

House of Commons
Committee of Public Accounts

**INLAND REVENUE: TAX
CREDITS**

Sixty-seventh Report of Session
2001–02

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*Report, together with
Proceedings of the Committee,
Minutes of Evidence and an Appendix*

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Committee of Public Accounts

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Footnotes

In the footnotes of this Report, references to oral evidence are indicated by ‘Q’ or ‘Qq’ followed by the question number; references to the written evidence are indicated by the page number as in ‘Ev’.

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SIXTY-SEVENTH REPORT

The Committee of Public Accounts has agreed to the following Report:

INLAND REVENUE: TAX CREDITS

INTRODUCTION AND LIST OF CONCLUSIONS AND RECOMMENDATIONS

1. In 2000–01, the Inland Revenue collected £148.7 billion in taxes and duties, and £62.8 billion in National Insurance contributions. It paid out £4.7 billion of Tax Credits. Figure 1 shows the development of the revenue over the last five years.

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

Net receipts (see note below) and Tax Credits					
£ billion	1996–97	1997–98	1998–99	1999–00	2000–01
Income Tax	69.1	76.8	86.6	94.0	105.9
Payment of Tax Credits	-	-	-	(1.0)	(4.7)
Corporation tax	27.8	30.4	30.0	34.4	32.4
Capital gains tax	1.1	1.5	2.0	2.1	3.2
Inheritance tax	1.5	1.7	1.8	2.0	2.2
Stamp duty	2.5	3.4	4.6	6.9	8.2
Petroleum revenue tax	1.7	1.0	0.5	0.9	1.5
Windfall tax	-	2.6	2.6	-	-
Total tax receipts (£ billion)	103.7	117.4	128.1	139.3	148.7
Source: <i>National Audit Office analysis of Inland Revenue data</i>					
Note: Shown net after allowing for tax reliefs and allowances, and for repayments (2000–01 £11.9 billion)					

2. Each year, the C&AG reports on the work he has carried out to examine the management of the tax system by the Inland Revenue (the Department). On the basis of his Report on the 2000–01 accounts¹ and a supplementary note² from the Department, we examined the Department on its management and control of Tax Credits, including controls over Tax Credit payments made by employers on behalf of the Department.

3. Tax Credits are available to people with children, or disabled people who work 16 or more hours a week. Around 1.2 million people were receiving an average of just under £80 a week in Tax Credits in March 2001.³ About 30% of Tax Credits were paid by employers to their employees based on awards made by the Department. Employers recouped the cost from tax and National Insurance they collected before they paid them over to the Department.

¹ C&AG's Report, *Inland Revenue Appropriation Accounts 2000–01* (HC 335 XVI, Session 2001–02)

² Ev 1–4

³ C&AG's Report, para 3.4

4. In the light of our examination, the Committee draws the following overall conclusions:

- Employers, as agents of the Inland Revenue, are paying out over £1.3 billion in Tax Credits each year. The Chairman of our predecessor Committee expressed concern that there was no provision for the Comptroller and Auditor General to have statutory access to employers who act as paying agents for the Department. Hence the Comptroller and Auditor General is not able to obtain direct assurance about the payments at the point they are made. To provide independent assurance to Parliament that Tax Credits are properly paid, the Comptroller and Auditor General needs access to employers' records.
- The Department do carry out some checks to assess the accuracy of the payments by employers to their staff, but these checks have not been sufficient to provide the necessary assurance that Tax Credits are properly paid. They have not found it practicable to reconcile the total amount of Tax Credit paid by each employer with the amount the Department had authorised. The Department are making further efforts to reconcile the Tax Credit payments for subsequent years.
- These problems highlight the inappropriateness of expecting the Comptroller and Auditor General, in auditing the Departments' arrangements for the administration of Tax Credits, to rely exclusively on the Department's own checks on employers' records, without any facility to validate those checks by inspections of his own.

5. Our further conclusions and recommendations are as follows:

- (i) To demonstrate that Tax Credit funds held by employers have been properly applied, it is important for the Department to continue to refine their risk assessment processes so that they can target their compliance work on employers and applicants to best effect. The Department quantify the error rates they detect. They should report those error rates with their annual accounts, together with their analyses and the trends that they show.
- (ii) Improvements in Departmental checks on employers' records would enable the Comptroller and Auditor General to gain more assurance from them, but he would still need to do sufficient work to ascertain that the Inland Revenue's controls are effective, as he is required to do under the Exchequer and Audit Departments Act 1921.
- (iii) Such selective inspection of employers by the Comptroller and Auditor General should not add significantly to the existing burden of administering Tax Credits.
- (iv) The inspections would call for expertise in the examination of payment systems and controls, though within a tax environment. Such work is within the competence of auditors, as in other specialised environments, and is distinct from the work of Inland Revenue tax experts on the executive management of the tax system. The technical complexity of tax administration should not therefore preclude effective external audit of Tax Credits.
- (v) The Department should ensure that the new Tax Credit schemes to operate from April 2003 provide for direct reconciliation of the total amount paid by each employer with the amount authorised by the Department.
- (vi) The Department have not been able to estimate how many people are eligible for Tax Credits. To enable them to do so they need to complete their analysis of the Family Resources Survey quickly. They should then use this information to assess

and report upon the effectiveness of their efforts in getting Tax Credits to those entitled to them.

INTRODUCTION OF TAX CREDITS

6. Part 3 of the C&AG's Report⁴ examines developments on Tax Credits since the Department gave evidence to the Committee in April 2001. Tax Credits are part of the government's programme of tax and benefit reforms to make it worthwhile to work. They are available to families and single parents with children, or disabled people who work at least 16 hours a week. As at March 2001 around 1.225 million individuals were receiving an average rate of just under £80 a week in Tax Credits. From April 2000, employers could pay the Tax Credit awarded by the Department to applicants with their wages. Employers could then recoup the cost from the tax and National Insurance they had collected, before paying them over to the Department. Some 30% of the £4.7 billion Tax Credits paid in 2000–01 were routed via employers and mainly funded from the PAYE tax deducted from other employees.

7. During consideration of the Tax Credits Bill in 1999, the Chairman of our predecessor Committee asked the Paymaster General whether the C&AG would have access to employers to obtain direct assurance about Tax Credit payments made on behalf of the Department. The Chairman drew attention to the fundamental principles of Parliamentary control over public expenditure under which Revenue Departments pay tax revenue gross into the Consolidated Fund. Expenditure is then approved by the House through the annual voted Supply Procedure. The Tax Credit legislation in 1999 amended the Exchequer and Audit Departments Act 1866 so that in respect solely of Tax Credits, the gross pay-over requirement was replaced with a net pay-over requirement.⁵ The cost of Tax Credits is not therefore voted by Parliament. The previous Chairman expressed concern that the new arrangements represented a significant weakening of the system of control over public expenditure that had served the House well for over a century.

8. The previous Chairman also expressed concern that the accounts through which the Tax Credits would be reported to Parliament were not on a statutory basis, unlike the accounts for practically all other expenditure. Furthermore, there was no provision for the C&AG to have statutory access to employers who would be taking on the new role as paying agents for the Department. Hence he would not be able to obtain direct assurance about the payments at the point they were made, as part of his independent audit on behalf of Parliament.

9. The Paymaster General's response emphasised that the new support was seen as part of the tax system - not as benefits - and that the level of individual Tax Credits would be set by regulation laid before Parliament. The total expenditure would be in the Department's accounts and also the national accounts. Under subsequent legislation the Departmental accounts were made statutory. The Paymaster General said that the Government would be unwilling to see the NAO added to the many inspectors that could visit employers because of the burden upon them, and expressed the preference that the C&AG should derive assurance by examining the Department's programme of checking the operation of PAYE and National Insurance by employers. The Paymaster General also said that if this caused major difficulties the government would reconsider the question of the C&AG's access.

10. This Committee's Report in March 2002 recorded that the Department expected to be able to give the C&AG sufficient assurance about employers' operation of the Tax

⁴ C&AG's Report, paras 3.2–3.5

⁵ The Tax Credit Act 1999 Section 5(2) amended the Exchequer and Audit Departments Act 1866 Section 10.

Credit scheme during 2000–01.⁶ For that year, therefore, to satisfy himself that employers acted in accordance with regulations, the C&AG would have to take assurance from the Department's compliance visits to employers as well as from Departmental reconciliations of year-end returns of payments by employers, with the amounts authorised by the Department.⁷ As we explain in paragraphs 14 to 16 below, these reconciliations which were eventually concluded in April 2002, proved less than satisfactory.

NEED FOR C&AG'S ASSURANCE

11. We asked the C&AG about his need for access to the employers who pay Tax Credits on behalf of the Department. He told us that essentially Tax Credits were a form of payment and the external auditor should have access to the books and records of the organisations which made those payments. The C&AG did not have the same access to the people who paid the Tax Credits, because they were employers, as he had to government departments which made other payments. He stressed that the external auditor of any activity needed direct access to that activity. To get a full understanding of the way the Tax Credit system worked, he needed access to employers, which he could use when he saw advantage in doing so. It was up to the external auditor to determine the mode, method and occasions on which he exercised access powers. He emphasised that he would of course use those powers with circumspection and care, and would not seek to go to every employer every year. He concluded that he needed access to be able to report adequately to Parliament on the disbursement of public money.⁸

12. The Department expressed concern that letting auditors visit employers, even if they went with the Department's own compliance staff, would be a problem as the National Audit Office were not experts and would detract from the work of the Inland Revenue.⁹ This is to misunderstand the role of auditors, who independently audit the systems and procedures in question, which is their field of expertise.

13. The Department told us that they were content to discuss with the C&AG how best to give him the assurance which he sought, but their concern was that the intervention of a further party would increase what employers saw as a burden.¹⁰ The C&AG's staff would be quality assuring the efforts of the Department in ensuring that employers were operating Tax Credits correctly.¹¹ The C&AG's view, on the other hand, is that he would be securing direct assurance on the payment of Tax Credits by employers, effectively as agents for the Department.

DEPARTMENTAL CHECKS ON TAX CREDITS

14. The C&AG's Report for the previous year, 1999–2000, had highlighted the lack of management accounting information on Tax Credit awards made and recommended that the Department should produce this information as a matter of routine.¹² Nevertheless, the Department were unable to obtain details of award notifications sent to employers during 2000–2001 that were needed to reconcile payments made by employers to those authorised.

15. The Department therefore undertook a separate exercise to interrogate the Tax Credit database for details of awards made, and then tried to reconcile these figures with payments made by employers. The results of that exercise are summarised in the supplementary note

⁶ 23rd Report from the Committee of Public Accounts, *Report on Inland Revenue Appropriation Account 1999–2000* (HC 631, Session 2001–02), paras 31–32.

⁷ C&AG's Report, para 3.25

⁸ Qq 76, 107, 155

⁹ Q 49

¹⁰ Q 52

¹¹ Q 59

¹² C&AG's Report, para 3.29

that the Department sent to the Committee. We are grateful for this note and we welcome the candour of the Department's admission that currently it is not feasible to tie up the aggregate amounts of Tax Credit paid, as declared by employers in their annual returns, with the amounts authorised by the Department. This is mainly because employer payroll cycles do not coincide with the tax year; there are errors in identifying the employers' schemes when authorising individuals' Tax Credits; there are errors by employers in completing their returns; and errors in keying data into departmental systems. The Department recognise that the first year of payment via employers was a learning experience, and that they had not made as much progress as they had hoped. They accepted that there would still be problems for 2001–02 and over the next few months they would be discussing with the National Audit Office the full details and findings of their exercise and their proposals for further work in this area.¹³

16. The Department noted that in investigating these issues, their Internal Audit and operational staff had found no evidence of anything other than genuine error. They were sure that the work they planned to undertake over the next few months would help to reduce further problems and would put their assurance about employers on a sounder footing. The Department offered to report back to the Committee on progress later in 2002.¹⁴ We look forward to that progress report.

