



House of Commons
Public Accounts Committee

HM Revenue and Customs: Tax Credits and Income Tax

Fourteenth Report of
Session 2008–09

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

*Ordered by the House of Commons
to be printed 2 March 2009*

HC 311
[Incorporating HC 1085–i, Session 2007–08]
Published on 24 March 2009
by authority of the House of Commons
London: The Stationery Office Limited
£0.00

The Public Accounts Committee

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Summary

HM Revenue & Customs (the Department) has paid £85 billion in tax credits since the scheme was introduced in 2003. Every year, the Department uses provisional data to decide the level of tax credits to pay to claimants. It makes a final assessment after the end of the year based on the claimant's actual circumstances. The final assessments often differ from the initial awards. The Department overpaid £7.3 billion in the first four years of the scheme and underpaid more than £2.0 billion. By the end of March 2008, it had collected £2.7 billion (37%) of this debt and written off £1 billion (14%). £3.6 billion of the total of overpayments are outstanding and the Department is unlikely to recover £1.8 billion.

Policy changes announced in the 2005 Pre-Budget Report have helped the Department to reduce recoverable overpayments from £1.9 billion to £1 billion annually. Nevertheless, overpayments continue to affect many people, including some of the most vulnerable in society. Many hundreds of thousands of people are constantly worried about incurring overpayments.

The Department has not given claimants the support they need in making claims and reporting changes in circumstances, and it has assumed too much on the part of claimants in their understanding the tax credits system. The Department is now doing more to target those with more complex circumstances and to provide them with more tailored support. It is introducing these changes progressively up to April 2009, as part of the Tax Credits Transformation Programme.

Tax credits continue to suffer from high rates of error and fraud. The Department estimates that in 2006–07 claimant error and fraud led to incorrect payments of between £1.31 billion and £1.54 billion (7.2% to 8.4% of the final value of awards). This led the Comptroller and Auditor General to qualify his opinion on the HMRC Trust Statement for the sixth consecutive year. In July 2008, the Department set a target to reduce claimant error and fraud to not more than 5% of the value of finalised awards by 2011.

In 2007–08, the Department collected £225 billion in income tax and national insurance contributions through the Pay As You Earn (PAYE) system. The Department has deferred until Spring 2009 the planned transfer of the administration of PAYE to its National Insurance Recording System. This decision will add to the backlog of tax cases that the Department must check manually. In March 2008, the backlog stood at over 16 million cases. Delays in clearing these cases may mean that taxpayers are unaware of an outstanding query against their tax record, which may give rise to an additional demand for tax or a refund.

In 2007–08, the Department collected £30.2 billion (net) through the Self Assessment system. A total of 46% of Self Assessment returns were filed online, significantly exceeding the 35% target. The Department's latest estimate, based on the 2002–03 tax year, indicates that 34% of filed returns were inaccurate, putting between £2.9 billion to £3.7 billion tax at

risk.

On the basis of a report by the Comptroller and Auditor General,¹ the Committee examined HM Revenue and Customs on its administration of Tax Credits, including the level of overpayments, its service to claimants, and claimant error and fraud. The Committee also examined the Department on its collection of Income Tax through PAYE and Self Assessment.

¹ C&AG's Report, *HM Revenue and Customs 2007–08 Accounts: Tax Credits Part Two and Part Three: Follow-up on the collection of Income Tax*, HC (Session 2007–08) 674

Conclusions and recommendations

1. **Overpayments of tax credits continue to affect too many people—1.3 million families in 2006–07—including some of the most vulnerable in society. Many hundreds of thousands of other people worry that they will be overpaid and find themselves in debt.** The Department has reduced annual overpayments to be recovered from £1.9 billion to £1 billion following policy changes in the 2005 Pre Budget Report. This level of overpayment is still higher than was originally envisaged when the scheme was introduced.
2. **The Department has made less progress in tackling underpayments to claimants.** In 2006–07, underpayments totalled £525 million and affected some 800,000 families, only marginally below the levels in previous years. To ensure that more claimants receive their entitlement to tax credits when they need them, the Department should analyse the reasons for underpayment and identify ways to reduce them.
3. **The Department considers that the root cause of problems with tax credits is the obligation placed on claimants to report changes in circumstances as they occur, but these procedures are complex and create difficulties for many claimants.** The Department has not helped claimants sufficiently to understand their obligations and has been slow to change its processes. By April 2009, the Department plans to introduce new measures to support claimants. To assess whether these measures have improved claimants' experience of tax credits and reduced over and underpayments, the Department should evaluate their effectiveness at the end of 2009–10.
4. **At the end of March 2008 the Department was seeking to recover £4.3 billion of tax credit overpayments. Claimants have disputed £900 million of these overpayments, while the recovery of a further £1.8 billion is considered doubtful by the Department.** To avoid hardship, the Department allows some people more time to pay. The Department needs to understand better the circumstances of people who are overpaid if it is to improve customer support and to clear the backlog of debt. The Department should also give more training to its staff to ensure that all repayment cases are handled correctly and sensitively, based on accurate information.
5. **In 2005–06, 82% of families entitled to receive child tax credits and only 61% of those entitled to receive working tax credits actually claimed them.** The Department should establish the reasons why people fail to claim tax credits and develop more effective methods for reaching these people. It should also establish targets for the take-up of both child and working tax credits, and establish clear action plans for increasing take-up in those claimant groups and regions where take-up is lower.

6. **The Department plans to reduce claimant error and fraud to not more than 5% of the value of finalised awards by 2011.** It is strengthening its measures for deterrence and prevention through better risk profiling, improving the deployment of compliance resources and making better use of other data to allow it to corroborate information from claimants. In 2007–08, the Department's compliance teams identified or prevented £337 million of incorrect payments from their checks on 157,000 of the highest risk claims, less than 3% of the claimant population. In the light of the levels of error and fraud currently being detected by its compliance teams, the Department should reassess the number of checks performed on high risk claims and consider whether they should be increased.
7. **The Department's current definition of fraud risks overstating the level of genuine error and understating those cases where claimants are setting out to exploit the scheme.** The Department classifies cases as fraud only where it has evidence that the claimant deliberately set out to misrepresent their circumstances, and estimates that these amount to 10% of the losses due to error and fraud. The Department's response to fraud should take full account of those groups who set out to exploit the scheme even though it may not have clear evidence of an intention to defraud.
8. **The Department has deferred its plan to move the administration of Pay As You Earn onto its National Insurance Recording System because it significantly underestimated the volume of processing required.** The Department must be satisfied that the new system will work, but the deferral of the plan will delay the benefits of the transfer. To avoid similar delays in the future, the Department should identify the reasons why the volume of processing on this transfer was not established during project planning so that the necessary lessons can be learned.
9. **At the end of March 2008 there were 16.2 million PAYE cases awaiting clerical checking.** Many taxpayers will be unaware of outstanding queries against their tax record and the possibility of either additional demands for tax or refunds. The backlog of cases will get worse due to the delayed transfer of processing to the National Insurance Recording System. The Department should establish a strategy and a timetable to deal with, and eliminate, this backlog.
10. **The Department's latest estimate that 34% of 2002–03 Self Assessment returns were inaccurate, placing £2.9 billion to £3.7 billion of tax at risk, fails to give an up to date view of the Department's success in targeting and dealing with high risk cases.** To assess the effectiveness of its compliance work on Self Assessment returns, the Department should seek to produce estimates of tax at risk more quickly. To achieve this, it should expedite compliance enquiries as promptly as possible. It should also investigate whether a provisional estimate of inaccuracy, based on the results of completed enquiries and a projection of non-compliance from ongoing enquiries, could provide a useful indicator of taxpayer compliance.

1 Overpayments of tax credits

1. In April 2003, Child Tax Credit and Working Tax Credit (tax credits) were introduced as part of the Government's reforms of the tax and benefits system. Tax credits are designed to help families with children and working people on low incomes. HM Revenue and Customs (the Department) paid some £85 billion of tax credits in the first five years of the scheme. The Department estimates that 5.7 million families benefited in 2006–07, receiving an average award of some £3,500.² In 2007–08, the Department employed 9,200 staff in managing the scheme, at a cost of £581 million.³

2. Tax credits are awarded on an annual basis. The Department makes a provisional award based on information it holds on the claimant's income and circumstances. It can adjust the award if claimants report a change in circumstances during the year. After the year end, the Department asks claimants to confirm their circumstances to allow it to calculate their actual entitlement. Differences between the provisional award and actual entitlement give rise to overpayments or underpayments. The Department seeks to recover overpayments and pay any underpayment.⁴

3. Over the first four years of the scheme, overpayments have been substantial, and the obligation to repay them has caused claimants great anxiety.⁵ The 2005 Pre-Budget Report announced changes designed to provide greater certainty to claimants, particularly if they have a rise in income. The measures included raising the disregard of an increase in income from £2,500 to £25,000 when finalising awards for 2006–07 and subsequent years.⁶ The 2005 measures, together with administrative improvements, reduced overpayments from £1.9 billion in 2005–06 to £1 billion in 2006–07 (**Figure 1**).⁷

4. While the overall level of overpayments has fallen year by year, the number of families affected by them is still significant and greater than originally envisaged. In 2006–07 1.3 million families were affected by overpayments and will have to repay the Department on average £770 for the year. At a previous hearing, the Department told us that when the scheme was introduced it expected around one million awards to be reassessed as a result of income rises in the first year of the scheme, and around 750,000 in subsequent years.⁸

2 Q 53; C&AG's Report, Figure 1

3 Qq 88, 90

4 C&AG's Report, paras 2.5, 2.6

5 Q 10

6 C&AG's Report, para 2.30

7 Qq 12–13

8 Committee of Public Accounts, Eighth Report of Session 2007–08, *Tax Credits and PAYE*, HC 300, para 14

Figure 1: Overpayments and Underpayments from 2003–04 to 2006–07

	2003–04	2004–05	2005–06	2006–07
Total families benefiting from tax credits	4.6m	5.0m	5.3m	5.5m
Families affected by overpayments	1.9m	2.0m	1.9m	1.3m
Total overpayments*	£2.3bn	£2.1bn	£1.9bn	£1.0*
Families affected by underpayments	0.7m	0.9m	0.9m	0.8m
Underpayments	£464m	£556m	£ 549m	£525m

Source: HM Revenue & Customs⁹

*Total overpayments for the three years to 2005–06 include subsequent changes to entitlement identified in finalised awards through the Department's compliance activity.

5. The Department has made less progress in tackling underpayments. **Figure 1** shows that in 2006–07, 800,000 (14.5%) of the 5.5 million families receiving tax credits did not receive their full entitlement during the year. The Department has now paid the £525 million due to these families following finalisation, an average of £660 per family.

6. In the first four years of the scheme, the Department overpaid £7.3 billion (**Figure 2**). By 31 March 2008, £2.7 billion of this has been recovered, either from ongoing tax credit payments or through cash recoveries. A further £1 billion, mainly relating to official error, has been written-off.¹⁰ After including a further £700 million of overpayments relating to change of circumstances on 2007–08 awards, the Department had £4.3 billion to recover.¹¹

Figure 2: Recovery and write-off overpayments from 2003–04 to 2006–07

	2003–04	2004–05	2005–06	2006–07	Total
Total overpayments	£2.3bn	£2.1bn	£1.9bn	£1.0*	£7.3bn
Amounts written off by 5 April 2008	(£0.4bn)	(£0.3bn)	(£0.2bn)	(£0.1bn)	(£1.0bn)
Amounts recovered by 5 April 2008	(£1.3bn)	(£0.8bn)	(£0.6bn)	(£0.1bn)	(£2.7bn)
Debt outstanding at 5 April 2007	£0.7bn	£1.0bn	£1.1bn	£0.8bn	£3.6bn

Source HM Revenue & Customs¹²

Figures may not sum due to rounding

7. To prevent hardship, the Department restricts recoveries made against the payment of future awards, and complete recovery of overpayments may take several years.¹³ A significant proportion of these overpayments will never be repaid. The Department

9 C&AG's Report, Figure 9

10 Qq 69, 112

11 Q 7; HM Revenue & Customs 2007–08 Accounts, Trust Statement, Note 3.2, page 99

12 C&AG's Report, Figure 11

13 Q 78; C&AG's Report, para 2.33

currently considers the recovery of £1.8 billion to be unlikely, and a further £900 million of overpayments are being disputed by claimants.¹⁴ In 2007–08, 241,000 households disputed the recovery of overpayments, but fewer than 3% of cases resulted in write-off (**Figure 3**).¹⁵ Complaints have fallen in recent years, but claimants dispute almost one in five of overpayment cases.

Figure 3: Disputed Overpayments

	2004–05	2005–06	2006–07	2007–08
Disputes received (000s)	217	364	371	241
Number of overpayments written off following the dispute (000s)	10.3	160.7	9.9	6.8

Source HM Revenue & Customs¹⁶

8. The Committee has previously recommended that the Department should introduce a more objective test to determine what overpayments should be recovered.¹⁷ In January 2008, the Department published a new Code of Practice for recovering overpayments involving official error. The Department no longer considers whether it was reasonable for the claimant to have believed the award was correct. Instead claimants must check information that the Department is working with, based on what it has been told.¹⁸

9. The Department must take reasonable steps to recover overpayments, but it must be sensitive in the way it acts.¹⁹ In too many cases, the Department has not taken account of individual circumstances and has blamed claimants for not noticing something which they were unlikely to be able to do.²⁰ There have also been too many cases where the Department continued to recover overpayments where it could not support its case with the necessary evidence such as the initial application form, the award notice or related correspondence.²¹

10. The Department has exceeded its powers under the 2002 Tax Credits Act by adjusting some final awards when it is not entitled to do so.²² In some cases it had enquired into awards without informing the claimant, even though the Act requires it to write to the claimant. In other cases, it had recovered overpayments arising from official error when the Act allows such adjustments only if they are in the claimants favour. The Department is reviewing some 250,000 awards to identify and amend the incorrect adjustments. The Departments estimates that it owes an average repayment of between £800 and £1,000 to some 20,000 claimants.

