we made about the accessibility and updating of manuals and reference material is still valid.

- In paragraphs 39 and 40 we commented on some customer service aspects of self assessment. The Revenue now has a short tax return for those with simpler affairs, and has changed the criteria so that higher rate taxpayers with otherwise straightforward tax affairs need not remain in the self assessment system.

- Paragraph 41 discusses payment methods and that taxpayers should be able to pay in a way that suits them. The recent NAO review The Recovery of Debt by the Inland Revenue (to which the ICAEW contributed) contains relevant findings and recommendations in this area.

10. Subject to the comments above, the evidence and views contained in our October 2003 paper remain valid for current consultations on the merger of the departments.

KEY ISSUES FOR THE MERGER OF THE REVENUE DEPARTMENTS

11. This section highlights some key issues to be considered in the proposed merger of the revenue departments. It builds on our October paper and comments on particular aspects of the O’Donnell Report.

The consultation process and policy making

12. One of our key concerns is how consultation will take place when policy is formulated—both consultation between the Treasury and the new Revenue Department, and consultation with outside stakeholders. We are encouraged by the recommendation (page 11 of the O’Donnell Report) that there should be “greater contact between officials and external stakeholders”. We are also pleased to note (paragraphs 6.45 et seq) the emphasis on the importance of the Treasury and the new department maintaining good links. But we would wish to know more, as the consultation progresses, about how these things will be achieved in practice.

13. The O’Donnell Report proposes that the Treasury will be responsible for tax policy making and that the new merged Revenue Department will deal with policy implementation. Whilst we can see that this should lead to a wider strategic overview and to more joined-up tax policy making, which has been another of our concerns, there is a danger that this will widen the gulf which undoubtedly already exists between policy and operational issues.

14. We said in our October report that “those with the requisite experience and knowledge of taxation matters and the practical issues that are likely to arise need to be nearer to the centre of policy formulation”. But with operational/delivery matters handled by the new Revenue Department and policy making at the Treasury, it looks as though these experts may be further from, not nearer to, the centre of policy making. Our experience has shown the drawbacks of this. A case in point would be the consultation on the new tax credits, where the consultation process takes place under the umbrella of the Revenue’s policy division, but it was clear from the start that the policy and delivery/operational aspects of delivering it could not really be separated and both needed to be considered from the start. It is crucial that this point is addressed when developing the structure for liaison between the departments.
15. As a professional body, we would like to understand how we ourselves will take part in consultations under the new departmental structure. An important part of our role is to represent our members in consultation work on all aspects of the tax system. Our staff and volunteers already devote considerable time to this. When making representations, we do not distinguish between policy and operational matters in the way that the revenue departments do at present. Our preference is generally to look at both aspects together in the context of a particular tax issue, and bring both our technical expertise and practical experience to bear as part of the same consultation.

16. Although the O’Donnell report mentions the importance of outward-facing policy making and liaison with external stakeholders, it does not say a great deal about how in practice this might be implemented. We are keen to ensure that future consultation arrangements prove to be effective for both professional bodies and the government. The questions which occur to us as a professional body are:

— Under the new departmental structure, are we to consult with the Treasury on policy matters and the new Revenue Department on operational ones?
— How will any operational points we make to the Revenue Department be referred to the Treasury, and vice versa on policy points?
— Will we need to consult with both bodies on the same topic, thus leading to duplication of effort and putting a strain on our finite resources?

These may seem obvious points but we flag them now so that they can be addressed at an early stage in considering how the O’Donnell representations will be taken forward.

Customer service issues

17. The O’Donnell Report identifies the importance of customer service, and improving this is one of the stated aims of the proposals. However, we can see a risk that despite best intentions, as the reorganisation progresses, the focus on improved customer service will be lost, or at least overshadowed by more pressing priorities. The new department appears to be focusing on businesses, risk-management and improved compliance, and is also facing a significant reduction in staff.

18. We are pleased to note the frequent references throughout the O’Donnell report to the needs of small businesses and trust that this theme will continue as the recommendations are implemented. However, we are concerned that the needs of the Revenue’s non-business customers must be catered for in a new and larger department and that taxpayers see real improvements in the current service.

19. The Revenue already has champions for certain customer groups—notably pensioners and students. We would recommend that wider use should be made of the champion idea, to ensure that a consistent standard of service is maintained to all customer groups during the reorganisation.

20. As agents for our clients, we too are customers of the Inland Revenue, and are concerned that current projects to improve services to agents (such as the Working Together initiative) should continue to have the support they need within the new department and during the transitional process.

The transitional process

21. The O’Donnell Report recognises the risks of disruption to ongoing services while a major reorganisation is underway. We are encouraged to note (from page 8 of the Report) that international experience shows that the risk is manageable. However, at this stage we would simply comment that this is clearly a key aspect of implementing the proposals which will affect the day to day lives of our members and their clients, so we would hope to be involved in future consultation on the topic.

22. It is crucial that the revenue departments communicate effectively with their customers while reorganisation is underway, so that they can understand what is happening and always know whom to contact, at the Revenue or at Customs & Excise, regarding their tax affairs. We would point here to the experience of the Revenue’s reorganisation into Area Management and a call centre structure, from which we feel there are lessons to be learned. Many practitioners and taxpayers have felt completely at sea as this process has gone on, because they did not understand what the Revenue was trying to achieve and because the old structure for contacting tax offices was superseded but the new structure was not being clearly presented or communicated. Even now, our members are experiencing frustration in getting through to Revenue call centres. Better and fuller publicity, at an early stage, and better access to information, would have helped.

April 2004
INTRODUCTION

1. The HM Treasury Review of Inland Revenue and HM Customs and Excise was announced by the Chancellor of the Exchequer, Gordon Brown on 2 July 2003. The Press Release issued at the time indicated that “the major focus of the Review will be making public service delivery more effective and efficient.” This document is based on a paper submitted to the Treasury in October 2003.

WHO WE ARE

2. The Institute is the largest accountancy body in Europe, with more than 123,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

3. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy (which includes taxation).

4. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter “TAXline” to more than 11,000 members of the Institute who pay an additional subscription.

General comments

5. We welcome the opportunity to contribute to this review. The Review was announced by the Chancellor of the Exchequer, Gordon Brown on 2 July 2003. The Press Release issued at the time indicated that “the major focus of the Review will be making public service delivery more effective and efficient.”

6. Members of the Tax Faculty met with Anthony Zacharzewski on 27 August who was at that time finalising a project report on “service delivery”. We had a subsequent meeting on 24 September with Dave Ramsden the Team Leader of the Review plus two of his colleagues, Daniel Thornton and John Fiennes.

7. At their invitation we have put together some initial thoughts on the four major areas to be covered by the Review Team, namely:

— Tax policy and analysis issues.
— Accountability, governance and legislative issues.
— Information issues.
— Delivery issues.

