



House of Commons
Committee of Public Accounts

HM Revenue & Customs: PAYE, tax credit debt and cost reduction

**Fifty-eighth Report of Session 2010–
12**

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

*Ordered by the House of Commons
to be printed 23 November 2011*

HC 1565
Published on 20 December 2011
by authority of the House of Commons
London: The Stationery Office Limited
£13.50

Committee of Public Accounts

The Committee of Public Accounts is appointed by the House of Commons to examine “the accounts showing the appropriation of the sums granted by Parliament to meet the public expenditure, and of such other accounts laid before Parliament as the committee may think fit” (Standing Order No 148).

Current membership

Rt Hon Margaret Hodge (*Labour, Barking*) (Chair)
Mr Richard Bacon (*Conservative, South Norfolk*)
Mr Stephen Barclay (*Conservative, North East Cambridgeshire*)
Jackie Doyle-Price (*Conservative, Thurrock*)
Matthew Hancock (*Conservative, West Suffolk*)
Chris Heaton-Harris (*Conservative, Daventry*)
Meg Hillier (*Labour, Hackney South and Shoreditch*)
Joseph Johnson (*Conservative, Orpington*)
Fiona Mactaggart (*Labour, Slough*)
Mr Austin Mitchell (*Labour, Great Grimsby*)
Nick Smith (*Labour, Blaenau Gwent*)
Ian Swales (*Liberal Democrats, Redcar*)
James Wharton (*Conservative, Stockton South*)

The following Members were also Members of the committee during the parliament:

Dr Stella Creasy (*Labour/Cooperative, Walthamstow*)
Justine Greening (*Conservative, Putney*)
Eric Joyce (*Labour, Falkirk*)
Rt Hon Mrs Anne McGuire (*Labour, Stirling*)

Powers

The powers of the Committee are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the internet via www.parliament.uk.

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) are on the internet at www.parliament.uk/pac. A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

Committee staff

The current staff of the Committee is Philip Aylett (Clerk), Lori Verwaerde (Senior Committee Assistant), Ian Blair and Michelle Garratty (Committee Assistants) and Alex Paterson (Media Officer).

Contacts

All correspondence should be addressed to the Clerk, Committee of Public Accounts, House of Commons, 7 Millbank, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5708; the Committee’s email address is pubaccom@parliament.uk.

Contents

Report	<i>Page</i>
Summary	3
Conclusions and recommendations	5
1 Processing of PAYE	7
2 Tax credits and child benefit	10
3 Reducing costs	12
Formal Minutes	15
Witnesses	16
List of printed written evidence	16
List of Reports from the Committee during the current Parliament	17

Summary

HM Revenue & Customs (the Department) faces a huge challenge to resolve long-standing problems with the administration of PAYE and tax credits while making substantial reductions to its running costs. The Department needs to stabilise its administration of PAYE following the problems encountered after a new processing system was introduced in 2009. It also needs to recover a significant amount of outstanding tax credit debt while minimising the amount of new debt being accumulated. While £900 million extra has been allocated to tackle tax avoidance, at the same time, following the 2010 Spending Review, the Department is required to reduce its running costs by £1.6 billion over the next four years.

We took evidence on two reports from the Comptroller and Auditor General which examined the Department's cost reduction programme and its administration of PAYE and tax credits.¹ We found that the Department was making concerted efforts to improve its administrative performance while reducing costs, although we have concerns about how coordinated those efforts are and the Department's ability to meet all of its intended objectives.

The Department has made welcome progress in improving PAYE administration since our last examination of this area in 2010. However, as a consequence of the Department's handling of the 2009 transition to the new PAYE Service, it has had to forgo up to £1.2 billion of income tax underpaid from 2004-05 to 2009-10. Under current plans, it will take until 2013 before all processing backlogs are cleared and the new PAYE Service is operating as intended. The Department needs to focus on improving data quality in particular to sustain progress in PAYE administration.

Levels of debt arising from overpaid tax credits have been rising in recent years. Without a clear plan for reducing tax credit debt, the level of uncollected debt will continue to rise to an estimated £7.4 billion by 2014-15. The Department has been forced to acknowledge that much of this debt will never be recovered from tax credit claimants, and recently wrote off some £1.1 billion of debt dating back to the introduction of the scheme.

The Department is preparing to introduce means testing to Child Benefit in 2013. However, as for tax credits, unless the Department can introduce systems that respond quickly to changes in circumstances, increasing numbers of families will find themselves receiving the wrong amounts and later being faced with repayment demands.

The Department has made plans to reduce its running costs by £1.6 billion (25% in real terms) by 2014-15. However, we are concerned that its plans are overly optimistic, including the intention to achieve more than one third of new savings in the final year of the Spending Review period. Furthermore, the Department has not yet built in any contingency to allow for setbacks in the 24 projects currently included in its savings programme. The Department also needs to be clearer about how its savings measures are

1 C&AG's Report, *Reducing Costs in HM Revenue & Customs*, HC 1278, Session 2010-2012; C&AG's Report, *HM Revenue & Customs 2010-11 Accounts: Report by the Comptroller and Auditor General*, HC 981, Session 2010-2012

likely to affect taxpayer compliance, to prevent the drive for cost reduction from having a counterproductive effect on its ability to collect tax revenues.

Conclusions and recommendations

- 1. The Department's administration of PAYE has improved, but it still has a huge backlog of records for manual reconciliation.** The new PAYE Service has finally begun to realise improvements and allowed the Department to improve its performance in issuing annual codes and reconciling the bulk of end of year returns on time – although at a cost of not being able to process all changes to taxpayers' PAYE records arising in-year. The Department still has a backlog of 6.7 million records to reconcile manually for the 2008-09 and 2009-10 tax years, and will have to manually process 3-4 million more for the 2010-11 tax year. The Department must maintain its programme to deal with the backlog by 2013 and not let it slip. It also needs to determine exactly how it will manage in-year changes going forwards, so amendments to taxpayer records are processed as people's circumstances change.
- 2. Increasing the accuracy of PAYE data is fundamental to implementing Real Time Information and stabilising the administration of PAYE.** The introduction of Real Time Information (RTI) is designed to allow the Department to update records as soon as taxpayers' circumstances change, making PAYE administration more accurate and efficient in the long run. RTI will significantly increase the amount of PAYE data collected, but it is still not clear how the Department will manage this additional data. The Department must have a clear plan for how it will use the increased volumes of data under RTI to update PAYE records. RTI is also essential for the Universal Tax Credit to function, so efficient implementation of RTI is vital.
- 3. We are concerned that the implementation of RTI should have proper regard to employers in small- and medium-sized enterprises.** Not all employers process their wages and salaries through the Bankers' Automated Clearing Services (BACS) system, and therefore providing the detailed information required under RTI could place an additional burden on them. The Department should take advantage of the pilot phase of RTI to assess the impact on small- and medium-sized employers, and ensure that the system can be introduced without placing unnecessary burdens on them.
- 4. The Department's strategy to reduce tax credit debt is not working and without new steps to improve the situation, debt levels are expected to increase to £7.4 billion by 2014-15.** The Department's efforts to get people on the right tax credit award have not gone far enough, and the resulting overpayments of tax credits place unacceptable burdens of debt on many people already suffering hardship. The Department recognises it will be impossible to recover much of this tax credit debt and has recently written off £1.1 billion of debt. The Department should focus its efforts on preventing the problem arising by minimising the number of incorrect tax credit awards it makes. It should also clarify its approach to reducing tax credit debt, including writing off debt where there is a value for money case for doing so.
- 5. Planned changes to Child Benefit may heighten the risk of incorrect payments being made.** Child Benefit will be means tested from 2013. Unless the Department introduces systems that process changes to people's circumstances quickly and accurately, more families will find themselves receiving the wrong amounts and later

being faced with demands for repayment. The Department has yet to decide the changes needed to the system for administering Child Benefit, pending final policy decisions to be made by HM Treasury. In redesigning the system, the Department should take account of the experience of tax credits so that it can minimise the levels of under and overpayments that arise because of changes in claimants' circumstances.

- 6. The Department does not fully understand the potential impact of cost reductions on customer service and taxpayer compliance.** The Department has modelled the effects of planned staff reductions on operational performance in the Personal Tax business area. It has also conducted some initial modelling which indicates that reducing resources may lead to a fall in voluntary compliance with tax rules. Small percentage changes in taxpayer compliance could have large adverse consequences on tax revenues. It would therefore be a false economy to reduce costs if that resulted in damage to the Department's ability to collect tax revenues. The Department must extend its modelling to cover the risks and potential consequences of cost reductions on customer service and taxpayer compliance, and use the results of this modelling to inform its future approach to making cost reductions.
- 7. The Department's cost reduction plans appear over-optimistic and are not supported by adequate contingency plans.** The Department is relying on delivering all savings as planned across the 24 projects currently in its savings programme, including making one third of the savings in the final year of the Spending Review period. It has not built in contingencies for any failures to make the required reductions, relying instead on simply speeding up the delivery of other planned savings. The Department must demonstrate the credibility of its cost reduction programme by testing the realism of its plans, including their sensitivity to changes in the assumptions made, and ensuring adequate contingency is built in.
- 8. The scale and speed of change planned will place significant additional demands on the Department's management capacity.** All of the projects have started, although some are still in planning and design phases. With a programme of this size, it needs to understand the linkages between projects and be able to respond early and in a coordinated way to any slippage. Continuity in project management is also critically important. The Department must ensure its project management arrangements provide clear evidence on the progress of all projects against the critical path for delivery, so that it has early sight of under-delivery, understands the consequences on other projects and can respond quickly. It should also ensure that staff are held accountable for delivery against key milestones.

1 Processing of PAYE

1. The Department faced significant operational challenges in 2009-10 following its implementation of the new PAYE and National Insurance Service (the PAYE Service).² Since the Committee last considered PAYE in 2010, the Department has begun to use new computer systems to accelerate its processing and bring PAYE administration up to date. In the last year it has completed the automated reconciliation of individual records for the 2008-09 and 2009-10 tax years and is currently reconciling records for 2010-11.³ It also issued new tax codes in advance of the 2011-12 tax year.⁴

2. It will not, however, deliver its plan for a fully stabilised PAYE Service until 2013.⁵ To achieve this, it needs to complete the reconciliation of taxpayer records that can only be cleared manually by its staff and establish a plan for clearing changes to individuals tax records as they arise through the year.⁶

3. Some 6.7 million records for 2008-09 and 2009-10 are being reviewed manually before they can be reconciled.⁷ While 39% of these cases have been cleared, this work will not be completed before March 2012.⁸ The Department will then clear similar cases for 2010-11 and 2011-12 by March 2013. It estimates that 3 to 4 million taxpayers' records will have to be manually reviewed as part of each end of year reconciliation. Prior to the introduction of the new PAYE Service, between 16-17 million records were manually reconciled each year.⁹

4. In-year changes to PAYE are triggered by letters and telephone calls, as well as by new information generated by the Department's own processing. The Department receives 9.5 million letters and 16 million telephone calls on personal tax issues a year. It has prioritised the clearance of post, and now has only five days' post on hand, and is working to improve its handling of telephone calls.¹⁰ In addition, day to day processing by the new PAYE Service generates "work management" cases which also have to be reviewed by the Department's staff. These cases arise for a variety of reasons, including potential mismatches between records, repayments identified for compliance checking, or new information on taxable benefits, such as company-paid health insurance or a company car. As a consequence of diverting staff resources to end of year reconciliations and annual coding, the Department does not have all the resources it needs to process in-year changes as they occur, leaving some to be captured as part of its end of year reconciliation.¹¹ The

2 Q 42, Public Accounts Committee, Eighteenth Report of Session 2010-11, *HM Revenue and Customs' 2009-10 Accounts*, HC 502

3 C&AG's Report on the 2010-11 Accounts, para 22

4 Q 57, C&AG's Report on the 2010-11 Accounts, para 22

5 C&AG's Report on the 2010-11 Accounts, para 3.35

6 Q95, C&AG's Report on the 2010-11 Accounts, para 3.30, 3.37

7 Q 42

8 Q 57

9 Q 42

10 Qq 90-91

11 Q 86

Department is reviewing PAYE work management items to determine which ones really need to be cleared in-year to keep individual records up to date.¹²

5. Some 85% of people pay the right amount of tax in the year through the PAYE system. Where people have not paid the right amount of tax, for example where their taxable benefits change in-year, the Department collects any underpayment in the following year.¹³ For 2008-09 and 2009-10 the Department has so far identified 1.1 million underpayments worth £1.1 billion, compared with its expectation of 1.1 million underpayments worth £1.4 billion.¹⁴

6. The transition to the new PAYE Service has been costly, with an estimate of up to £1.2 billion in income tax revenues lost from 2004-05 to 2009-10 (Figure 1).¹⁵ These revenue losses have arisen for a number of reasons: most notably because the Department was unable to clear the backlog of un-reconciled taxpayer records in the predecessor PAYE system before it ran out of time, and also because of its decision to temporarily increase the threshold for the recovery of underpayments from £50 to £300 for 2007-08 to 2009-10.¹⁶ It has not yet quantified the revenue loss from its failure to reflect the state pension of 250,000 new pensioners in their tax codes.¹⁷ The Department reintroduced the £50 underpayment threshold in 2010-11, and is now completing the end of year reconciliations in time to collect underpayments of tax.¹⁸

12 Q 95

13 Q 66

14 Qq 67-71, C&AG's Report on the 2010-11 Accounts, para 3.22 Fig 9

15 Q 58

16 Qq 44-54

17 Qq 55-56

18 Qq 57, 62

Figure 1: Estimate of Income Tax Forgone

Years	Amount	Description
2004-05 2005-06	£150 million	Notional estimate of underpayments not collected following changes in the time limits for recovery introduced in the Finance Act 2008
2006-07	£500 million	Notional estimate of underpayments not collected
2007- 08	£126 million	Notional estimate of underpayments not collected
2007-08 2008-09 2009-10	£266 million	Underpayments not collected following the temporary increase in the threshold for recovery from £50 to £300
2008-09 2009-10	£41 million	Underpayments not collected following successful claims for remission under Extra Statutory Concession A19
2008-09 2009-10	<i>Not quantified</i>	Tax forgone as a result of its failure to reflect the state pension of 250,000 new pensioners in their tax codes

Source: C&AG's Report¹⁹

7. The Department is working to improve PAYE data quality. It reviewed 11 million records before it issued tax codes for 2011-12, and has assessed the accuracy of the codes issued at over 98%. It has also improved the first-time matching of employers' data with its records to 98.3%, above the 98% threshold required for Universal Credit. The Department recognises that it needs to improve PAYE data quality further. It is working to understand where data quality problems are arising in PAYE, introducing customer relationship managers to work with employers to improve PAYE data quality, and cleansing the records of taxpayers who have at some stage been given temporary national insurance numbers.²⁰

8. The Department told us the Real Time Information programme (RTI) for PAYE is on track and will be delivered on time. Some 320 volunteer employers, representing more than 1 million taxpayers, will participate in a 12 month pilot starting in April 2012.²¹ Receiving PAYE data in real time will help the Department identify when income changes to the point where tax and/or benefits should change, and thereby enable it to avoid making over and underpayments. The Department acknowledges that the RTI processes will introduce new challenges for its governance and control of tax and benefits.²² It will, for example, need to determine how it will manage the increased volume of data under RTI, and how it will act on this information; in particular, how the decisions to change tax and benefits will be made, and how they will be communicated to individuals, their employers and other stakeholders. The implications of RTI for employers will vary according to whether, and to what extent, they operate the Bankers' Automated Clearing Services (BACS) system.²³

19 Qq 44-56, C&AG's Report on the 2010-11 Accounts, para 3.10-3.11, 3.23-3.25, and 3.31

20 Qq 79, 81

21 Qq 102, 103

22 Qq 109-111

23 Q 79

2 Tax credits and child benefit

9. Tax credit debt stood at £4.7 billion at the end of March 2011.²⁴ The Department's campaign to collect £550 million of newly established tax credit debt has met with limited success, with only £170 million collected or cleared after five months.²⁵ It estimates that £1.7 billion of new tax credit debt will be generated in 2011-12 and that the overall level of debt could increase to £7.4 billion by 2014-15 without further intervention.²⁶ The Department has reviewed £1.7 billion of tax credit debt no longer under active recovery, and considers that it is no longer value for money to pursue further the collection of £1.055 billion.²⁷ This debt relates to overpayments between 2003-04 and 2008-09, for which it has either received no payment in the past 12 months or the individuals cannot be traced.²⁸ The department's limited success to date on collecting debt means that the challenge to meet the new targets set is substantial, especially in the context of reducing departmental resources.

10. In October 2010 HM Revenue and Customs and the Department for Work and Pensions launched a Joint Strategy to reduce the level of error and fraud in the benefits and tax credit systems. At the time the Joint Strategy was published the estimated level of error and fraud was £5.2 billion, comprising £2.1 billion from tax credits and £3.1 billion from benefits. The Joint Strategy aims to reduce this figure by £1.4 billion, or around a quarter, by 2014-15.²⁹

11. Separately, as part of the Spending Review 2010, the Department has committed to prevent losses from error and fraud in tax credits of £8 billion over the next four years. In 2011-12 it will deploy around 1,770 full time equivalent staff to meet this commitment. Forty-two staff are currently deployed on working with the Department for Work and Pensions on specific projects under the Joint Strategy.³⁰

12. As well as preventing losses from error and fraud in tax credits, the Department is required to implement the Government's welfare reforms to reduce its expenditure on Child Benefit, tax credits and other welfare entitlements by £8.3 billion over the four years to 2015. Some £5.5 billion of the savings are due to come from the planned withdrawal in 2013 of Child Benefit from higher rate taxpayer families.³¹ The Department has yet to determine the changes needed to its administrative systems, pending final decisions from HM Treasury on the nature of the benefit.³²

24 C&AG's Report on the 2010-11 Accounts, para 4.15

25 Q 210, C&AG's Report on the 2010-11 Accounts, para 4.18

26 C&AG's Report on the 2010-11 Accounts, para 4.15 and 4.17

27 Q 223

28 Q 211

29 Qq 228-232; Ev 38

30 Ev 38

31 Q 96 and C&AG's Report on cost reduction, para 1.8

32 C&AG's Report on cost reduction, para 1.9

13. The Department acknowledged that the introduction of means testing means changes in entitlement to Child Benefit as people's circumstances change and to the prospect of having to recoup overpayments (as for tax credits).³³ It envisaged that where claimants notified it of changes in their circumstances it would be necessary to make in-year adjustments to the benefit paid. Otherwise there would need to be retrospective adjustments in the following year.

3 Reducing costs

14. The 2010 Spending Review required the Department to reduce its running costs by 25% in real terms by 2014-15. This amounts to cumulative cash savings of £1.6 billion over four years. Over the same period it will reinvest £917 million of these savings in tackling tax evasion and avoidance to bring in additional tax revenues. It is also required to reduce welfare expenditure by £8.3 billion by 2014-15.³⁴

15. The Department plans to achieve the reduction in running costs mainly through: staff reductions; a significant reduction in the number of offices; improvements in efficiency and productivity; reducing the time spent correcting customer errors in incoming information; and reorganising corporate services. Some 60% (£964 million) of the cash savings are to be achieved through investment in 24 projects, which form part of the Department's wider Change Programme. Separate to these specific projects, business areas are required to achieve the remainder (£647 million) through improved staff productivity, reduced sickness absence and lower IT costs.³⁵

16. The largest reductions in staff will be in the Personal Tax business area, where the numbers are planned to fall by 34% by 2015.³⁶ The reductions are scheduled mainly for 2013-14 and 2014-15 after the Department has completed the planned stabilisation of PAYE work.³⁷ The Department has modelled the effect of a reduction in processing staff on its operations, including the impact on service standards and work backlogs. The model enables the Department to assess the consequences of operational decisions on tax revenues. For example, the department expects to achieve major cost reductions from remodelling its customer operations and telephone contact centres and eliminating unnecessary calls, but accepts that this could affect PAYE compliance.³⁸

17. The Department recognised that reducing resources could lead to a fall in voluntary compliance with tax rules, and accepts that even a small fall in compliance could affect large amounts of revenue.³⁹ The Department clearly should not implement short term cuts which lead to a disproportionate loss of tax revenues. The Department had not built any contingency into the cost reduction plans reviewed by the National Audit Office, even though the profile of cost reductions emphasises the importance of delivering reductions in line with the planned trajectory. For example, cost reductions identified for the first year are expected to contribute over a quarter of all savings over the four years. New cost reductions of £158 million are planned in the final year of the Spending Review period, which amounts to 36% of all new savings.⁴⁰

34 C&AG's Report on cost reduction, para 2

35 C&AG's Report on cost reduction, paras 1.12-1.13

36 Qq 172-173

37 Q 175

38 Ev 38

39 Qq 176-182

40 C&AG's Report on cost reduction, para 2.19

18. There is uncertainty about whether the Department will be able to make all of the planned savings. One of its measures to reduce costs is to reduce sickness absence. Even though the target of an average of 9 days per person in 2010-11 was missed, it is seeking to reduce sickness absence to an average of 7.9 days per person in 2011-12 from the 9.9 days in 2010-11.⁴¹ The figure for 2011-12 to date was 8.7 days per person, based on a rolling 12-month average.⁴² The Department acknowledged that if it did not achieve its target reduction, that would have an impact on productivity and clearance of workloads because staff numbers were fixed.⁴³

19. Since the National Audit Office review, the Department has started to develop contingency arrangements in case planned savings do not materialise.⁴⁴ It was considering, for example, speeding up action in two areas: reducing the number of buildings occupied and its PaceSetter programme for improving business operations using Lean principles.⁴⁵ Planned savings in these areas contain uncertainties. Achieving accommodation savings will depend on achieving planned staff reductions, the availability of funding to meet up-front costs and innovative working with other departments to maximise use of space. On PaceSetter, the National Audit Office concluded that planned savings in these areas already carry some uncertainties.⁴⁶ The Department did not plan a specified level of contingency; rather it intended to adjust the level to the degree of risk revealed by its on-going monitoring of progress.⁴⁷

20. The Department's wider Change Programme also includes initiatives to increase tax revenues and improve customer experience.⁴⁸ As a whole, the Change Programme comprises 69 projects designed to help the Department also achieve its other priorities of increasing revenue, improving customer experience, reducing fraud and error in tax credits and the benefit system, and introducing Real Time Information to support more fundamental change in PAYE and the wider reform of welfare benefits. The number of projects has increased from 54 to 69 since the National Audit Office's report in July 2011.⁴⁹

21. A key factor critical to the Department's success will be its capacity to implement a Change Programme of this scale while managing and improving its day to day business.⁵⁰ With the pace of change planned, it is particularly important for the Department to understand the linkages between projects and be in a position to react early to recover any slippage.⁵¹

41 Qq 150-154

42 Qq 155-160

43 Qq 168-169

44 Qq 134-135

45 Q 136 and C&AG's Report on cost reduction, 2.18

46 C&AG's Report on cost reduction, para 2.18 and 3.15

47 Q 198

48 C&AG's Report on cost reduction, 1.12 and 1.13 and Figure 4

49 Ev 38

50 C&AG's Report on cost reduction, para 3.13

51 Qq 201-202

22. The Department told us that a recent initial review by the Major Projects Authority had commented favourably on its governance arrangements for the Change Programme. The Department's Chief Executive is the Senior Responsible Owner for the Programme. In her absence the Chairman has assumed that role, with the Chief Information Officer responsible for overseeing the Programme.⁵² The Department had appointed change directors for each business area and considered that its monitoring arrangements, based on weekly reporting of progress, were effective.⁵³ In response to our concerns about maintaining clear responsibility and accountability over the lifetime of projects, the Department said it aimed to retain project managers in post but noted that some would inevitably move.⁵⁴

23. The Department's mid-year review of the Change Programme concluded that progress was being made as planned, and that there was no need for any radical redesign.⁵⁵ All of the programmes had started although some were still in the planning and design phase, where the benefits for these projects were expected in the later years of the Spending Review period. The Department subsequently told us that the latest monthly review by its Change Delivery Committee in October 2011 assessed 13 of the 69 programmes as 'green', 55 as 'amber' and 1 as 'red'. The programme rated as 'red' was the Security, Knowledge and Information Management programme which was behind schedule.⁵⁶

52 Qq 125-130

53 Q 203

54 Qq 123-126

55 Q 118

56 Qq 117-118 and Ev 38

Formal Minutes

Wednesday 23 November 2011

Rt Hon Margaret Hodge, in the Chair

Mr Richard Bacon
Stephen Barclay
Matthew Hancock
Chris Heaton-Harris
Meg Hiller

Jo Johnson
Fiona Mactaggart
Austin Mitchell
Nick Smith

Draft Report (*HM Revenue and Customs: PAYE, tax credit debt and cost reduction*) proposed by the Chair, brought up and read.

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

Paragraphs 1 to 23 read and agreed to.

Conclusions and recommendations 1 to 8 read and agreed to.

Summary read and agreed to.

Resolved, That the Report be the Fifty-eighth Report of the Committee to the House.

Ordered, That the Chair 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.

Written evidence was ordered to be reported to the House for placing in the Library and Parliamentary Archives.