14 Qq 9, 69

15 Q 84

16 C&AG's Report, Figure 12

17 Committee of Public Accounts, *Tax Credits and PAYE*

18 Q 25

19 Qq 32, 88

20 Q 88

21 Qq 24, 30, 33, 102

22 Q 15

11. The problem of incorrectly amended finalised awards arose because the tax credits computer system did not include a warning to prevent staff taking such actions,²³ and the Department failed to check its process adequately.²⁴ The Department also found that aspects of its guidance issued to staff were incorrect, and staff did not understand the statutory limitations on their ability to make enquiries and amend awards. It has since corrected the guidance and is now examining its wider tax credits guidance to ensure it complies with the legislation.²⁵

23 Qq 15, 38, 41, 151

24 Qq 36, 147

25 Qq 42, 153

2 Service to Claimants: The Tax Credits Transformation Programme

12. The design of the tax credits system is complex, leading to problems for claimants.²⁶ The Department believes that the obligation placed on claimants to report changes in circumstances as they occur is the main reason why tax credits are difficult to administer.²⁷ For example, claimants faced with household breakdown are unlikely to give their highest priority to contacting the Department about tax credits.²⁸ At the time it was developing the tax credits system, the Department failed to appreciate the variety and frequency of changes in claimants' circumstances that would occur in practice.²⁹

13. The Department has not supported claimants adequately when they are making claims and reporting changes in circumstances.³⁰ Too many claimants have had to cope with the anguish and irritation of trying to get reliable information out of the system.³¹ For example, claimants have had to cope with contradictory letters from the Department, and find that staff providing the phone service do not have the necessary information to deal with their enquiry.³²

14. In May 2008, the Department and the Treasury issued a discussion document setting out proposals for:

- reducing the scope for error by tailoring support more closely to claimants' needs and making it easier for them to claim, receive and renew tax credits;
- giving claimants greater certainty and more control over how they manage their tax credits affairs, while continuing to support those whose income falls or whose circumstances change, and
- improving financial support for childcare through tax credits and simplifying the system for claimants.³³

15. As part of its Tax Credits Transformation Programme, the Department is doing more to identify and understand those claimant groups with more complex circumstances who have a history of getting their claims wrong.³⁴ The Department aims to provide more targeted help to these groups by providing more assistance when they make a claim, report

26 Qq 12, 33

27 Qq 54–55, 101, 136

28 Qq 33, 54

29 Q 101

30 C&AG's Report, para 2.7

31 Qq 23, 33

32 Qq 26, 27, 30, 124

33 Qq 104, 136; HM Treasury and HM Revenue & Customs, *Tax Credits: improving delivery and choice*, May 2008

34 Q 33

changes in their circumstances or renew their claim.³⁵ The Department is contacting people it has not heard from for a while to check whether there have been changes in their circumstances that the Department needs to know about. It is also improving the documentation it sends to the different categories of claimants.³⁶ These changes, to be introduced progressively up to April 2009, also involve providing training in new skills for operators in the Department's contact centres.³⁷

16. Some claimants have found dealing with the Department sufficiently difficult not to claim the tax credits to which they are entitled.³⁸ The Department estimates that in 2005–06 only 82% of families entitled to receive child tax credits, and 61% of those entitled to receive working tax credits actually claimed them (**Figure 4**). The Department believes that take-up is very high for people on low incomes or with families. Take-up levels are lower for other groups, such as people without children and people living in certain parts of the country, particularly London.³⁹ The Department estimates that only 64% of families in London who were entitled to working tax credits claimed them in 2005–06. It also estimates that the highest levels of take-up were in Yorkshire and Humberside, where 86% of families entitled to working tax credits claimed them.⁴⁰

Figure 4: Child and Working Tax Credit Take up (based on 2005–06 awards)

	Estimated Possible Recipients	Actual Recipients	Estimated non-recipients	Estimated Take-up rate (and range estimate)
Child Tax Credit	6.9m	5.7m	1.2m	82% (80 to 84%)
Working Tax Credit	2.9m	1.8m	1.1m	61% (59 to 63%)

Source: HM Revenue & Customs⁴¹

35 Q 13

36 Qq 12–13

37 Q 35

38 Q 124

39 Q 121

40 HM Revenue & Customs, *Child Tax Credit and Working Tax Credit Take-up rates 2005–06*

41 HM Revenue & Customs, *Child Tax Credit and Working Tax Credit Take-up rates 2005–06*

3 Claimant Error and Fraud

17. Tax credits are vulnerable to fraud where claimants deliberately misstate their income or their circumstances. Claimants may also make genuine errors in their applications which result in incorrect awards.

18. Since the tax credits system was introduced in April 2003 it has suffered from high levels of error and fraud. The Department's most recent estimate of claimant error and fraud shows that in 2006–07 between £1.31 billion and £1.54 billion (7.2% to 8.4% of the final value of awards) was incorrectly paid to claimants.⁴² This led the Comptroller and Auditor General to qualify his opinion on the regularity of tax credit expenditure in HMRC's Trust Statement for the sixth consecutive year.

19. In response to the Committee's previous recommendations, the Department has:

- set a target for reducing claimant error and fraud, and
- produced its error and fraud estimates more quickly.⁴³

The Department aims to reduce error and fraud to not more than 5% of the value of finalised awards by 2011.⁴⁴ Thereafter, it considers that within the existing policy it is possible to achieve an underlying level of error and fraud of somewhere between 2% and 5%.⁴⁵ The Department published its fraud and error estimates for 2006–07 during the summer of 2008, almost a year earlier than for previous financial years.⁴⁶

20. The Department aims to address the causes of error and fraud in different claimant groups and to ensure it has robust measures to tackle deliberate non-compliance. It considers that initiatives under the Transformation Programme (paragraph 16) will improve the education and support for claimants who want to get their claims right, thereby reducing genuine error.⁴⁷ The Department is also strengthening its deterrence and prevention measures by:

- enhancing its risk profiling to improve its targeting of high risk cases and claimant groups;
- improving the way it uses its compliance resources in order to examine high risk cases, and

42 C&AG's Report, para 2.10

43 Committee of Public Accounts, Twenty-second Report of Session 2006–07, *Tax Credits*, HC 487, paras 3–4

44 Q3; C&AG's Report, para 2.26

45 Q 114

46 C&AG's Report, para 2.12

47 Q 3

- making better use of data from other sources to allow the corroboration of information which claimants provide.⁴⁸

21. The Department believes that fraud is responsible for around 10% of the overall loss and that 90% stems from claimants making genuine errors.⁴⁹ There is a risk that this estimate may understate the actual level of fraud. The Department classifies cases as fraud only if it has evidence that claimants deliberately set out to misrepresent their circumstances.⁵⁰ However, the absence of such evidence, does not necessarily mean the claimant made a genuine error.

22. The Department employs 1,430 people on tax credit compliance work.⁵¹ In 2007–08, its teams carried out over 157,000 pre-payment and post-payment checks on the highest risk claims. These identified £187 million of incorrect payments already made, and prevented incorrect payments of £150 million.⁵² The yield in these cases averaged some £235,000 for each member of the compliance team and over £2,000 for each case investigated.⁵³ The Department has considered putting more resources into tax credit compliance but it has to strike a balance between what they would save and protecting the wider tax system.⁵⁴ It is working to improve the productivity of its compliance teams through the use of risk based techniques, and has increase the case success rate of some of its teams from 50% to 80%.⁵⁵

48 C&AG's Report, para 2.26

49 Q 3

50 Q 108; HM Revenue & Customs Report, *Child and Working Tax Credits: Error and Fraud Statistics 2005–06 and 2006–07*, 2008

51 Q 139

52 Q 6

53 Q 136

54 Qq 6–7, 139

55 Q 144

4 Collecting Income Tax through PAYE and Self Assessment

23. In 2007–08, the Department collected £127 billion in income tax and £98 billion in National Insurance Contributions through the Pay As You Earn (PAYE) system. It collected a further £30.2 billion (net) through the Self Assessment system.

24. The Department's computer systems for administering PAYE were introduced in the 1980s.⁵⁶ Its designers assumed that the majority of people would continue in single employment with the same employer. An increasing proportion of the working population, however, now change jobs more frequently than in the past and often have more than one job.⁵⁷ As the PAYE system is organised around employers rather than employees, it can be more difficult for the Department to ensure that it has a complete view of the income of those individuals with more than one job and to ensure that they are paying the correct amount of tax.

25. The Department plans to move the administration of PAYE to its National Insurance Recording System. This will allow all information on individuals to be brought alongside their national insurance record and provide the Department with a more complete view of their income. The transfer of processing to the new system is now planned for Spring 2009, having been twice postponed. The Department's initial assumptions significantly underestimated the capacity needed to cope with the likely volume of processing. The delay is regrettable, but the Department must be absolutely sure the new system is working correctly before it is introduced.⁵⁸

26. At the end of the tax year the Department's computer system checks whether annual return of pay and tax deductions and other information submitted by employers is consistent with its own records.⁵⁹ The Department creates an 'open case' where its checking raises doubts about whether the right amount of tax has been paid or there are other difficulties matching information to a taxpayer's record. These cases have to be examined clerically. At the end of March 2008, the Department had 16.2 million open cases, against its original target of 10.5 million.⁶⁰ Delays in clearing these cases may mean that taxpayers are unaware of an outstanding query against their tax record, which may give rise to an additional demand for tax or a refund. The Department's decision to defer the transfer of processing to its National Insurance Recording System will increase further the level of open cases and it is working to see how to mitigate this.⁶¹

56 C&AG's Report, para 3.6–3.8

57 Q 116

58 Q 16

59 C&AG's Report, para 3.9

60 C&AG's Report, para 3.10

61 Q 17

27. In 2007–08, 46% of Self Assessment returns were filed online, significantly exceeding the Department’s target of 35%.⁶² In the period since 6 April 2008 the number of returns filed electronically was 28% more than the same period last year.⁶³

28. In 2007–08, 88.6% of returns were filed by the 31 January deadline, well below the Department’s target of 93%. For 2008–09, the Department has brought forward the deadline for those who file paper returns from 31 January to 31 October. The Department has received fewer paper returns than in previous years, but it does not know what proportion of those who have not filed by the end of October will submit electronic returns.⁶⁴

29. The Department’s latest estimates, based on the 2002–03 tax year, indicate that 34% of filed returns were inaccurate, putting between £2.9 billion to £3.7 billion tax at risk. A small group of taxpayers account for the majority of the tax at risk, and the Department targets these groups accordingly.⁶⁵ The Department’s latest online version of the self-assessment return enables to do some of this risk analysis in real time.⁶⁶

62 C&AG’s Report, para 3.26

63 Q 18

64 Q 18

65 Q 57–58

66 Q 57

Formal Minutes

Monday 2 March 2009

Members present:

Mr Edward Leigh, in the Chair

Mr Richard Bacon	Rt Hon Keith Hill
Mr Paul Burstow	Mr Austin Mitchell
Rt Hon David Curry	Geraldine Smith
Mr Ian Davidson	Rt Hon Alan Williams
Mr Nigel Griffiths	

Draft Report (*HM Revenue and Customs: Tax Credits and Income Tax*), proposed by the Chairman, brought up and read.

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

Paragraphs 1 to 29 read and agreed to.

Summary read and agreed to.

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

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

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

[Adjourned till Wednesday 4 March at 3.30 pm]

Witnesses

Wednesday 8 October 2008

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Mr Mike Clasper CBE, Chairman, **Mr Dave Hartnett CB**, Acting Chief Executive Officer and **Ms Sarah Walker**, Director of Benefits and Credits, HM Revenue and Customs

Ev 1

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Fourteenth Report	HM Revenue and Customs: Tax Credits and Income Tax	HC 311

Oral evidence

Taken before the Committee of Public Accounts

on Wednesday 8 October 2008

Members present

Mr Edward Leigh, in the Chair

Angela Browning
Mr Paul Burstow
Mr David Curry
Mr Ian Davidson
Nigel Griffiths
Mr Austin Mitchell

Dr John Pugh
Geraldine Smith
Mr Don Touhig
Mr Alan Williams
Phil Wilson

Mr Tim Burr, Comptroller and Auditor General, **Ms Caroline Mawhood**, Assistant Auditor General and **Mr John Thorpe**, Director, National Audit Office, were in attendance.

Ms Paula Diggle, Treasury Officer of Accounts, HM Treasury, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

HM REVENUE AND CUSTOMS STANDARD REPORT (HC626)

Witnesses: **Mr Mike Clasper CBE**, Chairman, **Mr Dave Hartnett CB**, Acting Chief Executive Officer, and **Ms Sarah Walker**, Director of Benefits and Credits, HM Revenue and Customs, gave evidence.

Q1 Chairman: Good afternoon and welcome back to the Committee of Public Accounts. Today we are considering Part Two and Part Three of the Comptroller and Auditor General's 2007–08 Report on the accounts of HM Revenue and Customs, and we are looking at recent developments in tax credits and income tax. We welcome back to our Committee Dave Hartnett, who is the Acting Chief Executive Officer and interim Principal Accounting Officer of HMRC, and he is accompanied by Mike Clasper, who joined HMRC on 1 August 2008 as the non-executive Chairman, and Sarah Walker, who is the Director of Benefits and Credits. Mr Hartnett, presumably, as you are the Accounting Officer, should I start by addressing most of my questions to you?

Mr Hartnett: I think the questions on the Standard Report will fall to me, but inevitably, Chairman, with a new Chairman in HMRC—

Q2 Chairman: Well, it is up to you. You take the questions as you like. Actually, Mr Clasper, perhaps I could just ask you, to start off the proceedings, how you envisage your new role because this is a new development, having a non-executive Chairman, so what do you see your role as?

Mr Clasper: I am happy to answer that, Chairman. I come along obviously not as the Principal Accounting Officer, but I thought it would be useful for the Committee that I did come along. I see the role really as being threefold: firstly, to help the Department develop its long-term strategy, objectives and vision through the auspices of the Board that we are in the process of creating; secondly, to hold the Executive to account for the

performance against that strategic plan; and then, thirdly, to ensure that the standards of corporate governance across the whole of HMRC are to the highest levels. Perhaps later I can expand on exactly what I mean by the last one because we are in the process of setting up some sub-committees with specific targeted areas around those issues of governance.

Q3 Chairman: Thank you for that. So, gentlemen, fraud and error is currently estimated at running between 7.2 and 8.4%. What realistic chance have you of meeting your target 5%?

Mr Hartnett: The target is 5% by 2011, Chairman, we are absolutely determined to meet it. There are a number of things we are doing, and I will ask Sarah in a minute to expand on the detail, but we are improving our guidance, we are improving our detection, and I think it is probably important for me to say that, at a best estimate, we think that fraud is around 10% and most is error and, through our transformation programme in tax credits and in other ways, we are seeing the error rate and the fraud rate fall and we do think we will get there, but we need to do better as well.

Q4 Chairman: So you will get there?

Mr Hartnett: I believe so.

Q5 Chairman: When?

Mr Hartnett: 2011 is our target.

Q6 Chairman: So you will meet that target in 2011 of 5%. Thank you for that. Now, Mr Hartnett, last year you awarded 5.7 million tax credit awards; a lot. You only checked 157,000 of them and, from that, you identified £337,000 of incorrect payments.

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That is, on average, £2,000 for each one you checked, so the obvious question is: why do you not switch more resources from tax collection into checking tax credits as you seem to get so much money back from the ones you check?