SPECIFIC COMMENTS

TAX POLICY AND ANALYSIS ISSUES

Communication

8. We believe that a recurring theme of the issues we discuss further below is a lack of adequate communication. We do not necessarily believe that a structural reform, integrating tax policy formulation within the Treasury, would of itself overcome many of the issues Indeed it would create further difficulties of its own.

Operational matters

9. We believe that when formulating tax policy, insufficient attention is given to operational issues and addressing likely problem areas which will arise. The result is that operational problems arise which detract from the policy and cause needless friction between taxpayers, their agents and the revenue departments.

10. The most recent example is the implementation of Tax Credits. For example, it is clear that there are many unresolved issues around claims made by couples. There are also practical problems arising in respect of the backdating of claims. We suspect that this is caused by a lack of proper consultation, planning and staff training, but the results are that relations become strained and time and effort are being wasted in putting right the problems which are occurring.

Annex A

HM TREASURY REVIEW OF INLAND REVENUE AND HM CUSTOMS & EXCISE

11. The need to focus more on operational issues at an earlier stage is not a new concern. In our review of the introduction of self assessment published in March 1998, we stated that “There was far too little consultation on operational matters” with the result that relations between the Revenue and the professions were damaged”. We are also concerned for the Revenue’s staff who have to deal with such problems.

12. How can likely operational problems be minimised? We believe that those with the requisite experience and knowledge of taxation matters and the practical issues that are likely to arise need to be nearer to the centre of policy formulation. We believe the Review should consider ways in which operational issues can be given detailed consideration as part of policy formulation. This should involve identifying potential problem areas and how those problems will be avoided or overcome. One possibility, discussed below, is that a review of operational issues should be part of the Regulatory Impact Assessments.

Regulatory Impact Assessments

13. As mentioned above, one possibility would be to incorporate a review of operational issues as part of the Regulatory Impact Assessment (RIA) process. A senior staff member could take responsibility for the operational aspects of the policy and “sign off” on operational issues as part of the determination of policy.

14. We are also concerned that RIAs are not currently given the importance they deserve. Our experience is that they are completed merely as a matter of form rather than being a key tool in assessing and analysing the impact of the change. Many are incomplete and few are revisited or audited in the light of practical experience. We believe that RIAs have a valuable role to play in policy formulation and implementation and more importance needs to be given to them. The Review needs to consider how RIAs can be improved to help inform both policy making and operational planning. RIAs also need to anticipate more accurately any behavioural change that may occur as a result of tax changes. For example, the RIA in relation to the introduction of a nil rate of corporation tax did not anticipate the inevitable increase in incorporations by small traders looking to reduce their overall tax bills. This outcome was always likely to be a consequence of the proposals and has major implications both at the policy level and at the operational level.

“Official Pronouncements”

15. We believe that the Review should look at the ways in which official pronouncements etc are published and made available to taxpayers. Currently, there is a wide range of material published, but it is not always consistent and coherent. The Review should consider whether the current arrangements would be improved if the responsibility for the issue of Statutory Instruments, Extra Statutory Concessions, Statements of Practice and other written formulations of Revenue policy, such as Tax Bulletin rested with a single department. In the case of Customs and Excise, this would include Business Briefs.

Parliamentary Counsel

16. We believe the Review should also consider how more efficient use can be made of Parliamentary Counsel. They are a scarce resource and the maximum use must be made of them. The recent Income Tax (Earnings and Pensions) Act 2003 (ITEPA) is an illustration of a product which has been almost immediately spoiled by inserts from the Finance Act 2003 which did not follow the “Tax Law Rewrite” style of ITEPA.

“Joined up” tax policy

17. Tax policy needs to be “joined up”. This means a consistent policy needs to be adopted both between and within the revenue departments. Two examples will suffice to illustrate the problems.

18. In order to deal electronically with Customs and Excise, you need to purchase a digital certificate. If you wish to deal with the Inland Revenue then you need to obtain a PIN number through the post. There should be a single system common to both. The Government Gateway project notionally bridges IR and C&E—and other departments—in a single user interface, but in practice much is still done through their individual portals.

19. If you are a self employed businessman, then you have been discouraged from sending your accounts to support your tax return. However, if the same business is operated through a company, submission of the accounts is a mandatory part of the company’s tax return.

20. If tax policies are confused and even revenue departments send out confused messages, the result is that taxpayers have reduced confidence in the system. We believe that steps need to be taken to ensure more consistency, both across and within departments.

Earlier reviews of policy making

21. A peer review “Architectural Engineers” reported in October 2000 on the Inland Revenue’s Policy Making Function. The review made the following findings:

— There was a lack of high quality analysis within the Inland Revenue.
— It noted the new role of the Department in supporting the Government’s economic and social policy objectives rather than simply acting as tax collectors.
— It noted that the public now has heightened expectations about swift access to information and service.
— There are too many “engineers” good at the detail of the tax system and not enough “architects” able to take a broader view.

22. We would suggest that the present Review should take account of the content and conclusions of that earlier Review and of any similar review carried out in relation to Customs and Excise.

ACCOUNTABILITY, GOVERNANCE AND LEGISLATIVE ISSUES

Feedback on problem areas

23. The Head of Operations at both Inland Revenue and Customs and Excise should as a matter of course be reporting to Ministers on a regular basis the major complaints that have been received about the system. This should be done at the time the problem has been identified and not wait until the Department believes it has a solution. There should also be earlier discussion on such problems with representatives from the ICAEW and other professional bodies who are often better placed to comment on proposed solutions.

Consultation

24. The Departments should be more prepared to engage in informal consultations with the ICAEW, particularly when there is (as is usual in relation to proposed changes to tax policy) insufficient time to allow for the minimum three month public consultation period which is the recommended minimum in the Code of Practice on Consultation. However we still require adequate notice of such informal consultations to ensure that we can provide reasoned responses. There have been numerous instances during the implementation of the tax credits system where a response has been required within four weeks, or even less.

INFORMATION ISSUES

Information technology

25. One of the key issues is the use of information technology. We believe firmly in the increased use of IT to bring about improvements to the tax system and lower costs for both the revenue departments and for taxpayers and agents. However, many of the problems with the tax system appear to emanate from IT problems. It is often not clear whether these problems stem from poor computer programming or poor inputting of data. We suspect it is a mixture of both. In respect of the former, once again we suspect that inadequate attention is paid to the operational aspects. If we take again the example of Tax Credits, the computer system does not show how the Credit has been calculated. It was clearly essential for a calculation to be produced so that it could be checked and we are disappointed that no one thought that this was necessary. Equally, additional information supplied in box 23.5 and other designated white spaces on self assessment tax returns is still not captured as part of the data entry process—six years after the introduction of the self assessment tax system. The reasons for poor take up of Internet and electronic filing are well known but are not being addressed. Only a very few individuals within the IR have external email access, which is very surprising.

