



House of Commons  
Treasury Committee

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# The administration of tax credits

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Sixth Report of Session 2005–06

*Volume I*

*Report, together with formal minutes*

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## The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration, and policy of HM Treasury and its associated public bodies.

### Current membership

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Lorely Burt (*Liberal Democrat, Solihull*), Susan Kramer (*Liberal Democrat, Richmond Park*) and Mr David Ruffley (*Conservative, Bury St Edmunds*) were also members of the Committee during this inquiry.

### Powers

The Committee is one of the departmental select committees, the powers of which are set out in House of Commons Standing Orders, principally in SO No 152. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk). The Committee has power to appoint a Sub-Committee, which has similar powers to the main Committee, except that it reports to the main Committee, which then reports to the House. All members of the Committee are members of the Sub-Committee, and its Chairman is Mr Michael Fallon.

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) from Session 1997-98 onwards are available on the Internet at [www.parliament.uk/parliamentary\\_committees/treasury\\_committee](http://www.parliament.uk/parliamentary_committees/treasury_committee). A list of Reports of the Committee in the present Parliament is at the back of this volume.

### Committee staff

The current staff of the Committee are Colin Lee (Clerk), Fiona McLean (Second Clerk and Clerk of the Sub-Committee), Dominic Lindley, Andrew Staines and Adam Wales (Committee Specialists), Lis McCracken (Committee Assistant), Mandy Sullivan (Secretary) and James Clarke (Senior Office Clerk).

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## Summary

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‘New’ tax credits—the child tax credit and the working tax credit—were introduced in April 2003. The Government states that the tax credits regime provides support for six million families and ten million children, as compared to 800,000 families who received support under the previous regime of family credit. However, in 2003–04, about one-third of all tax credits awards paid—nearly 1.9 million awards—were overpaid, at a cost of nearly £2 billion. This was significantly higher than the Government had predicted. The Government recently indicated that, but for the reforms announced to the regime in the Pre-Budget Report 2005, initial estimates had suggested that subsequent years’ overpayments would have been of broadly the same level as in 2003–04.

We consider reasons why such a high level of overpayments has arisen. Recent research suggests that the tax credits regime, which is designed to deliver the correct amount of State assistance over the year as a whole, rather than over any shorter period, could be aligned more closely to the financial needs of such families, in particular to their tendency to budget over a month or less, rather than over the whole of a tax year. It seems self-evident to us that HMRC cannot take steps to improve the way in which it administers tax credits without first identifying, and developing a detailed understanding of, the factors which cause overpayments and the extent to which each individual factor has contributed to the overall overpayments problem. A significant gap in HMRC’s understanding is the lack of analysis of the extent to which official error and IT system error have caused or contributed to overpayments.

We then consider current issues associated with the administration of tax credits. We look at a variety of issues associated with HMRC’s recovery of overpayments, including the need for a ‘pause’ before recovery commences, the test which HMRC applies in deciding a disputed overpayment and a claimant’s appeal rights from this decision. We consider the incidence of fraud, error and organised crime in the tax credits regime, including fraud and error on the part of claimants.

We then consider future issues. We welcome the fact that the Government is seeking to improve the operation of the tax credits regime by introducing a package of reforms, although we raise questions about the Government’s estimates of the overall costs of the package and the effect the increased disregard may have on claimants. We consider how HMRC might improve its service to claimants. Our overwhelming impression is the extent to which, within HMRC, the administration of the tax credits regime has been based around individual functions or tasks, rather than centred around the needs of claimants, which has had implications for both staff and claimants. Finally, we discuss the adequacy of data about tax credits available to HMRC, and specific matters relating to the design of the tax credits regime.

The difficulties associated with administering the tax credits regime have detracted from the regime’s successes and have had real impacts on the lives of some claimants. We conclude that it is crucial that HMRC focus on what more it can do to institute a claimant-centred approach to administering tax credits. The quality of service provided to claimants by HMRC will be crucial to the success of the tax credits regime.



# 1 Introduction

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## Conduct of the inquiry

1. In July 2005, the Treasury Committee established a Sub-Committee, to examine the work of the minor departments accountable to the Treasury and other matters referred to it by the main Committee. In October 2005, the Sub-Committee announced that it intended to examine the handling of the payment of child and working tax credits in the United Kingdom by Her Majesty's Revenue and Customs (HMRC). In particular, the Sub-Committee would:

- examine HMRC's implementation of the six measures for improving the tax credits regime which the Paymaster-General identified in her written statement to the House on 26 May 2005;
- examine HMRC's recovery of overpayments of tax credits; and
- seek to identify future solutions to the difficulties encountered in administering the payments system.

2. The Sub-Committee specifically requested that those submitting written evidence should address future solutions in their evidence, rather than simply raking over past administrative decisions and practices.

3. The Sub-Committee received 39 written memoranda and took oral evidence from: Citizens Advice, Child Poverty Action Group (CPAG), One Parent Families (OPF), the Chartered Institute of Taxation (CIOT), the Chartered Institute of Taxation (Low Incomes Tax Reform Group) (LITRG), Advice Northern Ireland, Citizens Advice Northern Ireland, the Institute of Chartered Accountants in England & Wales, the Association of Taxation Technicians (ATT), Mr Mike Brewer from the Institute for Fiscal Studies (IFS), Rt Hon Frank Field MP, the Public and Commercial Services Union (PCS), Rt Hon Dawn Primarolo MP, Paymaster-General, HM Treasury, together with HM Treasury and HMRC officials, and Sir David Varney, Chairman of HMRC, Mr Paul Gray, Deputy Chairman of HMRC, and HMRC officials. We are grateful to all those who gave evidence or otherwise assisted with our inquiry. Members of the Sub-Committee also visited the Tax Credits Office (TCO) in Preston on 13 March, where they met with management and staff. We are grateful to all those in the TCO who took the time to talk to us.

## *Our approach*

4. Our purpose in this inquiry, as we indicated in our terms of reference, was not to dwell on or attribute blame for past problems. We have, of necessity, spent some time examining current issues with the regime, which have been ongoing since its introduction in April 2003. However, we have also endeavoured to look forward, in part by explicitly inviting evidence from submitters on possible future solutions for improving the administration of the tax credits regime. One message which came through was that, despite the difficulties associated with tax credits, the regime still enjoys a great deal of support and goodwill. For example, Citizens Advice told us that "we want to see the current system work ... by

increased stability being introduced into [it]”.<sup>1</sup> For this reason, Citizens Advice described the package of reforms to the regime, announced in the PBR, as “very welcome indeed”.<sup>2</sup> The Child Poverty Action Group (CPAG) pointed out that, since the introduction of tax credits, “we have ... seen quite a significant drop in child poverty [and] ... lone parents ... moving into paid work”.<sup>3</sup> CPAG thought that, “on balance”, tax credits had “tended in the right direction [although] they perhaps have not been as successful as they should have been because of some of the administrative and design difficulties”.<sup>4</sup>

5. We agree that the policy underpinning tax credits of taking people, and especially children, out of poverty, is laudable, and that the programme has had considerable success. We have also borne in mind a point put strongly to us in oral evidence by Mr Field—that, regardless of whether new tax credits are the *right* regime, working with what exists and seeking to consolidate both the procedural changes to the regime’s administration announced by the Paymaster General in May 2005, and the structural changes to the regime’s design announced by the Chancellor of the Exchequer in December 2005, are key.<sup>5</sup>

6. Finally, we have sought throughout our inquiry to approach the tax credits regime from the perspective of tax credits claimants. As constituency MPs, we have all had significant experience of assisting constituents who are grappling with the complexities of the tax credits regime. For some 6 million or so people, claiming and receiving tax credits may be the area of their lives in which they come most closely into contact with Government and its bureaucratic processes. It is the question of how the Government can better meet the needs of these people which we have sought to address.

### **Background information**

7. A great deal of background information about the tax credits regime is already in the public domain. In order to enable us to focus on those parts of the regime in which we are particularly interested, we have dealt only briefly with the background to the regime. Supplementary background information is contained in an annex to this report.

8. Several reports discussing the difficulties with the tax credits regime have been presented to the House in the past year:

- On 21 June 2005, the Parliamentary Commissioner for Administration (the Ombudsman) presented a report to Parliament, *Tax Credits: Putting Things Right*.<sup>6</sup> The Ombudsman’s report investigated the administration of the child and working tax credits, in response to the growing number of complaints her office had been receiving about the tax credit scheme since its introduction.

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1 Q 3

2 *Ibid.*

3 Q 2

4 *Ibid.*

5 See, for example, Qq 215 and 250.

6 Parliamentary and Health Services Ombudsman, Third Report of Session 2005-06, *Tax Credits: Putting Things Right*, HC 124

- The Ombudsman's report has in turn been reported on by the House of Commons Public Administration Committee, which is appointed by the House to examine reports laid before Parliament by the Ombudsman. In its report on *Tax Credits: putting things right*, published on 12 January 2006, the Committee reported on the implementation of the recommendations contained in the Ombudsman's report.<sup>7</sup>
- More recently, on 25 April 2006, the Committee of Public Accounts reported to the House on the former Inland Revenue's Standard Report for 2004–05.<sup>8</sup> The Committee focused on issues associated with tax credits, in particular, overpayments, error and fraud and HMRC's settlement with EDS, the company initially responsible for providing the IT system for new tax credits.

We refer to key points in these reports as appropriate.

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7 Public Administration Committee, Second Report of Session 2005–06, *Tax Credits: putting things right*, HC 577

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

## Part A: Current issues

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### 2 Overpayments of tax credits

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#### Meaning of “overpayments”

9. Except where the context otherwise requires, when we refer to “overpayments” in this report, we mean both excess payments and overpayments:

- an “overpayment” is an amount owed to HMRC after the end of the tax year, which HMRC ordinarily recovers in the following tax year;
- an “excess payment” is an in-year reduction which HMRC makes to tax credit payments, with the aim of avoiding an overpayment at the end of the tax year.

#### Level of overpayments

10. The Government set out its proposals for the new tax credits in a paper published alongside Budget 2002, *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*.<sup>9</sup> In this paper, the Government explained that the new tax credits regime had been “designed to minimise the scope for substantial overpayments”, before setting out its estimates of the number of families whose awards might need to be reassessed as a result of rises or falls in income.<sup>10</sup> The Government was “reasonably confident” that, “in steady state”:<sup>11</sup>

- around 1 million cases would see their awards change as a result of a fall in income;<sup>12</sup>
- around 750,000 individuals and couples a year would see their awards change as a result of a rise in income;<sup>13</sup> and
- exceptionally, for the 2003–04 financial year, around 1 million awards would be reassessed as a result of rises in income, as tax credit awards for the year beginning in April 2003 would be based upon income information for the tax year 2001–02, not 2002–03.<sup>14</sup>

The paper stated that those people who experienced a rise in income “would be advised to ask for an adjusted award during the year to reduce the risk of overpayments”.<sup>15</sup>

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9 HM Treasury and Inland Revenue, *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, April 2002; available at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk).

10 *The Child and Working Tax Credits*, para 4.48

11 *The Child and Working Tax Credits*, paras 4.43 and 4.49

12 *The Child and Working Tax Credits*, para 4.43

13 *Ibid.*

14 *Ibid.*

15 *The Child and Working Tax Credits*, para 4.43

11. Data released by HMRC shows that the level of overpayments for 2003–04 was significantly higher than that predicted by the Government in April 2002. About one-third of all awards paid—nearly 1.9 million awards—were overpaid, at a cost of nearly £2 billion. In December 2005, the Paymaster General indicated that, but for the reforms announced to the scheme in the Pre-Budget Report 2005, “initial estimates” had suggested that subsequent years’ overpayments would have been “of broadly the same level as in 2003–04”.<sup>16</sup> The tables below summarise numbers of awards made in 2003–04, and the amount of money paid out in tax credits awards in 2003–04. HMRC hopes that equivalent data for 2004–05 will be available shortly.<sup>17</sup>

**Table 1: Tax credits awards, 2003–04**

	<b>Numbers of awards</b>
Awards underpaid	713,000
Awards neither under nor overpaid	3.078 million
Awards overpaid	1.879 million
<b>Total</b>	<b>5.670 million</b>

Source: HMRC, *Child and Working Tax Credits Statistics, Finalised awards 2003–04, table 1*

Of the 1.879 million claimants who received overpayments, about 41,000 received overpayments of £5,000 or more.<sup>18</sup> Half of the total overpayments related to some 283,000 families who had been overpaid by £2,000 or more.<sup>19</sup>

**Table 2: Tax credits awards payments, 2003–04 (£ million)**

	<b>Entitlement</b>	<b>Net paid</b>	<b>Net overpayment at 5 April 2004</b>
Awards underpaid	2,191	1,727	-464
Awards neither under nor overpaid	5,332	5,332	0
Awards overpaid	4,539	6,470	1,931
<b>Totals</b>	<b>12,062</b>	<b>13,529</b>	<b>1,468</b>

Source: HMRC, *Child and Working Tax Credits Statistics, Finalised awards 2003–04, table 1*

12. Evidence received from the National Audit Office discussed the reasons for overpayments, and explained why the design of tax credits necessarily results in overpayments:

A tax credit award is provisionally based on a family’s income and circumstances from the preceding tax year. The award is finalised after the end of the tax year once

16 HC Deb, 5 Dec 2005, col 57WS

17 Qq 561–562

18 HC Deb, 10 Oct 2005, col 324W

19 Comptroller and Auditor General, *Standard Report on the Accounts of the Inland Revenue 2004–05*, 7 October 2005; available at [www.nao.org.uk](http://www.nao.org.uk)

income and circumstances are known for certain. The final award will be lower than the provisional award where incomes increase, although the first £2,500 of any income increase is disregarded.<sup>20</sup>

However, the NAO also states that “further unforeseen overpayments” have occurred.<sup>21</sup> Full recovery of overpayments from 2003–04 is expected to take at least 5 years.<sup>22</sup> To date, the Government has written off some £95 million of overpayments and has made provision for a further £961 million to eventually be written off.<sup>23</sup>

### **Extent of income volatility amongst low-income families**

13. We explored the question of why the actual level of overpayments had been so much higher than would have been expected, based on the Government’s predictions about the number of claimants who would experience a rise in income.

14. Mike Brewer, Programme Director of the Direct Tax and Welfare sector at the Institute for Fiscal Studies, commented that:

In the Revenue’s defence ... there was not a good source of data for them to design the initial [tax credits] policy, when they were thinking about this in 2001–02. Basically, that remains the case even now, except the Revenue now have data from one or two years of operation of tax credits.<sup>24</sup>

He explained that “large household surveys”, used by researchers such as himself, did not generally collect information about respondents’ *annual* income, as opposed to weekly or monthly income, and that therefore “there just was not a good source of data out there about families’ annual income and how it changes over time”.<sup>25</sup>

15. Rt Hon Frank Field MP referred to the Paymaster General’s statement that the recent package of reforms to tax credits, announced in the Pre-Budget Report 2005, should “reduce the value of overpayments by around one third”.<sup>26</sup> Mr Field observed that, given that the increase in the disregard threshold to £25,000 should mean that overpayments due to income changes virtually cease, this suggested that “it is household composition changes which are the basis of the [remaining] two-thirds of overpayments”.<sup>27</sup> He commented that, if his suggestion was correct, it said “something extraordinary about these changing circumstances of lots of our constituents at the bottom end of the income scale”.<sup>28</sup>

16. This lack of information about the financial circumstances of lower-income families appears to be a continuing problem for HMRC. For example, in October 2005, the

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20 Ev 159

21 *Ibid.*

22 Ev 160

23 *Ibid.*

24 Q 183

25 Q 183

26 Q 249; HC Deb, 5 Dec 2005, col 57WS

27 Qq 248–249

28 *Ibid.*

Paymaster General told the House that information about the number of changes of circumstances relating to tax credits entitlement reported to HMRC in 2003–04 and 2004–05 was not available.<sup>29</sup> What evidence there is suggests that this number is likely to be high. For example, research carried out on behalf of OPF between May and July 2004, based on a sample of 100 lone parents receiving tax credits, found that, in 2003–04, nearly half (47%) had experienced between two and seven changes of circumstance.<sup>30</sup>

17. Some indication of the extent to which some tax credits claimants' circumstances are subject to frequent change is given by a recent study, the initial results of which were reported in March 2006 by the Economic and Social Research Council Research Centre for Analysis of Social Exclusion in *Tracking income: how working families' incomes vary through the year*.<sup>31</sup> The study was financed by HM Treasury and the Inland Revenue (now HMRC) and aimed: "to reveal the range of income patterns across a whole year for a group of particular policy interest, low- to middle-income working families with children", information which "has not been collected in the UK before".<sup>32</sup> Its results were based on data for the financial year 2003–04, for a total of 4,800 weeks of income from 93 families, all of whom were receiving the Working Families Tax Credit in the winter of 2002–03. The average total net family income for the 93 families was £17,000, and most of the families had total net incomes in the range between £12,000 and £22,000.<sup>33</sup> The report's authors described it as shedding light on three key issues:

- how the distribution of incomes across a whole year compares with those measured over a short period;
- patterns of income mobility at a finer level than observed before; and
- the extent to which state transfers (social security benefits and tax credits) smooth incomes over the year.<sup>34</sup>

18. The authors concluded that "patterns of income mobility ... involve considerably greater volatility of income within the year (for this particular kind of working family) than many might have expected".<sup>35</sup> For instance:

- only seven of the 93 cases had incomes in the 13 periods that varied within a range of +/- 10% of the case's annual average;
- a quarter of the families had at least four periods with incomes outside a range of 85% to 115% of their annual average;

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29 HC Deb, 25 Oct 2005, 318W

30 One Parent Families, *The new tax credits system: knowledge and awareness among recipients*, 2005, p 25; available at [www.oneparentfamilies.org.uk](http://www.oneparentfamilies.org.uk).

31 Economic and Social Research Council Research Centre for Analysis of Social Exclusion (John Hills, Rachel Smithies and Abigail McKnight), *Tracking income: how working families' incomes vary through the year*, 1 March 2006

32 *Tracking income: how working families' incomes vary through the year*, p 3

33 An average income of £17,000 excluding housing and council tax benefits.

34 *Tracking income: how working families' incomes vary through the year*, p 3

35 *Tracking income: how working families' incomes vary through the year*, p 69

- generally speaking, those families with the greatest volatility of income were those with lower incomes (total net incomes for the year below £15,000), and a higher proportion of lone parents and tenants had more variable income;
- high degrees of variation affected some cases from all of the family types studied, and some of the families had patterns of income receipt that were very variable indeed.<sup>36</sup>

19. Of particular relevance are the report's findings on the extent to which benefits and tax credits "smoothed" the net incomes of the families studied. The study found that both benefits and tax credits reduced inequality between the total net incomes of the 93 cases, and did so to the same degree. However:

while both social security benefits and tax credits reduced the variability of individual families' incomes within the year, benefits did so to a greater extent than tax credits, even though the amounts of benefits involved were less than half the amount on average than that of tax credits. In nearly a third of cases income was more variable after including tax credits than before doing so ...<sup>37</sup>

20. The report's authors suggest that the difference between the income-smoothing effects of benefits and tax credits lies in the different design of each: "some social security benefits are based on circumstances over short periods with benefits adjusted immediately, and pound for pound. Tax credits are generally intended to reflect the position over the year as a whole, with their payments adjusted to achieve this for the year as a whole, not in any particular week or month."<sup>38</sup> They conclude:

It might be argued that it is achieving the correct position over the year as whole by its end that matters—which is what the new tax credit and older PAYE systems are designed to do—rather than income smoothing within the year. However, our interviews suggest that families with incomes at these levels budget on a much shorter-term basis than over the whole of a tax year—over a month or less—so such adjustments may come too late for them. Given the generosity of the new tax credit system, making up more than a quarter of the sample families' total net incomes, the ways in which credits are paid obviously have major effects on their income flows through the year, and their design has to be carefully considered and monitored in the light of findings of the kind reported here.<sup>39</sup>

## **Our conclusions**

**21. Recent research published by the Economic and Social Research Council Research Centre for Analysis of Social Exclusion indicates that the month-to-month incomes of low- to middle-income working families with children are considerably more volatile than might have been expected. We welcome the fact that such research has been undertaken: it offers valuable data to those involved in designing tax credits policy. We**

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36 *Ibid.*

37 *Ibid.*

38 *Ibid.*

39 *Tracking income: how working families' incomes vary through the year*, p 70

are pleased to see the Government funding such a study, which seems to us to offer precisely the sort of information the Government needs to enable it to provide State assistance in a way which fits with the income patterns of those targeted. We recommend that the Government direct additional resources to funding research likely to inform the formulation of tax credits policy.

22. We are particularly struck by the Research Centre's findings that such families tend to budget over a month or less, rather than over the whole of a tax year, and that, in nearly a third of cases studies, income was more variable after including tax credits than before doing so. These findings suggest that the tax credits scheme, which is designed to deliver the correct amount of state assistance over the year as a whole, rather than over any shorter period, could be aligned more closely to the financial needs of such families. End-of-year adjustments in tax credit entitlement may come too late for such families, and any demand for reimbursement is felt very keenly by them. We suggest that there is evidence that determining awards over shorter time periods would reflect the needs of lower income families more accurately than annual awards.

### Causes of overpayments

23. We sought to establish how much HMRC knows about why individual overpayments have arisen. In April 2005, HMRC acknowledged, in a letter to the Ombudsman, that it could not "easily identify the reasons why an overpayment arose".<sup>40</sup> HMRC indicated that it did not intend to examine each individual award because this "would be prohibitively expensive in terms of resources", and concluded that, as a result, it did "not yet have sufficient data to allow [it] to publish information on the causes of overpayments."<sup>41</sup>

### HMRC's account of causes of overpayments

24. In December 2005, the Paymaster General issued what seems to be the Government's most complete statement yet about the causes of overpayments. The Paymaster General told the House:

Analysis of overpayments suggests that they result from a number of factors: income rises from one year to the next; families overestimating the extent to which their income has fallen when they seek extra support during the year; provisional payments made at the start of the tax year, which are based on out-of-date information that is subsequently updated when the award is renewed; and delays in reporting changes in families' personal circumstances to HMRC.<sup>42</sup>

25. During our visit to the Tax Credits Office (TCO) in Preston, we were told by TCO management that the 'top three' reasons for tax credits overpayments were the first three of the four factors listed by the Paymaster General, above. TCO management estimated that these three factors accounted for about 70% of overpayments, and that about 40% of overpayments were attributable to the first reason alone. We subsequently took oral

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40 Letter to the Ombudsman from Nigel Jordan, Assistant Director of HMRC, 21 April 2005; published in Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, Appendix C

41 *Ibid.*

42 HC Deb, 5 Dec 2005, col 56WS

evidence from HMRC officials who repeated these three factors as the ‘top three’ reasons for overpayments. Officials noted that these three factors:

will not always operate in isolation and you will quite often have two or more of them operating in combination. Our best estimate ... is that if you take those three factors together they probably account for about two-thirds of total overpayments. But it is very difficult, with the best will in the world, to actually precisely identify the component that each of them makes because they are not always in unique operation.<sup>43</sup>

26. Shortly before we agreed this report, HMRC told us that, from the data available to it, it was not possible “to produce reliable estimates showing the relative importance of these factors in explaining overpayments”.<sup>44</sup> The Department explained that this was because there are “significant interactions” between the different factors: for example, a family could have a rise in income of more than £2,500, as well as a change of circumstances that reduced entitlement, and both factors could contribute to an overpayment.<sup>45</sup>

### *Our conclusions*

27. **From the above figures it follows that about 30% of all overpayments are due to delays in reporting changes in families’ personal circumstances, such as family breakdown or the establishment of new partnerships, or a child going to school or leaving home. However it is clear from the oral evidence from HMRC officials that the focus is on the other three categories of overpayment. We believe that enough attention has not been paid to the problems caused by families’ changing circumstances and the difficulty of adjusting tax credits to reflect these. We therefore recommend that more research is undertaken into this, especially in view of impending changes in reporting requirements.**

28. **The factors cited by the Paymaster General and her officials as contributing to the problem of overpayments do not appear to us to give a comprehensive account of the reasons which overpayments have arisen. While we are not in a position to draw up our own comprehensive list of factors resulting in overpayments, it is obvious to us that the Paymaster General’s account makes no reference to causes of overpayments which have arisen as a consequence of the Department’s own processes—for example, official error and IT system error. Rather, the Paymaster General has referred only to those causes of overpayments which can be attributed to claimant error or omission, or to the design of the tax credits regime, or a combination of both. We examine these other possible causes of overpayments below.**

29. **It seems self-evident to us that HMRC cannot take steps to improve the way in which it administers tax credits without first identifying, and developing a detailed understanding of, the factors which cause overpayments and the extent to which each individual factor has contributed to the overall overpayments problem. We**

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43 Q 451

44 Ev 192

45 *Ibid.*

**recommend that, as a matter of priority, the Government provide a detailed breakdown of as much of this information as is currently available.**

### **Official error**

30. As OPF pointed out to us, “what is interesting in the Paymaster General’s analysis of overpayments [of 5 December] is that she does not include official error [as a cause of overpayments], and we do know there has been a huge amount of official error. Looking at the figures, they wrote off, for example, £24,000 in July [2005] due to official error.”<sup>46</sup> OPF carried out research into tax credits between May and July 2004, based on a study of 100 lone parents. This research showed that “28% of people [surveyed] had been overpaid and, of those, 80% was due to official error”, although OPF pointed out that that figure reflected the early years of the scheme, so was probably unusually high.<sup>47</sup> OPF described it as “very difficult” for anyone outside HMRC to establish levels of official error. Although figures are available about the number of overpayments HMRC has written off due to official error, those figures represent only those cases in which HMRC has accepted that it was reasonable for the person to have believed their award was correct, “so you lose a big chunk of the official error figures”.<sup>48</sup>

31. **It is clear that official error has been a cause of overpayments in a significant number of cases.** The National Audit Office told us that “Departmental error can also lead to many overpayments”.<sup>49</sup> The Comptroller and Auditor General’s standard report on Inland Revenue’s 2004-05 accounts referred to an example of the consequences of official error:

The unexpected problems at the time of the introduction of tax credits in 2003 caused the Department to issue 500,000 manual cheque payments totalling £170 million, with the supporting documentation being inadequately completed in some cases. In 2004-05, the Department wrote-off £33 million because the records were not good enough to cost-effectively match them to claimants.<sup>50</sup>

32. The NAO also noted that HMRC has improved the accuracy with which it processes information received from claimants: 78.6% of information was processed accurately in 2003-04, compared with 96.5% in 2004-05.<sup>51</sup> Sir David noted that “error tends to create re-work, which tends to create more havoc, so the more accuracy we can get into the system ... the better we are at that the less we will need to put resources into fixing problems which we have helped create”.<sup>52</sup>

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46 Q 7

47 Q 46; see One Parent Families, *The new tax credits system: knowledge and awareness among recipients*, p 36

48 Q 46

49 Ev 159

50 Comptroller and Auditor General, *Standard Report on the Accounts of the Inland Revenue 2004-05*, 7 October 2005, para 2.26; available at [www.nao.org.uk](http://www.nao.org.uk).