Mr Hartnett: I think it is important for me to say first, Chairman, that the 167,000 or whatever the number was—

Q7 Chairman: The 157,000 that you checked.

Mr Hartnett:—it is a distillation from a bigger population and they are what we believe are the high-risk cases, and it is no surprise at all that, having identified them as high-risk cases, we should make more money from them. We thought very hard about whether to put more resource into tax credit compliance, but there are two reasons which militate against it. The first is this: that we have got to cover compliance across the whole piece of the tax system and history shows that, where we significantly reduce our compliance effort in an area, those who want to be non-compliant and are determined to be non-compliant will immediately become non-compliant in those areas, so we have got to protect the whole system. The second is that in many other areas we have significantly improved our performance. For example, with small business, when I was last here, over the last few years we have gone from a return of about £1.80 in some circumstances for £1 spent to over £10 for £1 spent, so it is a question of balancing the books.

Q8 Chairman: So the answer to my question is no then, is it, that you are not going to switch resources from tax collection?

Mr Hartnett: Not at this moment.

Q9 Chairman: Fair enough. Is it realistic to think that you are going to collect the remaining £4.3 billion outstanding debt?

Mr Hartnett: Can I start with the gross figure and come down to the 4.3 so that I can explain what we are doing. The £7.3 billion of debt, to which there is an adjustment which needs to be made, which, if you will forgive me, is quite technical and I can use time to explain it, but that £700 million gets me to £8 billion. We have collected already about 2.6 and we have written off £1 billion as uncollectible which gets me to the 4.3. There are three elements in the 4.3. There is £900 million which is subject to dispute, there is £1.8 million which we presently regard as something we need to make a provision against, but which we are still trying to collect, and 1.6 is due to be collected out of ongoing tax credit payments and in other ways. There is some doubt about that residual 1.8, but we are trying to collect it.

Q10 Chairman: Well, as you know, the whole point of tax credits was to relieve poverty and to give people peace of mind, but in fact a lot of people have had sleepless nights over this, as you know.

Mr Hartnett: Absolutely.

Q11 Chairman: So why do you not just tell these people, through this Committee, that you are letting them off this debt and be done with it, given that it is unrealistic that you are ever going to collect it anyway?

Mr Hartnett: Well, we may have to agree to disagree on whether we are going to collect it, but we cannot do that at the moment because it is not clear that it is impossible to collect and it would not be fair to the many other people from whom we have recovered debt and other people in the tax credit system to simply write this off.

Q12 Chairman: All right, a fair answer. Now, obviously this is a very complex system and we know that claimants do not fully understand it. It is not their fault or their obligation, but there has been a lot of confusion about this. Why do you not give more priority to explaining the system to them?

Mr Hartnett: Well, we are. We have improved our guidance. When our people talk to claimants who have got difficult questions or when they phone in a change of circumstances and the like, we ask them proactively questions about other aspects of their claim. Where we know that people have a history of not getting it right, we proactively now contact them and I think we can see that this is working as a strategy because the amount of overpayments have come down over the last two years, and Sarah will correct me if I get this wrong, from something like 1.7 billion in 2005–06 to a billion in 2006–07.

Q13 Chairman: Do you want to comment further on that?

Ms Walker: Yes. I think part of the reason for the reduction in overpayments in 2006–07 is of course the introduction of the policy changes that were announced in the 2005 PBR, but a lot of that is due to service improvements. For example, what we are planning to do is pick up a lot of the people when they make their first claim and, where it looks like a complex case, we are proactively phoning them so that we can be on the phone with them while they are filling in the form and answer their questions at that point. We are also contacting people we have not heard from for a while to check whether there are any changes that we have not heard about. We are improving the documentation that we are sending out to them and we are doing a lot of trying to understand the different types of customer, the different categories of customer who find things difficult and give them tailored help.

Q14 Chairman: Now, Mr Hartnett, your Department specialises in compliance, does it not?

Mr Hartnett: Indeed it does.

Q15 Chairman: Why then do we read in paragraph 2.39 of this Report from the Comptroller that, “The 2002 Tax Credits Act gives the Department certain powers to adjust awards after finalisation. In 2007 the Department found that it had made

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adjustments to some finalised awards beyond the circumstances provided for in legislation”. If you cannot follow legislation, why should the ordinary punter do so?

Mr Hartnett: It is a matter of enormous regret, Chairman, that we did not get that right. No one is going to lose out from it, no one’s award is going to be reduced, and we will be giving money back to some people. What happened, in a nutshell, is that the guidance for our people was taken from the design of the system rather than the legislation and, as I say, that is to be regretted. Fortunately, that sort of error has only happened once or twice in the past, but it does happen. I wish we had not done that.

Q16 Chairman: All right, that is an apology, fair enough. Now, you wrote to me in July, saying you had deferred the latest PAYE computer system. Now, why has there been such difficulty around this project, which is obviously vital?

Mr Clasper: On this one, I got involved in reviewing some of the details. I think it was so important that this project started up properly and that we had no problems at the beginning that we wanted to make absolutely sure that it was fit for purpose on day one and, in order to do that, we needed to defer, particularly because the volume of processing that had been assumed at the beginning of the project had significantly increased and we might, therefore, literally not have the capacity that we needed to handle the necessary processing, so I think it was absolutely the right decision to make sure it works perfectly on day one, but of course it is regrettable in the sense that the sooner we get it, the better we will be able to improve our performance in that area.

Q17 Chairman: Does this deferral, Mr Hartnett, affect the number of open cases you are dealing with?

Mr Hartnett: Yes, it will affect the number of open cases, Chairman, for one year and we are working very hard at the minute to see how we can mitigate any increase in the number of open cases.

Q18 Chairman: Now, this latest deadline for filing your tax return of the 31 October, is this going to work? Do you think taxpayers are going to manage to meet this deadline?

Mr Hartnett: It seems to be working pretty well already. If I can just dig out the most up-to-date numbers, I am sure they are very much at hand, we have seen a pretty significant reduction in the number of paper returns for the period since 6 April to now and the number of electronic filings are up by 28% compared with last year, which I think was up 24% compared with the year before that. We cannot look into a crystal ball and sort out unfortunately, I wish we could, is whether some people are deferring filing because we have issued more returns this year than we did last year because they are going to file electronically later or whether there is a group, and I think it would be a small one, that is saying, “Well, if I can’t file on paper, I’m not going to file”. I hope that is not happening, but we will not know for a while yet.

Q19 Mr Touhig: Mr Clasper, you have got a new role and I hope you do very well in it.

Mr Clasper: Thank you.

Q20 Mr Touhig: Mr Hartnett, when he was Acting Chairman, came to my constituency at my request to meet some of my constituents who had problems with tax credits and was hugely professional. He was very human in his approach and he treated my constituents with respect and with courtesy, and I want to thank him for that.

Mr Hartnett: Thank you, Mr Touhig.

Q21 Mr Touhig: However, the follow-up visit by his staff was less successful. My constituent, a Mrs T, was treated very badly, ended up in tears and, if I had been there, I would have thrown your staff out into the street for their behaviour. Will you investigate that?

Mr Clasper: I will hand over to David who is aware of this.

Mr Hartnett: Mr Touhig, we have exchanged letters, you asked me to investigate and I did. I am obviously troubled by the fact that there are just two different versions of this visit and, in order to make sure that I got nothing wrong or the team got nothing wrong, I did actually ask Sarah and her team, which is a policy team rather than an operational team, to look at this case very carefully, and she reached the same conclusion as everyone else. I regret enormously that there was some upset and there is not much more I can say.

Q22 Mr Touhig: You met Mrs T of course.

Mr Hartnett: I did, and she was delightful.

Q23 Mr Touhig: She was not a lady to be bullied, she was a lady in command of all the detail and yet she went from my office in tears.

Mr Hartnett: I am really sorry.

Q24 Mr Touhig: I think that was a pretty poor performance. Mr Clasper, why do you continue to pursue people for repayment of tax credits when the clear balance of evidence is that it is your fault and not theirs? Why are you wasting taxpayers’ money doing this?

Mr Clasper: I think there is a generic response which says that our role is to be as even-handed as we possibly can be and that, as Dave has already said, it is important that we are fair and then the issue becomes how we manage going after situations where—

Q25 Mr Touhig: It is right, if people have been overpaid and it is a complete failure, that they should repay it, but, when the balance of evidence clearly demonstrates that the failure was yours, you are spending, it seems to me, a large amount of money on continuing to pursue people when you are at fault.

Ms Walker: Perhaps I can help. As you know, I am sure, we changed the rules in our Code of Practice about recovering overpayments in cases where there is an official error. We published the new Code of

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Practice in January. Since then, we no longer expect to decide whether the customer could reasonably have believed that their award was correct and we now have a very objective set of tests to determine whether they actually fulfilled their obligations which are around having checked specific pieces of information that we have played back to them of stuff that they have told us. What we have found since then is that very few cases where we have identified an official error are being refused under the Code of Practice and over 90% of those cases were—

Q26 Mr Touhig: Can you explain the case of Mrs T because her overpayment occurred because your system could not read or scan four words, “Finished 19 Jan 2003”? I have her form here. She completed this form, she was asked to put an “X” in a box if she had received any of the below, she did, “X—received income support” and that finished on 19 January 2003. Now, the Ombudsman who investigated this discovered that your staff lied to me in a letter about this matter and your system—here it is—could not read those four words, your system could not scan it in, and that led to the whole process of this woman being pursued for an overpayment which was your fault, not hers.

Mr Hartnett: Maybe I could come back here because I do not have total recall of the case, but I think there is a really important thing here. The Ombudsman did point out that we could have done some things better, but what the Ombudsman concluded, in a nutshell, is that we were not stopped from seeking this repayment, and I think that is the most difficult issue between us, if I can put it that way.

Q27 Mr Touhig: Yes, but you admitted, Mr Hartnett, that you had blundered. In fact the Ombudsman’s report says, “On 17 September 2004, Mrs T asked the Revenue to reconsider the recovery of their overpayment. On 29 November, she was told this had been refused on the grounds she had failed to declare in the original claim that she had been in receipt of Income Support. This was wrong”, says the Ombudsman. It goes on and on 17 December, in response to an enquiry from me on behalf of Mrs T, the Revenue then changed its position by stating, “Due to technical errors, the income was incorrectly calculated and a nil award was issued”. The letter continues, “We did try several times to amend these details, but again, due to technical failures, this could not be done”, so it is your fault, you admit it, and you still pursued this woman for repayment.

Mr Hartnett: Mr Touhig, can I suggest that I do this? I do not know what more we can do in HMRC because the Ombudsman has looked at this, but I am very happy to go back to Ms Abrahams and just tell her about the discussions you and I have had and to see whether she wants to think about it again.

Q28 Mr Touhig: But why do you not think about it? Do you not think there is some justice here? The error is clearly demonstrated on your part, your system could not read those four words and, therefore, she got an overpayment. The

Ombudsman discovered you had lied to me in a letter, I had been misled and you admitted that you attempted to correct the details, but failed to do so, so it is not her fault, it is your fault, and you still pursue her.

Mr Hartnett: I will come back to you.¹

Q29 Mr Touhig: Well, I hope you will.

Mr Hartnett: I will.

Q30 Mr Touhig: There is another case of a Mr and Mrs P, again an overpayment. The Ombudsman said, “I see that the Tax Credit Office has been singularly unable to back up what they say about Mr and Mrs P’s tax credit application with any documentary evidence. They have been unable to provide a copy of the award notice they sent to Mr and Mrs P, a copy of Mr and Mrs P’s initial application form or the letter they claim to have sent to Mr and Mrs P”. You have no evidence and yet you continue to pursue this couple.

Mr Hartnett: I am not familiar with that one, not the detail, but I will undertake to go and look at it.

Q31 Mr Touhig: These are but two examples to your new Chairman and it seems to me that of course you must pursue if there has been an overpayment and it is the fault of the person receiving the payment if they have not given you the correct information, but, where all the evidence, the balance of evidence shows that it is your fault, in the name of justice, you should stop pursuing these people and stop wasting taxpayers’ money by continuing to pursue them and put an end to this farce.

Mr Hartnett: With enormous respect, Mr Touhig, I want to say this: that the underlying policy, and the Chairman brought me up correctly on the issue of our use of the legislation, the underlying policy is not whose fault it is. Sarah laid out the policy earlier on and we believe that we are right to collect overpayments. The Ombudsman has looked at a lot of cases, the adjudicator has looked at a lot of cases and we have had some very helpful steers. We have looked at the Code of Practice, which covers this, with ministers, it has been changed twice and I think the Code of Practice is now much, much clearer that people are accountable today for checking what they have told us effectively.

Q32 Mr Touhig: But you know that in one case, Mr Hartnett, in particular it was made quite clear that you failed, that your system could not read the four words she had written and that led to the whole thing. Now, what more could this person have done? Now, I accept that it is right and proper, as I say, to pursue if people have failed to take proper account of the paperwork you have sent them and they have been overpaid. Of course they should respond to that, but you seem to be falling back now on a legislative answer when one could wish perhaps, when representatives of Revenue and Customs have been here before and we have been interrogating them about companies that managed to avoid

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corporation tax, that you could have been so diligent with those multi-million pound companies as you were with somebody who does not have two ha'pennies to rub together and who feels they might be sent to prison because they owe you some money.

Mr Hartnett: If you give me the details of Mr and Mrs P, Mr Touhig, I will happily look at that.

Q33 Mr Burstow: I just want to pick up a couple of aspects to the question we have already had, and I think many of the questions that Mr Touhig had we would all like to be going through and getting answers to particular constituency cases, but I think there are too many of them, and certainly I have plenty of constituents of mine who feel the anguish, irritation and anger at trying to get intelligence out of the system. It is in that regard I just want to ask you how come it has taken so long for you to recognise, as you do in this Report, that you have not been providing claimants with sufficient support? Why has it taken so long for you to come to that conclusion and start to do something about it?

Ms Walker: I think it was very early on, and I cannot speak right from the beginning, but certainly it was in 2005 that we started to look at what we call "segmentation", looking at the different types of customers, looking at more proactive support. It was very clear from the early years of the system, where the original design really assumed quite a lot of understanding and quite a lot of work by the customer, if you like, to understand it and to do the right thing at the right time, that that was not appropriate for a section of our customers. What we have been doing since then is taking some advice from people in the private sector and using customer understanding to target customer service much more effectively and we have looked at introducing new services on the basis of that. One of the things that we have recently introduced is a new service for people whose relationships break down, either where husbands and wives split up or where people who have been claiming jointly split up. In those circumstances, a claim will come to an end because that household no longer exists and usually at least one of the partners has to make a new claim and we have put in a new system to make that easier.