26. The result of these types of problems is that few people have much confidence in the Revenue’s computer systems. This has been a concern for some years. We raised this issue in our 1998 review of self assessment to which we referred earlier when we suggested that a separate and urgent review of the computer system should be carried out. The computer systems need to be subject to regular independent monitoring and emerging problems need to be highlighted and dealt with.

Public utterances

27. We believe that information is often put into the public domain in a manner which is unhelpful and counter productive. The implications of the 2002 case of Mansworth v Jelley were not adequately considered by the Revenue before a public announcement was made concerning the practical consequences of the case. This was followed by several months of confusion for taxpayers and their advisers before the Revenue took steps to resolve the position. Procedures need to be in place to ensure that material which is particularly technical and sensitive is reviewed at a high level before it is released.

28. The more recent announcement of the Revenue policy in relation to section 660A, ICTA 1988 in relation to family companies and partnerships has demonstrated a seeming gap in understanding between senior Inland Revenue officials and the front line Inspector of Taxes. At meetings, senior Revenue officials have stated that the “new” policy is unlikely to affect more than 50–100 cases per year whereas there is already evidence that the new policy is being used by a significant number of Inspectors of Taxes throughout the country.
29. The Inland Revenue’s website is highly successful and reflects great credit on those who designed and built it and keep it updated. However, we think that there are a number of ways in which the site can be improved further. For example, we remain concerned that one is unable to see more than a single paragraph of a Revenue Manual on screen at any one time. This severely reduces the value of making the manuals available on-line. They should be available for download in, for example, Word or pdf format. There are also continuing problems with updating material such as Business Briefs. The websites need to provide a better “audit trail” of material that has been changed. Where material is updated, we have suggested on a number of occasions that the date of changes should be highlighted and if possible earlier references retained on the system.

30. The website of Customs and Excise is also highly successful although perhaps not as well structured or consistent as the Inland Revenue’s site. Like the Inland Revenue’s site, we believe that further improvements can still be made. For example, because VAT is a transaction based tax, the timing of changes is extremely important and the effective date of changes is often not clearly flagged on the website.

31. There is also a tendency for any advice given on the site to be one sided. For instance in relation to the flat rate scheme, the Customs’ website states:

“It saves you time, by simplifying your VAT accounting procedure into a single calculation, and in some cases can deliver potential savings of up to £1,000 per annum by reducing administration costs.”

32. As the scheme was set up to be “revenue neutral”, there must be as many losers and winners and the decision to enter the scheme is at best finely balanced. The advice needs to be even handed.

33. Once again, a named person accepting responsibility for a particular area such as the website might improve the situation. If this already happens, then it is not obvious.

**DELIVERY ISSUES**

**Creating a customer culture**

34. Taxpayers are now usually referred to as customers. However, the two words are not synonymous: the main definition of customer in the Oxford Compact English Dictionary is “a person who buys goods or services from a shop or business” whereas the definition of a taxpayer is (unsurprisingly!) “a person who pays tax”. It is not in our view wholly correct for taxpayers to be called customers as they are not buying anything: instead they have a legal obligation to pay the right amount of tax.

35. This is not just a question of semantics. We can understand why the revenue departments may wish to call taxpayers customers. However, if they are to continue to be called customers then the revenue departments need to make far greater efforts to treat them as such, with all the attention to detail and customer aspirations that this entails. A truly customer focussed organisation would have a long term strategy to improve customer service, keep up with competitors and demonstrate increased satisfaction ratings.

36. How should the revenue departments seek to emulate this approach? By adopting a clear medium to long-term strategy to improve services that can be measured and demonstrated. It requires a willingness to explore radical ideas and new ways of working, share best practices across departments and with other tax authorities and to commit time and effort to bring about real improvements. We set out below possible ways, some of them quite radical, in which customer service could be improved:

37. The UK tax system is far too geared to a “penalty culture”. For example, if you do not submit your tax return by 31 January and do not have a reasonable excuse, then you will be fined. No business organisation would dream of treating its customers like that. The US has a system whereby you can delay filing your return in return for a fee. The two systems achieve similar results but the perception is totally different: the perception is that the US system is more customer friendly.

38. The self assessment return deadline creates a major headache for all concerned. It needs to be reconsidered—after all VAT return periods are staggered. The 30 September “deadline” merely creates confusion and is not enough to help taxpayers with their tax calculations. One solution might be to provide improved incentives such as discounts for earlier filing.

39. Most taxpayers are happy to pay their tax but want little or no contact with the Revenue and want the tax form filling to be as painless as possible. Of course, the PAYE system has been highly successful in ensuring that the majority of taxpayers have little contact with the Revenue. However, with the increase in the number of higher rate taxpayers, more taxpayers are likely to have to fill in tax returns in the future.

40. How can taxpayers’ expectations be achieved? One starting point is to first undertake detailed risk profiles of taxpayers (which will take into account such factors as the complexity of a taxpayer’s affairs). Taxpayers can then be stratified into various categories. For low risk customers with simple tax affairs, the Revenue should adopt a light touch approach which minimises the need for contact and also helps taxpayers. How can they be helped? Most taxpayers find filling in their tax return difficult, confusing and time consuming. The majority of taxpayers have simple tax affairs and the existing tax return forms are far
too complicated for their needs. Usually a one or two page form would suffice. In many cases, the Revenue already holds all of the data which the taxpayer needs to fill in, namely employment and investment income and the information could be provided on the return sent to the customer. The Revenue could then adopt an approach along the lines of “please review this and if you agree with it, sign it and return it to us”. If the Revenue has risk assessed its customers, then such a light touch regime would be a logical approach for its straightforward compliant customers. Resources could then be concentrated on the higher risk non-compliant customers.

41. Many taxpayers would appreciate more flexible ways of paying the Revenue and many would not be adverse to paying in advance or more regularly in order to manage their cash flow. However, the existing interest rules are highly complicated and favour the revenue authorities. If customers want to pay in a way that helps them budget, then they should be encouraged to do so.

42. We welcome the increased use of IT in allowing better access for the taxpayer to the Revenue and Customs and Excise. However, the use of email has become the de facto way of communicating between customers and suppliers. The revenue departments need to address this need as a matter of priority.

43. There is frequently a very rapid turn round of staff in any one position. Whilst this may be good for staff morale and personal development, it needs to be weighed against a lack of continuity and poor service delivery. One recent example is the departure at the same time of both the head and deputy head of the Working Together Revenue team. There have been similar instances throughout the Tax Credits team.

44. Consideration should be given to providing one single person as a principal point of contact for businesses, possibly linking up the activities of the Revenue’s Large Business Office and Customs and Excise’s Large Trader Office.

45. We have some concerns about the relatively recent change to modular training which seems to have resulted in some slippage with officials not having the depth and breadth of training that they received in the past.

46. We could go on, but the above examples highlight the considerable scope for real service improvements. We think that the Revenue departments need to be bolder in identifying and implementing real improvements.