[Adjourned till Monday 28 November at 3.00pm]

Witnesses

Wednesday 12 October 2011

Page

Dave Hartnett CB, Permanent Secretary for Tax, **Stephen Banyard CBE**, Acting Director General for Tax, and **Simon Bowles**, Chief Finance Officer, HM Revenue and Customs

Ev 1

Monday 17 October 2011

Dave Hartnett CB, Permanent Secretary for Tax, **Stephen Banyard CBE**, Acting Director General for Tax, and **John Keelty**, Director, Finance Planning and Performance, HM Revenue and Customs

Ev 19

List of printed written evidence

1	HM Revenue and Customs	Ev 38
2	CreDec	Ev 40
3	Institute of Chartered Accountants in England and Wales	Ev 42

List of Reports from the Committee during the current Parliament

The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

Session 2010–12

First Report	Support to incapacity benefits claimants through Pathways to Work	HC 404
Second Report	Delivering Multi-Role Tanker Aircraft Capability	HC 425
Third Report	Tackling inequalities in life expectancy in areas with the worst health and deprivation	HC 470
Fourth Report	Progress with VFM savings and lessons for cost reduction programmes	HC 440
Fifth Report	Increasing Passenger Rail Capacity	HC 471
Sixth Report	Cafcass's response to increased demand for its services	HC 439
Seventh Report	Funding the development of renewable energy technologies	HC 538
Eighth Report	Customer First Programme: Delivery of Student Finance	HC 424
Ninth Report	Financing PFI projects in the credit crisis and the Treasury's response	HC 553
Tenth Report	Managing the defence budget and estate	HC 503
Eleventh Report	Community Care Grant	HC 573
Twelfth Report	Central government's use of consultants and interims	HC 610
Thirteenth Report	Department for International Development's bilateral support to primary education	HC 594
Fourteenth Report	PFI in Housing and Hospitals	HC 631
Fifteenth Report	Educating the next generation of scientists	HC 632
Sixteenth Report	Ministry of Justice Financial Management	HC 574
Seventeenth Report	The Academies Programme	HC 552
Eighteenth Report	HM Revenue and Customs' 2009-10 Accounts	HC 502
Nineteenth Report	M25 Private Finance Contract	HC 651
Twentieth Report	Ofcom: the effectiveness of converged regulation	HC 688
Twenty-First Report	The youth justice system in England and Wales: reducing offending by young people	HC 721
Twenty-second Report	Excess Votes 2009-10	HC 801
Twenty-third Report	The Major Projects Report 2010	HC 687

Twenty-fourth Report	Delivering the Cancer Reform Strategy	HC 667
Twenty-fifth Report	Reducing errors in the benefit system	HC 668
Twenty-sixth Report	Management of NHS hospital productivity	HC 741
Twenty-seventh Report	HM Revenue and Customs: Managing civil tax investigations	HC 765
Twenty-eighth Report	Accountability for Public Money	HC 740
Twenty-ninth Report	The BBC's management of its Digital Media Initiative	HC 808
Thirtieth Report	Management of the Typhoon project	HC 860
Thirty-first Report	HM Treasury: The Asset Protection Scheme	HC 785
Thirty-second Report	Maintaining financial stability of UK banks: update on the support schemes	HC 973
Thirty-third Report	National Health Service Landscape Review	HC 764
Thirty-fourth Report	Immigration: the Points Based System – Work Routes	HC 913
Thirty-fifth Report	The procurement of consumables by National Health Service acute and Foundation Trusts	HC 875
Thirty-seventh Report	Departmental Business Planning	HC 650
Thirty-eighth Report	The impact of the 2007-08 changes to public service pensions	HC 833
Thirty-ninth Report	Department for Transport: The InterCity East Coast Passenger Rail Franchise	HC 1035
Fortieth Report	Information and Communications Technology in government	HC 1050
Forty-first Report	Office of Rail Regulation: Regulating Network Rail's efficiency	HC 1036
Forty-second Report	Getting value for money from the education of 16- to 18-year olds	HC 1116
Forty-third Report	The use of information to manage the defence logistics supply chain	HC 1202
Forty-fourth Report	Lessons from PFI and other projects	HC 1201
Forty-fifth Report	The National Programme for IT in the NHS: an update on the delivery of detailed care records	HC 1070
Forty-sixth report	Transforming NHS ambulance services	HC 1353
Forty-seventh Report	Reducing costs in the Department for Work and pensions	HC 1351
Forty-eighth Report	Spending reduction in the Foreign and Commonwealth Office	HC 1284
Forty-ninth Report	The Efficiency and Reform Group's role in improving public sector value for money	HC 1352
Fiftieth Report	The failure of the FiReControl project	HC 1397

Fifty-first Report	Independent Parliamentary Standards Authority	HC 1426
Fifty-second Report	DfID Financial Management	HC 1398
Fifty-third Report	Managing high value capital equipment	HC 1469
Fifty-fourth Report	Protecting Consumers – The system for enforcing consumer law	HC 1468
Fifty-fifth Report	Formula funding of local public services	HC 1502
Fifty-sixth Report	Providing the UK's Carrier Strike Capability	HC 1427
Fifty-seventh Report	Oversight of user choice and provider competition in care markets	HC 1530
Fifty-eighth Report	HM Revenue and Customs: PAYE, tax credit debt and cost reduction	HC 1565
Fifty-ninth Report	The cost-effective delivery of an armoured vehicle capability	HC 1444

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 12 October 2011

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon
Stephen Barclay
Stella Creasy
Matthew Hancock
Joseph Johnson

Austin Mitchell
Nick Smith
Ian Swales
James Wharton

Amyas Morse, Comptroller and Auditor General, **Paul Keane**, Director, National Audit Office, **John Thorpe**, Director, National Audit Office, **Marius Gallaher**, Alternate Treasury Officer of Accounts, HM Treasury were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

Accounts 2010–11 and HMRC cost reduction

Examination of Witnesses

Witnesses: **Stephen Banyard CBE**, Acting Director General Personal Tax, HM Revenue and Customs, **Simon Bowles**, Chief Finance Officer, HM Revenue and Customs, **Dave Hartnett CB**, Permanent Secretary for Tax, HM Revenue and Customs, gave evidence.

Chair: Welcome, Mr Hartnett.

Dave Hartnett: Good afternoon.

Q1 Chair: We are going to focus this afternoon first on tax disputes, and then we will look at PAYE and tax credits, if we can.

I am going to start with a rather tough question: it seems to me that you lied when you told the Treasury Committee on 12 September that “I do not deal with Goldman’s tax affairs.” In preparing for this afternoon, we had access to a note of a meeting on 8 December in the offices of your lawyers which states that you had settled and, in fact, had “shaken hands” with Goldman Sachs on a deal on its tax affairs.

Dave Hartnett: Chair, I did not lie, and I think the *Hansard* extract demonstrates that. I was first asked by Mr Norman whether I had had corporate hospitality from Goldman’s, and I explained that I had had supper at Goldman’s to speak to 20 FTSE 100 CFOs with one of my managing director colleagues from the Treasury. I went on to say that “I do not deal with Goldman’s tax affairs.” I met Goldman’s on a single occasion, on 19 November 2010, when I had been asked by two of my colleagues to assist them with a difficult relationship issue. I have no deep knowledge of Goldman’s tax affairs. I have never worked in a normal way, in my understanding, dealing with their tax affairs on an everyday and routine basis. I have never done that.

Q2 Chair: The minutes of the meeting in Anthony Ingles’s office at 100 Parliament street on 8 December 2010 say that “a late submission had come in about a deal on which DH”—you—“had ‘shaken hands’ with GS”, which is Goldman Sachs. Is that a lie?

Dave Hartnett: Well, I am not going to say it is a lie, and I am certainly not lying.

Q3 Chair: Well, one or other is a lie.

Dave Hartnett: No, Chair, I am afraid it is not. I was at a meeting on 19 November with two of my colleagues and representatives—

Q4 Chair: Did you do a deal with Goldman Sachs?

Dave Hartnett: We reached a settlement—

Q5 Chair: On which you shook hands.

Dave Hartnett: I have no recollection—

Q6 Chair: So if you reached a settlement, why did you say at the Treasury Committee to Jesse Norman, “I do not deal with Goldman’s tax affairs”?

Dave Hartnett: Because what I meant by that is I do not deal, as my colleagues deal on a regular basis, with Goldman’s tax affairs. I attended the meeting on 19—

Q7 Chair: This is a big bit of Goldman’s tax affairs, for heaven’s sake! This is a dispute on which you personally negotiated the settlement, yet you told the Treasury Committee, “I do not deal with Goldman’s tax affairs.”

Dave Hartnett: I am very sorry, Chair, but I did not negotiate the settlement on my own. I went to help the resolution of the issues.

Q8 Chair: So the minutes of the meeting with Anthony Ingles, Alan Evans, John Sandford and Dean Rowland—all HMRC people, I assume—are not true.

12 October 2011 HMRC and HM Treasury

Dave Hartnett: I am sorry. These are absolute terms. I saw the minute for the first time yesterday. I was not at the meeting. Mr Inglese saw the minute for the first time on Monday—of this week.

Q9 Chair: That is laughable. I shall read you more about this meeting: “It was not clear whether DH”—you—“had settled on £24m or on whatever the principal was. There was discussion about whether there could be justification for settling without interest, especially in view of the Litigation Strategy...It was, however, clear that the proposed settlement gave GS no additional penalty for having resisted for 5 more years, including as DR”—that must be Dean Rowland—“explained raking every conceivable point in the Tribunal”. At the end of this minute, it says, “AI”—Anthony Inglese—“said he would always want to assist DH, but not if this were ‘unconscionable’”.

Dave Hartnett: Well, I’ve read the minute. I don’t think that Mr Inglese says in it that anything was “unconscionable”.

Chair: It is pretty clear that that is what they all felt. He referred to the difficulty all those present at this meeting were having in justifying a settlement without an interest element. It is pretty clear to me.

Q10 Mr Bacon: What I don’t understand about this is that this is one of your top lawyers. What is the position that Anthony Inglese holds?

Dave Hartnett: He is our general counsel and solicitor.

Q11 Mr Bacon: So he is a very important lawyer within HMRC?

Dave Hartnett: Yes.

Q12 Mr Bacon: And he was at the meeting, and it wasn’t clear to him at the meeting, apparently, whether you “had settled on £24m or on whatever the principal was.” There was then a discussion about whether there could be “justification for settling without interest”. Now, this note is dated 8 December. What date did your meeting with Goldman Sachs take place?

Dave Hartnett: I believe that it was 19 November.

Q13 Mr Bacon: 19 November. I read in the newspaper that it was 30 November—or was it at a subsequent meeting where they discovered your meeting that had taken place on the 19th? Perhaps that is the way round it was. But you think that you met on the 19th?

Dave Hartnett: I believe so.

Q14 Mr Bacon: And was there a note of what was agreed at that meeting on the 19th?

Dave Hartnett: I don’t know, Mr Bacon.

Q15 Mr Bacon: You don’t know?

Dave Hartnett: No.

Q16 Mr Bacon: You were negotiating the deal on behalf of HMRC—

Dave Hartnett: No. I don’t want to be difficult, but you keep saying that I was negotiating a deal. I went to assist my colleagues to deal with a very difficult relationship issue. One of the things that I did to assist the relationship issue was to persuade someone to come in from New York from Goldman’s, because it was quite clear that elements of the relationship in the UK had broken down.

Chair: I have to say to you, Mr Hartnett, that your officials say that you shook hands and it was your settlement. Your name is all over this note.

Q17 Mr Bacon: I don’t understand how there cannot be a record from the HMRC side of the meeting. That you don’t know whether there was a record or not of the meeting is astonishing.

Dave Hartnett: Well no, because the other HMRC people at the meeting were the head of our banking sector in the large business service and the case relationship manager with the bank. They are people who were managing the issues and would have made the note. I went abroad fairly soon afterwards—

Q18 Mr Bacon: You didn’t see the note.

Dave Hartnett: No, I haven’t seen the note.

Q19 Mr Bacon: That is extraordinary. I worked in a bank—in a fairly junior capacity—and one of the things you always did without fail was to take a note of a meeting. That was just normal practice. First of all, you answered by saying that you didn’t know whether there was a note. Then you said that there would have been a note. Then you said that you haven’t seen it. Yet this was an extremely important meeting with some very top people there: your large business guy; your client guy; you, the senior official in the entire organisation—and you are telling us that you didn’t see a note of the meeting afterwards.

Dave Hartnett: No, I didn’t. I left the country shortly afterwards to go and visit another Government.

Q20 Mr Bacon: And yet we now know that that was the date upon which this agreement was struck, which subsequently your top lawyer seems to be having some difficulty with, because he wants to assist you wherever possible, but not if it is “unconscionable”. The problem that he, and the meeting, appeared to have—indeed, the wording in the note is “all present”, I think—

Chair: It says: “He referred to the difficulty all those present at this meeting were having in justifying a settlement”. It is the last sentence.

Q21 Mr Bacon: Yes, all those present at the meeting were having difficulty “in justifying a settlement without an interest element.” This appears to be the bone of contention, because you ended up agreeing a settlement that did not include the extra interest, despite the fact that they had resisted for five years, put up a stooge witness and all the rest of it. You have not seen a note of the meeting at which that decision was made, with your imprimatur not to pursue them for the interest. Subsequently your top legal people are saying that they are very uncomfortable with it

12 October 2011 HMRC and HM Treasury

and that they cannot assist you with something that is unconscionable.

Dave Hartnett: Well, I would never want them to assist me with anything that is unconscionable.

Q22 Mr Bacon: The whole thing sounds extremely odd, Mr Hartnett.

Dave Hartnett: Well, when I answer questions from Mr Norman I have to be careful—I expect we will get on to taxpayer confidentiality shortly—with what I say, because I cannot breach taxpayer confidentiality. But if you look at the transcript of the TSC hearing, I make it clear that there was an issue in relation to which a mistake was made, because we saw an impediment to dealing with an issue. In fact, the impediment had been removed. A number of us at the meeting did not know that.

Q23 Chair: That sounds like a bit of gobbledegook. Was the taxpayer ripped off in the deal that you did with Goldman Sachs?

Dave Hartnett: Absolutely not.

Q24 Chair: Did we lose £10 million that we should have had?

Dave Hartnett: The sum is smaller than that.

Q25 Chair: What was it?

Dave Hartnett: I am sorry, but I am now in grievous difficulty of breaching taxpayer confidentiality.

Q26 Chair: Well, the figure in the public domain is £10 million. Our duty as a Committee is to ensure that you provide value for money in the work that you do in settling tax disputes. There is a lot of money at stake. There is £25 billion outstanding in tax disputes. Therefore, in the same way that we delve into the detail when we look at the development of fire stations or whatever, we will delve into the detail here. It appears that £10 million was lost to the taxpayer because of the deal that you did with Goldman Sachs.

Dave Hartnett: Well, I'm sorry—

Q27 Chair: We were ripped off. The taxpayer was ripped off. That is what it feels like.

Dave Hartnett: No, I do not agree with that at all. A mistake was made. Papers have appeared in the media.

Q28 Chair: How much did we lose on the back of a mistake made?

Dave Hartnett: Chair, I cannot answer a specific question about that.

Q29 Chair: The difficulty is that our duty as a Committee is to ensure value for money for the taxpayer. My problem with this, and in reading all the papers preparing for today, is that you are the guy who does the deals, you are the guy who sits on the board that vets the deals, you are the commissioner who vets the deals and you are the guy who decides what comes into the public domain. The NAO does not look at the details, so there is nobody checking on whether the deals that you personally do provide value for money

for the taxpayer. It is an outrageous, unprecedented situation.

Dave Hartnett: With enormous respect, I do no settlements on my own.

Q30 Chair: We don't know that—nobody knows. The minutes we have are of a meeting—either they are lying, or there are lies around the place—where the minutes clearly say to me that you made that deal with Goldman Sachs.

Dave Hartnett: Well, I am sorry, but not one person named in that minute was there. There were a number of people in the room. I did not do a deal personally.

Q31 Mr Bacon: You may not be the only person in the room, but it is an odd state of affairs when your own chief lawyer—your own general counsel—has serious concerns about what you appear to have done. In the case of Vodafone, it was clear in the controlled foreign corporations case there that the experts inside HMRC who knew the law on that issue were excluded from the meetings. They were explicitly not consulted. Here you are doing a deal where you forwent the interest. Presumably, in the earlier days, one of the aspects of the dispute was that you wanted the interest if they continued to resist.

Dave Hartnett: Of course.

Q32 Mr Bacon: Did HMRC warn Goldman Sachs that if it continued to resist, it would continue to be liable for the interest?

Dave Hartnett: The interest was always in our mind, Mr Bacon.

Q33 Mr Bacon: Did HMRC warn Goldman Sachs that it would be liable for interest if it continued to resist?

Dave Hartnett: I am sorry, you are asking me to cross the margin of taxpayer confidentiality again, but maybe I can pick up the prior point you made. As we have said before, on the Vodafone case, at no stage did I or anyone else stand down experts. Our foremost experts were involved in the matter.

Q34 Mr Bacon: Let me help you on this question of the warning. HMRC did warn Goldman Sachs that if it resisted it would be liable for the interest; that was in the letter written by HMRC to Goldman Sachs in 2005. And yet here we are, five years later, and you just, with a wave of the hand, agreed. Despite the fact that it had resisted enormously—and all the other people involved in this type of scheme and the other users of the scheme basically 'fessed up and settled—Goldman Sachs held out and does not pay any extra penalty. This is one of the things that Mr Inglese and his colleagues in the meeting were so concerned about.

As the Chairman quoted earlier: "It was clear...the proposed settlement gave GS no additional penalty for having resisted for 5 more years." As Dean Rowland explained, Goldman Sachs was "raking every conceivable point in the Tribunal, and putting up a 'stooge' witness when Mr Housden"—a Goldman Sachs official—"was the obvious person to answer questions." It did not suffer any penalty for that. For

12 October 2011 HMRC and HM Treasury

the avoidance of doubt, what we are talking about here is a scheme whose purpose was to ensure that extremely rich and extremely highly paid people paid less tax and national insurance in this particular case on their bankers' bonuses than would otherwise have been the case. I do not think that this type of deal would have been available to a medium-sized company of 150 employees in my constituency, would it?

Dave Hartnett: Mr Bacon, what I have made clear already—

Q35 Mr Bacon: We are supposed to be equal before the law.

Dave Hartnett: That is a principle of HMRC. There was no wave of the hand. There was no pushing aside of interest in order to secure a deal. That is not what happened. Mr Rowland was not there; nor was anyone else. A mistake was made and it was actually me who took the mistake to Mr Inglese.

Q36 Chair: A mistake was made that cost the taxpayer what?

Dave Hartnett: I cannot answer that, Chair.

Q37 Chair: I will go to Austin, but first I will say one final thing before I hand over to Austin. I still assert that in whatever role you played with Goldman Sachs—you clearly played a role, as you say, alongside others—you lied to the Treasury Committee in saying, "I do not deal with Goldman's tax affairs". You did not say, "I do not solely deal with Goldman's tax affairs." You said, "I do not deal with Goldman's tax affairs". You did, and that was a lie.

Dave Hartnett: No, it was not, with respect. I do not deal with Goldman's tax affairs. I do not know about its tax provisions, how much tax it pays generally—

Q38 Chair: Wasn't this negotiating? This is really playing with words. This negotiation was dealing with Goldman's tax affairs. It was dealing with a really important part of Goldman's tax affairs.

Dave Hartnett: I went to the meeting to make the relationship work.

Q39 Mr Bacon: But the point the Chairman is seeking to make is that less than a year before you told the Treasury Committee "I do not deal with Goldman's tax affairs", you have been in a meeting in which you have dealt with Goldman's tax affairs. That is the point. I accept what you are trying to explain. You would have been more accurate if you had said, "It's not my job normally in the ordinary course of business to deal with Goldman's tax affairs on a month by month or week by week basis. That's not my job. But occasionally I have got involved." That might have been a more accurate way of putting it, but it is not what you said. You just said, "I do not deal with Goldman's tax affairs", when in fact you had.

Chair: It is even worse. You said, "I knew nothing of Goldman's tax affairs", but you had been at a meeting to discuss it.

Mr Bacon: "When I was at that supper" may have been true for all we know. But the next sentence, "I

do not deal with Goldman's tax affairs", was not a true sentence. It should have been qualified; it was not a true sentence.

Dave Hartnett: I am really sorry. In the cut and thrust of the hearing, I said "I knew nothing of Goldman's tax affairs when I was at that supper. I do not deal with Goldman's tax affairs." I do not deal with Goldman's tax affairs in the way I have dealt with hundreds of thousands of people's tax affairs during my career.

Q40 Nick Smith: So what were you assessing at that meeting apart from Goldman's tax affairs?

Dave Hartnett: The fact that the relationship had broken down and that the issue was not being moved forward. My colleagues dealt with Goldman Sachs.

Q41 Nick Smith: But the nub is you were talking about the tax affairs.

Dave Hartnett: With respect, Mr Smith, I did not have the deep knowledge to deal with Goldman's tax affairs. I did not make a deal. I did not wave interest away.

Q42 Austin Mitchell: But you cannot be surprised that we find it inconceivable that you can go into a meeting with Goldman Sachs—which is not, after all, a charity for handing money to impecunious bankers—not knowing anything about its tax affairs. Do you go into all meetings as ignorant as that?

Dave Hartnett: No, Mr Mitchell, I do not go into meetings ignorant—I try very hard not to do that. I did not force myself into that meeting or anything like that, I was asked by my colleagues for assistance and I sought to provide it, mainly with the relationship issue. My colleagues were seeking to settle something.

Q43 Austin Mitchell: Relationship advice. That is very interesting. Perhaps you would give us some information here, because the Chair has asked for an estimate of how much was given away to Goldman Sachs. My understanding is that we are talking about £22 million that was not paid in national insurance contributions on bankers' bonuses. What would the interest on that be, and how long was the period involved?

Dave Hartnett: I cannot answer that question.

Q44 Austin Mitchell: Well, can you give us a note stating the number of years involved, the rate of interest that would be charged and the amount of interest written off?

Dave Hartnett: I don't know whether I can give you a note—I don't think I can, because I think the law prevents it.

Q45 Chair: I know Jo wants to come in on this, but I shall just tell you why this is deeply irritating. We are trying to find out whether the work you do provides value for money. You are hiding behind confidentiality on a case that is in the public domain, and about which we have published whistleblowers' information—that is where a lot of this comes from, so it is protected. You are perfectly at liberty in that context. It is all in the public domain, it is protected

12 October 2011 HMRC and HM Treasury

anyway and, by answering, you would help us to decide whether or not you and your team provide value for money. Do not hide behind confidentiality.

Dave Hartnett: Before I came here, I put together for myself a mental profit and loss account of the issues that I and my colleagues have dealt with over the past five years. The mistake that was made, for which I and my colleagues are very sorry, is one thing; the income side of this is billions of pounds. It may be helpful if I say something about the legal position.

Chair: We will come to that, but people want to pursue this point.

Q46 Austin Mitchell: Can I pursue it? You had given Goldman Sachs a huge competitive advantage. All its competitors coughed up in 2005, but you gave it the full use of all that money from 2005 to the date of settlement. That is a big advantage given to Goldman Sachs—you would not give such an advantage to any small business that is hounded and punished for interest payments.

Let me move on. There is a great similarity between that deal with Goldman Sachs and the one you reached with Vodafone. In each case, the interest was not charged. Why was that?

Dave Hartnett: Well, I gave to the Treasury Select Committee an example—a particular example—of the circumstance in which interest would not be charged. I face the same difficulty, Mr Mitchell, with your Vodafone question as I face with your Goldman Sachs one. I cannot talk to the Committee about the affairs of an individual—

Chair: Would you talk to us in confidence?

Q47 Austin Mitchell: Perhaps you could give us the interest on the Vodafone affair. I remind you that the advice given to HMRC from leading tax silk Malcolm Gammie was that it could recover the dodged national insurance if it went to court. That meant that, under its own litigation and settlement strategy, it must not reach an out of court settlement for less than 100% of the tax and interest at stake. In other words, you are cutting right through—defying—your own department's strategy on tax settlement.

Dave Hartnett: Mr Mitchell, I am sorry that this has arisen, but the really difficult issue is truly—and I say this in all conscience—that a mistake was made. It was a mistake; it was not a deal to wave away interest, as Mr Bacon says. I am prevented by law from—

Chair: You are prevented by choice, not by law.

Q48 Mr Bacon: May we pursue this point for a minute? I am literally looking at the Wilberforce and Scarman judgments that point out that the laws of the United Kingdom have long struck a public interest balance between taxpayer confidentiality and the Revenue's official secrecy on the one hand and accountability and taxpayer confidence in the administration of the tax system on the other, so it is not an absolute. In fact your own legal advice says that it is not an absolute duty against disclosure and you have discretion in the exercise of your functions. That is true isn't it?

Dave Hartnett: There is discretion in relation to our functions, but maybe I can set out—

Q49 Mr Bacon: One of your functions is ensuring that the public have confidence in the tax system and that you are able to account to Parliament as accounting officer—or at least your colleague, Lesley Strathie, is able to account to Parliament as accounting officer—for the effective, efficient and economic administration of the tax machinery, so plainly you could make a very good case for saying that in certain circumstances disclosure is required. It is not a difficult conclusion to reach.

Dave Hartnett: The Commissioners for Revenue and Customs Act 2005 sets out very clearly public interest and similar issues. Our view, which we have been through with our own lawyers and legal counsel, is that we are prevented from disclosing information and that these provisions reflect earlier provisions and that is a well established policy here. There are gateways and section 18 of the Commissioners of Revenue and Customs Act provides greater strictures than we had before. The key, Mr Bacon, is that there is no specific gateway that enables the disclosure of information to parliamentary Committees and our advice is that I or any other official in HMRC disclosing specific taxpayer information to a Committee is in jeopardy of committing a criminal offence.

Q50 Stephen Barclay: May I just pick up on that point? I think it goes to the nub of whether you are prevented by law from discussing individual cases or whether it is your choice. In your evidence a little earlier, you said, "I don't think I can, because the law prevents it", whereas at the Treasury Committee you were a bit clearer. You said that you "cannot talk" about it—in other words, you were prevented legally—and, "twice in the last 10 days I have been to see our most senior lawyers to see whether there was anything" you could do, so even if you wanted to, you were prevented. Again you said that you were prevented by law. Perhaps we can work our way through it. Section 18(1) prevents disclosure except in the circumstances described in subsection (2). That is correct, is it?

Dave Hartnett: Yes.

Q51 Stephen Barclay: Okay, so if we then look at subsection (2), it says that disclosure is permitted, and this is the point that Richard alluded to, if it is made in connection with "a function of the Revenue and Customs". Is that correct?

Dave Hartnett: Yes.

Q52 Stephen Barclay: One of those functions is to assist Parliament. Is that correct?

Dave Hartnett: Let me just have a look at the list of functions.

Q53 Stephen Barclay: One of the functions of Revenue and Customs is to assist Parliament.

Dave Hartnett: Could you point to that in the list of functions, Mr Barclay?

Q54 Stephen Barclay: I'll go one better. I'll quote from the first Treasury counsel, who said in the minutes to the meeting dated 23 June 2009, paragraph 6, "In any case, we sought legal advice from First

12 October 2011 HMRC and HM Treasury

Treasury Counsel. He advised that as PAC are a parliamentary body with an oversight role over HMRC it follows that HMRC's functions would extend to assist PAC with that oversight role. So there is no absolute bar on disclosure but this would still be at HMRC's discretion". The first counsel is making the point that I am making, which is that a function of HMRC is to assist Parliament. Is that correct?

Dave Hartnett: Mr Barclay, I have to say to you here—and I fear that you are not going to like this answer—that I am unable to discuss the legal advice of Treasury counsel.

Q55 Stephen Barclay: I am not asking you to discuss the legal advice, Mr Hartnett. I am asking you to explain whether a function of HMRC is to assist Parliament. I am not even asking you about this specific issue. I am asking you about whether a function of HMRC, as first Treasury counsel advised, is to assist Parliament. It is a very straightforward question. Yes or no?

Dave Hartnett: I am going to say that I don't know, because—

Q56 Mr Bacon: You don't know whether one of your functions is to assist Parliament?

Dave Hartnett: Mr Bacon, I want to be as open as I can. I am sitting here with advice—

Q57 Mr Bacon: You are here now, assisting us. It is plainly one of your functions. It is obvious—why even discuss it? It is obvious that one of your functions is to assist Parliament.

Dave Hartnett: Because the same advice that Mr Barclay has quoted from—I have no idea whether you have the full advice, because this material appears to have been leaked—says that providing information about specific taxpayers will put officials in jeopardy of prosecution.

Q58 Stephen Barclay: With respect, that is a different point. I note that, at the Treasury Committee, three different members complained to you about what they termed "Sir Humphrey" answers. I was asking a very straightforward question; I was not asking about the wider legal advice. Is a function of HMRC to assist Parliament? It stands to reason that the answer is yes or no.