Q34 Mr Burstow: But my question was why it took so long to actually identify that the lack of support for claimants was a cause of many of the problems that you were experiencing.

Ms Walker: We have been working on improving support for claimants really all the way through. We have been improving our literature and we have been trying to improve the standard of service in our contact centres, and I think that has improved steadily over the years. What we are doing now is moving into, if you like, a new phase of that with new techniques.

Q35 Mr Burstow: So the implementation programme that you have set out in the Report, I think it is part 12, which will not be fully completed until April 2009, seems to be a very, very lengthy process to get to the sorts of improvements that you

are talking about. Why is it going to take so long before you are really delivering the improved service to claimants that the Report is talking about?

Ms Walker: This is quite a lot of specific changes that we are having to introduce one after the other. A lot of them involve new training for our operators in the contact centres. They are new skills for some of our staff and all of that takes time and we will want to make sure that we have got them right, that we have got the training right and that we have got people properly equipped before we introduce them, but they are starting now, they are coming in progressively between now and next April and they will make a big difference to our customers.

Mr Hartnett: Mr Burstow, can I just add one thing because I would not like you to think that we just guessed at the sort of guidance we started out with in 2003 or anything like that. We have laboratory facilities where we test our guidance, our forms, and I can remember before 2003 visiting it on a number of occasions and looking at people that quite literally we had brought in off the street and paid a small fee to help us test all this material, and very substantially, not entirely, but very substantially people were coping. I think when we got into live running we had a confidence about our guidance which, to an extent, was misplaced and we have learnt as we have gone, but I wish it had not been like that.

Q36 Mr Burstow: That sort of process of testing that you have described, were similar sorts of methodologies applied to the technical manuals that were being used by the Department itself in terms of providing proper compliance advice and implementation of the Government's legislation? As I understand it, you had a manual which was put in in 2004 which was left untouched, despite the fact that it resulted in lots of errors being made, until quite recently.

Mr Hartnett: Not to the same extent and the reason for that is, sadly, it was all hands to the pumps, if I can put it that way, at the early stages of tax credits and we did not do as good a job on that.

Q37 Mr Burstow: So all hands to the pumps meant that the manual was not compliant with the legislation?

Mr Hartnett: No, no, making the tax credit system work. This is a matter of public record, that we had queues of people and we were paying 80/90% in a perfectly proper way, but we had people we were not providing a great service to and we used our people to deal with that.

Q38 Mr Burstow: Is that also the explanation for why the specifications for the computer system themselves were not written in a way that was compliant with the legislation?

Mr Hartnett: No, I think as I said to the Chairman, this Committee knows full well a great deal about the difficulties with the computer system. That was a mistake; I am afraid they happen.

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Ms Walker: It is not true that the working of the computer was not legally compliant. What it did not have was a limit in the system to stop people doing things that—

Q39 Mr Burstow: But you did not warn the staff and so on?

Ms Walker: It did not stop them from doing something that was wrong.

Q40 Mr Burstow: Yes, they could make changes which they were not allowed to.

Ms Walker: Yes, it was not that the computer was doing something itself that was illegal.

Q41 Mr Burstow: So it allowed the interaction with the human being which actually allowed the human being to get it wrong and the system could have safeguarded against that if the specification had been correct?

Ms Walker: Yes.

Q42 Mr Burstow: And that was allowed to lie like that for how long?

Ms Walker: The computer change has not yet been made. What we have got is a manual process, a management process—

Q43 Mr Burstow: The manuals have been updated, so hopefully the staff will read them at the relevant point and know whether or not they should or should not be doing something, so presumably this adds to yet more of the woe that we were hearing from Mr Touhig just now. Can you say who will be responsible and accountable for that particular mistake around specification?

Mr Hartnett: Ultimately, accountability lies with the Accounting Officer, but we have directors, senior managers and others who would also want to bear some accountability.

Q44 Mr Burstow: How does that accountability manifest itself? In what way is that accountability obvious to the public?

Mr Hartnett: Well, that is quite a difficult question. I think where we have manifest errors and mistakes, it can manifest itself in how we reward people, what people's prospects are in the organisation, but, Mr Burstow, the absolutely crucial issue for us is that we learn from our mistakes and move on to do things better.

Q45 Mr Burstow: I am certainly hopeful that learning takes place as part of this, but in any of the cases of the sort we have just been describing was any consideration given to any disciplinary proceedings?

Mr Hartnett: No.

Q46 Mr Burstow: Was anyone actually financially out of pocket in terms of bonuses as a consequence of this?

Mr Hartnett: I would have to look, but certainly my recollection, and I would need to check, is that in tax credits for quite some time senior managers did not get the full bonus which they might otherwise have been provided with.

Q47 Mr Burstow: Perhaps you could let us have a note just to confirm that.²

Mr Hartnett: I will. It will be a fairly anonymous note, but on the basic question.

Q48 Phil Wilson: I think it was 5.5 million families benefited last time round and 5.7 million, it is estimated, for 2007–08. With how many of those families do you think you will have problems with overpayments, underpayments and fraud?

Ms Walker: We are down to the number of families with overpayments in 2006–07 being 1.3 million.

Q49 Phil Wilson: Where you had a problem with overpayment?

Ms Walker: Who had an overpayment. Some of those overpayments will be small and they will be dealt with by adjusting ongoing payments. In a large number of cases, that does not cause a significant problem for the customer and clearly they are getting less money than they would have otherwise, but the number of people who get into serious difficulties is obviously a lot smaller than that.

Q50 Phil Wilson: A lot smaller than that?

Ms Walker: Yes.

Q51 Phil Wilson: What is the average payment you would pay? On tax credit, what is the average payment to families?

Mr Hartnett: Can we answer that in a moment, Mr Wilson?

Q52 Phil Wilson: The question I was going to ask, not knowing what the average payment is, is that where it works successfully, where there is not a problem, what are the benefits to the family in receiving that tax credit? Have you done any research to find out how much people are getting and what are the good things that the tax credit system has actually produced for individual families?

Ms Walker: We have done quite a bit of research. For instance, it has allowed a lot of people to take jobs when they would not have been able to, particularly, if you like, the support for childcare. Lone parents, who otherwise might well not be able to afford to take a job, because we are giving them quite significant amounts of money to support their childcare costs, are getting into jobs. I do not know if we have quantitative evidence, but certainly a lot of the qualitative research that we do and the interviews we do with people show that the vast majority of people getting tax credits are very, very grateful for the amount of money that they get and the difference it makes to their family life.

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Q53 Phil Wilson: So in general it has improved the living standards and the accessibility to the workplace for a lot of these families?

Ms Walker: Absolutely, yes. Work incentives and child poverty reduction are the two big objectives of tax credits and it has been successful in both of those areas.

Mr Hartnett: Mr Wilson, can I just say that Mike Clasper was absolutely spot on. The average for a household is around £3,500³.

Q54 Phil Wilson: As far as my colleagues are concerned, having postbags with letters from constituents or surgeries where people have come with underpayments, overpayments and problems with the system, do you think basically the problem is that you are relying upon the client to actually let you know about their change in circumstances? I notice that you have actually tightened up the rules, I think, whereby they have got to let you know more quickly that their circumstances have changed, but, if it was not working in the first place, why get them to do it more quickly? What difference does it make, if you do not do it right in the first place, by getting them to do it more quickly? What improvement does that make?

Mr Clasper: Forgive me if I do not get this exactly right, but a core part of this is the need to have families, when things are happening around them, inform us at the time of change of circumstance. If you put yourself through the eyes of some of your constituents, and household breakdown is a very good example of the things that are happening in their lives, letting us know about it quite possibly is not the highest priority, yet those things are the things that make the payment award start to be wrong. I would like to go back to what Sarah was saying earlier, that the breakthrough, whether it has occurred fast enough or not, Mr Burstow, I do not know, but the breakthrough is to actually think about this from a segmentation point of view, think about individual groups and what their needs are and then outreach to these vulnerable groups, whether that is through childcare centres or whether it is through an easy-to-access household breakdown service or whatever, because the policy requires that, as circumstances change, the payment changes. These are groups that, quite naturally, one would not expect to be the first ones to immediately phone us with a circumstance change and that is one of the root causes that makes this an extremely difficult policy to administer.

Q55 Phil Wilson: So, in that case, changing it so that they have got to notify HMRC of their change of circumstances more promptly does not really matter because, if you have got a crisis in the family, it does not matter?

Mr Clasper: But it will matter to the whole issue we have been talking about of overpayments or underpayments because, if we know what has happened, we can adjust payments immediately. If we do not adjust them immediately and this change of circumstance happens in the second or third payment period, then across the year they will build up too much, we will have paid them too much, and that is the root cause of the difficulties. Now, everything that has been said about the tax system, computers not working and everything, is also part of it, but the root, root cause is this need to get information from the claimant at change of circumstance time very, very quickly, and it is very difficult because they are not naturally going to call us, so we have to outreach. That is where the Department, in my view, is moving forward significantly, but it is difficult and I do not know the history, but we are starting to do really big things now, though it would have been ideal if we had all had 20/20 hindsight and it was done several years ago.

Q56 Phil Wilson: The other point in the Report, I think it is in the conclusion, paragraph 2.46, is that, "The Department has set a target to reduce the current level of claimant error and fraud to not more than 5% by 2011". How does that compare with the benefit system error and fraud or how does that compare with other benefits? Is there an equivalent figure?

Mr Clasper: I think some of the ones within DWP have been driven down to the 2 to 3% level over many years.⁴

Mr Hartnett: And it has taken 10 years to get down to that level in DWP, Mr Wilson, and sometimes more, but they are ahead of us at the minute, but we aim to catch up, as I said to the Chairman.

Q57 Angela Browning: I would like to talk to you about self-assessment, if I may, and £2.9 billion to £3.7 billion of tax is regarded at risk as a result of inaccuracies, not fraud, but inaccuracies on the way people submit their self-assessments, yet you do not seem to have a strategy to deal with this so that you can minimise that amount of money. I wonder if you could just tell me why that is.

Mr Hartnett: Because we have, Ms Browning, a broader compliance strategy. Let me say one thing about this risk rate of 34% of self-assessment filers. We have analysed it in great detail and we know that most of the risk lies in a relatively small number of filers involving large amounts of money, so we target those. What we have done is exactly what Mike has described in relation to tax credits: we segment that risk and apply different approaches to dealing with it, and one of the things that has come out of it that has been important is reform of the self-assessment

³ Note by witness: £3,500 was the average net cash paid by HMRC to families in 2007–08. Average entitlement to tax credits in 2006–07 was £3412. Average entitlement for 2007–08 will be published in 2009 as part of National Statistics.

⁴ Note by witness: Overall fraud and error in the benefit system is estimated to be 2.1% in 2007–08. Around 5.3% of benefit expenditure for Income Support/Job Seekers allowance, 4.8% of benefit expenditure for Housing Benefit and 5.3% of benefit expenditure for pension credit is estimated to be overpaid because of fraud and error over the period October, 2006 to September, 2007.

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tax return at times as well. If I may say so, I am incredibly proud that the latest online version of the self-assessment return enables us to do that diagnosis in real time and make changes to guidance in real time as well.

Q58 Angela Browning: So was it the case then that a lot of these inaccuracies came on the submissions that came manually rather than those where you have been very successful in getting the numbers to apply online? Is that where the problem was, with the manual submissions?

Mr Hartnett: I think the root problem is that some people find tax difficult, irrespective of online or on paper, but the great benefit of the online system is that it forces you to think about manifest errors and will not let you make manifest errors, but it cannot do anything about calculations that you have done before you have come to file, for example, because it will not know what they are.

Q59 Angela Browning: You have been offering a financial incentive to people to file online. Is that still ongoing?

Mr Hartnett: Not for a long time. I will be corrected from behind if I have got this wrong, but we offer a small financial incentive right at the start of self-assessment, but there is no financial incentive today for individuals to file. I think it is easier for them and faster, but no financial incentive.

Q60 Angela Browning: I was really leading on to ask you because I did think there was an amount of money, £120 or something—

Mr Hartnett: There was an incentive for employers to file electronically, but I thought you were asking me about individuals.

Q61 Angela Browning: Yes, I was, you are quite right. What I was going to come to was: has that financial incentive for people to file online been good value for money? That is really what I was coming to.

Mr Hartnett: For employers to file?

Q62 Angela Browning: Or when you were doing it to get people to do it for self-assessment.

Mr Hartnett: I think the incentive in relation to employers worked pretty well. There was mischief, and I will come back to mischief, if I may, in a moment, but in the first year of mandatory online filing, I think we expected 100,000 employers to file and we had something like 1 million filings. Now, there will be more than one for some employers, and I think all the research we have done with employers seems to suggest that they really like the system. The mischief came from some employers fragmenting themselves in order to get more than one incentive and that was a real worry because it became a little bit of an industry which we had to stamp on.

Q63 Angela Browning: Could I now move on to fraud in self-assessment. We noticed in the Report that some of this has been identified in the area of people who file unsolicited assessment forms. Can

you just explain to me how they come about in the first place? If somebody submits a form unsolicited, (a) where did they get the form from, and (b) does that not stand out in the way you process forms that these are rather different from the rest?

Mr Hartnett: I am afraid not. Let me give you a worst-case scenario and then I will happily refine it if you have more questions. The worst-case example of this will be a high-street tax adviser who will contact HMRC and say, “I have got 10 clients who have self-employed income or gross interest and I need to send tax returns in for them. Here are their names”. The names are quite often the names of genuine people, but what comes in is entirely bogus and quite often they will be looking to make repayment claims. That is the worst-case scenario and I am pleased to say that, where we have trapped accountants or tax advisers, I should say, it is not particularly accountants, who have done this, we aim to send them to jail. It is possible for it to happen in other circumstances very rarely, but, if you would not mind, I would prefer not to give you the detail here in an open session.

Q64 Angela Browning: No, I am very happy about that. Can I just ask you one more thing about that and that is: is it still the manual returns that cause this problem as opposed to the online returns?

Mr Hartnett: I think we have more trouble with manual returns than online returns.

Q65 Angela Browning: But you know where you are looking to deal with it?

Mr Hartnett: Yes, we absolutely do.

Q66 Angela Browning: Could I just ask you one final thing and it is not really so much income tax as people having to make a claim in terms of their liability for capital gains tax. Can you tell me how well integrated, do you think, the documentation is to ensure that you pick up capital gains tax liability when people make their annual returns? I am not 100% convinced that you are actually picking up all the CGT that you should be collecting and I wonder if there is not more scope in terms of integration and simplicity, not necessarily for people who have a capital gains tax liability on a regular basis and know the ropes and the format, because they are quite complicated computations now with the scales involved, so how have you approached that?