51 Ev 162

52 Q 455

33. The Paymaster General has said that “no complete analysis exists of official error causing or contributing to overpayments”.<sup>53</sup> When we asked her if she was able to give us an estimate of the amount of overpayments caused by official error, she replied:

No, I cannot, but if you look at the interim findings it was 3.4%, and I think it will be a little higher than that. You do not have to believe me ... look at the NAO Report and the information there on this study ...<sup>54</sup>

It appears that the Paymaster General was here confusing the NAO’s interim finding of the level of *claimant* fraud and error with *official* error. HMRC officials appeared to be similarly confused: they confirmed that 3.4% was the provisional figure for claimant error and fraud but then, when asked what contribution official error made to overpayments, said they could not remember “whether it is claimant or official error which is the bigger element within that, but it is a significant part of the 3.4[%].” Officials appeared to confirm that figures for both official error and for claimant error and fraud should be available in Spring this year.<sup>55</sup>

34. Subsequently, shortly before we agreed this report, HMRC indicated that it was still considering “whether it will be possible to give a meaningful breakdown of the estimates of error between official error and claimant error for future enquiries.”<sup>56</sup> The Department explained that it was “difficult” to establish, on the basis of tax credits records, “whether the claimant or the Department is responsible for a particular error, for example, whether information was incorrectly reported or incorrectly recorded”.<sup>57</sup>

### *Our conclusions*

**35. The Paymaster General has said that no complete analysis exists of official error causing or contributing to overpayments. This is a significant gap in HMRC’s understanding of the reasons why overpayments arise. If HMRC is to succeed in improving the administration of the tax credits regime, the first thing it needs to understand is what is going wrong within its own processes, before it looks to problems elsewhere. As Sir David himself acknowledged, the more accuracy HMRC can achieve, the fewer resources it will need to put into fixing problems which it has helped to create. We recommend that the Government undertake a complete analysis of the incidence of official error and the extent to which it causes or contributes to overpayments, and that it publishes that analysis. If it is unable to carry out such an analysis, it should explain why.**

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53 HC Deb, 12 Sept 2005, col 2387W

54 Q 373

55 Qq 566–68

56 Ev 194

57 *Ibid.*

## IT system error

### Background

36. It is also clear that IT system, or software, error has been another significant source of overpayments. According to the National Audit Office, the administration of payments “suffered from the serious problems with the computer systems during the introduction of tax credits in April 2003”, which “both delayed the processing of claims and led to incorrect payments being made”.<sup>58</sup> The NAO told us that software errors resulted in overpayments of £184 million in 2003-04 and 2004-05, and that HMRC was “continuing to investigate the reasons for other incorrect payments caused by system miscalculations.”<sup>59</sup> The Comptroller and Auditor General’s standard report on Inland Revenue’s 2004-05 accounts summarised the cost of writing off overpayments arising from software error as follows:

In my 2003-04 report I noted that certain software errors had resulted in overpayments calculated as £94 million in 2003-04 of which the Department had written-off overpayments of less than £300 totalling some £37 million. I also noted that the Department expected further write-offs in respect of the balance of £57 million. In addition, the Department calculated and wrote off other overpayments of some £2 million that it considered had been caused by software errors. The Department calculated that [these] software errors ... resulted in further incorrect payments in 2004-05 of £7.9 million. Various other incorrect payments have also resulted from other system miscalculations.<sup>60</sup>

37. In recognition of these difficulties, the Paymaster General undertook, in her Written Ministerial Statement of 26 May 2005, that HMRC would “improve the speed with which it identifies IT system problems and processing errors so that they can be resolved more quickly.”<sup>61</sup>

### Difficulties with the IT system

38. At the time the new tax credits regime was set up, it was intended that its administration would be wholly IT-based. It is evident that the administrative process currently requires significant human intervention. For example, when we visited the TCO in Preston, we heard that only about 25% of all claims went straight through the automated system without the need for manual intervention. About 80% of new claims required intervention; about 30%–35% of claims for renewal required intervention. The Public and Commercial Services Union (PCS) told us that the Government:

initially intended that the ‘rapid data capture’ process (the conversion of written information from application forms into electronic data) would handle around 90%

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58 Ev 161

59 Ev 162

60 Comptroller and Auditor General, *Standard Report on the Accounts of the Inland Revenue 2004–05*, para 2.23-24

61 HC Deb, 26 May 2005, col 23WS

of claims without further need for human intervention. Our estimate is that only 10% of the information is captured by this method.<sup>62</sup>

39. HMRC is involved in ongoing work to improve the IT system. In October 2005, Sir David told us that HMRC had:

been trying to stabilise—and I think have been successful—the IT system. It is still potentially fragile and, therefore, every time we have to do something, I approach it in the spirit that we do not want to lose any progress that we have made in stability.<sup>63</sup>

More recently, Sir David told the Committee of Public Accounts that HMRC still did not feel it knew “enough about the system to be clear of its resilience ... it is a very complicated system”.<sup>64</sup> In the course of the present inquiry, the Paymaster General updated us on the performance of the system:

IT performance has been significantly improved ... a significant new software release was introduced without a hitch in November. Largely invisible to people outside, this will deliver real improvements in operational performance. In total there have been 300 improvements made to the system since April 2005.<sup>65</sup>

40. We received evidence from both PCS and the voluntary sector that the IT system was continuing to cause difficulties both for staff and claimants. PCS acknowledged an improvement in “identification of IT system problems”, but felt that the resolution of processing errors had not similarly improved:

The computer system is not user friendly and continues to be often unavailable at key times ... Our members report continuing problems with the interface between the [tax credits] computer system and treatment of data that HMRC operatives are forwarding for inclusion (such as a claimants’ change of circumstances).<sup>66</sup>

41. Representatives from the voluntary sector referred to many examples, generally involving the tax credits helpline, where claimants had been disadvantaged by what appeared to be software error—although, from the perspective of helpline users, it is often difficult to tell whether it is official error or software error which is the problem. A recurring theme was the IT system’s lack of flexibility, and the difficulty of correcting a mistake once it had been (erroneously) entered into the system—staff may accept that information is wrong, but still be unable to correct the information.<sup>67</sup> The system also appears to lose claimants’ records periodically, as a representative from a Citizens Advice Bureau explained:

I used to think [the problem] was a lot administration, a little bit computer, but I personally now believe it is a lot computer and a little bit administration, particularly

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62 Ev 175

63 Oral evidence taken before the Treasury Sub-Committee on Wednesday 12 October 2005, HC (2005–06) 524-i-ii, Q 22

64 Committee of Public Accounts, *Inland Revenue Standard Report: New Tax Credits*, Q11

65 Q 307

66 Ev 174

67 Qq 35–36

with this issue of losing clients. There are two times of year where a lot of clients drop off the system, particularly around the beginning of October ... I was led to believe they could not get them back on the system. I am now told that about a quarter go back but they cannot tell you why, but the others are all left with manual payments ... one of the suggestions at a meeting was a to change people's national insurance numbers because that way you could put them back on the system with a new national insurance number.<sup>68</sup>

42. Mr Field mentioned an example of a claimant he knew of who, when completing an application form, had put a line through a section of the form to be filled in by claimants with disabled children—to indicate that this section was not relevant to her. Her form was read electronically as indicating that she did have a disabled child.<sup>69</sup> The Chartered Institute of Taxation (CIOT) commented on the fact that the IT system had, on occasion, produced award notices containing internally inconsistent information—for example, where the number of children has differed in different parts of the notice.<sup>70</sup> The CIOT considered that the IT system should operate in such a way that “errors like these are isolated for checking, or are just never possible in the first place”.<sup>71</sup>

43. The Paymaster General rejected PCS's statement that the IT system was often not available at key times:

The computer has downtime in order for it to have the software put on to it ... I have no information ... that the computer was repeatedly going down. The only incident I can find in all of the last 12 months is that there was a period of maybe two hours, and I cannot remember when it was, when the system did not perform as it should have done. This idea that it is repeatedly not available and you cannot get access I disagree with.<sup>72</sup>

### *Terms of settlement between HMRC and EDS*

44. The tax credits IT system went live in April 2003, under a contract with Electronic Data Services (EDS). This contract ended on 30 June 2004 and was replaced by a contract with Cap Gemini.<sup>73</sup> On 22 November 2005, the Paymaster General announced that HMRC had reached a settlement with EDS:

the aggregate settlement is £71.25 million ... including an up-front payment and payments of additional amounts over time. Details of the settlement are commercially sensitive and therefore bound by a legal confidentiality agreement as is normal in agreements of this nature.<sup>74</sup>

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68 Q 35

69 Q 224

70 Ev 100

71 *Ibid.*

72 Q 350

73 HC Deb, 25 Oct 2005, col 317W

74 HC Deb, 22 Nov 2005, col 101WS

The Paymaster General had earlier stated that, as at 31 August 2005, the “identifiable costs” paid to EDS and, subsequently, Cap Gemini for running the IT system were £236 million, exclusive of VAT.<sup>75</sup> Between 2002–03 and 2004–05, the Department spent £19.7 million on IT consultants in relation to tax credits.<sup>76</sup>

45. HMRC has so far received £47 million from EDS; Sir David told us that the payment has “had the effect of being as if it was £47 million cash”, but was “funded in different ways through different streams”.<sup>77</sup> £24.25 million remains outstanding. Since the Paymaster General’s November announcement, further details of the settlement have emerged. Subsequent to our 19 April hearing with Sir David, the Committee of Public Accounts reported to the House that “staged payments of up to £26.5 million are contingent on EDS winning new business with the United Kingdom Government ... there is however no guarantee that EDS will win sufficient new business to trigger payment of the full amount”.<sup>78</sup> Prior to our 19 April hearing, however, the substance of the Committee of Public Accounts’ report to the House was leaked to the media. We therefore discussed with Sir David the conditions attaching to the payment of the remaining £24.25 million.

46. Owing to the confidentiality agreement which formed part of the HMRC–EDS settlement, Sir David felt constrained in what he was able to tell us about the terms of the settlement. By way of context, he explained that the cost of taking EDS to court over the matter was estimated at £20 million and expected to take two years.<sup>79</sup> In reaching the settlement, HMRC considered it had a choice:

we could have settled for a lower sum of money and been certain or [taken] this mechanism [of staged payments contingent on EDS winning new business with the UK Government] against the threat that we did not reach a full and final settlement. There will only be full and final settlement with EDS when we are paid the £71,250,000.<sup>80</sup>

Prior to agreeing the settlement, HMRC had inspected EDS’s order book and found that it “many, many times covered” the amount of the contingent payments. Sir David said he would be “extraordinarily disappointed if EDS did not honour this obligation to pay the remaining amount of money”.<sup>81</sup>

47. We raised with Sir David the propriety of making part of the HMRC settlement contingent on EDS’s future business with other departments of the UK Government. He stressed that nothing HMRC had done was meant “to influence in any way any decision [by] anybody in government to procure services from EDS”.<sup>82</sup> He also contended that the

75 HC Deb, 25 Oct 2005, 317W

76 HC Deb, 10 Oct 2005, 326W

77 Qq 510, 537

78 Committee of Public Accounts, *Inland Revenue Standard Report: New Tax Credits*, para 21

79 Q 513

80 Q 519

81 Q 513

82 Q 512

terms of the settlement would not in fact influence any decision by government as to whether to award a contract to EDS, on the basis that:

[government] departments are under an obligation under EU law to make value for money declarations in terms of contract procurement ... You are asking, 'When you come to make a value for money consideration in the National Health Service, would you factor into your calculation that there was a benefit for HMRC?' Answer, no.<sup>83</sup>

48. We also questioned Sir David about who in Government made the decision to accept the settlement with EDS. He described the situation as follows:

... we went specifically to the Treasury and to the NAO, who went all through this in great detail ... this is an accounting officer deal. This is an accounting officer [that is, Sir David himself] who is responsible ... We talked at the working level to the Treasury, but this was a matter for us to determine what we thought was in the best interests of [HMRC] ... I did not seek ministerial approval ... The decision to accept this deal was the decision of the Commissioners of the Revenue. It has nothing to do with the Treasury.<sup>84</sup>

### *Our conclusions*

49. On the basis of the evidence we have received, the rate of error within the IT system seems to us to have been significant. **Just as HMRC appears to have attempted no complete analysis of the contribution made by official error to overpayments, so we have seen nothing from the Department attempting to assess the contribution made by IT system error. Again, it seems obvious to us that HMRC must acquire a thorough understanding of the problems which have arisen if it is to succeed in improving the administration of the tax credits regime. We recommend that the Government undertake a complete analysis of the incidence of IT system error and the extent to which it causes or contributes to overpayments, and that it publishes that analysis.**

50. The settlement of £71.25 million agreed by HMRC and EDS appears to have provided for staged payments of up to £26.5 million which are contingent on EDS winning new business with the United Kingdom Government. **It is clear that the IT system which EDS delivered for the running of new tax credits was unsatisfactory in a number of respects. We have grave concerns about the wisdom of an agreement which then makes the payment of compensation to the affected government department by the provider of the unsatisfactory service contingent on that provider winning other contracts with government. Our concern is not that we believe the contingent payments will influence future decisions by government departments to award contracts, but that it will be impossible to be sure that they have not. The agreement has the appearance of impropriety, if not the fact.**

51. We also draw the attention of the House to the confidentiality agreement which formed part of this settlement, and which so constrained the Chairman of HMRC in his ability to respond to our questioning. We are extremely concerned that HMRC appears

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83 Qq 520, 524

84 Qq 521, 528–530, 545

to be claiming to have effectively ‘contracted out’ of its obligation to be publicly accountable for its administration and expenditure, by virtue of having entered a private contract. The existence of such a confidentiality requirement also makes it impossible for the House to assess what happened in this particular case, and to seek to draw broader lessons from it about the problematic area of government IT contracts. We recommend that the Government ensure that this particular settlement does not indicate the start of a trend on the part of public bodies towards agreeing such confidentiality requirements. We further recommend that the procurement, design, project management and delivery of the tax credits process and systems be independently examined by the National Audit Office, regardless of this agreement.

## 3 Recovery of overpayments

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### Concerns about operation of recovery process

52. Much of the evidence we received focussed on the difficulties which recovery of overpayments has caused to claimants. Two key points were raised by representatives from the voluntary sector. Citizens Advice pointed out that “it is entirely left up to the claimant to challenge” HMRC’s decision to recover an overpayment—if a claimant does nothing, the overpayment will be recovered in full, even if it was the case that the overpayment would have been written off, had the claimant disputed it.<sup>85</sup> Consequently, Citizens Advice believed it was “really important” for HMRC to give claimants the clear message that, unless they challenge an overpayment, it will automatically be recovered from them in full.<sup>86</sup>

53. OPF explained that, at present, when an overpayment occurs, “people are not being informed as to why they have been overpaid ... [given that there is] no standard way of informing people by explaining what is happening, it is scandalous that overpayments continue to be recovered with no explanation”.<sup>87</sup>

### A ‘pause’ before recovery commences

54. One of the Ombudsman’s key findings was that, where HMRC recovers an overpayment to the detriment of a customer before considering Code of Practice 26, a “fundamental unfairness” has arisen:

Effectively, the Revenue has fettered its own discretion by making an initial determination to commence recovery action, before it has considered the full facts of the case. That is maladministration. Unless customers are alerted to the existence of the provisions of COP 26 and then take steps to request that the Revenue apply its Code, they may end up wrongly paying back tax credits which should not, in fact, be recoverable.

The Ombudsman therefore recommended that HMRC “should not seek to recover either an excess payment made in the current year, or an overpayment from the previous year until it has come to a decision, based on all the relevant facts, as to whether or not the excess amount paid should be recovered in accordance with COP 26.”<sup>88</sup>

55. The evidence we took from the voluntary sector was strongly supportive of the Ombudsman’s recommendation for a ‘pause’ before recovery of an overpayment commences. For example, the CPAG told us:

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85 Q 47

86 *Ibid.*

87 Q 10

88 Parliamentary and Health Services Ombudsman, *Tax Credits: Putting Things Right*, para 5.17

I think all of our organisations would say very clearly that, whilst we welcome the fact that the Paymaster General has said that she will consider this, it seems to us to be absolutely essential that it is considered as a matter of urgency.<sup>89</sup>

CPAG believed that introducing a pause before recovery was in fact a legal requirement.<sup>90</sup>

56. In its response to the Ombudsman's report, the Government appeared to accept her recommendation with regard to introducing a 'pause':

HMRC are working on how to suspend the recovery of overpayments in disputed cases while they consider whether there is a good reason not to pursue recovery. They are looking to put these arrangements in place at the earliest opportunity for both new cases and those where an overpayment has already been disputed.<sup>91</sup>

However, the recommendation is yet to be implemented. In her evidence to us, the Paymaster General referred to "considerations" which she was "still pursuing with regard to whether or not there should be a pause."<sup>92</sup> She indicated that, although implementing the 'pause' was one of a number of improvements which she was currently considering, all of which required IT changes and legislative changes, it was not one to which she felt able to give the highest priority.<sup>93</sup> When we suggested to Sir David that implementation of the package of reforms announced in PBR 2005 appeared to have delayed implementation of other improvements, he responded:

I am not sure it is delay, but there is always a choice and there is so much you can do. We had, I think, a very good discussion with the Ombudsman about the technical problems of delay, of creating a pause, and she accepted that this was not a lightly entered into judgment.<sup>94</sup>

57. Sir David has also given evidence on this point to the Public Administration Committee. He told the Committee that the Ombudsman's finding of maladministration had caused him "real difficulty not because I dispute the right of the Parliamentary Ombudsman to make such a finding but because I cannot accept that it is maladministration to operate a system in the only practical way that will provide an efficient service to protect the public purse."<sup>95</sup> The Committee expressed concern that HMRC was "presuming to define what constitutes maladministration. Moreover the Revenue seems to suggest that protection of the public purse overrides other considerations, including fairness. Public services cannot be designed or delivered without regard to costs but an unfair system, while it may well be cost-effective, cannot be said to constitute good public administration."<sup>96</sup>

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89 Q 45

90 *Ibid.*

91 Letter from the Paymaster General to the Ombudsman, 29 July 2005; available at [www.ombudsman.org.uk](http://www.ombudsman.org.uk).

92 Q 360

93 *Ibid.*

94 Q 520

95 Public Administration Committee, *Tax credits: putting things right*, para 18

96 Public Administration Committee, *Tax credits: putting things right*, para 19

### ***Our conclusions***

58. We endorse the Ombudsman's recommendation that HMRC should not seek to recover either an excess payment made in the current year, or an overpayment from the previous year, until it has come to a decision, based on all the relevant facts, as to whether or not the excess amount paid should be recovered in accordance with COP 26. We are pleased that the Government appears to have accepted this recommendation. However, we are concerned by the apparent lack of urgency in seeking to implement the 'pause' before recovery of an overpayment, and seek an explanation from the Government for the reasons for this delay.

59. We understand that implementing such a pause may well be technically difficult, and that it is only one of a number of improvements which the regime requires. However, it is crucial, in the interests of natural justice, that excess payments and overpayments are not automatically recovered without due regard first being given to the principles set out in COP 26. It is unfortunate that implementation of this essential improvement appears to have been sidelined by the package of reforms announced in PBR 2005. We recommend that the Government reassess the priority which it appears to have assigned to this improvement.

### **Application of the reasonableness test**

60. Where a claimant disputes the recovery of an overpayment, the case is considered by the disputed overpayments team at the TCO in HMRC. In considering whether to write off the overpayment, the TCO applies a two-stage test:

- i. Did HMRC make a mistake?*
- ii. If so, was it reasonable for the claimant to think that his or her payments were right?*

This test is set out in HMRC's code of practice 26, *What happens if we have paid you too much tax credit?* (COP 26). The relevant sections are given below:<sup>97</sup>

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<sup>97</sup> HMRC code of practice 26, *What happens if we have paid you too much tax credit?*, March 2006; available at [www.hmrc.gov.uk](http://www.hmrc.gov.uk).

**Extracts from COP 26, What happens if we have paid you too much tax credit?**

*In which circumstances will you write off an overpayment?*

For us to write off an overpayment you must be able to show that the overpayment happened because:

- we made a mistake, and
- it was reasonable for you to think your payments were right.

This means that you must have checked your award notice when you received it.

*Checking award notices and payments.*

We expect you at least to have checked that the following details on your award notices (whether at the start of the award period, during the year or when the final award notice comes) were correct:

- whether the award is for you as an individual or as part of a couple,
- the hours you work,
- whether you receive Income Support or income-based Jobseeker's Allowance or Pension Credit,
- whether you, or anyone in your household, has a disability element,
- the number and age of any children in your household, childcare costs,
- your total household income for the period shown on the award notice.

You should also have checked the amounts going into your bank account. We would expect you to tell us if you received any payments that did not match what was shown on the award notices during the period that the overpayment arose.

We expect you to contact us to let us know about any incorrect information for your circumstances on the day the notice was issued. If you have a change to your circumstances or income, we expect you to contact us again.

We expect you to check that your final award notice correctly shows the details for that tax year. If there is a dispute regarding an overpayment, we may check our call records to make sure that you contacted us to let us know of any changes or mistakes.

*I misunderstood my award notice.*

We will normally ask you to pay back the overpayment. If you had received an award notice that you did not understand, we would normally expect you, or someone on your behalf, to ask for advice.

*I couldn't check my award notice or the payments going into my bank account.*

Unless there were exceptional circumstances—for example a bereavement of a close relative or you were in hospital—we expect you to check that the personal details on your award notice are correct and that the payments you receive in your bank account match those shown on the award notice.

61. In the course of our inquiry, concern was expressed both about the substance of the reasonableness test and, in particular, the way in which HMRC applies it.

### ***Substance of the reasonableness test***

62. In her report to the House on tax credits, the Ombudsman also recommended that the reasonableness test be replaced with a statutory test “consistent with the test that is currently applied to social security benefits ... In general, an overpayment of a social security benefit must be repaid [only] if the claimant has misrepresented or failed to disclose a material fact.”<sup>98</sup> The basis for her recommendation was as follows:

... I am not convinced that the current test properly reflects the weight of obligation there should be on the Revenue to give prompt, accurate and reliable awards to its customers ... I am conscious of the fact that, within the benefits system, a statutory test for the recovery of overpayments has been applied for many years. In general, an overpayment of a social security benefit must be repaid if the claimant has misrepresented or failed to disclose a material fact ... Tax credits resemble benefits, in that they are income-related cash payments paid by a government department, intended to help people on modest incomes with their daily living expenses. Indeed, they have replaced previous benefits paid for the same purpose. This test seems to strike the right balance between the obligations on the part of the administrators and those on the part of the recipients.<sup>99</sup>

63. In October 2005, Sir David told us that Government was still considering whether to accept the Ombudsman’s recommendation.<sup>100</sup> We sought an update from Sir David on this matter on 19 April. He indicated that the point was still under consideration, and said that HMRC officials were “in discussion with ministers and giving advice on an ongoing basis”.<sup>101</sup> Mr Paul Gray, Deputy Chairman of HMRC, told us that the Department was considering “a range of issues”, including:

... whether or not it is necessary and appropriate to give that particular form of right to a claimant in order to generate the right kind of outcomes for them ... consistency with other parts of the tax system and with the benefits system, ... the administrative and cost implications of introducing an appeal right on disputed overpayments and putting that into the whole mix ... of the pressures and competing priorities on our resources.<sup>102</sup>

In relation to HMRC’s timescale for reaching a decision on this matter, Mr Gray said that the Department has “not fixed a particular point at which we say we must reach a decision on this” and that the timescale “is something we are keeping under review”.<sup>103</sup>

64. The Ombudsman’s call for the reasonableness test to be replaced by a test parallel to that applied for recovery of overpaid benefits did not, on the whole, appear to be taken up by our witnesses representing the voluntary sector. Citizens Advice acknowledged that the

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98 Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, recommendation 11 and para 5.64

99 Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, paras 5.63–5.65

100 Oral evidence taken before the Treasury Sub-Committee on Wednesday 12 October 2005, HC (2005–06) 524-i-ii, Qq 94, 96–97

101 Qq 586–588

102 Q 579

103 *Ibid.*

tax credits regime “is a different system” from the benefits regime, and made it clear that they would not argue that claimants “who receive random amounts of, say, £5,000—which has happened—into their bank accounts should get to keep it”, as that would not be a good use of resources.<sup>104</sup> CPAG took a slightly different approach, advocating the abandonment of the second part of the reasonableness test altogether, until such time as better award notices were introduced.<sup>105</sup> CPAG commented that there were “a number of stages we could be working through on the way, in the long term, to recognising that of course there will have to be some sort of test that takes account of what the claimant knew”.<sup>106</sup>

### *Application of the reasonableness test*

65. Many of our witnesses argued strongly that the way in which HMRC applies the reasonableness test is unduly harsh and exacting. The Ombudsman considered that the HMRC’s “internal system for determining whether sums should be repaid” did not operate “in a fair and transparent manner”.<sup>107</sup> OPF stated that, based on its current experience, it had “no confidence whatsoever” in HMRC’s ability to apply the test fairly.<sup>108</sup> OPF suggested that, in applying the second limb of the test, HMRC used an unduly high standard of ‘reasonableness’:

For example, we do not think that anyone independent looking at the award notices at the moment would say that it was reasonable for you to have believed your award was correct, because you just would not know; but when the Revenue looks at it, they think, “You should have read that.”<sup>109</sup>

66. A similar point was made by the Low Income Tax Reform Group (LITRG), which considered that “the problem with the way in which the reasonableness test has been applied ... is that it is a very objective reasonableness test and it is a very high standard of understanding that is imposed upon people.”<sup>110</sup> LITRG believed that HMRC should be taking into account the capability of individual claimants: “for example ... a lot of their claimants maybe have a reading age of 11, say, and ... it is simply not reasonable for them to be able to understand a lot of this stuff”.<sup>111</sup> A representative from Citizens Advice argued that “a reasonableness test for myself would be totally different from a reasonableness test for possibly one of my physically or mentally disabled clients—more often the mentally disabled”.<sup>112</sup>

67. Representatives from the voluntary sector pointed to examples of cases in which HMRC appeared to have applied the reasonableness test unfairly. Citizens Advice Northern Ireland referred to a case in which a particular computer error, known as the

104 Q 40

105 Q 41

106 *Ibid.*

107 Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, para 5.63

108 Q 43

109 *Ibid.*

110 Q 98

111 Q 99

112 Q 44

‘Red A’ computer error, which occurred in June 2004, caused the miscalculation of hundreds of thousands of award notices:

... Having fought many of those cases for clients who disputed the overpayment and the recovery of it, every single case was dealt with differently. Although they were caused by exactly the same computer error at exactly the same time and the reason for the overpayment was the same ... every case was dealt with differently. Some were remitted fully at stage one of the process, others had gone all the way up to the Adjudicator because they had gone through every stage of the four stages of the Inland Revenue decision saying, “No, it is fully recoverable. It was not reasonable for you to think your award was correct”.”<sup>113</sup>

68. Advice NI told us that it had written to HMRC in January or February 2005, making a request under the Freedom of Information Act 2001 relating to “the issue of people disputing recovery and the outcomes of that”:

... over 3,600 claimants had looked to have their overpayment looked at again and, as a result of that, 39 cases were remitted in terms of Child Tax Credit and 15 were remitted in terms of Working Tax Credit. A total of 50 cases were remitted out of 3,600 who applied ...<sup>114</sup>

69. We took up the issue of the way in which HMRC applies the reasonableness test in the course of our visit to the TCO in Preston, on 13 March. We requested a written note from the TCO on the processes it has in place to ensure that the test is applied consistently by all the 1,000 or so staff working on disputed overpayments. More than two months later, and shortly before agreeing this report, we received a response from HMRC to our request. The Department said that the “vast majority” of overpayments made were “properly recoverable”.<sup>115</sup> Beyond the criteria set out in COP 26, the Department appears to have no further written guidance in place for staff considering disputed overpayments. If the claimant has checked all the details listed in COP 26, “HMRC would normally agree that the claimant could have reasonably assumed their payments were right”.<sup>116</sup>

### *Our conclusions*

**70. We recommend that, as a minimum, HMRC ensure it has written guidelines in place to assist staff in determining whether it was reasonable for a particular claimant to have thought his or her payments were right, in all the circumstances. The reasonableness test cannot be applied as a stringent objective test, but must take account of a claimant’s circumstances, the clarity of the award notices issued to him or her and, where appropriate, any limitations on the claimant’s capacity to understand an award notice. No doubt these requirements could place a heavy investigative burden on HMRC in certain cases. However, it seems to us that this is the price HMRC must pay if it is to continue applying a reasonableness test, rather than a test along the lines**

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113 Q 124

114 *Ibid.*

115 Ev 193

116 *Ibid.*; see the box in paragraph 60 for the details listed in COP 26.