OTHER POINTS

Some practical examples

47. In our meeting with Dave Ramsden and his team they were anxious for us to give examples to support any comments that we made. The main example we gave then of how things have gone wrong was in relation to the introduction of Tax Credits. We pointed out at that meeting that it was particularly unhelpful for the Treasury to have issued a Press Release on 4 September entitled “Tax Credits a Huge Success” at a time when the Inland Revenue staff, claimants and agents were grappling with the operational problems.

48. We are currently dealing with the run up to the implementation of Stamp Duty Land Tax, which has begun to exhibit many of the same practical problems as Tax Credits. We note the somewhat unhelpful press release dated 20 October 2003 pronouncing help for small businesses through a modification to the calculation of the new charge. However, it did not highlight that the new rules impose a charge to Stamp Duty Land Tax (SDLT) where there was none before. Furthermore, we remain unconvinced that, whilst the policy is clear, the practical interaction of the new SDLT self assessment rules with those for income tax and corporation tax, has been fully explored and the likely operational issues addressed.

Future meetings

49. We would be very happy to meet with the Treasury Review team either to expand on the comments in the present document or to discuss other issues in relation to the overall Review.

October 2003

Memorandum submitted by The Law Society

INQUIRY INTO THE MERGER OF CUSTOMS AND EXCISE AND THE INLAND REVENUE

1. The Law Society welcomes the conclusions of the review of the Revenue departments. Merger of the Inland Revenue and HM Customs and Excise is long overdue. While there are potential risks with the proposed reforms of the policy making process, we are pleased that the defects in the existing arrangements have been recognised. We would encourage the continued involvement of all external stakeholders and in particular the professional bodies as the most immediate “users” of the product of tax policy during the period of implementation of change.
ISSUES RELATING TO THE MERGER

2. We see clear advantages in one body being responsible for the administration of the tax system. It is not clear from the report what timetable is envisaged to achieve merger and we are concerned that this should achieve both swiftly enough to demonstrate real gains as soon as possible and also with sufficient care to ensure that the risk of damage to policy making and the administration of the tax system and its effects on stakeholders is minimised.

The process of merger

3. The merger will require a number of areas of policy and practice to be addressed where the two departments operate in different ways, or under different sets of rules. This will be an opportunity not merely to achieve a single set of procedures but also to modernise the law and practice in a number of different areas and to address problems. We have in the past expressed concerns at the way Revenue departments have operated, for example, the inappropriate use of PACE powers, the mixed use of criminal and civil powers and in the use of regulations and guidance. The merger should be taken as an opportunity to clarify many outstanding issues and to introduce improvements. In particular the following should be addressed—

(i) There needs to be clarification as to the use of criminal and civil powers and when they should be used. For example, if is thought that an investigation will lead to criminal proceedings, PACE requirements need to be adhered to from the outset to ensure that the investigation is human rights compliant. Likewise, the more onerous criminal powers should not be used to deal with purely civil issues.

(ii) The balance between legislation, regulations and guidance needs to be considered and a more consistent approach taken across the taxes.

(iii) Operational procedures—both organisations have areas of excellent practice. Where a more uniform practice is to be adopted, the choice of which department’s is to be adopted should be decided on an objective and case by case basis and not simply on the basis of “sharing out” the right to continue existing practices.

(iv) Consultation—The use of consultation should be widespread and operated consistently across the merged departments. The lessons learned from good (eg the reform of double tax relief) consultations should be learned and applied consistently.

4. The process of merger will undoubtedly be a difficult one, but we believe that there are major gains to be had if it is done well. We would encourage open consultation on each aspect of the way in which the Revenue departments function to ensure that the new department incorporates the best of both organisations, but also to achieve a greater degree of acceptance from the department staff for any changes which need to be implemented.

Technical support and expertise

5. While we accept that findings of the Gershon Review are to be implemented across Whitehall, the revenue departments are the leading example of an area where Government risks being “penny wise, pound foolish”. Insufficient resource devoted to tax policy and collection can result in revenues lost and inefficiencies being imposed on the economy. We would be extremely concerned if the review and subsequent merger were to be treated primarily as a cost-cutting exercise leading to the reduction in the number of technical experts available to deal with queries or give guidance on a particular issue.

6. Currently it can be difficult to obtain answers to technical queries from staff at Customs and Excise, particularly given the inability of the help line to provide answers to non-routine questions. It is hoped that this could be improved following the merger with the strengthening of the policy maintenance role of the departments. Experience both with VAT call centres and the SDLT helpline demonstrates only too clearly that the adoption of a call centre approach will not lead to the benefits anticipated unless the call centre is supported by a sufficient number of experienced technical experts. The merger should be used as an opportunity to develop a central body of expertise and to spread their expertise throughout the organisation, not as an excuse to cut out the heart of two excellent organisations.

Legislative matters

7. We are pleased to see that the report recognises the legal differences between the taxes administered by the two departments, which will need to be addressed over time. As is acknowledged in paragraph 4.23, there is good reason for the difference in powers. Any alignment of powers following the integration of the two departments should not result in an automatic levelling up of the powers to the highest level currently applied. The opportunity should be taken for a thorough review of all information gathering and enforcement powers. While there needs to be a credible enforcement regime with commensurate powers, the approach to be adopted should be to adopt powers which are tougher on those who are deliberately non-compliant with a lighter touch for those who are compliant.
8. Any legislation necessary to harmonise information and enforcement powers will need to take account of the significant differences in the definitions used within the tax system. This is a major opportunity to produce a coherent and sensible set of enforcement rules which should not be rushed into by simply bolting legislation (principally the Taxes Management and the Customs & Excise Management Acts) together. There should be full consultation on making the powers consistent and appropriate for the new Revenue authority.

The collection and use of information

9. We accept that the new tax authority will mean, in effect, that any existing barriers regarding the exchange of information between the two departments will be dismantled. We agree that there should be full exchange of information within the combined tax authority. Paragraph 4.63 recognises that information is necessary for good policy making and good enforcement. We favour the use of information if this is to reduce a burden on business, either to achieve better overall tax collection or to avoid the need for duplication of information reporting. However, the emphasis should be on the reduction in compliance burdens and we would not want the merger to be taken as an opportunity to increase the overall amount of information collected from business.

10. We also have some concerns about the wider implications of the more cohesive collection and use of information by the new tax authority. The extent to which information held by the new tax authority will be exchanged with other Government departments needs to be clarified. We are also unclear as to the implications that merger will have on the exchange of information with international authorities as the enlarged department will have routine access to information which was previously only held by Customs & Excise and which would not have been automatically available for exchange by the Inland Revenue under the terms of double tax treaties. Consideration will need to be given to the need for constraints as to who authorises the transmission of information held, who can request and receive this information and what information is given about a taxpayer to protect both individual and commercial confidentiality. Human rights considerations will also need to be considered. We recommend that the opportunity be taken to revisit the terms of exchange of information powers.