Mr Hartnett: In two principal ways. First, we now have a two-page capital gains part of the return which is much, much simpler and allows us to interface with the filer more easily than in the past if this is a one-off complex transaction or anything like that, but actually, much more importantly I think, in our operation we have significantly changed our approach and now we have more capital gains tax specialists in the teams, nests, whatever I should call them, around the country able to help.

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Q67 Angela Browning: “Nests” sounds terrible!
Mr Hartnett: Does it?

Q68 Angela Browning: Yes.

Mr Hartnett: Well, I was struggling to get to “teams”, so I am sorry about that, but able to help and we want to help people, where we can, with those issues.

Q69 Mr Mitchell: I am just worried about the enormous amount of arrears you have got. You identified overpayment of £8 billion and by the end of March this year, you had collected £2.7 billion and written off £1 billion, which leaves £4.3 billion of overpayments to be collected. You are not going to get that, are you?

Mr Hartnett: I think, Mr Mitchell, as I said to the Chairman, it breaks down in three ways. £900 million is genuinely in dispute and we are not pursuing it until we have sorted out the dispute. £1.6 billion, I hope this is going to add up, its collection is provided for against ongoing awards and £1.8 billion is seen as doubtful, but, as I explained to the Chairman, we are pursuing it and, with our auditors, I am sure that will be refined when we come to our next accounts.

Q70 Mr Mitchell: Well, Mr Clasper said, and I think you repeated, that it would not be fair to other people not to pursue it.

Mr Hartnett: Yes.

Q71 Mr Mitchell: Fair to whom?

Mr Hartnett: Well, to people who have paid. What we want in relation to debt is people who owe, through HMRC, money—

Q72 Mr Mitchell: But much of this is so old. You are judge and jury in this case of course. Through your fault, you have had a wonky computer system which has made mistakes, you have raised the limit on what people can earn as their earnings increase in the course of the year by quite a big increase and there are all the teething problems, so much of this must be your fault and yet you are pursuing the poor to get it back.

Ms Walker: One reason why there is so much debt outstanding is that we are collecting a lot of the debt very slowly. We do have rules and part of the package that was introduced in 2005 was to give extra safeguards—

Q73 Mr Mitchell: If it is your fault, why collect it at all?

Ms Walker: No, the amounts where there is official error, then we will, in the vast majority of cases, write off.

Q74 Mr Mitchell: Yes, but you are judge and jury in that case. You decide what is official error and what is their error.

Ms Walker: We look to identify whether there was a mistake made or not.

Q75 Mr Mitchell: But you decide that.

Ms Walker: Well, that can be referred to the Ombudsman or the adjudicator, so there are ways of questioning that, but again the amounts disputed are very small amounts, but, as Dave said, there is £900 million in there which is subject to dispute and will not be collected until the dispute is resolved. The rest of it is overpayments and the vast majority of that is being collected, but being collected in instalments.

Q76 Mr Mitchell: But still you are trying to extract large sums of money cruelly from very poor people. Yes or no?

Mr Hartnett: No, I am afraid, Mr Mitchell. There are cases like those Mr Touhig has referred to, and I suspect that all members of the Committee have seen cases which feel pretty unfair, but we are trying—

Q77 Mr Mitchell: Yes. Mr Touhig made my heart bleed when he recounted his particular case. Why does it not make your heart bleed?

Mr Hartnett: Mr Touhig has made my heart bleed which is why I went down to see him and to meet his constituents, but having my heart bleed is not necessarily enough to change the interpretation of the rules.

Q78 Mr Mitchell: Yes, but I cannot help contrast what you are doing here to these poor people, and if they were not poor, they would not have been given the credit, with the way, according to *Private Eye*, you treat big corporations, wining and dining them, trusting them to pay their tax. Here are big bodies which are fiddling tax through tax havens and trying to cut their payments down by buying schemes from big accountancy houses and you are lavishing attention on them, but you are grinding the faces of the poor for small sums.

Mr Clasper: I think we are a lot more balanced than you might suggest. Again I am a newcomer, but I have been incredibly impressed by the commitment of HMRC staff to pursue companies that try and break or bend the rules. Although I do not have the details, there are tax cases that we have won which represent a massive amount of money where we have gone after corporations that try to bend or break the rules. I think in this particular case we have a policy to administer whose purpose is, as has already been said, to alleviate child poverty and to help low-paid people into work. The problem with it is that there is a distinct possibility that we will overpay people because the way the policy works is that we need change of circumstances immediately from them, and that is embedded in the law. Quite naturally, in some cases, because they do not inform us of the change, we will end up overpaying them. If we have overpaid, surely the right taxpayer response is to find a sensible way of recovering that overpayment. In doing that, where there are hardship cases, we ensure that that pressure to repay that overpayment is spread over time.

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Q79 Mr Mitchell: If the principle of the thing is to help the poor, you do not help the poor by taking back sums paid to them in error and grinding their faces in it, do you?

Mr Clasper: Well, I think we have to be clear here that our approach has to be even-handed and, if we have overpaid—

Q80 Mr Mitchell: But this is payments out, not money coming in.

Mr Clasper: No, if we have overpaid versus the policy because they have not informed us of their change of circumstance, surely it is not, I know it is not in the policy that we should be making arbitrary decisions about the fairness of the way we then execute that policy. It is not that we are taking money from people undeservedly, but that we overpaid them.

Q81 Mr Mitchell: This is a fairness benefit. Now, I will just tell you in passing that I am dreading what is going to happen in this coming recession as unemployment, misery and debt increase—

Mr Clasper: So am I.

Q82 Mr Mitchell:—because we have built up a huge clobbering machine which clobbers the poor and we have increased the powers of bailiffs, we have increased the ability to put attachment on court judgments, we have got big organisations, the utilities like British Gas, led by them with the most incompetent billing system in the world, rushing people to county court and now you are joining the procession.

Mr Hartnett: Mr Mitchell, may I just add two things. First, I want to repeat the assurance I have given the Committee on a number of occasions that we are really, really tough on big corporations that do not pay the right tax at the right time. If I may, I will keep saying that when the suggestion is otherwise because it is important people understand that. The second thing is—

Q83 Mr Mitchell: But they still get meals out of you.

Mr Hartnett: And we get great learning out of them.

Q84 Mr Mitchell: These people do not. Anyway, let me move on because you have made that point and I want to move on because some of this arises in cases where, you tell us, the clients are expected to know they have been overpaid. Now, that is ridiculous. You had, according to the Report, 371,000 households dispute the recovery of overpayments, of which only 10,000 resulted in write-off. Now, it cannot be conceivable that people can be expected to know when you have overpaid them, and in only 10,000 cases out of that huge number, 371,000, did you—

Mr Hartnett: Let me go back, Mr Mitchell, to what Sarah said earlier on about Code of Practice number 26. Broadly, what it says now is that we expect people to check how we use the information they give us. Overpayments or actually the

possibility of overpayments are actually part of the design of tax credits and that is what gives it its flexibility. Now, 10,000 out of 371,000 in relation to disputes may certainly seem a very small number—

Q85 Mr Mitchell: It is.

Mr Hartnett:—when it comes to the concerns we all have for people who are asked to repay money which they just do not have anymore. That is why, as Sarah said to you or it may have been someone else, there are rules built in, and Sarah can say more if it is helpful, about how we can recover and the rate at which we recover, and we will always try and agree an appropriate plan with someone who is struggling to repay, always.

Q86 Mr Mitchell: Okay, I want to move on and shift to another subject because I think from the 8th Report on the EDS computer cock-up, the Department agreed that £26.5 million of the settlement, compensation, could be paid in instalments through effecting new government business won by EDS. Now, you have not recovered much of that and is it not a balmy principle that, if I am a computer firm and I cock up your contract, I have got to be given other government contracts before I can pay compensation to you?

Mr Hartnett: Mr Mitchell, I think I have explained before to the Committee that we took enormous care through the Office of Government Commerce and with other departments to make sure that procurement rules were followed very carefully and no government department issued a new contract in order to help us recover our money, but let me say one other thing, if I may, Chairman, with a slight smile, and Mr Bacon usually grills me and others on this. We are as unhappy as this Committee is that we have not yet been paid out. Mr Mitchell, we are in delicate discussions at the moment. The time within which we expected to be paid runs out within the next couple of months. I wonder would you just indulge me at the moment not saying more about those discussions, but we are absolutely determined to get our money.

Q87 Chairman: Thank you, that is very reassuring Mr Hartnett because, as you know, this Committee is very concerned about these issues.

Mr Hartnett: Indeed.

Chairman: We will keep a close tab on it. David Curry.

Q88 Mr Curry: I suppose somebody ought to speak up for the hardhearted tendency, so let me do that, noting of course that not everybody who receives tax credits is poor, it goes quite a long way up the income scale as a matter of fact so we need to be careful about that. We should always be rather careful that as the Committee of Public Accounts we assume that anybody overpaid retains an entitlement to maintain the overpayment; what matters is the sensitivity with which you approach that issue and, taking account of the individual circumstances and its recovery, and avoiding the

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tendency which I complained about in the past to blame the recipient for not noticing something which, by almost definition, they were not capable of noticing. Can I move on and look at the little chart about your overview of the scheme? If you look at the net cash paid to claimants in a year there is a pretty straight line increase there from 2003 up to the provisional 2007/08—it is going from 13.5, 15.8, 17.3 to an estimated £20 billion in the current financial year. The final value of awards is a pretty straight line but then we come to two aberrations, we see the administrative costs suddenly jump by £120 million from 2005 to 2006, the number of staff employed by the department jumps by 1,370. One might think that is okay, you are obviously doing more work and changing the rules, but then you look at the provisional 2007–08 and you find that the number of staff is predicted to come down by nearly 1,000 yet the administrative cost has only come down by a couple of bob. According to my very amateur calculations, literally on the back of the envelope, you add in costs of about £5,400 per employee in 2005–06, £5,800 in 2006–07 and £6,200 in 2007–08. What is causing this steady rise in the cost of employing—this is not salary, these are the administrative costs of your workforce. What is causing those jumps?

Ms Walker: I can help with some of it. It is quite difficult to compare those figures from year to year because the way in which we apportion overheads has been different from year to year so we cannot be sure that those are calculated on a consistent basis, so doing that calculation per head is not necessarily the most helpful thing to be able to do.

Q89 Mr Curry: I am not here to be helpful.

Ms Walker: I do understand that. It might help if we could give you some background.

Q90 Mr Curry: It would. You must admit that as the little chart sits here these figures rather jump out and if you can deliver that in a way which is, if you like, consistent or gives an accurate impression then that would be helpful.

Mr Hartnett: Let me just say a couple of things, Mr Curry, if I may. The progression in relation to our staff costs really manifests a realisation in 2005–06 that we needed to put more people into contact centres and other parts of our tax credits business to stabilise what was not a fantastically good performance at the time—we needed more resource and we did that. The blip in the bottom line, if that is the right way to describe it—8,750, 10,120, down to 9,200—we needed extra contact centre resource for more than one reason and we moved people away from tax credits because we needed them elsewhere. In terms of rough numbers we have increased our people resource on tax credits by about 25% at a time when we have been reducing by about 14% in other areas. We will check and we will write but I think in this administrative costs line are things like start-up of new contact centres.

Q91 Mr Curry: If you look at the actual staff numbers here, once again we have got what looks like a fairly consistent line and then there is a jump, but in the current year you are expecting to lose 1,000 people pretty well. Is that the case, or are they being redeployed?

Mr Hartnett: Not necessarily, they are being moved across to other things we are using contact centres for, for example, but let me send you detail about that.⁵

Q92 Mr Curry: Could I move on to another subject because, by coincidence, I got a letter from you this morning about tax offices.

Mr Hartnett: Right, yes.

Q93 Mr Curry: Do not look too cheerful about it.

Mr Hartnett: I am not cheerful at all.

Q94 Mr Curry: Because, as you know, you are proposing to close the tax offices at Skipton and Ripon—which are two of the main towns in my constituency—along with lots and lots of other ones. This is driven by Treasury demands to lose running costs and staff, is it not—it is according to the briefing that your predecessor gave, let me put it that way.

Mr Hartnett: I want to say two things. Running a cost-efficient and cost-effective tax system is certainly part of it, but the second thing is that our customers, taxpayers, credit claimants and the like no longer go into our offices in the numbers they used to and we have found that efficient processing of our work goes much more effectively in bigger offices than in smaller offices.

Q95 Mr Curry: But you have set down various criteria in your consultation process and one of the criteria is that people can get to their new place of work within an hour. I do not know how you have worked this out, quite frankly, whether you have done Google Earth or something, to try and work out how people are supposed to get from a village in Craven down to the middle of Leeds in an hour, but I do this trip practically every week and I have to tell you that your calculations simply do not bear any relationship to the reality on the ground. People often do not live in the middle of Skipton, for example, they do not live in the middle of Ripon, transport is haphazard and things can very easily go wrong. You have also made the promise that everyone will be redeployed, but again as you know your workforce is overwhelmingly female in these offices, overwhelmingly they may have other responsibilities and have got the pattern of their work in order to be family-friendly or to correspond to caring obligations. The impression I get looking at the consultation, looking at the returns on the consultation, is that quite frankly all this is predetermined: at the end of the day these offices will be closed and nothing will stop these offices closing. There is a procedure you are obliged to go through, but at the end of the day the

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outcome is that there will be no difference whether you have gone through it or not. I am afraid to say that that is the conclusion I have reached.

Mr Hartnett: I am really sorry, Mr Curry, that you have got to that conclusion because, frankly, it is just not right. If we were going to do that we would not have gone through the extent of consultation we have done, this has been genuine consultation. I know that numbers of our people are unhappy about some of the conclusions and others about the uncertainty. If you want me to drop you a line about the next bit I will, but we are not using measurements of our own devising, we are using a facility we have found that we regard as objective and we are going to get to some really difficult issues here.

Q96 Mr Curry: If I may, that is what I would like to know a little bit more about.

Mr Hartnett: I will write to you.⁶

Q97 Mr Curry: As I said, that is my constituency, I am up there every week, often for longer periods, so in every possible circumstance that the Almighty ordains I do those commutes. The hypothesis that you base this on simply does not work out in practice, leaving aside the lifestyle issues, the issues about commitments and trying to employ people in ways which are compatible with family obligations. I understand the pressures you are under, it is quite clear that that was set out to us at the very beginning, but in a sense there is a contradiction between the imperative which you are under—which I understand—and a procedure which in a sense is almost calculated to undo that, just like, as you have just explained, your procedure under tax credits where people have to notify you of changes in circumstances is guaranteed almost genetically to leave you overpaying.

Mr Clasper: Or underpaying.

Q98 Mr Curry: Actually we have almost forgotten those poor people—there is rather more money, is there not, which has been underpaid rather than overpaid?