Dave Hartnett: I believe it is a function of HMRC to assist Parliament.

Q59 Stephen Barclay: Okay, thank you. If it is a function of HMRC to assist Parliament, there is nothing in the 2005 Act that legally prevents you from discussing an individual case, which is contrary to the advice given to Edward Leigh, the former Chairman of the Public Accounts Committee.

Dave Hartnett: I am sorry; I did not understand that.

Q60 Stephen Barclay: The letter that was sent in 2009 to Mr Leigh specifically cited section 18 of the 2005 Act as the grounds on which you could not disclose individual cases to the Committee. What you have just said to us is that a function of HMRC is to assist Parliament. The 2005 Act does not prevent you

from discussing individual cases that relate to a function of revenue. Therefore, there is nothing in the 2005 Act, as I understand it, that prevents you; it is your choice whether you do so, but you are not legally prevented from doing so. That is correct, is it not?

Dave Hartnett: If I may read out section 18 fully, it says, "is made for the purposes of a function of the Revenue and Customs, and...does not contravene any restriction imposed by the Commissioners". The commissioners of Revenue and Customs, when—

Q61 Chair: That's you.

Dave Hartnett: There are others.

Q62 Chair: Yes, but you're a commissioner. Don't pretend that they are separate people.

Dave Hartnett: I am certainly not suggesting that I am not a commissioner. When this was put to the commissioners and, indeed, to our executive committee, they took the view, on advice, that the strict rule of taxpayer confidentiality—which I expounded for the TSC and here today—was their understanding of the position. The Mr Eadie advice, which you appear to have, makes it clear as well that none of this is free of difficulty.

Q63 Stephen Barclay: Again, that is a different point. My point is that, in law, you are not prevented by the 2005 Act from disclosing this information. It is entirely at your discretion whether you wish not to disclose information, but you are not prevented in law from doing so.

Dave Hartnett: My advice, Mr Barclay—what I would like to do, because it seems to make more sense, is write to you fully.

Q64 Stephen Barclay: But you have already consulted on this issue. You even spoke twice before seeing the Treasury Committee, at which point you said, after talking to the most senior lawyers—you took a special interest in this before—that you were prevented legally. Having had that advice and after telling the Treasury Select Committee that you were legally prevented, now you are saying that perhaps that advice is not correct and that you need to speak to lawyers again.

Dave Hartnett: No, I am not saying that at all. I am saying that that is my advice, and my advice has not changed—the advice I have received.

Q65 Chair: So writing to us will simply confirm what you are saying.

Dave Hartnett: I am offering to write fully around the considerations that I have discussed with our lawyers and to explain the advice that I have received.

Q66 Chair: Well, we welcome that, but I do not think it takes us further. I'll come back to you later, Stephen.

Q67 Joseph Johnson: I just want to go back to Goldman, if we can. The £24 million that seems to be at stake here is a small proportion of the £25.5 billion of outstanding potential tax that is at risk. It is 0.1%, if my calculator is correct. It surprises me that your

12 October 2011 HMRC and HM Treasury

personal intervention was necessary for such a relatively trivial sum. Why doesn't your Department have the capacity to deal with such trivial sums in the context of the outstanding amount without your personal intervention?

Dave Hartnett: There are two or three things that I could say. First, I am the head of tax, and my colleagues consult me regularly. I do not normally get involved with issues such as £24 million. There was a huge relationship issue, and from my previous work, I happened to know someone who I thought could unlock it, and that person flew in from New York.

Q68 Joseph Johnson: You weren't talking about the tax affairs per se—you have already made that clear—but you were talking a lot during that meeting. How long did it last? What were you talking about? What was the personal relationship that was so important to the successful management of the tax affairs of Goldman Sachs that it required your personal intervention?

Dave Hartnett: From memory, the meeting was a couple of hours—maybe a little longer, maybe a little shorter. The relationship between our team and the Goldman's team had got into a bad place.

Q69 Joseph Johnson: In what sense?

Dave Hartnett: The teams weren't getting on with each other; they weren't making any progress; and there was no meeting of minds on any issue.

Q70 Chair: You had dinner with Goldman Sachs on 19 May 2009, and you also had lunch with Goldman Sachs on 25 July 2008, yet it is so small in terms of outstanding liability.

Dave Hartnett: Neither of those had anything to do with Goldman's as such. The supper—it was hardly a dinner—was about explaining developments in international tax practice to 20 chief finance officers, and the lunch was on private business with somebody with whom I set up the business tax forum.

Q71 Chair: Is it sensible to have lunch and dinner with people with whom you are in dispute?

Dave Hartnett: Do you know, I had no idea we were in dispute at that time.

Q72 Joseph Johnson: It surprises me that it is that important for there to be buddy-buddy relations between HMRC and someone that is liable for tax.

Dave Hartnett: There is no cosy relationship at all.

Q73 Joseph Johnson: Well, what is wrong with the straightforward application of the tax code?

Dave Hartnett: That is exactly what we were trying to do.

Q74 Joseph Johnson: And why does that require amicable relations between HMRC and Goldman?

Dave Hartnett: It doesn't particularly require amicable relations; it requires the dispute to be managed in an orderly way. That is what I was trying to facilitate.

Q75 Joseph Johnson: But the tax code is set down in legislation. It is relatively simple to apply, is it not?

Dave Hartnett: Surprisingly enough, no.

Q76 Joseph Johnson: Why did it require your personal intervention to repair a human relationship?

Dave Hartnett: My colleagues asked me to help, and I agreed to do so. That is part of my role.

Q77 Joseph Johnson: You mentioned that you flew someone in from New York. Was that an HMRC person?

Dave Hartnett: No, it was the global head of tax at Goldman's.

Q78 Joseph Johnson: Who you requested to attend the meeting in London.

Dave Hartnett: I asked him whether he would come. As I said, I've met him in the context of the OECD.

Q79 Joseph Johnson: Continuing with the Goldman stuff, did you personally sign off the Goldman Sachs settlement?

Dave Hartnett: No, the Goldman tax settlement was delayed but went through a governance process in which an error was found. It was then considered by commissioners and by other senior officials.

Q80 Joseph Johnson: Did one of the commissioners sign it off, and were you one of those commissioners?

Dave Hartnett: I was.

Q81 Joseph Johnson: How many other commissioners were involved in signing it off?

Dave Hartnett: One other.

Q82 Joseph Johnson: So you oversaw the process by which the settlement was arrived at, and you were then 50% of the commissioners who agreed that it was a fair settlement?

Dave Hartnett: Yes.

Q83 Joseph Johnson: The Goldman Sachs settlement was, therefore, one of the four large tax cases in which you bypassed your own governance arrangements?

Dave Hartnett: I can't answer that question.

Joseph Johnson: It self-evidently is.

Dave Hartnett: We really did not bypass our own governance arrangements. For those cases, we set up bespoke governance arrangements because people—

Joseph Johnson: Bypassing your own governance arrangements.

Dave Hartnett: Because the people who sit on the high-risk corporate programme board were all people involved in the cases.

Q84 Joseph Johnson: I am just going to pedal back, if I can. You set up, I think, in 2007 or 2006, this high-risk corporate board.

Dave Hartnett: Yes.

Joseph Johnson: To enable a bit of objectivity to be given to big settlements, to enable people to step back and say, "Is this really a fair settlement for the taxpayer?"

12 October 2011 HMRC and HM Treasury

Dave Hartnett: Yes.

Q85 Joseph Johnson: In a number of the largest tax cases you decided to bypass that special arrangement, which you had set up specifically for that purpose. Could you please explain why you decided to bypass that governance arrangement, which had been specifically set up to deal with exactly the case that Goldman Sachs presented?

Dave Hartnett: I think I have, but let me go back again. We set up for each of those large cases the role of inquiry co-ordinator: someone who would manage the case. We used very senior people to do that, and many of those senior people actually sat on the high-risk corporate programme board. Given their involvement in the case, we decided that bespoke governance arrangements could apply, and that is what we did.

Q86 Joseph Johnson: Did you need to seek anybody's authority before giving yourself a waiver on the need to apply the standard corporate governance arrangements?

Dave Hartnett: Well, one case had started before the high-risk corporate programme was set up. One was outside the high-risk corporate programme—I think two were actually outside the high-risk corporate programme. The high-risk corporate programme is not just a governance mechanism; it is a way of working. It is a way of working I first saw in the United States. It looked like a very good way of us making significant progress on cases that had been going on for a long time, or where disputes were particularly difficult.

Q87 Joseph Johnson: Did you need to consult anybody before you took Goldman Sachs outside the normal mechanisms?

Dave Hartnett: We didn't take Goldman Sachs outside the normal mechanism.

Q88 Chair: You did. You took them outside your defined strategy. You could have got 100% back and you did not.

Dave Hartnett: We made a mistake on one issue.

Q89 Joseph Johnson: You took them out of the high-risk corporate bracket.

Dave Hartnett: They were never inside it.

Q90 Joseph Johnson: Goldman was never inside it. But in normal circumstances, because it was a large company and a large case, a large taxpayer, it would have been inside that.

Dave Hartnett: No; we make decisions carefully about the cases that are inside the programme, and they were not inside the programme.

Q91 Joseph Johnson: Why? It is a large company and a big taxpayer, one would hope.

Dave Hartnett: I am sorry, Mr Johnson, you are taking me where I cannot go again. I would need to tell you something about an individual taxpayer to answer that, but the case did go—

Q92 Chair: The important thing that Mr Johnson is asking, which the Committee would like to know, is whether you gave yourself authority to waive what appears to be the procedures you should have followed in this particular case?

Dave Hartnett: No; I did not manage the taking or not taking of this case to the high-risk corporate programme board. I was not involved in that. I was not in the country.

Q93 Chair: But according to the minutes of the meeting we have, it was your decision, and you were one of the commissioners. You were involved. You might have been out of the country on the day of the meeting, but you were involved because you were one of the commissioners that signed it off.

Dave Hartnett: The case was taken to the high-risk corporate programme board as a governance mechanism. It was not inside the high-risk corporate programme as a case. We use the high-risk corporate programme—

Q94 Joseph Johnson: You are giving contradictory evidence.

Dave Hartnett: I am trying not to, but help me if I have.

Q95 Joseph Johnson: You have been saying quite clearly to me for the past few minutes that it was not ever in the corporate high-risk programme, and you are now saying it was taken into it as a governance mechanism.

Dave Hartnett: Simply for the governance.

Q96 Joseph Johnson: But then it was taken out of it again.

Dave Hartnett: The matter was referred to the commissioners.

Q97 James Wharton: Just on some of the evidence that you have already given us this afternoon, Mr Hartnett, you said that when you met Goldman Sachs and went to a lunch and a supper, you did not know that HMRC was in dispute.

Dave Hartnett: Yes.

Q98 James Wharton: The employee benefit trust issue affected a number of companies, did it not?

Dave Hartnett: Yes.

Q99 James Wharton: HMRC resolved it in 2005.

Dave Hartnett: Yes. I oversaw that.

Q100 James Wharton: And is it true that 21 companies held their hands up and said, "We accept what the court has said, and we will pay," and Goldman Sachs was the only one that did not, at that time?

Dave Hartnett: I think the number was slightly larger. I think there was another that couldn't, rather than didn't, settle, and then I think what you said is fair.

Q101 James Wharton: Yet you did not know that there was an ongoing dispute. I just want to understand why you did not know. You oversaw this.

12 October 2011 HMRC and HM Treasury

Everybody else either settled and paid up or said, “We cannot,” for a variety of reasons. Goldman Sachs had not and was fighting tooth and nail not to, and yet you did not know that there was a dispute.

Dave Hartnett: I was dealing with numerous other tax issues at the time. I went to Goldman’s to lunch to see a—

Q102 James Wharton: I don’t dispute any of that, but you said very specifically in your evidence this afternoon that you did not know that there was a dispute. Is that accurate.

Dave Hartnett: I think it is, Mr Wharton. It was certainly not in my active knowledge at the time.

Q103 James Wharton: I find that surprising—

Dave Hartnett: I am very sorry.

James Wharton: But I accept your answer.

Chair: We will check the answer.

Q104 James Wharton: I appreciate that you dispute what has been in the media.

Dave Hartnett: I do.

Q105 James Wharton: The media imply that there was handshake meeting between yourself and Goldman Sachs that led to a resolution. My understanding of your evidence is that there was a meeting about relationships, but not about that specific issue. Can you tell us who was at that meeting? Was David Goldberg at that meeting?

Dave Hartnett: Goodness—the people at the meeting from HMRC were the head of the banking sector and the large business service and the relationship manager for Goldman’s. There were three representatives of Goldman’s. This is terribly difficult. My advice is that I cannot name them. There was no one else.

Q106 James Wharton: You say that you cannot name them. Is that off the top of your head or is that because you just do not know?

Dave Hartnett: No, my advice is that that is taxpayer confidential information.

Q107 James Wharton: So you cannot because of the advice that you have been given. You cannot tell us whether David Goldberg was there.

Dave Hartnett: No, I think I have given you the answer to that slightly obliquely. Three Goldman’s officials and three HMRC officials were there.

Q108 James Wharton: Okay. Did you ask for a briefing before you went to that?

Dave Hartnett: I did. I had a briefing a day or two before. It was a short briefing.

Q109 James Wharton: Did that briefing mention the detail of this ongoing dispute? Would it normally?

Dave Hartnett: It mentioned certain details of the issues that were going to be discussed.

Q110 James Wharton: I want to ask a slightly different question. You have said several times that a mistake was made. Although I appreciate that you do

not feel that you can reveal the quantum of the cost of that mistake, it had a cost to the Revenue. Who made that mistake?

Dave Hartnett: I was the most senior person there. I am entirely responsible for it.

Q111 James Wharton: If you make a mistake in most walks of life that ends up costing, say, a private company a significant sum of money, there would be some sort of disciplinary action. What disciplinary action has been taken in respect of that mistake?

Dave Hartnett: None. Mr Wharton, we learn from our mistakes as an organisation, and we have learned from this one.

Q112 James Wharton: I need to understand that. I accept that if the mistake is in the framework that exists, you would therefore amend the framework, but if it is a mistake by an individual, who for whatever reason has not done their job properly, you would expect some sort of action to be taken against that individual who made the mistake or the responsible person if they were taking responsibility. Was it a mistake in the framework that existed in the systems at HMRC? If it was, what has changed? Or was it a mistake by an individual, and if so, why has no disciplinary action been considered against that individual?

Dave Hartnett: A mistake about what seemed to be a legal impediment was made by a number of people, and we have made sure that a mistake like that cannot be made again.

Q113 James Wharton: Just for absolute clarity, has any disciplinary action been taken against anybody as a result of that mistake?

Dave Hartnett: No.

Q114 James Wharton: But you have amended your procedures so that that cannot happen again.

Dave Hartnett: We certainly have.

Q115 Matthew Hancock: I just want to follow up on exactly that point. People make mistakes. You cannot reveal to us the numbers that you were looking at relative to the mistake, which I think would be helpful—not least to you—to put this into context.

Dave Hartnett: Absolutely.

Q116 Matthew Hancock: But I am worried about the accountability around this. There are procedures in place to ensure that you cannot make public an individual company’s tax position. But what I am concerned about is that the system ensures that, when mistakes like this are made, they are learned from and that the people who make them are held responsible. How many mistakes of this scale are made?

Dave Hartnett: With respect, Mr Hancock, we have not got anywhere near the scale issue yet, but we are not an organisation that is prone to making mistakes.

Chair: We don’t know. People have no idea.

Q117 Matthew Hancock: So how many mistakes of a scale in the millions are made by HMRC each year?

12 October 2011 HMRC and HM Treasury

Dave Hartnett: Few, because often we are able—normally we are able to intervene to correct them because they are spotted by the process. I spotted the mistake here.

Q118 Matthew Hancock: After it had been made. And what process is there to ensure that those not responsible for the mistake can hold to account those who are responsible for such mistakes?

Dave Hartnett: There are line management issues in there that are important. We expect our managers, when mistakes are made, to ensure that people learn from them. I think, Mr Hancock, if I may, there is another important issue here. You have the NAO report and the NAO report found just two errors in procedure in their work. They looked at 27 cases involving hundreds of issues. I am not suggesting for a moment that the NAO did a detailed review of tax issues. Their report makes that clear. The NAO report generally gave HMRC a good write-up for our governance and how we manage these large—

Chair: I have to say—

Q119 Matthew Hancock: One last question. Do you think the accountability through the NAO report, like that, is sufficient? In these questions of large sums of public money, is there sufficient accountability, given the constraints on the ability to have a public accountability for your actions in this sort of area?

Dave Hartnett: What I was trying to offer you, Mr Hancock, is the independent view of how we govern these issues. You asked me what the framework was like. I think we have a sound framework. On this occasion, a mistake was made.

Q120 Chair: Can I ask the Comptroller and Auditor General: do you think the loss to the taxpayer after the settlement with Goldman Sachs was reasonable—bad value, good value?

Amyas Morse: I can certainly say that the error we are talking about, which is referred to in our report—

Q121 Chair: We do not know the quantum. Do you?

Amyas Morse: Let me just go on. I think the error was probably one which might have led to the belief that interest was applicable or mistakenly thinking that interest was not applicable. The range of the error—not simply the amount of tax that might have been involved—that it is reasonable to give is between £5 million and £8 million. However, and having been a tax person myself many, many years ago, negotiating much smaller settlements—I have never negotiated anything of this size—I know that a lot of factors will be involved in this settlement. If the interest had been on the table, it does not follow that because the interest was not considered, as it clearly should have been, the settlement would necessarily have fully reflected that in increased quantum.

Q122 Chair: Did the taxpayer get value for money out of the settlement that was made with Goldman Sachs?

Amyas Morse: I cannot give you an answer. I am not being coy.

Q123 Joseph Johnson: I am sorry; I did not understand the interest that could be lost.

Amyas Morse: What I am trying to say is this. In negotiating any large case, a whole series of factors is taken into account and there is give and take. If it was really an open-and-shut negotiation—forgive me—I am talking from very out-of-date experience. If it was really open and shut, it would be open and shut. It is not as simple as that. There must be a sustainable argument on the side of the taxpayer if there is any prolonged negotiation.

Q124 Mr Bacon: Can I just pick up on that very point? Twenty-one of the 22 scheme users realised that it was open and shut and paid up. The litigation and settlement strategy is very clear. We had this conversation with Lesley Strathie last year on this very point. Where the character of the case is all or nothing, and the question is merely, “Does the law apply or not?”, the strategy says clearly that you should settle for 100% and you should not take down. They took down, in circumstances where it was quite clear that interest was applicable. Not only that, HMRC had actually warned Goldman Sachs that if it persisted in resisting, which it did for five years with a lot of spurious arguments in front of the tribunal with stooge witnesses, that interest would be liable. HMRC itself had told Goldman Sachs that interest would be liable; that is the context.

Amyas Morse: Well, not necessarily. Setting aside for a minute whether we are talking about Goldman Sachs, if in a multi-factor settlement there was an admitted mistake in taking into account entitlement of interest, I am simply making the point that if you say, “That amount of mistake is exactly the amount of tax lost”, it is a little bit simplistic. There was a composite settlement. I think that is all I can say.

Q125 Matthew Hancock: Are you saying that the cost due to this mistake is £5 million to £8 million?

Amyas Morse: I am saying that the quantum of the mistake was £5–8 million.

Paul Keane: The financial error was £5–8 million.

Q126 Stephen Barclay: Why was the mistake binding, if this was an informal meeting, unminuted, with just a very brief document in advance?

Dave Hartnett: You are taking me to the margin of what I can and cannot say, Mr Barclay, but I am going to try. When I recognised the mistake, the first person I turned to was Anthony Inglese as our solicitor and general counsel, to ask the very question you have asked. Here is where I’m afraid I frustrate you. There were a number of issues to be taken into account. Mr Inglese said to me that there were two entirely acceptable approaches in law; one was to stay with the proposed settlement and one was to put it to one side. There I have to stop, because I begin to talk about—

Q127 Stephen Barclay: Okay. Were those discussions minuted?

Dave Hartnett: I don’t know the answer to that. I received all of the advice.

12 October 2011 HMRC and HM Treasury

Q128 Stephen Barclay: So you did not even get written advice.

Dave Hartnett: I received it all. All legal advice is good advice.

Q129 Stephen Barclay: I am not saying it was not good; I don't know because we cannot see it.

Chair: We are trying to find value for money for the taxpayer.

Ian Swales: To come at this from a different angle, you will be pleased to know I am not going to ask about Goldman Sachs.

Chair: If you are going on to something different, let us finish.

Q130 Ian Swales: No, I am coming at the same point but from a different angle. You said earlier that when you thought about this mistake, and you thought about your profit and loss account, you knew about the mistake but on the plus side there were billions. Can you say what you mean by that plus side being billions? What are you measuring against?

Dave Hartnett: What I was trying to say, Mr Swales, is that I am not proud; I am very sorry that a mistake was made. My colleagues may want to remind me of things but I could not, when I was thinking about this, remember another mistake like that. So, for me, that is on the deficit side. If you look at the NAO's Report, I think the number is £9.3 billion brought in from the high-risk corporate programme, billions brought in from other cases, and billions brought in from other initiatives. That was what my profit—

Q131 Ian Swales: My question is, how are you measuring those billions? Remember we are talking about tax assessments. What are you actually measuring? When you say you brought in £1 billion, what is it measured against? I cannot imagine they are volunteering to pay more tax than has been assessed. What do you mean?

Dave Hartnett: I am talking about cash to start with. That is cash that we have argued is due to the Exchequer that we have recovered. As the Committee has considered before, a lot of our work involves tax avoidance. Perhaps I could go back to something that was said on my left, but I cannot remember by whom. It is only in the past three or four years that we have been able to address sums of money like this in cases; that did not happen before, so our new process works. We are mounting arguments on tax avoidance that are winning arguments, largely, with large corporates and their advisers.

Simon Bowles: To put that into context, Mr Swales, we achieved a compliance yield of £13.9 billion last year, which is double what we achieved five years ago, in the context of—

Chair: But we do not know what you lost. We do not know what we could have got.

Q132 Ian Swales: May I then ask, because it is relevant to what we have been talking about, what the fact that you have recovered these billions—whatever they are—says about the records inside the Inland Revenue, in terms of assessments and so on? At the back of all this, what the Committee, and by inference

taxpayers and Parliament, are concerned about is the idea that people within your organisation and perhaps you personally have the power to negotiate on billions, without having too much governance or accountability record keeping. That is the elephant in the room that we are exploring. My question is: once you have got to the point that you have recovered billions, is that all reflected in the detailed records in the Inland Revenue? How does it all work?

Dave Hartnett: We keep very detailed records, indeed. We want them for more than one reason. We want them for governance. We want them for precedent value. We also want them to record what techniques worked and what arguments worked.

Q133 Ian Swales: So, if we go to the records of an organisation like the one we have been talking a lot about and we open up the files, we will know how that organisation was assessed and what the final settlement was.

Dave Hartnett: Absolutely.

Q134 Chair: Mr Hartnett, you are saying yes to that, but that's a nonsense, because you would not tell us the information—it's a nonsense.

Ian Swales: That is why I asked it the way I did, because I am asking about governance.

Dave Hartnett: I'm sorry, Chair. I think Mr Swales asked a different question.

Q135 Chair: No, he didn't. He said, "If we went to the file of company X, could we look at the way you dealt with them?" And the answer is no, because you would not let us see the files.

Dave Hartnett: I think he asked a different question. I am sorry, but I think Mr Swales asked the question, "Do we have the record?" And yes, we do.

Chair: No, he asked, "Could we go and see the file?"

Q136 Ian Swales: Let me put it in very simple terms. We could not go to a file—could we?—in your organisation and see that this company, whichever it was, was assessed for £1 billion in tax, that you did a deal and they paid £0.5 billion, and that there was a simple note saying, "And we wrote the rest off." Would we find that in any of your records?

Dave Hartnett: I would be very upset if you found a record which said, "We wrote off £0.5 billion." Can I just say, Mr Swales, that the National Audit Office has complete access to our records? We hide nothing from it at all.

Q137 Stella Creasy: Mr Hartnett, I am a little confused, and I wonder if you could talk me through this. You talked about using a bespoke process. Who designed it?

Dave Hartnett: It is truly bespoke. It works for each of those four cases.

Q138 Stella Creasy: Who designed that bespoke process?

Dave Hartnett: The process evolved as we tackled the cases.

12 October 2011 HMRC and HM Treasury

Q139 Stella Creasy: Who designed it, because if it is bespoke it was created at that point?

Dave Hartnett: Well, the design of a bespoke process happened within our business tax area and it will have been designed by senior officials there.

Q140 Stella Creasy: So by senior officials, but it was not anything to do with the high risk corporate programme?

Dave Hartnett: Yes, because, as I said earlier, members of the high risk corporate programme board are those senior officials.

Q141 Stella Creasy: Such as yourself.

Dave Hartnett: No, I am not a member of the high risk corporate programme board, and I have not designed any of those processes.

Q142 Stella Creasy: So you were made to apply a bespoke process that you did not design yourself, but that you ultimately judged.

Dave Hartnett: Ultimately judged, yes.

Q143 Stella Creasy: Would you use that again?

Dave Hartnett: No. We are changing the process. We learned from what the NAO had to say, and we are making a significant change. We will put everything through the high risk corporate programme board and we are changing the way—we have started already—in which commissioners operate cases. We believe that there will always be a small number of cases, and there have been only a small number of such cases in the past, where a commissioner will be heavily involved in negotiations. Where that happens in future, two other commissioners will review the process to ensure that the process was appropriate.

Q144 Stella Creasy: So in this instance what you have learned is that more than two commissioners should have been involved, and that the bespoke model that the board put together was not the right model to use.

Dave Hartnett: I want to change that just slightly, if I may. What we have learned is there will be greater assurance if two commissioners unconnected with negotiations review the process.

Q145 Stella Creasy: How are you going to achieve that? You said earlier that it was quite difficult, given the nature of these cases, to get that level of separation.

Dave Hartnett: We have four commissioners at the moment. As head of tax, I am most likely to be a commissioner involved in negotiations in a small number of cases and, in future, any case like that will be reviewed by two other commissioners who will be able to say, "This cannot proceed to settlement".

Q146 Stella Creasy: That is a slightly different point, though, Mr Hartnett. You said earlier that one of the difficulties you faced in having the separation that your own government structure said was required was that other commissioners were involved in resolving cases in the same way that you had been. Now you are saying that that is possible. I don't quite understand.

Dave Hartnett: Where we are going to draw the line—and we are going to draw it very conservatively—is that it will be acceptable for a commissioner to advise on an issue and, depending on the degree of advice, perhaps to review the process. But commissioners who have done more than that or have been involved in negotiations will not be part of the process for reviewing the process of the case.

Q147 Stella Creasy: That is terribly unclear.

Dave Hartnett: Well, let me try again.

Q148 Stella Creasy: They can review, and they can advise to some extent, but they can't negotiate. Is that what you are saying?