17. The C&AG reported that he had difficulty in obtaining satisfactory information relating to visits to employers by the Department's compliance teams due to weaknesses in their management information. There is therefore uncertainty about the number of visits which included cases where Tax Credits had been paid and how many checked. The C&AG considered that there was a need for detailed information on the results of compliance visits to employers. This would enable an early evaluation of risk and targeting resources on key areas. In addition, a lack of detailed data meant that the Department could not estimate level of error where employers had paid Tax Credits incorrectly. The Department told the C&AG that their random reviews would enable them to estimate amounts at risk from non-compliance in the future.¹⁵

18. The Department also told the C&AG that for 2002–03 they should have a better reporting system for their compliance work which should enable them to say when credits were looked at and whether there were problems. Nevertheless, we are not convinced as to the balance between compliance work on individual applicants and that on employers, and the Department promised to let us have a note on the staff numbers deployed on these two areas.¹⁶

DEPARTMENTAL ANALYSIS OF CASES

19. Between the start of the Tax Credit scheme in October 1999 and November 2001, around 49,000 cases relating to individuals had been referred to the Department's Compliance Co-ordination Unit. Of these 22,500 were not followed up because of a lack of evidence or because the case was considered to be insufficiently high-risk. This suggested that the risk scorecard, which was the source of 37% of the 49,000 referrals, needed to be further refined. 3,600 of the 26,500 cases examined were closed without necessary work being completed, due to staff shortages.¹⁷ The C&AG's examination of a sample of cases confirmed that the investigations had been thorough. In 226 cases, however, overpayments identified had not been properly reported to the Department's debt

¹³ Ev 1–4

¹⁴ Ibid, para 18

¹⁵ C&AG's Report, paras 3.26–3.27

¹⁶ Q 119; Ev 20–21

¹⁷ C&AG's Report, paras 3.16–3.18

recovery team, resulting in a failure to recover some £114,000,¹⁸ which the Department admitted was their fault.¹⁹

20. The amount of errors made when the Department processed Tax Credit applications was low in proportion to the aggregate amount paid. Nevertheless, the Department need to analyse their quality assurance results to identify and address the types of error most likely to lead to significant under- or over-payments. The absence of management information meant that the Department could not evaluate the relative cost-effectiveness of different sources of referrals to compliance teams. The C&AG recommended that the Department should routinely identify the yield from each source so that they could target resources effectively. He also said that they should assess the appropriateness of the risk scorecard criteria that led to referrals and continue to keep these under review to make sure that the scorecard remains an effective tool. We endorse these recommendations.²⁰

21. The Department emphasised that a major purpose of the risk scorecard was to get staff administering this new system used to analysing the risk. Across all of their compliance activity, they tried constantly to refine their indicators and their analysis of risk. They told us that the Department for Work and Pensions did not apply the kind of risk based approach to benefits that are applied to Tax Credits. The Inland Revenue applied the sort of compliance approach that they had found worked well for tax.²¹

TAKE-UP OF TAX CREDITS

22. We enquired about the take-up of Tax Credits and were told that the Department could not know how many people were eligible until they had the results of the Family Resources Survey. The Department had a dedicated team of analysts working on tax credits and they expected to have eligibility figures towards the end of 2002. Take-up was of the order of 1.3 million.²²

23. The Department did not expect a material number of people currently taking up Tax Credits to fall out of the system as the new Tax Credits were introduced from April 2003. One change would be that fewer would actually be paid by the employer, as many would be paid by automatic credit transfer to a bank account. We suggested that this should increase take-up and accuracy, because there would not be an intermediary to make mistakes. The Department hoped so, but could not guarantee it until they had had a good look at the detail.²³

24. The Department told us they were doing a number of things to bridge the gap between eligibility and take-up. In addition to advertising campaigns they were working with employers to help them raise awareness of the new Tax Credits. They were also helping representative groups such as the Low Income Tax Reform Group, the Citizens Advice Bureau and a charity called Tax Aid, to raise awareness of the availability of the new Tax Credits.²⁴

EXTENT AND MANAGEMENT OF FRAUD

25. The new Tax Credits will operate from April 2003, and over a four-year period the cost of setting up and administration is estimated at £1 billion. The Department said that the computer system is eight times bigger and more complicated than that for Self-

¹⁸ C&AG's Report, para 3.19

¹⁹ Qq 144–145

²⁰ C&AG's Report, paras 3.30–3.32

²¹ Qq 13, 83

²² Qq 61–67

²³ Qq 71–74

²⁴ Q 75

Assessment. It is a much more significant structure than Working Families Tax Credit.²⁵

26. The C&AG reported on the procedures the Department had established to manage the risk of non-compliance and fraud, with their staff as the first line of defence. Using risk assessment procedures, they identified cases where non-compliance was most likely and targeted their enquiries accordingly. The Department's Special Compliance Office is responsible for investigating cases where significant tax evasion or fraud was suspected. The Department estimated for the year 2000–01 its compliance activity had identified additional tax liabilities of £4.5 billion (compared with £5.4 billion for 1999–2000).²⁶

27. We enquired about the extent and management of fraud on Tax Credits. We were mindful that just as some landlords had fraudulently claimed housing benefit for their non-existent or with collusive tenants, some employers might seek to defraud the Tax Credits system. The Department told us that they had already prosecuted two employers for collusive activities with their employees that had led to loss of Tax Credit funds. Of the 131 cases working towards prosecution in the Department's Special Compliance Office, 13 involved apparent collusive activities on the part of employers. However, the reconciliation work referred to in paragraph 17 above did not find substantial large-scale frauds by employers. The Department felt that they had evidence of the level of fraud detected and were always trying to identify employers at risk. Further, the Department considered that their current study of 3,250 cases, although small, would give them a better idea of the scale of the problem.²⁷

28. We pointed out to the Department that when the Customs and Excise gave evidence to this Committee on tobacco smuggling, they estimated fraud overall as between £6.4 and £7.3 billion which was much more than the Inland Revenue's estimates. The Department said that they did not know why their fraud estimates were so much lower than those of Customs and Excise or the Department for Work and Pensions. They emphasised that they had a robust fraud strategy and had appointed the director of their Special Compliance Office as the Departmental fraud champion. They were seeking to achieve a much better understanding of the risks and the amount at risk. For this purpose they were conducting various piecemeal studies and they had appointed a leading academic economist last year as the director of analysis and research who would be leading the analytical work. They recognised that they needed to do more to scope and scale the fraud problem than they had in the past.²⁸

29. The Department noted that the C&AG was conducting an investigation into fraud in the Department for Work and Pensions, Customs and Excise and the Inland Revenue, which they thought would be an invaluable exercise. They noted also the long-standing compliance problem of balancing the need to get Tax Credits to deserving claimants as soon as possible while preventing fraudulent claims.²⁹

²⁵ Qq 80–82

²⁶ C&AG's Report, para 2.5

²⁷ Qq 115–116, 142

²⁸ Q 152

²⁹ Q 141

MINUTES OF PROCEEDINGS OF
THE COMMITTEE OF PUBLIC ACCOUNTS

SESSION 2001-02

MONDAY 20 MAY 2002

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Mr George Osborne
Geraint Davies	Mr David Rendel
Mr Barry Gardiner	Mr Gerry Steinberg
Mr George Howarth	Jon Trickett
Mr Brian Jenkins	

Sir John Bourn KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Brian Glicksman, Treasury Officer of Accounts, was further examined.

* * * * *

The Comptroller and Auditor General's Report, Audit of the Inland Revenue under Section 2 of the Exchequer and Audit Departments Act 1921 (HC 335-XVI), was considered.

Sir Nicholas Montagu KCB, Chairman, Mr David Hartnett, Director General (Policy and Technical), and Mr Stephen Banyard, Director (Local Services), Inland Revenue, were further examined (HC 866-i).

* * * * *

[Adjourned until Wednesday 22 May at Four o'clock.

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WEDNESDAY 6 NOVEMBER 2002

Members present:

Mr Edward Leigh, in the Chair

Angela Eagle	Mr Nigel Jones
Mr Frank Field	Mr David Rendel
Geraint Davies	Mr Gerry Steinberg
Mr Brian Jenkins	Mr Alan Williams

Sir John Bourn KCB, Comptroller and Auditor General, was further examined.

The Committee deliberated.

Mr Rob Molan, Second Treasury Officer of Accounts, was further examined.

* * * * *

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

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

Paragraphs 1 to 4 read and agreed to.

Paragraph 5 postponed.

Paragraphs 6 to 29 read and agreed to.

Postponed paragraph 5 read and agreed to.

Resolved, That the Report be the Sixty-seventh Report of the Committee to the House.

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

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

* * * * *

[Adjourned until Monday 18 November at Four o'clock.]

MINUTES OF EVIDENCE

TAKEN BEFORE THE COMMITTEE OF PUBLIC ACCOUNTS

MONDAY 20 MAY 2002

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon
Geraint Davies
Mr Barry Gardiner
Mr George Howarth
Mr Brian Jenkins

Mr George Osborne
Mr David Rendel
Mr Gerry Steinberg
Jon Trickett

SIR JOHN BOURN KCB, Comptroller and Auditor General, further examined.

MR BRIAN GLICKSMAN, Treasury Officer of Accounts, HM Treasury, further examined.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL:

APPROPRIATION ACCOUNTS 2000–01

Volume 16: Class XVI Department of the Chancellor of the Exchequer (HC 3355-XVI)

Audit of the Inland Revenue under section 2 of the Exchequer and Audit Departments Act 1921,
Part 3 Tax credits

Correspondence to the Chairman of the Committee and a memorandum submitted by Sir Nicholas Montagu KCB, Chairman, Inland Revenue

When I appeared before the Public Accounts Committee last year for a Hearing on the departmental accounts for 1999–2000, we spoke briefly about our plans for administering the payment of tax credits via employers—which only came into force in April 2000.

Since I am due to appear before you again on 20 May to answer questions on our accounts for 2000–01, I thought you and the Committee might find it helpful to have a note from me on developments in this area, since that earlier hearing and also since the Comptroller and Auditor General's report on the 2000–01 accounts was published on 13 February 2002. I attach this, and should of course be happy to supply any further information which you or your Members would like to have in advance of the 20 May Hearing. I look forward (if that is the *mot juste*) to seeing you then. I am copying this letter and the note to the Comptroller and Auditor General.

National Audit Office (NAO) Report on Inland Revenue Accounts—tax credits

1. This note explains why we have made less progress than we had hoped in providing the Comptroller and Auditor-General (C&AG) with the level of assurance he expected on the value of tax credit payments made by employers (PVE) during 2000–01. One way for us to gain assurance that employers have only paid out to their employees the level of tax credit that we authorised is to reconcile the payments they declare they paid with our internal records of payments authorised. We hoped to be able to make this comparison for 2000–01, but it has turned out to be less straightforward than we thought. We have nevertheless found no evidence to suggest that the mismatches between records arise from anything other than genuine error. We have discussed these issues with the NAO and agreed to work together to improve the level of assurance in this area for 2001–02. I will be happy to report back to the Committee on progress.

2. I should also mention a factual error in the C&AG's report which we should have picked up before publication. The figure of 230 employers visited in paragraph 3.26 should be 199: we have already told the NAO about this.

BACKGROUND TO PAYMENTS VIA THE EMPLOYER

3. Employers get instructions to pay tax credits to their employees at a daily rate; but they only have to make the payments at the same frequency and to cover the same period as their pay their wages. For example, if an employer who paid monthly in arrears on the last day of the month were told to pay £10 per day for 20¹ weeks starting on 15 March 2001, the first actual payment would be on 31 March; and the amount of tax credit included in the pay packet would be £170 (£10 × 17 days). The next month they would pay £300 on

¹ An award normally lasts 26 weeks and where an employer pays monthly we will pay direct for the first six weeks to ensure that they have time to set up their systems to make the payments.

20 May 2002][Continued

30 April, in May they would pay £310 on 31st and so on every month thereafter. Employers tell us how much they pay out in tax credits to all their staff once a year when they submit their annual return of PAYE and NICs (the “P35”). In the example, the employer’s P35 for the tax year 2000–01 would show that they had paid over £170 in tax credits in that tax year.

4. We received about 1.2 million P35s from employers for the tax year 2000–01 (of whom some 226,000 employers had been authorised to pay tax credits to their employees), and approximately 54 million associated individual returns (P14s) for their employees². We process the majority of the returns by around the October/November following the end of the tax, so, we cannot include the actual figures from P35 returns in our accounts. The C&AG accept in the report both our consequent need to estimate the figures in our accounts and the method used to do so.

MONITORING EMPLOYER PERFORMANCE

5. Although employers have to report the amounts paid out only once a year, we have other ways of monitoring their performance during the tax year. Every individual whose tax credit will be paid through their wage packet is told when their credit is awarded the daily rate their employer is required to pay and when the payments will start. So they can see at once if they get less than they should. Our staff in the Tax Credit Office always act promptly to deal with anyone reporting difficulty/delay in getting their payments, and we will step in to take over payment if an employer cannot or will not meet their responsibilities.

6. We also monitor employer performance in-year through the visits our employer compliance officers make to employers. The Tax Credit Office ask the compliance teams to visit a small number of employers, but we select many more for visits by using our national and local risk analysis—and responsibility for paying tax credits is one of the elements pointing towards the need for a visit. Where they visit an employer who pays tax credits, our employer compliance officers will check at least one employee’s tax credit payments, and we keep a record of employers who made mistakes. We checked tax credit payments by an estimated 6,800 of the employers we visited in 2000–01, and found only 18 (0.26 per cent) where wrong payment resulted in our recovering any money.

7. After the end of the tax year, P35s can provide a cross-check against our records although this will always be fairly rough-and-ready. The example used at paragraph 3 may help again to explain this problem. The employer had to pay £10 per day from 15 March 2001, so that we would expect the tax credit paid over in the first year to be £220 (£10 per day until the end of the tax year on 5 April 2001). But the employer (because of paying monthly in arrears) only paid over the tax credits up to and including 31st March in that tax year and so only recorded £170 of payments on the P35. Because the £50 of tax credit to cover 1 to 5 April was included in the wage packet on 30 April, it would be recorded in the P35 for the following tax year. So comparing the entry on the first year’s P35 could make it look as if the employer had underpaid in the first year. The next year it would look as if they had overpaid £50 when we made a similar comparison. This shows the difficulty of linking payments authorised for payment by an employer in any given tax year with the tax credits shown as paid on the P35.

8. Some employers do not collect enough tax and NICs from their employees to cover the tax credit payments we ask them to make. Throughout the year we provide funding to help them cover the credits due. When we process their returns we check them against the amount of funding we know we provided, so as to ensure that they took the funding payments fully into account.

CHECKING 2000–01 P35s

9. We checked all P35s for employers to whom we had provided funding to cover their tax credit payments as they came in. This did not reveal any significant problems.

10. Between October and December 2001 we also carried out a series of computer “runs” which compared the tax credit payments we recorded as authorised for payment by each employer with the value of tax credits they recorded on their P35 return. These produced a list of employers whose tax credit payments appeared to exceed their authorisations. We wanted to identify employers whose records should be examined by a compliance team to determine the cause of the discrepancy and to satisfy us that there was no fraud involved. We initially set tolerances to exclude the year end variances explained in paragraph 7, but the final run in December excluded all tolerances to give us a list of all those who appeared to have “overpaid” tax credits in 2000–01.