**of the social security test, where overpayment of a benefit can be recovered only where the claimant has misrepresented or failed to disclose a material fact.**

## Calls for an independent right of appeal

71. Claimants may appeal to an independent tribunal a decision by HMRC about the *amount* of tax credit to which they are entitled. Claimants do not have a comparable right to appeal a decision by HMRC to recover an overpayment, once the claimant has disputed it—in other words, to appeal the way in which HMRC has applied the reasonableness test. The claimant’s position is set out in COP 26, the relevant sections of which are given below:<sup>117</sup>

### Extracts from COP 26, *What happens if we have paid you too much tax credit?*

*What will you do when I dispute?*

We will suspend recovery of the overpayment ... We will decide whether you must pay back all or only part of the overpayment ... If we decide that part or all of the overpayment should be recovered after reviewing the information that you provide, we will start recovery again.

*What can I do if you still think that the overpayment should be recovered?*

If you are unhappy with a decision to recover the overpayment, and there is some new relevant information that you can provide, please write to us at the address at the back of this booklet, as soon as possible. We will suspend recovery of the overpayment again while we review the information you give us.

If you are still unhappy with the decision, or if there is no new relevant information, you may wish to contact a professional adviser or an organisation like Citizens Advice to consider what options are open to you to dispute the recovery, including any through the courts.

[...]

### *Appeal rights*

You cannot appeal against our decision to recover an overpayment although you may have other options available to you, see the section ‘What can I do if you still think that the overpayment should be recovered?’ [this is, the section set out immediately above].

72. Consequently, if a claimant is unhappy with HMRC’s decision not to write off a disputed overpayment, but has no new relevant information to submit, COP 26 suggests that they “contact a professional adviser or an organisation like Citizens Advice to consider what options are open to you to dispute the recovery, including any through the courts”. We assume the reference to the courts here is to the theoretical possibility that a claimant could seek judicial review of a Departmental decision, as there is no right of appeal through the courts from HMRC’s decision.

73. Representatives from the voluntary sector were strongly in favour of introducing a right of appeal to an independent tribunal against HMRC’s decision on a disputed overpayment. Citizens Advice argued that, without such a right of appeal, HMRC was “judge and jury on

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117 HMRC code of practice 26, *What happens if we have paid you too much tax credit?*, March 2006

making decisions about what claimants know and do not know” and was able to “pay people and claim it back” whenever it wanted to.<sup>118</sup> The CIOT also called for claimants to be able to seek an “independent review” of the application of the reasonableness test.<sup>119</sup> OPF believed establishing a right of appeal to an independent tribunal was “the really critical thing”, because “then you might get some case law established about what ‘reasonable’ means ... that is why we think it is the independent right of appeal, as opposed to the nature of the [reasonableness] test, that is the really important factor.”<sup>120</sup> OPF believed that, at this stage, it would be better not to try to define what constituted ‘reasonable’, “because there are going to be exceptional circumstances that would fall outside” any such definition; allowing a definition to develop over time, through case law, would be preferable.<sup>121</sup>

### **Comparable right of appeal in the benefit regime**

74. The need for claimants to have the right to appeal to an independent tribunal was also central to the Ombudsman’s recommendation that the Government consider introducing a statutory test. The Ombudsman commented that, within the benefits regime, there was:

... long and established case law on how [the existing statutory test] should be interpreted. A claimant who is unhappy about a decision on recovery can appeal to an independent tribunal ... It is therefore difficult to understand why this model of a statutory test should not be applied in tax credits cases, with a right of appeal to an independent tribunal.<sup>122</sup>

75. Mr Gray commented specifically on this element of the Ombudsman’s recommendation. Although he did not frame his comments as such, he appeared to contradict the Ombudsman’s account of the right of appeal in the benefits regime:

There is a right of appeal in the benefits system in relation to awards of benefit, just as within the tax credit system we have a right of appeal in relation to award decisions on tax credits. In the benefits system in DWP there is not a statutory right of appeal in relation to recovering overpayments generated by official error, which is the closest parallel to the specific recommendation which the Ombudsman made. It is not about the right of appeal on awards, where we are lined up with the benefits system, it is a question of right of appeal in relation to overpayments, where also our current practice is very close to the benefits system.<sup>123</sup>

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118 Q 40

119 Q 100

120 Q 41

121 Q 42

122 Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, paras 5.64–5.65

123 Q 580

76. In the social security regime, the right of appeal is set out in the Social Security Act 1998, as follows:

- section 12 provides that a benefit claimant has a right to appeal to an appeal tribunal against any decision of the Secretary of State made under section 8 of the 1998 Act;
- a section 8 decision includes a decision made by the Secretary of State under section 71 of the Social Security Administration Act 1992;
- section 71 of the 1992 Act provides that the Secretary of State may recover payment of a benefit where a claimant, fraudulently or otherwise, misrepresented or failed to disclose any material fact.

### *Our conclusions*

77. **The relevant statute law would appear to directly contradict HMRC's Deputy Chairman's statement that, in the benefits regime "there is not a statutory right of appeal in relation to recovering overpayments generated by official error". Such a right of appeal appears to be precisely what section 12 of the Social Security Act 1998 is intended to provide.** For the removal of doubt, section 12(4) of the 1998 Act states that "Where the Secretary of State has determined that any amount is recoverable under or by virtue of section 71 [of the 1992 Act], any person from whom he has determined that it is recoverable shall have the same right of appeal to an appeal tribunal as a claimant." By contrast, the Tax Credits Act 2002 provides no such right of appeal. Section 38 of the Act lists the decisions made under the Act against which an appeal may be brought. The section 38 list does not include decisions made under section 28, the section which empowers HMRC to recover overpayments. **We are bemused by the account of the law given by HMRC's Deputy Chairman, which appears to directly contradict the relevant statutory provisions. We invite the Government to clarify what it understands to be the rights of people receiving social security benefits to an independent appeal of a decision to recover an overpayment.**

### *Appealing disputed overpayments to the Adjudicator*

78. The HMRC Adjudicator, currently Dame Barbara Mills QC, operates under a service level agreement with HMRC, under which she investigates and helps to resolve complaints from individuals and businesses who remain unhappy about the way their affairs have been handled by HMRC. HMRC must itself have first investigated a complaint thoroughly before the matter can be referred to the Adjudicator. The Adjudicator can look at:

- mistakes;
- delays;
- poor or misleading advice;
- staff behaviour; and
- use of discretion.

The Adjudicator cannot consider disputes about departmental policy or matters of law.<sup>124</sup>

79. The Paymaster General told us that, in order to “supplement the revised [COP 26] and help build confidence in the decision-making, and in line with exploring all options with regard to an appeals procedure”, she was considering “with the Adjudicator” whether “a fast-track, independent review of decisions to recover overpayments in disputed cases” could be provided through the Adjudicator’s office.<sup>125</sup> Mr Gray confirmed that HMRC was looking at this possibility, “which would fall short of a formal statutory right of appeal”, in order to “try to address the underlying point the Ombudsman has raised”.<sup>126</sup>

### *Our conclusions*

80. **We strongly support the calls from the voluntary sector and the Ombudsman for the introduction of a right of appeal to an independent tribunal against a decision by HMRC on a disputed overpayment.** The current situation, whereby a claimant’s only comeback is to seek judicial review, is highly unsatisfactory: judicial review is hardly a realistic option for the vast majority of tax credits claimants. **We recommend that the Government introduce whatever legislation is necessary to enable claimants to exercise such a right of appeal, as a matter of priority. If the Government intends to delay still further on this matter, we recommend that it explain its reluctance to allow tax credits claimants access to justice, and that it report on the practical implications of introducing an independent right of appeal.**

81. **We note that HMRC is considering, with the HMRC Adjudicator, if the Adjudicator might be able to provide a fast-track, independent review of decisions on disputed overpayments. Although it is unclear from the Paymaster General’s statement, we assume that introducing such a regime would require the Adjudicator’s remit to be extended.** The point on which claimants require a right of independent appeal is not the way in which HMRC dealt with a disputed overpayment—claimants already have a means of pursuing such matters through the complaints procedure, within which the Adjudicator is already the final port of call. Rather, claimants require a right of independent appeal against the substance of any decision by HMRC about a disputed overpayment.

82. **Even if the Adjudicator’s remit were to be extended, we do not accept that such a review procedure is an adequate substitute for a right of appeal to an independent tribunal.** A tribunal operates under a set of rules laid down by law, and within the context of precedent and case law; its members are drawn from a community of experts, and it manifestly operates separately and independently from the body whose decision it is reviewing. **We will continue to follow this issue closely, and will examine with interest any detailed proposals which may be forthcoming from HMRC and the Adjudicator.**

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124 Ev 92

125 Q 307

126 Q 584

## 4 Fraud, error and organised crime

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### Levels of claimant error and fraud

83. The National Audit Office told us that HMRC’s work to identify the level of error and fraud in 2003–04 awards is not due to be completed until Spring 2006, but that:

In July 2005, [HMRC] announced interim findings which indicated that [in 2003–04] it overpaid 3.4% by value (£460 million) because of claimant error and fraud. These results are subject to a wide margin of error as they based on an initial sample and are likely to involve the more compliant cases. The final results are likely to show an increase in the proportion of cases involving claimant error and fraud.<sup>127</sup>

84. Sir David told us that HMRC’s work to identify the final levels of loss for 2003–04 due to claimant error and fraud was not yet complete.<sup>128</sup> He explained that, in order to “satisfy the NAO because this will go into our accounts”, the Department was looking in detail at a sample of 4,700 cases.<sup>129</sup> He confirmed that he expected the final level of claimant fraud and error to be “significantly more” than 3.4%:<sup>130</sup>

What I said at the time we published the initial findings was that I expected those to increase because they were the easiest cases. So when we do the more complicated cases the characteristic is that error is much more important in financial terms in fraud. We have got to tackle both. I am not saying we should be complacent, but error is a much more important feature.<sup>131</sup>

85. Analysis undertaken recently by the Institute for Fiscal Studies suggests there may be significant levels of fraud or error amongst people claiming tax credits as lone parents.<sup>132</sup> According to the IFS, HMRC and the Department of Work and Pensions (DWP) together estimate that they are paying income-related support for children, in the form of tax credits or out-of-work benefits, to 2.1 million lone parents, but the Office for National Statistics estimates there are only 1.9 million lone parents living in the United Kingdom. The IFS suggests this indicates that:

a portion of the tax credits or out-of-work benefits which HMRC or DWP think they are paying to lone parents are probably being received by cohabiting couples with children, whether through deliberate fraud or errors made by claimants or the government. If one disregards the threat of fines or penalties, it is often financially worthwhile to pretend to be a lone parent, rather than a couple, when claiming tax credits or out-of-work benefits.<sup>133</sup>

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127 Ev 161

128 Q 462

129 Qq 462, 563

130 Q 463

131 Q 462

132 Institute for Fiscal Studies press release, ‘Government paying tax credits and benefits to 200,000 more lone parents than live in the UK’, 12 March 2006; see IFS briefing note 70, available at [www.ifs.org.uk](http://www.ifs.org.uk).

133 *Ibid.*

## Our conclusions

86. We are concerned that it is now over two years since the end of the 2003–04 tax year, and yet HMRC is still to establish final levels of claimant error and fraud in the tax credits regime for that year. Given that the final figure is likely to be significantly higher than the interim figure of 3.4%, we question why the Department has not moved more quickly to establish a complete picture of patterns of claimant error and fraud in 2003–04, to put it in a stronger position to address the problem in more recent tax years. We recommend that the Government put appropriate procedures in place to ensure that similar work for tax years 2004–05 onwards is completed more promptly.

## Recent incidences of organised fraud

### a) Background

87. Commenting on the former Inland Revenue’s accounts for 2004–05 on 7 October 2005, the Comptroller and Auditor General noted that HMRC had evidence that tax credits had been targeted by organised criminals, particularly where they were able to make claims over the internet without proving their identity, but that the Department’s Internal Audit Office had concluded that “there was a lack of comprehensive information to allow a robust analysis of the problem”.<sup>134</sup> Shortly thereafter, on 2 December 2005, HMRC announced the closure of the tax credits e-portal, following identification of attempts to defraud the tax credit regime by making claims through the tax credits e-portal.<sup>135</sup> These claims falsely used internal information held by DWP about its staff. HMRC stated that it had closed the e-portal whilst it developed new checks to ensure that the system remained secure, and that a criminal investigation was underway.

88. Subsequently, on 18 January 2006, the Paymaster General gave further details of this fraud. She stated that:

- some 8,800 DWP staff identities “may have been stolen” in 2003–04;
- of these, 6,800 had been used in an attempt to defraud the tax credits regime in autumn 2005;
- of the 6,800 fraudulent claims, around 4,100 were fully intercepted by HMRC before any payment, so that no payment was made;
- of the remaining 2,700 claims, where tax credit payments were made into multiple bank accounts using the stolen identities, payments were suspended immediately they were discovered, and all payments were suspended by 16 December 2005.<sup>136</sup>

The Paymaster General estimated the loss from this fraud as £2.7 million.<sup>137</sup> She also gave details of another fraud, involving the use of identities stolen from Network Rail

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<sup>134</sup> Comptroller and Auditor General, *Standard Report on the Accounts of the Inland Revenue 2004-05*, 7 October 2005, para 2.44

<sup>135</sup> HMRC and DWP, ‘*Closure of tax credits portal*’, 2 December 2005; available at [www.gnn.gov.uk](http://www.gnn.gov.uk).

<sup>136</sup> HC Deb, 18 Jan 2006, col 1357W

<sup>137</sup> HC Deb, 18 Jan 2006, col 1358W

employees, stating that HMRC's investigations had so far resulted in at least 16,000 claims being stopped and that details had been passed on to what is now the Serious Organised Crime Agency.<sup>138</sup>

89. The Paymaster General has also given figures for the numbers of cases of organised fraud detected by HMRC since April 2004:

- in 2004–05, HMRC intervened on 17,164 incorrect claims before the tax credit payments were made where fraud or error was suspected;
- from April 2005 to the end of November 2005, HMRC made 38,924 such interventions, of which HMRC estimate over half arose as a result of organised attacks;
- from October 2004 to the end of November 2005, HMRC identified and stopped 22,284 tax credit claims in payment, where organised fraud was suspected.<sup>139</sup>

### **Scale of frauds**

90. According to the NAO, recent HMRC estimates show losses to the Exchequer of some £15 million due to organised fraud:

This figure relates to the losses to date in some 25 cases of significant organised fraud, defined as those involving more than £25,000. As a result of the further work on tackling organised fraud, the Department believes that the £15 million figure will increase, but it is too early to give a firm estimate at the moment.<sup>140</sup>

91. Sir David told us that the scale of the frauds perpetrated on the tax credits regime was “pretty unprecedented”.<sup>141</sup> The identities used fraudulently were not only those of DWP and Network Rail employees, but also those of other individuals.<sup>142</sup> The Paymaster General told us that HMRC decided to close the e-portal because “what was particular” about this fraud was the use of stolen identities to open “vast numbers” of individual bank accounts: “whether those bank accounts were funnelled somewhere else eventually is a matter for the investigation now”.<sup>143</sup> Officials were able to give us an idea of the scale and complexity of the frauds:

... production orders ... have been served so far have been on 19 banks and building societies, around 2,200 ... bank accounts, which have spawned, we believe, around 6,000 further sub-accounts within the financial institutions. The sub-accounts range from one link to a main account to up to 105 ... We are also about to apply to the courts for further production orders covering 6,000 more bank accounts and we expect there to be the same web of sub-accounts coming from this.<sup>144</sup>

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138 *Ibid.*

139 HC Deb, 10 Jan 2006, col 558W

140 Ev 161

141 Q 464

142 Q 465

143 Qq 314–15

144 Q 465

92. The criminal investigation into the frauds remains ongoing; as at 19 April, two arrests had been made in connection with these frauds; the individuals concerned were charged with money-laundering offences and remanded in custody.<sup>145</sup> HMRC hopes “to be able to say something, whether it is a definitive figure about organised crime”, when it publishes its report into the results of its work to identify the final levels of loss for 2003–04 due to claimant error and fraud.<sup>146</sup>

### **Paymaster General’s awareness of fraud**

93. We specifically asked the Paymaster General when it was first reported to her, as Minister, that HMRC was concerned about organised fraud. She responded:

What became clear in late November [2005] was that there was substantial suspected identity fraud in the system. HMRC advised me accordingly. I took their advice and we closed what was then the e-portal as quickly as was possible in order to close off that particular attempt.<sup>147</sup>

She subsequently clarified that it was “towards the end of November” that she became aware of the attack by organised gangs on identity fraud.<sup>148</sup>

94. Following our session with the Paymaster General, Mr David Laws MP wrote to us, expressing concern that the Paymaster General’s evidence appeared to contradict her answer to an earlier Parliamentary Question (PQ) put by Mr Laws.<sup>149</sup> The Paymaster General had responded to the PQ on 10 January 2006, in the following terms:

Over the last 12 months HMRC has detected an increase in the number of organised attacks on the tax credits system, predominately via the internet. HMRC continued to monitor the situation closely and updated me in June 2005. A decision was taken to suspend the internet service from 2 December ...<sup>150</sup>

95. Mr Laws considered that this answer indicated that the Paymaster General “had been updated on the problem [of organised fraud] in June and had probably known about it for far longer”.<sup>151</sup> He stated his belief that “the Paymaster General has therefore misled Parliament” and asked that we “investigate exactly what the Paymaster General knew about the level of fraud and when”.<sup>152</sup>

96. The Paymaster General subsequently wrote to us, responding to Mr Laws’ allegations, which he had also put to her directly.<sup>153</sup> She explained that her response to the PQ of 10 January referred to a specific report she had received in June 2005, which provided

<sup>145</sup> *Ibid.*

<sup>146</sup> See paragraph 33.

<sup>147</sup> Q 310

<sup>148</sup> Q 311

<sup>149</sup> Ev 172

<sup>150</sup> HC Deb, 10 Jan 2006, col 551W

<sup>151</sup> Ev 172

<sup>152</sup> *Ibid.*

<sup>153</sup> *Ibid.*

information about trends in suspected fraudulent activity and related matters. In June, HMRC advised her that the compliance procedures in place were effectively managing the risk. Subsequently, in November, “new information came to light about what appeared to be a specific and unprecedented attack on the system”—the fraud perpetrated using identities stolen from DWP staff.<sup>154</sup> The Paymaster General stated that, “in the light of the virulent and highly organised nature of this attack, HMRC judged the balance of risk had changed significantly, and recommended closing the e-portal”.<sup>155</sup>

### **Levels of staffing in compliance**

97. PCS alleged that HMRC had plans “to shed almost 300 jobs from [tax credits] compliance and anti-fraud activity in this financial year [that is, 2005–06]”.<sup>156</sup> In oral evidence, PCS reduced this estimate to “around 150 jobs”, and commented:

We have major concerns based on our understanding of where job cuts are destined to fall. I say “our understanding” because here we are, some one year on, from the Chancellor’s announcements about efficiency savings and job cuts across the Civil Service, still not knowing from David Varney and his colleagues exactly where these cuts are destined to fall ... One area where we do have some information to suggest where staff cuts are imminent is in the area of tax credit compliance.<sup>157</sup>

PCS argued that additional resources should be put into tax credits compliance and anti-fraud activity, because “it is an established fact that organised criminals see the design of the [tax credits] system as the provider of ‘low hanging fruit’ for their activities”.<sup>158</sup> The union told us that a “knock-on” effect of HMRC’s initiative to supplant staff with an IT system was the Department’s “pay out first and check later” policy, which had in turn enabled a substantial number of fraudulent claims to be made and National Insurance numbers to be ‘hijacked’.<sup>159</sup>

98. We put PCS’s evidence to the Paymaster General. She described herself as “stunned and surprised” by the alleged plans to cut jobs in tax credits compliance and anti-fraud activity, and told us that there would “not be reductions in the compliance within the Tax Credits Office, in fact quite the reverse”.<sup>160</sup> Later in the same evidence session, she stated that HMRC was “currently considering across the whole of the Department, including tax credits, what the appropriate level of compliance activity should be.”<sup>161</sup>

99. We subsequently asked HMRC officials which of the Paymaster General’s statements was more accurate—that that there would be increases in compliance activity within the TCO, or that the matter was still under consideration. Sir David responded:

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<sup>154</sup> *Ibid.*

<sup>155</sup> *Ibid.*

<sup>156</sup> Ev 175

<sup>157</sup> Q 260

<sup>158</sup> Ev 176

<sup>159</sup> Ev 175

<sup>160</sup> Q 322

<sup>161</sup> Q 444

I think the Paymaster General did capture all elements of the argument, and I think this is where Sir Humphrey comes to the fore! ... We are looking at how do we take a risk-based approach to compliance and therefore how do we deploy our compliance resources to the best effect.<sup>162</sup>

100. Officials confirmed that there were currently “no plans to reduce the number of compliance staff allocated to this work”.<sup>163</sup>

### ***Our conclusions***

101. The problem of organised fraudsters targeting the tax credits regime, using thousands of stolen identities to channel tax credits to individual bank accounts, is obviously a complex one, and investigations by HMRC, DWP, the Serious Organised Crime Agency and the banks involved will no doubt continue for some time. As an indication of the scale of the problem, between April and November 2005, HMRC made over twice as many interventions on incorrect claims where fraud or error was suspected as it did in between April 2004 and March 2005; HRMC estimates that over half the interventions between April and November 2005 arose as a result of organised attacks.

102. **On the basis of the information available to us at the present time, and given that a criminal investigation is underway, it would be inappropriate for us to comment on whether HMRC could have done more to prevent fraudulent claims from entering the tax credits system. At this stage, we are also not in a position to establish whether HMRC ought to have identified the problem at an earlier stage, or to have realised the vulnerability of the e-portal sooner.** We welcome the Paymaster General’s clarification of the advice she received from HMRC on the issue of fraud, and at what date.

103. **We note the Paymaster General’s assurances that the Government has no current plans to reduce the numbers of staff working in tax credits compliance. In its response to this report, we recommend that the Government make a clear statement about its future plans for compliance, both in terms of levels of staffing and processes, to indicate how developed those plans are and to set out a timescale for any decisions it intends to take in this area.**

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162 Q 471

163 *Ibid.*

## Part B: Looking forward

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### 5 Package of reforms announced in PBR

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#### Background

104. The Government announced a number of modifications to the design of the tax credit regime in the Pre-Budget Report 2005 (the PBR), published on 5 December 2005. The Government intends that these modifications will:

... ensure that the system strikes the right balance between providing a stable award and maintaining the ability to respond to changes. The package includes a number of measures to increase the flexibility of the tax credit system and involves new responsibilities for claimants to tell HMRC about changes in their circumstances promptly ... the flexibility to respond to falls in income and changes in circumstances will be maintained.<sup>164</sup>

105. Key changes to the design of the tax credits regime included:

- increasing the disregard for increases in income between one tax year and the next ten-fold, from £2,500 to £25,000 (from April 2006);
- applying automatic limits on the amount of overpaid tax credits (“excess payments”) HMRC recovers from claimants where awards are adjusted in-year, following a reported change (from November 2006); and
- in the case of claimants who report a fall in income during the year, continuing to adjust their tax credits payments for the rest of the year to reflect their new income level but assessing whether they are entitled to a one-off payment for the earlier part of the year at the end of the year, rather than at the point at which they report the fall in income (from April 2007).<sup>165</sup>

106. Key changes to claimants’ obligations included:

- shortening the deadline for the return of end-of-year information, from the end of September to the end of August (in 2006);
- increasing the types of change in circumstances which it is mandatory to report to HMRC (from November 2006); and
- shortening the time within which claimants are required to report changes of circumstances to HMRC, from three months to one month (from April 2007).<sup>166</sup>

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<sup>164</sup> HM Treasury, *Pre-Budget Report 2005*, Cm 6701, December 2005, para 5.22 and box 5.2,

<sup>165</sup> HM Treasury, *Pre-Budget Report 2005*, ie box 5.2.