Reform of the tax policy making process

11. We welcome the aim of improving the tax policy-making process. As users of the legislation and policy which flows from the policy making process, we are very aware of the numerous failures which have occurred from the disjointed nature of the existing policy making machinery.

12. There is clearly a tension between the need to ensure that tax policy advice is able to take as wide a view of the implications of particular decisions as possible and the value of informing all policy decisions with the practical experience of the revenue departments. While we believe that, on balance, the proposal to strengthen the Treasury's policy making function is the right one, we do have some reservations about the proposals in the report.

The revenue departments' contribution to policy making

13. The strengthening of the Treasury's policy-making unit should allow a more balanced decision-making process to operate, which will be able to take account of both the practicalities of particular policies and the wider context of the tax system as a whole. However, this should not allow purely economic (or indeed political) considerations to over-ride practical issues. Policies may be economically sound, but practically unworkable, as has been demonstrated by many previous attempts to correct genuine market failings through the tax system. The reform should strengthen the contribution to policy-making of economic and wider considerations, but not weaken the practical contribution from the revenue departments. The report is unclear on the way in which this link with practical considerations is to be maintained by the new policy divisions within the Treasury.

Systemic checks and balances

14. Equally, the strengthening of the Treasury’s policy function should not be used as a means for Government to push through policies which are inadequately researched or evidence-based. Systemic checks should be included to ensure that particular policies are subjected to adequate pre- and post-implementation review. The embedding of such checks within the process will both ensure that better policy results and also give a greater degree of credibility to policies once implemented.

15. Although we recognise that the Government has improved external involvement and consultation in policy making over recent years, we believe there is still considerable scope for improving the openness of the policy making process. We would recommend that the Treasury consider adopting a similar procedural approach to policy making as in New Zealand, which improves the degree of external (and internal) scrutiny and allows more time to be taken over consultation and implementation. So long as there is no revenue risk, we see significant benefits in this, and believe this will result in better drafted legislation with more clarity and certainty for the taxpayer and advisers.
**Personnel issues**

16. Any processes incorporated into the new arrangements will only be as effective as the personnel charged with their implementation. It is clearly important that the Treasury tax policy staff are of a high calibre, and we welcome the principle of external seconded forming part of the Treasury team. We do, however, have some concerns as to the ability of the Treasury to attract and retain high-quality external staff experienced in tax issues in practice, given the highly competitive market for tax personnel in the private sector. While secondments from the professional firms may be possible, there is naturally a reluctance on the part of the professional firms to allow highly qualified (and valuable) staff to be seconded for any significant period without any material financial return. Recently retired tax practitioners may, however, provide a valuable source of experienced personnel.

17. Equally, while the calibre of the tax policy unit at the Treasury is important, it will also be necessary to ensure that the Revenue department is able to retain high quality staff both experienced in the practicalities of tax administration and also able to provide support to the Treasury team as appropriate.

18. It is important that the staff of the tax policy unit and the Revenue department should cooperate fully and that there should be frequent interchange of personnel. The effectiveness of the tax policy unit will depend to a significant extent on the flow of appropriate information from the Revenue department to the tax policy unit and on impartial scrutiny by the Revenue department of tax policy proposals. It would be only too easy for the tax policy unit and the Revenue department to regard each other with mutual suspicion. Frequent interchange of personnel should alleviate this risk.

**Contact points with external stakeholders**

19. We are pleased that the report acknowledges in paragraph 5.52 that there needs to be a link between implementation and policy. At present the effective responsibility for policy formulation at the Inland Revenue has meant that there is a broad degree of identity between those officials advising ministers on new policy and those responsible for its implementation. This allows a practitioner or taxpayer who has difficulties in interpreting new legislation to liaise with the appropriate official and be confident that he or she is best placed to provide advice to the taxpayer or practitioner and, if necessary, propose an amendment to the policy or the issue of guidance.

20. The separation of policy formulation from implementation will both make it more difficult for the choice between policy amendment or the use of guidance to be made and will create uncertainty as to who is the appropriate official to advise on a particular matter—the one responsible for formulation or the one responsible for implementation. There is a risk of duplication and uncertainty. Advisers, representative bodies and others may need to maintain two points of contact to be sure that they are able to discuss both a practical and a policy solution to any particular problem. It is not clear to us how this will be addressed, but at the very least it will require clear and open lines of communication and responsibility between Treasury and revenue department.

**The drafting and production of legislation**

21. The role of the Parliamentary Draftsmen in the policy and legislative process is critical to the quality of the final product. We believe that it is inappropriate for Parliamentary Counsel to form part of the policy making teams—there is a definite advantage in the draftsman maintaining a degree of distance from the day to day process—but we think that it is essential for him (or her) to be consulted at a very early stage in policy making. This will allow, for example, Counsel to identify policy proposals, which may give difficulties in drafting. We believe that the quality of staff at Parliamentary Counsel Office is extremely high (although they continue to be understaffed relative to their workload). Where poorly drafted legislation is produced we believe that this is more as a result of poor or late instructions, problems which can be addressed by ensuring that members of the policy teams are trained in preparing instructions for the draftsmen and by adopting a more extended timetable for policy implementation as advocated above.

22. The creation of a single Treasury-based tax policy team will also require the existing differences in the way in which instructions are given to Parliamentary Counsel between Customs and the Inland Revenue to be addressed. For example, we understand that Customs use lawyers to instruct Parliamentary Counsel (increasing the distance between the draftsman and the policy advisers, but possibly improving the quality of the instructions) whereas the Revenue officials can draft instructions themselves (reducing the risks of misunderstanding but requiring an additional level of skill in the policy adviser). There are important issues to be addressed in the style of drafting and the need for consistency of approach. Training will be essential to resolve any lack of expertise in drafting instructions and to ensure consistency of approach and although we recognise that this would have resource implications, we believe that good training in this area is likely to provide significant long term benefits for government and taxpayers in terms of the quality and robustness of legislation.

April 2004
Memorandum submitted by the Public and Commercial Services Union

MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE

INTRODUCTION

1. The Public and Commercial Services Union (PCS) is by far the largest civil service trade union with a total membership of 300,000 working in the civil service and related areas.

2. PCS represents the overwhelming majority of staff and senior managers employed by both the Customs and Excise Department and the Inland Revenue. We represent over 18,000 staff working for Customs & Excise and over 55,000 staff in the Inland Revenue.

3. PCS welcomes the select committee’s timely inquiry and is happy to supplement this written submission with oral evidence or further written evidence.

KEY ISSUES

4. Whilst recognising the potential of a new department of state created by merging HM Customs and Excise and the Inland Revenue, if it is to be successful we believe it must deliver:

   — Additional yield for the Chancellor.
   — Improved support for business, employers and customers.
   — A quality department, providing quality jobs.
   — A national, accessible service for cities, towns and rural areas.
   — Well paid, well motivated staff.