11. The list was far longer than we had expected, but we could not provide an explanation in time for the C&AGs report on our 2000–01 accounts. Since then our internal auditors and operational people have been working on the list, and we now have a clearer view of what has caused the problems. Of the 1.2 million P35s received around 27,000 showed an amount of tax credits paid out by the employer higher than our records

² The number is so large because many employees have more than one employment in a single year.

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led us to expect. The value of these discrepancies varied significantly, but the top 90 cases (those with a discrepancy in excess of £100,000) accounted for £38 million (over 50 per cent of the estimated total value of the discrepancies).

12. We looked at 50 of the cases, the 25 with the biggest discrepancies and 25 taken from those where the discrepancy ranged in value from 1p to £100,000, to try to see why so many mismatches were occurring. The results of this work show that in the majority of these cases the discrepancy has risen because of error either within the Inland Revenue or by the employer when completing the form. From our sample it seems that the causes of the discrepancies include:

- A mismatch between the employer reference held in our systems and the employer reference under which the employer is making payments. We believe that (although there are a small number of examples of changes during the year that rightly change the reference since the award was made) much of this was caused by our Tax Credit Office making mistakes in assigning the employer reference to the case when they processed the application for tax credits from the employee.
- Errors in the information on the P35 resulting from mistakes made either when we processed them or when employers completed them.

13. Many problems with the employer references arise because the individual applying for tax credits does not know their employer's reference. The staff at our Tax Credit Office have clear targets to process claims quickly to ensure that people get their credit paid as soon as possible. Where, for example, an applicant describes their employer as Smiths, Newsagent, High Street, Anytown, it can be difficult for us to differentiate between a sole trader running their own business and a local branch of a national concern. Similarly, many companies run several PAYE schemes and they may allocate employees to a particular scheme by location eg Midlands or NW England or by frequency of payment eg Weekly/Monthly Paid—so deciding which scheme to assign the payments to can be very difficult. Our performance in this area is improving and we have taken action to raise staff awareness of the importance of getting this right.

14. We have also found evidence of keying errors made when processing the P35: given the scale of our operations, it is inevitable that some of these will occur, but we aim to keep them to a minimum. And employers make all kinds of mistakes. We have seen several cases of their seeing the relevant “box on the form” as some sort of balancing item they need to complete even when they have no tax credits to pay. We have improved our guidance for the 2001–02 P35s which went out early in 2002 and have asked our Business Support and Employer Compliance teams to remind employers of the right way to complete the box when making their normal visits. We have also issued guidance to our people processing the forms to try and pick up some of the more obvious errors before we input the information. In addition I have asked my Head of Internal Audit to consider whether in the light of these results we should take a look at the information provided on P35s to see what risks are associated with the level of errors we and employers make.

15. Although we are working to improve the position, we know that there will still be problems with the forms received for 2001–02; so we are also considering:

- taking a sample of individual tax credit cases to track them from the original application to an entry on the employers' returns and vice versa; and
- running a series of comparisons through the year (as P35s come in) of tax credit entries with our records. This should allow us to identify some problems as soon as the P35s are processed and so make it easier to correct errors.

16. We believe both these steps will help us both to identify genuine “process” errors and problems which we can take steps to correct and to provide an assurance about how well the system is running and the level of employer compliance with their statutory obligations. We have already started to discuss with the NAO how best to approach this work.

17. As part of our continuing employer compliance work, we expect to carry out 32,500 visits during 2002–03. Although not all will be on employers paying tax credits, we should at least have an equivalent level of coverage to that in 2000–01.

18. We had to learn a great deal in a very short time during and from the first year of operating PVE—a major change by any standards—and there have been inevitable teething problems. While we have made less progress with some of our processes than we had originally hoped, my Internal Audit and operational people have to date found no evidence of anything other than genuine error. I am confident that the work we plan to undertake over the next few months will help to reduce further problems and will put us on a sounder footing, and I will report back to the Committee on our progress later in the year.

Sir Nicholas Montagu KCB
Chairman
Inland Revenue
2 May 2002

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Examination of Witnesses

SIR NICHOLAS MONTAGU KCB, Chairman, MR DAVID HARTNETT, Director General (Policy and Technical) and MR STEPHEN BANYARD, Director (Local Services), Inland Revenue, examined.

Chairman

1. Order, order. Welcome to the Committee of Public Accounts and welcome once again Sir Nicholas. It is always a delight to have you with us.

(*Sir Nicholas Montagu*) It is always our pleasure to be here.

2. Today we are examining the Comptroller and Auditor General's report attached to the Inland Revenue's Appropriation Accounts for 2000–01. You have been kind enough to send us a supplementary note. Thank you very much. Would you please introduce your colleagues?

(*Sir Nicholas Montagu*) To my left is Dave Hartnett, who is a member of my Board and Director General (Policy and Technical). On my right is Stephen Banyard, who is Director of Local Services.

3. You have been kind enough to give us this supplementary note and you have told us that you have had to learn a lot in a very short time and you have been very honest with us in saying that perhaps you have not made as much progress as you might have hoped for and perhaps my first question can refer to that. If you turn to page R16, paragraph 3.28 and read that you will see that "... when end of year returns are analysed the Department will be unable to reconcile payments made by employers to those authorised". When you answer this question you might just fill members in a bit on what this actually means. I had this explained to me kindly by the Comptroller and Auditor General but that clearly is a bit of a problem. As well as explaining this to me, can you also tell me why you have tolerated such a major weakness in your systems and when the situation will be resolved?

(*Sir Nicholas Montagu*) I am not sure that the situation will as such be resolved, nor is it a weakness in our systems. The point is this. The structure of the tax credit system is such that we authorise employers to pay tax credits at a daily rate from a certain date. Depending on whether employers pay salaries weekly or monthly, on that also will depend when the first payment occurs. What this means effectively is that payments which were authorised for a particular tax year may actually be paid with salaries in the following year. If that happens, then that payment will appear on the employer's return, which we call the P35, for the following year. So a direct year on year reconciliation is not possible. What we have been trying to do is to arrive at a system, working with the National Audit Office, which gives us a sound basis for an estimate and the Comptroller and Auditor General has said in his report that he is satisfied that this gives us a satisfactory way of reconciling and of estimating.

4. Could you explain for the benefit of members the difference between P11 and P35?

(*Sir Nicholas Montagu*) The P11 is an individual tax document relating to an individual employee. The P35 is the schedule that the employer submits to us at the end of the year listing all the employees with the tax and national insurance deducted, and also tax

credit payments. The sum of the individual documents is actually more the P14s, which are the individual end of year documents for each employee which accompany this.

5. Is it right that you have difficulty in tying up P35s with what the Revenue have authorised? Is that the problem?

(*Sir Nicholas Montagu*) A direct tie-up; yes.

6. You claim this is not a real problem. You can live with this.

(*Sir Nicholas Montagu*) We can live with it provided that we keep a tight control on ways in which we do check up on authorisation and provided that we can work with the Comptroller and Auditor General so as still to have a system which gives us what Sir John regards as a sound estimate. There are certain circumstances in which we would always be able to check directly, as for example where we put the employer in funds in order to enable him to pay out tax credits.

7. You say you are quite relaxed about it, but does this really tie in with the assurances you were giving to the Committee or are you denying that you did assure the Committee that you could reconcile these two factors?

(*Sir Nicholas Montagu*) I think what I am saying is that I am not relaxed about it, but given what is essentially an issue of periodicity, in other words the way in which tax credits are administered according to legislation and the way in which the end of year documentation works, there is an intrinsic difficulty in getting that straight tie-up. What I am not relaxed about at all, as I said in my letter to you, is the state of the checks that we made on levels of error. Our checks after the National Audit Office report and Sir John's conclusions did not reveal any serious systemic problem.

8. We can always come back to that later if we need to. Could you look at paragraph 3.27? It says there that you do not have detailed data about compliance visits to employers, which I find somewhat surprising. Perhaps you could explain that. You cannot therefore estimate the extent of errors in tax credits made by employers. How can you satisfy yourself therefore about the accuracy of tax credits in general?

(*Sir Nicholas Montagu*) When we visit employers, if we find something wrong, then there are 74 different possible errors against which we will record what is wrong. I think I am right in saying that incorrectly paid tax credits would be one of those.

(*Mr Banyard*) Indeed.

(*Sir Nicholas Montagu*) What Sir John was concerned about was more the detailed routine reporting of employer compliance visits. In line with the National Audit Office recommendations we have expanded our manual records so that we can enable more detailed analysis in the year and at the year end; and we shall now analyse annually details from all reviews so that we get a better feeling for trends and for behaviours. Of course the fact that an employer

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[Chairman Cont]

is paying tax credits is itself one of the indicators which our compliance teams would use in deciding to make a visit. Also, in the case of the 6,800 employer compliance visits made to employers who paid tax credits, payments in excess of what should have been made were found only in 18 cases. What I am saying is that I take, as I think Sir John takes, some comfort from what we have found. I absolutely accept his recommendation that we need more in the way of routine data and we are moving to give effect to his recommendation.

9. Do I understand your answer correctly? Are you saying that despite the deficiencies in the information you are getting from these visits you can still measure whether you are targeting your compliance teams to the best effect? That is what you are saying to us, is it?

(*Sir Nicholas Montagu*) What I am saying to you is this. Where something is wrong on a visit, we record it already; that includes tax credit payments. That, along with a whole raft of other things, will give us a feel for whether we are targeting the right employers.

10. I am still rather worried about this. Have you seen a letter which was written by Dawn Primarolo to my predecessor, David Davis, dated 23 July 1999?

(*Sir Nicholas Montagu*) I am sorry, if I have seen it, I certainly do not have it with me.

11. We will let you have a look at that letter. Basically what my predecessor was asking for was direct access on behalf of the National Audit Office. What the Minister was saying was, "I would have thought it reasonable for you to audit tax credit arrangements by looking at the Inland Revenue's records. If this causes you major difficulty in practice we can clearly reconsider, but I am certainly not at present disposed to impose further burdens on employers". I hope I am not taking the National Audit Office in vain, but in view of what I have been asking you, they might well be worried that you are not entirely living up to the assurances you made to the Committee and that we may ask you to look at this again and give the National Audit Office direct access.

(*Sir Nicholas Montagu*) Of course if the Committee asks me to do that I shall be happy to do it. If I may say so, the position that the Minister set out is still relevant. It remains a major concern of the Government and the Inland Revenue to keep burdens on employers, particularly small employers, to a minimum. I am afraid that it is true that such employers would regard any additional government visitors—and I fear they would not be sufficiently sophisticated to distinguish the majesty of the National Audit Office from the mundane of the Inland Revenue—as a burden. What I should like to do, in the light of what I have said about accepting Sir John's recommendation and in the light of what Sir John has said about accepting the basis of our estimate, is to talk further with him about how best to provide the Comptroller and Auditor General with the assurance that he requires but without imposing a further burden on small employers.

12. We are very concerned about burdens on small businesses but our primary duty is to insist that Parliament has proper oversight of what is a very important area. Am I right in saying, to sum this up, that tax credits are another way of delivering social

security benefits? Sir John and his team have full oversight of the Department for Work and Pensions in their work, but because of the way the Minister has replied to my predecessor, there is a lacuna in the way that Parliament can see tax credits.

(*Sir Nicholas Montagu*) I am not sure I would actually agree with that.

13. I did not think you would.

(*Sir Nicholas Montagu*) It was a complex question. You asked whether I would accept that tax credits are social security benefits. The answer has to be no. If you listen to the Chancellor's dicta on the subject, it is true that the working families' tax credit replaced family credit, but what Mr Brown is saying is that this is something very different, this is part of a system linked closely to the tax system and linked to work to further his employment incentives again. I think I must qualify your assumption on that. So far as the assurances are concerned, I would hope to be able to satisfy you that we either have or are going to have the necessary arrangements in place. If I might make one further point—and forgive a long answer, but I think it is very important for context—the transferred responsibility for tax credits to the Inland Revenue is probably the biggest change ever to hit us. We have, I think rightly, devoted our attention to making sure that the credits reach the people at whom they are aimed. At the same time we have been seeking to refine our compliance regime, and this includes applying the kind of risk analysis that the Department for Work and Pensions—then the Department for Social Security—did not. I hope that I can satisfy the Committee that the Inland Revenue is taking extremely seriously its duty to ensure compliance, alongside its duty to ensure maximum take-up by people entitled to the credit.

14. You are certainly forgiven for a long answer. This is a very important area. Tax credits are going to become more and more important: child benefit is going to become a tax credit also. So that is why you will forgive me for taking an interest in this whole area.

(*Sir Nicholas Montagu*) Of course. May I just say that as new tax credits come in an awful lot of what Sir John covers in his report here will become automatic, things like risk analysis. They will be built into the new tax credit system, which is something of the order of five times the size of the system required for self-assessment. It is a very, very big project.

15. Please turn now to page 20 and look at Figure 9. You will see that you still failed to meet your targets for clearing records despite devoting additional resources and that you have been trying to reduce the number of tax cases requiring clerical intervention. Would you like to comment on that. Is that a problem?

(*Sir Nicholas Montagu*) Yes. It is a problem in the sense that I cannot report to the Committee the progress which I hoped to when I appeared before you previously. The news is not all bad and it is certainly mitigable. We cleared more open cases—the Committee will be familiar with that term of art—last year than in the previous year. We still do have a very large number outstanding for a variety of reasons. We gave priority last year, and I think rightly, to meeting what I might call day to day

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customer service targets, and we did so despite some of these—for example the time for post turnaround—being more stringent than in the previous year. At the same time we were undergoing major structural change in Stephen's part of the organisation, moving from 500-plus local offices to 65-plus areas. I think I may say that it is a great tribute to Stephen and his people that they achieved that level of customer service. What it did mean was that we still have more open cases at the moment than I had hoped. We have set up machinery specifically to tackle this and we really do want to get through it.

