House of Commons

Committee of Public Accounts

HM Revenue & Customs: tax credits error and fraud

Fourth Report of Session 2013–14

HC 135

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Report, together with formal minutes, oral and written evidence

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Committee of Public Accounts

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Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Sonia Draper (Senior Committee Assistant), Ian Blair and James McQuade (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

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Summary

HM Revenue and Customs (HMRC) paid £30 billion in tax credits in 2011-12, providing support to nearly six million individuals and families. The scheme is complex as the eligibility of claimants and their awards are based on a range of criteria and the scheme is designed to react to changes in claimants' circumstances. Tax credits are difficult for claimants to understand and equally challenging for HMRC to administer. In 2010-11, HMRC estimated that one in five awards contained error or fraud which resulted in claimants receiving more money than they were entitled to.

HMRC acknowledges that its performance in reducing tax credits error and fraud is disappointing. It lost £2.3 billion to error and fraud in 2010-11, £850 million higher than it had expected. HMRC's target in the 2010 Spending Review was to save £8 billion from reducing tax credits error and fraud by 2015. It now estimates that it will miss this target by £5 billion. HMRC needs a more realistic target for the amount of savings it should achieve from reducing error and fraud.

The support provided by HMRC to claimants, in writing and through its helpline, needs to be improved. This will help ensure claimants receive the correct amount and avoid overpayments, which they often struggle to repay. In 2011-12, HMRC wrote off £1.7 billion of tax credits debt. HMRC must work more closely with organisations that represent claimants to get a better understanding of where claimants need help so it can make improvements to the support it provides to claimants.

HMRC has increased the number of awards it checks, resulting in more people contacting Citizens Advice for help with their claims and a greater number of appeals against decisions to reduce or terminate the amount of tax credit paid. HMRC did not put in place sufficient resources to deal with the increase in appeals resulting in delays and causing unnecessary distress and hardship to claimants.

Using data to identify patterns and trends in claimant behaviour, as well as checking claimant information against other data sources to identify discrepancies, is crucial to tackling error and fraud. HMRC has made some progress in its analysis of data, but it has not always checked tax credits against child benefit data that it holds and it should also explore how it can use a wider range of data sources. HMRC also needs to improve its understanding of why claimants do not always report changes to their circumstances as this is when the majority of error happens.

On the basis of a Report by the Comptroller and Auditor General,[1] we took evidence from HM Revenue & Customs and Citizens Advice on tax credits error and fraud.

1 C&AG's Report, *Tackling tax credits error and fraud*, Session 2012-13, HC 891

Conclusions and recommendations

1. **HMRC has made little progress in reducing the amount of money it loses due to error and fraud in tax credits.** HMRC missed its target to reduce tax credit error and fraud to 5% by 2010-11 by a wide margin. The actual level of error and fraud in 2010-11 was 8.1%, some £850 million higher than HMRC had expected. The Department estimated that 70% of this loss was due to error. In the 2010 Spending Review HMRC's target was to save £8 billion from reducing tax credits error and fraud by 2015. However, it now estimates it will miss this target by £5 billion. HMRC should agree with the Treasury a new target for savings from reducing tax credit error and fraud, up to the end of the scheme in 2017 and the Treasury should hold HMRC to account to ensure real savings are delivered.

2. **HMRC needs a better understanding of its performance as it hugely overestimated its progress in tackling error and fraud.** HMRC believed it was on target to reduce tax credit error and fraud to 5% until June 2012, when 2010-11 data became available, and it became clear that this was not the case. It had increased interventions on individuals from 123,000 to nearly two million, but that produced only a two-fold increase in monies saved. HMRC had to revise its estimates for the amount of tax credits error and fraud prevented in 2010-11 from £1.4 billion to £480 million. HMRC had not tested how effective its activities would be. It needs to improve the time it takes to produce the data it needs to monitor progress and determine actions. HMRC also needs a more accurate measurement of the impact of its work and to increase the quality of its in-year tracking of claims. It should work with the Department for Work and Pensions to ensure a consistent approach to measuring error and fraud throughout the welfare system.

3. **HMRC has not done enough to reduce error and fraud resulting from claimants not reporting their circumstances accurately.** Over 80% of tax credits error and fraud relates to changes in claimants' circumstances. HMRC needs a more effective response to this issue. There is no automatic check against the data it collects on Child Benefit. If a parent notifies HMRC that their child has left school at 16 for the purposes of Child Benefit this change is not registered for tax credit purposes. HMRC should produce a plan setting out the actions it will take to tackle losses occurring due to individuals' change of circumstances.