   PCS does not accept the proposed job losses as we believe that these objectives cannot be achieved with reduced staffing levels.

REDEPLOYMENT OF RESOURCES

5. PCS would welcome further details on the new department’s plans to operate “spend to earn,” “spend to raise” and “spend to save” initiatives. The “tax gap” in the UK is at least £20 billion. There are billions of pounds of illicit goods smuggled through our ports every year. PCS believes the merger provides the perfect opportunity to re-deploy resources into tackling evasion, avoidance and debt recovery. Recent “spend to raise”, and “spend to save” initiatives demonstrate the potential for the targeted redeployment of existing resources. This is illustrated by the achievements of just one area of Inland Revenue’s spend to raise initiative. Extra resources on the debt recovery have produced:

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<th>Daily Penalties</th>
<th>Specialist Recovery &amp; Enforcement</th>
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<tr>
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<td>Cases started</td>
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<tr>
<td>No of returns o/s</td>
<td>No of years o/s</td>
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<tr>
<td>No of determinations</td>
<td>Value of debt</td>
</tr>
<tr>
<td>Value of determinations</td>
<td>No. of closed year</td>
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<tr>
<td>No of returns received</td>
<td>Yield collected</td>
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<td>Qualified yield</td>
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6. PCS would also welcome details from the committee on the departments plans to re-deploy staff in order to tackle the billions of pounds of illicit goods smuggled through British ports every year.

SERVICE DELIVERY

7. Employers and business, especially new businesses, need good quality support from both departments to help them deal with widespread and sometimes complex responsibilities on behalf of government. Rural communities and inner cities need greater support to obtain all their entitlements including tax credits in their various forms. PCS seeks a commitment that the merger will not result in a reduced local service.
STAFFING

8. Both departments have strong records of achievement for Government and the UK economy. They have loyal, experienced and effective staff. Those staff have implemented New Tax Credits with record “take up” levels, reduced smuggling and increased compliance tax yield. Both departments have a deserved reputation for high quality service delivery. PCS has produced a progressive submission to this year’s Spending Review which is packed with ideas for service improvements and is enclosed for your attention.

9. To be successful the new department needs to retain good quality staff. PCS would seek to know what plans are in place to harmonise the terms and conditions of staff in the merged department and what assurances can be given regarding their job security. Current uncertainty is deeply unsettling for existing staff.

10. The culture of the new department will be an important factor in securing the commitment of existing and future staff. Staff from neither organisation should feel they have been the subject of a takeover or that their skills and knowledge are no longer valued. PCS would welcome details on what steps will be taken to ensure that this does not occur.

11. PCS seeks a comprehensive re-skilling programme, with sufficient funding available for this programme, in the lead up to the merger and in the early years of the new department to allow the merger to take place smoothly, and to enable our members to be in a position to deliver a quality service from the outset. Adopting the Development Opportunity and Change agreement across both departments would help in the process.

INDUSTRIAL RELATIONS

12. Open and comprehensive industrial relations arrangements will set the tone, raise confidence and support service delivery. PCS can contribute positively to the merger and as the trade union for the vast majority of staff we seek reassurances that we will be fully consulted throughout.

CONCLUSION

13. PCS would like to see effective and wide consultation with trade unions over the merger.

14. It is important that the review is thorough and is not used as an excuse to reduce costs. PCS would expect joint resources to be re-deployed into tackling evasion, avoidance and debt recovery in line with government commitments.

15. We also seek assurances that the high quality of service offered by both departments is maintained and that staffing resources are not reduced within the new department. That terms and conditions of existing staff are harmonised to ensure staff morale is not affected, and that a commitment is made to a progressive programme of pay and conditions of service, skills development, job designs and family friendly policies.

April 2004

Memorandum submitted by The Inland Revenue

The Inland Revenue’s oath of confidentiality

1. Although popularly referred to as an oath, the requirement in the 1970 Taxes Management Act is in fact a statutory declaration. Every member of staff of the Inland Revenue is required, as soon as possible after appointment, to make the following declaration in front of a witness:

I, ......, do solemnly declare that I will not disclose any information received by me in the execution of the duties which may from time to time be assigned to me by the Board of Inland Revenue except for the purposes of my duties or to the Board of Inland Revenue or in accordance with their instructions, or for the purposes of any offence relating to inland revenue, or in such cases as may be required by law.

2. In practice this takes the form of a signed declaration rather than an oral “oath”. A similar declaration is required of members of the Inland Revenue Board and appeal commissioners.

3. Staff of the Inland Revenue and Customs and Excise are also bound by a further statutory confidentiality provision—Section 182 of the Finance Act 1989—which makes it a criminal offence to disclose information relating to a recognisable customer, except in very limited circumstances. Those circumstances include cases where the customer consents to the disclosure of information, where the information is already in the public domain, or where there is lawful authority to disclose (eg by way of legislation or a court order).

October 2004
Supplementary memorandum submitted by the Public and Commercial Services Union

MERGER OF CUSTOMS & EXCISE AND THE INLAND REVENUE

PCS BRIEFING

INTRODUCTION

The Public and Commercial Services Union (PCS) is the largest civil service trade union, with a total membership of 310,000 working in over 200 civil service departments, non-departmental public bodies and related areas. PCS is uniquely qualified to comment on the merger as we represent the vast majority of staff and senior managers employed by Customs & Excise (over 18,000 members) and Inland Revenue (over 60,000 members).

PCS is committed to achieving high quality public services and we represent the staff who are a fundamental resource required to deliver customs and revenue services to the public. The creation of the new Her Majesty’s Revenue and Customs (HMRC) department will bring momentous change and uncertainty amongst many staff. This change will work best if it includes the goodwill and commitment of staff and their union. PCS therefore wants to be at the centre of change within the new department and looks forward to positive and pro-active industrial relations.

In addition we believe that our aspirations for good pay and conditions for our members go hand-in-hand with the delivery of high quality public services. We agree with the HMRC Chairman, Mr David Varney, that employers need to address the diversity and equality agenda; recruitment, motivation and retention issues; and the challenges of an ageing workforce. Evidence shows that positive industrial relations and good working conditions leads to a highly motivated workforce, higher productivity, lower absence rates, lower turnover and a greater emphasis on innovation and development.

10 STEPS TO SUCCESS

Below are PCS’s key concerns on operational issues the new department must address in order to be effective:

— A commitment to equitable, consistent and high quality public services.
— Winning the confidence and trust of customers through a community-based approach to tax compliance and credits.
— Investment in proper resources and procedures to address tax compliance, close the tax gap and increase revenue yields.
— Taking effective steps to detect and deter criminal activity.
— A measured and rational approach to change.
— Examination and review of the impact on HMRC of the government’s proposals for the future of the civil service.
— An end to the scandal and waste generated by the privatisation of public service functions and the widespread use of highly-paid consultants.
— A joined-up, inclusive approach to operational, personnel and accommodation matters throughout HMRC and with other departments.
— Valuing, and investing in, staff to establish a highly-trained, skilled and committed workforce with good job security, pay, conditions and career development opportunities.
— Good industrial relations to be at the heart of the operation and culture of HMRC.