16. Lastly I want to refer you to page R19, paragraph 4.5. At the bottom of that paragraph you will see, "On the basis of the responses received to date the Department estimate that underpaid tax totals £2 million and overpaid tax £15.1 million". Obviously this Committee has taken an interest in this subject in the past. You have sent out letters to your clients seeking their advice. What I should like to know is how many individuals actually responded to the letters you sent out?

(*Sir Nicholas Montagu*) From recollection, something of the order of 160,000.

17. Can you break it down at all between underpayments and overpayments or in any other way?

(*Sir Nicholas Montagu*) Yes, I can indeed. We received 160,000 responses and we have made over 14,000 repayments and calculated 1,600 underpayments.

18. Do you think you are treating the public entirely fairly in this matter? Your systems do seem to be deficient in some respects. You are having to write to them again, some respond, some do not respond, indeed why should they have to respond? Should you not try to get things right in the first place?

(*Sir Nicholas Montagu*) It is not always a question of us getting it right in the first place. The important point to make here is that open cases are entirely normal. We have a load every year and they arise either when the correct amount of tax has not been paid or where we cannot tell whether it has, for example because the employer has used the wrong national insurance number. We try to correct matters, we try to track down the employees, but there is always a limit to what we can do. The particular problem which I discussed with the Committee previously arose for reasons with which you are familiar in 1997–98, and that has a knock-on effect. It is not fair to say that the number of open cases reflects deficiencies in our records. The other point I should make is this. In 85 per cent of the responses we had, the tax paid was actually right. Most of these open cases have not paid too much or too little. It was simply that, for the kinds of reasons I mentioned, we had no way of knowing. The other point I should make is that these are not closed cases; they remain open. If we get other information, through employers, through the individuals or whatever, which enables us to get the record straight, we do so.

Mr Rendel

19. I should like to start on income tax self-assessment which is probably the most important part of the collection of income tax nowadays as far as you are concerned; although not as big as what you get through PAYE, undoubtedly more complex. We had a meeting about this on 22 October at which there was a lot of confusion about how the penalties work. But as a result of one of your notes since then, we have now clarified that. Have all those who failed to get their forms in on time at the end of January this year now been sent their penalty notices?

(*Sir Nicholas Montagu*) Yes, they should have been.

20. Is that regardless of circumstances altogether? They have all been sent notices.

(*Sir Nicholas Montagu*) Yes; indeed. Equally, this year for the first time, we have flagged up very specifically, if you think you should not have got this penalty notice or you don't know why you have, give your local tax office a ring.

21. Towards the end of last month, I received a letter from the tax office following the sending off of my tax return which I sent off just before the due date by First Class post. At the end of April I got a letter from your group in Cardiff which was a late tax return penalty notice. It says, "Notice of Determination of Penalty for Late Tax Return for the Tax Year ended 5 April 2001". You quite rightly said at the last meeting that of course you could not rely on the post and if the post was late it was your fault. So I was not entirely surprised to receive this notice, except for one reason. The notice says, "I did not receive your tax return by the due date so you are liable to a penalty. Under section 8 or 8(a), as extended by section 12 of the Taxes Management Act 1970 you were required to send in a tax return for the tax year ended 5 April 2001 but I did not receive it by the due date. As a result the penalty imposed on you under section 93 (2) of the Taxes Management Act 1970 is £0.00", which did sound like a big penalty and I looked over to see how I should pay this. It says, "The penalty is due for payment 30 days after the date of this notice". I am happy to say I still have six days to pay you £0.00; thank you very much for that.

(*Sir Nicholas Montagu*) You have certainly done so successfully so far.

22. You do warn me that if I pay late, interest is charged on this amount. I am wondering when and if you are going to send me a reminder because I am refusing to pay this penalty and I am expecting that I will get a reminder shortly to tell me that I must pay the penalty of £0.00 and if not you are probably going to take me to court.

(*Sir Nicholas Montagu*) I think the way you are going you will probably get a knock on the door at dawn from the heavy mob working for the special compliance office.

23. This is what I am worried about. I wonder not only whether I am going to get a knock on the door from the heavy mob, but how many other people are also going to get a knock on the door.

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[Mr Rendel Cont]

(*Sir Nicholas Montagu*) To go back to the point about penalties, I have to ask you this: are you quite happy for me to discuss your tax affairs with you in this Committee?

24. I am perfectly happy and I am sure what you want to reveal is the reason why I have a penalty of £0.00 which I am happy to say is because I overpaid my tax, rather than underpaid.

(*Sir Nicholas Montagu*) Exactly. As I said to the Committee on previous occasions, the normal penalty is £100, but the maximum penalty is the amount actually due to us. If somebody has overpaid or has given us a payment on account which extinguished the liability or has a liability of less than £100, that would be reflected in the penalty. What you have is a computer generated notice.

25. I am sure it is computer generated; I am sure they are all computer generated.

(*Sir Nicholas Montagu*) No doubt when we extend the customised portal, whose virtues I was extolling to you last time, it will say, "Thanks, Mr Rendel, you're a whizz taxpayer: be as good next year", but we ain't there quite yet.

26. Not only are you not quite there yet, but you are apparently sending out payment notices for £0.00. I do not know how many people you are sending them to, but I do wonder if you know how many people you are sending them to.

(*Sir Nicholas Montagu*) No, I do not. What we are doing is sending out something to tell people like you that we got your tax return late. You are okay. Other people are not. You say you had overpaid. Maybe you will not have overpaid next year. What we are trying to do is to encourage you to think about it and maybe, bearing in mind Consignia's performance, on which it is of course not for me to comment, to get your cheque in the post to us on 24 January next year.

27. It is interesting though that you do not know how many of these penalty notices have been sent out. It does seem to me that the Inland Revenue is wasting a considerable amount of money sending out notices to people and charging them £0.00 and in particular, if I do not pay it, I am wondering whether you are going to send me a reminder, because if you do send me a reminder that is going to cost twice as much. The refund payment came to me two months earlier. You sent me the money towards the end of February which I claimed on my form. You must have had the form within a day or two of the due date, it having been delayed in the post. You sent me the refund almost straight away and yet continued to charge me a penalty of £0.00 two months later. That seems to me a considerable waste of your money and I am surprised you do not know how many people are sent this. May I suggest that if you do not know or your department does not, then you ought to look into this because frankly I think you are wasting an awful lot of money on this, and it is no doubt of some concern to some of the people. I was able to understand what had happened pretty well immediately, but maybe some people would be concerned to receive a penalty notice like this and think they are genuinely due to pay something even if it says £0.00.

(*Sir Nicholas Montagu*) I think you underestimate the intelligence of your fellow taxpayers.

28. Maybe I do, but I would suggest that it might be sensible to have a simple line in your computer programme which says, "If the penalty is £0.00 don't be so silly as to send out a form claiming it". It just needs one line in the computer programme.

(*Sir Nicholas Montagu*) The penalty notices went out later than usual this year, which may be why you noticed that time lag. The plain fact is we did not get your tax return on time. We should like you to be a compliant taxpayer next year and let us have it on time. Whether you had to pay this year or not is in that sense neither here nor there.

29. If you are seriously using that as an excuse, may I suggest it would be a lot better if you were to send out a notice saying "Although you were actually an overpayer and therefore there is no penalty due, please note that your form did not actually reach us until after the due date". It must be very simple to do a letter of that sort.

(*Sir Nicholas Montagu*) I have to say that you delude yourself if you think that anything of that kind is simple when you are dealing with a system which has to cope with nine million taxpayers. I am sure that were I here in five years' time, which I shall not be, answering questions from you, who may or may not be here, we would be having a very different sort of conversation because we will be talking about much more individualised portals of the sort that we talked about last time. At the moment we are talking about systems which are in the factual rather than the evaluative sense gross. We deal with nine million people from whom we expect self-assessment returns on time.

30. I have to say to you that I have written computer programmes myself in the past and to write a line in there which says, "If penalty equals zero then do this other form of letter", is really a very simple computer programme change to make. I really cannot believe that it is going to take your computer people that much effort to put in a line of that sort.

(*Sir Nicholas Montagu*) I should be very happy for you to come up to Telford and show my computer people how to do it. Dead seriously. The computer environment for self-assessment, the so-called CESA system, is pretty inflexible. Ever since I arrived at the Revenue, I have been making a nuisance of myself about much more customised statements of account and it is extraordinarily difficult to change the system. We keep on trying and we shall get better, but for the moment I would urge you to pay us on time rather than hold out hope for a customised letter next year.

31. I paid you not only on time, I paid you early, may I remind you.

(*Sir Nicholas Montagu*) Let us have your return on time. I am delighted you paid us on time. Keep that up.

32. I paid you too much.

(*Sir Nicholas Montagu*) Keep that up too please.

33. I have another case which is slightly more worrying, which is one of my constituents, who last year was told that, as a result of having retired and no longer having the form of income that he had before, a tax form would no longer be needed. He was nevertheless sent a tax form last year and then he

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was sent a second tax form as a reminder after 5 April 2002. When he phoned the helpline to say that in fact he had been told he would not need a tax form this year and why was he being asked to fill it in, he was told the simplest way to get over the problem would be to fill it in, even though he had been previously told he did not need to, and send it in. So he did fill it in and send it in, as a result of which he is now being charged a penalty for not having sent it in on time. He was not actually owing any tax, so he does not have to pay any tax, but he is nevertheless being charged a penalty for having done what he was told to do in order to try to overcome this blip in the system where he had been sent a form when he should not have been.

(Sir Nicholas Montagu) Did you say he was being charged a penalty?

34. Yes, he is being charged a penalty for late payment.

(Sir Nicholas Montagu) No, he will not have been charged a penalty. You said he had no tax to pay. It follows from what I said to you a few minutes ago that if his tax liability is nil, his penalty is nil. In the case you mention, I can only apologise to your constituent. We do get this wrong from time to time. What we have done this year is to analyse the most frequent causes of error on our part. We are trying to clean up our database maintenance. We know that in some cases, when people have told us they do not need to complete a return and we have confirmed that they do not need to, we have not kept our records straight or something has gone wrong and they get it. I apologise. That is absolutely a fair cop, guv.

35. He has been charged a penalty at present of £100; presumably because nobody has yet calculated how much tax he owes. He has sent in his form but currently he is being charged a penalty of £100.

(Sir Nicholas Montagu) If he gets in touch with his local office, they should be able to sort it. If not, please write to me and I will.

36. May I come back now to something the Chairman was asking about on page R19 of the report? He was talking to you about the overpayments and underpayments which are being claimed for the year where some of the data is missing. A lot more has been claimed in overpaid tax, £15.1 million, than £2 million, which has been offered up in underpaid tax, in spite of the fact that a little higher up that paragraph 4.5, it talks about the 1.04 million records with no pay or tax details would have been cleared automatically had the information been available. In other words, these are all ones which you expected to have been correct payments of tax.

(Sir Nicholas Montagu) May I correct you? What Sir John is saying in paragraph 4.5 is that on the basis of the responses received the underpaid tax totals £2 million and overpaid tax £15.1 million. These are not actual payments which have been made. What these do, I think quite interestingly, is to qualify the earlier figures which we agreed with the Comptroller and Auditor General on the basis of our estimates then and our internal audit survey. Overpaid tax looked like being £22 million. What the actual analysis of the replies suggests is that it is smaller and that underpaid tax is also much smaller *in toto*.

37. What you are saying is that this is the whole 1.04 million which amounts to a total of overpaid tax.

(Sir Nicholas Montagu) Yes, that is the projection from it.

38. How much of that have you actually received in total? You said you have 160,000 responses out of 1.04 million.

(Sir Nicholas Montagu) We have repaid £1.54 million to 14,000 people.

39. So what you are now saying is that of the other 900,000 people or so for whom you have no records, you think that they are owed another £13.5 million. Your current estimate is that they are owed another £13.5 million.

(Sir Nicholas Montagu) Yes, it looks as though the overpayments are in that region.

40. Are you making any further efforts to make sure that these people receive their money?

(Sir Nicholas Montagu) No.

41. So there are 900,000 people out there who are owed £13.5 million and at present do not know it.

(Sir Nicholas Montagu) No. Again, I emphasise that it looks as though 85 per cent of the people we contacted and who contacted us back had paid the right amount of tax. Take in that case, if you will, your 1.04 million, let us call it one million because your head for figures is better than mine, in that case what we are talking about is 850,000 people who paid the right amount of tax. If you are saying that among the remainder it looks as though there are still overpayments, yes, we have contacted them, we have made every reasonable effort to contact them; relatively few—160,000—have responded. As I think I said at a previous hearing, we have to judge the point at which there are diminishing returns and at which our people and our money are better employed getting on with day-to-day customer service.

Geraint Davies

42. Would you accept that in constructing a tax system there is a need to balance simplicity and fairness and what in essence the Chancellor is doing through a system of working families' tax credits and other tax credits is trying to introduce a reasonably complex system to deliver social justice? That is very straightforward. That is true, is it not?

(Sir Nicholas Montagu) That certainly is the way in which the Chancellor presents his policies.

43. Well said.

(Sir Nicholas Montagu) When you are as old as I am, you get cautious.

44. I notice that you are not in fact that old and you should be with us in four years' time unless you retire at the early age of around 60.

(Sir Nicholas Montagu) I am afraid the Civil Service has these repressive policies. It has not heard of the third age.

45. Well, we hope to see your portal again. Given that this is a complex system and it is evolving quite quickly into new consolidated tax credit systems, child tax credit, working tax credit, etcetera, against that your statement this afternoon to Mr Rendel that

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the computer system is pretty inflexible, is that not something for us to worry about? Does not inflexibility at a time when we are having continuous change imply problems both for take-up, accuracy and fairness.