Dave Hartnett: Let me try again. I am very sorry for not being clear.

Where a commissioner has been involved in the process of negotiation of a case, that negotiation and any proposed settlement will have to be reviewed by two independent commissioners who have had no role in the case before it can be formally settled.

Q149 Stella Creasy: So if you are saying that that is a better process—

Dave Hartnett: Yes.

Q150 Stella Creasy: You accept that the mistake in this case was that somebody was involved in both the negotiation and the review of the settlement, and that calls into question the process that was undertaken.

Dave Hartnett: But there were two other people involved in the review of the settlement who hadn't been involved.

Q151 Stella Creasy: But you have just said that actually—

Dave Hartnett: No, we are changing in the way I have described.

Q152 Stella Creasy: So you would accept that there was a problem with the way in which this decision was made.

Dave Hartnett: I think there has been a lack of objective assurance, which the NAO brought out. We have accepted its recommendations.

Q153 Mr Bacon: I just want to clarify with the NAO. Mr Hartnett, earlier you characterised this report as being quite good in its conclusions, but my reading of it is basically that it says, "Are the processes adequate? Well, no they are not. And, to the extent that the processes were as they stood—however inadequate that might have been—were they complied with? Well, no they weren't." Is that a fair summary, would you say?

Paul Keane: I think it is fair to say that we conclude that the processes were adequate, but we note the four large cases that have been discussed where effectively, HMRC set aside those governance arrangements, and that's where we raised concerns around the adequacy of the process.

Q154 Stella Creasy: There is something that confuses me. If you are saying that you need to use a

12 October 2011 HMRC and HM Treasury

different system and you did not design that original bespoke system, what did you say when they came to you and asked you to take part in the resolution of this case? Did you not raise concerns yourself that you were being put in a difficult position?

Dave Hartnett: Can I just explain the process by which we raise the level of assurance on cases? The high risk corporate programme board will agree to settle cases where more than £100 million is involved—under consideration, that is, because it might not be £100 million in cash. When it gets to £250 million, the matter has to go to commissioners, or where the high risk corporate programme cannot agree. We have had one instance of that. It goes to commissioners because we require 100% complete consensus agreement on the part of the high risk corporate programme.

Q155 Stella Creasy: Mr Hartnett, this is interesting, but the question I actually asked you is about a slightly different issue. If you didn't design this bespoke system—and you have now outlined to me some of the challenges that you have learnt from the NAO—why did you participate in it? You were saying that actually, you want in future to work in a different way. Did you raise any concerns that you might be in a difficult position—that you might find yourself saying, as we are saying, “Well, how you can negotiate and agree?”

Dave Hartnett: I have had concerns at various times that—if I can put it this way—I am the only commissioner in HMRC who has deep tax knowledge, so I was always going to be involved. I think that the NAO has shown there is a very clear way to do this better.

Q156 Stella Creasy: Did you try to excuse yourself from this? Did you try to put that separation in because of your concerns?

Dave Hartnett: No.

Q157 Stephen Barclay: Did you just say you are the only commissioner with tax knowledge?

Dave Hartnett: Deep tax knowledge. And there are six tax commissioners altogether.

Q158 Stephen Barclay: So for being a commissioner of HMRC, having tax knowledge is not part of the job spec.

Dave Hartnett: Well, we have many requirements of our commissioners. They are very talented people.

Q159 Chair: Well, how on earth are they going to judge, if you do all the negotiation? You are now going to exclude yourself in the future from signing off those negotiations, but the people who are going to have responsibility have no understanding of tax. I would not want to sign them off. Lesley Strathie has no knowledge or qualifications on tax. If she will be signing off your work, that is not sufficient; that is not a check.

Dave Hartnett: No. Alongside what we decided to do on the back of the NAO Report, we will be appointing more commissioners—subject to the sovereign agreeing—who have tax knowledge. That is another

step. If I may, I think this analogy is reasonable—forgive me if it is not. The commissioners will have advice; they will be able to check whether advice was taken; they could get advice from inside or outside the Department—so their position is a little like that of Ministers, who must make decisions.

Q160 Chair: No, because what you were very careful in saying in your evidence to us was that all they are looking at is process. To take the Vodafone instance, where we know Vodafone had £2.2 billion, or thereabouts, in its accounts, set aside to settle tax disputes, you ended up getting something like £1.4 billion out of them—I cannot remember—much less than they had even made provision for. I am interested, as the Chair of the value-for-money Committee, in whether that loss of nearly £1 billion even from what Vodafone had in its account, set aside to pay tax, was value for money. I need tax knowledge to be able to assess whether the deal that you finally did was a good deal. It is crazy to think that someone like Lesley Strathie—and I have huge regard for her as a manager—can make that judgment.

Dave Hartnett: Let me say that there is frequently a difference between what companies provide—some provide very low; some do not provide at all—and what the tax issue is resolved for.

Simon Bowles: Can I just come in there? I was a public company finance director in a previous life, and it is my experience that companies will want to provide conservatively—often very conservatively—for their tax liabilities, because what you do not want to do is go to the market twice: once with a surprise about a tax liability, and then, “Actually we had to up it.”

Q161 Stephen Barclay: What was HMRC's assessment? I do not mean of any individual case—we have already covered that; but what was the combined value of the four cases where governance was not correctly followed?

Dave Hartnett: Oh dear, I am having to disappoint you again, Mr Barclay. Billions, but given that a number of the companies involved, and other companies, released public details of provision and the tax they pay, if I give you a more precise figure—

Chair: We do not even know which companies are involved. We know Vodafone, because *Private Eye* gets it out. We know Goldman Sachs, because *The Guardian* or someone gets it out. We do not know the other two.

Q162 Stephen Barclay: On all four of those cases, was written advice sought by any commissioner signing off the deal, prior to that acceptance being communicated to the company?

Dave Hartnett: I am trying to remember. Certainly on three of them there was extensive advice.

Q163 Stephen Barclay: I do not want to talk about Vodafone. We cannot talk about specifics. My question was this. There were four cases where the NAO says governance was not followed. In an early answer, Mr Hartnett, you referred to one of the controls that we should take comfort from being the

fact that the NAO has unfettered access. I assume that, in exercising that unfettered access, it would want to see the written legal advice in order to assess whether the legal case was strong—and you were one of the people signing off deals, as a commissioner. To come back to my question, if I may: was written legal advice sought, in all four of those cases, prior to any acceptance being communicated to the companies?

Dave Hartnett: I can assure you it was in three. I can't remember for the fourth.

Q164 Stephen Barclay: You can't remember?

Dave Hartnett: I just can't remember. I am very sorry. I will go and check.

Q165 Stella Creasy: Did the person participating in the negotiations also review the decision? For the one where legal advice was not sought and the one where you are unsure whether legal advice was sought, can you clarify whether it is also the case that the person participating in the negotiations also reviewed the settlement?

Dave Hartnett: There are three cases. The NAO will help if I get this wrong. For three of the four cases, at least one commissioner was involved in negotiations and in approving the settlement.

Paul Keane: One at least, and in one case both commissioners.

Q166 Mr Bacon: I am staggered at so many tax commissioners not having deep tax knowledge. I am delighted that you are hoping to appoint more. Can you remind us who the other two tax commissioners are, apart from you and Dame Lesley?

Dave Hartnett: They are Steve Lamey, who is the director-general in benefits and credits, and Mike Eland, who leads our enforcement and compliance.

Q167 Mr Bacon: So we are talking about full-time employees of HMRC. The analogy of a non-executive director of a public company would not apply. These are full-time people, one of whose jobs is to be judge, jury, executioner and gravedigger on deals. You are rightly concerned that you are the only one with deep tax knowledge, which I find extraordinary. Only in this country could that happen. How many more are you seeking, with the sovereign's consent, to appoint?

Dave Hartnett: Two.

Q168 Mr Bacon: And they will both have deep tax knowledge?

Dave Hartnett: One will have deep tax knowledge.

Q169 Mr Bacon: Will it be a future requirement that eventually they should all have deep tax knowledge?

Dave Hartnett: Our non-executive chairman has made it clear that his aspiration for our executive committee—I do not think he has expressed this in terms of commissioners—is that half would have deep tax knowledge. It is not like that yet.

Q170 Mr Bacon: Half would be marvellous. There are a number of issues I want to pursue, but Mr Barclay raised the issue of the NAO having full access and being able to decide whether the case was strong

enough. The fact is that you have resisted the NAO's demand for detailed legal advice. I have been looking at an internal e-mail from HMRC, which you were copied in on. It discusses the cases with over £100 million tax at risk, which we are intending to disclose to the NAO. It states: "You will remember that NAO were pushing very hard for detailed information on the cases where we make a provision or contingent liability in the trust statement. Dave and Alan"—I don't think it is the comedian from the 1970s; I believe it is you and Alan Evans—"were able to convince them to accept less detailed information that did not give any indication as to whether we thought our case was strong or weak." In those circumstances, it makes it very difficult for the auditors to do their job properly, doesn't it?

Dave Hartnett: Can we put this in context, Mr Bacon? I am sure that the NAO will help me if I go astray. These are our accounts that we are talking about. It is the provision for disputed tax that appears in our accounts. The discussion that we had with the NAO, which has a lot to do with taxpayer confidentiality, was on how we could provide more transparency in relation to the provision in our accounts. I think I have that right.

Q171 Mr Bacon: Given that the NAO has full access and will not disclose it further, so it should have oversight, the confidentiality issue in this relationship is not an issue. The issue is whether the case is strong or weak. The point is that the NAO and, indeed, we, cannot make an assessment as to whether you have been administering the affairs of your organisation effectively, efficiently and economically if we cannot understand whether you were following your own litigation and settlement strategy by going for 100% in strong cases, because you have resisted telling them whether the cases were strong or weak.

Dave Hartnett: The issue there was not resisting at an absolute level; it was what was going to be disclosed by the NAO. The Comptroller and Auditor General may want to say something about this.

John Thorpe: Could I say something about it? I think that this relates to the audit of the financial statement. This is how the process worked. We identified approaching 100 legal cases which we thought may have a bearing on the financial statements. We carried out a review of those and did some in-depth testing on some of those cases. The issue is that the schedules that sit in the finance department are anonymised, because they cannot be passed around the organisation with taxpayers' details on them. To get the assurance that we needed—first, to say what the strength of the case was—we had to go to the legal department, and to tax experts. We also spoke with analysts about how they quantified whether it was a liability or an asset. In a spectrum of cases, some have a liability for the department, and from memory that approaches £6 billion in the accounts. There are contingent liabilities, so we must identify which cases fall into that category. On the other side, there are contingent assets, and cases where the department has a potential claim to recover tax. We cannot make an assessment of how that should be recognised without looking at the

12 October 2011 HMRC and HM Treasury

individual papers or talking to the individual experts to assess the strength of the case.

Q172 Mr Bacon: But that is precisely what they say they are not given: “Dave and Alan were able to convince them”—the NAO—“to accept less detailed information that did not give any indication as to whether we thought our case was strong or weak.” The list is set out as follows: alphabetical order; no split between cases where there is provision for a contingent liability; and a very brief description of the case.

John Thorpe: We have very detailed working papers with all those cases, and with the supporting documentation, which supports where they fall in provision or contingent liabilities.

Q173 Mr Bacon: I understand that this is under your financial audit hat, but presumably there would be nothing to stop the NAO going back in with a value-for-money hat on and doing a value-for-money study, looking at the whole issue of strong and weak cases if you wished to do that.

John Thorpe: Indeed. If I can talk from the financial audit perspective, I should also say that we track those cases. They’ve been on the books for many years, so we are reviewing them on an ongoing basis. It is not simply an end-of-audit activity.

Q174 Mr Bacon: I am relieved to hear it. Thank you very much. May I quickly move on?

Mr Hartnett, you mentioned in answer to Mr Wharton earlier that at the meeting with Goldman Sachs three HMRC officials were present, and what you described as three Goldman officials. Did you mean employees of Goldman rather than advisers to Goldman?

Dave Hartnett: Yes.

Q175 Mr Bacon: So you were not that oblique in saying that basically, David Goldberg QC wasn’t there, because he’s not an employee of Goldman?

Dave Hartnett: I keep being asked the same question—whether Mr Goldberg is at our meetings.

Q176 Mr Bacon: Well, it seems that many of us want to know.

Dave Hartnett: There are lots of tax silks.

Q177 Mr Bacon: It says here, “Was David Goldberg, QC there?” That is my first question. Have you had lunch with Mr Goldberg?

Dave Hartnett: Yes. I had lunch with Mr Goldberg perhaps once, twice or three times in the last five years.

Q178 Mr Bacon: Three times in the last five years.

Dave Hartnett: He acts for us also.

Q179 Mr Bacon: Does he—because he is a leading tax silk?

Dave Hartnett: Yes. It took a long time, but we managed to persuade him to work for us.

Q180 Mr Bacon: At least he has deep tax knowledge.

Dave Hartnett: Not all tax silks work for us.

Q181 Mr Bacon: I have a marvellous schedule of your lunches, and if I had had as many lunches I’d be even fatter than I am. I accept that it is sensible for someone in your position to meet people “socially”, whether for dinner or breakfast. We all have such encounters and they are very useful, so I’m not attacking you for that—although there are quite a lot of them—but I have a couple of questions.

Dave Hartnett: May I just say something first? Many of those are not simply lunches. I speak extensively on tax.

Q182 Mr Bacon: So you were guest speaker.

Dave Hartnett: Quite often.

Q183 Mr Bacon: On the right-hand side, it sometimes says, “Speaking engagement”. Am I to take it that when it doesn’t say so you were still a guest speaker?

Dave Hartnett: Absolutely.

Q184 Mr Bacon: Where it says “individual”, what are we to make of that, and why can’t the individual be named?

Dave Hartnett: Because the convention that we have been given across Whitehall is that we don’t name individuals if they’re taxpayers, and the individual might be a taxpayer.

Q185 Mr Bacon: Most people are taxpayers—or are you having lots of lunches with non-doms?

Dave Hartnett: Not really, Mr Bacon.

Q186 Mr Bacon: Everybody’s a taxpayer. Even the Queen is a taxpayer.

Dave Hartnett: What we’re trying to do by that is to ensure that it is not simply put into the public domain what individual we might be talking to about tax issues. That’s our convention.

Q187 Mr Bacon: It’s not the only view one can take. I am sure that in Sweden you can probably go in and look at a list every day.

Dave Hartnett: We have a look at the tax—

Q188 Mr Bacon: Is there any serious reason why we couldn’t be more open about that? It would give extra confidence, and confidence in the tax system would be a good thing.

Dave Hartnett: Let me put it like this: imagine that you appeared on my list—named.

Q189 Mr Bacon: I would be delighted to come to lunch, by the way, should you wish to invite me. I’d put it on my website.

Dave Hartnett: There are probably only two reasons why the public at large would deduce you were there: first, that you had a constituency issue, but we do not tend to have meetings like that; and secondly, that you had a problem. The convention is that you should not be identified.

12 October 2011 HMRC and HM Treasury

Q190 Chair: I have to say, I do not take as generous a view of this as Mr Bacon does. In your position as the chief negotiator on tax disputes, it is very dangerous for you to go and have lunches—107, we are told, in two years—with a range of organisations with which you have been negotiating. Had I, as a Minister, done that with organisations I was doing business with, I would have been on the front of the *Daily Mail* and pushed out of my job. That is the reality of it.

Dave Hartnett: Chair, that list does not involve companies that I am negotiating with.

Q191 Chair: It does. Well, we don't know because some of them say "taxpayer confidential". The list involves a load of organisations that will be acting as the advisers to individuals with whom you will be negotiating—PricewaterhouseCoopers happens to be the old firm that I worked for, so I know that it would have done it for them.

Dave Hartnett: As I understand it, there are competition rules about how and when leading figures in the big four accounting firms can get together. Once or twice we have had real trouble getting them together when we wanted to talk to them. The heads of tax of the major accounting firms have supper quarterly, I think, and once or twice a year they have invited me to go.

Q192 Chair: You have had 107 lunches—corporate hospitality engagements—in two years, which is at least one a week.

Dave Hartnett: They are not all lunches, with respect.

Q193 Chair: Dinner, lunch—I can go through the list.

Dave Hartnett: I am scrupulous about recording everything.

Chair: I think it is deeply unwise.

Q194 Stella Creasy: Mr Hartnett, can we stay with your point? You said that you might not have lunch with Mr Bacon, because people might draw inference from that. What inference do you think they would draw from your having lunch with companies like Goldman Sachs?

Dave Hartnett: They might infer that a tax issue is under consideration. Since we have started publishing fully, I do not do that—I find other ways of doing things.

Q195 Stella Creasy: What other ways?

Dave Hartnett: Well, maybe a cup of coffee in my office.

Q196 Stella Creasy: So you do not record every contact you have with these companies.

Dave Hartnett: We are not required to record a cup of coffee. Permanent secretaries are now required to record and publish all meetings we have with people outside the civil service. If you look at my published list, it says "a taxpayer"; it does not say who the taxpayer is.

Q197 Stella Creasy: Given that, potentially, four firms are involved, and you do not have to name any of them, have you had more contact with—

Dave Hartnett: I always name the firms.

Q198 Stella Creasy: Have you had other contact, apart from that involving just a coffee or a drink, without any food—no crisps, or whatever, down the pub—with the four firms involved in these disputes?

Dave Hartnett: Sorry, I am now confused.

Q199 Stella Creasy: In that same time period, can you clarify that the only social contact you had with the firms that the Department was in dispute with—that you were negotiating on—was the ones that are listed? Or were there other times when you were in contact with them?

Dave Hartnett: There is nothing other than coffee—

Q200 Stella Creasy: So you confirm that, on top of those contacts, you had other contacts with the four firms in question.

Dave Hartnett: Yes, they might have come in for a meeting on an issue.

Q201 Ian Swales: I understand why you might not want to have this information in the public domain, and you have given us reasons for that. But we are also talking about internal governance in HMRC. Is the knowledge of whom you have seen available anywhere in HMRC?

Dave Hartnett: Yes. My line manager has it and lots of other people in HMRC will know about it.

Q202 Ian Swales: So the top people in HMRC know about all those meetings.

Dave Hartnett: Yes.

Q203 Chair: Who is your line manager?

Dave Hartnett: Lesley Strathie.

Q204 Chair: But she is now on sick leave.

Dave Hartnett: Yes.

Q205 Chair: So, who is your line manager?

Dave Hartnett: Nominally—that is probably the right way to describe it—Sir Gus O'Donnell.

Q206 Stella Creasy: So have you been in contact with Gus O'Donnell to report all the coffees as well as the lunches?

Dave Hartnett: He gets a copy of—

Q207 Stella Creasy: He gets that list, doesn't he?

Dave Hartnett: He gets that list, yes.

Q208 Stella Creasy: He doesn't get the coffee list.

Dave Hartnett: He gets the permanent secretary's list as well.

Q209 Stella Creasy: So he doesn't get the cumulative total.

Dave Hartnett: Miss Creasy, when I have coffee with an accountant or an adviser, it is almost always to address a particular issue, usually accompanied by

12 October 2011 HMRC and HM Treasury

someone else from my department, and sometimes—if you can forgive me for putting it this way—they bring a great gang with them from their firm.

Q210 Ian Swales: Can I ask one last question? Do you think it would be wise if you always had somebody else with you from HMRC at such meetings?

Dave Hartnett: That often happens, and yes, it could be wise.

Q211 Ian Swales: Well, you have said it often happens. I am asking, do you think it should always happen?

Dave Hartnett: Not necessarily, but perhaps on the back of this discussion I will think again.

Q212 Stephen Barclay: It is reasonable to have coffees and to meet people. You have to be accessible and you have to be able to work. It comes back to the point that we touched on earlier about what the written legal advice is and whether the NAO has access to it. Can I take us to a slightly different area? Once you reach settlement with a firm, what is the maximum period over which they must settle the outstanding claim?

Dave Hartnett: That depends entirely on what the issues are and the financial position of the organisation. Some £1 billion-plus settlements have not been fully provided for, and there are significant issues.

Q213 Stephen Barclay: So it's unlimited? It is at your discretion?

Dave Hartnett: No, we are always trying to strike the right balance between getting the money as fast as we can and collecting for the Exchequer the maximum amount of money that fits with—

Q214 Stephen Barclay: I don't want you to talk about—well, I would like you to talk about individual cases, but you have given your position on that and you are going to write to me with a legal note on that earlier discussion. Can you tell us the maximum period that a firm has been allowed before settling its outstanding agreed tax bill with you?

Dave Hartnett: The longest I can remember—this goes back a little way—was probably 10 years.

Q215 Stephen Barclay: My constituents, especially small firms, would find it very odd that at your discretion you are giving firms 10 years to settle their tax bill.

Dave Hartnett: Well, I don't know about your particular constituents, but I can certainly say that we have given small firms and individuals longer than that at times.

Q216 Stephen Barclay: Okay. Where you give a firm more than 12 months to settle its outstanding bill, do you look at its balance sheet to see what assets it has got?

Dave Hartnett: We do more than that. It is in the nature of our enquiry to look at the balance sheet. I would expect our people to be thoroughly familiar

with the balance sheet. Our business payment support service, for example, which is the way we support smaller businesses by giving them time to pay, will ask for financial reports as well before we agree the time. Where we are settling with a business over time, we will often ask for a bank report or some other financial report.

Q217 Stephen Barclay: How are the governance criteria around that documented within the department?

Dave Hartnett: We have clear guidance for our people on things like the business payment support service, and we have advice on the time to pay for investigation settlements in our manuals.

Q218 Stephen Barclay: And that is something that the NAO would look at?

Dave Hartnett: I don't know whether it has looked at it, but it is very welcome.

Q219 Stephen Barclay: To take a hypothetical case, it would not be possible, for example, for firm X with a bill of £1 billion to have £5 billion or £7 billion in assets?

Dave Hartnett: Yes, I think it would be. It depends on what is on the other side of the balance sheet. We want our money—we want the nation's money—as fast as we can get it. Normal terms are 30 days; sometimes that will stretch to months. If we cannot get it faster, we will take it over a longer period.

Q220 Joseph Johnson: On Stephen's point about a level playing field between smaller businesses and the like of Goldman Sachs, I have businesses in Orpington that are being put out of business for late payment of their VAT returns, and they are not even being allowed to stagger them over a quarter, let alone a period of years, so I really don't buy the argument that there is a level playing field.

That is not the point that I want to go back to, which is that we are in a period of incredible fiscal consolidation in Britain. You have got a huge job to do—£25.5 billion of potential tax out there to be clawed in. I am concerned that HMRC's credibility has taken something of a knock in the past 18 months as a result of the decision—not quite sure whose decision, at this point—to go outside usual procedures with these bespoke arrangements in respect of Goldman Sachs, Vodafone and a couple of other important cases. Do you acknowledge that—that HMRC's credibility in the public and between the corporates has taken a knock?

Dave Hartnett: I think the speculation, if I may call it that, about what we have done as a department in one or two large cases has been damaging to HMRC but, actually, much of the speculation has been plain wrong. At the TSC hearing before last, for example, on advice I aimed to take away in respect of one corporate some of the mischief that was out there about how we had operated.

Q221 Chair: May I ask you another question? You did the deal in Switzerland for UK residents with

12 October 2011 HMRC and HM Treasury

funds in Swiss bank accounts—I understand that you negotiated that, didn't you?

Dave Hartnett: I negotiated, but it is a ministerial agreement.

Q222 Chair: Do you think it is a good deal?

Dave Hartnett: I think it's a terrific deal.

Q223 Chair: And how do you justify the difference in treatment of rich people who have Swiss bank accounts and the single parent who is being pursued for an overpayment of tax credit?

Dave Hartnett: I think, Chair, what we have achieved in relation to Switzerland was that—

Q224 Chair: How do you justify the difference in treatment?

Dave Hartnett: I am sorry, I need to explain a little about Switzerland first. I will be very quick. What we have achieved will be money for the Exchequer that we would not have got in any other way. We have protected the Exchequer in relation to cases that are already working—so they cannot come within the arrangement—and we have protected the Exchequer in relation to serious organised crime and the like. My answer to you would be that this Switzerland deal is gaining for the Exchequer billions of pounds that it would not otherwise have got. We are addressing issues in the UK for large and small individuals—

Q225 Chair: How do you justify the difference in treatment for rich people? And I am not sure that you have protected, because they can all take their money offshore to another country before May 2013. How do you justify the difference in the treatment of UK taxpayers who are rich enough to have bank accounts in Switzerland, and the way your department treats the overpayment of tax credit to single parents—if you pursue it at all?

Dave Hartnett: We know the people who have been overpaid tax credits and can address that, but we do not know the identity of people in Switzerland and we cannot establish who they are.

Q226 Chair: So your justification of the difference in treatment is—

Dave Hartnett: A pragmatic solution to a long-standing difficulty.

Q227 Chair: Although they can all go offshore somewhere else by 2013.

Dave Hartnett: But we have made arrangements to follow the money, which has been very important to us. And we will follow the money. With Lichtenstein and with Switzerland, we are bringing in huge amounts of money for the Exchequer.

Q228 Chair: We haven't covered everything that we wanted to this afternoon, but I think in the interests of everyone—if you are happy with this—we shall draw

the sitting to a close. I just want to say a general thing and ask you a final general question.

What comes out of this for me and the members of the Committee is that there is a huge sum of money—£25.5 billion, which is an enormous amount of money in potential income to the taxpayer, and incredibly important at a time of deficit reduction—and you are responsible for trying to collect it. You are also a member of the board that oversees your action. You are also a commissioner who oversees the action of the board on an action you have taken. The NAO does not do the detailed work to assess whether the deals you reach are value for money and, at present, there is no way in which you account to the public or to MPs—to us as custodians of the taxpayer's pound—and nor do you account for whether you are doing a job that is providing value for money. That is how it feels to me. My final question: do you feel that? If you do, what would you change so that we, as the custodians of the taxpayer's pound, can feel better about ensuring that you and your team provide value for money?

Dave Hartnett: If I may, I'll say two things. First, I am very confident that we are providing value for money, but I think that both the TSC hearings and interim report, and this hearing, make it clear that there are real concerns here. The TSC has flagged up to us that it wants to consider, as part of its current review of my department, how greater clarity can be brought—

Q229 Chair: What is your view? You are currently the permanent secretary there. What is your own view? I have to tell you that everyone came to this with a fantastic unanimity of view around the table—across party—and no one prepared, in that sense, for it. We came with a unanimity of view and the Treasury Committee has a similar view. You have been around for a long time. How can we get a system? You tell us you are value for money, but the only bits that hit the press question that. Your behaviour in relation to things like lunches makes us even more suspicious, and there is no way of verifying things on behalf of the taxpayer.

Dave Hartnett: I think the answer to your question is going to have to be determined by others to whom we provide advice. The TSC asked whether we had seen systems elsewhere. There is one in Finland, for example, where there is an independent body between the tax administration and the taxpayer when it comes to resolving issues. Most other countries have a system like the United Kingdom's. I did look before I came here at the policy statements made in the United States, for example, which mirror our own mission statements and the like. But we will provide advice to others, because it will be their decision as to whether the system changes.