4. **HMRC's advice and guidance to claimants needs to improve.** HMRC believes that it is responsible for only 2.5% of tax credit error, an estimate that sits uneasily with the evidence from Citizens Advice on the inaccuracy of HMRC's advice to claimants over the phone. HMRC does not have a good record on recovering tax credits overpayments and wrote off debts of £1.7 billion in 2011-12. HMRC should systematically review the guidance and support it provides for claimants and staff with stakeholder groups, including Citizens Advice, and front-line staff, to identify and address the areas where improvements are required.

5. **HMRC needs a faster and more effective appeals process.** HMRC has increased the number of claimants it contacts almost ten-fold, but has not put in place adequate resources to deal with the consequential increase in the number of appeals. In 2011-

12 there were some 8,000 appeals against tax credit decisions, around 40% of which were decided in favour of the claimants. The appeals process can take many months and cause hardship and distress to those waiting to have their awards re-instated. HMRC needs to review its appeals process to minimise delays and ensure that when changing its approach to checking claims, it has adequate resources to handle any increases in the volume of appeals.

6. **HMRC needs to make more effective use of available data to prevent and detect errors and fraud.** HMRC intends to build on how it uses data analysis to identify patterns and trends in error and fraud. There are six risk categories for error and fraud loss, which relate to the main elements of tax credits awards. HMRC has made some progress in its analysis of these risks, but this has led to little improvement in reducing error and fraud in two categories—working hours and undeclared partner—which together accounted for losses of over £1 billion in 2010-11. HMRC is looking for new data sources to help identify error and fraud, but it has not always made best use of the information it holds, such as child benefit data. HMRC should systematically review what internal and external data sources are available, for each of its six risk categories, before Parliament's Summer Recess and develop a credible plan for reducing error and fraud losses in each category.

1 HMRC's performance in reducing error and fraud

1. Working tax credits and child tax credits (tax credits) are payments to support workers on low incomes and those with responsibility for children and young people. HMRC paid £30 billion in tax credits in 2011-12, providing support to just under six million individuals and families. The system of tax credits is extremely complex. HMRC calculates the value of claims based on a range of factors, including hours worked, the number of dependent children, childcare costs, disability and household income.[2] Claimants need to keep HMRC up to date with their circumstances, but can find it difficult to understand the system and what they are required to report. This leads to HMRC making incorrect payments based on incomplete, outdated, or wrong information.

2. Although the tax credits system was launched in April 2003, HMRC has made very little progress in reducing levels of error and fraud which are very high in comparison to other benefits and payments made by other government departments.[3] In response to our previous recommendations on tax credits HMRC committed to reduce total error and fraud to no more than 5% of the amount claimants are entitled to receive by 2010-11.[4] However, HMRC has missed its target with error and fraud standing at 8.1% in 2010-11. This equates to an estimated loss of some £2.3 billion to error and fraud by 31 March 2011, some £850 million higher than it had expected.[5] In 2010-11, HMRC estimated that one in five awards contained error or fraud.[6]

3. HMRC agreed with the Treasury in the 2010 Spending Review to stop £8 billion in tax credits error and fraud by 2015. HMRC has now confirmed that they will be unable to achieve this amount and estimates that it will now only prevent around £3 billion in error and fraud.[7] The agreement with the Treasury does not commit HMRC to delivering cash savings and HMRC does not have to report separately on its progress. At a time when departments are making cuts this is surprising and HMRC was unclear as to what the consequences of missing this commitment to deliver £8 billion in savings would be.[8]

4. HMRC believed it was on track to meet its targets until summer 2012. It initially estimated it had reduced error and fraud by £1.4 billion during 2010-11. Following the publication of the error and fraud estimates, HMRC revised the estimated impact of its work down to £480 million.[9] HMRC did not test the assumptions it made in measuring the impact of its interventions to tackle error and fraud. These included assumptions as to how long a claim would remain correct following an intervention and the deterrent effect of its

2 C&AG Report, paras 1-2.

3 Qq 29-30, 67-68

4 HC Committee of Public Accounts, *Tax Credits*, Twenty-second Report of Session 2006-07, HC 487, April 2007

5 Q 32; C&AG Report, para 1.7

6 C&AG Report, para 2

7 Qq 114-117

8 Qq 158-161

9 Q 107

work. HMRC found that claimants made the same mistakes again and awards become incorrect quicker than was previously believed. It also found it difficult to evidence the deterrent effect expected from claimants telling friends and family about changes HMRC made to their award and helping them to avoid similar errors.[10] HMRC has identified the need to engage with customers' claims more frequently to ensure they are receiving the right amount of money.[11]