Mr Clasper: It is the other way round, but the system does cause overpayment and underpayment. I would like to say—and again I do not know the details—I have been truly impressed by the commitment of the department to find ways in which we can redeploy people in the ways we have talked about. It is not perfect but there is a massive effort going on to match people to opportunities.

Q99 Mr Curry: I hope that will continue and I hope you will look hard at the travel distances because, if I may say so, the people in the offices in my constituency are not raging, bearded Trotskyites—especially the women—they are good, sensible, solid, very loyal people who have worked for the department for a long time.

Mr Hartnett: We know that Mr Curry.

Q100 Mr Curry: They are very committed to the department and are genuinely concerned about the fortunes of their customers in an area which often feels as if service has been drained out of it from every direction. At least I would like to feel that they have had a proper say and a proper deal at the end of the day and that the criteria are ones that are reasonable.

Mr Clasper: Obviously I have not been able to visit many of the tax offices but I have been able to visit a few sites and have talked to the people, as I would describe it, on the front line who do the hard work. I totally agree with your comments around the pride that they take, their desire to look after customers, their loyalty to the department, so we do owe them massive efforts to try and match people, but as you have said yourself this is a balancing game. We have 600 offices across the country in a world that has gone national, online, global, telephone, and the number of people needing to go into an individual office, as you will readily admit, has gone down significantly. This is a very, very difficult balancing act.

Chairman: Thank you. We still have four or five colleagues who want to come in so if we could have brisk answers, please. Also, please speak up because there is a tendency to drop your voices at the moment. Geraldine Smith.

Q101 Geraldine Smith: It is important to remember the benefits that tax credits can bring because I have seen people's lives transformed for the better through tax credits, but equally of course I have seen some horror stories like everyone else. Mr Clasper, you probably hit the nail on the head when you said the weakness in the policy is the fact that people have to notify immediately of any change in circumstances, and I think what was not really envisaged when the policy was set up was just how often people's circumstances change. People's lives are very precarious, partnerships and marriages may break down, people may take on part-time jobs, there are all sorts of changes. Have you made any recommendations to ministers about anything that could possibly be done to resolve that?

Mr Hartnett: Let me pick that up if I may. It is very hard for us to tell you the advice we have given to ministers so can I try and do it in a different way. If I may repeat what you have said I think you have hit the nail on the head about changing circumstances and the range, the variety and rapidity of changes of circumstances have been greater than certainly we in the tax administration thought they would be during the design phase. Sarah also made an incredibly important point about the transformation programme that we are actually in. We are doing a lot of things, there are more things happening, we are using our researchers who are very skilled to look at these sorts of issues all the time to work out what we should be saying to those who determine the shape of the policy, and I want to give you that assurance.

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Q102 Geraldine Smith: The problem is that on the ground it does not feel like that. In my constituency office—I just spoke to one of the people who work there before I came here and the thing they described was carelessness with the most vulnerable cases, call centre staff—lots of complaints about them not being knowledgeable enough, not being consistent with the advice, wrong answers being given. I looked at one case recently of a constituent where I received a letter back to me saying that there was no overpayment due—“according to our records there is no overpayment that has been made and no need to pay anything back”. A week later they got a bill for £1,800 or something like that. These people were devastated, especially as I had just sent them the first letter, and yet the tax credit people say “Yes, there has been a clear error but we still have to get this money that is outstanding.” I appreciate if people are deliberately not informing you of their circumstances then it does become a problem because in those cases I would say, yes, they should pay the money back. It is a very grey area, however, and quite often you just do not know, people will come in and they will be absolutely distracted and tell me how, yes, they have notified you, they have rung several times, and nothing has happened. What can you do to improve the customer care and can you also tell me have you thought of having any tax credit surgeries in MPs’ offices because I think it would be very helpful for me—my heart sinks.

Mr Hartnett: Mr Touhig is a living example of a surgery in his office.

Q103 Geraldine Smith: I mean maybe once every six weeks with members of staff coming into MPs’ offices so that at least we can have a face to face explanation. It feels so often a bit like the computer says no.

Mr Clasper: I go back to something I said earlier, and I will be brief. This concept of segmentation and this concept of outreaching to vulnerable customers is to me the critical way forward if we put aside, as implied in your question earlier, about whether there are ways to simplify the actual policy, and obviously any simplification of the policy in the right direction would reduce these issues. I do not know whether I am allowed to say that but I certainly think it.

Q104 Geraldine Smith: That seems to me the main way forward.

Mr Clasper: Yes. Segmentation and going to where people are naturally going to be, like child care centres for example, and trying to resolve some of these issues I think is the way forward. I do not want to be over-critical of people in the junior levels of the organisation who have been under a lot of pressure through all of the issues that you have rightly raised. We do need to drive up the professionalism of both our leaders and managers in those organisations and some of our frontline staff. I am certainly focused on it and I think the whole team is going to drive forward that professionalism agenda across the whole of HMRC.

Ms Walker: If I could just add on the question of policy changes, of course the Treasury did publish a discussion document in May for which the consultation period ended in September proposing a number of policy simplifications which were addressed at particularly the sorts of things you are talking about—for instance, a run-on of entitlement after a change of circumstance so that if you took a few days or a few weeks to report something it would not immediately create an overpayment. We have had a mixture of responses to that and those are being considered by ministers at the moment, but those sorts of changes have certainly been floated.

Q105 Geraldine Smith: Can I move on to a slightly different topic, that of tax offices—Lancaster tax office to be more precise. Many of the staff who work there are indeed my constituents and I have to say can you pass on my thanks to them for the excellent job that they do. The problem is it is a long-established staff, they have got a great deal of loyalty to the service and quite a lot of them are quite well-paid workers and they are being forced to relocate to Preston, Manchester or Blackpool I believe. The one hour travelling time that has already been mentioned, it clearly does not apply in this case because where some of those people live they clearly could not get to those new locations within an hour. I would also put the counter view of the carbon footprint—there is something to be said for a local presence, Lancaster is a very successful inquiry office and a lot of people come in. Indeed, the Chamber of Commerce, myself and the MP for Lancaster & Wyre, Ben Wallace, and indeed the local council are strongly objecting to this. I take what you say about meaningful consultation and I will judge, I guess, by the outcome whether I think it has been meaningful or not, but I would say these staff are in a purpose-built office, well-established and they do provide a very high standard of service. I think you would lose some of that by those staff moving to a larger office and I think it would be outwith your own rules in view of the travelling distance and time. I have tried to get a meeting with yourselves so I just thought I would use this opportunity to put forward my very strong views that that office should be retained in Lancaster.

Mr Hartnett: Ms Smith, let me say this. I am very proud of what happens in Lancaster tax office because it is one I have done work in—although I have never belonged to the office—on a number of occasions in my career, on major enquiry cases and the like. The important thing, in addition to what we have said, is what we discussed at the last hearing: our investigation and related work is no longer selected locally because we have better ways of doing that. Your point about the quality of people is well-made—Revenue and Customs, for those who have been in it for a while, is like a big family and we have a terrific sense of how much pain some of our people are suffering in relation to this. We have a one hour rule but it can be flexible, indeed some of our people want to flex it. The reason this is taking time is we are trying to be as objective as we can in how we sort out our estate and our offices going forward. I hope that

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the letter that I am going to send to the Committee with the detail that Mr Curry wanted will help you see how objective we are being in a very difficult circumstance.

Q106 Dr Pugh: I just want to touch on a few issues very briefly and concerns that other colleagues have. The total overpayment figure was £8 billion; as a percentage of what is actually paid out what is that? If the total overpayment is £8 billion, what has been paid out?

Mr Hartnett: £8 billion out of about £80-ish billion, if I have added it up right. I am sure the NAO will tell me if I have got it wrong.

Q107 Dr Pugh: Do you have any feeling as to how much of that overpayment is fraud, how much is error and how much of the error is client side error and how much is, as it were, service error?

Ms Walker: The way that we define fraud and error is that it is—

Q108 Dr Pugh: I know there is a difficulty in distinguishing quite often between what is fraud and what is error.

Ms Walker: The overpayments that are in those statistics are overpayments that are recognised within the year, so that is on the assumption that any error has been corrected and that we have correctly identified the entitlement. We have paid out the money on the entitlement but we know what has been paid and we know what the entitlement is. Fraud and error is a separate calculation where we go and look at that entitlement figure after the end of the year to find out whether there are still mistakes in it, either because of our mistake or because of customer mistake or because of deliberate fraud.

Q109 Dr Pugh: Everything that is overpaid must be either due to fraud or due to error, there is nothing else is there?

Ms Walker: It depends what you mean by error. The way that we define fraud and error in the statistics—certainly the statistics we are setting a target of 5% for is fraud and error that survives beyond finalisation.

Q110 Dr Pugh: Okay. You have collected £2.7 billion; of the sums of money you have collected if you were to break them down how much would have been taken initially by fraud, how much of it was taken by error, how much of it was taken by error but was not the client's fault—have you got any figures for that?

Ms Walker: If you are saying how much of that that we recovered which we knew was caused by our own official error, I think that is very small because the vast majority of the official error that we have identified we have written off.

Q111 Dr Pugh: Of the £2.7 billion you are firmly convinced that most of it is due to client error or alternatively due to client—

Ms Walker: It is due to the normal operation of the system which involves us learning about changes late and therefore paying the wrong rate for a certain amount of time and therefore having to recover it later.

Q112 Dr Pugh: Of the amount you have written off, how much are you putting down to client error?

Ms Walker: That will be official error, that will be due to HMRC error.

Q113 Dr Pugh: You are not writing off cases of fraud because it is impossible to follow them up.

Ms Walker: There will be some amounts of fraud in there but most of the write-offs are due to HMRC error.

Q114 Dr Pugh: If you had the system working absolutely perfectly there would still be some element of overpayment in it, but you must have a working idea of what is an acceptable level of overshooting, if I can put it like that. What is that figure?

Mr Clasper: If I can jump in just for a second, I have seen the plans going forward, which are extensive, to try and drive it down and genuinely getting to 5% in three years is going to be really tough. The benchmark that you might look at in other areas of government would be the 2% to 3% that DWP do after multiple years of effort and, I do not know whether I can say this, probably a slightly simpler policy to administer. There is a root error rate here with great performance, unless policy changes, of somewhere between 2% and 5%.

Ms Walker: That is the figure for fraud and error, not for overpayment.

Mr Hartnett: Dr Pugh, I am sat here worrying that we may be unintentionally beguiling the Committee by muddling up two things on our part, which is fraud and error and overpayments. If I can just say this, we are already driving down overpayments—£1.9 billion down to £1 billion—and, separately, we are driving down fraud and error. I just think once or twice in the last two questions we have conflated the two.

Q115 Dr Pugh: Many overpayments are in fact error.

Mr Hartnett: Absolutely, but we have unintentionally conflated the two.

Q116 Dr Pugh: Just touching on the computer issue, I totally agree with what Geraldine Smith said about the clients; it is very, very frustrating because they give information in good faith to the Revenue and the computer does not actually acknowledge that information and the computer persistently says no. We wonder and we puzzle as to why this happens. I suppose there are two sorts of computer error, are there not? There is computer error where, in a sense, the wrong data gets put in and it is uncorrected and there is computer error where simply the programme is not working as planned—one is functional and the other is a matter of human error, I suppose, as much as anything else. What are these compute errors that

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you have complained about to EDS largely composed of, is it a question that in a sense they do not suit the operator or is it that the software itself is so flawed that even where revisions and corrections are made they are not then recorded and embodied and the client has to face up to the same information being wrongly displayed time and time again?

Mr Clasper: There is a really big other group and let me go to the PAYE system and the MPCC3 delay. We built a system a long, long time ago that assumed people would continue in a single employment with an employer, so the PAYE system, as I am sure the Committee knows—although it is an employee system it is actually administered through employers that go to an individual tax office. You were talking earlier about the changing circumstances of people and the fact that they do not behave like they did before, and one aspect of that is that no longer do most people stay with a single employer. Therefore, when you have eight tax offices with an employer base and as an individual if you move around between employers, even living in the same place, your tax records are moving around between computer systems that were never designed to talk to each other because the people who built them many, many years ago had assumed that people would, in general, stay with an employer. Although all of the categories that you said are true, therefore, there is a fundamental issue going on in that the systems were not built for today's lifestyle; therefore we have to go back and re-jig them and every time we go back and re-jig them we have to do it extremely carefully because I am sure this Committee would not want us coming forward with what happened in Japan where you lose a million pension records as you transfer from one system to another.

Q117 Dr Pugh: Right. We have already touched on the issue of EDS and their failure to cough up and so on. There are some around the table who suspect you are never going to take EDS to court because you are not at all confident that you will actually win a case even if you do. What is the trigger point when you finally lose patience? At what point in the next few months, or judging by the quantity of money produced, are you going to snap and say "We will see you in court"?

Mr Hartnett: Where we have got to, Dr Pugh, is this: patience is wearing thin. The payment plan was to have been completed by the end of this year, I craved some indulgence from Mr Mitchell earlier on in that we are in discussion with EDS at the moment, with enormous help from Nigel Smith the head of the Office of Government Commerce, and we are impatient. I am hoping you are going to give me the indulgence that Mr Mitchell gave me; I do not want to talk openly about the discussions today, I promise to do so soon.

Q118 Dr Pugh: Okay. The final point, going back to the tax offices again, I would agree with everything that Geraldine Smith and David Curry said—you can say the same about Skipton tax office, you can say the same about Morecambe tax office; they are all in the same situation, they all have loyal staff and

they all do not want to move. I am questioning the efficiency of the move because fundamentally your big saving is in offices and the offices are all held under a PFI contract, are the not?

Mr Hartnett: Yes.

Q119 Dr Pugh: Does any saving that materialises depend upon Mapely actually disposing of these offices, or are you going to end up paying for them but not actually inhabiting them?

Mr Hartnett: There are two sorts of saving here. There is the saving that comes from salary as we downsize the organisation—that is a really important saving—and then there are savings from the offices. In broad terms the contract with Mapely enables us to identify a number of offices each year which we return to them and stop paying for, but we are also identifying others where we can come to arrangements with Mapely and return the office.

Q120 Dr Pugh: But if they cannot find a tenant to replace you, do you have to continue to pay?

Mr Hartnett: If we emptied offices and did not reach an agreement with Mapely we would have to continue paying.