<sup>166</sup> *Ibid.*

107. Alongside the publication of the PBR, the Paymaster General made a written statement to the House providing more information about the package of reforms. In that statement, she said that, once the reforms had been implemented, they would provide “greater certainty for claimants, particularly those on lower incomes, while maintaining flexibility to respond to falls in income and changes in circumstances” and would give “claimants clear responsibilities to report changes promptly and more regularly”.<sup>167</sup> HM Treasury officials appearing before this Committee at the time of the PBR described the reforms as:

a package ... of rights and responsibilities in that the Government is giving people a more generous treatment both in terms of in-year repayments and threshold payments, but in return they are expecting, assisted by HMRC, more responsibility [to be taken by claimants].<sup>168</sup>

108. The Paymaster General also commented on the likely effects of the package on the level of overpayments:

Without the changes announced today, initial estimates suggest that subsequent years’ overpayments would be of broadly the same level as in 2003–04. When fully implemented, it is anticipated that today’s changes will reduce the value of overpayments by around one-third.<sup>169</sup>

### Costing the package of reforms

109. The Government has estimated the costs and yields of the package of reforms as follows. These figures are estimates of the net effect of the package, against a baseline forecast gross expenditure figure. HMRC officials told us that this gross expenditure figure does not include any assumptions about losses or write-offs.<sup>170</sup>

**Table 3: Estimated costs and yields of PBR package of reforms**

Year	Cost/yield to the Exchequer (£ million)
2006–07	-£100
2007–08	+£200
2008–09	+£50
2009–10	-£50
2010–11	-£150
<b>Net cost</b>	<b>-£50</b>

Source: Treasury Committee, *Third Special Report of 2005–06*, The 2005 Pre-Budget Report: Government Response to the Committee’s Second Report of Session 2005–06, HC 1013, para 35

167 HC Deb, 5 Dec 2005, col 57WS

168 Treasury Committee, Second Report of Session 2005–06, *The 2005 Pre-Budget Report*, HC 739, Q 227

169 HC Deb, 5 Dec 2005, col 57WS

170 Qq 472–76

110. We have already discussed the question of the cost of the PBR package in our Report on the PBR.<sup>171</sup> In the course of the present inquiry, and during our earlier examination of PBR 2005, we have repeatedly asked the Government to provide us with the costs or yields of each individual measure within the package. The Government has consistently said that it is unable to provide us with this information, because:

the way that tax credits are scored on a National Accounts basis means that there are significant timing effects ... there are also complicated interactions between elements of the package ... that make the cost of individual elements meaningless. For example, the cost of the disregard in the absence of all the other measures would differ substantially from its cost as part of the package announced. These overlaps in the costs of the various elements of the package make any attempt to assign a cost to any one element arbitrary.<sup>172</sup>

The Paymaster General told us that, for the reasons set out above, the disaggregated costs or yields “cannot be available”.<sup>173</sup> HMRC officials have told the Committee of Public Accounts that “what we are undoubtedly talking about is figures that can be measured in a few hundreds of million pounds for each of the components of this package.”<sup>174</sup>

111. Subsequent to our hearing with the Paymaster General, Mr Brewer provided us with a letter he had received from HMRC, explaining why HMRC had refused to disclose to him, under the Freedom of Information Act 2001, information about the likely cost of increasing the disregard threshold from £2,500 to £25,000.<sup>175</sup> In the letter, HMRC stated that costings for the PBR package were based on limited information:

At the time policy costings were prepared for the PBR the department had only incomplete and uncertain information on tax credits overpayments since 2003-04. (This remains the case.) ... Of course the published data are not as up-to-date or comprehensive as one might wish. But nor are the (taxpayer-disclosive) [that is, confidential] data available internally, given all the IT difficulties there have been.<sup>176</sup>

HMRC then explained that using such information “involved a substantial degree of judgement”:

No explicit measures of statistical quality and integrity would be possible. Moreover a significant amount of additional modelling was needed to produce a costing. This required a range of assumptions of a policy-related nature about the administration of the existing tax credit regime and the changes to the regime under consideration for the PBR package ... It was not, for instance, possible in the work for the PBR to track a representative sample of cases on a continuous basis through time to identify and quantify precisely why overpayments of tax credits were occurring. The costings

171 Treasury Committee, *The 2005 Pre-Budget Report*, para 90ff

172 Treasury Committee, Third Special Report of 2005-06, *The 2005 Pre-Budget Report: Government Response to the Committee's Second Report of Session 2005-06*, HC 1013, p 21-22

173 Q 411

174 Committee of Public Accounts, *Inland Revenue Standard Report: New Tax Credits*, Q 53

175 Ev 190

176 *Ibid.*

for the PBR package had to use partial data and required the exercise of substantial skill and judgement. If need be, there are agreed procedures within HMRC for getting 'senior sign off' of complex or controversial costings.<sup>177</sup>

### **Likely revenue costs associated with reforms**

112. The decision to increase the disregard threshold from £2,500 to £25,000 will, on the face of it, register as an increased cost to the Exchequer. The Chancellor of the Exchequer has told the House that he expects the increase to “cover 95% of all income rises during a year.”<sup>178</sup> HMRC expects that about 600,000 families “will benefit from the increase in the disregard”, based on data from the first two years of the regime’s operation.<sup>179</sup> The NAO told us that HMRC has estimated that, in 2003–04, the final entitlement to tax credits would have been £800 million lower without the £2,500 disregard.<sup>180</sup> Despite this evident cost, the Government expects the reform package to be broadly revenue neutral. Mr Brewer suggested to us that this apparent anomaly indicated that the Government expected to save money as a consequence of writing off fewer overpayments:

Of course, if they were collecting all their overpayments now, these measures would not save them any money; but because they are writing off more overpayments than they thought they would have to, then it will save them money.<sup>181</sup>

Mr Brewer described the increase in the disregard as the “key element” in the package, “in the long run”, because “it genuinely increases families’ entitlement to tax credits”, whereas most of the other measures either “just affect cash flow ... or they affect the writing-off of overpayments.”<sup>182</sup>

### **Likely revenue yields associated with reforms**

113. Given that the ten-fold increase in the disregard threshold will be costly, and yet the Government nevertheless expects the package of reforms to be broadly revenue neutral, it must be assumed that the Government expects some or all of the remaining components of the package to represent a saving to the Exchequer. Savings may arise from the tougher reporting requirements due to be introduced under the PBR reforms. One effect of these tougher requirements should be to provide HMRC with a wider range of more up-to-date information than at present, which should in turn enable the regime to operate more efficiently and represent a saving for the Exchequer.

114. Several witnesses raised concerns with us about the possible effect of the tougher reporting requirements. The LITRG described the reduction in the notification period, from the existing three months to one month, as “a big problem and unworkable in many

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<sup>177</sup> *Ibid.*

<sup>178</sup> HC Deb, 5 Dec 2005, col 611

<sup>179</sup> Ev 191

<sup>180</sup> Ev 159

<sup>181</sup> Q 185

<sup>182</sup> Q 186

cases”.<sup>183</sup> Citizens Advice referred to starting a new relationship or separating from a long-term partner as examples of common changes in circumstances that might not lend themselves to being reported within a month, and emphasised the importance of HMRC getting across to claimants the message that, “in order to get your increase in your tax credit and all of it at the time you need it, you will need to report that change [in circumstance] quite quickly”.<sup>184</sup> OPF pointed out that those claimants who qualify for the childcare element of WTC are required to report any change in childcare arrangement that lasts for four consecutive weeks and that, by definition, this is a difficult change of circumstance to report within a month.<sup>185</sup>

115. Claimants who do not report changes in circumstances to HMRC, or who negligently provide information, are liable to significant fines. Claimants can be fined up to £300 if they:

- do not tell HMRC about a change in circumstances that results in a tax credits overpayment, or
- supply incorrect information about their tax credits claim.<sup>186</sup>

HMRC’s guidance for claimants states that claimants may be charged interest if HMRC has overpaid tax credits because of negligence on the part of the claimant. HMRC will also charge interest on any penalties that a claimant is late in paying.<sup>187</sup> Finally, HMRC may charge a penalty of up to £3,000 if a claimant has negligently not taken care to make sure any information sent to HMRC was correct.<sup>188</sup>

116. CPAG expressed concern that, if HMRC was not careful in the way in which it enforced the penalty regime, the changes could foster a “climate of punitiveness as opposed to encouraging people to report appropriately”.<sup>189</sup> CPAG felt it was “not credible to start by talking forcefully about fining already people who are in difficult financial circumstances, when plainly their view of the system already is that they do not feel very confident in it”.<sup>190</sup> Similarly, Citizens Advice said it would want to watch very carefully whether HMRC moved to clamp down on charging penalties.<sup>191</sup>

117. We discussed with the Paymaster General how HMRC intended to enforce the penalty regime once the new reporting requirements were implemented. She told us that the Department already recognised exceptional circumstances in which failure to meet the three month reporting deadline would not be penalised, and cited bereavement, accident

183 Q 91

184 Qq 15, 53

185 Q 17

186 HMRC, leaflet WTC7, *Tax credits penalties: What happens at the end of a check*, February 2005; available at [www.hmrc.gov.uk/leaflets](http://www.hmrc.gov.uk/leaflets).

187 *Ibid.*

188 *Ibid.*

189 Q 17

190 *Ibid.*

191 Q 15

and serious illness as examples of such exceptional circumstances.<sup>192</sup> When we asked if these exceptional circumstances would continue to apply in respect of the one month deadline, the Paymaster General responded:

Yes. I cannot see any reason why that would not carry over. It would be unreasonable not to, would it not?<sup>193</sup>

### *Our conclusions*

118. As we said in our Report on the 2005 Pre-Budget Report, we welcome the fact that the Government is seeking to improve the operation of the tax credits regime by introducing a package of reforms. However, we remain concerned that the Government has said it is unable to provide a breakdown of the costs or yields of each individual measure within the package. We feel greater attention needs to be paid to trying to disaggregate the different costs of the present system, especially those associated with reporting changes of circumstances. We have received evidence which suggests that the costings for the package were based on “incomplete and uncertain” information, the use of which required HMRC to exercise “a substantial degree of judgement” and to make “a range of assumptions of a policy-related nature”. Given this, we question how the Government can be confident of its estimates of the overall costs of the package.

119. The Government expects the package of reforms to be broadly revenue neutral, despite the fact that the decision to increase the disregard threshold from £2,500 to £25,000 will be costly. It follows that some or all of the remaining components of the package must be expected to reduce expenditure or yield revenue. Officials told us that the baseline figure against which the cost of the package has been estimated did not include any assumptions about losses or write-offs, suggesting that any revenue yielded does not arise from revised predictions of the amount of overpayments which HMRC expects to write off.

120. We infer from this that the Government expects the reduction in expenditure or yield in revenue from the introduction of tougher reporting requirements for claimants to be significant. These tougher requirements should enable HMRC to operate the tax credits regime more efficiently, thus representing a saving for the Government. However, another effect may be that more tax credits claimants fail to meet the tougher requirements, and thus incur a fine—another potential source of increased revenue for the Government. Claimants who do not report changes in circumstances to HMRC, or who negligently provide information, are liable to significant fines. We recommend that the Government clarify whether, as a result of the implementation of the PBR package of reforms, it expects to receive increased revenue from fines payable by tax credits claimants and, if so, by how much it expects revenue to increase. We seek an assurance from the Government that it will enforce the penalty regime proportionately, taking into account the circumstances in which an individual claimant finds him- or herself. We recommend that the Government undertake and publish a review of the operation of the system of fines after the first 18 months of operation.

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192 Q 395

193 Q 397

## Assessing the PBR reforms

### a) Effect of increased disregard on claimants

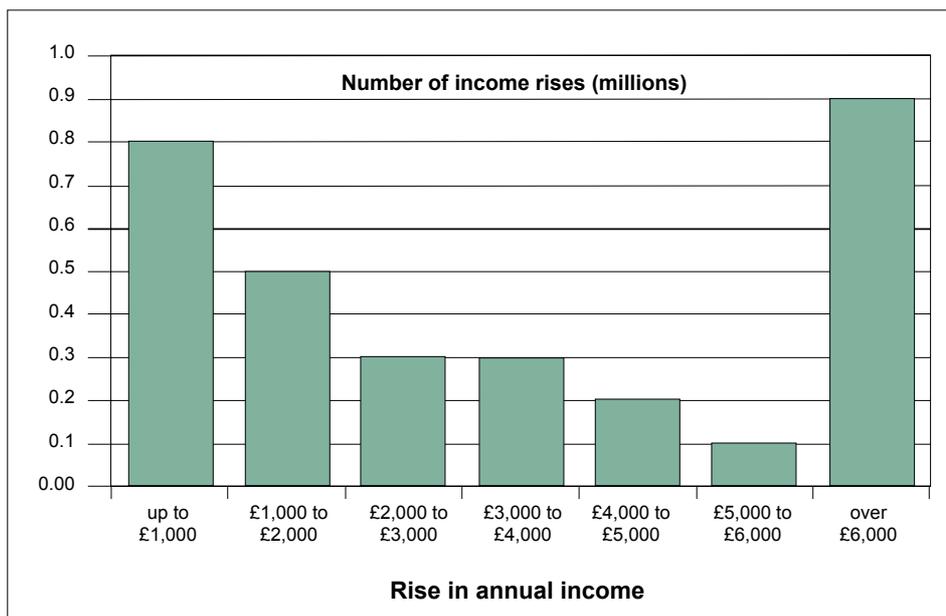
121. We discussed with witnesses the likely effects of the ten-fold increase in the disregard threshold from £2,500 to £25,000. The Government set out the benefits of a £2,500 disregard in its April 2002 paper setting out proposals for tax credits, *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*:

#### *Why a £2,500 disregard?*

[...] Increasing the size of the disregard would further reduce the numbers of those who might need to have their awards reassessed. But a larger disregard increases the cost of the new tax credits and reduces the effective targeting of resources.

Analysis of the British Household Panel Survey (BHPS) suggests that around 60 per cent of households in the new tax credits population could be expected to see a rise in income between one year and the next. The chart below shows the distribution of income rises for the new tax credit population drawn from the BHPS. It shows that households tend to experience either relatively small increases in income of £1,000 or £2,000 a year or else much larger increases.<sup>194</sup>

Chart showing rises in income among the new tax credit population



122. Although the increase in the disregard was broadly welcomed by witnesses, several of them raised concerns that such a significant increase in the threshold would have inequitable consequences. As noted above, the Government itself acknowledged, in 2002, that further increasing the disregard would also further reduce the effective targeting of resources. PCS believed that this measure would lead to “unfairness in terms of relative need between claimants with vastly different incomes”, although it did not explain

<sup>194</sup> HM Treasury and Inland Revenue, *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, paras 4.40 and 4.42, chart 4.2

precisely how it thought this unfairness would arise.<sup>195</sup> Citizens Advice Northern Ireland (CAB NI) expressed concern that:

... in the first year that your income goes up by that much you are going to continue on the same level of tax credits and then have a lower income in the second year and you are going to have a massive drop. Many of these are low income clients who may have made financial commitments based on the level of tax credits they are receiving and suddenly there will be a drop in their payments in the second year when the income disregard no longer applies and where will that leave them ...<sup>196</sup>

123. Ferret Information Systems, a company consulting on the law relating to welfare benefits, has undertaken some analysis of the possible impact of increased disregard threshold. Its analysis is based on a theoretical example of a couple with two children and with one of the adults working more than 30 hours a week, with no disabilities or child care costs, where one of this couple starts work after a long period of unemployment, education or illness and receives the median UK 2005 pay of £22,412. The analysis shows that “the total tax credits payable over the first 2 years, in these circumstances, is substantially higher under the new rules [and] ... that the concession is worth considerably more to the better paid than to those on lower incomes.”<sup>197</sup>

124. CPAG and OPF pointed out that the increased threshold would help only those people who see an increase in income in the current year compared with the previous year.<sup>198</sup> Both groups expressed concern that people who, in the current tax year, see their income start and finish lower than the previous tax year but nonetheless rise within the year will receive no benefit from the increased threshold.<sup>199</sup> OPF referred to the example of a woman taking maternity leave. Taking such leave could well result in a family’s income both decreasing and then increasing in the current tax year, but not increasing to the level it was in the previous tax year.<sup>200</sup> Such an increase would presumably not qualify for the disregard, and the level of tax credits received would decrease.

125. HMRC officials acknowledged that some “discrepancy” would arise, in terms of how the increased disregard affected different claimants, but said it was “far from clear-cut” whether the discrepancy would “match directly to better-off and less well-off families.”<sup>201</sup> We asked HMRC whether it intended to warn claimants that, when their income rose, their tax credits were likely to decrease, perhaps significantly, in the following year. Officials responded that, although HMRC was seeking to be “increasingly clear” in its communications with claimants about the implications of the way the regime operated,

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195 Ev 173

196 Q 123

197 Ferret Information Systems, *Some implications of the change in the income increase disregard in Tax Credits*, 16 December 2005; available at [www.ferret.co.uk](http://www.ferret.co.uk).

198 Qq 12–13

199 *Ibid.*

200 Q 13

201 Q 487

“whether we should be getting formally into the position of offering what is kind of close to financial advice ... is a rather broader and more difficult question.”<sup>202</sup>

### *Our conclusions*

126. The existence of the disregard threshold means that those claimants whose income increases will receive the benefit of both their increased income and their unadjusted tax credits entitlement for the remainder of the tax year, before experiencing a drop in income in the following tax year. One effect of the ten-fold increase in the disregard will be that this drop in income may well represent a significant sum of money (depending on the amount of the increase in income). We recommend that HMRC make clear to all claimants who report an increase in income of between £2,500 and £25,000 that, if their other circumstances remain relatively unchanged, their tax credits entitlement in the following tax year is likely to drop, possibly by a significant amount. We do not consider this amounts to HMRC presuming to offer “financial advice” to claimants, as officials suggested: the purpose should be to make clear to claimants that they should not plan their financial arrangements on the basis that they will continue to receive their current level of tax credits payments.

127. We have received evidence that the increase in the threshold will benefit only those claimants who see an increase in income in the current year as compared with the previous year, because the income disregard threshold is applied on the basis of comparison with the previous year’s income. Claimants who, in the current tax year, see their income start and finish lower than the previous tax year but nonetheless rise within the year will receive no benefit from the increased threshold. We invite the Government to comment on whether it has considered ways of addressing this anomaly.

### *Potential for abuse of increased disregard*

128. Ferret Information Systems have pointed out that the increased disregard threshold creates a much greater incentive for claimants to arrange to be paid, or to pay themselves, different sums in alternate years—for example, in annual payments of £20,000, £45,000, £20,000, £45,000, £20,000 and so on.<sup>203</sup> Such an alternating pattern would mean that a claimant’s entitlement would be calculated on the basis of an annual income of £20,000, while the real average gross income is £32,500:

... Put this together though with changes in pension legislation which remove limits on contributions into pension plans from April 2006 ... Instead of reducing gross pay in alternate years, make pension contributions of £25,000. Pension contributions are disregarded from income for tax credit purposes so the effect is [the] same, perhaps even enhanced by other tax considerations.<sup>204</sup>

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202 Q 489

203 Ferret Information Systems, *Some implications of the change in the income increase disregard in Tax Credit*.

204 *Ibid.*

129. We put this possibility to HMRC officials, who described it as an avoidance scheme.<sup>205</sup> Officials said the Government had “not put formal measures in place” to counter such a scheme, although they would be “reviewing it extremely closely once the new disregard regime is in place.”<sup>206</sup> **The increase in the disregard of income to £25,000 creates a greater incentive for claimants to seek to substantially increase their tax credit entitlement by arranging for their annual income to fluctuate in alternate years. We recommend that the Government ensure it has adequate procedures in place to detect such abuse of the regime.**

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205 Q 593

206 Q 594

## 6 Improving HMRC's service to claimants

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### Continuing challenge of overpayments

130. The Paymaster General has said that, even if the PBR package of reforms is implemented entirely successfully, this is expected to reduce the level of overpayments by only one-third.<sup>207</sup> This suggests that overpayments will continue to be an ongoing problem. As Mr Brewer commented:

We know that the increase in income disregard is so large [£25,000] that almost no families will now see an overpayment because of income rises, but it surprised me—I am sure it is true but it surprised me—that the Revenue think that their package of reforms is only going to reduce overpayments by a third. That means there are an awful lot of families who are still going to experience overpayments, presumably due to changes in circumstances other than income. So although the Revenue may have done as much as it can to reduce overpayments caused by income rises, there will still be—we do not know the exact numbers—presumably over a million families, over £1 billion of public spending, in overpayments. So ... overpayments are still going to happen.<sup>208</sup>

131. Nor does a one-third reduction in overpayments necessarily mean a one-third reduction in HMRC's administrative caseload. Evidence from Citizens Advice suggested that, while that the number of clients coming through its doors appeared to be decreasing, the cases being dealt with by bureaux seem to be getting increasingly complex, and taking a long time to resolve.<sup>209</sup>

### *Our conclusions*

**132. The Government expects the ten-fold increase in the disregard threshold to reduce the current level of overpayments by one-third. This suggests that the remaining two-thirds of overpayments arise as a result of changes in claimants' circumstances other than increases in income. Consequently, over the next few years, although the tax credits regime may see a decrease in the numbers of overpayments being made, levels of overpayments are likely to continue to be high. At the same time, claimants' problems may well become increasingly complex, as their case history within the regime lengthens.** We have therefore considered what HMRC needs to do to improve its administration of tax credits, and its capacity to make these improvements.

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207 HC Deb, 5 Dec 2005, col 57WS

208 Q 181

209 Q 14

## HMRC's capacity to deliver

### a) *Departmental culture*

133. One aspect of service which the Department provides to claimants is the extent to which the culture within HMRC is suited to, and has adapted to, the characteristics of the tax credits regime. This point is, of course, as much about the former Inland Revenue as the current Department, given that it was Inland Revenue which administered new tax credits from their introduction in April 2003. In March 1998, the taskforce commissioned by the Government to advise on the reform of the tax and benefits regimes, and which recommended the introduction of a tax credits regime, discussed the differences between the tax regime and the benefits regime:

For a start, the tax and benefits systems have traditionally had different objectives: the funding of Government expenditure and the relief of need, and although one can be seen as a negative version of the other, this inverse relationship is arguably superficial. Second, although many recipients of in-work benefits also pay income tax, more generally benefit recipients are not taxpayers. As a result of this, the collection and delivery functions, both in human terms and in terms of the technology used by the two systems, vary considerably.<sup>210</sup>

134. Some witnesses made effectively the same point, about the difference between the nature of the tax collection work which HMRC (or Inland Revenue) has been accustomed to undertaking and the nature of the work it is now being asked to undertake in administering tax credits. Mr Field drew a contrast between the roles of HMRC and the Department for Work and Pensions (DWP):

... paying out money is something that the [DWP] knows something about. The Revenue knows something about collecting money ... in theory, of course, [tax credits] ought to be in DWP ... but I would put my savings on it not being moved and we might as well save the paper for some other recommendation.<sup>211</sup>

OPF suggested that, at least in the earlier years of new tax credits, HMRC “did not really understand what this money meant to people and therefore were slower to respond than they otherwise might have been”.<sup>212</sup> Citizens Advice explained that “we find it is very hard sometimes to press the urgency of the issues” with the Department, and to ascertain “what is somebody going to do in the meantime, until the computer can sort out this particular problem?”<sup>213</sup>

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210 HM Treasury, *The Modernisation of Britain's Tax and Benefit System: Number Two; Work Incentives: A Report by Martin Taylor*, 17 March 1998, para 3.04

211 Q 251

212 Q 6

213 Q 14

### *Our conclusions*

135. The contribution which HMRC's departmental culture may have made to the difficulties experienced by tax credits claimants is difficult to measure. We consider that the transfer from DWP to the Inland Revenue of administrative responsibility for delivering State assistance did require a culture shift on the part of the latter Department, in order to take account of the different objectives of funding Government expenditure through tax collection, on the one hand, and delivering State assistance to those in need, on the other. On the basis of the evidence we have taken and our visit to the TCO in Preston, it seems to us that HMRC has started to make the cultural transition required, although it still has some way to go. However, we are not convinced that the Paymaster General and the Department fully realise the extent to which HMRC needs to re-focus its administrative structures for tax credits around the needs of claimants. We discuss the need for HMRC to focus on the service it provides to claimants, below.

### *Claimant service*

136. Witnesses representing claimants' interests suggested that the crucial factor in improving HMRC's service to claimants is what the Department does with a claimant's report of a change in circumstance, once it has received it. For example, Citizens Advice told us:

Our main concern ... is the Revenue's ability to deal with those reports of changed circumstances and deal with them quickly. I think a lot of our evidence ... is that people do report changes. We frequently get told—and I am sure you do in surgeries—that people have reported and yet they have not been taken on board or still we are getting people saying that the helpline is telling them, “Don't worry, sort it out at the end of the year.” The Revenue need to make sure that their messages are properly spread throughout the whole of the organisation—and, particularly on the helpline, what to do, when people do report, to take it down. Can their computer cope with taking down several changes at once? ... it is really, really important that the Revenue has sufficient resources to deal with this so that people can be confident that when they do report they will be taken on board.<sup>214</sup>

OPF agreed that “what is really important is what the Revenue does when you inform them of a change in circumstance”, and added that it was vital “not to attribute too many of the problems within the system at the moment to claimant error”.<sup>215</sup> OPF thought that many of these problems were in fact attributable to the Department's administrative difficulties, rather than claimants' shortcomings in reporting changes in circumstances.<sup>216</sup>

137. Citizens Advice also referred to the difficulties experienced by claimants and their advisers when attempting to engage with the apparently complex administrative structure of the Department:

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214 Q 15

215 *Ibid.*

216 Q 17

For instance ... if ... the case [is referred] to the Citizens Advice helpline,<sup>217</sup> the normal helpline are not allowed to help you any more; if the Citizens Advice Bureau helpline are helping you and you get referred to the special payments team, the special payments team then take priority over the Citizens Advice helpline,<sup>218</sup> and, if you get referred to complaints ... they then take priority over everybody else. It is very difficult.<sup>219</sup>

Citizens Advice suggested that these difficulties had actually worsened over time, as HMRC had developed systems for dealing with claimants' problems.

### *Our conclusions*

**138. As we have already discussed, the Paymaster General's public account of the causes of overpayments referred only to those attributable to claimant error or omission or to the design of the tax credits regime. Her statement made no reference to causes of overpayments which have arisen as a consequence of the Department's own processes, such as official error and IT system error. We consider it would be much more helpful if the Department were to focus on the quality of the service it provides to claimants, rather than seeking to attribute the majority of problems with the tax credits regime to error or omission on the part of claimants. We recommend that the Government examines closely what contribution its own processes have made to the difficulties experienced with the tax credits regime.**

### *Current priorities*

139. The Paymaster General indicated to us that she was constrained in terms of how many improvements could be made to the administration of tax credits. She explained to us how she was seeking to set priorities, within the constraints of the IT system:

I have to balance ... the importance of getting the award notice out and correct, the playback,<sup>220</sup> the guidance [that is, revising COP 26], the increase in the disregard [to £25,000], the considerations that I am also still pursuing with regard to whether or not there should be a pause [before recovery] ... All of that requires IT changes and some of it legislative changes. I have got to balance the importance, and that is what I am doing. At the moment I am going for award notice, changes in in-year recovery, playback, [£]25,000, being more proactive in making sure the claimants understand what changes of circumstance are relevant to tell us ... and how quickly they should tell us and getting the renewals window from [its current] six months [down to three months].<sup>221</sup>

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217 That is, the group 33 intermediaries team—see paragraph 162 below.

218 That is, the group 33 escalating cases team—see paragraph 162 below.

219 Q 14

220 The Paymaster General has elsewhere defined 'playback' as a process "whereby the tax credit claimant would receive a playback of all the awards and the changes that had been made through the year, so [the claimant] had a clear statement"; HC Deb, 12 Jul 2005, col 753.

221 Q 360

140. Since we heard from the Paymaster General, COP 26 has been revised and re-issued, in March 2006. We take it from the Paymaster General's evidence to us that she is currently asking the Department to focus its resources on implementing the package of reforms announced in the PBR changes and on implementing matters associated with the award notice.