Chair: Thank you very much. I ask my members to stay behind.

Monday 17 October 2011

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon
Stephen Barclay
Stella Creasy
Matthew Hancock

Mrs Anne McGuire
Nick Smith
Ian Swales
James Wharton

Amyas Morse, Comptroller and Auditor General, **John Thorpe**, Director, National Audit Office, **Jane Wheeler**, Director, National Audit Office and **Marius Gallaher**, Alternate Treasury Officer of Accounts, HM Treasury were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HMRC Structured Costs Reduction

Examination of Witnesses

Witnesses: **Stephen Banyard CBE**, Acting Director General Personal Tax, HM Revenue and Customs, **Dave Hartnett CB**, Permanent Secretary for Tax, HM Revenue and Customs, and **John Keelty**, Director, Finance Planning and Performance, HM Revenue and Customs, gave evidence.

Q230 Chair: Welcome again, everybody. We have a lot to get through because we want to focus on the parts of the Report that we weren't able to cover last week and we want to deal with the other Report from the NAO, on cost reduction in HMRC. It is appropriate to say in the public arena that we aren't going to let matters rest from last week. The Cabinet Secretary has asked to see me and I intend to attend that meeting with Richard Bacon from the Conservatives and, I hope, Ian Swales from the Lib Dems. From there, we will decide what further action we're going to take. We would like Amyas to do some further work, and perhaps, Amyas, you'll describe that further work. There are one or two questions and then we'll move to that. In the first instance, would you like to describe the work?

Amyas Morse: The proposal is that we would put ourselves in a position to examine the reasonableness of some of the larger settlements, probably with the benefit of some tax advice, and we would aim to report on that in a confidential—private—session at some point in future. I know HMRC and Gus O'Donnell would co-operate, but it would be helpful to have that confidential session. That might help to satisfy a lot of the issues that are still there.

Dave Hartnett: Chair, if I may, you asked me a question on Wednesday, which I was not able to answer because Mr Mitchell asked a question at the same time, and I fear I turned to his question rather than yours. The question was whether we would talk to you in confidence. Had I answered, I would have talked of the sort of confidential discussion just described by Amyas Morse. We are ready for that sort of discussion.

Chair: Good.

Dave Hartnett: And we will support the NAO in its work.

Chair: Thank you very much. There are just few questions arising out of the transcript from last week that Stephen, and perhaps Richard, would like to put

to you. Then we will move on to discussions of PAYE and other matters.

Q231 Stephen Barclay: Starting with the legal advice, which you offered to send. We have not received that ahead of today's hearing. Could you clarify when that will be received?

Dave Hartnett: The difficulty, Mr Barclay, is that the legal advice is subject to legal, professional privilege. The Government do not disclose their legal advice publicly, save in very rare circumstances. We have said that we would write setting out the legal position. We have been asked to advance the time by which we do that to Wednesday lunch time, and we will meet that timetable.

Q232 Stephen Barclay: Can you advise the Committee on which areas you sought legal advice?

Dave Hartnett: I'm thinking of the legal advice all the way back to 2009. We were going to cover the whole piece for you. Basically, it is legal advice on taxpayer confidentiality.

Q233 Stephen Barclay: Coming on to one of the issues we were trying to get at around the point that you are arguing on individual taxpayer confidentiality, Vodafone, in its own regulatory announcement on 23 July 2010, said that the settlement comprising the £800 million in the current financial year would be paid over five years. In your evidence to us last week, you said that time to pay would be granted only if a company did not have the assets to settle its bill. Given the strength of the Vodafone financial position, why was it given five years to settle its bill?

Dave Hartnett: I fear, Mr Barclay, we are back where I was last week. I cannot talk about Vodafone, but I am sure we should be able to pick up something like that in confidence in the context Mr Morse and the Chair have described.

17 October 2011 HMRC

Q234 Stephen Barclay: This is an area that the company itself has put in the public domain. It made a statement saying it had five years. You have guidelines—also in the public domain—that say time to pay cannot be granted, except if the company does not have the assets. Vodafone’s financial position is in the public domain. I can happily quote its position on its operating profit increasing from £11.8 billion to £12.2 billion, the dividends it was paying and other points regarding its financial strengths. That is all in the public domain. It seems there is a clear breach of your own guidelines, yet that is information Vodafone has shared with its investors.

Dave Hartnett: I am sorry but, even where information has been put in the public domain, I cannot discuss a taxpayer’s position. We will try to do so in the “in confidence” discussions.

Q235 Stephen Barclay: Is it just a coincidence that the settlement with Vodafone was reached the day before the quarterly announcement by Vodafone?

Dave Hartnett: I have no idea. I am sorry.

Q236 Stephen Barclay: So, the fact that that settlement was reached with Vodafone, without written legal advice, the day before the company announced its dividend position and its quarterly returns—that is just a coincidence, is it?

Dave Hartnett: I cannot comment on that.

Q237 Mr Bacon: Mr Hartnett, I want to ask you about the mistake that you referred to last week. That was what you described as “an issue in relation to which a mistake was made, because we saw an impediment to dealing with an issue. In fact, the impediment had been removed. A number of us at the meeting did not know that.” You went on to say, “It was actually me who took the mistake to Mr Inglese.” When did you first know that there had been a mistake?

Dave Hartnett: Probably four or five days after the meeting.

Q238 Mr Bacon: Just to remind us, what was the date of the settlement meeting?

Dave Hartnett: I think 19 November.

Q239 Mr Bacon: So you were abroad when you found out about the mistake?

Dave Hartnett: There was—I need to check. I may need to correct when I went abroad. I may have gone abroad a week later.

Q240 Mr Bacon: You were in London on the 22nd. On the 23rd and the 24th you were in Liechtenstein. On the 25th and the 26th you were in Switzerland. That was the whole of that week. The following Monday, the 29th, you were in India, and you did not get back until 5 December. In fact, you said to us last week that you went straight abroad after the meeting.

Dave Hartnett: I thought I had done, Mr Bacon.

Q241 Mr Bacon: What I am trying to figure out is—because you say that you identified the mistake—

when did you first know that there had been a mistake?

Dave Hartnett: I believe—I will have to check—immediately following the weekend after the settlement meeting, when I was talking to my colleagues. I think I explained to the Treasury Committee that there were actually two mistakes. There was one financial error, and there was a mistake made in not reporting the case instantly to our high-risk corporate programme board.

Q242 Mr Bacon: When you say not reporting the case, do you mean not reporting the settlement?

Dave Hartnett: Not reporting the settlement, yes.

Q243 Mr Bacon: So you cut a deal but you did not tell anybody? Is that what you are saying?

Dave Hartnett: No, no. I am not saying that at all.

Q244 Mr Bacon: I am not trying to be glib—I know it sounded glib; I am often accused of that, I’m afraid—but that sounded to me like what you just said. A deal was struck but it was not reported immediately. What does that mean, if not that you cut a deal but you didn’t tell people?

Dave Hartnett: A settlement was reached, which all the HMRC people believed to be within the authority of the sector lead and the case relationship manager to reach. Over the weekend following the settlement, the sector lead began to realise that it was not within his competence to do that. That was the other mistake, and it was referred late to the high-risk corporate programme.

Q245 Mr Bacon: Right. How late? How much later was it referred?

Dave Hartnett: Days.

Q246 Mr Bacon: And why wasn’t it within his competence?

Dave Hartnett: Because he had not fully consulted the other areas of our business interested in the issues.

Q247 Mr Bacon: That sounds familiar, actually—not consulting people who are familiar with the issues. So that was the second mistake: the deal was not reported immediately. The first mistake was what you described as a financial error.

Dave Hartnett: The NAO described it as such, but I agree with the description.

Q248 Mr Bacon: That was also the legal error in thinking that you could not charge interest, was it?

Dave Hartnett: Yes.

Q249 Mr Bacon: Whereas you actually could. In coming to the conclusion that you could not charge interest, did you consult lawyers about that?

Dave Hartnett: No.

Mr Bacon: You didn’t?

Dave Hartnett: No.

Q250 Mr Bacon: Since it is very common to charge interest—it is standard practice to charge interest—

17 October 2011 HMRC

wouldn't consulting lawyers on that question have been the obvious thing to do?

Dave Hartnett: There are two things to say with that, Mr Bacon, one of which I touched on last week. I had overseen the 2005 settlement of the issues, and I knew of the legal impediment to collecting interest. My colleagues were in a similar position of knowing, and so was someone from the taxpayer. We were all confident that we knew that. The dispute that was in the hands of the lawyers was over the principal sum; it was not a dispute about interest.

Q251 Mr Bacon: Hang on a minute. The legal impediment that you thought you were confident about was a supposed impediment to the charging of interest.

Dave Hartnett: Yes.

Q252 Mr Bacon: But the 2005 settlement that you were talking about was several years previously.

Dave Hartnett: Yes.

Q253 Mr Bacon: Would it not have been standard practice to revisit why it was that you were so confident about the nature of that impediment?

Dave Hartnett: Well, because I had not been running the case, but those with me had, and between us—and I am very sorry about this—we all believed the impediment still to be there.

Q254 Mr Bacon: But you actually wrote to Goldman Sachs—

Dave Hartnett: I don't think—

Q255 Mr Bacon: Sorry, not you. HMRC wrote to Goldman Sachs and told it that the interest would run—that the interest would continue to roll up and be due if it did not settle with the other 21 companies.

Dave Hartnett: I'm sorry, Mr Bacon, I was unaware of that letter until you mentioned it to me.

Q256 Mr Bacon: I bet you found out afterwards.

Dave Hartnett: I might have.

Q257 Stephen Barclay: At our previous hearing you said that you could not recollect whether a detailed note was taken at the meeting. Have you now had an opportunity to check?

Dave Hartnett: I have not yet had a chance to check, Mr Barclay.

Q258 Stephen Barclay: You have not had a chance to check?

Dave Hartnett: No, not yet, but I will do so.

Q259 Stephen Barclay: When?

Dave Hartnett: Tomorrow, if I can.

Q260 Stephen Barclay: In your evidence to us last week, you said, "We keep very detailed records, indeed." It's surprising that you felt it necessary to phone the global head of tax at Goldman Sachs to summon him from New York and a meeting record was not kept.

Dave Hartnett: Mr Barclay, I know there is a meeting record, which HMRC has, that was prepared by the taxpayer. I do not know whether there is an HMRC record as well.

Q261 Stephen Barclay: But these were senior people at the meeting. When the mistake was identified on the Monday, was a note circulated to lawyers at that stage?

Dave Hartnett: I spoke to Mr Inglese to seek his advice. I do not know whether he circulated a note; I certainly did not.

Q262 Mr Bacon: When did you speak to Mr Inglese?

Dave Hartnett: I think on the Monday, but I need to check, Mr Bacon. I'm sorry.

Q263 Mr Bacon: You think it was the 22nd, after the Friday.

Dave Hartnett: Very soon after, yes.

Q264 Mr Bacon: On the interest and the nature of the mistake, you prefaced your remarks about the interest by saying that you were involved in the 2005 deal. But it was in October 2005 that HMRC had warned that the interest would continue to accrue. It defeats me how, in apparently being so confident that you could not charge interest and therefore it was not something that you seriously thought about doing, the record showed the exact opposite. You had warned them about the fact that you would continue to charge interest, and yet you, or the people you were with, did not revisit the question. If you had, you would have discovered that there was not an impediment. That is the whole point.

Dave Hartnett: I think, Mr Bacon, that if the NAO is going to look at the matter, it should all come out then, because there is much more detail to come out.

Q265 Stephen Barclay: You also said, in answer to one of the questions last week, "normally we are able to intervene to correct them", as in mistakes, "because they are spotted by the process. I spotted the mistake here." If the mistake was spotted as quickly as the Monday following the Friday meeting, why was it so binding on HMRC that you were not able to rectify it as would be normal practice?

Dave Hartnett: I am not going to be able to answer that in public, Mr Barclay, but we will be able to deal with it through what Mr Morse is going to do. But let me just say this: there were discussions with the taxpayer shortly after we discovered the interest and the governance error.

Q266 Stephen Barclay: But you accept that legally you were not bound by that decision. Legally you could have rectified it.

Dave Hartnett: I received advice that we could regard ourselves as bound by it, or not bound by it.

Q267 Stephen Barclay: In other words, you were not bound by it.

17 October 2011 HMRC

Q268 Mr Bacon: Mr Barclay has put it as perfectly as one could. You have the option of either going back and revisiting it and saying, “Yes, we will charge the interest” or accepting that it was a done deal, and you went with the “It’s a done deal” option, although you did not have to. That is correct, isn’t it?

Dave Hartnett: Mr Bacon, I have just been passed a note by my lawyers to tell me that this is taxpayer confidential and will need to be dealt with in the review of the case rather than now.

Q269 Mr Bacon: I think we probably will not get much further today, and I look forward to the CAG’s further report. It does seem very odd that not only did you choose the second option of accepting it as a done deal when you could have gone back and revisited it and fixed it, but Mr Inglese signed it off in that way, and so did two tax commissioners. That must have resulted in a negative impact on the revenue. The legal advice was that it need not have been that way. That seems very odd.

Dave Hartnett: If I may, one final comment from me: “must have” may not be right. Mr Morse explained other possibilities last time, and there is more to this that will come out.

Q270 Chair: Okay, we are going to come back to it after both the NAO work and our discussions with the Cabinet Secretary. We will probably expect him to give evidence to us anyway, although he was clearly unable to do so this afternoon.

Right, PAYE. I do not know whether you are dealing with this, Mr Hartnett. One issue slightly concerns us. You have stepped up to be acting permanent secretary in the circumstances, which we completely appreciate. Are you able to do all this work of sorting out all the deals that you get involved in, and making sure that the rest of the Department is functioning well?

Dave Hartnett: I am doing my very best to do that, Chair. It is not the first time that I have stepped up. I am Lesley Strathie’s second permanent secretary—I led the Department for a year once before while trying to do other things. I am doing my very best.

Q271 Chair: We might come back to that, because there are some concerns about your cost cutting.

The PAYE story is a better one than when we looked at it six months ago and we welcome that—it is a better place to be in. Looking at it in that context of a welcome improvement, let me briefly deal with the issues that remain. I am concerned that on page 9, in paragraph 26, we are told by the NAO that you have nearly 7 million individual records that are awaiting reconciliation, which is still 15%, which is one heck of a lot. When will you have done that reconciliation, and what is the impact of those figures on the financial loss to the taxpayer?

Dave Hartnett: I’ll ask Stephen to pick that up, if I may.

Stephen Banyard: Under the old pay-as-you-earn system we had to manually reconcile 16 million or 17 million records a year; under the new one, we expect to have to reconcile 3 million to 4 million a year, so there is a huge reduction in the amount of manual work we have to do. The 6.7 million is the number of

cases that needed to be looked at by our staff this year. We are 39% into that and we expect to have completed it this year—on schedule.

Q272 Chair: In this financial year?

Stephen Banyard: Yes.

Q273 Chair: Can you update the Committee on the total income tax forgone because of the delays and difficulties in introducing NPS? Have you got that figure or can you put it together for us?

Dave Hartnett: I have got some numbers for you. For the years 2004–05 and 2005–6, we have only a notional figure. The Committee may remember that when Lesley Strathie was here she explained that notional meant the largest amount, but that we would not have necessarily collected it all. It is important to realise that. That was a figure was £150 million. In 2006–07, the amount forgone was of the order of £100 million.

Q274 Chair: We’ve got £500 million.

Dave Hartnett: Again, I think that is the notional figure. Lesley was at pains to explain that the actual amount that we might have collected in the summer of 2010 stood at £100 million, and by November 2010 it was down to £25 million.

Q275 Chair: What do you in the NAO feel more comfortable with looking at? There is a heck of a difference between £500 million and £100 million.

John Thorpe: Both the figures are included in paragraph 3.11 of the report. The £500 million was the notional amount at the time, in 2006–7; the £100 million was based on the Department’s assessment.

Q276 Chair: Whose notional figure at the time? HMRC’s or yours?

John Thorpe: It is from HMRC records—from the database of open cases. The £100 million is the estimate of what could have been collected at the start of the recovery exercise in June 2010.

Q277 Chair: So what could have been collected is different from what was owed.

John Thorpe: Yes, because had HMRC acted at the time, there was a potential to collect £500 million.

Q278 Chair: Okay, so let’s take £500 million. So far, we are at £650 million—go on.

Dave Hartnett: There is a real problem with £500 million, because that is not what could have been collected; the £100 million is what could have been collected.

Chair: No—yes. It is a question of what could and what should—what was owing and what could have been collected—there is a difference.

Q279 Ian Swales: For example, that includes your changing the de minimis rules, I believe.

Dave Hartnett: I am coming to that next, Mr Swales. The £500 million includes every penny—

Q280 Chair: That should have been paid.

17 October 2011 HMRC

Dave Hartnett: That should have been paid, but not every penny could have been collected. It would have been cost-inefficient to do so.

Q281 Chair: I accept that. I understand that. Of course, in all these figures we do not have the—

Dave Hartnett: The £300 threshold we introduced for 2007–08, 2008–09 and 2009–10, involved the sum of £266 million.

Q282 Chair: Right. I have another figure of £136 million of underpayments on the 2007–08 cases, not worked or collected.

Stephen Banyard: That is down to £126 million now.

Q283 Chair: That is down to £126 million from £136 million. Then I have another figure of £41 million for recovery of tax forgone following successful taxpayer claims of remission under extra-statutory concessions.

Dave Hartnett: That is correct.

Q284 Chair: Then we have an unquantified amount, which you might like to quantify, of tax forgone from some 250,000 pensioners, where their tax codes failed to reflect their state pension between 2008 and 2010.

Dave Hartnett: We do not have a figure for that yet. I think that is correct, Stephen?

Q285 Chair: Do you have a ballpark figure?

Stephen Banyard: All of these estimates are to an extent unreliable, but the figure for the pensioners' tax is so unreliable that neither we nor the NAO could put it into the report.

Q286 Chair: Presumably, there will be another figure for these 6.7 million accounts that you have yet to reconcile, of which you have done 30-something per cent.

Stephen Banyard: No, we expect to put all of those into charge, because they are in time. They are for 2008–09 and 2009–10, and we are working them so that they will be in time.

Q287 Chair: So, we are talking about, in total, £1.2 billion or thereabouts.

Dave Hartnett: If the notional figure for 2006–07 is taken, it comes to that order.

Chair: That is a shocking loss to the taxpayer.

Q288 James Wharton: Do you think that, given where we are now and what we now know of how things have progressed, it was the right decision to increase the de minimis limit in order to streamline administration, but obviously taking on the cost of that?

Dave Hartnett: I will bring in Stephen in a moment. We would have had real difficulty if we had not done that. It was a case of managing the work to make sure that we got the work done before the time limits ran out and that we caused less distress to taxpayers than we might otherwise have done.

Stephen Banyard: What the Department faced, as it brought in the NPS system late, was a concertina of work. You cannot carry that bow wave forward for

ever; you have to unwind it and start to operate the tax system in real time. By introducing the £300 tolerance, the Department cut out 40% of the adjustments, but only 8% of the yield. It was on that judgment that we took that decision.

Q289 James Wharton: One of my concerns is related to discussions that I have had with HMRC employees who are my constituents about how they work. One of the issues that has repeatedly been raised with me is the lack of flexibility when data are input into systems. For example, when they enter things from people's tax returns, even if they know a figure is wrong, in many cases they have to enter that figure as it appears on the tax return in order that it can be picked up and corrected later.

My concerns are twofold. First, can you explain—if possible, I would be grateful if somebody could send me the guidance that HMRC employees use—whether, if they have a figure that is wrong, they know within what bounds they are allowed to change it or to raise such a matter at the point of input? If there is some guidance on that, I would like to see it.

My other concern is that a judgment was made that, because there was a backlog of errors, the value of which added up disproportionately to the work that it would take to chase them up, the Revenue decided not to chase people beyond that de minimis limit. If what these constituents are telling me is true—that errors are still being input as data go forward, with the idea being that they are picked up later—is there a danger that this will happen again, perhaps on a smaller scale, because where the systems are not in place early enough in the data input process, we create errors that could have been resolved? Therefore, we may find ourselves making such a judgment again, saying, "Well, we have all of these errors backed up, so we will increase the limit. It doesn't cost that much". However, we would be building in a system in which errors are commonplace—I am sorry that that is a long question.

Stephen Banyard: The general answer is that I am very mindful of the fact that data quality is extremely important, and therefore, with pay-as-you-earn and the RTI programme, we focused on getting data quality built in from the start. In relation to your point—I know our staff are concerned about this matter—self-assessment is a "process now, check later" regime. Just because the figures have been put in does not mean to say that we have shut our eyes to them. The people who do the checking then receive a list of exception cases, or cases where there is reason for concern, and we can then take a risk choice on which ones we decide to pursue. We have resource to pursue compliance, and we have to use it to best effect.

Q290 James Wharton: The way that the process is working is at the heart of my concern. I am being told by people—and you have acknowledged that staff are raising this with you internally—that they are putting in data that they know are wrong, and people feel that they do not have sufficiently clear guidance or flexibility to correct that at the input stage. I understand what you are saying, which is that you put the data in and then check them. You have just said

17 October 2011 HMRC

now, however, that those that stand out get checked, but how many are being missed? And, when you take the judgment on which are worth pursuing, with how many are you saying, “We won’t pursue that”, but had the data been put in right in the first place, it would not even have been an issue? I am concerned that—although on a much smaller scale—on a regular basis, the problem that we have seen with this process is actually being built into the system.

Dave Hartnett: Mr Wharton, may I help? We recognise this issue. Our staff have raised it with us, certainly in the past. The extent of electronic filing now, particularly for self-assessment and by employers, and the electronic checks that happen there, throw things out much faster when they are evidently wrong. Those are put on to work lists and we address them. With nearly 80% of individual tax returns and a huge proportion of employer returns now filed electronically, we are detecting these things automatically. It does not excuse the past, however.

Q291 James Wharton: Do you believe that your system, as it is at the moment—accepting reasonable errors and problems that will be thrown up—is working sufficiently well, and therefore, you will not be revisiting it, saying, “We are either going to increase the de minimis limit”, or “We are not going to chase those and actually try to get that money in, because there are so many of them, or because there is such a backlog”? Do you believe it works sufficiently well to avoid being in this position again via a different means?

Dave Hartnett: We think there has been a sufficiently significant improvement for us to be able to reduce the de minimis back from £300 to £50. Certainly, on current performance levels, we do not expect to have that problem, but we are watching it very carefully.

Q292 James Wharton: That was my last question, but for clarification, if you could send us a copy of the guidance that staff are given on when they can amend at the data input step, that would be much appreciated.

Dave Hartnett: Of course.

Q293 Chair: I have two other areas that I want to pursue—I am looking around to see if anyone else wants to. One is that on figure 9 on page 36, you have now calculated that you have £1.9 billion in overpayments by individuals, and £1.1 billion in underpayments by individuals. Am I reading that right?

Dave Hartnett: That’s £1.1 billion—I can’t find it.

Chair: Is that £1.1 billion by individuals?

Dave Hartnett: By individuals.

Q294 Chair: How confident are you that you will get that money in? What proportion of it?

Stephen Banyard: We are fairly confident.

Q295 Chair: What—100%?

Stephen Banyard: Yes. Within the normal collection parameters, of some people going missing, some dying, and some becoming insolvent—within those sorts of limits. These are within time limits, and we

would expect to collect them. The way that the pay-as-you-earn system works is that at the end of the year, most people—85%—will have paid the right amount of tax. Some will not, for very good reasons. Usually, it is because the taxable benefit that they get in the year has changed. We make a correction at the end of the year and we collect the money normally in the following year.

Q296 Chair: You do not normally have this size of correction, do you? Over £1 billion a year correction.

Stephen Banyard: It is not £1.9 billion—

Chair: Overpayments—which you have to pay back.

Stephen Banyard: That is cash.

Chair: That is cash, but £1.1 million underpayments—is that the sort of size we get every year?

Stephen Banyard: That is cash too. £1.1 million underpayments, can I—

John Thorpe: These issues cover two years, of course, because the Department had to reconcile two years together—

Chair: And they have not completed the reconciliation—there is another 15% to come.

John Thorpe: Yes, so it captures two years.

Q297 Chair: But so far? What is the size usually of the underpayments?

John Thorpe: I do not have a number for that.

Q298 Chair: Do you?

Stephen Banyard: For?

Chair: Underpayments.

Stephen Banyard: Yes. For this year or last year?

Chair: Usually.

Stephen Banyard: Usually. We are operating a new system but last year the overpayments were 5.6 million (customers). We have completed the overpayments—

Q299 Chair: This is 2011–12? Sorry, 2010–11.

Stephen Banyard: For 2010–11 the number of overpayments is half what it was last year. It was 2.3 million (customers with) overpayments.

As for the underpayments, we are about to start issuing. We estimate—I emphasise “estimate” because, until we have worked through all the records, we will not know the position—that on a like-for-like basis, compared with last year and with the £300 limit, there will be half as many. But, because we have lowered the limit from £300 to £50, there will be the same number. So there will be about 1.2 million—

Q300 Chair: Billion—we are talking billions here.

Stephen Banyard: 1.2 million adjustments, and the estimated size of the adjustment is about a half of what it was last year.

Chair: Oh yes, I see what you mean. Anne.

Q301 Mrs McGuire: May I move us on to some of the work that you are currently preparing for, which is the linkages between the child benefit and the new systems, and indeed the universal credit? I think I saw a headline recently—but I never believe everything I read in the newspapers—that indicated that the

17 October 2011 HMRC

Treasury effectively thought that the introduction of the universal credit was just not achievable, certainly within the time scale and the financial limits that had already been set. Would anyone like to proffer an opinion on that particular comment? Was it just a bit of fluff in the newspapers? Was there a genuine dispute between DWP, the Treasury and indeed HMRC, or were you just piggy in the middle between two major Departments?

Dave Hartnett: Stephen is closer, as the SRO for real time information, but both Stephen and I sit on a ministerial committee dealing with this, and I am not sure I would call it a bit of fluff in the media but, certainly, we did not recognise from the discussions that we had been involved in the descriptions that appeared.

Stephen Banyard: We cannot comment on the universal credit programme because that is for DWP to comment on. What I can say is that I—

Mrs McGuire: But you are managing it.

Stephen Banyard: I am responsible; I am accountable for the real time information programme, which provides the—

Q302 Mrs McGuire: So you are crucial to the delivery of the universal credit.

Stephen Banyard: Absolutely.

Q303 Mrs McGuire: Because if your information is wrong, then lots of people out there are going to find themselves in dire financial difficulties.

Stephen Banyard: And we are very mindful of that.

Q304 Mrs McGuire: I do not know whether or not the child tax credit legacy still looms hard and you have a big sign up saying, "Please do not repeat what happened with the child tax credit situation."

Stephen Banyard: We will put every emphasis that we can, which we are doing, on collecting and transmitting accurate data—

Q305 Chair: You're not doing anything on real-time information at the moment. That is one of the things that the Report says. The Report says that, because you have been trying to sort out both the PAYE numbers that we all get—whatever you call it—and the returns, you have done nothing on real-time information.