CIVIL SERVICE CHANGE

Proposals for major change throughout the civil service are currently the subject of intense debate and significant concern amongst our members within Customs & Excise and Inland Revenue. In particular the impact of the Gershon and Lyons Reviews and the Chancellor’s announcement of plans to reduce and/or relocate significant numbers of posts over the next five years must be a key issue for HMRC.

HMRC PLANS TO DELIVER THE GERSHON AND LYONS REVIEW

In particular PCS is seeking clarity on the impact of these proposed changes within HMRC. PCS would like to ask the following questions:

— Exactly what cuts are proposed?
— Over what timescale is it envisaged that these should take place?
— What will be the likely impact of any reduction in jobs on public services, communities, fighting crime and the efforts to close the “tax gap”?
— Are there any plans to close local offices?
— Will access for citizens and business be improved or curtailed?

Initial indications are that 16,500 posts are under threat within the Customs and Revenue areas as a whole. It has yet to be made clear how these cuts will be managed, and how detrimental consequences for the quality and effectiveness of services are to be avoided. For example, if efficiencies cannot be achieved through cutting so-called “backroom” staff (which PCS believes is a false and arbitrary distinction) will front-line staff also be in the firing line, as they already appear to be in other areas of the civil service?

PCS believes that the emphasis should be on improving public services and setting staffing levels accordingly. Therefore where any genuine efficiency savings can be achieved within HMRC as a whole, resources should be redeployed as necessary in an effort to achieve further net improvements in services. We believe that it makes more sense for the Chancellor to employ HMRC staff on work that would generate £billions from uncollected tax and excise on goods currently being smuggled illegally via ports, rather than seek to generate £millions from job cuts. This would realise a huge net increase in government income and make money available for schools, hospitals and other services.

In essence, the HMRC management board will have to decide whether the focus of the new organisation is on the achievement of high quality public services or the achievement of the government’s arbitrary job cuts.

HMRC Service Delivery

Closing The Tax Gap

We endorse the idea encapsulated in both departments “Spend To Save” and “Spend To Raise” initiatives where investment in jobs, skills and services is made in order to achieve better quality services and higher revenue through more effective tax and excise compliance. In short, more people and resources equals more money.

Evidence indicates a current “tax gap” in the UK of around £30 billion. Closing this gap is a stated objective of the Chancellor and will be a key performance indicator for HMRC. It is difficult to envisage how this objective will be achieved against a backdrop of a reduction in 16,500 jobs within HMRC. In fact we believe additional resources and robust processes will be required in order to address these problems. The tax gap takes no account of the shadow (“black”) economy that represents an additional opportunity to both address tax compliance and address law enforcement and other considerations.

Customer service and confidence

Resources should be focussed in areas that represent significantly high potential tax yield, however equally important is the need to establish and sustain an equitable and consistent compliance regime that wins the confidence and trust of the public. We are keen for a network of local offices to be retained throughout the country maintaining the link with communities and placing a focus on quality customer service.

PCS also believes that there is scope for new and innovative ideas to improve customer service and accessibility around the UK. We are concerned about how HMRC intends to support tax credit claimants and other customers? And we would question what additional support will be offered for businesses? In relation to New Tax Credits, we believe that HMRC has an opportunity to support local businesses and people within a community focussing on providing high quality customer service.

There is a balance to be struck between properly resourced, potentially lucrative tax compliance opportunities and a customer service/consistency focus. PCS wants to see this debate taken forward and is ready to support the efforts of the new department in these areas.

E-Business Impact

Within Customs 3,500 job losses are anticipated through efficiency improvements arising from “e-business”, in particular VAT work. PCS do not believe that it is realistic to expect to achieve significant improvements in efficiency via this route. Britain is not properly prepared to embrace such technological change, an example such as the disastrous introduction of the Criminal Records Bureau and their assumption that the majority of applications would be made via the internet was wrong as applications were overwhelmingly submitted in paper format.

We would in any case wish to seek clarification on the cost of any e-business initiatives and question whether these represented value for money.
**Crime**

The trend within Customs in recent years has been the gradual reduction in posts at ports of entry within the UK. For example, cuts of 300 in 1985; 200 in 1995; and further reductions in 2001.

We would question whether HMRC management could realistically provide a reassurance of the department’s ability to protect against threats in light of these reductions. Crime is always becoming more sophisticated and organised criminals are always looking to stay one step ahead—it is likely that they are well aware of reductions in resources and use this to their advantage. Continued cuts in resources will continue to breed a new class of criminal, and this needs to be addressed in the new department.

The seizure of drugs or weapons in such circumstances does not in our view represent an indicator of success—rather that the majority of illegal activity goes undetected because of the lack of proper resources and an effective deterrent. We reject the idea that a lack of seizures indicates that a reduction in resources is appropriate. In fact we believe that the opposite is true, that in actual fact proper resources act as a deterrent and therefore reduce criminal activity (a key indicator of HMRC success).

We strongly believe that as a first step a review of resources and procedures at ports of entry is required in order to establish the degree of the risk.

**Staff Deployment**

We do not believe that Customs enforcement staff are deployed in the most efficient and effective manner. An increasing trend is for these staff to be mobile to target hot-spot areas. This has resulted in the farcical situation where groups of staff pass each other on the motorway along the south coast en route to their designated temporary stations.

Forcing mobility on staff in such a way is neither reasonable nor effective. PCS believe proper resources should be maintained throughout the UK in order to deliver effective intervention and deterrence. The removal of local teams only encourages and promotes smuggling into the UK.

**Offices**

We regret that the trend towards reducing resources has on occasion been extended to the closure of particular offices, where current intelligence indicates that such decisions were flawed. We believe that current plans to close the existing IR local office network (see Customer Confidence and Service) are equally flawed, as this will undermine the consistency of the drive for tax compliance across the UK. We are also concerned about the issue of emergency New Tax Credits in 2003 where, due to the closure of a number of local offices, many customers were forced to make long and expensive journeys to receive payments.

PCS believes that there is scope to utilise current unused office space within respective Customs/Revenue locations and take reasonable steps to co-locate services with single HMRC sites where this is consistent with wider public service and staff relocation concerns. We are ready to work the HMRC management board on this.

**Joined-Up Government**

We anticipate that a joined-up, inclusive approach will be adopted by the management board in relation to operational matters, working conditions and progression opportunities for staff. Clarity is required at this stage on whether compliance and other relevant activities will in fact be joined-up.

**Role of the Private Sector**

Given the negative impact of a number of privatisation/contracting-out exercises within Customs & Excise, Inland Revenue and throughout the civil service, we believe that any proposals to further outsource HMRC work would be a mistake. The emphasis should be on utilising and developing in-house skills and solutions.