Q121 Mr Davidson: I was fascinated by the response that Mr Hartnett gave to Austin Mitchell earlier on about having meals with bloated capitalists as it were; this is the first I have ever heard of this concept of eat your way to knowledge. I remember when I was at university there were a fair number of lads there that tried to drink their way to a degree, but this is the first time I have heard it from the Revenue. Like Geraldine Smith I think tax credits are an excellent principle and I know that there are a substantial number of people in my constituency benefiting from it, but I also know that there are a substantial number of people who refuse now to have anything more to do with you because they are afraid of you, because they do not want to get into arrears, either because they themselves have had an unfortunate experience and they do not want any more, so once they have cleared that they do not want to have anything else to do with you, or they know somebody else who has been in the same position and they do not want to have anything to do with you either. Do you have an estimate of how many people fall into that category and how much money is not being claimed as a result of people who are eligible would receive money from you who do not want to have anything to do with you?

Ms Walker: Generally the take up of tax credits is very high; there are some areas where, particularly people on low incomes, people with families, the take-up is very high and is higher than for any previous equivalent benefit. There are some categories of people where the take-up is lower—people without children we are trying very hard to increase take-up and there are some areas of the country, particularly London, where the take-up levels are lower. We are pleased that the take-up is high. I have heard the stories too about people who are telling people that they will not have anything to

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do with it, I know the Citizen's Advice Bureau have seen those people, but I have never seen any statistics of how many of them there are.

Q122 Mr Davidson: How high do you believe the statistics to be in terms of take-up, in Scotland for example?

Ms Walker: I do not have the regional figures in front of me but we could certainly write to you and let you have them.⁷ They are published figures.

Q123 Mr Davidson: It would be helpful to have that on a regional basis.⁸ How robust are those figures because in a sense by definition if people are not coming into contact with you, even though they are eligible to do so, you have no way of telling in a sense, have you?

Ms Walker: We make estimates of the eligible population based on other sources so from social surveys of other kinds we make estimates of the population who ought to be eligible to claim based on their income and their family circumstances.

Q124 Mr Davidson: I wonder if you would let us have the background to that and if we could maybe have the NAO run their eye over that just to see whether or not they think that is robust. From the tone of your answers it does not seem to gel with my experience or my staff's experience. Indeed, my wife mixes with more normal people than I do and she tells me that this is a regular issue that she comes up against with people that she knows or that her friends know, some of her friends in teaching and so on and so forth. The general reputation amongst a whole category is that they do not want, as I say, to have anything to do with yourselves any more, and I do find that very worrying. Can I follow up this question of your staff who no doubt are wonderful and all the rest of it, but the whole organisation does have somewhat of a reputation for incompetence and that is one of the things that alienates people. We have had examples where people are not simply getting contradictory letters a few days apart but actually getting contradictory letters on the same day. That sort of arrangement clearly does distress people and the people on the phone service that you have are less well trained, I suspect, than they might be, or they do not have access to sufficient information because certainly my staff find themselves frequently unhappy about the level of detail that they have been able to get, and that is using the MPs' phone line. Can you clarify for me whether or not that is the intention?

Mr Hartnett: I am sorry, I missed the point about the MPs' phone line.

Q125 Mr Davidson: Is it the intention that it is not able to provide us with full information, or is that just the way it works out?

Mr Hartnett: I did not think it worked out like that because this is a Committee I have been in front of before who have had a lot of good things to say about the service available on the MPs' phone line, but let me get back to your basic point which is the quality of our performance and our people. We have invited members of this Committee and another committee before to send us examples of these contradictory things, and they do happen. I think the number is much smaller than you imply and we have never had large numbers of contradictions sent to us, but the key point, as Mike said earlier on, is that we are absolutely determined now to raise the professionalism of our people and the quality of our workforce.

Q126 Mr Davidson: Yes, we have heard this before. I have never yet had an official come in front of this Committee telling us we are determined to drive down the level of professionalism of our staff, it is one of the standard things that people say to us, we are determined to improve. Nobody has ever come and said we are determined to provide a worse service next year than we did last year.

Mr Clasper: I suppose I am an official now although I have not spent my life as an official. I have gone into some of the places where we are at the leading edge within HMRC of tackling the issue of driving up the performance of our staff, particularly up in my home territory which is the North East—I have been to Washington and Longbenton. There are some examples there of teams that are performing at the highest standards that I would have seen in some of the great companies that I have been associated with and I think the thing that we should be tested on all the time is how quickly that becomes not a minority of the organisation, which it is today, but is a majority of the organisation. I do not know whether I am allowed to do this but I would more than welcome taking people to visit those locations in the North East—and there are others around the country—and you would be seriously impressed.

Q127 Mr Davidson: I am a bit hesitant about doing visits because it is a bit like visiting places where everything smells quite clean—it has all been done for you. It is a question of the outcome.

Mr Clasper: The deal that I will do is that we will give you a list of these offices and you tell us the day before.

Q128 Mr Davidson: That in a sense is not quite—
Mr Clasper: I am trying to address the fact that we will not dress it up for you.

Q129 Mr Davidson: I understand that, I am unlikely to be shown the worst performing section. What I want to have is no complaints from my constituents and we are not there yet by a long shot. Why are my staff complaining to me about the quality of service they receive on the MPs' hotline, and as MPs' hotlines generally are far better than the service available to normal members of the public there is something wrong there.

⁷ Ev 21

⁸ Ev 21

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Mr Clasper: Any organisation would want to drive to zero complaints and zero errors.

Q130 Mr Davidson: Yes, I accept that. Earlier on I think Ms Walker said that there were 1.3 million outstanding cases of disputes and so on, did I hear you correctly?

Ms Walker: No, 1.3 million were overpaid in 2006–07.

Q131 Mr Davidson: That is 2,000 per constituency; that is really quite a lot of constituents who have families by and large. I very seldom ever get anybody coming to me saying the tax credits system is fine, I have no complaints, who walk two miles in the rain to my constituency surgery to tell me that everything is okay, and they seldom go to my colleagues about things if they are happy. I would expect that my constituency would probably have a disproportionately large number of people claiming so pro rata we have more than 2,000 people who are in dispute as it were with yourselves. That is not adequate.

Ms Walker: Those are not the people who are in dispute, those are people who during the course of the year have been paid more than what we finally decide is their entitlement. That overpayment will normally be offset against the payments in the following year without any dispute.

Q132 Mr Davidson: So these are happy people then. How many are unhappy do you think?⁹

Ms Walker: The number of people who are complaining and the number of people who are disputing is actually reducing year on year. We have had a reduction in complaints by a third between 2006–07 and 2007–08 and the number of people disputing an overpayment, so suggesting that the overpayment is not due, again has fallen by around a third between those two years so the number of disputes is actually falling.

Q133 Mr Davidson: It would be helpful if you could let us have that broken down by geographical area.¹⁰

Ms Walker: We will see what we can do.

Q134 Mr Davidson: As I say, it is not entirely my experience.

Mr Hartnett: Mr Davidson, could I just ask when you have a moment to drop me a line about your concerns about the MP hotline because that is really important.

Q135 Mr Davidson: Yes, I will get my staff to do that. I have some sympathy with some of the positions you have adopted and certainly I am not in favour of an amnesty because it would be unfair to those who have been conscientious. I am aware that there are some of my constituents who find themselves unable to make any headway in disputing the amount that is owed to yourselves

and have just given up because you end up in a situation quite frequently where they say they do not owe this, you say they do, you do not actually provide explanations that they understand, they keep saying that they do not, you keep saying that they do, again you do not provide explanations that they understand or accept and eventually some of them just give up because they are afraid of you basically. That is not a satisfactory situation. My staff and I cannot understand how some of these people have got into that position because you do not provide sufficient explanations. This is simply not acceptable, given how long the service has been operating.

Ms Walker: It is fair to say that the quality of our explanations has not been consistently good in the past and we are putting a lot of effort at the moment into improving that. I have been to see the team in Preston who are working on disputes and the material they have, the guidance and the training and to actually write letters in a way that people are likely to be able to understand is quite impressive and they are doing a much better job. It is a very complicated system and will always be complicated, particularly when it goes wrong it will always be complicated to explain to somebody why it has gone wrong, but we recognise that that is important and we are putting extra training in to help people to explain that better.

Q136 Mr Davidson: The final point I want to raise, Chairman, is about the way in which the rule about notification is applied. As I understand the position somebody makes a claim, they are entitled to it, their circumstances change and if they notify you that they are no longer eligible adjustments can be made timeously and so on and on they go. They then get something at the end of the year which they have to notify in return and my understanding is that if they do not notify you of that timeously they become liable to repay the whole amount. We have got constituents who have ended up being liable to pay the whole amount, even though in fact they were correctly paid and the clause under which you are attaching them for complete repayment seems to be unless they have actually notified you within the appropriate time. That does seem to me to be unfair. Even if it turns out much later on that they were actually correctly paid, they still end up having to repay because they did not convey that information to you within a certain time window. Surely you could look at that again.

Ms Walker: Because it is an annual system there is a requirement on people at the end of the tax year to complete a renewal form and to return it. We remind them of that and we have advertising to remind people to return their form. Some people will not do that and I admit it is particularly an issue for people perhaps where their claim has come to an end during the year because their relationship has broken down and then some months later, after the end of the tax year, they get a form asking them to report in relation to an award that they do not

⁹ Ev 21

¹⁰ Ev 21

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think is relevant any more. One of the things that was in the discussion document published by the Treasury in May is a proposal to try and finally close down those awards at the time when the people split up, so although strictly in the legislation we cannot close them down until the end of the year, what we are going to try and do is deal with all of that, try and crystallise any overpayment and recover it if we need to at the point where they notify.

Mr Davidson: I understand what you are trying to do but that presumably will not work as it were in arrears so as of now I have got people that you are pursuing for money that they were not overpaid, but the only reason that they are having to repay it is because they did not convey the appropriate information to you in time. I have lots of constituents who live somewhat chaotic lives and it just seems absurd to me—obscene to me actually—that you continue to pursue them in these circumstances.

Chairman: We will have to leave it there because Mr Davidson has had 14 minutes. Mr Williams is your last questioner.

Q137 Mr Williams: Just a couple of tidying up questions. The Chairman raised with you the issue of compliance teams and he referred to the £337 million savings which they made, which is very encouraging, but that works out according to me at just over £2,100 per check that they carry out. How many of these teams do you have and how many are in a team?

Mr Hartnett: I confess to not knowing the answer.

Ms Walker: I do not have the number of compliance staff but we can certainly let you know.

Mr Hartnett: We will write to the Committee; I am afraid we do not have it here.

Q138 Mr Williams: How do you decide the number of teams? Do you say they are still making money, therefore we will have another team, because that did not seem to be the answer you gave to the Chairman. The Chairman asked if you were going to have more teams and you said, if I understood you correctly, no. Why not more teams while the teams are making a profit?

Mr Hartnett: Essentially the reason I gave to the Chairman is that we look across the whole piece of our responsibilities and try to make a good estimate of the risk of loss to the exchequer. We then look at what the teams are bringing in but have to make the right balance between what teams are actually bringing in and the level of protection that goes to the tax system. If we have an area where the teams are producing £1500 a case we would think very hard about moving people across to the tax credits area.

Q139 Mr Williams: How many are in a team and what does a team cost?

Mr Hartnett: Teams can be large or small. There are 1,430 people doing this work plus 50 people in relation to child benefit, and in that 1,430 people will be some risk specialists who do not actually run cases but are managing our assessment of cases.¹¹

Q140 Mr Williams: You do not seem to be able to tell me whether any of them are loss-making.

Mr Hartnett: I apologise.

Q141 Mr Williams: This is what I am trying to get at. While they are not loss-making they must be worth money, must they not? You said you have various areas of accountability and your area of accountability to us is value for money; value for money would suggest that if these teams are making money they could be bigger and therefore you may be expected to encourage them. You do not seem to have any background comparable figures that would enable you to decide whether you would benefit from having more of them.

Mr Hartnett: We do have that analysis but we do not have it with us. Let me compare it with another area of our business—

Q142 Mr Williams: I do not want a comparison, you can write to me about it because I understand you do not have it here, but have you even evaluated it? Have you done an evaluation to say this team is in an area where they are effective, have you decided that you are now at the optimum level where you would be loss-making if you had any more teams or is it more a matter of perhaps the manpower levels and trying to keep manpower levels down?

Mr Hartnett: We carry out that sort of evaluation all the time and it has become more sophisticated.

Q143 Mr Williams: If you carry that out all the time I would expect you to have the information available.

Mr Hartnett: I have not got it with me, I have said I will write.

Q144 Mr Williams: Writing does not enable me to ask further questions now, does it, because I do not know what you are going to disclose in your answers. It seems to me at the moment that you have got an arbitrary situation where you have decided that is the number of teams we have but you do not seem to be able to tell me whether you would benefit from having one, two, three, four, five more teams where they would still cover their costs.

Mr Hartnett: What I am saying is this. There are 1,430 people and by a process of assessment of the risk we have determined that 1,430 people strikes the right balance between what we can afford and what we can do—which is the value for money issue—and also strikes the right balance between what we need to invest in tax credit compliance and what we need to invest elsewhere.

Mr Clasper: There is a lot of effort going on to make those teams more productive by using risk-based tools, both people-based risk tools but also to use a

¹¹ Note by witness: The 50 child benefit compliance staff are included within the 1,430 members of staff working on tax credit and child benefit compliance.

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figure where it gets artificial intelligence approaches. I do not know the details but I do know that some teams have gone from, for example, case successes being 50% to 80% where the core has been a massive improvement in the use of risk-based tools. So this is not just about the numbers, it is about the productivity of the people, and I do know—it is early days for me—that the department is focused on driving high productivity in terms of getting money back from these teams and therefore delivering value for money for the taxpayer.

Q145 Mr Williams: What I want to focus on and what I want your note to focus on is whether you are now at an optimum level where to create more would be loss-making, and if you are not at that level why is it that you are not doing it.¹²

Mr Hartnett: Okay.

Q146 Mr Williams: Elsewhere we were told that you made adjustments to some finalised awards outside legal powers. How do you come to do that?

Mr Hartnett: Mr Williams, I have said to the Chairman already we got it wrong.

Q147 Mr Williams: Yes, but how did you get it wrong and why?

Mr Hartnett: We got it wrong because the people leading that work made mistakes, we did not check processes carefully enough and we are going to learn from it.

Q148 Mr Williams: When did you discover that you were outside your legal powers?

Ms Walker: Early last year, early in 2007.

Q149 Mr Williams: So you have had about a year and a half in which to address the problem. I understand from the information we have that there are 20,000 claimants with an average of £800 to £1,000 that you owe money to, and that means that it is in the range of £16 million to £20 million that you still owe. Why do you still owe it so long afterwards?

Mr Hartnett: Mr Williams, we have to check 250,000 cases to find the 20,000 and that is the process we are involved in now.

Q150 Mr Williams: One final question on the computer specification. Obviously, the fact that it is a specification means that the department got it wrong, you fed in the wrong information to the design, is that correct?