Stephen Banyard: No, that is incorrect, Chair. We have a major programme running. I do not know where that comes from—

Chair: My reading of the Report.

Stephen Banyard: But we have a substantial programme running on RTI, and I can reassure you—

Chair: You might have a policy, but your guys are busy pursuing 2008–09 and 2009–10.

Q306 Mrs McGuire: Can I ask the NAO why? Are we misinterpreting what is in the Report?

Stephen Banyard: Yes.

Q307 Matthew Hancock: Which bit of the Report?

John Thorpe: The commentary on RTI is in paragraphs 3.38 to 3.41. We describe the programme and the time line in terms of how the Department is

implementing RTI, so we just comment on the principal milestones. Our commentary is principally around the challenges around data quality and how those are being addressed. My understanding is that it is a separate programme from the work that is going on around the NPS stabilisation.

Q308 Ian Swales: It says in 3.41 that the pilot phase runs from "July to October"—so it should be completed in two weeks' time—"prior to full implementation from November 2011." So how are we doing?

Stephen Banyard: Can I help? The first thing to say is that we have done a lot on the new pay-as-you-earn system to improve data quality, and you will have read in the Report that the Department has repaired 11 million records. They were not wrong, but we needed to check to make sure. As a result of that, the tax codes that we issued this year—the Committee will be concerned with this—were very accurate compared with the inaccurate codes from the year before. We achieved an accuracy of over 98%.

Another key indicator, and one that DWP are interested in, is how well the data coming in from employers matches into our systems, and whether it will drop into the right customer account. We have been working on that over the past two or three years, and we have increased its accuracy, in successive years, from 97.3% to 97.8% to 98.3%. The acceptance criterion for universal credit is 98%, so we have already achieved what universal credit needs from us. We are not content with that, and we have set up a separate data quality programme within the RTI programme.

We are particularly looking to find out where the problems are arising, and we have developed a tool that enables us to look by employer to see where the problems are. Over the past three months, we have piloted—this is what you are reading in the Report—the introduction of customer relationship managers, who will go out and work with employers and talk to them about data quality and its importance.

Most employers need good quality data, just as we do, and they very much understand our need for it, but different organisations have different data needs. For example, you may work for the House of Commons and they have you down as Mrs A McGuire, but on our records you would be Mrs Anne McGuire, and something as simple as that can cause problems. We are working through with employers. We have a list of the employers who are likely to cause us most problems and we are working with them in a collaborative way to improve our and their data.

Q309 Mrs McGuire: The thing that identifies me within the system is my national insurance number, so why do I even need to have my name there at all? I do not want to put it into the public domain at the moment, but I can give you my national insurance number off the top of my head—I have had it for a long time.

Stephen Banyard: And you are wonderful, but not everybody can do that.

17 October 2011 HMRC

Q310 Mrs McGuire: All right. I am being a bit facetious here, but people do carry their national insurance numbers, and, frankly, I never cease to be amazed—I do not know about my colleagues—that when you ask a constituent for their national insurance number, they can just run it off the top of their head. Many people do know it. Is that not the identifier, and not whether I am Mrs Anne or Mrs A—or, indeed, Mrs A McQuire, which I sometimes get and which is even more confusing?

Dave Hartnett: It is the primary indicator, and many people do exactly what you do, Mrs McGuire. They know their national insurance number off by heart. Others no longer know their national insurance number. Others still have been given temporary national insurance numbers at some stage. You begin to see how the confusion can arise. Our challenge is to cleanse all that.

Q311 Ian Swales: Just on this very point, in data quality terms, you talked about an acceptance criteria of 98%, so that is 2% error. How many errors would that be if you hit your acceptance criteria? A million?

Stephen Banyard: The acceptance criteria are around data hitting the account first time. We then try to match it using our staff. The matching criteria that we use are normally name, NI number, address, date of birth and gender. It is important that we can match accurately. While we are not content with 98%, it is a good starting point.

Q312 Mrs McGuire: Can I come back on the second part of my question, which was about the child benefit changes? What do you perceive to be the major challenges in implementing a real-time database to assess whether an individual or family are entitled to child benefit, under the new system that is coming in?

Dave Hartnett: I think, Mrs McGuire, that the starting point is this: we have got to make system changes to deal with that, and we have until February or March next year to understand what those changes are—once the policy design is completed, which is in the hands of our colleagues in the Treasury. It is hard to answer your question today. We do not envisage any special difficulties with real-time information and child benefit.

Q313 Mrs McGuire: That does not strike me as a long read-in time to introduce something that will make a significant difference.

Dave Hartnett: No, we have been thinking about it.

Q314 Mrs McGuire: You've been thinking about it.

Dave Hartnett: We have been thinking about it for a long time. I hope we understand what the options might be, but there are still decisions to be made.

Q315 Chair: But, to be clear, you have done no in-year changes. Para 23, page 8 of the NAO Report says you have put the resources into the recovery work. It states: "This recovery work was extensive, covering over 11 million records...A consequence of diverting operational resources to recovery is that some in-year changes to individuals' records have not been processed".

Dave Hartnett: But they are in-year changes to individuals' pay-as-you-earn records, which, currently, will have nothing to do with child benefit.

Q316 Chair: But they could have something to do with their tax. There may be overpayments or underpayments.

Dave Hartnett: Indeed.

Q317 Chair: So it will add to your overpayments-underpayments problem.

Stephen Banyard: Nobody will pay the wrong tax at the end of the year.

Q318 Chair: Why? Because you will do in-year changes? This says that you are not.

Stephen Banyard: We want to do in-year changes.

Q319 Chair: But you are not.

Stephen Banyard: We are in some cases. May I give some context? The position we have faced is this concertina of work at the start. In-year information comes to us from three sources: people write to us—some 9.5 million letters a year—around 16 million people telephone us, and the computer throws up items for us to look at. Perhaps I should say this: 12 months ago we had a backlog of post, which was noted by the Committee. We are fully up to date with our post here. We have been working on it over the summer. Our postal position is up to date.

Q320 Chair: What is your definition of "up to date", out of interest?

Stephen Banyard: We have only five days' post on hand.

Q321 Chair: So do you reply within five days or do you open it after five days?

Stephen Banyard: No. People will start replying to a letter, if it is urgent, at the five-day point. It will go out then.

Q322 Chair: When will someone get a letter? That is what I am really after. That is what we, and the punters, care about.

Stephen Banyard: You ought to get a letter well within the service standard period.

Q323 Chair: Which is what?

Stephen Banyard: Three weeks.

Q324 Chair: Right. Do you think that you are there?

Stephen Banyard: We want to do better than that, but we have got to that position. People will begin to see that in the autumn, because we have only just got there. We have also improved the telephone service. What we are left with are the work-management items, which are quite a mixed bag. Some of them are about data quality, which we have been talking about. For example, we may have a record that matches on four of the five items, but perhaps a character in the name is wrong. We will match the record and throw up a work-management item and ask whether it is right or wrong. It may be a compliance check, as we discussed earlier, such as a repayment. The system

17 October 2011 HMRC

will ask whether we want to check it. We set a level or criteria for checking.

A lot of those work-management items are about information management. Some of those items relate to taxable benefits, such as company-paid health insurance or company cars, that have changed during the year—we may not have worked through the items that come from the computer this year, so we will pick them up at the end of the year—but that is the final piece of the jigsaw of trying to get pay-as-you-earn back up to date. We are carrying out a major review to address those work-management items and to determine which ones we actually need.

Q325 Mrs McGuire: My final question is about the integration of child benefits into the real-time programme.

Say that I am a school teacher with three children and that I get promoted in August, which takes me over the threshold. When will you catch up with me—if I may put it in those terms—and withdraw my child benefit?

I bear the scars of the child tax credit, which left people with horrendous bills. I remember someone, although they were perhaps not in your position, Mr Hartnett, explaining that there is a difficulty with the culture of the HMRC because it is only used to collecting money, rather than giving money out. What is in front of those constituents who, during the tax year, flip over the point at which they are no longer entitled to child benefit? Potentially, significant sums of money are going to be withdrawn.

Dave Hartnett: I agree. If we know that the child benefit needs to be withdrawn, there will be an in-year change; if we do not know, it will be dealt with in the following year.

Q326 Chair: You won't force people to pay it back? Who loses out in Anne's example of a woman being promoted in September without the local authority telling you until the following April?

Dave Hartnett: If the woman does not contact us to tell us of the change, there will be a tax charge for the year of promotion, but, where it is appropriate to do so, we will encourage people to take themselves out of child benefit.

Chair: That is very unclear. Anne's example is quite good.

Q327 Stella Creasy: Flipping it round the other way: what about the person who breaks up with their partner and becomes entitled to child benefit? How will you deal with that?

Dave Hartnett: If we know that has happened, and if the person has come out of child benefit, we will put them back into it.

Q328 Stella Creasy: How quickly can you operate that system? It sounds as if you will not make an adjustment until the following tax year for people who are no longer entitled to child benefit. How quickly will you be able to assess whether someone is entitled to child benefit?

Dave Hartnett: If someone contacts us, we will be able to make such an assessment in a very short time.

Q329 Stella Creasy: What's a short time?

Dave Hartnett: Weeks at the maximum; perhaps even immediately.

Q330 Stella Creasy: So how can you do it if they are entitled, but it will take longer if they are not entitled, therefore?

Dave Hartnett: Because we're more likely to find out if someone is entitled than if they are not entitled. I think that's how it will happen.

Q331 Matthew Hancock: May I push you a bit more on real-time and the change programme around that? You have described how you are catching up with the backlog within the existing system and how you are improving the data, to go up from 97.3% to 98.3%. Operationally, it is probably better described as a 2.7% error rate going down to 1.7%, because one is much bigger, but it's the proportion that matters. But there are other elements, particularly the link to the new universal credit, that are part of the change programme. How is that work proceeding?

Stephen Banyard: The RTI programme is on track and we are confident that we can deliver on time. We have hit all of our recent milestones. We are running a 12-month live trial, and we have run workshops to start preparing 320 volunteer employers. We are on track to start the pilot in April, and it will run for 12 months, which will enable us to test the system. If—

Q332 Matthew Hancock: Excuse me. Are the 320 people all in work?

Stephen Banyard: I said 320 employers, representing more than 1 million taxpayers.

Q333 Matthew Hancock: Do you also include unemployed people in that trial?

Stephen Banyard: This is a trial of the operation of pay-as-you-earn.

Q334 Matthew Hancock: The real-time pay-as-you-earn, rather than the DWP's end of it?

Stephen Banyard: Yes. HMRC is responsible for delivering real-time pay-as-you-earn information.

Q335 Matthew Hancock: But you are also jointly responsible for delivering a real-time link-up with the universal credit.

Stephen Banyard: Indeed, and we will provide the information to them through that linkage.

Q336 Matthew Hancock: And the milestones on that interface?

Stephen Banyard: Yes, we are building that, and we are on time with all our IT.

Q337 Matthew Hancock: How would you describe the working relationship with the DWP team that is doing the same?

Stephen Banyard: First class.

Matthew Hancock: I thought you might say that.

Stephen Banyard: I would, and it is. Most of HMRC's programmes require us to work with a lot of stakeholders. The programmes that I have been involved in require me to work with tax agents,

17 October 2011 HMRC

software manufacturers, employers and various groups. You don't deliver programmes unless you work well—or try to work well—with those groups. You need to do three things: first, share goals—you need to know what you are trying to do and agree it. Secondly, you need good working mechanisms, such as steering groups. We have cross-representation, we have seconded people across each way and we meet regularly. Thirdly, you need good personal relationships and you need to trust each other. We have, from the outset, set out to build good personal relationships with the DWP team. Relationships are good.

Q338 Ian Swales: Without wanting to go back over the ground that Mr Wharton covered earlier, we start from a position where anecdotally, your staff are not even allowed to, when they are inputting data, take information that they can see in front of them and use it to get the data right. If we are expecting to move to a situation where all these benefits and credits come together—my question is about the management and governance of it, not just the systems.

Taking the points that Mrs McGuire and Ms Creasy were making, it ought to be automatic in the future that you know when someone has reached a certain point in the tax system and then benefits change, and vice versa. If it isn't automatic, this whole new system is not going to work. My question is not just about whether the systems will do it, but what you are going to do about management, governance and control. Who is going to make the decisions and communicate these changes?

Stephen Banyard: Can I take the child benefit part of the question first? Real-time information will help us on that, because even if you don't phone us up and tell us, we will spot that your income on a monthly rate has gone up and may have tripped the higher rate boundary. We would have governance around those sorts of things, perhaps to go in and ask the employer or you, "Have you crossed the boundary?"

Q339 Ian Swales: But that's exactly the point. It all sounds extremely woolly and gentlemanly. The point is that something has changed and you know it has changed. Aren't you going to do something to avoid overpayments and underpayments? "We might perhaps let you know or talk to your employer" doesn't give me the warm feeling that the new, dynamic real-time system is going to have the right management structure around it.

Stephen Banyard: I assure you that it will. We haven't operated a real-time system. We have to get used to it.

Mrs McGuire: That's what worrying and concerning us.

Q340 Stella Creasy: It's the postbag we're going to get from the family that breaks up, but which may still be under the same roof for a period or can't prove to you that they have broken up; or perhaps from a person who gets promoted but doesn't get their salary straight away. All those people will come to us in our surgeries and will be looking to us to help them sort out what's going on with you guys.

Stephen Banyard: I understand that, but those are not 'hard' facts. The real-time programme, if you bring that into it, gives us a facility to be able to spot those cases and intervene.

Q341 Ian Swales: I don't necessarily expect you to read people's minds or understand everyone's social situation, but you have to be able to see data moving on tax and credit. Otherwise, the universal credit system isn't going to work. We need to have a system that works. Are we going to trip up over the fact that more than one Ministry is involved, for example, or is that all going to get sorted?

Stephen Banyard: I hope we do not trip up over two Ministries being involved. We have put very good governance, which has been externally examined, around the programmes. As we move into implementation, that governance will have to adapt as we face new situations.

Q342 Ian Swales: It is the operational governance I am talking about. I am not minimising the issue of getting the systems in place—we all know that is going to be massive. But assuming success, are we confident that we will have operational governance that is fast and avoids the situations we have been talking about?

Stephen Banyard: There will be and I accept the point. In a real-time world we will need to respond in real time to those sorts of situations.

Q343 Stephen Barclay: This really follows on from Mr Swales's questions. Of the 54 projects in the change programme, how many have started?

Dave Hartnett: Twenty-four have got—

Q344 Stephen Barclay: You are working on the business plans for 24, so they have not really started, have they? It is just the initial work.

Dave Hartnett: No, they have started, Mr Barclay. John may be able to help.

Q345 Stephen Barclay: It says, "preparing full business cases for the 24 projects to deliver the £964 million." It is a really simple question. We have 54 projects in the change programme.

John Keelty: I cannot give you the number immediately, although it may come. For example, on some of the reinvestment of the savings, we have already started recruiting people into various areas so that we can start those compliance projects going. We have already started to bring in more yield as a result of the reinvestment of the savings we are making this year. There are a number of projects that we have started this year. It is not the case that we are just planning. Yes, we are planning for some that will materialise in 2013–14 and beyond, but for those that we need to get going now, we are well on the way to doing that.

Q346 Stephen Barclay: Sure, but that was not really my question. I appreciate that for 24 you are working out a business case, but what I am saying is that by 2015 you have to deliver 54 change programmes. That seems quite a lot for a department that has business

17 October 2011 HMRC

as usual and has other issues to address. Perhaps you could send us a note about how many of those have started. How many of those that have started are off-track?

John Keelty: Again, I am not aware of any but I do not have the precise details. We monitor these reports on a monthly basis, so what we get each month from them is to see their current status. As we work through them, there will be some that will be rated “green”—absolutely perfect, no problems—and there will be some that will be rated “amber”, where we need to do more work. I have run programmes before and that is what happens.

Q347 Stephen Barclay: I fully appreciate that you have ratings; hence my question. Surely senior management has a sense, if you monitor it monthly, of how many of these 54 change programmes have started. We have less than four years to deliver them—it seems a lot of work—and it seems odd if senior management does not even know how many have started and how many are already behind schedule.

John Keelty: We have just undertaken a mid-year review of the change programme and the conclusion we got from that is that we do not need any radical redesign or radical changes. Everything is moving in the way that we would expect it to move at this point in time. That does not answer your numbers question, but senior management at this time have seen that mid-year review and are comfortable that it is progressing in the way that we would expect it to progress.

Q348 Stephen Barclay: Sure, but a 25% cost saving and those 24 projects are just under £1 billion, which suggests more than a bit of tinkering and modification. Perhaps we could look at external spend. Fifty-four change programmes suggests that you may need some external resource. I am very conscious that the Cabinet Office has strict controls around external spend. How much are you budgeting this year to spend on external resource for these change programmes?

John Keelty: For consultancy we are budgeting about £5 million.

Q349 Stephen Barclay: So £5 million on consultancy. What about other professional support?

John Keelty: We have, of course, outsourced our IT development. So that is also being spent outside. We have outsourced our accommodation so we have quite large amounts that go out through that.

Q350 Stephen Barclay: Okay. So legal spend, that sort of thing, do you have a total budget in mind to deliver? I am asking specifically about the change programmes because again, in previous hearings Mrs McGuire and Mr Swales talked about staff morale in HMRC. There is always the question around how much you spend on staff internally for the tax that you recover. There is a trade-off in terms of how much spend and what that brings in. As part of this change programme, which is to save money, what is the total quantum in terms of professional external support?

John Keelty: I’m sorry; I don’t have that figure.

Q351 Chair: I think you’ve got to provide us with that figure. It’s really important and it is an issue that Mr Barclay has raised, so you might have thought about it before you came, because we have raised it every time.

John Keelty: Of course.

Q352 Stephen Barclay: Again, this is not a new issue to the PAC, but another area is about staff moving mid-project and whether that links into deliverables. Can you assure us that for the 54 projects, all staff will have interim milestones and not be able to move prior to their milestones? I am not suggesting that staff should be in place until 2015. That is clearly not a sustainable position, because you need to keep people fresh and motivated. Can you at least assure the Committee that no staff moves for those running the projects will happen that are not linked to a deliverable milestone?

Dave Hartnett: Let me pick that up, Mr Barclay. We don’t aim for our programme and project managers to move, but some will. It is in the nature of a huge organisation such as ours that some of our very best people are managing those programmes and projects, and part of the task we have given them is to develop those behind them.

Q353 Chair: I think our interest as a Committee is, do you aim to keep them there? The most frustrating thing we see as a Committee is that lack of responsibility and accountability. You come back three years later and somebody else is there. It is not that you aim for them to leave, but do you aim to keep them there?

Dave Hartnett: We certainly do.

Q354 Chair: Do you aim to keep them there?

Dave Hartnett: We plan to keep them there, but all sorts of things can happen in those four years. It is perhaps worth adding that the major projects authority in the Cabinet Office has recently sponsored a starting gate review of our change programme, which has had many good things to say about the governance and how tightly we are managing it. I wanted to say, Mr Barclay, that you asked us how many were off track. I cannot remember the technical term for them, so can I call them “hit squads”? They go in when things go off track. To my knowledge—others may need to correct me—we have only done that twice and on some projects we are ahead of plan at the moment.

Q355 Stephen Barclay: I wasn’t suggesting that you could stop people leaving.

Dave Hartnett: I understand that.

Q356 Stephen Barclay: I am saying that for example the FiReControl project had five programme directors over six years, and a number of those moves were within the civil service. Interim milestones should be set, which are linked to people’s appraisals and therefore to people moving. A thing that we repeatedly see on the Committee is that that is not being done. I do not get an assurance from your answer that that has been done in this case, but

17 October 2011 HMRC

perhaps that could be taken away. Who is the senior responsible owner for the 54 projects?

Dave Hartnett: Lesley Strathie.

Q357 Stephen Barclay: And she's not in post at the moment. She's off, is she not?

Dave Hartnett: She is off at the minute and Mike Clasper has filled that role while she has been away.

Q358 Stephen Barclay: Right, and she will resume that as SRO.

Dave Hartnett: Yes, that's the plan.

Q359 Stephen Barclay: And how will she, given her other duties, get oversight of 54 projects?

Dave Hartnett: We have a core project team, which is stronger probably than we have ever put into any programme before, and the starting gate review confirmed that. Our CIO is the change director. He and his team are leading the oversight.

Q360 Stephen Barclay: So if she is personally responsible, which an SRO is, how many of the 54 projects would need to go wrong for her to be held seriously responsible from a career perspective?

Dave Hartnett: I don't think I know the answer to that, Mr Barclay, largely because we do not plan for any of them to go seriously wrong. One of the key messages from the recent review is that the governance is in really good shape and would identify things like that, and we would act quickly.

Q361 Stephen Barclay: Should you not plan? It is the nature of projects that if you are running 54 projects, some will go wrong. We have two PAC hearings a week because so many projects, sadly, go wrong. It seems to be a leap of blind faith to assume that all 54 projects will go well.

Dave Hartnett: Not at all. One thing we have learned time and again from the NAO is that it is all too easy to be over-optimistic and that is exactly what we are trying not to do.

Q362 Chair: Can I come in on that? Following on from that, you have no contingency at all. You were set a financial cuts target. You are working entirely on the assumption that you will achieve them all with absolutely no contingency. Is that wise?

Dave Hartnett: Chair, we have no cash contingency. Given the state of public funding—

Q363 Chair: You've got to achieve your cuts. You have no contingency plans. Of course, you must achieve the financial cuts; that is an imperative from the Treasury. You have no contingency plans for alternative ways in which to achieve those financial cuts other than the 54 projects and the other bit.

Dave Hartnett: No, since the NAO review, and during it, we have developed other plans as to what we might do if we needed a contingency.

Q364 Chair: They are not in the NAO Report, are they?

Dave Hartnett: No, because our thinking on this is very recent. It was prompted by the NAO work.

Q365 Chair: So, you are creating contingency plans?

Dave Hartnett: May I quickly tell you what we are doing? For example, we could speed up the reduction of the number of buildings that we occupy. We can speed up our process change in our tax systems and in our PaceSetter work as well. Those are the sorts of areas in which we would find contingency. It is important to say that we have a proud record of delivering the savings that we set out.

Q366 Chair: No, you don't. We looked at that. The very first Report that we looked at across Government was the performance of all Departments in relation to the 5% year-on-year cuts in the last spending review. I'm looking for the figure. Perhaps the NAO can help me. On page 16, paragraph 1.15, it says that 12.6% of savings were not evidenced, not new and not reported net of ongoing costs. So, you don't have a proud record.

John Keelty: That review took place at the halfway point when we had planned only to realise something like 40% of the savings.

Q367 Chair: What that review showed was the savings that you had reported. It was not showing the savings that you hadn't reported. These were savings you had reported and 12.6% of them were not evidenced, not new and not reported net of ongoing costs.

John Keelty: By the criteria, that is absolutely right, but this was halfway through that SRO7 efficiency programme. We learned from that.

Q368 Chair: Well, I rather resent you saying, "We have a proud record." The last time we looked at this we found that our 12.5% were again not evidenced.

John Keelty: Some 87% of them were sustainable efficiency savings.

Chair: You should not be putting up savings and pretending that there are savings when they are not evidenced. That is not how any public servant in any Department should be operating.

Q369 Mr Bacon: Mr Hartnett, you have said that, prompted by the NAO, you are now doing something about the contingency. Why did it require the prompting of the NAO to do something about the contingency?

Dave Hartnett: We were actually thinking about where we would have back-up for our cost-savings project if any started to go wrong. The engagement with the NAO on the cost-saving Report was significant. It made a number of recommendations.

Q370 Mr Bacon: And one of them was about contingency?

Dave Hartnett: One of them was an observation about contingency.

Q371 Mr Bacon: What interests me is that the failure to have contingency is a hardy perennial. Among the many mistakes that the Rural Payments Agency made was the failure to have a contingency plan. Actually, in that particular case, it had one and then it scrapped it. Such behaviour is commonplace, and we have seen

17 October 2011 HMRC

it many times. Folk come to this Committee with projects that have gone wrong and where there was no contingency plan. I would hope that by now tattooed on the eyelids of permanent secretaries are the words, among many others, "Make sure you have a contingency plan." Therefore, why did it require the prompting of the NAO for people to think, "Hey, we need a contingency plan." Why was it not already so deeply embedded in the DNA that the NAO noticed and commented on the fact that there was a robust contingency plan? Why was it not that way round?

Dave Hartnett: Because we wanted to get our change programme going. We knew we had to do this, and the NAO helped us—

Q372 Mr Bacon: You make it sound like because you were in a hurry. The Rural Payments Agency was in a hurry; it was in such a hurry that it chose the shortest of all the available timetables, as well as choosing the most complicated of all the possible payment systems. But the evidence is over many projects that being in a hurry is not enough. In fact, being in a hurry can cause delay.

Dave Hartnett: I agree with that.

Q373 Mr Bacon: But back to my question. Why did it require the NAO to prompt you to have a contingency?

Dave Hartnett: The crucial thing for us, Mr Bacon, was to make sure we understood the risks. That can be done certainly without cash contingency. There was some thought that maybe we should have had some cash contingency, and we could not do it, which is now why we have looked in the other areas that I have mentioned.

Q374 Chair: And 36% of your current proposals' new cost reductions are in the final year, so if you fail on those, you've had it.

Dave Hartnett: If we fail.

Q375 Matthew Hancock: One thing that came out of that is that you mentioned that part of your contingency is to do more on buildings and make greater savings there. I wonder why you are not doing that anyway.

Dave Hartnett: Well, we are.

Q376 Matthew Hancock: Hold on. You cannot be doing the same amount as is in your contingency. You must be doing more.

Dave Hartnett: No. We are doing a lot on buildings. What we can do, Mr Hancock, is to speed it up. Let me tell you the record for last year. I think we achieved 43% of building savings across Government, despite only having 14% of the estate.

Q377 Matthew Hancock: But if you can speed it up, and these are savings that you could deliver, why don't you deliver them?

Dave Hartnett: Well, we are trying to do that.

Q378 Chair: I have to say that as an Arts Minister I spent for ever trying to get you out of Somerset House. We finally succeeded and put it to better use,

but you were very, very, very late in getting out of there.

Mr Bacon: Your fingernail marks are all over the outside of the building.

Dave Hartnett: We are about to mothball it to save our costs.

Q379 Chair: Can I raise two other issues that are of concern to me? One is that you are assuming a cut in sickness absence, from your assumption of 9.9 days in 2010–11 to 7.9 in 2011–12. Did you achieve your 2010–11 target?

Stephen Banyard: We very nearly achieved the sickness absence target last year, or we hit it, and this year we are in front of profile for getting down, so we believe that we will get there.

Q380 Chair: So what was "very nearly"?

Stephen Banyard: I can only speak for my own area. The target there was 10.76 and we achieved 11.01, but we are currently tracking at 8.3.

Q381 Chair: The figure I have got here for sickness absence in 2010–11 is 9.9.