5. HMRC has taken action to improve its understanding of the impact of its interventions, with the aim of providing better information on its progress in tackling error and fraud. HMRC has commissioned an independent company to undertake social and economic research to establish why some claimants repeatedly make the same mistakes in providing information to HMRC.[12] It has also selected 500 tax credits claims to track in real time, which will allow it to identify when an error reoccurs. HMRC recognised that 500 claims is not enough and has agreed to track a greater number of claims in the future.[13]

10 Qq107-109; C&AG Report, paras 3.3 – 3.10

11 Q 109

12 Q 109

13 Q 108

2 The support and advice provided to claimants

6. HMRC provides written guidance to tax credits claimants and offers support through its helpline to help them manage their claims. However, our experience from helping our constituents is of problems with the accuracy and consistency of HMRC's advice.[14] Citizens Advice has also identified inaccurate information from the tax credits helpline through a mystery shopping exercise.[15] This experience seems to be at odds with HMRC's estimates that only 2.5% of error is due to errors by HMRC officials.[16] HMRC's reporting of these figures does not appear to be consistent with the way the Department for Work and Pensions reports the breakdown of claimant error, administrative error and fraud for other benefits.[17]

7. Providing accurate advice and support is important for both claimants and the taxpayer. Without this claimants may provide HMRC with the wrong information which in turn may lead to overpayments that HMRC will seek to recover. Some claimants find it difficult to understand why such debts have occurred and struggle to cope with the resulting repayments.[18] HMRC acknowledges that the level of tax credits debt created is significant and challenging.[19] In 2011-12 HMRC wrote off £1.7 billion in tax credits debt that it could not recover from claimants.[20]

8. HMRC could reduce overpayments and error through providing better quality information and advice when people make a claim or report a change in their circumstances.[21] Voluntary sector organisations, such as Citizens Advice, have a great deal of knowledge of how claimants experience the tax credits system and what areas they struggle to understand. HMRC already works with the voluntary sector, but recognised that it could do more to build on this relationship and work more closely to share information at a local level.[22] HMRC's front-line staff also have expertise of claimants' experience of the tax credits system. HMRC is working to ensure that staff are supported to feedback their views of what does and does not work.[23] It is clear from the evidence we heard, particularly in regard to claimants not being able to recognise when they meet HMRC's definition of living as a couple, that guidance and support needs to improve.[24]

14 Qq 40, 101, 133

15 Q 4

16 Qq 30-35

17 Qq 29-30

18 Q 40

19 Q 40

20 Q 40

21 Q 1

22 Qq 134-135

23 Q 134

24 Qq 9, 13-15

9. HMRC has to make decisions on the amount of money claimants are entitled to, using the evidence it holds which may be incomplete, outdated or incorrect.[25] This leads to claimants appealing against HMRC's decision and providing additional evidence. We heard from Citizens Advice that HMRC is making retrospective decisions which should have been made when the claim was made or when a change was reported.[26] When a decision is appealed it is important HMRC deals with it quickly as during the process awards are reduced or stopped leading to people suffering financial difficulties, hardship and distress.[27] In 2011-12, around 8,000 people lodged an appeal, of which 40% were successful.[28]

10. HMRC has increased significantly the number of tax credits claims it checks for error and fraud from 123,000 in 2008-09 to 1.6 million in 2011-12.[29] It has not, however, always considered the impact this would have on the volume of appeals it receives. For example, it took action in 2011 to identify claimants who had not told HMRC that they were in a relationship. HMRC undertook 100,000 checks to identify undeclared partners and ended 40,000 tax credits awards.[30] However, HMRC failed to put in place adequate resources to handle the subsequent increase in appeals. Citizens Advice told us that this had led to a huge increase in the number of lone parents seeking their assistance[31] and that some appeals had taken over six months to resolve.[32] HMRC accepted that it had not responded sufficiently quickly enough in these cases.[33]

25 Q 37

26 Q 9

27 Q 16

28 Q 39

29 C&AG Report, paras 2.10, 4.3

30 Q 95

31 Q 13

32 Qq 13, 15-18

33 Ev 23

3 Improving the quality of interventions to tackle error and fraud

11. To reduce error and fraud HMRC must identify where claimants have not reported their circumstances accurately or have done so fraudulently. The tax credits system is designed to be responsive to changes in claimants' lives and the amount people should be paid changes with their circumstances.[34] HMRC has developed how it uses data to identify patterns and trends in error and fraud to focus its interventions.[35] HMRC told us it has delivered a return on its investment in tackling error and fraud, but it recognises the need for improvement.[36]

12. There are six risk categories for tax credits error and fraud loss, which relate to the main elements of tax credits awards. While HMRC has reduced error and fraud in three of these areas, it has made little progress in two key areas — 'undeclared partner' and 'work and hours'. We recognise these are difficult areas to deal with. Together they accounted for losses of over £1 billion in 2010-11.[37]