(*Sir Nicholas Montagu*) No, we are talking two different worlds, quite honestly. Self-assessment came in five years ago. You know better than I just what advances have been made in technology since then, and you mentioned the portal a moment ago. It is certainly true that the computerised environment for self-assessment is inflexible. What we are aiming to do is to design the massive computer system which we will require for new tax credits to be as flexible and as user-friendly to every one operating it as possible. Dave, here, is the programme sponsor at board level for tax credits and if you would like more detail, I know he can supply that for you.

46. What I am really getting at is that you know this Committee has had a number of reports on the national insurance system and the difficulties of implementing new computer systems. What we are talking about this afternoon is the problem of transferring information to an income tax system and national insurance system at a time that the Chancellor is quickly changing the tax law for understandable reasons.

(*Sir Nicholas Montagu*) If I may say so, I do not think that is wholly right. What we are talking about in the context of the so-called open cases is a hangover from a specific problem in one specific year, 1997-98, in the transmission of data from the national insurance recording system to the system—

47. That is all sorted out now, is it?

(*Sir Nicholas Montagu*) That is completely sorted. We are talking about a completely distinct system for new tax credits.

48. Just because there was a problem in the past it is obviously logic that there is no particular reason why there should be one in the future.

(*Sir Nicholas Montagu*) Exactly; yes.

49. I notice you are a philosopher. Excellent. In terms of the confidence we have in the system, obviously there has been some dialogue with the C&AG about access to employers and you have made the point that the Government are interested in not putting any more burdens on small business. Would it not be the case that if the NAO in fact went in with your compliance people, it would be possible to do it with one check without a massive overburden? Would there not be a practical way of doing this without having a significant impact and indeed, presumably that would be done with a sample of employers, you would not want to do it with everyone? You would just want to get a taste of the real accuracies you were achieving.

(*Sir Nicholas Montagu*) I have to say, with the greatest respect to the National Audit Office, our people are experts in a way which by definition, with their wider remit, Sir John's people cannot be. We can get in there, get at things pretty quickly, pretty expeditiously and get out.

50. Like the SAS.

(*Sir Nicholas Montagu*) I hope equally effectively, yes.

51. My suggestion is that they go in with you. They are the normal squaddies next to the SAS and they just look at a particular area.

(*Sir Nicholas Montagu*) If you asked the SAS whether they would like to have a few squaddies with them on their next expedition, you might get the same answer I am respectfully giving Sir John.

Chairman: I think it is *lèse majesté* to accuse Sir John of being a squaddy.

(*Sir Nicholas Montagu*) Sir John is a Field Marshal, but he has the odd squaddy working for him.

52. I withdraw that analogy: active partner. You mentioned a moment ago that when you do compliance tests, the tax credit issue is one of 74 possible errors by employers. That illustrates that there is a lot of stress and strain on employers, but also, if you are saying this is just one area, this is quite a large area because there is a variety of different tax credits available and it is quite a significant area from the point of view of an employer. What I am talking about is the NAO accompanying one of your compliance people looking at 74 possible error areas and focusing in on the tax credit issue as particularly significant. Why can they not do that? It seems quite reasonable in a certain number of cases?

(*Sir Nicholas Montagu*) I am very happy to talk with Sir John about the best way of giving the National Audit Office the assurance which they are seeking. My worry is that with the best will in the world, an extra party in on the act would increase what employers see as a burden.

53. I know that, but there is a cost and benefit. What we want is the assurance that these systems are in fact working. We are not looking to have access to all employers, but to do a certain amount of sampling alongside your people.

(*Sir Nicholas Montagu*) I am happy to talk to Sir John.

54. At the moment you do not know that you are delivering the outputs you are suggesting you are.

(*Sir Nicholas Montagu*) Essentially what Sir John's people would be doing would be giving an assurance that we are doing the work properly.

55. No, not you, that the employers are.

(*Sir Nicholas Montagu*) I am sorry, we need to get one or two things absolutely straight. First you said that there are a whole lot of tax credits. There are not. There is the disabled person's tax credit and there is working families' tax credit. End of story. Those are the only credits paid via the employer.

56. There is the children's tax credit.

(*Sir Nicholas Montagu*) Yes, there is the children's tax credit, which operates slightly differently.

57. There is the housing credit as well. I shall tell you about that later.

(*Sir Nicholas Montagu*) Housing credit?

58. I do not think this will be the end of all tax credits.

(*Sir Nicholas Montagu*) The Chancellor has not told me to the contrary yet.

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59. There are complexities here as regards an employer filling in these things. The issue is whether the NAO can simply come along and check this out. Yes, they are checking that your people are doing it correctly as well as checking employers.

(*Sir Nicholas Montagu*) No, I am sorry, I think this is a genuinely important point. They are not checking up on whether the employer is doing it right. What Sir John's people are doing is quality assuring the efforts of my people in ensuring that employers have got it right.

60. I will not split hairs. The issue is whether they can go along or not.

(*Sir Nicholas Montagu*) We are very happy to talk to Sir John about the best way of delivering that assurance to him.

61. What percentage of tax credits which should be taken up are taken up at the moment?

(*Sir Nicholas Montagu*) Until we have the Family Resources Survey, we have no way of knowing. Take-up at the moment is of the order of 1.3 million, which is getting on for half a million more families than receive family credit.

62. How many people should be taking it up? How many are eligible?

(*Sir Nicholas Montagu*) Until we get the Family Resources Survey, and we do not have the results of that yet, we shall not know.

63. Do you have any idea what the range is? Is it in the range of 1.4, 1.5, 1.6, 1.35, or what?

(*Sir Nicholas Montagu*) We do not know.

64. No idea at all?

(*Sir Nicholas Montagu*) Dave has just passed me a note saying that the Family Resources Survey has just come in. We certainly have not had time to analyse it.

65. Not even a top line estimate of the global figure?

(*Sir Nicholas Montagu*) No. I know that this Committee likes evidence-based figures from me. I do not have them yet.

66. No; I just want a range. I do not want to pin you down. You have no range, no idea at all.

(*Mr Hartnett*) Maybe I can help. We just have the Family Resources Survey. We have a dedicated team of analysts working on tax credits and we would expect to have information in order to answer your question later this year, but it will be later this year.

67. Which half of the year?

(*Mr Hartnett*) Towards the end, I am afraid.

68. I look forward to that. Moving on. The issue of the reconciliation of awards to employers and payments made. You explained that in terms of timing and tax year and cycle. I understand that there are other reasons, namely that there are discrepancies between the employers' return, the P45, and the aggregation of the P14. Is that correct?

(*Sir Nicholas Montagu*) We are all of us looking blank here. That is unfamiliar as a problem.

69. This is something I picked up from our NAO brief. I shall move on. I have here that there are errors in identifying the employers' schemes when authorising individual tax credits.

(*Sir Nicholas Montagu*) That is certainly right. One of the things in my letter to the Chairman that we had found and which was unwelcome was the apparent discrepancy between our records and payments. There is an important proviso. There is nothing to suggest from these discrepancies that people are getting tax credits who should not, or that people are not getting tax credits who should. What it does suggest is a training need for our own people who are sometimes getting the employer's reference number wrong and a training need for employers on what they should and should not put on the P35.

70. Looking to the future, clearly we are moving to this new child tax credit, working tax credit. Of the current universe of those who apply for these benefits, and the current benefits will be translated into these new formats, what proportion of the people who are currently taking it up, do you expect to fall out of the system or do you not expect any of them to?

(*Sir Nicholas Montagu*) I do not know. If we have more detail Dave will give that in a moment. Remember that what is happening is this. What is at present the working families' tax credit will be split so that you will have a work tax credit and separately there will be a children's tax credit. The work tax credit will be paid through the wage packet as the working families' tax credit is, and also people on low earnings without families will be eligible for it.

71. I know there will be this new work tax and child tax credit. What I want to know really is whether you envisage that in moving from the current system to that system a couple of percentage points of those people who are currently getting benefit and who will therefore be eligible for benefit under the new system, because of the complexities and the change and all the rest will fall out of the system?

(*Sir Nicholas Montagu*) I do not think so.

72. So the answer is zero. Just for the record.

(*Sir Nicholas Montagu*) I think so. You will have seen the figures Mr Brown gave in the recent Budget, which I think will mean that people will not fall out of the system.

(*Mr Hartnett*) We certainly do not expect any material number to fall out of the system. At this stage I cannot tell you that it is absolutely zero. What will change is that there will be a smaller number—again I cannot tell you precisely—who are actually paid by the employer. That is one change.

73. Who will they be paid by?

(*Mr Hartnett*) They will either be paid by automatic credit transfer to a bank account or through—

74. That should increase take-up and accuracy presumably, because you do not have an intermediary to make mistakes. Is that right?

(*Mr Hartnett*) I would hope so, but we cannot guarantee that until we have had a good look at it.

75. Assuming, on the figures you do not know, a difference between those people who are allowed to take up and those who do take up, the figures you are about to evaluate, what action are you going to take to bridge that gap, whatever it might be?

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(*Mr Hartnett*) We are doing a number of things. There have already been advertising campaigns; there will be more. We are working with employers to help them raise awareness of the new tax credits and we are working with various representative groups such as the Low Income Tax Reform Group, the Citizens' Advice Bureaux, a charity called Tax Aid, to raise awareness far and wide of the availability of the new credits.

Chairman

76. Sir John, you were mentioned quite a lot in that previous line of questioning about access to employers. I should like you to comment, please. My predecessor took this very seriously. He said in a letter to the Financial Secretary, Dawn Primarolo, "... I remain concerned that the proposed changes associated with the tax credits initiative will diminish Parliament's current role in sanctioning public expenditure" and he wanted to draw attention "... to the fundamental principle of Parliamentary control of public expenditure". I think it is quite an important point. In previous centuries we have had calls to civil war on these things. Would you like to comment?

(*Sir John Bourn*) My comment would be that essentially tax credit is a form of social security. If you look at the other forms of social security which are paid by the Department for Work and Pensions, the external auditor, myself and my colleagues, have access to the books and records of the organisation which makes those payments. Under the tax credit system, the impact on the lives of citizens is the same. They get more money than they otherwise would have had. They receive a benefit from the State. However, I do not have the same access to the people who pay that benefit, because they are employers, as I have to the Government Department which pays it. There is an asymmetry there. That is what your predecessor Chairman took up with the Government. Naturally enough I see the public sector auditor as providing assurance to Parliament, not as a burden on the private sector firms. If I had this power, I should of course apply it with circumspection and care, but nonetheless I should hope with effectiveness in terms of reporting to Parliament.

Mr Osborne

77. Do you agree with the Comptroller and Auditor General that tax credits are essentially a form of social security payment?

(*Sir Nicholas Montagu*) I have already indicated—

78. I know you have, that is why I am asking the question.

(*Sir Nicholas Montagu*) I am not going to express a view different from the Chancellor of the Exchequer's.

79. Do you not agree with the Comptroller?

(*Sir Nicholas Montagu*) I have cited the view of the Chancellor of the Exchequer, who takes a different view from Sir John.

80. You said the tax credit system was the biggest change ever to hit you. What is the total cost to the Department of setting up and administering this new system?

(*Sir Nicholas Montagu*) Dave can tell you the cost of new tax credits. I certainly do not have a figure to hand, though I could probably produce one, for tax credits as a whole.

(*Mr Hartnett*) For new tax credits over a four-year period the figure is about £1 billion.

81. The cost of administering it.

(*Mr Hartnett*) In staff, in computers and everything else which goes with setting up something new.

82. Would that be a similar figure, would that be a good estimate for what it has cost so far?

(*Mr Hartnett*) No; new tax credits, for example, has a computer system which is eight times bigger, more complicated or whatever, than for self-assessment. It is a much more significant structure than working families' tax credit where we were actually able to build, in part at least, on the computer systems which came to us with the Family Credit Unit which became the Tax Credit Office.

(*Sir Nicholas Montagu*) On a procedural point, just to avoid my having to send you a note, may I say that I have been characteristically modest. The Committee will have noted that I said five times; Dave is undoubtedly right when he says eight times.

83. Although the Chancellor does not accept that it is a form of social security benefit, would you agree that the kind of compliance checks you have to run are rather like the old DSS used to run?

(*Sir Nicholas Montagu*) No, I do not think I would. I have indicated in reply to an earlier question that the Department of Social Security, now the Department for Work and Pensions, does not apply the kind of risk based approach that we are applying to tax credits. What we are trying to do, and obviously we shall be talking with DWP and picking their brains as well, is to apply the sort of compliance approach that we have found works well for tax to new tax credits. Dave, with his sponsoring responsibility, may want to add to that answer.

(*Mr Hartnett*) There are three stages to this. There was the compliance regime which existed for benefits before tax credits were introduced. Some new things have come with tax credits. Nick mentioned one of the most important, which is risk assessment. There is also a progressive compliance response now. In the past it was essential for what is now DWP to consider prosecution in order to make recoveries. We do not have to prove debt now, we can use something like a tax assessment to recover money where we have to recover money.

84. The Department of Social Security, or indeed the Department for Work and Pensions now, has to be fairly intrusive into people's family circumstances and arrangements. Are you finding, because you are now administering tax credits, that you are having to undertake that kind of intrusive work which perhaps previously you did not have to do?

(*Sir Nicholas Montagu*) It is not entirely new to us. Although independent taxation has been in for some time, a lot of our work has turned on households. For example, when an additional personal allowance was

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paid to a single parent, we needed to be sure that the person claiming that allowance was not living with somebody as a partner. There are new elements to it, but it is not as new as you might think.