Stephen Banyard: I was speaking for my own area.

Q382 Chair: And by 2011–12 you want to get to 7.9. That is out of the report, isn't it, Jane?

Jane Wheeler: The target for HMRC was an average of 9 days per person in 2010–11, which the Department did not achieve. I am not sure how far it was below it.

Q383 Chair: And you were at 9.9. So it is not very nearly—10% is not nearly, on these figures.

Stephen Banyard: I gave you the answer for my own area, which is about third of the Department. We made a substantial reduction last year. We did not hit the target, but I am confident that we will beat the target this year.

Q384 Chair: Okay. I understand that you looked at your bit. Mr Keelty, you have some responsibility. You are here answering for this whole change programme, where you do not know where you are on the 54 projects. I picked up that you have assumed a cut in sickness absence. I also picked up that you failed to achieve that in 2010–11. I want to know what you have done in 2011–12, and I want to know how viable your assessment of the cash savings is.

John Keelty: At this point in 2011 for the Department as a whole we are tracking at 8.7 days, and our target is 7.9. As Stephen said, we are on target, we believe, to get the 7.9 by the end of this year.

Q385 Chair: And that will give you your cash savings. So we can hold you, Mr Keelty, to account, if you don't achieve that. Is that right? Or do we hold Mr Hartnett to account?

Dave Hartnett: I think you hold the accounting officer to account, so that would be Lesley or me.

Q386 Mr Bacon: Mr Keelty, when you say that you're on target—

Stephen Barclay: You're not on target.

17 October 2011 HMRC

Mr Bacon: Mr Barclay says you are not on target. Even if Mr Barclay were wrong—and he rarely is—how do you know that you are on target? How do you know who is going to be ill on 12 December or next January? How do you know there is not going to be an outbreak of measles or flu or avian flu?

Stephen Banyard: We don't. What we do is to look at seasonal patterns. We are trying to reduce sickness absence, so we are looking at where we have now got to. The figures you have been given are the 12 months up to a certain point—today. Those figures are falling fast because the figures in current months are very much lower than they were a year ago.

Q387 Chair: If you know that, why don't you know what the 2011–12 figure is?

John Keelty: The 2011–12 figure, as of today, is 8.7. That's the year we are in at the moment.

Q388 Chair: Sorry, why don't you know the 2010–11 figure?

John Keelty: I believe that is 10.8.

Chair: 2010–11 was 10.8.

Q389 Mrs McGuire: 2011–12 is 8.7. Is that year-on-year or is that from 1 April?

Ian Swales: They are rolling.

John Keelty: These are rolling trends. I have just been passed a note: 2010–11 was 9.65 days, and 2009–10 was 10.49.

Q390 Chair: Do you agree with that?

Jane Wheeler: We have 9.9 days for 2010–11 in the report—paragraph 2.18, final bullet. That is against the average of 7 point—

Q391 Chair: Seven point what? Across Government? Don't talk about the private sector.

Jane Wheeler: The cross-Government figure was 8.5 for year ending September 2010.

Q392 Stephen Barclay: The reality is that you set a target for 2010–11 and you missed that target. Having set a target, you missed it. You are now about to embark on a major change programme. Do you think a major change programme in isolation will improve or worsen potential sickness rates?

John Keelty: During the beginning part of this year we did a lot around improving the mechanisms and processes for recording sick leave and generally improving it. If we see the tracking for this year, since we introduced that initiative in the Department, the sickness leave has dropped substantially.

Q393 Stephen Barclay: Again, with respect, you are not answering the question I put. My question was not, "Is the trend moving in the right direction?" I would hope, given the focus the Department is placing on sickness, that the trend would be moving. It is pleasing to hear, and the Department deserves praise for achieving that. That is good news.

The point that I think the Chair was driving at is that you set a very aggressive savings target related to sickness, without any contingency, if that is not achieved. Therefore, that saving will have to come

from somewhere else if it is not achieved. While past performance is not a guarantor of future performance, given that this target related to a higher target than the eventual one, it should have been easier to achieve than the eventual one.

The point is that, going on your performance to date, you set a target and missed it. Looking ahead, there is going to be a shortfall in the savings. There is no contingency allocated. The question for the Committee must be, "Where else are you going to get that money?"

John Keelty: The failure of the 2010–11 target was not in the spending review period. That is the first thing.

Q394 Stephen Barclay: No, but your starting point is higher.

John Keelty: We are on track this year for the revised target that we set, irrespective of the achievement that we got in 2010–11.

Q395 Stephen Barclay: Sure, but you start from a higher point. So the delivery, the savings, the improvement you need to achieve, are increased, because you are starting from a worse point.

John Keelty: Absolutely, and we are on target to hit those savings.

Q396 Mr Bacon: Are we basically saying that the head count you are planning for is predicated on this particular level of sickness absence, and that is how the saving is achieved? Is that right?

John Keelty: Sorry, I am not sure I understand the question.

Q397 Mr Bacon: If I know that in my organisation I am going to have a 1% sickness absence, I know that I need fewer people to achieve the same amount of work—because only 1% of them will be absent during a calendar year—than would be the case if I knew that 7.9% were going to be absent. Are you basically saying that in doing your sums, you work out how many people you need and, predicated on a reduction in the sickness absence, you come to the conclusion that you need slightly fewer people, because your sickness absence is down?

John Keelty: Yes.

Q398 Mr Bacon: Right. Presumably, if you do not achieve your target, it is not in the end a question of money, because the people will have gone. The answer is an increase in backlog, isn't it? It is a reduction in service.

John Keelty: It will have an impact on productivity, if that is to be the case.

Q399 Chair: Let me ask a question arising out of that. You intend to cut your staff by 19,000.

John Keelty: No, we intend to cut them over the spending review period by 10,000.

Q400 Chair: No—19,000, and then recruit 9,000. You have almost given away the first bit of the question. The 9,000 you are recruiting are all going to be redeployments out of the 19,000, are they?

17 October 2011 HMRC

John Keelty: Virtually all, yes.

Q401 Chair: How interesting. You are not taking the opportunity perhaps to change the quality or calibre of your staff; you are just going to move staff around the place in-house. We will take that as read. You are cutting the staff on personal taxation by 50%.

John Keelty: Not 50%.

Dave Hartnett: It is 34%.

Q402 Chair: Sorry—you are cutting by 34%. What have you done about modelling that in terms of a rise in non-compliance?

Dave Hartnett: We have done quite complicated modelling. Our top priority in relation to the reduction in staff in personal tax has been to minimise it in the first two years, so that we can complete the stabilisation of pay-as-you-earn, and to back-load. I will ask Stephen to come in, but our basic strategy is to continue to improve the performance of pay-as-you-earn to take savings from more effective processing through NPS. For example, last year, we were addressing eight tax years in one year, whereas normally for pay-as-you-earn we want to be addressing three: the end-of-year reconciliation for one year, the coding for the next year and in-year changes for another one. That will be a huge efficiency for us.

Q403 Chair: I understand that you think the workload will go down, because you will have dealt with the backlog. In effect, that is what you are telling us. But have you done an assessment for such a massive reduction in staff in the one section, and what it will mean for non-compliance? Have you modelled that?

Stephen Banyard: We do not believe it will have an effect—

Q404 Chair: At all?

Stephen Banyard: We do not believe so. Our first priority is to stabilise pay-as-you-earn. In the first two years, we are not planning to take many savings out of this area at all. In fact, we have put additional staff in to try to get the place up to date. The savings are back-loaded to years 3 and 4. They fall into a number of areas.

Q405 Chair: Mr Banyard, have you actually modelled it? I ask because one of the criticisms is that the NAO thinks you have a decent understanding of your costs, but in going forward you do not understand the relationship between expenditure and outcomes. I don't quite know how you put it, but there is a way in which they put it in the report—

Jane Wheeler: The relationship between cost and value.

Q406 Chair: Thank you. I have taken this as an example of where you are going for a huge change—a 34% cut—because you think you will have dealt with the backlog and the system will have settled down. I really want to know whether you have modelled it. Or is this Committee going to come back to this in 2014, when we will still be the same

Committee, and find that your non-compliance has gone up?

Dave Hartnett: We have done the modelling.¹ We are also wary that there is a risk that voluntary compliance might drop.

Q407 Chair: By what?

Dave Hartnett: A few percentage points.

Q408 Chair: What? Can we see that? Can the NAO see the paper setting that out? What percentage?

Q409 Mr Bacon: A very small percentage could amount to a very great deal of money, couldn't it?

Dave Hartnett: Indeed. Our objective is to maintain—

Q410 Chair: I can understand your objective. I can understand that. We all share that and we welcome it. But you are cutting your staff by 36%. You are going to have dealt with the backlog. We need to know what you think that means non-compliance will go up by. What percentage? What total? You have done the work. You ought to be able to share the papers with the NAO, which can then reflect that in its report.

Stephen Banyard: We have a new operating model for pay-as-you-earn operating under NPS. The system is new, and for the first time we have a whole-customer view. Our new operating model is therefore built around a completely new rendering of pay-as-you-earn. We are learning about that as we go along.

Q411 Chair: So you have not yet done the modelling to show the impact. That is slightly finger in the air, saying, "We think we'll have dealt with the backlog, that the system will have settled down and that the data will be a bit better, so there will be fewer errors."

Stephen Banyard: No, not at all.

Chair: You have not modelled it. Mr Hartnett just said that you are expecting voluntary non-compliance to go up by a few percentage points.

Q412 Mrs McGuire: Could you explain what a full customer means rather than a half customer or a quarter customer?

Stephen Banyard: I can. Pay-as-you-earn was computerised in the mid-1980s, and it was computerised on the basis of employments. If you had an employment with someone, that employment information would be held on one of 12 regional databases. If you had two employments, the second employment could well be held on another database, and the only connection between them was pieces of paper.

Q413 Mrs McGuire: So you are looking at me now as an individual as opposed to an employee?

Stephen Banyard: Indeed. If you phoned our call centre—

Q414 Mrs McGuire: Assuming I could get through.

¹ Real Time Information will improve voluntary PAYE compliance because reporting to HMRC will be integrated into the payroll process and employers will know that HMRC has earlier visibility of payments due

17 October 2011 HMRC

Stephen Banyard: Our staff would bring up your record for you and look at all your employments, as they do, and make the whole pay-as-you-earn tax right. That is a new facility for us.

Q415 Mrs McGuire: And that is working?

Stephen Banyard: Yes, it is working well.

Q416 Mr Bacon: May I ask if you have the facility to take on temporary staff when, for example, you have a sickness absence gap that was larger than you expected and therefore you have a backlog growing? Can you take on temporary staff to help sort out the problem?

Stephen Banyard: We can and we do, and we train them to a required level to do the work.

Q417 Mr Bacon: And where do you get them from? If they are temporary, they come and go—where do you get them from?

Stephen Banyard: We do not get them in the sense of temporary come-and-go; we would recruit people for a term appointment.

Q418 Mr Bacon: I see—on a fixed-term contract.

Stephen Banyard: On a fixed-term contract. We would bring them in for 11 months or 23 months, and we would give them full training. We have not had difficulty recruiting good people.

Q419 Mr Bacon: Why 11 or 23? So they cannot sue you for unfair dismissal?

Stephen Banyard: We have recruited for 23 months because that is the period we think we will need people for.

Q420 Stephen Barclay: How many people have you hired externally in the past 12 months?

Stephen Banyard: People or full-time equivalents?

Q421 Stephen Barclay: How many people have you hired externally?

Stephen Banyard: All of our staff have been recruited externally at some point.

Q422 Stephen Barclay: No, I said in the past 12 months. You are reducing head count to make staff savings. Over the past 12 months, how many people have you hired externally?

Stephen Banyard: In terms of people, rather than full-time equivalents, approximately 2,500.

Q423 Stephen Barclay: Right. I am conscious of the Cabinet Office freeze on external recruitment, but all those 2,000 people are defined as essential front-line staff?

Stephen Banyard: They are essential front-line staff, and they are helping us to get pay-as-you-earn up to date. We are determined to deliver a good system and a good service to the public, and that is how we are doing it.

Chair: As Stephen has just said, if you look at page 26, paragraph 2.20—

Q424 Stephen Barclay: Just coming back to that again, it is highlighted in the report, which states, at paragraph 2.20, “Wider experience indicates that organisations tend to over-estimate how much their cost reduction plans will actually save and best practice is to identify a contingency of 50 per cent.” What level of contingency are you planning to identify?

Dave Hartnett: At the moment, certainly not 50%.

Chair: What?

Q425 Stephen Barclay: So you are not following best practice.

Dave Hartnett: We are not following what is here, because at the moment we cannot. I think, Mr Barclay, the key is we are monitoring risk incredibly carefully.

Q426 Chair: What is your contingency level? You said that you are now planning contingency, so what level are you up to?

Dave Hartnett: I do not have a level.

Q427 Chair: Do you have a number, Mr Keelty?

John Keelty: We are not planning for a specific number. As Dave says, we are monitoring the risk and we will adjust things as we get to them.

Chair: This is very waffly.

Q428 Mr Bacon: May I labour the point about the Rural Payments Agency? It introduced an enormous change programme at the same time as sacking all their most experienced staff and replacing them with temporary workers. You say that you are monitoring the risks, and it is good to hear that you are. What do you do about it when you identify that a risk that you have been monitoring has materialised? What happens next?

John Keelty: That is a very difficult question, because it could be any sort of risk. But as soon as that risk becomes an issue and we need to take action, we will certainly consider what is the appropriate action to take. It might be right to move another programme forward or, if the risk is a shortage of staff—we have 66,000 staff in the Department—we might have to move some staff from over there to here to help with that programme.

Q429 Stephen Barclay: Where you have identified savings, are you not moving as quickly as you can on those? From your answer to Mr Hancock’s question about property and to Mr Bacon, your contingency seems to be, “Ah well, we can speed up other programmes to deliver other savings.”

Mr Bacon: Move things forward.

Stephen Barclay: Surely you would be delivering those as quickly as possible anyway.

John Keelty: We have a history of handling large programmes—we are a large Department handling large change. Throughout the past few years, as necessary, when things ebb and flow, we adjust our programmes accordingly. I am having difficulty answering your question, because it is a largely hypothetical situation.

Chair: Okay. Maybe the Comptroller and Auditor General can put it in another way.

17 October 2011 HMRC

Amyas Morse: I will try to. Everything you've just said is fair—you have a large Department and you have a record of handling large programmes. It is also fair to say that you have been able to take a reasonable amount of time over doing that. That is not a criticism; it's just a factual statement and, I think, a fair comment. You now move into an era in which you are trying to change a lot faster than you were. I think that is fair to say.

Dave Hartnett: It is.

Amyas Morse: And you have been able to carry out what I call fairly discrete change programmes, but now the connection between one another is becoming much closer. So what we are trying to say—I urge you to consider this and I shall be interested to hear your reaction—is that you must be able to react early, to understand the linkages early and to get whatever actions you are going to take into place in time to retrieve the situation before the performance gap is too great. It is not that we do not think you are trying to tackle those things, but you could do with developing a more sophisticated and integrated approach as early as possible.

John Keelty: We do recognise the need to look at the risk and take an integrated approach. You have recognised in your Report that we are setting up the governance arrangements to do that. The question is: can we set aside a chunk of money for the eventuality that something might happen? As a Government Department in times of austerity, finding a chunk of money that you can just set aside is extremely difficult. The Government want to use that money in other ways.

Q430 Amyas Morse: I have every sympathy with what you have said. A chunk of money not doing anything should be as small as possible. But that is a result of how fast you can react—how quickly you can spot if you are off plan. We are talking about what you would do. How big a gap is there from flash to bang? If something is off track, are you geared up to react really quickly and put those extra measures into place, or will quite a long time gap be allowed?

Dave Hartnett: We are geared up to identify any suggestion that a project is starting to go that way. With regular, weekly reporting, we have put change directors into each of our major business areas, and that monitoring process is working very effectively.

Q431 Mrs McGuire: But it is not about identifying the risk or the problems; it is about how quickly you can react. Is HMRC now flexible enough to give a far quicker response when a risk is identifiable? Have you learned any lessons, dare I say it, from the child tax credit fiasco, where the risks were obvious to everyone and HMRC was so far behind the curve that people are still recovering from the damage done?

I wonder what business people listening to this exchange would think of it, because HMRC demands precise information, yet there is a lot of woolliness in our discussion this afternoon. We have heard, "Contingencies are not there. We are not sure what we will do if this happens. We are monitoring things." Frankly, you guys are in the front line not just of tax, but of tax and benefit, child benefit—the lot. People's

financial viability will depend on your being flexible enough. Frankly, I do not think that you have given us much confidence today that you do have that flexibility. Maybe I am alone in that.

Amyas Morse: May I just make one comment? I was listening to a presentation recently by your change director, Phil Pavitt—is that right?

Dave Hartnett: Yes. Chief information officer and change director.

Amyas Morse: I have to say that if the performance matches everything that he was saying—I am sure that it does—then it sounded pretty impressive to me.

Chair: He is not giving evidence to us Amyas

Mrs McGuire: There is always a gap between rhetoric and delivery. We have three senior people here from HMRC and I am just not getting enough from them, which makes me feel that, within the next two or three years, they will be implementing major changes in terms of the flexibility of response.

Q432 Chair: I think Anne has summed up the view of the Committee very precisely.

I want to ask a final thing on tax credits. My understanding is that the current debt is £4.7 billion. I have two questions. How much of that is due to customer error, and how much is down to HMRC error?

Dave Hartnett: Most of it is due to customer error or worse.

Q433 Chair: What proportion?

Dave Hartnett: I will have to write to you, because I cannot remember the number.

Q434 Chair: In a week, please.

Dave Hartnett: Of course.

Q435 Chair: Can you give us a ballpark figure?

Dave Hartnett: I will give you a figure, but I may be wrong: 80%.

Q436 Chair: So that is customer error. How much is realisable out of that £4.7 billion?

Dave Hartnett: We think probably something of the order of three to three and a half currently, but we are working on that. We have taken a new approach to debt generally, and we are aiming to reduce the debt to £3.7 billion by the end of the spending review.

Q437 Chair: It is going up at the moment. You will reduce the debt by getting the calculation right in the first place with this cohort of people, not by pursuing the debt. My understanding of paragraph 38 on page 11 is that you have only collected £380 million against your target of £550 million. So you are 50% down on your target. Then there is this funny little sentence in the Report—I did not mean peculiar—that there is £1.7 billion of outstanding debt that you are remitting.

Dave Hartnett: We are certainly planning to remit a substantial number.

Q438 Chair: £1.7 billion?

Dave Hartnett: I am trying to find it in the Report. Currently, we are remitting £1.055 billion relating to tax credit customers and that is in relation to debts

17 October 2011 HMRC

incurred between 2003–04 and 2008–09, where we have received no payment in the past 12 months, and some of those people we cannot find.

Q439 Chair: So we have lost over a billion, and we might lose another £700 million or whatever it is.

Dave Hartnett: I don't know yet.

Q440 Chair: When are you going to take that decision?

Dave Hartnett: Whether to remit the £1.055 billion?

Q441 Chair: No. There is a figure in the Report. I think you have been pointed to it. What page is it? Where did I pick this up from?

Amyas Morse: Page 47.

Chair: Page 47. It's in the other Report. "The Department estimates that £1.7 billion of new tax credits debt is likely to be generated"—blah, blah, blah. Is that where I got the figure?

Dave Hartnett: Yes, but that is not about remission.

John Thorpe: That is not about remission. Based on the Department's own calculations, "without any further intervention" or action to reduce debt, "debts could increase to £7.4 billion by 2014–15."

Dave Hartnett: I am terribly sorry. I have forgotten the question.

Q442 Chair: It's a heck of a lot of money is what we are saying. My own view, which I am sure is shared by the Committee, is that the only way you really get this right is by getting the calculation right in the first place, not by trying to pursue really poor people.

Dave Hartnett: I agree, and our strategy is to help our customers and ensure that our calculations are right in the first place.

Q443 Chair: But you are remitting over a billion?

Dave Hartnett: That is the plan.

Q444 Ian Swales: I want to ask a couple more things about tax credits. Just to put this into context, what is the entire operating cost of HMRC, just to the nearest billion?

John Keelty: £3.5 billion.

Q445 Ian Swales: So about £3 billion of staff costs. Would that be about right?

John Keelty: A little less than that.

Q446 Ian Swales: I think it is really important to have that number in context when we are talking about the size of these numbers.

John Keelty: £2.2 billion.

Ian Swales: £2.2 billion is the staff cost. Your entire staff costs are £2.2 billion—

Q447 Chair: And the rest takes you up to? That is huge. What was your original figure to Ian?

John Keelty: £3.5 billion, so on IT and accommodation—

Ian Swales: £3.5 billion, so that is all the other costs of offices and so on.

Chair: A third and two thirds, really.

Q448 Ian Swales: Okay. I just want to pull out a few figures from this. It says in paragraph 33, page 10, that you have a target to reduce tax credits error and fraud to no more than 5%. My calculation is that that is about £1.4 billion—that is your target to get down to, for errors and frauds. Is that a fair assumption? I am taking 5% of the £28 billion spent on tax credits in the previous paragraph.

Dave Hartnett: We actually have a higher target each year, Mr Swales, because the number of new claims coming into the tax credit system is about 20% a year. So our target is to bring this down by £1.4 billion by 2014–15, but we will do that by tackling error and fraud at roughly £2 billion a year. We have changed the whole strategy to do that. Whereas you heard Stephen Banyard talk earlier on about "process now, check later", the big change in tax credits is to check now, process afterwards.

Q449 Ian Swales: It says: "The Department has a target to reduce Tax Credits error and fraud to no more than 5%", so what are we talking about? Some £1.5 billion or so as your target—is that right, or have I got the wrong number? What would your target be?

Dave Hartnett: £1.4 billion.

Q450 Ian Swales: So it is £1.4 billion—that was the first figure I said. Okay. So that is one figure that is important. Let us then move to the one that the Chair just mentioned, which is that you are going to assess—in paragraph 38, on the facing page—"the value for money of collecting £1.7 billion of tax credits debt not under active recovery". Can you just talk us through how you are going to assess the value for money of collecting that debt?

Dave Hartnett: Broadly, we assess the value for money by looking at what we think we are going to recover as against the cost of the actual recovery. That is a balance that we are making all the time in the area of tax credit.

Q451 Ian Swales: So when you say "the cost of making the recovery", what kind of things are we talking about? People and resources, presumably.

Dave Hartnett: People and resources. We have outsourced some debt collection to debt collection agencies.

Q452 Mr Bacon: Can you just remind us how much? On the record.

Dave Hartnett: I cannot—

Q453 Mr Bacon: It was £214 million, wasn't it? That you have outsourced.

Dave Hartnett: I think it was more across our whole business.

Stephen Barclay: Well, it was £214 million between 27 July 2010 and 14 January 2011—

Q454 Mr Bacon: So that is in the last full year. And, of that, 26% or £57 million was recovered. Well, if you are adding an extra level of new tax debt of £1.5 billion in a year, and you are getting £57 million through recovery, it doesn't take Einstein to work out how those two graphs are going to diverge, does it?

17 October 2011 HMRC

Ian Swales: In fact, the Report says that “without any further intervention tax credits debts could increase to £7.4 billion by 2014–15.” That is in paragraph 37. So what intervention are you going to make?

Dave Hartnett: We have changed our approach to managing tax credits. The four key things are: first, checking first, paying second; secondly, reviewing the risky areas of tax credit, such as the cost of child care, which is one of our highest risk areas; third, by having a process of cleansing, which is automatic checking of claims when they are made, for which we have a new risk tool; and, finally, ensuring that we improve the training of our people and how they work with claimants, so that there is less over-claiming.

Q455 Ian Swales: Okay. Much nearer the end of the Report, on page 46, in the detailed tax credit area, it discusses your having launched a joint fraud and error strategy with the Department for Work and Pensions, targeting £8 billion of tax credit losses over the next four years. How much resource, in people and money, has HMRC put into that?

Dave Hartnett: I do not know the answer to that.

Q456 Ian Swales: Well, approximately. Is it 10 people? Is it 100? Is it 1,000?

Dave Hartnett: No, it will be hundreds.

Q457 Chair: Does Mr Keelty know?

John Keelty: No, I don’t know the exact number.

Chair: Does anyone behind you know?

Q458 Ian Swales: We are talking about something that is about £8 billion of your tax credit losses. I would have thought that you would know something about this project that you have set up. Do you have any metrics at all on it?

Dave Hartnett: Not today, I am afraid. I am very sorry.

Chair: Very finally—

Dave Hartnett: The information has come from behind. We have 1,700 people or full-time equivalents in tax credits working on compliance activities.

Chair: That is on tax credit.

Q459 Ian Swales: Is that on this joint project with the Department for Work and Pensions?

Dave Hartnett: No, we do not have that number with us.

Q460 Ian Swales: Could you write to us?

Dave Hartnett: Of course.

Q461 Ian Swales: I made the context-setting remark at the start that the entire manpower of HMRC cost only £2.2 billion. My final question is: if you had your time again, would you have cut your staff in HMRC as fast as you did? Do you need to revisit your future staffing strategy in the light of all the issues that we have discussed today?

Dave Hartnett: There is a real balance there. If you have look at what we have achieved, despite cutting, we cut our compliance resource by 20%. In five years, while that was going on, we doubled the compliance yield from £6.9 billion or £7 billion to £13.9 billion.

Stephen talked about how we had improved the post. Our contact centres are nothing like good enough yet, but there has been a huge improvement there too. We have taken our debt balance down by £3 billion to £4 billion. We are doing good things.

Q462 Ian Swales: Other than the well publicised £900 million, you do not think that there are any more “invest to save” projects for HMRC, given the tax gap that we have talked about before.

Dave Hartnett: No, Mr Swales. We are constantly looking for projects. Whether we can get the funding for them is another matter. Some of our offshore work—in the last week we have made it public how we are approaching the 6,000 account holders in a particular Swiss bank—we will be looking to fund.

Q463 Ian Swales: Thinking about some of the things that we have spoken about this afternoon, have you raised any “invest to save” projects with the Treasury that have been turned down?

Dave Hartnett: Not that I can recall. The reason for that is that we want to demonstrate clearly what we can do with the £917 million first. We are ahead of profile in what we promised to deliver.

Q464 Ian Swales: But the £900 million, as I understand it, is specifically to do with tax avoidance. We have many other issues, such as recovery of debts.

Dave Hartnett: No, there are lots. It’s debt recovery, avoidance, and principally evasion.

Q465 Stephen Barclay: Quickly to pick up on a question, it is very misleading to talk about the compliance yield in isolation. What Mr Swales was driving at was the cost of staff compared to the amount of tax missed that could have been collected. If a company owes £5 billion in tax and you do a handshake deal with them for £1 billion, the compliance yield looks exceedingly good—we have brought in £1 billion. What it does not show is that we have lost £4 billion. So talking just about the compliance yield does not address the point that Mr Swales was driving at, does it?

Dave Hartnett: I think, Mr Barclay, that you know that I am going to say this: we don’t do handshake deals. I cannot think of a case like the one you have just described.