### **Future resources**

141. We have borne in mind the possible impact of the Government's efficiency programme on the resources HMRC has available to direct to tax credits. By April 2008, HMRC is required by Government targets to achieve efficiency savings of at least £507 million and reduce full-time equivalent (FTE) posts by 16,000 gross, 12,500 net of redeployment to front-line services.<sup>222</sup> This represents a 13% cut in staffing. HMRC states that its financial target is "primarily based" upon the achievement of the 16,000 gross reduction in FTEs, which it intends to reduce from about 98,000 at 1 April 2004 to about 85,000 at 1 April 2008.<sup>223</sup> It expects 80% of its projected savings to arise from its 'transactional services' workstream, which appears to include payment of tax credits.<sup>224</sup>

142. In 2004-05, the administrative cost of the tax credits scheme was £422 million and HMRC employed around 8,200 staff to deliver it.<sup>225</sup> This cost has increased significantly from that forecast in 2002, when the Government expected administering the regime for 6 million claimants would cost £300 million annually.<sup>226</sup> During our visit to the TCO in Preston, we were told that the TCO currently has 3,300 staff, of whom 2,800 are permanent, full-time staff, and between 250 and 500 are employed on fixed-term contracts. PCS expressed "serious concerns" about HMRC's capacity to implement "much needed administrative improvements" in the face of its plans to reduce the numbers of FTE posts:

The workforce within the TCO relies heavily on temporary staff and is continuing to employ fixed-term staff for long periods. There has been a continual extension of contracts that limits the job security and prospects for these staff.<sup>227</sup>

143. We asked the Paymaster General whether HMRC had considered reducing the number of staff on fixed-term contracts, by putting these staff on permanent contracts. The Paymaster General told us that appointing permanent staff "would generally be the policy of the Department", but undertook to provide us with details of the basis on which the Department recruits temporary staff.<sup>228</sup> We received that information from HMRC shortly

222 HM Revenue and Customs, *Annual Report 2004-05 and Autumn Performance Report 2005*, 19 December 2005, p 30

223 HM Revenue and Customs Spring Departmental Report 2005, Cm 6542, 16 June 2005, p 20

224 According to the Gershon review of public sector efficiency, ... "transactional services ... include the payment of benefits and pensions, the collection of taxes, charges or fees": Sir Peter Gershon, *Releasing resources to the front line: Independent Review of Public Sector Efficiency*, July 2004, para 2.2.

225 Comptroller and Auditor General, *Standard Report on the Accounts of the Inland Revenue 2004-05*, para 2.6 and table 5

226 Inland Revenue Regulatory Impact Assessment, 'The New Tax Credits', July 2002, para 2.24

227 Ev 173

228 Q 324

before we agreed this report. The Department explained that, in the TCO, it was currently using fixed-term staff “for seasonal and tactical reasons”.<sup>229</sup>

144. We asked HMRC officials how they expected the Department’s efficiency targets to impact on the delivery of tax credits, if at all. They told us that, in respect of tax credits, for the next two years “our real focus is on improving productivity and customer service” and that “the management team’s focus at the moment is on improving customer service and productivity”.<sup>230</sup> Sir David indicated that, following 2006–07, “we would look for TCO to be part of the productivity drive” across the whole of HMRC.<sup>231</sup> Richard Summersgill, Director of the TCO, agreed that, as the TCO became more efficient, it would be “able to reduce [its] size and contribute to the broader efficiency targets, and I think that will be a good sign of our success”.<sup>232</sup>

### *Our conclusions*

145. **Under the Government’s efficiency savings programme, HMRC is required to make a 13% cut in staffing by April 2008. We note evidence from HMRC officials that these efficiency savings are not expected to affect the TCO until 2007–08. We appreciate that staff numbers are not a measure of effectiveness. We nevertheless recommend that, prior to implementing any cuts in TCO staffing, the Government consider carefully whether such cuts will have a detrimental effect on the administration of tax credits. We intend to keep a watching brief on how the Government’s efficiency savings programme affects the administration of tax credits, as part of our broader interest in the Government’s efficiency savings agenda.**

## **Future improvements**

### ***a) Award notices, calculations and playback***

#### *i. Award notices*

146. On 26 May 2005, the Paymaster General undertook that HMRC would “review the effectiveness of information provided to claimants”, in particular by developing “solutions to reduce the number of cases where people receive unnecessary duplication of award notices”.<sup>233</sup> Since then, HMRC has worked in consultation with the voluntary sector to revise the format and content of the award notices sent to claimants. HMRC started issuing the revised notice to claimants on 6 April 2006. The revised notice contains a clear reference to the availability of COP 26, the revised version of which was also published on 6 April 2006.<sup>234</sup> Citizens Advice described the revised notice as “much improved”, but said that, because it also contained more information than previously, “for somebody whose circumstances are complicated, the award notice ... could be up to eight pages long, so ...

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229 Ev 193

230 Qq 453–54

231 Q 453

232 *Ibid.*

233 HC Deb, 26 May 2005, 22WS

234 Ev 193

people will still need help in understanding the figures on them”.<sup>235</sup> OPF commented that the new notices were “better from an adviser’s point of view—now, if you are an adviser, you can understand what is going on—but I think if you are a claimant it is still going to be quite difficult”.<sup>236</sup>

147. Witnesses representing claimant advisory groups told us that, despite the promise of improved notices, problems with award notices continued. Unnecessary duplication of notices appears to be a continuing problem: OPF told us there had been no progress towards achieving the 26 May undertaking to reduce the numbers of such cases.<sup>237</sup> In addition, claimants continue to receive large numbers of award notices, as an award notice is automatically issued to a claimant on each occasion that a change in circumstance is recorded—a Citizens Advice representative told us that she had had clients come to her with 30 or 40 notices.<sup>238</sup> Mr Field called for HMRC to make a greater effort to reduce the number of different notices that the HMRC can currently send to tax credit claimants:

According to the Tax Credit Manual there are 123 different forms which relate to the application and renewal of tax credits. The Committee should ask outside experts if it is possible to concertina these forms down to a maximum of, say, ten, which still provide claimants with accurate information.<sup>239</sup>

The CIOT commented that it was “difficult” to see how the number of award notices being issued could be reduced, “unless you did something about the number of changes that people have to notify”.<sup>240</sup>

148. In October 2005, the Paymaster General told us that, from April 2006, claimants would receive with their award notice a two-page summary document, which “explains the most important aspects of their award and tells them what information on their award [notice] needs to be checked”.<sup>241</sup> We have now seen a copy of this document, form TC602, which we understand is being issued alongside award notices. It is set out as a checklist of items which claimants should check for accuracy on their award notice.

### Calculations

149. Claimants are able to apply to HMRC for what is known as a TC647 form, which gives details of how their tax credit award was worked out. Between 3 March 2004 and 27 September 2005 around 370,000 TC647 forms were printed and issued to tax credit claimants.<sup>242</sup> A Citizens Advice adviser commented that “theoretically, you can ask for [these forms], but ... I have asked for them on numerous occasions and not yet received one. I think it is like a lot of things, they are technically available but in practice I have not

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235 Q 31

236 Q 28

237 *Ibid.*

238 Q 35

239 Ev 149

240 Q 72

241 Oral evidence taken before the Treasury Sub-Committee on Wednesday 26 October 2005, HC (2005–06) 524-i-ii, Q 168

242 HC Deb, 29 Nov 2005, col 349W

seen them.”<sup>243</sup> Mr Field believed that “the most important reform” the Government could make would be “to introduce a statement which clearly set out how the tax credit had been computed. Such a wage/tax credit slip is [already] produced (form TC647) but this form is only sent to claimants who request one.”<sup>244</sup>

### *Playback*

150. In October 2005, the Paymaster General told us that a new renewal notice would be introduced in 2006 so that, when a claimant received their renewals pack, they would receive a comprehensive ‘playback’ statement of the Department’s records of their income and circumstances for the previous year. The timetable for introducing playback appears to have slipped in the interim: in February, the Paymaster General told us that playback should be place in time for the 2007 renewal process.<sup>245</sup> New software is required in order for “the full playback” to be possible; the necessary changes to the IT system are scheduled to be made in November 2006.<sup>246</sup>

### *Our conclusions*

151. **We commend HMRC for recently introducing improved award notices, in consultation with the voluntary sector, and on the helpful two-page checklist which now accompanies award notices.** Such improvements should help to improve claimants’ understanding of their entitlement.

152. We appreciate that, to an individual claimant, being inundated with award notices may well be both confusing and burdensome. We acknowledge that, to some extent, the issuing to claimants of large numbers of award notices is an inevitable consequence of a tax credits regime which seeks to respond to claimants’ changing circumstances. It also appears to be a feature of the tax credits IT system, which is no doubt difficult to change. **We recommend that the Government work towards developing a more proportionate and flexible system for the issuing of award notices, in which notices are not issued for trivial changes in circumstance (for example, a change in phone number) and in which, at the time of reporting a change in circumstance, a claimant can choose not to receive a consequential notice.**

153. **We are concerned by evidence that claimants have experienced difficulties in obtaining form TC647, which sets out details of how their award was calculated.** According to the Paymaster General, only 370,000 TC647 forms were issued between 3 March 2004 and 27 September 2005. This figure seems surprisingly low, given that 1.9 million claimants were overpaid in 2003–04. In this regard, we note that the revised tax credits form does not appear to contain any reference to form TC647, or to a claimant’s ability to request such a calculation. **We recommend that the Government ensure that all claimants are made aware of, and regularly reminded of, their ability to request details of the calculation of their award entitlement.**

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243 Q 29

244 Ev 149

245 Q 326

246 *Ibid.*

154. We are disappointed that the Government's timetable for introducing an annual comprehensive 'playback' statement for an individual claimant, setting out HMRC's records of his or her income and circumstances for the previous year, appears to have slipped. We consider that the introduction of such a measure would be valuable, and we will continue to monitor progress on its implementation.

### *The helpline*

155. The helpline, or HMRC contact centre, is the first port of call for most claimants seeking to report changes in circumstances or to raise some other issue with HMRC. The Paymaster General's 26 May 2005 statement undertook that HMRC would:

... develop options to improve the quality of service on the helpline, in particular to ensure that helpline operators can track the progress of individual cases in the system, reducing the need for families to contact the helpline on multiple occasions.<sup>247</sup>

### *Quality of helpline advice*

156. The effectiveness and quality of helpline advice was a major cause of concern for most of our witnesses. Citizens Advice said its advisers "commonly report that when things have gone wrong, the helpline has been unable to explain what is happening with the case", and that "poor helpline advice causes serious problems".<sup>248</sup> When we asked witnesses what change they would make to the helpline tomorrow, were they in charge, a Citizens Advice representative told us that she would "skill-up the standard helpline to the level of the CAB helpline, because most of my clients can deal with their own problems if they have the level of support that we get".<sup>249</sup>

### *Limitations imposed by IT system*

157. Problems with the quality of helpline advice appeared closely connected with the limitations imposed on helpline adviser by the IT system. Citizens Advice commented that:

... there certainly appears to be an IT system problem. Different people are limited in the information they can give you. For instance ... I have found it very difficult to get more than one change of circumstance in a day recorded on a client's case – and, oddly enough, changing a mobile phone number is a change of circumstance, so it is not the sort of stuff that you or I would think to be important.<sup>250</sup>

158. Where claimants believe they have reported a change in circumstance, but this change is not recorded on the computer, claimants' only fallback appears to be reliance on the fact that all helpline calls are recorded.<sup>251</sup> This system appears to rely on claimants having

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247 HC Deb, 26 May 2005, 22WS

248 Ev 121

249 Q 39; the "CAB helpline" is part of group 33, discussed at para 162 below.

250 Q 35

251 Q 32

recorded the date and time at which they phoned the helpline, although even this is not without difficulties, as a Citizens Advice adviser explained:

The record of the call log is not anywhere near the computer ... My clients now know to ask the name of the person and to give the time and to get itemised BT bills; otherwise, we have found it very difficult even to prove that the call was made, because the call record is somewhere separate to the computer system.<sup>252</sup>

159. The Paymaster General's 26 May statement undertook particularly "to ensure that helpline operators can track the progress of individual cases in the system". Due to the limitations of the IT system, helpline advisers are apparently unable to see all details relating to an individual claimant's case on the screen at any one time. They also appear to lack the ability to track an individual's case history.<sup>253</sup> Citizens Advice believed that "improved management information" was needed "to ensure all correspondence regarding the same household [is] linked and accessible to an official looking at the case."<sup>254</sup> We asked the Paymaster General what progress had been made on this issue since May 2005:

Our helpline advisers still will not be able at the present time to get the full case review on the screen. That is tied into releases for software onto the computer system. At the moment I cannot recollect the date. I am not an IT specialist so I take advice from IT specialists in the Department who tell me when something can be done and when it cannot. If that is something that you particularly want to look at, how fast we can do them, when it is coming in and how we deliver it, we need to find a way to get that discussion going with the people who advise me.<sup>255</sup>

HMRC officials expanded on this point, indicating that making changes to enable staff to have the full case on screen was certainly desirable but not, as yet, practical:

... The construction of tax credits means that all that information is in one cell. So extracting that information out into a screen which would make a lot of good sense is, we are finding, very, very difficult to do, in fact I have not yet cracked it. ... That particular desired state is not what we are planning to do yet.<sup>256</sup>

### *Our conclusions*

**160. The tax credits helpline is the frontline for claimants making direct contact with HMRC. As such, it is critical that the advisers staffing it are thoroughly trained and properly equipped to perform their roles.** On the basis of evidence we have received and our visit to the TCO at Preston, it would seem that the specialist helplines for the voluntary sector and for Members of Parliament operate to a higher standard than does the general helpline. **We recommend that the Government ensure that all advisers staffing the general helpline are thoroughly trained, and that all helpline advisers receive the same high level of training and supervision.**

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252 Q 33

253 Ev 113

254 Ev 120

255 Q 337

256 Q 496

161. **We are concerned by the Paymaster General’s update to us on progress on her May 2005 undertaking to ensure that helpline operators can track the progress of individual cases in the system, and seek clarification from the Government on this point.** The Paymaster General herself told the House, less than a year ago, that this was a measure to which she was asking the Department to give priority, yet she suggests that progress on this measure is beyond her control, and entirely in the hands of the Department’s IT specialists. She offers to look particularly at making progress on this issue “if that is something that you [that is, the Sub-Committee] particularly want to look at”. **We can confirm that this is indeed an issue that we would like to see the Government taking forward as a matter of priority. We consider it is absolutely fundamental to the successful administration of tax credits that HMRC staff dealing with an individual claimant can see all relevant information pertaining to that claimant ‘at a glance’. We recommend accordingly.**

### **a) Dealing with complex cases**

#### **i. The escalating cases team**

162. Sir David told us that, whilst HRMC was limited by the need to try to provide a “plain vanilla service for everybody”, at the same time it was endeavouring to put “more focus on the really complex cases” and to “see whether we can use more skilled staff in those areas where people are most vulnerable and have the most difficult lifestyle change which we have to follow”.<sup>257</sup> A team in the TCO, known as “group 33”, is primarily responsible for dealing with complex cases. Group 33 was set up in January 2005 and consists of two parts:

- an escalating cases team (ECT), with 67 staff, which deals with claimants referred to it by the helpline—claimants cannot contact the team directly although, once a claimant has been referred, the escalation team will contact them via telephone; and
- an intermediaries team, also known as the CAB helpline, with 15 staff, which deals directly with voluntary sector advisers, via telephone.

163. Witnesses representing claimant interest groups welcomed the creation of the ECT, but had some reservations about its remit and capacity. For example, CPAG welcomed the introduction of a “separate team able to respond to more complex circumstances and, presumably, take ownership of particular cases” but was concerned about the team’s limited capacity, based on CPAG’s understanding that, as at Autumn 2005, the ECT had the capacity to deal with only around 1 in every 400 calls made to HMRC contact centres.<sup>258</sup> OPF reported that its initial evaluation of the complex cases process was positive, but expressed concern that the ECT was able to deal with only “a tiny proportion of cases, and, importantly, cannot deal with overpayments”.<sup>259</sup> Citizens Advice considered that it had not seen “any real improvement” as a result of the work of the team, “because it is simply too small as a team”, and recommended that the ECT should be enlarged to enable it to deal with all ‘problem’ cases until the current difficulties with the tax credits regime are resolved.<sup>260</sup> It suggested that claimants referred to the ECT could end up falling between

257 Q 497

258 Ev 113

259 Qq 165–166

260 Q 20

two stools, as they were unable to contact the ECT, so phoned the general helpline, only to find that “the helpline is simply unable to update the [claimant] on what is happening with their case”.<sup>261</sup>

164. Concerns were also raised about the way in which cases were referred to the ECT from the helpline. PCS said its members were concerned that “the focus is on quickly ‘clearing’ incoming telephone calls at contact centres, and then forwarding tens of thousands of difficult enquiries to specialists at the TCO, often staffed by fixed term appointees.”<sup>262</sup> Mr Field suggested that the existence of the escalating cases team risked downgrading the skills of helpline advisers, because:

... not all of us are bushy-tailed and literally learn everything about our jobs. If you think there is another group of people who might deal with an inquiry, the tendency must be—it is human nature—for some people to say, “I will pass it over to the clever boys and girls who are in the specialist team.”<sup>263</sup>

### *A caseworker-based approach*

165. A consistent theme throughout our inquiry was the suggestion that HMRC needed to institute a caseworker-based approach for difficult cases, so that a claimant would have a single point of contact to guide him or her through the system—“somebody I could physically talk to”, as one witness put it.<sup>264</sup> Although they acknowledged that the ECT was a move in the right direction, Citizens Advice, CPAG and OPF all felt that the most important change that could be made to the way in which tax credits are administered would be to “try to implement a whole case approach and put much more case management in place”.<sup>265</sup> They believed resources should be put towards this, to enable difficult cases to be referred on “very quickly”.<sup>266</sup> A Citizens Advice adviser suggested that a caseworker-based approach would address the current ‘segregation’ of claimants and their advisers, saying that, as an adviser, she was unable to talk to the ECT and could deal only with the CAB helpline.<sup>267</sup>

### *Our conclusions*

**166. We commend HMRC for the positive step it has taken towards improving the way it deals with complex cases, by setting up a specialist team for the express purpose of handling complex cases. We recommend that the Government give further consideration to ways in which it can implement a much more extensive caseworker-based approach for difficult or complex cases, so that a claimant would have a single point of contact to guide him or her through the system.**

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<sup>261</sup> *Ibid.*

<sup>262</sup> Ev 174

<sup>263</sup> Q 229

<sup>264</sup> Q 14 [Citizens Advice]

<sup>265</sup> Qq 20 [Citizens Advice] and 39 [OPF]

<sup>266</sup> *Ibid.*

<sup>267</sup> Q 14

### **Handling disputed overpayments**

167. During our visit to Preston on 13 March, TCO management told us that the TCO has recently been putting a great deal of resource into dealing with disputed overpayments. Since October 2005, an additional 500 staff have been deployed to the team which deals with disputed overpayments, meaning that about 1000 staff were currently engaged in this task. Nevertheless, the TCO was not meeting the target which the Paymaster General had set it, of reducing the backlog of unresolved disputes to the equivalent of four weeks' work—the backlog, at that stage, was 5 weeks. TCO management indicated that the fact the target was yet to be met was due to a lack of staff with the necessary level of expertise.

168. On 19 April, HMRC officials told us that the TCO is now meeting the four week target set by the Paymaster General.<sup>268</sup> We questioned whether meeting this target was actually an indication that the Department was on top of the overpayment problem. During our visit to the TCO in Preston, we were able to view a chart setting out the TCO's progress on processing disputed overpayments, which presented a rather more complex picture of progress on this front.<sup>269</sup> Information subsequently provided to us by HMRC shows that the number of disputed overpayments which it has "on hand" has declined, from 142,000 in April 2005 to 38,000 in March 2006.<sup>270</sup> The Department introduced a 'streamlined' procedure for considering disputed overpayments in Spring 2005, which we assume is partly responsible for this decline.

169. Whilst we are encouraged by the apparently substantial decline in the number of disputed overpayments awaiting consideration by HMRC, it is unclear how long the Department is taking to consider disputed overpayments, and what proportion of disputed overpayments it is writing off and on what basis. **We recommend that the Government publish data on the time taken to handle disputed overpayments. In addition to setting out average times, this data should also set out the numbers of disputed overpayments received in 2003–04, 2004–05 and 2005–06 and break down the time taken to process all of those disputed overpayments. We recommend that the Government also publishes data on what proportion of disputed overpayments it is writing off, and the basis on which they are being written off.**

#### **a) Writing off overpayments**

##### *i. Ombudsman's recommendation*

170. In her June 2005 report to the House, the Ombudsman recommended that the Government consider writing off all excess and overpayments caused by official error which occurred during 2003-04 and 2004-05.<sup>271</sup> She described as "striking" the "sheer range and extent of processing errors affecting tax credit claims during the first two years, leading to overpayments for which customers were not responsible, but which they had to repay."<sup>272</sup> Her recommendation was prompted by "customers' unfamiliarity with the new

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268 Q 570

269 Q 572

270 Ev 192

271 Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, recommendation 10

272 Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, para 5.61

system, its sheer complexity—particularly when customers’ circumstances change, and, above all, the wholly exceptional extent of the Revenue’s processing errors during the first two years.<sup>273</sup> In 2004–05, around 217,000 claimants asked HMRC to write off their overpayments on the grounds of official error, and another 54,000 requests were received in April and May 2005.<sup>274</sup>

171. In October 2005, Sir David told us that, of the 12 recommendations made by the Ombudsman, the only one which the Government had rejected outright was that it should consider writing off all excess and overpayments caused by official error which occurred during 2003–04 and 2004–05.<sup>275</sup> In the course of our present inquiry, he justified the Government’s decision on the basis that it struck a fair balance between the Government’s obligations to all taxpayers and its obligations to those claimants who received overpayments in 2003–04 and 2004–05 as a result of official error.<sup>276</sup>

### *The new streamlined procedure*

172. In Spring 2005, the Department introduced a new ‘streamlined’ procedure to enable it to clear a backlog of disputed overpayment cases arising from 2003–04.<sup>277</sup> This procedure appears to have resulted in a number of write-offs: between June and September 2005, HMRC wrote off overpayments to the value of around £125 million on the grounds of official error.<sup>278</sup> Shortly before we agreed this report, HMRC told us that it had ceased to use this procedure.<sup>279</sup> On 1 February, the Paymaster General confirmed that this procedure was still in operation; when we discussed the procedure with HMRC officials on 19 April, they said nothing to indicate that the procedure was no longer in use.<sup>280</sup>

173. At the time at which we heard from the Paymaster General and officials, little additional information was available about the streamlined procedure, because HMRC had refused to disclose the details of the criteria it was applying under the procedure.<sup>281</sup> The Paymaster General explained why the Government was refusing to make the criteria public:

The reason it is not available is because it is based on a risk-based compliance policy, and if we were to reveal what gets through then we would have a problem with compliance and people tailoring specifically to get through that compliance strategy ... Obviously what HMRC has to do is balance a number of things, the cost of

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273 *Ibid.*

274 HC Deb, 4 Jul 2005, col 100W

275 Oral evidence taken before the Treasury Sub-Committee on Wednesday 12 October 2005, HC (2005–06) 524-i-ii, Qq 94 and 95

276 Q 570

277 HC Deb, 26 May 2005, col 22WS

278 HC Deb, 10 Oct 2005, col 282W; HC Deb, 27 Oct 2005, col 497W

279 Ev 192

280 Q 385

281 *Ibid.*

investigation, various other concerns with regard to where the balance really lies. I am afraid I cannot be more specific than that.<sup>282</sup>

174. CPAG considered that the new procedure had “clearly led to a limited write-off” of overpayments.<sup>283</sup> The LITRG agreed, stating that “a great many more people have been let through under the streamlined procedure than were let through under the COP 26 processes”, and arguing that it was:

... vital from a fairness point of view that everybody who was rejected under COP 26 previously but whose overpayments are still being collected should have that opportunity of having the streamlined test applied to them so that they at least have the same chance as those who might have applied a little bit later on and got the streamline procedure applied to them.<sup>284</sup>

175. In the course of our visit to Preston on 13 March, we requested that the Government provide us with the criteria the Department is using in applying the streamlined procedure. We followed the matter up with Sir David on 19 April, who told us that the Government was working on its reply.<sup>285</sup> He rejected the suggestion that the Department was “attempting to make up a set of rules after the event ... and that a rather simpler judgment was made at the time”, which it was now seeking to rationalise.<sup>286</sup>

176. Shortly before we agreed this report, HMRC responded to our request for the criteria it was using in applying the streamlined procedure. The Department explained why it was now prepared to release the criteria:

Previously, while we were still operating the streamlined procedures we refused to publish details of the streamlined procedures on the basis that they involved a risk-based approach that meant we would not check low-risk claims in detail. Now we have ceased to use the procedures this logic no longer applies, not least because—given other changes to the procedures for dealing with disputed overpayments such as the introduction of suspension to recovery—we would not envisage using a the same matrix in future.<sup>287</sup>

177. The Department intended the streamlined procedure “to give relief in all cases where certain easily identifiable indicators pointed to a likelihood that relief was due and a relatively low risk of giving relief to claimants who were not entitled to it”.<sup>288</sup> The procedure relied on a “risk matrix based on modelling work that demonstrated a clear correlation between the number of award versions received by a claimant and the likelihood that official error was due”.<sup>289</sup> Under this risk matrix, HMRC wrote off the

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282 Q 386

283 Ev 112

284 Q 100

285 Qq 572–73

286 Q 574

287 Ev 192

288 Ev 192

289 *Ibid.*

overpayment on the grounds of official error in accordance with the following criteria. Cases which did not fit these criteria “were selected for detailed examination”.<sup>290</sup>

**Table 4: Criteria for write-off under the streamlined procedure**

<b>The overpayment is: <i>and</i></b>	<b>there are at least:</b>
£600 or less	4 award versions
More than £600 and less than or equal to £1,300	5 award versions
More than £1,300 and less than or equal to £2,000	6 award versions
More than £2,000 and less than or equal to £3,500	7 award versions

Source: HMRC, *Ev 192*

### ***Our conclusions***

178. We are pleased that the Government has finally disclosed the criteria it used in applying the ‘streamlined’ procedure, which was in place from Spring 2005 until at least 1 February 2006, and probably more recently than that. It is frustrating that the Government has chosen to disclose the criteria so late in our inquiry process, more than two months after we requested it, and well beyond the point at which we can reasonably seek comment from witnesses on the criteria. We would welcome an explanation of the relationship of the criteria chosen to the likelihood of error, as the criteria appear, on the face of it, to be arbitrary. Witnesses believed that this procedure had resulted in a significantly higher proportion of write-offs than had been the case under previous criteria.