85. It says in this report that you do cross-checks with the Department for Work and Pensions and the data they hold, "where appropriate" is the phrase used in the report. Is it not always appropriate? Often the people you will be dealing with will also be claiming other forms of benefit.

(Sir Nicholas Montagu) No, it will not always be appropriate. Our basic check is that the person says they are who they are. We then apply a risk assessment. With new tax credits, much of this will be done within the system. If there is an indication that somebody is a risk, then we would cross-check with our own data, for example, with the data warehouse to check on households, we would cross-check with the Department for Work and Pensions. With something like this, whether it is a social security benefit or whether it is a reduction in the tax bill, there is obviously a balance to be struck between proper and rigorous compliance and making it easy to claim.

86. You are talking about risk assessment. It says in paragraph 3.17 on page R14, "... 49,000 cases have been referred to the Compliance Co-ordination Unit" since October 1999. However, limited additional checking allowed you to eliminate a further 22,500. The view here is that your risk approach, particularly your risk scorecard, was basically a complete waste of time.

(Sir Nicholas Montagu) That is not wholly fair.

87. When you suspended it at 22,500 there was absolutely no impact whatsoever on the effectiveness of your activity.

(Sir Nicholas Montagu) Yes, but bear in mind that a major purpose of the risk scorecard was to get staff administering this new system used to doing the analysis of it. By the time we discontinued it, it would have been second nature to many of them. I am not saying it was perfect; clearly it was not. That is why, iteratively, we concentrated on improving the risk scorecard and re-introducing it. As I indicated to the Committee on previous occasions, what we try to do with the whole spectrum of our compliance activity, is constantly to refine our indicators and our analysis of risk.

88. You further decided that of the remaining 26,500 cases you accepted for inquiry, you would not pursue 3,600 of those. The truth is that you are not pursuing a huge number of these cases, are you?

(Sir Nicholas Montagu) We are not pursuing them for the sake of pursuing them, certainly. We identify the cases that we think call for further investigation. If they do, we have quite a lot of specialists working on this in tax credits, we then decide whether it should be what we call an aspect inquiry or a more comprehensive one. If there is only one point which needs to be checked up, this is probably done most effectively on the phone from the tax credits office. If more looks wrong, or if there are certain factors present like the claimant having an undeclared partner or self-employed earnings being involved, then we will undertake a full inquiry with the local compliance teams.

89. Your inquiries take so long that by the time you have completed them you find it very difficult to recover any overpayment you have given because by then you cannot recover it against the current award they have been given.

(Sir Nicholas Montagu) That is not wholly fair. The length of time for the inquiry looks longer than it actually is. The time is measured from when it first reaches the relevant compliance section. We conduct these inquiries in accordance with the code of practice that we use for other areas of our business. People must be given time to make their representations to us. As Dave has indicated, if we find that people have had more credits than they are due, we have a number of different mechanisms which we can use to recover that money and we shall use them.

90. In paragraph 3.21 it says, "Delay between an award being made and a decision being taken to recover an overpayment creates a risk that an erroneous award will have expired by the time the need for recovery has been established . . . These may not be easily recovered and in some cases may prove irrecoverable". If you speeded up the time you took to investigate these things, then it would be much easier to recover the money, would it not?

(Sir Nicholas Montagu) I can totally understand your worry. I hope I can reassure you. The amounts written off from overpayments are pretty small. The specialist debt recovery group remitted under 1 per cent of the amounts sent for recovery in 2000-01. That amounts to under £35,000. Against some of the background we are talking about, that is peanuts.

91. May I move on to a point Mr Davies made before he left, which I found extraordinary? You have no idea what the total number of eligible people is for these tax credits.

(Sir Nicholas Montagu) How can we without knowing what numbers in the population are earning below or have income from self-employment below the appropriate threshold? That is why we need to set off the numbers claiming against the Family Resources Survey.

92. When the Chancellor of the Exchequer is setting his budget, presumably someone must come to him, maybe in the Treasury as opposed to your Department, and say they think it is going to cost roughly X. They must have some estimate for the total number of eligible people or the take-up.

(Sir Nicholas Montagu) We would have an estimate.

93. What is the estimate.

(Sir Nicholas Montagu) Ministers have talked with the present credits in terms of expecting a take-up in the region of 1.4 million; we are at 1.33 million.

94. Take-up is not quite the same as total of eligible people.

(Sir Nicholas Montagu) As you know, Ministers are congenitally optimistic. I would have thought that represented a fair view of the number they thought was eligible. I really cannot give you a reply of the precision you would expect until we have compared take-up with the Family Resources Survey.

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95. You have been administering these tax credits since October 1999. Your Family Resources Survey must have taken two or three years to compile.

(Sir Nicholas Montagu) This is the 2000–01 survey relating to the accounts on which I am being examined.

96. So you have had previous surveys.

(Sir Nicholas Montagu) Yes, but remember we are talking about a system which came in at the end of 1999 and with payment via the employer from 2000. In other words, we are talking about the first full year of the system as reflected in these accounts.

97. It seems striking that when you heard you were going to take over this system or set up this system, which was when the Chancellor first announced it in 1998, you did not say you had better conduct some surveys to see the likely household expenditure and household incomes of the people you were going to be dealing with, instead of waiting until 2002, to do this survey in advance.

(Sir Nicholas Montagu) I have to give you a ‘not-me-guv’ answer there. The Family Resources Survey comes within the responsibility of the Department for Work and Pensions.

98. You could have got onto the phone to the Permanent Secretary there. I am sure you are good mates. You could have said it would be very useful to have one of these surveys.

(Sir Nicholas Montagu) We are very good mates. I am sure that you, like me, have experienced the sort of reaction that Rachel Lomax, for whom I have the highest regard, can give to unwelcome suggestions whether from this Committee or from one of her fellow Permanent Secretaries.

99. Why would it be an unwelcome suggestion, apart from the fact that you have taken over half her empire?

(Sir Nicholas Montagu) It would require her to do the job twice, and these things cost money.

100. In the scale of the benefits you are administering and the scale of the £1 billion you are spending on setting up this system, I would have thought was absolutely imperative to have some sort of survey so you have some idea of how many people are eligible for the credits which you are administering.

(Sir Nicholas Montagu) You are a very impatient man. I am being examined today on the accounts for the first full year of operation. You have heard from Dave that we now have the Family Resources Survey in and that towards the end of the year we should have some sort of comparison. Given the customary pace of the wheels of Government, I think we are doing pretty well.

101. May I ask you something on the general accounts? Table 1 on page R3 says that total tax receipts—very good political information for me, but I am not going to deploy it here—have gone up massively in the last five years. It specifically says that total tax receipts have gone up between 1999 and 2000 from £139 billion to £148 billion. Then if we turn to page R7, paragraph 2.5, we find that the non-compliance work of your Department has identified fewer tax liabilities, in fact the tax liabilities identified have dropped from £5.4 billion to £4.5 billion. So

even thought tax receipts have increased, the amount of money you have uncovered as being additional tax liability, has fallen. Why is that?

(Sir Nicholas Montagu) Who knows?

102. I hope you know, you are in charge.

(Sir Nicholas Montagu) Let me put it this way. If I asked all of you in your glory how many of you had been convicted of mugging old ladies, I guess that probably no more than one hand would go up in this room. That could be for a variety of reasons. It could be because only one of you has done so, or because the police have not got round to the rest of you. There is a very serious point there. With compliance yield, I have often said here that in the ideal world compliance yield would be zero. We do not know whether it is because we are getting more effective at encouraging voluntary compliance, whether we are getting less good at finding it or whether it is external factors. There are external factors. Undoubtedly, the fall in yield from international activity, which is subject to huge fluctuations each year, the yield from oil taxation, which was affected by the low oil prices and also things like the numbers of insolvencies can affect the amount of yield. It is a complex issue.

Jon Trickett

103. I have been listening with some curiosity to the exchanges between the Chairman’s predecessor and Dawn Primarolo. I just want to ask Sir John one or two questions on this matter. Am I correct in saying that effectively what must be regarded as Government expenditure has been transferred from DWP, or DSS as it was, through to Inland Revenue?

(Sir John Bourn) This is so. If the money which goes out as a tax credit had gone out as public expenditure from DWP, that is exactly what it would have been. What would have counted as public expenditure, no longer counts as public expenditure, but it is public expenditure.

104. Nevertheless, from the individual’s point of view, it is income.

(Sir John Bourn) Exactly.

105. Whether or not the taxonomy of all this is that it is taxation or whether it is benefits, it is income for the individual. Am I right, secondly, in saying that it is the same core group of people who were previously targeted by benefits as they were described previously and now by tax credits? Is it broadly the same group of people we are targeting?

(Sir John Bourn) Broadly; yes.

106. One could argue that we are talking really to some extent about a semantic difference. I could argue, but you probably would not care to make that comparison between benefits on the one hand and tax credits on the other and that previously you would have had a close interest in that matter and now you are excluded from that. Am I right in my understanding?

(Sir John Bourn) Yes, that is right. If it had gone out as benefits, I would have been the external auditor with access.

107. From my point of view, it seems the same bundle of money, perhaps more effectively targeted, but nevertheless broadly the same bundle of money.

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[Jon Trickett Cont]

One of the points which has been made by the Inland Revenue is that they do not want to disturb these poor employers any more than they need to. I notice that we do not disturb them a lot, so I am going to ask some questions about that in a moment. That seems to suggest that you wear size 15 boots when you undertake this kind of monitoring. But I understood you to be saying that you monitored the Department rather than the employers themselves. I am just wondering whether you would reflect briefly on how, if you were to be invited, you would undertake such a task and minimise the impact on the employer, which it seems to me is really what Sir Nicholas's argument is based on.

(*Sir John Bourn*) You are quite right to say that my concern is with the system of administration of the Inland Revenue. The way in which the money reaches the beneficiary is through the agency of the employer, therefore, as the external auditor, to get a full understanding of the way the system works, I would need access to employers, not of course because I would seek to go to every employer every year or anything like that. The importance is to be able to go in circumstances when I or my colleagues see advantage in going. That is what the giving of the power of access to the Comptroller and Auditor General would constitute. I think that describing the kind of work that I would do as the external auditor as an attempt to lay a heavy hand on the great range of industry and commerce, is an attempt to push me to one side on a false argument.

108. I am inclined to that point of view as well. In your role previously in monitoring the benefit system, is it not true that at that time you would have from time to time been approaching employers?

(*Sir John Bourn*) Certainly we would have approached employers from time to time. I do not have at my fingertips the exact legal details, but yes, certainly we would have had to.

109. So it is not something with which you are unfamiliar.

(*Sir John Bourn*) No.

110. Did that provoke large numbers of complaints about the C&AG and the NAO?

(*Sir John Bourn*) No.

111. I am happy that we have now heard both sides more fully perhaps than we had previously. No doubt the members will draw their own conclusions. I now want to ask about compliance and non-compliance. This non-compliance unit seems to me to have been heavily biased in one particular direction.

(*Sir Nicholas Montagu*) I am sorry, which unit are we talking about.

112. The Compliance Coordination Unit.

(*Sir Nicholas Montagu*) So we are on tax credits.

113. Yes; sorry. It does seem to have spent a large amount of its time looking at individual cases and hardly any time at all looking at employers, yet I should have thought it was fairly obvious that the large-scale fraud would take place with employers. I wonder whether I have misunderstood exactly what was happening.

(*Sir Nicholas Montagu*) No. If you want detail, I shall get Dave to help you. The point is this. If you think you are entitled to the working families' tax credit, you put in an application to the Inland Revenue. This is assessed at the tax credits office and after the identity check, if there is no reason to suppose that it is anything other than *bona fide*, then it will be paid out, arrangements will be made with the employer and so on. Essentially what we are talking about here is a unit at the tax credit office which deals with individual claims. Employer compliance comes in with the sort of things we have been talking about, with visits to employers by our employer compliance teams, by end of year checks on the P35. You also talked about large-scale fraud, and I have to say that in none of the work we have done is there any evidence of large-scale fraud or collusion by employers.

114. But there again, you have hardly done any visits to employers. I see 49,000 cases which I presume are individuals and disputed cases of 230 visits to employers which actually turned out to be 199, did it not?

(*Mr Banyard*) We did 29,000 visits to employers last year. In those 29,000 visits we found 6,800 who were paying credits and of those 6,800 only 18 required action. The view of our employer compliance teams at the moment is that this is not a difficult area.

115. Is it not obvious that an individual can only defraud the tax credit system by a relatively small amount, whereas the one or two individuals who claim to be employers perhaps when maybe they are not, could be defrauding you of large amounts of money.

(*Sir Nicholas Montagu*) One or two individuals who are what?

116. One or two individuals who are perhaps entrepreneurs but they have taken the wrong track in life might well set themselves up as employers and defraud you of very large amounts of money.

(*Mr Hartnett*) Maybe I can help with some numbers. We have already prosecuted two employers for collusive activities with their employees which led to loss of tax credit which we intend to recover. Out of the 131 cases working towards prosecution in our special compliance office, 13 involve apparent collusive activities on the part of employers. Stephen's point is a really important one, as is the work which Nick described to the Chairman in relation to the reconciliation of authorisations and what are now P35s. In all that work we have not found any substantial numbers of large-scale frauds by employers.

117. I am confused, perhaps justifiably. If we look at paragraph 3.26, I was speaking about the compliance unit and the figure I quoted is nothing like 29,000 employers visited in their own place of business. There is a disputed figure. Here it says 230 employers but in your letter to us it says 199. The point I am trying to address is that the compliance unit seems on the one hand to have dealt with tens of thousands of individuals who have been referred to it or whom they are looking at in some detail and on the other side only 230, or 199 as you corrected yourself,

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employers. Why should there be that apparent imbalance or do you not accept that it is an imbalance?