Q466 Stephen Barclay: I was just quoting internal notes. Whether it is done on a handshake or done through governance, the point stands. In talking about the compliance yield in terms of the optimum level of staff as against the amount of tax you collect, we also need to see how much tax could have been collected but wasn’t collected. That’s correct, isn’t it?

Dave Hartnett: I think that that’s a very fair point.

Chair: Matt has a question on the compliance issue.

Q467 Matthew Hancock: No, it’s on the broader point that Mr Swales raised. Something bugged me during the discussion on the savings that you are making and the contingency, which is linked to this point. Could you set out clearly where you are on the milestones to achieving that? The contingency is an

17 October 2011 HMRC

important question, but I don't think we got you on the record in that discussion with where you are up to in delivering the goals that you set out.

John Keelty: Let me try to answer the question. Please tell me if I am not answering it.

Matthew Hancock: Was I not clear? Are you on track?

John Keelty: We believe that we are on track, yes.

Q468 Matthew Hancock: You believe that you are on track, or you are on track?

John Keelty: The mid-term review that we had of the change programme showed that we were on track.

Like all big programmes, we need to take action to make sure that we keep going on the right track. That Report said that we didn't need to make any major changes to the direction we were heading in. So we are on track. With the large portfolios of change, there will be things that are doing a little better than others, but we are on track.

Chair: That is it. You end on a positive. Thank you very much for coming, and I am afraid to say that I think that there will probably be some more in the near future.

Written evidence from the Permanent Secretary for Tax, HMRC

INFORMATION REQUESTED AT PAC HEARING, 17 OCTOBER 2011: HMRC REVENUE AND CUSTOMS ACCOUNTS 2010–11 AND STRUCTURED COST REDUCTIONS

Please find attached the consolidated responses we promised to provide you at the hearing on 17 October 2011.

If you require any further information please do not hesitate to contact me.

26 October 2011

1. Q63 (James Wharton)—*The guidance given to staff about when they can amend Self Assessment data at the input stage*

Guidance is published on the HMRC web site on repairing obvious errors in self assessment returns.

For individuals:

<http://www.hmrc.gov.uk/manuals/sammanual/SAM121530.htm>

<http://www.hmrc.gov.uk.uk/manuals/sammanual/SAM121531.htm>

<http://www.hmrc.gov.uk/manuals/sammanual/SAM121541.htm>

For partnerships:

<http://www.hmrc.gov.uk/manuals/sammanual/sam122230.htm>

<http://www.hmrc.gov.uk/manuals/sammanual/SAM122231.htm>

and for Trusts:

<http://www.hmrc.gov.uk/manuals/sammanual/SAM123270.htm>

<http://www.hmrc.gov.uk/manuals/sammanual/SAM123271.htm>

<http://www.hmrc.gov.uk/manuals/sammanual/SAM123281.htm>

2. Q343 (Stephen Barclay)—*How many of the 54 change programmes have started, and of those, how many are off-track?*

HMRC's Change Programme currently consists of large portfolio of 69 change and capital programmes, including those referred to in the NAO report. All of the programmes have started, though they are at different rates of maturity. For example, some programmes where benefits are geared to later years of the SR10 period are still in the planning and design phases.

The progress of all programmes is monitored every month by HMRC's Change Delivery Committee, a sub-committee of ExCom. "Delivery" status is assessed monthly. The 5 October report to the Change Delivery Committee showed that of the 69 programmes 13 were "green", 55 were "amber" and one was "red". The one red programme was the 'Security, Knowledge and Information Management' programme, which was behind in its delivery.

3. Q347 (Stephen Barclay)—*The cost of external professional support supplied to the Change Programme?*

For 2011–12 HMRC has budgeted to invest £440 million across change and capital projects, plus £132 million of the £917 million re-investment funding. Apart from the spend associated with its IT supplier, the other external support costs are expected to be up to around £23 million in relation to commission costs for debt collection agencies, up to £2 million to publicise work tackling evasion (to maximise the deterrent impact)

and around £2 million covering a range of profession services such as rollout of pacesetter, supplementing tax skills in Large Business Service and further organisational development.

4. Q406 (Margaret Hodge)—*An assessment of the impact of the 34% staff reductions in Personal Tax.*

We have developed a model for the effects of a reduction in processing staff and its impact upon our operations. We also use a model that can estimate the potential impact on compliance yield and deterrence from re-deploying resources from one intervention type to another. We can share these models in a demonstration to the NAO if required.

For staff reductions in Personal Tax, our modelling shows that once we have eradicated backlogs and restored service standards, and with delivery of benefits from our change programme, we are able to reduce staff numbers and continue to maintain revenues through effective operation of our PAYE and SA processes. Our model relies on estimates of likely demand in a changing environment and assumptions about resource supply, together with assumptions about priority of types of work. We are able to assess the risks of failure to deliver benefits, or unplanned increases in demand, and the potential impact on either service standards or work not done. This then enables us to make a judgment of the potential revenue consequence of prioritising or de-prioritising certain activities. There is no expected reduction in PAYE compliance.

Separately, we have a strategic tool that allows us to forecast outcomes, in terms of compliance yield, and effects on the net tax gap in order to help us make resource allocation decisions. The model is not intended to give a definitive ‘right’ answer, but it does help us consider the effect of deterrence and in particular on the need to allocate resources to particular activities. We use this modelling, and our understanding of tax gap by customer segment, to design and target the right interventions, to manage and change behaviour and secure the largest amount of additional revenue, taking into account HMRC capabilities and capacity, longer-term effects on behaviour and immediate return on investment.

5. Q432 (Margaret Hodge)—*The split of tax credit debt attributable to either customer or HMRC error*

HMRC do not currently break down the tax credit debt figure between that caused by customer error and that caused by HMRC error as there is no business imperative to do so, nor does it add to our understanding of our customer base.

6. Q444–451 (Ian Swales)—*The amount of resource that HMRC has put into the joint Fraud and Error Strategy with DWP*

The “Tackling Fraud and Error in the Benefit and Tax Credits systems” strategy was launched in October 2010 and proposed a more aligned approach between HMRC and DWP to reduce the level of fraud and error in the Benefits and Tax Credits systems.

The strategy is based around five fundamental components: prevent; detect; correct; punish and deter. We have created overarching projects in line with these themes to take the joint strategy forward. Those projects include a single HMRC / DWP Intelligence function, Joint Investigation capability, complimentary Debt work and aligned penalties & sanctions. We are also working jointly to assess the use of communications as a deterrent to fraud and error.

The Joint Strategy aims to reduce the overall level of fraud and error in the benefit and tax credit systems by £1.4 billion, or 25%, from £5.2 billion to £3.8 billion by 2014/15. At the time the Joint Strategy was published the level of residual error and fraud was £5.2 billion, comprising £2.1 billion from Tax Credits and £3.1 billion from DWP administered benefits.

At the same time the SR10 announcement outlined that over the next 4 years HMRC will identify losses prevented of £8 billion, as part of the Tax Credits Error and Fraud strategy. The £1.4 billion reduction referred to in the Joint Strategy is not additional losses prevented; it represents the difference between the total residual level of Tax Credits error and fraud in both HMRC and DWP systems after the delivery of the SR commitments. The latest estimates of tax credit error and fraud, published in June 2011, show that the central estimate of the level of Tax Credits error and fraud favouring the claimant in 2009–10 has reduced to 7.4%, from 8.9% in 2008–09, or in value terms, from £2.1 billion to £1.95 billion of finalised entitlement.

In 2011–12 we will deploy in the region of 1,772 full time equivalent posts to error and fraud activity to meet the first year of HMRC’s SR10 commitments. In terms of the specific projects, undertaken as part of the Joint Strategy, we will directly deploy 42 staff to driving forward the work that will align the way the two Departments work.

Written evidence from CreDec

HMRC'S INTERIM SOLUTION FOR RTI

(Reform of PAYE & Introduction of Real Time Information)

Thank you for inviting CreDec to comment on HMRC's decision to introduce what HMRC terms the "Interim Solution" as its initial response to the introduction of RTI.

CreDec is the commercial BACS partner of the Institute of Chartered Accountants of England & Wales ("ICAEW"), and our interests are therefore directly aligned with ICAEW. We understand ICAEW have also been formally invited to respond to the PAC on this matter.

CreDec and the ICAEW represent indirectly the small employer segment of the UK labour market (defined as less than 50 employees) and in particular the 15,000 ICAEW member firms that provide payroll services to the overwhelming majority of these small businesses.

HMRC published its intention to depart from the introduction of the strategic BACS channel as its preferred channel for RTI on 22 July 2011, with its announcement of the decision to adopt the Interim Solution.

GENERAL BACKGROUND TO RTI

HMRC, since its public consultation in February 2011, has declared its intention to reform PAYE using the BACS payment network as the means by which all employers are to notify their liability to PAYE to HMRC at the same time as they pay net wages to employees. BACS remains HMRC's strategic channel for RTI.

The linkage between an employer's liability to PAYE and the payment of wages is central to RTI and HMRC's own reasons for its introduction. The motivation to make these changes arises from HMRC's stated key objectives for RTI:

1. To support the introduction of Universal Credit;
2. To improve data quality and efficiency of PAYE; and
3. To close the tax gap of PAYE deducted by employers but not paid promptly to HMRC.

HMRC declared on 22 July 2011 that it would introduce an Interim Solution for the introduction of RTI while ostensibly remaining committed to using BACS as the preferred "strategic" channel for RTI.

The migration to BACS as the strategic option arises because over 90% of UK employees are paid via this payment network and it is sufficiently robust and secure to channel RTI information to HMRC.

PRINCIPAL CONCERN

Central to RTI is the creation of a direct, explicit linkage between net payments from employers to employees and the employer's declaration of its liability to PAYE to HMRC.

Our concern is that HMRC's adoption of the Interim Solution and the implied delay to the opening of the BACS strategic channel threatens both unnecessary interruption and uncertainty to small (and medium) UK businesses and the success of the Universal Credit.

This arises because we believe it is not readily understood by HMRC how small employer payroll is actually paid or the numbers involved. Under the Interim Solution, the Internet Banking payment channel, which is how small businesses invariably pay their staff, is excluded. The Interim Solution does not require businesses paying employees via internet banking to link their net payments with their RTI return. The key point is that although bank internet payments made by employers to employees are terminated on the BACS network (and so contribute to the total figure of 90% of employees paid via BACS), HMRC's Interim Solution does not classify these payments as arising on the BACS network. HMRC's definition of BACS is any business with a bank sponsored BACS Service User Number, which does not apply to payments originating from an internet banking interface.

For the small business employer there will be, under the Interim Solution, no linkage whatever between their net payments to employees and their RTI return.

This means in effect that the Universal Credit which relies on the visibility of reliable earnings data for employees, will not have access to any proven earnings data (being net payments received from employers) for that part of the population employed by small business.

The scale of the problem is confirmed by ONS data in the public domain.

SCALE OF THE PROBLEM

We have set out in detail the ONS data we have referred to in the Appendix to this letter. However, in summary, some 50% of the UK population is employed in small businesses (private sector only) of 49 or fewer employees, which businesses rely on internet banking to pay their staff.

Therefore some 50% of the UK working population will not, under the Interim Solution for RTI, generate the level of visibility of earnings data DWP requires for Universal Credit, because their employers don't pay by "BACS" as HMRC defines it.

RISKS ARISING FROM HMRC'S "INTERIM SOLUTION" FOR RTI

It is not appropriate for CreDec to speculate on HMRC's reasons for the introduction of the Interim Solution. It is however a matter of public record that following representations from the EDI channel which is the current system by which major employers only communicate their liability to PAYE to HMRC, HMRC decided to postpone the introduction of the strategic BACS channel and adopt the Interim Solution.

However inadvertent, it would appear that HMRC's understandable wish to accommodate the EDI, large employer interest, risks seeing the postponement of the introduction of the strategic BACS channel, although HMRC have said that they will clarify their intentions for the strategic channel before the year end. This remains their public position.

Certainly, for as long as the strategic BACS channel is not deployed and HMRC rely exclusively on their Interim Solution, the Universal Credit is at risk and HMRC's stated objectives for RTI will be frustrated.

SUMMARY OF INTERIM SOLUTIONS KEY SHORTCOMINGS

1. HMRC's Interim Solution destroys the linkage between RTI notification of liability to PAYE with actual payments made to employees by small employers: This is the most important aspect of RTI's support of Universal Credit—creating a reliable level of earnings visibility for DWP.

- (a) HMRC does not currently propose to require any of the UK's smaller employers who currently pay by BACS via their banks' internet banking platform to observe the requirement to link RTI reporting with net payments to employees. HMRC does not consider such internet bank payments made by employers to be "BACS" payments, even though these payments are terminated by the BACS network; HMRC does not appear to understand fully how most small businesses actually pay their staff and are not aware of the scale of the gap the Interim Solution arrangements create by frustrating the RTI/earnings link. The Interim Solution covers a minority of the working population, albeit those employed by larger employers.
- (b) By effectively excluding small employers under the Interim Solution, HMRC will not be providing any reliable earnings data to DWP for smaller employers and by association those generally trending to lower earnings.
- (c) HMRC appear not to be aware of the size of the UK workforce that is paid by internet bank payments and therefore the number of employers/employees that will not present visible earnings information to DWP.

2. While it is acknowledged that HMRC have publicly stated they will clarify their intentions for the strategic BACS channel later this year, there are currently no plans from HMRC to close this gap on earnings data until April 2014 being the earliest implied date for the arrival of the strategic BACS channel. Although, again, we acknowledge this later date is not yet confirmed and HMRC may yet confirm the earlier availability of the BACS strategic channel.

3. Our understanding from our dealings with BACS/Vocalink is that Vocalink/BACS have already done the work to implement the strategic BACS reporting channel on the BACS network: and it is only HMRC that has not developed its systems. We are concerned that the announcement and distraction of the Interim Solution has resulted in the loss of three-four months work on the strategic channel by HMRC.

4. The RTI pilot HMRC will commence in April 2012 affects over one million taxpayers, but concerns only some 320 employers, according to HMRC's submissions to PAC (17 October 2011). This average pilot employer has over 3,125 employees: Nowhere are sufficient numbers of small employers being tested in this pilot.

5. The Interim Solution runs counter to HMRC's commitment to data improvement and accuracy as they accept that the provisional Interim Solution mechanism for creating a linkage between RTI notifications of liability to tax and actual net payments is imperfect and will result in data errors. We believe HMRC are too optimistic in the rate of data inaccuracy (0.1%) they accept the Interim Solution will create and the inadequate scale of the pilot will result in much higher data errors. The scale of the pilot does not adequately test the 40 accredited payroll software providers software changes across sufficient numbers of employers in particular the way they generate their Interim Solution, hach codes.

6. The PAYE tax gap of £2–3 billion, the sum outstanding at any one time, deducted by employers but not paid when due to HMRC will not be closed or eliminated because of the failure to link RTI submissions with payments for smaller employers where the bulk of arrears can be expected to lie.

CreDec together with ICAEW, and other stakeholders is working closely with the small business interest to plan for the smooth adoption of RTI. However, it is clear to us and other key stakeholders including the ICAEW, that HMRC's execution of RTI is flawed for as long as it continues to rely on its Interim Solution exclusively and does not make the strategic BACS channel available.

We would advise HMRC to confirm as soon as possible its original intention to introduce the strategic BACS channel from the commencement of the mandatory implementation of RTI in order that the small business interest that we, together with ICAEW, represent can plan for and progress efficiently towards its arrival. We hope you and the Committee find our submission helpful.

APPENDIX

ONS DATASETS SHOWING DISTRIBUTION OF UK LABOUR MARKET (EMPLOYEES) BY EMPLOYMENT SIZE BAND (SIZE OF EMPLOYER) BY LEGAL STATUS.

REFER TO ONS PUBLICATIONS

1. ONS—Business Register Employment Survey 2010 Statistical Bulletin

(30 September 2011) “BRES 2010 Bulletin” [PDF]

2. ONS—UK Business: Activity, Size and Location, 2011 [Excel]

The first file simply confirms the size of the UK working population (full and part time) as 26.8 million employees as of September 2010.

The link for the second file, which is <http://www.ons.gov.uk/ons/publications/re-referencetables.html?edition=tcM%3A77-227577> contains the number of UK businesses broken down by legal status and “employment size band” ie numbers of employees.

There are a number of worksheets in the file but refer to worksheets beginning A5:

A5.3—shows total UK business units broken down by SIC classification, by numbers of employees.

A5.4a—shows total UK sole proprietorships by numbers of employees.

A5.4b—shows total UK partnerships by numbers of employees.

A5.4c—shows total UK incorporated private limited companies and plcs by numbers of employees.

A5.4d—shows total UK general government and non profit entities by numbers of employees.

All of this data is based on business entities that are VAT registered and/or operating PAYE.

The cells highlighted in light blue show values taken from the data by CreDec.

CreDec has looked at the data for “small employers” only, those with less than 50 employees, which the data shows in the following four employee bands: 0–4; 5–9; 10–19 and 20–49 being the segment of the payroll market that pays by the internet banking channel. (Please note, there are also significant numbers of businesses with 50 employees who also do not pay employees directly via BACS via a Service User Number, but CreDec has not included these.)

CreDec values in blue assume the median number of employees for the number of businesses allocated to each employee band, eg If there are “Y” businesses in the table with between 20–49 employees, CreDec assumes the number of employees will be the median value (ie 34.5 employees) x “Y” and so on.

This provides a reliable estimate of the number of employees in small businesses (below 50 employees) that will not have any linkage between actual earnings received and Interim Solution RTI submissions.

A5.3 shows the numbers employed by all businesses in the UK with 49 or fewer employees, totals 14.86 million people, being 55.4% of the UK workforce.

A5.4a shows 1.68 million employees are employed by sole proprietors with less than 50 employees.

A5.4b shows 1.47 million employees are employed by partnerships with less than 50 employees.

15 November 2011

Written evidence from The Institute of Chartered Accountants in England and Wales (ICAEW)

REAL TIME INFORMATION—EVIDENCE FOR THE PUBLIC ACCOUNTS COMMITTEE

1. ICAEW welcomes the opportunity to submit evidence to the Public Accounts Committee.

2. We should be happy to discuss any aspect of our comments or provide oral evidence to the Committee.

3. Information about the Tax Faculty and the ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty’s Ten tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

DETAILED COMMENTS AND CONCERNS

The RTI Channels

7. We understand that employers will submit data using RTI through one of three 'channels', namely:

- The preferred 'strategic channel' using the BACS system, once that channel is ready (although this appears to be the preferred channel, we understand that BACS itself will not be ready when RTI becomes mandatory);
- An 'interim channel' using the Electronic Data Interchange (EDI) system; and
- An alternative channel using the Government Gateway (the Gateway).

The timetable proposes that a pilot exercise will begin in April 2012 and that RTI will be mandated for large employers by April 2013 and all employers by October 2013, with a power for HMRC to mandate for specified employers before October 2013.

The timetable for implementation

8. RTI is an ambitious project with a very demanding timetable for implementation. In light of this, and based on past experience with other IT-based projects, most recently with the mandating of iXBRL accounts, we are concerned as to whether this demanding timetable can be met and whether RTI will be ready by the date when employers are mandated to use it. We are concerned in particular with the impact on those least able to comply, in the micro-employer category (according to DBIS figures in October 2011, over 750,000 private sector enterprises have no more than four employees, and there are also several hundreds of thousands of single-director companies and non-business employers).

9. In relation to meeting the DWP timetable, we understand that DWP does not intend (or will not be able) to use the data for current claimants until April 2014, and the full migration process is scheduled to take until 2017. Given that DWP will not be in a position to use the data until April 2014 we would have thought mandating of RTI should be delayed until that date.

The RTI pilot exercise

10. Although HMRC has stated that the preferred strategic channel for the delivery of RTI will be BACS, HMRC has acknowledged that this channel will not be available during the pilot exercise. Instead, RTI delivery will only be delivered through the two other 'solutions' referred to above, namely EDI and the Gateway. The BACS route will only become available from a later date which has not yet been decided but which we understand will be April 2014 at the earliest, and possibly later. Thus, the BACS channel will not be available even when RTI is mandated, even though this is the preferred strategic channel.

11. We would welcome clarification of the statement that 90% of employees are paid by BACS, as our understanding is that the proportion is in fact much lower. While 93% of salaries and pensions are paid by BACS direct credit, the figure for wages is reportedly much lower, around 58% (BACS Payment Schemes Ltd figures), and we doubt that many of the 750,000-plus small or micro-employers use credit transfer rather than cash to pay wages.

12. If our understanding is correct, then all employers using EDI (usually larger businesses with sophisticated IT) will first have to adopt the interim channel and then later a final channel; even the minority of employers who use BACS currently for paying employees will have to invest in an interim solution. It is inevitable that this approach will increase costs for some employers, the software industry and HMRC.

13. The continued availability of the Gateway for submission of RTI information will be welcomed by many smaller employers.

Delivery of the Government's objectives

14. More generally, we are concerned whether RTI will deliver on the Government's objectives. We understand these are as follows:

- To minimise employee over-and under-payments by enabling correct PAYE code numbers to be issued on the basis of up-to-date information.
- To help HMRC to monitor and improve employer compliance.
- DWP will have correct and current data on employment income when assessing means-tested benefits such as the new universal credit.
- Submitting data using RTI should not impose undue burdens on business.

15. We have concerns as to how, without extensive manual input, the three separate channels for delivering RTI will interface with:

- The employee and pensioner/annuitant records on HMRC's NIC & PAYE Service (NPS);
- HMRC's systems within their Debt Management and Banking (DMB) section for accounting for PAYE tax and NIC paid by employers; and
- DWP's systems for means-testing and paying universal credit.

16. If the RTI solutions over the next few years do not interface automatically with payments actually made, to employees and to and from HMRC in respect of tax, NIC, statutory payments and student loan deductions, and pension contributions, we do not see how HMRC will be able to make use of the data for compliance checking without referring back to employers, thus increasing burdens on business.

17. Given the above comments we are not convinced that the proposed solutions, in particular the interim solutions, will satisfy the first three of the Government's objectives set out in paragraph 14 above. We understand that technically BACS should be able, in due course, to deliver information from employers that meets the Government's objectives. However, unless and until HMRC release more information about how this channel will operate we do not know for sure if this will be the case.

Increased admin burdens and costs

18. As for the fourth of the Government's objectives set out above, we think that RTI will impose administrative burdens and extra costs on employers. Regardless of what channel is adopted, the fact remains that employers will now be required to submit extra information to HMRC on a monthly basis rather than at the end of the year. This requirement is bound to increase the burdens and costs on businesses.

19. The Taxes Impact Assessment, published on 14 November 2011, states that 'RTI provides HMRC with an opportunity to support the Government initiative to expand digital inclusion ... to include those who have not yet been part of the digital revolution.' We do not think that mandating e-filing obligations on those who do not have a business need to e-file 'supports' digital inclusion: it does however impose extra burdens and costs on businesses with no clear benefit to them.

20. It is also far from clear whether RTI will produce any cost benefits for HMRC. The Taxes Impact Assessment shows no Exchequer savings before 2014–15 and expresses only an expectation that RTI data will 'create opportunities for HMRC to improve its enforcement and compliance activities' and that 'neither the resource impacts of any changes in this activity nor the resulting impacts on tax receipts and expenditure have yet been quantified'.

Detailed concerns about how RTI will work in practice

21. We are also concerned about how RTI will work in practice. We have summarised our concerns below:

- How adjustments to over-and under-payments of tax and NIC by employers will be dealt with in practice;
- Data security (both computer security and confidentiality risks, given that data will be available to other parts of HMRC and DWP, and that numerous employers will have to use computers in public places such as libraries and internet cafes to make monthly RTI reports online, although we acknowledge the availability of a paper return for a small number of cases);
- Employee identifiers (NINOs always take time to reach employers, and foreigners are supposed to provide passport numbers or equivalent details);
- End-of-year adjustments (owing to data received by payroll too late to be captured by when RTI data was originally submitted—this is particularly a risk with expatriates);
- Employers who are outside broadband coverage;
- Employers who do not use payroll software and/or are not computer literate, perhaps because they have no business need for a computer;

exempt micro-employers taking the option to file on paper—we have not seen any draft returns, but the data required in an electronic return in respect of each payment can occupy over 100 fields in the BACS record, and this return is to be required monthly.

22. We suspect that there are many other practical problems that need to be addressed.

23. Regarding new joiners' data (as RTI will not be providing data to employers, an HMRC provided standard format through which employers ascertain new employees' year-to-date data will continue to be needed), we welcome the fact that, presumably in response to concerns previously expressed, the draft regulations published on 14 November 2011 do provide a 'leavers statement' to replace the form P45 as tangible evidence of earnings and tax to date that employees can take to a new employer.

24. We should welcome confirmation that HMRC will provide a standard recommended layout on the lines of the current form P45 (and P46 for those who do not provide their new employer with a leaver statement) that every employer can follow, which will save all employers from having to design their own templates and ensure consistency of data transfer.

25. Abolishing the P45 will not obviously save employers any effort if they have to prepare and issue an alternative. Employers will no longer have to file a P14, but they will still be obliged to prepare a P60 end of year certificate for each employee, which is almost a carbon copy of the P14 that is to be abolished. Therefore, abolition of the forms P45 and P14 is not likely to save costs.

Clarity about HMRC's RTI intentions

26. In order for employers and the multitude of payroll software suppliers to plan and comply, we believe that HMRC needs to clarify its RTI plans.

27. HMRC should publish:

- a clear, robust and costed RTI strategy that clarifies how its proposals will meet the Government's objectives set out in paragraph 14 above;
- a clear timetable for developing the RTI channels, in particular the BACS channel, which we believe must be developed in parallel with the two other solutions and available and tested to a robust standard before RTI is mandated; and
- a strategy to help all micro-employers, whatever their level of IT expertise and equipment to comply at minimal cost.

We do not think that the consultation document published on 14 November 2011 adequately addresses these concerns.

28. We understand that it is the intention that the interim EDI channel is to be withdrawn at some stage in the future, but that the Gateway channel will remain available for the many employers who do not pay their employees via BACS. We should welcome an assurance that the Gateway channel will be permanent, once tested and judged reliable, and that HMRC will make available free software to enable any employer not using BACS to comply at minimal cost.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context; and
- the source of the extract or document is acknowledged and the title and ICAEW reference number are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

APPENDIX 1

THE TAX FACULTY'S 10 TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

- 1 Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
- 2 Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
- 3 Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
- 4 Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

- 5 Properly targeted: when anti-avoidance legislation is passed due regard should be had to maintaining simplicity and certainty of the tax system by targeting it to close specific loopholes.
- 6 Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
- 7 Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
- 8 Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
- 9 Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
- 10 Competitive: tax and rates should be framed so as to encourage investment, capital and trade in and with the UK.

There are explained in more details in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com~/media/Files/Technical/Tax/Tax%20news/Taxguides/taxguide-4-99-towards-a-better-tax-system.ashx>).

29 November 2011

ISBN 978-0-215-03991-0



9 780215 039910