179. We are concerned that claimants appear to have been treated differently, depending on whether their disputed overpayment was considered before or after the introduction of the streamlined procedure. Given that the streamlined procedure is no longer being applied, it is unclear if HMRC has returned to using the criteria in place prior to the introduction of the streamlined procedure, or if a further set of criteria is now being applied. We recommend that the Government ensure that those claimants whose disputed overpayments were not written off, prior to the introduction of the streamlined procedure, are given the opportunity to have their disputed overpayments reconsidered under the criteria applied in the streamlined procedure. We also recommend that the Government clarify what criteria it is now applying in considering disputed overpayments, given that the streamlined procedure is now in place.

### ***Level of service provided to Northern Ireland***

180. We heard evidence from Citizens Advice Northern Ireland and Advice NI, an umbrella group for independent advice organisations in Northern Ireland. According to their evidence, HMRC has reduced its capacity to deal face-to-face with claimants and advisers in Northern Ireland. Citizens Advice NI told us that, in April 2005—when Inland

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<sup>290</sup> *Ibid.*

Revenue merged with HM Customs and Excise—the Belfast customer services facility was moved to Preston:

That has removed a lot of key local contacts that we were able to build up in Northern Ireland to answer the complex or more involved cases ... Also, we have seen removed the facility for us to meet with HMRC representatives in Northern Ireland to talk about issues face to face. That whole area of local communication has been removed from Northern Ireland.<sup>291</sup>

181. There is also no representative from Northern Ireland sitting on the Tax Credits Consultation Group, which forms a point of contact between Government and stakeholder groups, including representatives from the other groups advising claimants from which we took evidence. Advice NI thought that an invitation may have been issued to the Advice Services Alliance in Northern Ireland.<sup>292</sup> Citizens Advice NI said that, if it wanted to have input into the group, it had to do so indirectly, via the main UK Citizens Advice organisation, which was “not an ideal situation obviously”.<sup>293</sup> **We recommend that the Government ensure that appropriate invitations have been issued to the Northern Ireland voluntary sector to be represented on the Tax Credits Consultation Group.**

## General conclusions

182. **Our overwhelming impression from considering how HMRC might improve its service to claimants is the extent to which the administration of the tax credits regime has been based around individual functions or tasks, rather than centred around the needs of claimants. This approach has had implications for TCO staff, who have been cut off in task-based silos, with no oversight of the whole tax credits process. Crucially, it has also had implications for claimants, who have been moved between these functional ‘silos’ with no one person having oversight of, or taking responsibility for, their case. If the design of the tax credits IT system did not institute this approach, it certainly perpetuated it.** As OPF put it, “it seems that HMRC designed a system that would work with the IT rather than that would work for claimants”.<sup>294</sup> HMRC officials told us that the system had been “designed as a transaction layer, not as a citizen layer”—that is, task-based, not claimant-centred—although officials also considered it was not “the computer alone” which had led to “the very functionalised way in which the TCO works”.<sup>295</sup>

183. **It is crucial that HMRC focus on what more it can do to institute a claimant-centred approach to administering tax credits. HMRC’s purpose in administering tax credits should be to provide a service to claimants. The quality of service provided to**

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291 Qq 112–113

292 Qq 115–116; the membership of the Tax Credits Consultation Group is: HMRC, the Department for Work and Pensions, the Chartered Institute of Taxation, the Low Incomes Tax Reform Group, Disability Alliance, One Parent Families, Child Poverty Action Group, Citizens Advice, Institute of Chartered Accountants for England and Wales, TaxSid, Gingerbread, Local Government Association and the TUC. Minutes of TCCG meetings are available at <http://www.hmrc.gov.uk/taxcredits/meetings.htm>.

293 Q 115

294 Q 6

295 Q 497

claimants by HMRC will be crucial to the success of the tax credits regime, and the critical measure of service will be what HMRC does with a claimant's report of a change in circumstance once it has received it. As Citizens Advice pointed out, one consequence of the fact that the tax credits regime gives claimants more money than its predecessor regimes is that, if administrative errors are made, claimants will incur more debt. HMRC has a responsibility to claimants to ensure that its administrative processes are geared around delivering reliable and predictable State assistance to those on low incomes.

184. We are encouraged that, on the basis of the evidence we have received and our visit to the TCO in Preston, the TCO's administrative processes seem to have begun to move in the right direction, towards a model in which staff are able to take greater oversight of the process. As the director of the TCO, Mr Summersgill, put it:

What we are actually beginning to do is move away from the very high degree of functionalisation towards giving groups of staff responsibility for a wider slice of the whole process. That is good for them in terms of job satisfaction and it is good for customers in [that] one person is more likely to be able to deal with the whole of the problem for a person.<sup>296</sup>

185. We commend HMRC for the moves it has made to deal better with complex cases and to improve the award notice, and for the introduction of the checklist which now accompanies the award notice. In addition to the specific recommendations set out above, we recommend that the Government ensure that the TCO continues to move away from a purely task-based approach to administering the tax credits regime, towards a much more claimant-centred approach.

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296 *Ibid.*

## 7 Availability of information about tax credits regime as a whole

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186. One theme which came through strongly in our inquiry was the apparently wide range of issues on which HMRC does not hold adequate information. For example:

- HMRC did “not yet have sufficient data to allow us to publish information on the causes of overpayments” (as at April 2005).<sup>297</sup>
- HMRC had no complete analysis of official error causing or contributing to overpayments (as at September 2005).<sup>298</sup>
- Although HMRC had evidence that tax credits had been targeted by organised criminals, particularly via the e-portal, the Department’s Internal Audit Office concluded that there was a lack of comprehensive information to allow a robust analysis of the problem (as at October 2005).<sup>299</sup>
- HMRC was still unable to give a final estimate of levels of claimant fraud and error in 2003–04 (as at 19 April 2006).<sup>300</sup>
- HMRC does not have information on the number of claimants whose awards have been reduced in order to recover an overpayment, nor on how many of this total have disputed this action.<sup>301</sup>
- Policy costings for package of reforms announced in the PBR were based on “incomplete and uncertain” information and “partial data” on tax credits overpayments since 2003-04; HMRC acknowledged that data available internally were “not as up-to-date or comprehensive as one might wish ... given all the IT difficulties there have been”.<sup>302</sup>

### Publicly available data

187. Mr Brewer had an interesting perspective on this point, as an independent researcher. He explained that HMRC’s own data was required if those outside HMRC were to be able to analyse the tax credits regime:

... apart from the administrative data that HMRC holds, there really is not another good data source that one can use to try to think about possible changes to tax credits policy. You just have to have HMRC's own administrative data. So it would certainly

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297 Letter to the Ombudsman from Nigel Jordan, Assistant Director of HMRC, 21 April 2005, Parliamentary and Health Services Ombudsman, *Tax credits: putting things right*, Appendix C

298 HC Deb, 12 Sep 2005, col 2387W

299 Comptroller and Auditor General, *Standard Report on the Accounts of the Inland Revenue 2004-05*, para 2.44

300 Q 568

301 Ev 147

302 Ev 190

be a great help to those outside government who are interested in policy-making to have access to such data ...<sup>303</sup>

Mr Brewer considered that HMRC publishes “very little of its own data”, and noted that the Institute for Fiscal Studies had “been critical for a number of years about how little information [the] Revenue publishes”.<sup>304</sup> He identified two different ‘degrees’ of publication:

There is publishing your own summaries of your own data, which is the first thing you would expect the Revenue to do, and the second thing, which it might resist for longer, is making that data open to everybody, so that they could do their own summary.<sup>305</sup>

Mr Brewer pointed to the DWP as a government department which does publish such data. He acknowledged that different legal issues might apply to data held by HMRC as compared with that held by DWP, but felt there was no reason in principle for any such distinction to be made.<sup>306</sup>

188. We raised with HMRC officials the question of the Department’s approach to publishing data about the tax credits regime. Sir David described the Department’s “direction of travel” as being a move towards bringing “more of the analytical information in our sort of annual reports and spring reports into the public domain, and obviously working with voluntary groups and sharing experiences ... there may be people outside who can see things more clearly and have got suggestions which obviously we want to take into the policy debate”.<sup>307</sup> We referred officials to the example of the DWP’s ‘Work and Pensions Longitudinal Study’, which was introduced in January 2004, and asked whether HMRC had considered doing something comparable. The study is intended to link benefit and programme information held by DWP on its customers with employment records from HMRC.<sup>308</sup> The DWP considers that the study offers the Department “the opportunity to significantly improve both [its] analytical evidence base and operational effectiveness”:

Its aims are focused around supporting the Department’s agenda for child poverty, welfare-to-work and retirement income planning policy, and enabling us to find out more about what works and what does not. This will, therefore, allow us increasingly to target our resources to the appropriate people, in the appropriate way.<sup>309</sup>

Examples of the uses to which the DWP is putting the longitudinal study include providing statistics, management information and research on the success of Jobcentre Plus in helping people into work and keeping them in work, determining the family unit for pensioners to establish overall pensioner income from benefits and aiding in the investigation of fraud.

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303 Q 214

304 *Ibid.*

305 *Ibid.*

306 Q 215

307 Q 592

308 [www.dwp.gov.uk](http://www.dwp.gov.uk)

309 *Ibid.*

189. Sir David told us that HMRC had “brought over” a member of staff from the DWP with experience of the longitudinal study, in order to try to improve the quality of its analytical work.<sup>310</sup> The Department was “working extremely closely” with the DWP on “developing very similar methodologies” to those in used in the longitudinal study, to look at “our ability to track samples and cohorts of customer groups over time to see the sorts of changes through which they go”.<sup>311</sup>

### Adequacy of management information

190. We asked officials how satisfactory they found the data available to them, as senior managers, as a basis for taking subsequent policy and operational decisions. We noted that, according to the NAO, in January 2004 an IT system release, which would have provided “management information systems” was only “part-delivered”.<sup>312</sup> Officials observed that, at the commencement of new tax credits, management information was not “necessarily always available as we would have liked it”.<sup>313</sup> However, officials felt that they had made progress since then in improving the level of management information available to them. A release which “went live” just before Easter this year had “actually added to the amount of management information we are now able to review and analyse”.<sup>314</sup> However, on the negative side, officials noted that the limitations of the IT system meant that the information “does not actually ... come out as you would hopefully ever expect, so we do have to still do an awful lot of manipulation of the data when it comes out to actually get it into a useable format, and that work is ongoing as we speak”.<sup>315</sup>

### Our conclusions

191. We are encouraged by the evident awareness amongst HMRC officials of the need to improve the analytical evidence base which is available to the Department as a basis for developing policy. Officials seemed prepared to learn from the experience of the Department for Work and Pensions in carrying out the Work and Pensions Longitudinal Study. The data which the IT system makes available to management is obviously still of limited use, although the Department is engaged in ongoing work to improve the quality of this data.

192. Despite this, it remains our experience that there appear to be serious deficiencies in the range of statistical data and information which HMRC holds about the operation of the tax credits regime. An example of such a deficiency arose in the course of oral evidence, when the Paymaster General indicated that she had not asked HMRC for an analysis of the

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310 Q 591

311 *Ibid.*

312 Comptroller and Auditor General, *Standard Report on Inland Revenue's 2003-04 Annual Accounts*, 1 October 2004, p 129

313 Q 452

314 *Ibid.*

315 *Ibid.*

current caseload of the group 33 complex cases team.<sup>316</sup> When we suggested this might be a useful analysis to ask for, she responded:

It might but I have to strike a balance between using the staff to run the system as opposed to using the staff to continually research and give me statistics that will not take it any further forward in improving the system but will detract them from running it. There is not bottomless access to analysis that can be done, however interesting we all might think it will be. I try and ensure that analysis is done where it is going to inform policy.<sup>317</sup>

193. An analysis of the current workload of the complex cases team strikes us as a good example of exactly the sort of data that *would* “inform policy”. Identifying the characteristics of cases which are not amenable to being dealt with at the ‘frontline’ of the tax credits regime, the helpline, would no doubt assist the Government greatly in designing processes specifically for such cases, which currently take up a disproportionate amount of staff time and departmental resource. **We consider that greater priority should be given to ensuring that HMRC collects and analyses such data as will enable the Government to improve the design of the tax credits regime. If the tax credits regime is to prove a success for all claimants, it is critical that the Government requires HMRC to take a thorough, planned approach to collecting data which will inform fine-tuning of the tax credits regime and appropriate deployment of departmental resources. We recommend accordingly.**

194. **However, it is not enough for the Government to ensure that HMRC collects appropriate and sufficient statistical data and information. We recommend that the Government also ensure that such statistical data and information is published, in a readily accessible form.** We believe that the Department would garner significant benefits from adopting a more open approach in respect of its work administering tax credits. Permitting, even inviting, independent researchers and academics to study, analyse and comment on the design and administration of the tax credits regime can only lead to a more informed public debate on the tax credits regime, which should in turn enable the Government to better understand the needs and changing circumstances of tax credits claimants.

195. Finally, we observe that the difficulties experienced by those outside HMRC in obtaining information about the tax credits regime have been made particularly evident to us in the course of this inquiry. HMRC did not provide a written memorandum in response to our initial call for evidence. Consequently, we wrote to the Paymaster General on 20 January, seeking a statement of the current status of HMRC’s administration of the tax credits regime, with particular regard to updating us on progress made on the six points identified in the Paymaster General’s statement of 26 May 2005, and seeking a summary of the most recent statistics HMRC held about levels of take-up of the child and working tax credits and levels of overpayments, broken down by income group where possible. Prior to her appearance before us on 1 February, we received nothing in writing from the

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316 Q 343

317 Q 344

Paymaster General. We subsequently received a 2,000 word statement from the Paymaster General.<sup>318</sup>

196. Subsequently, we requested supplementary written evidence from HMRC in respect of our visit to the TCO in Preston on 13 March and our hearing with officials on 19 April. At the time of agreeing this report, we were yet to receive this information. **We draw to the attention of the House the regrettable lack of priority which has been assigned to requests from this Committee for information central to our inquiry. We expect the Minister to ensure that the Department responds to requests from this Committee promptly.**

## 8 Design of the tax credits regime

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### Refining the design of new tax credits

#### a) *Childcare element of the working tax credit*

197. Claimants eligible for the working tax credit may qualify for the ‘childcare element’ of the working tax credit, although the childcare element is paid out with the child tax credit. According to the Paymaster General, 360,000 families are currently receiving the childcare element.<sup>319</sup> The childcare element is intended to help those parents who are eligible for it with the costs of “relevant” childcare.

198. The policy intention behind the childcare element received broad support from witnesses; CPAG, for example, described it as “important for overcoming barriers to work”.<sup>320</sup> However, those witnesses representing claimant groups expressed concern that the way in which the childcare element was delivered is unduly complex. The CIOT described the difficulties experienced by claimants:

... [claimants] have to notify these changes—childcare goes up and down; school holidays come and go; child minders come and go; jobs change—and the requirement to notify changes in childcare of £10 a week or more within a certain time and to be able to calculate all that, and [claimants] have to work out their costs for the last 52 weeks and average it, and if their costs are going to change they have to try and look forward 52 weeks, which is a very hard thing to do, to look forward and estimate what your childcare costs are going to be ...<sup>321</sup>

The CIOT concluded that “to be continually having to do this quite complex computation”, in order to claim the childcare element, seemed unduly burdensome.<sup>322</sup> Similarly, the LITRG considered that the “structure of childcare support within the working tax credit bears little resemblance to the reality of childcare arrangements” and that the current regime “requires people to predict the unpredictable”.<sup>323</sup> CPAG suggested that the poor design of the childcare element meant it was ineffective and a cause of overpayments: “take up is low, ill targeted on the poorest and subject to significant variation in level which itself may well lead to overpayments”.<sup>324</sup>

199. The CIOT, CPAG, LITRG and OPF all expressed support for removing the childcare element from the working tax credit and delivering the financial support it offers to claimants by some other mechanism.<sup>325</sup> The LITRG suggested that the childcare element

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319 Q 307

320 Ev 115

321 Q 94

322 *Ibid.*

323 Ev 105

324 Ev 115

325 Ev 102, 105 and 163

could be delivered via “a system of straight reimbursement ... or one where the state pays the support element to the childcare provider direct”.<sup>326</sup>

200. The Paymaster General appeared not to accept the points made by witnesses. She told us she was “of the view that the way we pay it ... is the correct way” and described it as “very successful ... in that there was a great deal said at the beginning that it would not work and the difficulties and should it not be paid to the provider and not the parent, and actually most of those forecasts of doom and gloom did not materialise”.<sup>327</sup> We pursued with her the question of whether financial support for childcare costs could be delivered in some other way. The Paymaster General responded:

Well, it could, but the question is whether it would be desirable. The point of tax credits and paying it to the parent is to put the power in the hands of the parent to determine the type of childcare that they require as opposed to specific provisions ... [problems with the childcare element are] not there at the moment in the quantities that demonstrate it is a structural problem or a policy issue which needs to be addressed.<sup>328</sup>

She also strongly implied that, if claimants are receiving overpayments as a result of over-claiming on the childcare element, it is their own fault:

Frankly, to tell us that you are claiming more childcare than you were paying, and that is how an overpayment would have accrued on childcare—it is difficult to think they did not know they were claiming more than they were paying.<sup>329</sup>

201. The Paymaster General indicated that HMRC lacked the information to enable it to model the implications of treating the childcare element differently within the existing regime, and HMRC officials told us that modifying the childcare element was not something they had modelled.<sup>330</sup> Nor did the Paymaster General appear to see a need for the Department to produce such information:

One of the problems is that people are very interested in the system and ask for lots of statistics which are not necessarily relevant to running the system and not what the system is designed to provide ...<sup>331</sup>

### *Our conclusions*

202. **We heard some compelling evidence from groups advising claimants that the childcare element of the working tax credit is unduly complex and a probable cause of overpayments.** Although these groups welcomed the financial support offered by the childcare element, they considered that the requirement to report even small changes in weekly childcare costs, and to work out average weekly childcare costs on both a

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326 Ev 105

327 Q 437

328 Qq 437 and 441

329 Q 440

330 Qq 439, 441, 595 and 596

331 Q 439

retrospective and forward-looking basis, was incompatible with many claimants' childcare arrangements.

203. **Despite this, HMRC has not undertaken any modelling to assess the implications of removing the childcare element from the working tax credit and delivering the financial support it offers to claimants by some other mechanism. The Paymaster General made it clear that she saw no point in undertaking such modelling, and suggested that it was difficult to understand how claimants could end up with overpayments as a result of claiming too much for childcare costs. From the evidence we have heard, claimants may well find the requirements associated with claiming the childcare element to be both complex and burdensome. It also seems to us that, because the amounts of money provided under the childcare element are quite generous, the potential for large overpayments is significant. We recommend that the Government examine whether the requirements associated with the childcare element are capable of being simplified. We also recommend that the Government seriously explore alternative mechanisms for delivering the financial support offered by the childcare element. If the Government decides not to pursue any of these alternatives, it should provide detailed reasons for this decision.**

### ***Family element of the child tax credit***

204. The family element of the child tax credit has a broad catchment: claimants with an income of up to £58,000 per annum may still be entitled to it, and nine out of ten families with children qualify.<sup>332</sup> The Government's intention was that the family element would recognise "the costs of parenthood borne by both middle and low income families".<sup>333</sup>

205. A number of our witnesses suggested that the administrative burden imposed on HMRC by the tax credits regime could be alleviated, and the tax credits regime simplified, by removing the family element of child tax credit and adding it to child benefit. Child benefit is a universal benefit; not everyone who receives child benefit also receives the family element of the child tax credit. As the CIOT explained, the family element covers "a very broad spectrum" and means that "you have got six million claimants in a system which is complex, but in fact for two million of them [that is, those receiving only the family element] it need not be because they need not be in the system anyway".<sup>334</sup>

206. The Association of Taxation Technicians (ATT) pointed out that "the maximum you are getting on the family element is £10.45" a week and that:

Although you would be widening the population who would be entitled to the family element if you added it to child benefit, it might be possible to tweak the figures. It is actually less than the normal child benefit for the second child.<sup>335</sup>

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332 [www.directgov.gov.uk](http://www.directgov.gov.uk)

333 HM Treasury and Inland Revenue, *The Child and Working Tax Credits. The Modernisation of Britain's Tax and Benefit System*, para 2.13

334 Qq 83 and 102

335 Q 163

207. The ATT thought that, as the withdrawal of the family element from the child tax credit would apply only “to the more wealthy claimants”, any overpayments which arose could be recovered through the income tax self-assessment or PAYE systems, as appropriate.<sup>336</sup> In this respect, the LITRG noted that those claimants receiving only the family element tend to receive a “fairly fixed” award.<sup>337</sup> The Institute of Chartered Accountants of England and Wales considered that, by failing to consider ideas such as adding the family element to the child tax credit, the Government had “missed an opportunity for a broader look at the tax credit system and a debate around some of these ideas”.<sup>338</sup>

208. We put the proposal to add the family element to child benefit to the Paymaster General. She told us that, although the implications of such a proposal had not been modelled, “it would be more expensive because child benefit is universal so if you gave the same to 100%, it would clearly cost you more”.<sup>339</sup> She was also concerned that such a modification would “have an interaction with the poverty targets, because what we are doing with the tax credit system is giving more to those who need it more, and [entitlement] tapers up the system [according to income]”.<sup>340</sup> HMRC officials told us that the Department had not done “detailed work” on assessing the pros and cons of removing the family element from the child tax credit and adding it to child benefit, although they reiterated the Paymaster General’s point about the probable costs of such a modification.<sup>341</sup>

209. The Paymaster General did not seem to think that the reduced administrative burden on HMRC that such a modification would achieve would compensate for the increased expense. She explained that “most people who are just on the family element ... just confirm to us the details of their income and then that is on automatic reconciliation and clarification in the system”—the implication, we assume, being that claimants who receive only the family element do not constitute a significant administrative burden.<sup>342</sup>

### *Our conclusions*

**210. A number of our witnesses also suggested that the administrative burden imposed on HMRC by the tax credits regime could be alleviated, and the tax credits regime simplified, by removing the family element of child tax credit and adding it to child benefit. The Government considers that such a modification would be “more expensive”, but was unable to comment in any detail, because HMRC has not modelled the implications of such a modification. We recommend that the Government examine in greater detail more efficient ways of delivering support, including the possibility of removing the family element from the child tax credit and adding it to child benefit.**

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336 Ev 97

337 Q 82

338 Ev 153

339 Q 434

340 *Ibid.*

341 Q 597

342 Q 436

## A regime of fixed awards?

211. In our Report on the Pre-Budget Report 2005, we briefly discussed the relationship between a tax credits regime in which awards respond to changes in a claimant's income and circumstances, and a regime in which awards are based on a claimant's income and circumstances in the previous year. Mr Robert Chote, director of the Institute of Fiscal Studies, neatly encapsulated the tension between these two models:

There has always been this choice to be made between having a system that is responsive but which has the potential then for overpayments and the associated difficulties, and something which involves fixed awards, which offers greater certainty to people but also cannot respond as easily when the circumstances get more difficult.<sup>343</sup>

In the course of our examination of the PBR 2005, the Chancellor of the Exchequer indicated that, if the package of reforms announced in the PBR “does not work and it is not going to be seen to be working”, the Government would then “have to look at” adopting a fixed awards regime in which tax credits awards are based on the previous year's income.<sup>344</sup> He told us that the Government would “continue to look at” such a possibility and that, if it became necessary, the Government would institute such a regime.<sup>345</sup>

212. Generally speaking, there seemed to be little support amongst our witnesses for returning to a regime of fixed awards. Amongst the groups advising claimants, OPF described itself as the organisation “most sympathetic” to the idea of returning to fixed awards, and emphasised that it would “want the idea of returning to fixed awards kept constantly under review, unless [the Government] can fix the current system”.<sup>346</sup>

We feel that we want the current system to work but we do not know whether it can yet. Until we have seen the improvements from the Pre-Budget Report, we will not know, but we do think it is worth still thinking about returning to a system of fixed awards because at the moment the system has been very unstable and has really affected the stability of income quite badly.<sup>347</sup>

213. Mr Brewer also made an interesting point, in respect of the package of reforms announced in the PBR, suggesting that these reforms had taken the design of the tax credits regime about as far as possible, if it was to continue to be a responsive regime:

It is very difficult to see what else could be done, whilst maintaining the principle of an annual cumulative system of tax credits, where your payments now depend on your income now. It is very difficult to see how you could preserve that principle but [undertake] any more reforms to reduce the problem of overpayments.<sup>348</sup>

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343 Treasury Committee, *The 2005 Pre-Budget Report*, Q 66

344 Treasury Committee, *The 2005 Pre-Budget Report*, Qq 327–328; see also; HC Deb, 5 Dec 2005, col 611 and col 57WS.

345 *Ibid.*

346 Qq 4 and 5

347 Q 4

348 Q 196

### ***Our conclusions***

214. We have not sought, in this inquiry, to ask whether the model of tax credits regime which the Government has adopted is the right model. Nor have we examined the pros and cons of the range of possible models. We note the Chancellor of the Exchequer's indication that he is keeping an open mind on the possibility of returning to a regime of fixed awards, in which entitlement is based on the previous year's income.

## 9 Conclusion

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215. The Government introduced new tax credits as a step towards achieving “three overarching objectives”:

- to provide adequate financial incentives to work;
- to reduce child poverty; and
- to increase financial support for all families.

According to the Paymaster General, the tax credits regime provides support for six million families and ten million children, as compared to 800,000 families who received support under the previous regime of family credit:

Put another way, over 19 million people in this country are benefiting from tax credits. That is seven times the level of family credit or nearly one in three of all people in this country.<sup>349</sup>

216. We support the principle of tax credits and are encouraged to hear that they are providing financial assistance to so many people, particularly families with children. Tax credits have succeeded both in achieving a significantly higher rate of take-up than was the case under previous regimes and in creating incentives for people to seek work.<sup>350</sup> We welcome the close attention that the Government continues to pay to improving the design of the regime, as evidenced by the package of reforms announced in the PBR 2005. We note that these reforms are not expected to be fully implemented until April 2008. Consequently, it will not be possible to assess the success of the design of the tax credits regime for several years—perhaps four years—as the reformed regime will need to be allowed to run for an annual cycle, and the data from that cycle will then need to be collected.

217. In the meantime, it is crucial that HMRC continues to push ahead with the fundamental shift in its departmental culture that is already, of necessity, underway. The difficulties associated with administering the tax credits regime have detracted from the regime’s successes and have had real impacts on the lives of some claimants. HMRC must remember that, as the Ombudsman put it, “the greatest difficulties are suffered by the core group that the tax credit regime is aimed at helping, namely families on low incomes.” Those families with the most fluctuating circumstances will often also be those families on low incomes, who are vulnerable to poverty. It is the needs of these families which HMRC must focus on, if the tax credits regime is to achieve its policy objectives of tackling poverty and making work pay.