(*Sir Nicholas Montagu*) I do not think there is any imbalance there at all. Individuals can lie about their circumstances in order to qualify for credits which they should not get or for more credits than they should. That is why we vet carefully the individual applications which come in to the tax credits office, subject to the proviso that I made in my answers to Mr Osborne. If the tax credits office, in the course of their work, have reason to suspect that an employer is involved in unacceptable behaviour of whatever sort, they will then alert the local employer compliance teams and what the paragraph you referred to is talking about is the 199 cases where employer compliance teams undertook a visit at the specific request of the tax credits office. The fact that an employer pays tax credits is in itself an indication for a visit, one of many. If an employer compliance team, not alerted by the tax credit office, visits an employer who pays tax credits, they will always check at least one tax credit record. Against that background, we have the evidence I mentioned, and which Stephen drew on, that employer collusion does not seem to be an issue. Put together the figures Dave gave you: two prosecutions, 13 under investigation for possible collusion by my special compliance office. Put that against 266,000 employers paying out credits. The point about the employer compliance team, and in a way it also goes back to your questioning of Sir John, is that they are the frontline professionals with our business support teams in our dealings with employers. They will cover a whole range of payroll and other employer related issues.

118. I am of the view, just as with landlords fiddling housing benefit with their non-existent or collusive tenants, that there will be employers out there seeking to defraud the system. I am also of the view that you have decided to run the employer side of the business with the lightest possible touch, perhaps because you believe that Ministers or the Government generally wish that to be the case. It is quite clear in the paragraph we have just discussed that you failed to collate information on the electronic databases. I notice in the next sentence that Sir John says, "... there are weaknesses in the Department's management information" in relation to this matter. I think your answers are complacent in relation to the employers. I believe that is what the fraud will be and I believe you have not uncovered it not because it is not there, but because you decided to approach the employers with the lightest possible touch.

(*Sir Nicholas Montagu*) I need to say quite a few things on that and I need to bring Stephen in. The first is that before we authorise a payment via the employer we run a check on them. The second is that, with the greatest of respect, I have evidence for my statement. Stephen has given it to you. When we looked at 6,800 employers who were paying tax credits, we found 18 cases where there had been overpayment. That is evidence. What you have is a hunch that there must be a lot of employers on the fiddle. We are always trying to improve our risk analysis and our management information. We are always trying to identify employers at risk, but we do

not really have evidence of largescale collusion. I know that you have just been given your yellow card, but perhaps I could get Stephen to comment and then very briefly Dave, because Dave led our recent review of links with large business.

(*Mr Banyard*) Our employer compliance teams are highly skilled in looking at employers' books and they look at them in the round. If you are going to find non-compliance in one aspect, for example credits, you might expect to find it in national minimum wage or in some other aspects. They do not take a narrow view; they have a number of mandatory checks which they make across each of the payments and functions, but they also take a broad view of the employer as a whole and look at whether the payments are reasonable, whether the hours look reasonable, whether any people look odd. They do that. In addition, of the 29,000 visits they did last year, four per cent of them are mandatory random visits. Next year we shall have a better reporting system for them which will enable us to say when credits were looked at and whether there were problems. We will take a random look across the population which is statistically significant and we shall be able to provide some degree of assurance.

119. If possible, could you give us a note about the structure of this compliance unit and how many people work on employer compliance and how many work on compliance by individuals? I have a feeling, and I am afraid your long answers—very thorough and detailed, so necessarily long answers—have not really convinced me and set my mind at rest.

(*Sir Nicholas Montagu*) I do have figures, but in the interests of time, we shall let you have a note on that.¹

Mr Steinberg

120. The last time we discussed this—and I cannot remember whether it was with you or with Rachel Lomax—

(*Sir Nicholas Montagu*) I sincerely hope that if it was on tax credits it was with me. I should not like it if Rachel has been poaching off her territory.

121. What appears in paragraph 3.11 seems to bear out what I was saying last time we discussed this. At the time I was very concerned that it appeared to be reasonably simple for somebody to tell a simple lie when filling in the application form, particularly regarding their marital status, to defraud the system. For example, husbands or partners leave the nest or say they have left the nest, the working families' tax credit being awarded then they miraculously make up and come back again. I have been given a number of tip-offs about this happening. Did you carry out any investigations?

(*Sir Nicholas Montagu*) Yes, we carry out enormous numbers of investigations. Basically, we have a comprehensive strategy to address the risk of fraud or manipulation in both the tax credits. Bear with me for a slightly long answer. What we have is a basic, up-front clerical check of identity. We sift out potential cases for referral and then the dedicated compliance staff mentioned in Sir John's report select cases for inquiry. What we did was to build on the

¹ Ev 20–21.

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checks for benefits in payment used by the Department for Work and Pensions, which may be why Rachel came into your mind, but we added our own checks against our own data. The main difference is that we actually use risk assessment and post-payment checks, as we already do for tax and national insurance contributions. We will check income data against the system which supports pay-as-you-earn tax or self-assessment. We tackle misrepresentation of circumstances, like living together, through our data warehouse. Do we have the same address for someone else not mentioned? We do have a pretty comprehensive strategy. We check with employers to ensure that employees do not overstate their hours.

122. How many cases of fraud did you find?

(Sir Nicholas Montagu) Fraud is difficult to establish. What we are talking about is a spectrum which covers everything from innocent misrepresentation through to "Well, it's worth a try", through to the kind of hard determined fraud which we prosecute. Somewhere I have statistics for prosecutions. In 2000–01 we prosecuted only two cases, but bear in mind—

123. I gave you information about 14 in one place doing it.

(Sir Nicholas Montagu) I have two where there were criminal proceedings.

124. Information was given to me that at least 14 people were doing it in the one establishment. You are telling me that you have prosecuted two people in the whole country.

(Sir Nicholas Montagu) We obtained two convictions during that year. While we are talking we will fiddle around with our papers and at the end of your questioning I will come back with the figure on that for you.

125. I find that quite staggering. After all the explanation you have given me on how deeply you go into it, you have found two people fiddling the working families' tax credit in the whole of the country.

(Sir Nicholas Montagu) No. Dave has given me the figures. Sixteen individual prosecutions plus two of collusive employers.

126. That is 18 cases out of 1.3 million people who are claiming it.

(Sir Nicholas Montagu) Yes.²

127. I was told of 14 in one place in my constituency.

(Sir Nicholas Montagu) May I just say, as I have said in writing to you, that if your informant would like to get in touch with the area directors whose names I have given you, we always act on third party information.

128. I was going to come to that. How seriously do you take tip-offs?

(Sir Nicholas Montagu) Utterly.

129. I gave you a tip-off and you do not seem to have taken it seriously.

(Sir Nicholas Montagu) You gave me a tip-off and I wrote to you and said that if you could give our people more detail we would look into it. Whenever we get a tip-off we look into it. What we do not do and cannot do is tell the informant what happened, which some informants find frustrating, because we are bound by statutory rules of confidentiality.

130. How many tip-offs did you get last year?

(Sir Nicholas Montagu) I do not have a figure for that off hand.

131. How much money did you recover because of tip-offs?

(Sir Nicholas Montagu) I do not know whether we have information in that form. If we do I shall let you have it. Sixteen thousand tip-offs, but I do not know whether we have a figure for the amount of money recovered.³

132. This is interesting. Sixteen thousand tip-offs and two prosecutions.

(Sir Nicholas Montagu) No; 16 prosecutions.

133. Sixteen thousand tip-offs and 16 prosecutions.

(Sir Nicholas Montagu) Yes, but they are not all as tax credit literate as you are.

134. I do not claim it.

(Sir Nicholas Montagu) The people tipping off. Quite a lot of tip-offs will be "Did you know he is working?". Of course we knew he was working. That is what working families' tax credits are for. Not all the tip-offs are well founded. Even where they are, there may not be enough to prosecute. Remember that an important part of our work is educating people. Remember also that by definition a lot of these people will be people we actually want to go on helping.

135. Let us move on slightly. According to the report, 3,250 cases were investigated. Is that right?

(Sir Nicholas Montagu) You are looking at paragraph 3.14. This is the representative sample.

136. Yes, that is right. Out of 1.225 million claimants you looked at 3,250 cases. Is that right? That seems to me to be a very small sample.

(Sir Nicholas Montagu) Yes.

137. How can you derive any sort of information from that? Do you regard it as accurate?

(Sir Nicholas Montagu) We regard it as statistically valid. Yes, of course you are right that it was a small sample. What we wanted was a structured study which would give us an indication of the likely levels and nature of fraud, or, let me say, non compliance

² Note by witness: A total of 16 prosecution cases were instigated in 2000–01, of which only two were completed in Court. The two collusive employer prosecutions were included in, rather than in addition to, that figure.

³ Note by witness: This figure relates specifically to allegations referred to the Inland Revenue via the Department for Work and Pensions' National Benefits Fraud Hotline. The precise figure is 16,676. The amount of money recovered as a result of reviewing those 'tip-offs' was £743,140. These figures relate to the period 1 October 1999, when working families tax credit was introduced, to 31 December 2001, and are available only as a result of a specific one-off exercise carried out in January 2002 to answer a Parliamentary Question. We do receive other types of information that could be described as 'tip-offs'. This information, however, is reviewed in the same way as other referrals to our Tax Credit Compliance Co-ordination Unit.

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because that covers everything from innocent error through to determined fraud. Our analysts advise that this was a statistically valid sample. Of course we could have done a bigger one, but it would have taken much longer to complete.

138. Let us move on to paragraph 3.18. Looking at this paragraph, it tells us that there were 26,500 cases accepted for inquiry and 3,600 were dropped because they were regarded as low risk. What is the difference between high risk and low risk? I am asking that quite seriously.

(Sir Nicholas Montagu) Basically you are talking about people who are compliance experts looking at cases referred to them and thinking actually this does not look that suspicious. What we had to do was make the case for following up simple aspect inquiries against the other imperative of making prompt and accurate payments to people who needed it. What we did was to end the inquiries into simple cases where the work done to date made it look as though they were unlikely to be non-compliant.

139. Would it be fair to say that you dropped these cases because there was a lack of resources to do the lot and you went for what you thought were the higher risk ones? I am not quite sure what the higher risk ones are.

(Sir Nicholas Montagu) It would not be wholly wrong, but it would be simplistic. If we had had a whole lot more people we could have followed these cases right through and at the same time concentrated on getting the right payments to the right people at the right time. Life being as it is, we have to make choices. We looked at the work done to date on these cases, picked out the ones which did not look as though they were compliant, looked at them again before we discontinued work and closed them down.

140. I am not sure this comparison is fair, but we had Mr Broadbent from the Customs and Excise—

(Sir Nicholas Montagu) A great friend of mine. I am afraid I am not going to name and shame a tobacco company. The Committee can leave now if they want. I am less entertainment value than Richard.

141. Mr Broadbent certainly seems to deal in much bigger sums of money in fraud than you do. What I seemed to conclude was that the more you invested in trying to catch people, the more people you caught and the more money you saved. As far as Mr Broadbent was concerned, the more money you put in to try to find out who was doing the smuggling and how much was being smuggled, the more you saved the taxpayer. Here I get a similar situation. The more money you put in to detect fraud, the more money you will save and the more money you will recoup. Is that right?

(Sir Nicholas Montagu) It depends entirely on the area. I shall resist the temptation to say that maybe Richard had more fraud in the first place than we did, because that would be hubris of the highest order and I might regret it when I re-appear before this Committee. There is a dead serious point, which is that Sir John is conducting an investigation into fraud in four different Departments: Health, Work and Pensions, Customs and us. I think this is going to

be an invaluable exercise, and I say that as somebody knowing he is quite likely to be dragged back to talk about it. I think that what you may find coming out is the different considerations as well as the common consideration between Departments. This is the age-old compliance problem. In some parts of my organisation, if I put an extra body there, she or he can bring in many times their salary. In other areas, it is less. What we have to balance the whole time in the tax credit office is the imperative need to get the benefit of the tax credits to the deserving claimant as soon as possible with the need to ensure that we do not allow fraudulent claims. There is always going to be a balance for any Department operating with necessarily limited resources. You are talking about choosing between priorities.

142. Can you anticipate what is actually fraud in working tax credits? How much the taxpayer loses?

(Sir Nicholas Montagu) The study which we were talking about earlier of 3,250 cases, although small, will give us a better idea, but it is always impossible, by definition. It is like the interesting discussions I have with the Committee on the size of the informal economy.

143. Continuing on paragraph 3.19, we are not talking huge amounts of money as we were with Mr Broadbent, but on the other hand, 3.19 tells us that you investigated and found overpayments had been made to people yet you did not recover them. Why not? It is a very small amount of money but I get the impression that you found out that £114,000 had been overpaid and you did not claim it back. Why? Or am I reading it wrongly?

(Sir Nicholas Montagu) Yes, you are reading it wrongly quite honestly. What Sir John is saying in that paragraph is that his example of—

144. No, I am not reading it wrongly. What I am saying is that overpayments have been made and you have found out that those overpayments have been made but it was not reported to the debt recovery team to get it back.

(Sir Nicholas Montagu) Yes, that is right. You have it right now, but not the way you said it before. What you said was that we failed to recover it. What Sir John is saying is that the failure to report to the debt recovery team—

145. It is the same, is it not?

(Sir Nicholas Montagu) Yes; absolutely. That is why, picking that up, even though extrapolation suggested that there might be 226 cases, 0.8 per cent, in every case now we require our managers to check that the overpayments are reported. It's a 'fair cop, guv'. Done something about it.