13. Claimants applying as a single person and not including their partner on the claim account for the largest area of error and fraud.[38] Claimants must report household income, but identifying couples who have claimed for tax credits as if they were single is difficult as HMRC holds limited data on living arrangements and financial relationships.[39] It has developed its ability to tackle this area using its CONNECT system, which helps identify hidden relationships between people, and new sources of third-party data. The results to assess the performance of this intervention are not yet available.[40]

14. There are a minimum number of hours claimants need to work and it is a significant area of error and fraud which HMRC has found challenging to address. This is partly due to wider changes in how people are employed. We heard from Citizens Advice of an increase in the use of zero-hero contracts and greater unpredictability in the hours many people work, which can make it hard for claimants to keep track of and report to HMRC.[41] HMRC is seeking ways to address this area of risk. It pointed to the requirement, from late 2013, for all employers to report real time information on how much they pay employees as a way to improve how it identifies error and fraud.[42]

34 Q 76; C&AG Report, para 1.2

35 Q 151

36 Q 97

37 Q 73

38 C&AG Report, Figure 1

39 C&AG Report, para 11

40 Q 74; C&AG Report, para 11

41 Qq 20,124. Zero hours contracts are where an individual is on call and is only paid for hours worked.

42 Qq 124-125

15. Losses due to error and fraud relating to 'children' have almost doubled in three years, from £325 million in 2008-09 to £640 million in 2010-11.[43] This was partly due to HMRC's decision to automatically renew around one million additional awards, so those claimants continued to receive tax credits without taking any further action. HMRC did not anticipate that this would lead to an increase in claimants not reporting children aged 16 to 19 who had left full time education or training. HMRC did not carry out enough checks in this area.[44] It intends to write to some claimants and require them to confirm the information relating to children continuing in further education or training on their claim.[45]

16. We heard from HMRC that it has improved its understanding of which interventions designed to tackle error and fraud work and which do not.[46] It recognises that there is more that can be achieved to improve the quality of how it targets claims for review. It is looking to develop its analysis so that it looks at fewer claims but with greater success in correcting awards.[47] HMRC is also seeking to identify new sources of data that it can use to inform this analysis and identify potential error and fraud. HMRC's child benefit computer system does not automatically link to tax credits and it undertakes a regular comparison of the data in the two computer systems to identify discrepancies. HMRC recognises it should be better at using the data it holds to identify patterns and trends.[48]

17. Over 80% of error and fraud relates to changes in the circumstances of claimants. This error and fraud can be due to a claimant providing HMRC unknowingly or knowingly with inaccurate information, or not proving any information at all. Claimants notify HMRC of around six million changes of circumstances each year and HMRC are unable to check the accuracy of each of these changes.[49] HMRC undertakes a risk assessment of claims, but it was unable to tell us how many of its interventions address changes of circumstance.[50]

18. Claimants do not always understand what information they need to report to HMRC and this presents a significant challenge to HMRC in keeping claimants on the right award. Around two-thirds of error and fraud that occurs due to a change of circumstance relates to unreported information.[51] It has begun to use new analysis and data sources to improve how it identifies unreported information, but the success of this work is not yet known.[52] HMRC needs to understand why claimants do not report the information it requires to

43 C&AG Report, para 12

44 Q 119; C&AG Report, para 3.19

45 Q 119; C&AG's report 4.13

46 Qq 96-97

47 Q 97

48 Qq 22, 64, 71-72, 106, 119

49 Qq 81, 87

50 Qq 87-97

51 C&AG Report, para 3.24

52 C&AG Report, paras 11, 4.7

make an accurate payment, but it has not yet developed a detailed picture of how claimants behave.[53]

53 Q 139

Formal Minutes

Monday 13 May 2013

Members present:

Mrs Margaret Hodge, in the Chair

Guto Bebb
Chris Heaton-Harris
Meg Hillier
Mr Stewart Jackson
Fiona Mactaggart
Nick Smith
Justin Tomlinson

Draft Report (*HM Revenue & Customs: tax credits error and fraud*), proposed by the Chair, brought up and read.

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

Paragraphs 1 to 18 read and agreed to.

Summary agreed to.

Conclusions and recommendations agreed to.

Resolved, That the Report be the Fourth 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 printing with the Report (in addition to that ordered to be reported for publishing on 6 March.

[Adjourned till Wednesday 15 May at 2.00 pm

Witnesses

List of printed written evidence

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 2013–14

First Report	Ministry of Defence: Equipment Plan 2012-2022 and Major Projects Report 2012	HC 53