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349 Q 307

350 Qq 304 and 307

# Conclusions and recommendations

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## Part A: Current issues

### Overpayments of tax credits

1. Recent research published by the Economic and Social Research Council Research Centre for Analysis of Social Exclusion indicates that the month-to-month incomes of low- to middle-income working families with children are considerably more volatile than might have been expected. We welcome the fact that such research has been undertaken: it offers valuable data to those involved in designing tax credits policy. We are pleased to see the Government funding such a study, which seems to us to offer precisely the sort of information the Government needs to enable it to provide State assistance in a way which fits with the income patterns of those targeted. We recommend that the Government direct additional resources to funding research likely to inform the formulation of tax credits policy. (Paragraph 21)
2. We are particularly struck by the Research Centre's findings that such families tend to budget over a month or less, rather than over the whole of a tax year, and that, in nearly a third of cases studies, income was more variable after including tax credits than before doing so. These findings suggest that the tax credits scheme, which is designed to deliver the correct amount of state assistance over the year as a whole, rather than over any shorter period, could be aligned more closely to the financial needs of such families. End-of-year adjustments in tax credit entitlement may come too late for such families, and any demand for reimbursement is felt very keenly by them. We suggest that there is evidence that determining awards over shorter time periods would reflect the needs of lower income families more accurately than annual awards. (Paragraph 22)
3. From the above figures it follows that about 30% of all overpayments are due to delays in reporting changes in families' personal circumstances, such as family breakdown or the establishment of new partnerships, or a child going to school or leaving home. However it is clear from the oral evidence from HMRC officials that the focus is on the other three categories of overpayment. We believe that enough attention has not been paid to the problems caused by families' changing circumstances and the difficulty of adjusting tax credits to reflect these. We therefore recommend that more research is undertaken into this, especially in view of impending changes in reporting requirements. (Paragraph 27)
4. The factors cited by the Paymaster General and her officials as contributing to the problem of overpayments do not appear to us to give a comprehensive account of the reasons which overpayments have arisen. While we are not in a position to draw up our own comprehensive list of factors resulting in overpayments, it is obvious to us that the Paymaster General's account makes no reference to causes of overpayments which have arisen as a consequence of the Department's own processes—for example, official error and IT system error. Rather, the Paymaster

General has referred only to those causes of overpayments which can be attributed to claimant error or omission, or to the design of the tax credits regime, or a combination of both. (Paragraph 28)

5. It seems self-evident to us that HMRC cannot take steps to improve the way in which it administers tax credits without first identifying, and developing a detailed understanding of, the factors which cause overpayments and the extent to which each individual factor has contributed to the overall overpayments problem. We recommend that, as a matter of priority, the Government provide a detailed breakdown of as much of this information as is currently available. (Paragraph 29)
6. It is clear that official error has been a cause of overpayments in a significant number of cases. The Paymaster General has said that no complete analysis exists of official error causing or contributing to overpayments. This is a significant gap in HMRC's understanding of the reasons why overpayments arise. If HMRC is to succeed in improving the administration of the tax credits regime, the first thing it needs to understand is what is going wrong within its own processes, before it looks to problems elsewhere. We recommend that the Government undertake a complete analysis of the incidence of official error and the extent to which it causes or contributes to overpayments, and that it publishes that analysis. If it is unable to carry out such an analysis, it should explain why. (Paragraphs 31 and 35)
7. Just as HMRC appears to have attempted no complete analysis of the contribution made by official error to overpayments, so we have seen nothing from the Department attempting to assess the contribution made by IT system error. Again, it seems obvious to us that HMRC must acquire a thorough understanding of the problems which have arisen if it is to succeed in improving the administration of the tax credits regime. We recommend that the Government undertake a complete analysis of the incidence of IT system error and the extent to which it causes or contributes to overpayments, and that it publishes that analysis. (Paragraph 49)
8. It is clear that the IT system which EDS delivered for the running of new tax credits was unsatisfactory in a number of respects. We have grave concerns about the wisdom of an agreement which then makes the payment of compensation to the affected government department by the provider of the unsatisfactory service contingent on that provider winning other contracts with government. Our concern is not that we believe the contingent payments will influence future decisions by government departments to award contracts, but that it will be impossible to be sure that they have not. The agreement has the appearance of impropriety, if not the fact. (Paragraph 50)
9. We also draw the attention of the House to the confidentiality agreement which formed part of this settlement, and which so constrained the Chairman of HMRC in his ability to respond to our questioning. We are extremely concerned that HMRC appears to be claiming to have effectively 'contracted out' of its obligation to be publicly accountable for its administration and expenditure, by virtue of having entered a private contract. The existence of such a confidentiality requirement also makes it impossible for the House to assess what happened in this particular case, and to seek to draw broader lessons from it about the problematic area of

government IT contracts. We recommend that the Government ensure that this particular settlement does not indicate the start of a trend on the part of public bodies towards agreeing such confidentiality requirements. We further recommend that the procurement, design, project management and delivery of the tax credits process and systems be independently examined by the National Audit Office, regardless of this agreement. (Paragraph 51)

### Recovery of overpayments

10. We endorse the Ombudsman's recommendation that HMRC should not seek to recover either an excess payment made in the current year, or an overpayment from the previous year, until it has come to a decision, based on all the relevant facts, as to whether or not the excess amount paid should be recovered in accordance with COP 26. We are pleased that the Government appears to have accepted this recommendation. However, we are concerned by the apparent lack of urgency in seeking to implement the 'pause' before recovery of an overpayment, and seek an explanation from the Government for the reasons for this delay. (Paragraph 58)
11. We understand that implementing such a pause may well be technically difficult, and that it is only one of a number of improvements which the regime requires. However, it is crucial, in the interests of natural justice, that excess payments and overpayments are not automatically recovered without due regard first being given to the principles set out in COP 26. It is unfortunate that implementation of this essential improvement appears to have been sidelined by the package of reforms announced in PBR 2005. We recommend that the Government reassess the priority which it appears to have assigned to this improvement. (Paragraph 59)
12. We recommend that, as a minimum, HMRC ensure it has written guidelines in place to assist staff in determining whether it was reasonable for a particular claimant to have thought his or her payments were right, in all the circumstances. The reasonableness test cannot be applied as a stringent objective test, but must take account of a claimant's circumstances, the clarity of the award notices issued to him or her and, where appropriate, any limitations on the claimant's capacity to understand an award notice. No doubt these requirements could place a heavy investigative burden on HMRC in certain cases. However, it seems to us that this is the price HMRC must pay if it is to continue applying a reasonableness test, rather than a test along the lines of the social security test, where overpayment of a benefit can be recovered only where the claimant has misrepresented or failed to disclose a material fact. (Paragraph 70)
13. The relevant statute law would appear to directly contradict HMRC's Deputy Chairman's statement that, in the benefits regime "there is not a statutory right of appeal in relation to recovering overpayments generated by official error". Such a right of appeal appears to be precisely what section 12 of the Social Security Act 1998 is intended to provide. (Paragraph 77)
14. We are bemused by the account of the law given by HMRC's Deputy Chairman, which appears to directly contradict the relevant statutory provisions. We invite the Government to clarify what it understands to be the rights of people receiving social

security benefits to an independent appeal of a decision to recover an overpayment. (Paragraph 77)

15. We strongly support the calls from the voluntary sector and the Ombudsman for the introduction of a right of appeal to an independent tribunal against a decision by HMRC on a disputed overpayment. We recommend that the Government introduce whatever legislation is necessary to enable claimants to exercise such a right of appeal, as a matter of priority. If the Government intends to delay still further on this matter, we recommend that it explain its reluctance to allow tax credits claimants access to justice, and that it report on the practical implications of introducing an independent right of appeal. (Paragraph 80)
16. We note that HMRC is considering, with the HMRC Adjudicator, if the Adjudicator might be able to provide a fast-track, independent review of decisions on disputed overpayments. Although it is unclear from the Paymaster General's statement, we assume that introducing such a regime would require the Adjudicator's remit to be extended. (Paragraph 81)
17. Even if the Adjudicator's remit were to be extended, we do not accept that such a review procedure is an adequate substitute for a right of appeal to an independent tribunal. We will continue to follow this issue closely, and will examine with interest any detailed proposals which may be forthcoming from HMRC and the Adjudicator. (Paragraph 82)

### **Fraud, error and organised crime**

18. We are concerned that it is now over two years since the end of the 2003–04 tax year, and yet HMRC is still to establish final levels of claimant error and fraud in the tax credits regime for that year. Given that the final figure is likely to be significantly higher than the interim figure of 3.4%, we question why the Department has not moved more quickly to establish a complete picture of patterns of claimant error and fraud in 2003–04, to put it in a stronger position to address the problem in more recent tax years. We recommend that the Government put appropriate procedures in place to ensure that similar work for tax years 2004–05 onwards is completed more promptly. (Paragraph 86)
19. On the basis of the information available to us at the present time, and given that a criminal investigation is underway, it would be inappropriate for us to comment on whether HMRC could have done more to prevent fraudulent claims from entering the tax credits system. At this stage, we are also not in a position to establish whether HMRC ought to have identified the problem at an earlier stage, or to have realised the vulnerability of the e-portal sooner. (Paragraph 102)
20. We note the Paymaster General's assurances that the Government has no current plans to reduce the numbers of staff working in tax credits compliance. In its response to this report, we recommend that the Government make a clear statement about its future plans for compliance, both in terms of levels of staffing and processes, to indicate how developed those plans are and to set out a timescale for any decisions it intends to take in this area. (Paragraph 103)

## Part B: Looking forward

### Package of reforms announced in PBR

21. As we said in our Report on the 2005 Pre-Budget Report, we welcome the fact that the Government is seeking to improve the operation of the tax credits regime by introducing a package of reforms. However, we remain concerned that the Government has said it is unable to provide a breakdown of the costs or yields of each individual measure within the package. We feel greater attention needs to be paid to trying to disaggregate the different costs of the present system, especially those associated with reporting changes of circumstances. We have received evidence which suggests that the costings for the package were based on “incomplete and uncertain” information, the use of which required HMRC to exercise “a substantial degree of judgement” and to make “a range of assumptions of a policy-related nature”. Given this, we question how the Government can be confident of its estimates of the overall costs of the package. (Paragraph 118)
22. The Government expects the package of reforms to be broadly revenue neutral, despite the fact that the decision to increase the disregard threshold from £2,500 to £25,000 will be costly. It follows that some or all of the remaining components of the package must be expected to reduce expenditure or yield revenue. (Paragraph 119)
23. We infer from this that the Government expects the reduction in expenditure or yield in revenue from the introduction of tougher reporting requirements for claimants to be significant. Claimants who do not report changes in circumstances to HMRC, or who negligently provide information, are liable to significant fines. We recommend that the Government clarify whether, as a result of the implementation of the PBR package of reforms, it expects to receive increased revenue from fines payable by tax credits claimants and, if so, by how much it expects revenue to increase. We seek an assurance from the Government that it will enforce the penalty regime proportionately, taking into account the circumstances in which an individual claimant finds him- or herself. We recommend that the Government undertake and publish a review of the operation of the system of fines after the first 18 months of operation. (Paragraph 120)
24. The existence of the disregard threshold means that those claimants whose income increases will receive the benefit of both their increased income and their unadjusted tax credits entitlement for the remainder of the tax year, before experiencing a drop in income in the following tax year. One effect of the ten-fold increase in the disregard will be that this drop in income may well represent a significant sum of money (depending on the amount of the increase in income). We recommend that HMRC make clear to all claimants who report an increase in income of between £2,500 and £25,000 that, if their other circumstances remain relatively unchanged, their tax credits entitlement in the following tax year is likely to drop, possibly by a significant amount. We do not consider this amounts to HMRC presuming to offer “financial advice” to claimants, as officials suggested: the purpose should be to make clear to claimants that they should not plan their financial arrangements on the basis that they will continue to receive their current level of tax credits payments. (Paragraph 126)

25. We have received evidence that the increase in the threshold will benefit only those claimants who see an increase in income in the current year as compared with the previous year, because the income disregard threshold is applied on the basis of comparison with the previous year's income. Claimants who, in the current tax year, see their income start and finish lower than the previous tax year but nonetheless rise within the year will receive no benefit from the increased threshold. We invite the Government to comment on whether it has considered ways of addressing this anomaly. (Paragraph 127)
26. The increase in the disregard of income to £25,000 creates a greater incentive for claimants to seek to substantially increase their tax credit entitlement by arranging for their annual income to fluctuate in alternate years. We recommend that the Government ensure it has adequate procedures in place to detect such abuse of the regime. (Paragraph 129)

### Improving HMRC's service to claimants

27. The Government expects the ten-fold increase in the disregard threshold to reduce the current level of overpayments by one-third. This suggests that the remaining two-thirds of overpayments arise as a result of changes in claimants' circumstances other than increases in income. Consequently, over the next few years, although the tax credits regime may see a decrease in the numbers of overpayments being made, levels of overpayments are likely to continue to be high. At the same time, claimants' problems may well become increasingly complex, as their case history within the regime lengthens. (Paragraph 132)
28. The contribution which HMRC's departmental culture may have made to the difficulties experienced by tax credits claimants is difficult to measure. We consider that the transfer from DWP to the Inland Revenue of administrative responsibility for delivering State assistance did require a culture shift on the part of the latter Department, in order to take account of the different objectives of funding Government expenditure through tax collection, on the one hand, and delivering State assistance to those in need, on the other. On the basis of the evidence we have taken and our visit to the TCO in Preston, it seems to us that HMRC has started to make the cultural transition required, although it still has some way to go. However, we are not convinced that the Paymaster General and the Department fully realise the extent to which HMRC needs to re-focus its administrative structures for tax credits around the needs of claimants. (Paragraph 135)
29. As we have already discussed, the Paymaster General's public account of the causes of overpayments referred only to those attributable to claimant error or omission or to the design of the tax credits regime. Her statement made no reference to causes of overpayments which have arisen as a consequence of the Department's own processes, such as official error and IT system error. We consider it would be much more helpful if the Department were to focus on the quality of the service it provides to claimants, rather than seeking to attribute the majority of problems with the tax credits regime to error or omission on the part of claimants. We recommend that the Government examines closely what contribution its own processes have made to the difficulties experienced with the tax credits regime. (Paragraph 138)

30. Under the Government's efficiency savings programme, HMRC is required to make a 13% cut in staffing by April 2008. We note evidence from HMRC officials that these efficiency savings are not expected to affect the TCO until 2007–08. We appreciate that staff numbers are not a measure of effectiveness. We nevertheless recommend that, prior to implementing any cuts in TCO staffing, the Government consider carefully whether such cuts will have a detrimental effect on the administration of tax credits. We intend to keep a watching brief on how the Government's efficiency savings programme affects the administration of tax credits, as part of our broader interest in the Government's efficiency savings agenda. (Paragraph 145)
31. We commend HMRC for recently introducing improved award notices, in consultation with the voluntary sector, and on the helpful two-page checklist which now accompanies award notices. (Paragraph 151)
32. We recommend that the Government work towards developing a more proportionate and flexible system for the issuing of award notices, in which notices are not issued for trivial changes in circumstance (for example, a change in phone number) and in which, at the time of reporting a change in circumstance, a claimant can choose not to receive a consequential notice. (Paragraph 152)
33. We are concerned by evidence that claimants have experienced difficulties in obtaining form TC647, which sets out details of how their award was calculated. We recommend that the Government ensure that all claimants are made aware of, and regularly reminded of, their ability to request details of the calculation of their award entitlement. (Paragraph 153)
34. We are disappointed that the Government's timetable for introducing an annual comprehensive 'playback' statement for an individual claimant, setting out HMRC's records of his or her income and circumstances for the previous year, appears to have slipped. We consider that the introduction of such a measure would be valuable, and we will continue to monitor progress on its implementation. (Paragraph 154)
35. The tax credits helpline is the frontline for claimants making direct contact with HMRC. As such, it is critical that the advisers staffing it are thoroughly trained and properly equipped to perform their roles. We recommend that the Government ensure that all advisers staffing the general helpline are thoroughly trained, and that all helpline advisers receive the same high level of training and supervision. (Paragraph 160)
36. We are concerned by the Paymaster General's update to us on progress on her May 2005 undertaking to ensure that helpline operators can track the progress of individual cases in the system, and seek clarification from the Government on this point. We can confirm that this is indeed an issue that we would like to see the Government taking forward as a matter of priority. We consider it is absolutely fundamental to the successful administration of tax credits that HMRC staff dealing with an individual claimant can see all relevant information pertaining to that claimant 'at a glance'. We recommend accordingly. (Paragraph 161)

37. We commend HMRC for the positive step it has taken towards improving the way it deals with complex cases, by setting up a specialist team for the express purpose of handling complex cases. We recommend that the Government give further consideration to ways in which it can implement a much more extensive caseworker-based approach for difficult or complex cases, so that a claimant would have a single point of contact to guide him or her through the system. (Paragraph 166)
38. We recommend that the Government publish data on the time taken to handle disputed overpayments. In addition to setting out average times, this data should also set out the numbers of disputed overpayments received in 2003–04, 2004–05 and 2005–06 and break down the time taken to process all of those disputed overpayments. We recommend that the Government also publishes data on what proportion of disputed overpayments it is writing off, and the basis on which they are being written off. (Paragraph 169)
39. We are pleased that the Government has finally disclosed the criteria it used in applying the ‘streamlined’ procedure, which was in place from Spring 2005 until at least 1 February 2006, and probably more recently than that. It is frustrating that the Government has chosen to disclose the criteria so late in our inquiry process, more than two months after we requested it, and well beyond the point at which we can reasonably seek comment from witnesses on the criteria. We would welcome an explanation of the relationship of the criteria chosen to the likelihood of error, as the criteria appear, on the face of it, to be arbitrary. Witnesses believed that this procedure had resulted in a significantly higher proportion of write-offs than had been the case under previous criteria. (Paragraph 178)
40. We are concerned that claimants appear to have been treated differently, depending on whether their disputed overpayment was considered before or after the introduction of the streamlined procedure. Given that the streamlined procedure is no longer being applied, it is unclear if HMRC has returned to using the criteria in place prior to the introduction of the streamlined procedure, or if a further set of criteria is now being applied. We recommend that the Government ensure that those claimants whose disputed overpayments were not written off, prior to the introduction of the streamlined procedure, are given the opportunity to have their disputed overpayments reconsidered under the criteria applied in the streamlined procedure. We also recommend that the Government clarify what criteria it is now applying in considering disputed overpayments, given that the streamlined procedure is now in place. (Paragraph 179)
41. We recommend that the Government ensure that appropriate invitations have been issued to the Northern Ireland voluntary sector to be represented on the Tax Credits Consultation Group. (Paragraph 181)
42. Our overwhelming impression from considering how HMRC might improve its service to claimants is the extent to which the administration of the tax credits regime has been based around individual functions or tasks, rather than centred around the needs of claimants. This approach has had implications for TCO staff, who have been cut off in task-based silos, with no oversight of the whole tax credits process. Crucially, it has also had implications for claimants, who have been moved

between these functional ‘silos’ with no one person having oversight of, or taking responsibility for, their case. If the design of the tax credits IT system did not institute this approach, it certainly perpetuated it. (Paragraph 182)

43. It is crucial that HMRC focus on what more it can do to institute a claimant-centred approach to administering tax credits. HMRC’s purpose in administering tax credits should be to provide a service to claimants. The quality of service provided to claimants by HMRC will be crucial to the success of the tax credits regime, and the critical measure of service will be what HMRC does with a claimant’s report of a change in circumstance once it has received it. As Citizens Advice pointed out, one consequence of the fact that the tax credits regime gives claimants more money than its predecessor regimes is that, if administrative errors are made, claimants will incur more debt. HMRC has a responsibility to claimants to ensure that its administrative processes are geared around delivering reliable and predictable State assistance to those on low incomes. (Paragraph 183)
44. We are encouraged that, on the basis of the evidence we have received and our visit to the TCO in Preston, the TCO’s administrative processes seem to have begun to move in the right direction, towards a model in which staff are able to take greater oversight of the process. (Paragraph 184)
45. We commend HMRC for the moves it has made to deal better with complex cases and to improve the award notice, and for the introduction of the checklist which now accompanies the award notice. In addition to the specific recommendations set out above, we recommend that the Government ensure that the TCO continues to move away from a purely task-based approach to administering the tax credits regime, towards a much more claimant-centred approach. (Paragraph 185)

### **Availability of information about tax credits regime as a whole**

46. We consider that greater priority should be given to ensuring that HMRC collects and analyses such data as will enable the Government to improve the design of the tax credits regime. If the tax credits regime is to prove a success for all claimants, it is critical that the Government requires HMRC to take a thorough, planned approach to collecting data which will inform fine-tuning of the tax credits regime and appropriate deployment of departmental resources. We recommend accordingly. (Paragraph 193)
47. However, it is not enough for the Government to ensure that HMRC collects appropriate and sufficient statistical data and information. We recommend that the Government also ensure that such statistical data and information is published, in a readily accessible form. (Paragraph 194)
48. We draw to the attention of the House the regrettable lack of priority which has been assigned to requests from this Committee for information central to our inquiry. We expect the Minister to ensure that the Department responds to requests from this Committee promptly. (Paragraph 196)

## Design of the tax credits regime

49. We heard some compelling evidence from groups advising claimants that the childcare element of the working tax credit is unduly complex and a probable cause of overpayments. (Paragraph 202)
50. Despite this, HMRC has not undertaken any modelling to assess the implications of removing the childcare element from the working tax credit and delivering the financial support it offers to claimants by some other mechanism. The Paymaster General made it clear that she saw no point in undertaking such modelling, and suggested that it was difficult to understand how claimants could end up with overpayments as a result of claiming too much for childcare costs. From the evidence we have heard, claimants may well find the requirements associated with claiming the childcare element to be both complex and burdensome. It also seems to us that, because the amounts of money provided under the childcare element are quite generous, the potential for large overpayments is significant. We recommend that the Government examine whether the requirements associated with the childcare element are capable of being simplified. We also recommend that the Government seriously explore alternative mechanisms for delivering the financial support offered by the childcare element. If the Government decides not to pursue any of these alternatives, it should provide detailed reasons for this decision. (Paragraph 203)
51. A number of our witnesses also suggested that the administrative burden imposed on HMRC by the tax credits regime could be alleviated, and the tax credits regime simplified, by removing the family element of child tax credit and adding it to child benefit. The Government considers that such a modification would be “more expensive”, but was unable to comment in any detail, because HMRC has not modelled the implications of such a modification. We recommend that the Government examine in greater detail more efficient ways of delivering support, including the possibility of removing the family element from the child tax credit and adding it to child benefit. (Paragraph 210)
52. We have not sought, in this inquiry, to ask whether the model of tax credits regime which the Government has adopted is the right model. Nor have we examined the pros and cons of the range of possible models. We note the Chancellor of the Exchequer’s indication that he is keeping an open mind on the possibility of returning to a regime of fixed awards, in which entitlement is based on the previous year’s income. (Paragraph 214)

## Background to new tax credits regime

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### Introduction

1. ‘New’ tax credits were introduced in April 2003. Two new tax credits were brought in:
  - the child tax credit, which the Government intended to be “a single, seamless system of support for families with children, paid directly to the main carer in a family”; and
  - the working tax credit, which the Government intended to pay “through the wage packet to people without children as well as families with children”.<sup>351</sup>

The Government intended new tax credits to “tackle child poverty and help to make work pay ... to tailor support to families’ specific circumstances, and to respond to their changing needs, providing most support when their need is greatest, for example, when they have very young children.”<sup>352</sup>

### The situation prior to April 2003

#### *b) Evolution of the tax credits scheme*

2. The new tax credits are part of a process of reform which started in May 1997, when the Chancellor of the Exchequer, Rt Hon Gordon Brown MP, invited Mr Martin Taylor, the then Chief Executive of Barclays Bank, to set up a taskforce “to advise on the reform of the tax and benefits systems”.<sup>353</sup> The taskforce’s terms of reference were to “... examine the interaction of the tax and benefits systems so that they can be streamlined and modernised, so as to fulfil our objectives of promoting work incentives, reducing poverty and welfare dependency, and strengthening community and family life.”<sup>354</sup> Within these terms of reference, the taskforce decided to concentrate on work incentives.