Previous experience in Revenue and Customs proves this point, in particular the Mapeley STEPS affair, where Revenue and Customs Offices were sold three years ago to an offshore company under the Private Finance Initiative (PFI). This sale brought great discredit and controversy on both departments. Payments to Mapeley are now averaging £307 million per year, rather than the anticipated facility price of £170 million. The contract may prove to be significantly more expensive than the rejected alternative of retaining the offices under public ownership. In addition over 40 firms of consultants and advisors have been used on the STEPS deal, at a cost to the taxpayer of £13 million to April 2004. The HMRC Chairman is due to give evidence on the affair to the Public Accounts Committee (PAC) on 27 October.

In addition, the Revenue has paid out nearly £1 million in compensation since April 2003 to those suffering delays and errors arising from the IT contract with Electronic Data Services (EDS). The PAC’s report on the matter that was published in April this year indicated that 400,000 families had not received
their child tax credit and working tax credit payments on time. Furthermore, one in five applications had been assessed incorrectly. The Revenue was forced to make interim payments, which were then clawed back, in many cases causing additional suffering and hardship to those who the credits were meant to help.

We regret that consideration is nevertheless being given to outsourcing further IT functions. We hope that the lessons of history will be learned, and that any such initiatives will be withdrawn.

**Civil Service Integrity**

We support the principle that the honesty, integrity and impartiality of all civil servants is maintained.

We note in this regard the recent example in the senior civil service, where serious concerns have been raised regarding the appointment of the ex-Inland Revenue Chairman, Sir Nicholas Montagu, to the advisory board of Pricewaterhouse Cooper (PwC). PwC is the most prolific PFI consultant, having advised on £30 billion worth of projects to date. The company, which has declared that it is looking forward to benefiting from Sir Nicholas’ "unique perspective", has been the driving force behind moves to overrule the UK's anti-tax avoidance laws in the British and European courts, encouraging as many of its corporate clients as possible to sue the government for having prevented them from avoiding tax.

This follows Sir Nicholas’ launch of an Inland Revenue campaign last year on the immorality of tax dodging, in the light of intense public criticism over the Mapeley STEPS tax haven affair and accusations that the government had “gone soft” on tax avoidance. We feel that integrity of senior civil servants is paramount in developing trust for the new department.

John Yard, the former head of information technology with the Inland Revenue, has also moved to a more lucrative post within private industry following his close association with PFI contracts.

**Other Matters**

A range of other practical operational matters are still to be addressed, for example:

— It is not clear whether Business Support Teams will cover PAYE and VAT.
— What enforcement powers are envisaged and at what levels within the organisation?
— Whether debt management procedures will be improved and how?
— Whether standardised hours of service will established for HMRC customers?

**Conclusion**

We acknowledge that the merger of the departments will inevitably bring rationalisation and change. However ensuring that proper resources and processes are in place and involving the staff will be fundamental to the success of the new department. We believe that pre-emptive decisions and a tendency to move too fast, too soon will prove to have disastrous consequences. We therefore hope that the HMRC management board will take a measured and rational approach to change and to the delivery of effective public services.

We look forward to working with the HMRC Chairman and his senior management team in order to deliver high quality services by putting people at the forefront and meeting the challenges of job security, diversity and development. We look forward to better opportunities for staff to attain career development and skill acquisition—to their own and the department’s benefit alike.

PCS has an established record of delivering agreed change through effective industrial relations and close working relationships with managers at every level. We have indicated our support for government and departmental initiatives, including new tax credits, and have supported the government at difficult and testing times (for example our support for rural communities during the foot and mouth crisis).

PCS therefore looks forward to being at the heart of the debate about the establishment and operation of HMRC into the future. We would welcome the opportunity to provide further written or oral evidence to the select committee on our vision for the new department.

*October 2004*
Letter from David Varney, Chairman, Inland Revenue and HM Customs and Excise to the Chairman of the Sub-Committee

Following the Select Committee hearing on Wednesday I thought it would be helpful to further clarify the Ministerial roles and responsibilities for the new Department.

The formation of HMRC ensures that a single Treasury Minister is the departmental lead for both revenue and customs functions. The Paymaster General is the departmental Minister for HM Revenue and Customs. I am the accounting officer who reports to the PMG on departmental issues and running the department.

The tax system impacts on a wide range of Treasury policies. As with previous governments different Ministers lead on policies that also cover taxation. The Economic Secretary’s areas of policy responsibility that also cover taxation include small business taxation, transport taxation and excise duties (including the excise fraud strategies). The Financial Secretary, as the lead Minister on Financial Services, also has responsibility for some areas of policy that include taxation including issues such as ISAs, the taxation of savings, stamp duty and pensions.

The PMG has strategic oversight for the tax system as a whole. Both the Economic Secretary and Financial Secretary update and consult with the Paymaster General as a matter of routine to keep her fully informed of policy developments which impact on her wider areas of responsibility. The Chancellor has overall responsibility for the Chancellor’s departments. I attach an annex, which gives a full list of Treasury Ministers’ portfolios, for your information.

MINISTERIAL RESPONSIBILITIES

Chancellor of the Exchequer: Rt Hon Gordon Brown, MP
The Chancellor has overall responsibility for the work of the Treasury.

Chief Secretary to the Treasury: Rt Hon Paul Boateng, MP
— Responsibility for public expenditure, including planning, control, pay, efficiency, capital investment and targets (including local authorities and public corporations);
— Public/Private Partnerships including Private Finance Initiative, and Partnerships UK;
— Ministerial responsibility for the Office of Government Commerce and procurement policy;
— Treasury interest in Devolution; and
— Strategic oversight of banking, financial services and insurance.

Paymaster General: Rt Hon Dawn Primarolo, MP
— Strategic oversight of the UK tax system as a whole including direct, indirect and corporate taxation, capital gains tax, inheritance tax and VAT;
— Departmental Minister for HM Revenue and Customs, including the HM Revenue and Customs Bill;
— Overall responsibility for the Finance Bill;
— European and international tax issues;
— Tax credits;
— Treasury interest in childcare issues; and
— Welfare reform group (welfare fraud).

Financial Secretary: Stephen Timms, MP
— Banking, financial services and insurance, and the Financial Services Authority, including financial services tax issues (such as ISAs, taxation of savings, stamp duty, insurance premium tax and pensions);
— Personal savings policy;
— Foreign exchange reserves and debt management policy;
— Support to the Chancellor on EU and wider international finance issues;
— EMU preparations;
— Corporate Social Responsibility;
— Ministerial responsibility for National Savings, the Debt Management Office, Office for National Statistics, Royal Mint and the Government Actuary’s Department, and Departmental Minister for HM Treasury;
— Support to the Chief Secretary on public spending issues and selected Cabinet Committees; and
— Support to the Paymaster General on the Finance Bill.

15 October 2004