146. Again I might be reading it wrongly, so forgive me if I am. Can we turn to your memorandum? In paragraph 14 of that memorandum, it seems to indicate that employers make all sorts of mistakes when they are filling in the P35 form and it also seems to indicate that you do not get the information at the right time. I might be wrong, but I gleaned that the end of the financial year is 5 April, but the form actually asks the employers to put down the results to 31 March, or the other way round. In other words, the form does not cover the

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time of the actual payments. If that is true, why are the forms and the financial year not the same date? I could be totally wrong.

(Mr Banyard) It is that the employer reports payments to 31 March if they have paid. The tax year is very slightly out of step.

147. That is right. What I am saying is that if that is the case and it causes problems, why do you not change the date on the form to the end of the tax year? They would then be the same and it would mean you do not have to wait another year to get the correct information. I could be wrong.

(Sir Nicholas Montagu) I think you probably are, with the greatest of respect.

148. Probably; I always am.

(Sir Nicholas Montagu) Not so; Homer very rarely nods in your case. Think of those employers paying monthly where you will get the payment at the end of April, even if it related to a period before the start of the new tax year.

149. Are you saying that it does not matter that the end of the financial year and the final date on the P35 are different, that it has no effect?

(Mr Hartnett) Maybe I can help. Some employers run their P35 to 31 March, others run it to 5 April. We have traditionally allowed that approach, provided it is applied consistently year on year by employers. If I have understood your question correctly, changing the date to 31 March would not help those who worked to 5 April.

150. No; the other way round. Do not change the end of the tax year, change the form to 5 April rather than 31 March.

(Mr Hartnett) For some people it is 5 April and 5 April appears on the form. The form is 5 April.

(Sir Nicholas Montagu) What you are getting from here, with a degree of bewilderment, is a clear message that the P35 relates to payments made by the employer in respect of the tax year, in other words from 6 April to 5 April.

Mr Bacon

151. I should like to start with some points of agreement about your friend Rachel Lomax and suggestions to her which are unwelcome. I certainly agree with you that she responds very robustly to suggestions which are to her unwelcome. I suggested to her that it might be a good idea if she gave the C&AG a set of Appropriation Accounts each year which were not qualified. Indeed I pointed out to her that if she were unable to do this, she might set a target date for when she was going to do it. It turned out that she was not proposing to do it at any point in the next three and a half years before she was planning to retire.

(Sir Nicholas Montagu) I find it very depressing that she is planning to retire. It makes me come back to the sense of deprivation which the Committee is obviously feeling about my impending retirement. Being deprived of Rachel within two years is more than any Committee, however vicious, deserves.

152. The reason I mention that is that I have only been on this Committee since last October. In that relatively short period of time, frankly I have gained

a very considerable and healthy degree of scepticism about the Government's abilities to do anything right. You mentioned your friend Mr Broadbent. Just to take him and Rachel Lomax together, Customs and Excise estimates tax fraud to be somewhere between £6.4 and £7.3 billion. Rachel Lomax, depending on which day of the week it is, seems to give a different answer. The Social Security White Paper in 1999 said £7 billion of fraud and error. She now thinks it is £2 billion, but I put down a Parliamentary Question the other day to which the answer was £3 billion and when the *Daily Mail* picked up the answer to my question—I did not speak to them—they published a little article and I subsequently had several letters from people who had worked as employees in the Benefits Agency talking about the despair they were in, one person resigned through ill health and so on. Of course the NHS, according to Stuart Emsley, who is inside the Department, loses somewhere between 16 and 20 per cent of its budget. That little lot alone comes to somewhere between £15 and £20 billion, depending on whether you take a conservative estimate or not. What I am therefore wondering about is why your level of fraud should be so much lower than all these other people. You have this new tax credit and it seems from the figures Mr Hartnett was giving that you have very few which required action. Why should yours be so much lower than the others?

(Sir Nicholas Montagu) The nature of Richard's and Rachel's and my businesses is different, which is why I think that Sir John's study will be genuinely valuable because it will bring in Nigel Crisp's empire as well. The plain answer on this one is that we do not know. This is why we have a robust fraud strategy and we have appointed the director of my special compliance office, John Middleton, as the departmental fraud champion. What we are trying to do is to arrive at a much better understanding of the risks, estimating the amount at risk, getting to where we want to be and thinking about how we should then get there. In addition we are doing various piecemeal studies like the ones I mentioned in reply to Mr Steinberg, which will give us a much better understanding of where we think we are with fraud. We appointed a leading academic economist last year as our director of analysis and research, David Ulph, whose name may be familiar to some members of the Committee, and he will be leading the analytical work on the rigorous lines I have discussed. It is an area where, although I would stand by the answers I have given the Committee previously, which were endorsed by Lord Grabiner. All of us recognise we need to do more to see whether we can scope the problem or the scale of it rather more than we have done in the past.

153. Sir John, may I carry on this subject of fraud and ask you a question? When you referred earlier, in answer to Mr Trickett, to the desirability from your officers' point of view of having access to employers, you were obviously thinking about the business of doing your job of assessing economy, efficiency and effectiveness. To what extent is fraud a component of your desire to have the ability to get in to employers?

(Sir John Bourn) It is an aspect of it. If you do have information which indicates the possibility of fraud in that aspect of work. As in any other the ability to

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secure direct evidence is certainly relevant and helpful. I do not base the case that I made simply on fraud.

154. You base the case on the ability to do your job of reporting to Parliament.

(*Sir John Bourn*) To report to Parliament on the disbursement of public money.

155. You were quite graphic, I paraphrase you, when you said that to say your heavy hand must be stayed is an attempt to push you aside with a false argument. Are you basically saying that you do not think you can adequately, properly and fully do your job of reporting to Parliament on how public taxpayers' monies are spent unless you have the ability at your discretion when you choose to exercise it but the ability to access employers?

(*Sir John Bourn*) I am saying that the external auditor of whatever activity needs direct access. It is up to the external auditor to determine the mode, method and occasions on which he exercises it. I think that in relation to this I should have the same rights of access as I have to the Department for Work and Pensions and the Inland Revenue.

156. Are you saying that without those rights of access it is not possible for you fully to do your duty to Parliament in respect of these expenditures?

(*Sir John Bourn*) I do not want to say that all my work in this field would be totally undermined. What I am saying is that the external auditor requires rights of direct access and that he or she determines upon their employment.

157. If this Committee were to recommend that, you would not have too much difficulty in agreeing with that recommendation.

(*Sir John Bourn*) I should have no difficulty at all.

Chairman: You might even assist us in writing the report.

(*Sir John Bourn*) That is a pleasure I could not decline.

(*Sir Nicholas Montagu*) I shall be totally hands-off where the Treasury Minute is concerned.

158. May I ask about the Tax Credits Bill? The Tax Credits Bill includes provision for the transfer of child benefit from Work and Pensions to the Inland Revenue. Could you just say something about what that will entail? How it will work?

(*Sir Nicholas Montagu*) I hope it will work very well. The child benefit centre of Work and Pensions is a highly professional organisation of some 2,000 people operating out of Washington in the North East. It has regularly exceeded its targets. It provides a first-rate service. The Prime Minister announced last year that they would join us in April of next year at the time when we acquire responsibility for the new tax credits. Certainly a lot of us are doing a great deal to ensure that the merger goes smoothly. We are talking with the trade unions, we are talking direct to them.

159. That whole payment centre is moving across under your aegis. Is that right?

(*Sir Nicholas Montagu*) Yes; absolutely. For example, a month ago I was up in Durham at their spring school, together with my Director of National Services who is Stephen's opposite number for national services and under whom they will come.

160. Is it going to remain a benefit?

(*Sir Nicholas Montagu*) The Chancellor has in all utterances, when speaking of the new tax credits and what they would do for families, in particular the new children's credit, spoken of building on the foundation of child benefit.

161. I am asking whether child benefit will remain a benefit.

(*Sir Nicholas Montagu*) I hope it will be of great benefit.

162. No. Is child benefit being abolished under these proposals?

(*Sir Nicholas Montagu*) No, absolutely not. The Chancellor has spoken about building on the foundation of child benefit.

163. I am not clear, because there is this new children's tax credit. Child benefit as a payment. Mr Osborne is newly a father.

(*Sir Nicholas Montagu*) Congratulations. Boy or girl?

Mr Osborne: Boy.

(*Sir Nicholas Montagu*) Commiserations!

164. Mrs Osborne currently receives child benefit and it is called child benefit. Will a thing called child benefit continue to be paid to Mrs Osborne but simply by your Department rather than by DWP?

(*Sir Nicholas Montagu*) Exactly that. I am sorry, I did not quite understand the question. The point I was making was that the Chancellor is giving a strong 'no-change' message where child benefit is concerned.

165. So why did it have to be moved from DWP to Inland Revenue?

(*Sir Nicholas Montagu*) On the machinery of Government you should ask the Prime Minister rather than me.

166. Did Rachel ask you why it was being moved across?

(*Sir Nicholas Montagu*) I suspect that probably communications between Permanent Secretaries are nearly as sacrosanct as those between Permanent Secretaries and Ministers.

Chairman: That line of questioning is a tiny bit unfair.

167. I was just curious that this new child tax credit arrangement seemed to imply that it was being turned into another form of tax credit. You are telling me that is not the case.

(*Sir Nicholas Montagu*) No.

168. It is child benefit, it remains child benefit, it will continue to be called child benefit and it will continue to be paid as a benefit not a tax credit.

(*Sir Nicholas Montagu*) Yes. I am grateful for your protection, Chairman. I think, again going carefully, that you will find what the Prime Minister and the Chancellor and the Secretary of State have said is essentially in terms of streamlining and bringing together the different types of support for families with children. The new children's tax credit will subsume the children's element in job seeker's allowance and income support as well as that in working families' tax credit.

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SIR NICHOLAS MONTAGU KCB, MR DAVID HARTNETT
AND MR STEPHEN BANYARD

[Continued

[Mr Bacon Cont]

169. It is merely the case that the organisation which is administering any tax credits is also the body which pays child benefit.

(Sir Nicholas Montagu) That seems to be the emphasis which Ministers have given in their speeches.

Chairman: Thank you very much, Mr Bacon and thank you Sir Nicholas and your colleagues. Once again your virtuoso performance has made even the Inland Revenue's Appropriation Accounts 2000–01 interesting.

(Sir Nicholas Montagu) They are a riot every year.

Chairman: Thank you very much. Order, order.

APPENDIX 1

Supplementary memorandum submitted by the Inland Revenue

Question 119: Could you give us a note about the structure of this compliance unit and how many people work on employer compliance and how many work on compliance by individuals?

STRUCTURE

The Department's Employer Compliance activity is structured around two customer groups:

- Very large employers are the responsibility of the Large Business Office Employer Compliance teams, based in 12 locations across the UK. These teams carry out compliance reviews of those employers with more than 1,000 employees and/or those with geographically dispersed locations.
- All other employers are the responsibility of 70 geographically based Area Employer Compliance Units spread throughout the UK.

	<i>Area Units</i>		<i>Large Business Office Teams</i>	
	<i>2000–01</i>	<i>2001–02</i>	<i>2000–01</i>	<i>2001–02</i>
Staff in post	2,650*	2,650	233	230
Reviews	29,707	39,166	282	297

* Estimated average: 2000–01 was the year in which Employer Compliance was restructured and this resulted in some staff fluctuation.

As part of the restructuring of Employer Compliance following the merger with Contributions Agency, specialist Employer Compliance Investigation posts were created in the Area Employer Compliance Units. These posts were created to reflect the fact that some Employer Compliance reviews involve substantial, time-consuming investigative work beyond that normally undertaken. One of the areas identified specifically as likely to be within the scope of these staff was collusive employers. Presently there are approximately 195 staff deployed to this specialist work.

REVIEWS

Employer Compliance staff are responsible for ensuring that employers are complying with their statutory obligations regarding, tax, NICs, Tax Credits, Statutory Payments and Student Loans. The Employer Compliance review achieves this in a number of ways by:

- undertaking a number of standard, mandatory checks designed to test the veracity of the employer's records (which are extended should any reveal anything untoward);
- scrutinising the employer's records to identify entries/anomalies requiring investigation/explanation;
- reviewing more widely the context of the employer's business and its records, including where appropriate discussion with the employer and employees;
- having full regard to all relevant information available; and
- scrutinising in-depth those aspects identified as areas of risk during the risk assessment.

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MANDATORY CHECKS INCLUDE CHECKS ON TAX CREDITS

Employer fraud and collusive employers are not confined to Tax Credits. If fraud is present in Tax Credits it is quite likely to be present in other areas as well. The Employer Compliance review enables anomalies that may be indicative of fraud/collusion to be identified and investigated.

RISK ASSESSMENT

Cases for review are selected in two ways. A small but statistically valid sample (around 4 per cent) is selected at random. The remainder are selected following risk analysis performed at both national and local level. Where an employer has been authorised to pay Tax Credits this will be a feature of the risk analysis. The degree of risk presented by a particular employer will have regard to all factors relating to the employer and the weighting given to Tax Credits will vary from case to case.

INDIVIDUALS

The Inland Revenue tackles non-compliance by individual applicants through central units within the Tax Credit Offices in Preston and Northern Ireland, called the Compliance Co-ordination Units and through around 30 teams of investigators in local offices across the UK.

The Compliance Co-ordination Units are staffed by about 240 people, most of whom carry out risk analysis and support functions, such as preparing information packages for investigators and calculating revised awards where non compliance has been found. About 25 people in these units carry out enquiries where face to face contact is not necessary.

The 30 local office teams have in total 260 investigators. They carry out enquiries where face to face contact with the applicant is necessary, for example where it appears that the applicant has not disclosed the existence of a partner or where a self-employed applicant appears to have understated their income.

*Inland Revenue**June 2002*

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