3. The taskforce’s report identified a number of criticisms of the effect of the existing tax and benefit systems on work incentives and the incomes of the low paid. The report discussed the ‘unemployment trap’ and the ‘poverty trap’: the former occurs where in-work support is not sufficient to make work worthwhile or provide adequate incomes for the low paid; the latter where the high rate of withdrawal of benefits as income rises deters the low paid from seeking to increase their earnings.<sup>355</sup> The report concluded that the impact of State benefits paid to those in work was “blunted by”:

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<sup>351</sup> HM Treasury and Inland Revenue, *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, April 2002; available at [www.hm-treasury.gov.uk](http://www.hm-treasury.gov.uk)

<sup>352</sup> *Ibid.*

<sup>353</sup> HM Treasury, *The Modernisation of Britain’s Tax and Benefit System: Number Two; Work Incentives: A Report by Martin Taylor*, 17 March 1998, para 1.01

<sup>354</sup> *Work Incentives: A Report by Martin Taylor*, para 1.02

<sup>355</sup> *Work Incentives: A Report by Martin Taylor*, para 3.04

- insufficient recognition of the costs of working (in particular, childcare);
- reluctance to take up entitlements because of the need to claim and the hassle and stigma involved;
- concerns about disruption to income and resulting cash-flow when benefit entitlements were introduced; and
- uncertainty about the level of in-work income.<sup>356</sup>

4. In the report, Mr Taylor noted that, at the time the taskforce was set up, “there was much speculation, by the very nature of my remit, that I should be tempted to advise that the tax and benefit systems should be fundamentally merged.”<sup>357</sup> He went on to explain why the report did not pursue “the issue of full-blown integration”:

For a start, the tax and benefits systems have traditionally had different objectives: the funding of Government expenditure and the relief of need, and although one can be seen as a negative version of the other, this inverse relationship is arguably superficial. Second, although many recipients of in-work benefits also pay income tax, more generally benefit recipients are not taxpayers. As a result of this, the collection and delivery functions, both in human terms and in terms of the technology used by the two systems, vary considerably. Finally, while taxation is paid by individuals, benefit is paid to household groups; both these arrangements are fiercely defended. Some may find this perverse or paradoxical; I think it just shows that the tax and benefit systems reflect the differences in their traditional objectives. I see no reason, however, why both systems cannot contribute to the same objectives, providing the means to improve work incentives and relieve poverty.<sup>358</sup>

5. To achieve the aim of improving work incentives, the taskforce recommended that the existing family credit should be replaced by a tax credit which would “associate the payment in the recipient’s mind with the fact of working” and would be likely “to prove more acceptable to society at large.”<sup>359</sup> This tax credit should be built on the existing system as this would also “allow the most rapid and least disruptive introduction for the tax credit”, rather than attempting to “replicate the very different structures” on which, for example, the United States’ Earned Income Tax Credit was based.<sup>360</sup> The taskforce considered that “the establishment of a tax credit system is likely to come in useful in future as a broader delivery mechanism, eventually allowing closer integration between the benefit system and conventional income tax.”<sup>361</sup>

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<sup>356</sup> *Ibid.*

<sup>357</sup> *Work Incentives: A Report by Martin Taylor*, para 1.10

<sup>358</sup> *Work Incentives: A Report by Martin Taylor*, para 1.11

<sup>359</sup> *Work Incentives: A Report by Martin Taylor*, para 1.22

<sup>360</sup> *Work Incentives: A Report by Martin Taylor*, para 1.23

<sup>361</sup> *Work Incentives: A Report by Martin Taylor*, para 1.22

### **The working families' tax credit**

6. As a result of the taskforce's report, the Government introduced the working families' tax credit (WFTC) and the disabled person's tax credit (DPTC) in October 1999, replacing the family credit (FC) and the disability working allowance (DWA).<sup>362</sup> The WFTC built on the structure of the FC, with entitlement based on a 'snapshot' of income and circumstances at the time of the claim and unaffected by changes in circumstance within the 26 week period of the award. The WFTC contained some new features, intended to improve work incentives and to lower marginal tax and benefit withdrawal rates for the families affected. These features included:

- a lower withdrawal rate—55%—than that of the FC—70%—and the level at which the tax credit started to be withdrawn was higher;<sup>363</sup>
- a new 'childcare tax credit', "designed to make support for childcare through the tax system more generous and more transparent", and replacing the childcare disregard in the FC;<sup>364</sup>
- payment through the pay packet, rather than to the main carer, in order to "reinforce the link between receipt of the credit and rewards of work".<sup>365</sup>

7. The Government emphasised that the WFTC was intended to be a "step towards greater integration of the tax and benefit system."<sup>366</sup> Further reform of the tax system followed in April 2001, with the introduction of the children's tax credit. This replaced the married couple's allowance and its related allowances, which were abolished from April 2000. The children's tax credit was intended to target resources "at lower and middle income families, with the credit tapered away from families where there is a higher-rate taxpayer."<sup>367</sup>

## **April 2003: the new tax credits**

### **a) The child tax credit and working tax credit**

8. In Budget 2000, the Government said that it was "determined to go further in improving the transparency and administration of income-related payments through the tax and benefit system", introducing "a more fundamental reform" than what had gone before.<sup>368</sup> In July 2001, the Government published a consultation document which described the primary aims of this next phase of reform as:

- separating support for adults in a family from support for children, so as to provide a clearer focus;

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<sup>362</sup> HM Treasury, *The Modernisation of Britain's Tax and Benefit System: Number Three; The Working Families Tax Credit and work incentives*, 17 March 1998

<sup>363</sup> *The Working Families Tax Credit and work incentives*, para 1.04

<sup>364</sup> *The Working Families Tax Credit and work incentives*, para 3.04

<sup>365</sup> *The Working Families Tax Credit and work incentives*, para 2.15

<sup>366</sup> *The Working Families Tax Credit and work incentives*, para 1.04

<sup>367</sup> HM Treasury, *Budget 2000*, HC 346, para 5.9

<sup>368</sup> *Budget 2000*, para 5.16; Inland Revenue, *New Tax Credits: supporting families, making work pay and tackling poverty: a consultative document*, July 2001, para 7

- making work pay for low-income households, including those without children, through the employment tax credit (now working tax credit);
- tackling child poverty and providing financial support for families with children, through the integrated child credit (now child tax credit) and child benefit;
- providing a common framework for assessing entitlement to income tax credits, based more closely on the rules and definitions of income on which people's tax bills are based; and
- rationalising administration by making one department, the Inland Revenue (now HMRC), responsible for administering all aspects of the Government's financial support for children, as well as income tax credits generally.<sup>369</sup>

9. The details of the next phase of reform were announced in Budget 2002.<sup>370</sup> Two new tax credits were to be introduced: the child tax credit (CTC) and the working tax credit (WTC). The CTC was to be “paid direct to the main carer, usually the mother”, which the Government described as “a single, seamless system of support for families with children, payable irrespective of the work status of the adults in the household”.<sup>371</sup> The Government intended the CTC to form “a stable and secure income bridge as families move off welfare into work” and to provide “a common framework of assessment so that all families are part of the same inclusive system and poorer families do not feel stigmatised.”<sup>372</sup> The Budget announced that, “in recognition of the costs of parenthood borne by both middle and low income families”, the CTC would be available to those on annual incomes up to £58,000.<sup>373</sup> The WTC was intended to “tackle poor work incentives and persistent poverty among working people” and to “extend support to low income working people without children aged 25 or over working 30 hours or more a week.”<sup>374</sup>

10. Budget 2002 also announced the introduction of a “modern income test”, building “on the definition of income [currently] used in the tax system”.<sup>375</sup> This new income test was intended to extend the approach taken with middle and high income families to all families. The Government explained that “aligning the income test for new tax credits with the income tax system means that income is looked at across the tax year as a whole” and that it meant “moving away from a system which excluded families with modest savings to one which, instead, takes into account the income from that capital, thus moving from a ‘means test’ to an ‘income test’.”<sup>376</sup>

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<sup>369</sup> *New Tax Credits: supporting families, making work pay and tackling poverty*, para 9

<sup>370</sup> HM Treasury, *Budget 2002*, HC 592, para 5.9

<sup>371</sup> HM Treasury and Inland Revenue, *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, April 2002, paras 2.3 and 2.15

<sup>372</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, para 2.3

<sup>373</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, para 2.13

<sup>374</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, para 2.4

<sup>375</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, para 2.13

<sup>376</sup> *Ibid.*

### **Rationale for new tax credits**

11. The Government considered that the new tax credits would provide “continuity of support for those who are not experiencing significant changes in circumstances or income, with the ability to adjust quickly for those who are facing major changes”.<sup>377</sup> This was in comparison to WFTC which was “relatively unresponsive to changing needs ... although WFTC awards can now be revisited if the family has a new child, the general rule is that, once an award has been made, it remains fixed for six months regardless of what happens to the family”.<sup>378</sup> The Government identified a number of advantages that it believed the new tax credits would have over the existing system, including:

- more generous provision than the existing tax credits;
- less form-filling, with one renewal process each year, rather than two;
- a fairer system, as awards would be based on family income for the whole of the tax year, rather than the short interval around the time an application was made; and
- a more responsive system, in that new tax credits could adapt to a family’s changing needs and circumstances during the tax year.<sup>379</sup>

Other improvements identified by the Government included better incentives for dual-income couples, better incentives to save, support for children paid directly to the main carer, a streamlined system of payment through the wage packet, more security on the move into work and a reduction in the stigma associated with being on a benefit.<sup>380</sup>

### **International comparators**

12. In arriving at a decision on how the new system should respond to changes in income and circumstance, the Government looked at similar systems in other countries, “such as Canada, which has a relatively simple and unresponsive system, and Australia, which has a very responsive system”.<sup>381</sup> These two systems “represented different trade-offs between competing objectives: providing certainty and administrative simplicity; and ensuring fairness, targeting support to needs and providing enough flexibility for families to choose to seek support when they need it”.<sup>382</sup> Neither system provided a model which the UK could replicate precisely:

The Canadian model is difficult to translate to the UK: the levels at which it provides support are relatively low, so targeting support to those who need it most is less relevant and it relies on provincial support systems to provide a safety net for falls in income. The Australian model is more generous and more closely targeted to family

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<sup>377</sup> *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, para 4.1

<sup>378</sup> *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, para 4.2

<sup>379</sup> *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, para 2.29

<sup>380</sup> *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, paras 2.29–30

<sup>381</sup> *The Child and Working Tax Credits: The Modernisation of Britain’s Tax and Benefit System*, para 4.15

<sup>382</sup> *Ibid.*

needs, but its first year of operation has demonstrated the risks, inherent in its approach to responsiveness, of a significant number of end-of-year debts.<sup>383</sup>

### **Design of the new tax credits**

13. The Government announced that the UK system would have three categories of change which could affect a tax credit award:

changes in the adults heading a household: for example, if a couple broke up or when people began living together as a couple;

changes in circumstances which determined the tax credits and elements for which claimants were eligible, such as the arrival of a new child or the use of qualifying childcare; and

changes in income between the current and previous year.<sup>384</sup>

Awards would be recalculated to reflect “all falls in annual income” and “rises in annual income of more than £2,500 a year, disregarding the first £2,500 of any rise”.<sup>385</sup>

14. The following table sets out the different elements of the CTC and WTC, and the amounts payable for each of those elements in 2006–07.

#### **The principal elements of the child and working tax credits**

Element	2006–07 annual amounts
<i>Working Tax Credit</i>	
<i>Child Tax Credit</i>	
Family element	£545
Family element (baby addition)	£545
Child element	£1,765
<i>Working Tax Credit</i>	
Basic element	£1,665
Couples and lone parent element	£1,640
Element for people working 30 hours a week or more	£680
<i>Childcare element of the Working Tax Credit</i>	
Maximum eligible cost for one child	£175 per week
Maximum eligible cost for two or more children	£300 per week
Percentage of eligible costs covered	80%

<sup>383</sup> *Ibid.*

<sup>384</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, para 4.6; the Government announced a broadening of these categories in the Pre-Budget Report 2005, p 96ff.

<sup>385</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, para 4.17; the Government announced an increase in the £2,500 disregard in the Pre-Budget Report 2005, p 96ff.

<i>Income thresholds and withdrawal rates</i>	
First income threshold	£5,220
First withdrawal rate	37%
Second income threshold	£50,000
Second withdrawal rate (per cent)	6.67%
Fist threshold for those entitled to Child Tax Credit only	£14,155
Income disregard	£25,000

*Source: HM Treasury, PN 02, 2005 Pre-Budget Report: Income tax allowances, national insurance contributions, child and working tax credit rates 2006-07 and fuel duties, 5 December 2005*

15. In calculating entitlement, HMRC adds together the different elements relevant to a particular family. In particular, families on income support, income-based jobseeker's allowance or with incomes below the first income threshold (£14,155 for families entitled to only CTC, or £5,220 for families entitled to WTC) are entitled to the maximum amount. In addition, families with income above the threshold receive less than the maximum—the award is gradually reduced at the rate of 37 pence for every pound of gross income above the threshold. The family element is then retained until income exceeds the second threshold of £50,000 a year, at which point this element starts to taper off.<sup>386</sup>

16. In 2003-04, the only year for which statistics on finalised annual awards are so far available, approximately 5.7 million families received tax credits. Of these:

- approximately 1.4 million were out-of-work families;
- of the approximately 4.3 million families in work, 2.09 million were entitled to the family element or less and 2.08 million entitled to more than the family element.<sup>387</sup>

17. Awards of the new tax credits were initially to be set on the basis of current circumstances and the previous tax year's income. The Government stated that, "if circumstances do not change and there are no significant changes in income, the award will run at that level until the end of the tax year ... once the system is up and running, awards will be able to run for 12 months at a time unless there is some reason for an adjustment".<sup>388</sup>

### **Levels of take-up of new tax credits**

18. According to the Government, there are currently six million families and 10 million children receiving tax credits, including 360,000 families being helped with childcare costs.<sup>389</sup> More working families appear to be receiving financial support for their children than was the case under the previous FC, as illustrated by the following table.

<sup>386</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, paras 2.21–24

<sup>387</sup> HM Revenue and Customs, *Child and Working Tax Credits Statistics: Finalised Annual Awards 2003-04*, p 3

<sup>388</sup> *The Child and Working Tax Credits: The Modernisation of Britain's Tax and Benefit System*, paras 4.3–4.4

<sup>389</sup> Q 307

### Numbers of families benefiting from Child and Working Tax Credit, as compared with Family Credit

	Numbers benefiting in 2003–04 <sup>390</sup>		
	Families	Children	Individuals
<b>Current tax credits</b>	5.9 million	9.9 million	19.4 million
<b>Previous system of Family Credit</b>	0.8 million	1.6 million	2.8 million

Source: evidence received from HMRC, 31 January 2006, Ev 170

19. The Government also states that the CTC and WTC provide more generous support than previously.<sup>391</sup> The table below shows the amount of support that a two-child family on half-male mean earnings (£15,400 a year) would receive.

#### Support provided to two-child family on half-male mean earnings (£15,400 a year)

	Award (2006–07 prices)
<b>Child and Working Tax Credit</b> (as at April 2006)	£82 a week (£4,200 a year)
<b>Working Families' Tax Credit</b> (as at April 2002)	£53 a week (£2,700 a year)
<b>Family Credit</b> (as at April 1999)	£18 a week (£900 a year)

Source: evidence received from HMRC, 31 January 2006, Ev 170

20. According to the Paymaster General, take-up rates for tax credits amongst families with children reached an “unprecedented level” in 2003–04. Government figures show take-up of about 80% overall, and 90% “for the poorest families”, which compares with 57% in the first year of the FC.<sup>392</sup> The Paymaster General told us that the level of take-up for new tax credits was seven times higher than that of FC, and that “the very poorest can now be receiving up to £107 a week compared with just £20 in 1997”.<sup>393</sup> She also told us that, since 1997, the lone parent employment had risen from 46% to 56% and “evidence suggests that tax credits contribute to nearly half of that rise”.<sup>394</sup>

### Administration of new tax credits

21. Prior to 18 April 2005 new tax credits were administered by the Inland Revenue. Since it merged with HM Customs and Excise on that date, the resulting Department, HM Revenue and Customs, has been responsible for their administration. In administering tax credits, HMRC has PSA targets for the length of time it takes to make decisions on claims, renewals and changes of circumstance and for the proportion it decides accurately. For

<sup>390</sup> 2003–04 is the most recent year for which data is available.

<sup>391</sup> Ev 170

<sup>392</sup> HC Deb, 2 March 2006, col 394

<sup>393</sup> Q 307

<sup>394</sup> *Ibid.*

example, HMRC estimates that it met these targets in 2004-05 but that it was unlikely to meet two out of three of the targets in 2005-06.<sup>395</sup>

**HMRC's achievement against the Service Delivery Agreement (SDA) targets supporting Public Service Agreement (PSA) 1: Deliver improvements in the number of individuals and businesses who comply with their obligations and receive their entitlements.**

	2004-05 target	2004-05 result
All new claims/renewals/changes of circumstances decided within 5 working days of receipt	55%	86.7%
All new claims/renewals/ changes of circumstances decided within 30 working days of receipt	95%	95.9%
All new claims/renewals/ changes of circumstances decided accurately	90%	96.5%

Source: *HM Revenue and Customs, Annual Report 2004-05 and Autumn Performance Report 2005, Cm 6691, pp 73-4*

22. On 26 May 2005, the Paymaster General made a written ministerial statement to the House, updating Members on the steps that HMRC was taking to address problems that had arisen in the administration of tax credits, which she said had affected “a small proportion of families”.<sup>396</sup> In her statement the Paymaster General set out six measures “to improve significantly the tax credits system, with particular regard to how the Department communicates with families about their tax credit award; reducing the risk of errors adding to the number of over-payments; [and] improving procedures for recovering over-payments.”<sup>397</sup>

<sup>395</sup> HM Revenue and Customs, *Annual Report 2004-05 and Autumn Performance Report 2005*, Cm 6691, p 74

<sup>396</sup> HC Deb, 26 May 2005, col 22WS

<sup>397</sup> *Ibid.*

# Formal minutes of the Treasury Sub-Committee

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Tuesday 23 May 2006

Members present

Mr Michael Fallon, in the Chair

Jim Cousins

Mr David Gauke

Ms Sally Keeble

Mr Andrew Love

Kerry McCarthy

Mr John McFall

Mr George Mudie

Mr Brooks Newmark

John Thurso

Mr Mark Todd

Peter Viggers

## *The administration of tax credits*

The Sub-Committee considered this matter.

Draft Report (The administration of tax credits), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 3 read and agreed to.

Paragraphs 4 and 5 read, amended and agreed to.

Paragraphs 6 to 14 read and agreed to.

Paragraph 15 read, amended and agreed to.

Paragraphs 16 to 21 read and agreed to.

Paragraph 22 read, amended and agreed to.

Paragraphs 23 and 24 read and agreed to.

Paragraph 25 read, amended and agreed to.

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 26).

A paragraph—(Ms Sally Keeble)—brought up, read the first and second time, and inserted (now paragraph 27).

Paragraph 26 read, amended and agreed to (now paragraph 28).

Paragraphs 27 and 28 read and agreed to (now paragraphs 29 and 30).

Paragraph 29 read, amended and agreed to (now paragraph 31).

Paragraphs 30 and 31 read and agreed to (now paragraphs 32 and 33).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 34).

Paragraph 32 read, amended and agreed to (now paragraph 35).

Paragraphs 33 to 37 read and agreed to (now paragraphs 36 to 40).

Paragraph 38 read, amended and agreed to (now paragraph 41).

Paragraphs 39 and 40 read and agreed to (now paragraphs 42 and 43).

Paragraph 41 read, amended and agreed to (now paragraph 44).

Paragraphs 42 to 46 read and agreed to (now paragraphs 45 to 49).

Paragraphs 47 and 48 read, amended and agreed to (now paragraphs 50 and 51).

Paragraphs 49 to 54 read and agreed to (now paragraphs 52 to 57).

Paragraph 55 read, amended and agreed to (now paragraph 58).

Paragraph 56 read and agreed to (now paragraph 59).

Paragraph 57 read, amended and agreed to (now paragraph 60).

Paragraphs 58 to 65 read and agreed to (now paragraphs 61 to 68).

Paragraph 66 read, amended and agreed to (now paragraph 69).

Paragraphs 67 to 99 read and agreed to (now paragraphs 70 to 102).

Paragraph 100 read, amended and agreed to (now paragraph 103).

Paragraphs 101 to 107 read and agreed to (now paragraphs 104 to 110).

Paragraphs 108 and 109 read, amended and agreed to (now paragraphs 111 and 112).

Paragraphs 110 to 114 read and agreed to (now paragraph 113 to 117).

Paragraph 115 read, amended and agreed to (now paragraph 118).

Paragraph 116 read and agreed to (now paragraph 119).

Paragraphs 117 and 118 read, amended and agreed to (now paragraphs 120 and 121).

Paragraphs 119 to 122 read and agreed to (now paragraphs 122 to 125).

Paragraphs 123 and 124 read, amended and agreed to (now paragraphs 126 and 127).

Paragraphs 125 and 126 read and agreed to (now paragraphs 128 and 129).

Paragraph 127 read, amended and agreed to (now paragraph 130).

Paragraphs 128 to 131 read and agreed to (now paragraphs 131 to 134).

Paragraphs 132 and 133 read, amended and agreed to (now paragraphs 135 and 136).

Paragraph 134 read and agreed to (now paragraph 137).

Paragraph 135 read, amended and agreed to (now paragraph 138).

Paragraphs 136 to 139 read and agreed to (now paragraphs 139 to 142).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 143).

Paragraphs 140 to 144 read, amended and agreed to (now paragraphs 144 to 148).

Paragraph 145 read and agreed to (now paragraph 149).

Paragraph 146 read, amended and agreed to (now paragraph 150).

Paragraphs 147 to 149 read and agreed to (now paragraphs 151 to 153).

Paragraph 150 read, amended and agreed to (now paragraph 154).

Paragraphs 151 to 153 read and agreed to (now paragraphs 155 to 157).

Paragraph 154 read, amended and agreed to (now paragraph 158).

Paragraphs 155 and 156 read and agreed to (now paragraphs 159 and 160).

Paragraph 157 read, amended and agreed to (now paragraph 161).

Paragraphs 158 to 163 read and agreed to (now paragraph 162 to 167).

Paragraph 164 read, amended and agreed to (now paragraph 168).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 169).

Paragraph 165 read and agreed to (now paragraph 170).

Paragraphs 166 and 167 read, amended and agreed to (now paragraphs 171 and 172).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 173).

Paragraph 168 read and agreed to (now paragraph 174).

Paragraph 169 read, amended and agreed to (now paragraph 175).

Paragraph 170 read, as follows:

**We are concerned that the Government has refused to give any indication of the criteria it is applying under the ‘streamlined’ procedure, which as been in place since Spring 2005. We requested such information over two months ago, but are yet to receive a response from the Government. Witnesses believed that this procedure had resulted in a significantly higher proportion of write-offs than was the case under the previous criteria. We are concerned that claimants appear to have been treated differently, depending on whether their disputed overpayment was considered before or after the introduction of the streamlined procedure. We recommend that the Government ensure that those claimants whose disputed overpayments were not written off, prior to the introduction of the streamlined procedure, are given the opportunity to have their disputed overpayments reconsidered under the new criteria currently in place.**

Paragraph disagreed to.

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 176).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 177).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 178).

A paragraph—(The Chairman)—brought up, read the first and second time, and inserted (now paragraph 179).

Paragraph 171 read and agreed to (now paragraph 180).

Paragraphs 172 to 174 read, amended and agreed to (now paragraphs 181 to 183).

Paragraph 175 read and agreed to (now paragraph 184).

Paragraph 176 read, amended and agreed to (now paragraph 185).

Paragraphs 177 to 183 read and agreed to (now paragraphs 186 to 192).

Paragraph 184 read, amended and agreed to (now paragraph 193).

Paragraph 185 read and agreed to (now paragraph 194).

Paragraph 186 to 188 read, amended and agreed to (now paragraph 195 to 197).

Paragraphs 189 to 193 read and agreed to (now paragraphs 198 to 202).

Paragraph 194 read, amended and agreed to (now paragraph 203).

Paragraphs 195 to 200 read and agreed to (now paragraphs 204 to 209).

Paragraph 201 read, amended and agreed to (now paragraph 210).

Paragraphs 202 to 204 read and agreed to (now paragraphs 211 to 213).

Paragraph 205 read, amended and agreed to (now paragraph 214).

Paragraph 206 read and agreed to (now paragraph 215).

Paragraph 207 read, amended and agreed to (now paragraph 216).

Paragraph 208 read and agreed to (now paragraph 217).

Summary read and agreed to.

Annex read and agreed to.

*Resolved*, That the Report, as amended, be the First Report of the Sub-Committee to the Committee.

*Ordered*, That the Chairman 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.

Several Memoranda were ordered to be reported to the Committee.

[Adjourned till Wednesday 24 May at 2.15 pm

# Formal minutes of the Treasury Committee

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**Tuesday, 23 May 2006**

Members present

Mr John McFall, in the Chair

Jim Cousins

Mr Michael Fallon

Ms Sally Keeble

Mr Andrew Love

Kerry McCarthy

Mr George Mudie

John Thurso

Mr Mark Todd

## *The administration of tax credits*

The Committee considered this matter.

Draft Report (The administration of tax credits), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 217 read and agreed to.

Summary read and agreed to.

Annex read and agreed to.

*Resolved*, That the Report, as amended, be the Sixth Report of the Committee to the House.

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

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

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

*Ordered*, That the Appendices to the Minutes of Evidence taken before the Committee be reported to the House.

Several Memoranda were ordered to be reported to the House.

[Adjourned till Wednesday 24 May at 9.00 am

## List of Witnesses

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### Wednesday 11 January 2006

**Ms Katie Lane**, Senior Policy Officer, Citizens Advice, **Ms Jackie Fielding**, Ev 1  
Income Maximisation Officer, Selby CAB, **Ms Kate Green**, Chief  
Executive, Child Poverty Action Group and **Ms Kate Bell**, Policy and  
Research Officer, One Parent Families

**Ms Liz Lathwood**, Technical Officer of the Personal Taxes Sub- Ev 13  
Committee and **Mr Robin Williamson**, Technical Director, Low Income  
Tax Reform Group, Chartered Institute of Taxation

### Wednesday 18 January 2006

**Mr Kevin Higgins**, Head of Policy and Research, Advice Northern Ireland, Ev 21  
**Caryl Williamson**, Regional Co-ordinator for Advice and Information,  
Age Concern Northern Ireland, **Ms Siobhan Harding**, Information and  
Policy Officer, Citizens Advice Northern Ireland and **Ms Andrea Bedell**,  
Senior Adviser, Ballymena CAB

**Jean Jesty**, President and Chairman of the Technical Committee, Ev 26  
Association of Tax Technicians and **Ms Jane Moore**, Technical Manager,  
Institute of Chartered Accountants in England and Wales

**Mr Mike Brewer**, Programme Director, Direct Tax and Welfare, Institute Ev 30  
for Fiscal Studies

### Wednesday 25 January 2006

**Rt Hon Frank Field MP**, Member of the House Ev 37

**Mr Ian Lawrence**, PCS Group Secretary and **Ms Lynne Wallace**, PCS Ev 45  
Representative Tax Credits Office, Public and Commercial Services Union

### Wednesday 1 February 2006

**Ms Dawn Primarolo MP**, Paymaster General, **Mr Tony Orhnia**, Director Ev 53  
of Personal Tax and Welfare Reform, HM Treasury and **Ms Sarah Walker**,  
Director of Benefits and Tax Credits, HM Revenue and Customs

### Wednesday 19 April 2006

**Sir David Varney**, Executive Chairman, **Mr Paul Gray**, Deputy Chairman, Ev 74  
**Mr Stuart Hartlib**, Director, National Compliance, **Mr Steve Lamey**, Chief  
Information Officer and **Mr Richard Summersgill**, Director, Child Benefit  
and Tax Credit Operations, HM Revenue and Customs

## List of written evidence

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1	Simon Abeles	Ev 92
2	Dame Barbara Mills QC, The Adjudicator	Ev 92
3	Advice NI	Ev 95
4	Association of Taxation Technicians	Ev 97
5	Chartered Institute of Taxation	Ev 100; 103
6	Chartered Institute of Taxation (Low Incomes Tax Reform Group)	Ev 103; 107
7	Child Poverty Action Group	Ev 112; 115
8	Citizens Advice	Ev 119; 124
9	Citizens Advice Northern Ireland	Ev 125; 135
10	Roger Cockfield	Ev 138; 140
11	Contact a Family	Ev 142
12	Rt Hon Frank Field MP	Ev 147; 150
13	Letter from the Deputy Chairman, HM Revenue and Customs	Ev 150
14	Institute of Chartered Accountants in England And Wales	Ev 151
15	Institute of Chartered Accountants in Scotland	Ev 155
16	Institute for Fiscal Studies	Ev 158
17	National Audit Office	Ev 159
18	One Parent Families	Ev 163; 166
19	Letter from the Paymaster General, HM Revenue and Customs	Ev 169
20	HM Revenue and Customs	Ev 170
21	Letter from David Laws MP	Ev 172
22	Letter from the Paymaster General, HM Revenue and Customs	Ev 172
23	Public and Commercial Services Union	Ev 173; 176; 177
24	Realistic Regulation for Consumer Credit	Ev 182
25	Redcar and Cleveland Borough Council	Ev 183
26	TaxAid	Ev 185
27	Mike Truman	Ev 188
28	Letter from HM Revenue and Customs to Mike Brewer, IFS	Ev 190
29	HM Revenue and Customs	Ev 191

## List of Reports from the Treasury Committee during the current Parliament

<b>Session 2005–06</b>		Report
First Report	The Monetary Policy Committee of the Bank of England: appointment hearing	HC 525
Second Report	The 2005 Pre-Budget Report	HC 739
Third Report	The Monetary Policy Committee of the Bank of England: appointment hearing for Sir John Gieve	HC 861
Fourth Report	The 2006 Budget	HC 994
Fifth Report	The design of a National Pension Savings Scheme and the role of financial regulation	HC 1074