Mr Hartnett: No, I do not think it is. On this specific issue or generally?

Q151 Mr Williams: On this one.

Ms Walker: The problem with the computer was that we did not include something in the design of the computer which would have prevented staff from amending finalised awards in a way that they should not have done. The answer probably is that there was such a pressure at the time to complete the work and get the computer right this was not as high a priority as other changes; either that or it was an oversight. It was a mistake that it did not happen.

Q152 Mr Williams: Since it was leading you to act again your legal powers it should have been a high priority should it not?

Ms Walker: We were relying on staff training and staff discipline so that they would not make those mistakes. It was a combination of things, both with the computer and with the guidance.

Q153 Mr Williams: You discovered it about 18 months ago and it says in this document that the department is now taking action to ensure that all tax credit guidance provided to staff is correct. Why has it taken so long? Once you discovered it was wrong surely it was a fairly simple matter to rectify it, why is it now that you are taking action—having discovered it about 18 months ago when did you start taking remedial action?

Ms Walker: The guidance on that particular issue, section 18, was corrected immediately and we are now studying all the rest of the guidance across the whole tax credits system to make sure that there are no other issues like that, because obviously once you have found one area where the guidance turned out not to be legally compliant we are very keen to have some assurance that there are not any others, and that is the programme we are on at the moment.

Q154 Mr Williams: It says “now taking action to see that it is correct”; is it correct now or are you still correcting?

Ms Walker: That review is not complete. We have done a lot of it and so far we have not discovered any other issues that are similar to section 18 but it is not yet complete.

Mr Williams: Thank you, Chairman.

Q155 Chairman: Thank you, Mr Williams, thank you, lady and gentlemen. It has been a very good inquiry; it is not for us to question the policy but you can be under no misapprehension as to our concern about the worrying concern about overpayments to some of the most vulnerable people in society, and I would have thought it is not beyond the wit of management to improve your advice to your clients so that as their income changes they know that they must inform you and also to make the system less finely tuned so that as their incomes rises and falls and as they move in and out of employment they are not constantly worried that they are going to incur overpayments. You must appreciate that this is a matter of huge concern to many hundreds of thousands of people. I hope that our report of this hearing will help resolve this very worrying situation. Thank you very much.

Mr Hartnett: Thank you, Chairman.

¹² Ev 22

Memorandum from HM Revenue and Customs

NAO STANDARD REPORT 2007–08 AND MODERNISING PAYE PROCESSES FOR CUSTOMERS (MPPC)

The NAO's Standard Report for HMRC was published on 14 July although it had been signed off earlier.

As in the previous two years, the chapter on PAYE contained references to our MPPC3 project to modernise our PAYE systems and, among other things, improve the speed and accuracy of our processing. The Report mentions that the expected implementation date as October 2008.

On 16 July, we decided that the implementation of MPPC3 was to be deferred. Given the close proximity of the publication of the Standard Report and our announcement, I thought it would be helpful to write to you to explain the reason for this deferral.

Given the size and importance of the PAYE system, HMRC's Executive Committee (ExCom) has taken a close interest in the MPPC3 programme. We are determined to implement it successfully. We have reviewed progress on a number of occasions and recently, as we approached implementation, we intensified our scrutiny in which we involved our non-executive directors and external advisers.

Towards the end of June a new risk relating to volumetrics in the MPPC3 programme was identified. In short, it became apparent that the volume of transactions that the new system needed to handle had been under-estimated. Urgent work was undertaken to understand the nature of this issue and to explore possible mitigation strategies. However, during the second week of July it became clear that this issue was sufficiently serious to put at risk successful delivery of the programme.

This new issue about volumetrics came up too late to be reflected in the Standard Report; or in the NAO's report on our Transformation Programme which also refers to MPPC3 being implemented in October 2008. We informed NAO as soon as the decision to defer MPPC3 was taken. We now expect to implement MPPC3 in the Spring of 2009.

21 July 2008

Supplementary Memorandum from HM Revenue & Customs

Questions 21–28 (Mr Touhig) discussed Tax Credit problems experienced by one of his constituents. Dave Hartnett promised to write to him on the matter. This matter will now be taken forward privately between Dave Hartnett and Mr. Touhig in view of taxpayer confidentiality.

Questions 46–47 (Mr Burstow) In discussing the delays in the resolution of problems with the Tax Credits system, Mr. Burstow asked whether any of the accountable staff were "financially out of pocket, in terms of bonuses" as a consequence?

Senior Civil Service (SCS) bonus arrangements are governed by Senior Salaries Review Body recommendations and the subsequent Cabinet Office (CO) advice. Depending on performance, all SCS members are considered for a bonus and CO provides guidance on the amounts available to fund bonuses and the parameters within which HMRC must work, including the percentage of SCS members who can be awarded a bonus.

As a consequence of their performance whilst working on Tax Credits, a number of the senior managers did not receive the maximum possible bonus payment and some received no bonus at all.

Since the inception of Tax Credits, 17 senior managers have been considered for bonuses for their work in this area. There has been scope to award up to 49 top bonuses but we have in fact only awarded 23 and, as a result of their performance, 9 people received no bonus at all.

Questions 88–91 (Mr. Curry) What is causing the steady rise in the administrative costs of employing the Tax Credit workforce?—how are overheads apportioned consistently?

The relationship between administrative costs and the number of staff employed has been affected by methodological changes in both 2006–07 and 2007–08.

HMRC introduced a new financial accounting system for 2006–07 which used a more appropriate method of allocating overhead expenditure. Significant overhead costs, particularly in respect of IT services, were allocated to directorates delivering centralised processing work (such as the Tax Credit Office) and customer contact centres (which in turn delivered a significant portion of their costs to tax credit delivery). The overall result was that a larger proportion of overhead costs were allocated to tax credit work in that year, creating the increase in costs reported. Additionally, the methodology used for reporting the number of staff employed on tax credit work in 2007–08 used a new on-line HR system recording staff usage.

The staffing for 2006–07 increased when the contact centres were expanded in 2006: the additional staff were initially deployed on tax credits. Some of those extra staff were subsequently redeployed into other areas of the Department's work to improve service to customers in other areas of the business.

Questions 95–96 (Mr Curry) In discussing Workforce Change, Mr Curry asked about the criteria used to calculate reasonable daily travelling time to new places of work.

The starting point for our Workforce Change Programme is the need to bring our estate into line with how we want to run our business processes in future, and that does mean closing some offices. Most business processes can be more efficiently run with much larger teams of staff than we currently have in many of our offices, and so our general planning assumption is that staff will be redeployed to join teams in offices within reasonable daily travelling time of their home. That is normally taken to be up to an hour, but will vary according to personal circumstances. Closing any office is likely to mean at least some of the staff from those offices will have farther to travel.

To determine what is reasonable, we have an established process starting with a one-to-one discussion between an individual and the manager about whether the new journey is reasonable in their particular circumstances, followed by moderating groups to ensure consistency of managerial decisions and, if necessary, grievance and appeals processes.

If individuals cannot relocate all other redeployment options will be explored with them, but the fact that some or even all staff may be outside reasonable daily travel of another office is not a sufficient reason to keep an office open if doing so would prevent business efficiencies being achieved from restructuring.

We publish overview impact assessments at the start of each consultation exercise in order to inform the consultation. They include, as an initial indication of how many staff might be able to commute to another office, estimates of staff travelling times to the offices which are relocation options, compared with travelling times to the current office. The calculations of travelling times are obtained from the government website www.transportdirect.info, using the home postcodes of the staff based at the office to be vacated, the postcode of that office, and the postcodes of the relocation options. Each journey is calculated for travel both by car and by public transport. The journey is calculated at 8:00 a.m. as being an average time at which commuters travel to work and is used to ensure that the calculation takes into account delays or congestion that may occur at a busy period.

Questions 122–123: Mr. Davidson: Numbers of people who are eligible for tax credits but don't claim, by region.

This information is published each year in the statistics reporting the take-up of tax credits. The latest available year is for 2005–6. The statistics define two types of take-up:

- The caseload take-up rate represents the proportion of families who are entitled to a positive tax credit award who take up, or claim, their entitlement.
- The expenditure take-up rate represents the proportion of total 2005–06 tax credit entitlements which have been claimed.

The key figures have been extracted and are in the table below:

	<i>Caseload</i>		<i>Expenditure</i>	
	<i>Entitled non-recipients ('000)</i>	<i>take-up rate (%)</i>	<i>Amount unclaimed (£m)</i>	<i>Expenditure take-up rate (%)</i>
North East	50	82	40	94
North West	130	80	180	90
Yorks & the Humber	70	86	80	94
East Midlands	90	78	140	88
West Midlands	80	83	130	91
East	100	80	120	90
London	220	64	340	79
South East	160	76	170	89
South West	70	84	80	93
Wales	60	78	80	89
Scotland	80	82	110	90
Northern Ireland	40	76	60	89

Notes:

In-work families only. Regions are defined according to Government Office region boundaries.

Further analyses of take up and a full description of the methodology and data sources are given in Child Tax Credit and Working Tax Credit Take up rates 2005-06 available at <http://www.hmrc.gov.uk/stats/personal-tax-credits/cwtc-take-up2005-06.pdf>

Questions 132–133 (Mr Davidson) The Numbers of tax credit complaints/disputes by geographical area

This information is not available. We do not collect geographical information on the number of complaints or disputes.

Questions 137–145 (Mr Williams) The allocation of compliance resources - why are more not put into tax credits when they are finding money—do we know whether tax credit compliance has the optimum number of people involved in it?

The level of resources applied to HMRC's various compliance activities is governed by a number of factors. These include, for example, known levels of error and fraud and the need to maintain the integrity of all the taxes, duties and benefits we administer by policing them all to sufficient minimum levels. We have now set a target to reduce the overall level of tax credits error and fraud to not more than 5% by 2011. This is a challenging target and the Department has revised its approach and strategy accordingly. Our assessment is that, with new ways of working, current levels of resourcing will enable us to maintain existing levels of compliance activity to achieve the stretching 5% target by 2011.

27 November 2008

Memorandum from the Low Incomes Tax Reform Group (LITRG)

The Low Incomes Tax Reform Group (LITRG) was set up by the Chartered Institute of Taxation to give a voice to the unrepresented taxpayer and tax credit claimant. Its members are practitioners in tax, social security and welfare rights and we seek to secure improvements in tax/benefits primary and secondary legislation, and in the administration of the tax/benefits system.

GENERAL COMMENTS

This is a short briefing from LITRG. Unfortunately we were not able to ascertain earlier the priorities of the PAC with the review being so soon after a return of Parliament. Nevertheless we hope that it will be helpful to Members.

TAX CREDITS

As we have already submitted extensive views on the existing tax credits regime to the Treasury consultation *Tax credits: improving delivery and choice—a discussion paper* we have not elaborated further here.

In our response, we have urged caution in making significant additional changes to a poorly administered system with an inflexible computer base. We believe that such changes (with the exception of those to childcare) would add complexity and confusion for tax credit claimants, if merely introduced to compensate for deficiencies.

In our view, excellent HMRC customer service is crucial to making the current system successful, but present standards fall far short of that goal. Only once this and other related defects are remedied will the true potential of the system be reached allowing a proper evaluation of what new measures, if any, are needed.

Our detailed response can be found here: http://www.litrg.org.uk/uploadedfiles/document/1_593_TRGresponsetoTaxcreditsdiscussionpaperMay2008final090908.pdf

INCOME TAX

The PAYE Service

The first area we would like to draw to the attention of Members is the new PAYE Service. The report indicates:

“In 2008 the Department is planning to transfer its processing of PAYE for individuals on to the National Insurance Recording System and so allow it to bring all information on individuals' employment and pensions income together. The Department has deferred this change from April 2008 to October 2008 to allow more time to assure supporting systems.”

In the event the launch was deferred from October 2008 until, we anticipate, October 2009.

We are very supportive of this HMRC initiative; however we have a number of concerns about the PAYE Service.

One of the most irritating difficulties for the pensioner population is the inaccuracy of the State Retirement Pension that is included within their coding notices. The new PAYE Service has the opportunity to take up to date information directly from DWP records so as to dramatically improve the accuracy of PAYE codes. However we understand that this is not proposed for the launch next year. We find this to be perverse.

The shortening of repayment periods

In the Finance Act 2008 the period of time for a taxpayer to be able to obtain a repayment where HMRC have made an error was reduced from six years to four years. We have no fundamental objection to that proposition in a normal situation; but we do have whilst HMRC have significant arrears of work and effectively owe many millions to low income families through unclaimed repayments of tax. Before this law becomes operative we want to see a major matching of data by HMRC so that we can enter this new era confident that there is not a significant number of outstanding repayments for some of the lowest income families.

The report states:

“At the end of March 2008 the Department had 16.2 million open cases, which exceeded its target of 12.5 million, because computer system developments did not deliver the reduction in cases expected, staff were released to other work and there was lower than anticipated overtime. The Department plans to reach a steady state position by 2010 where open cases for each tax year are cleared within a year and there are no backlogs for 2006–07 and earlier years.”

We would like Members to receive an assurance that proactive data matching will take place by HMRC to ensure, as far as possible, that there will be no low income customers of HMRC (in particular pensioners) who might have six years of repayments due to them when the four year cut-off comes into force. Probably the biggest sources of potential repayment lies with pensioners who have not been given their higher age-related allowances on reaching 65 or are non-taxpayers who are having tax deducted from savings income.

Campaigns to inform pensioners to take action are ineffective; the most effective way to repay is for HMRC to match data already in their possession.

Small pensions

Due to an HMRC error, going back to 1983, certain low income pensioners have not been paying the correct tax. The report indicates:

“Since 1983 the Department has not collected all the tax due from some pensioners because of a failure to apply the PAYE regulations properly. It estimates that this error could affect some 420,000 pensions with a tax loss of some £135 million per annum. It has taken steps to correct the tax treatment, but because of the deferral of the transfer of processing to the National Insurance Recording System, the Department will not now be in a position to correct tax codes until 2009–10. The Department has exercised its management discretion to waive the tax due for 2007–08 because it could not now give the taxpayers concerned reasonable notice of the tax payable. It will therefore not collect the estimated £135 million of tax due for 2007–08 as it originally planned. It will start to tax these pensions from 2008–09.”

LITRG has led a consortium of charities in assisting HMRC in the task of analysing the different types of pensioner who have been affected by this error. HMRC have approached this task sympathetically and with considerable professionalism.

Clearly they have a responsibility to collect taxes which are legally payable (subject to their care and management discretion), but the underpayment problem does seem to be of a much smaller scale than originally envisaged.

However it is critical that communications to pensioners (who are still in the dark) commence in the next few days. A failure to do so would mean that pensioners would otherwise first learn that they are in debt to HMRC just before Christmas. The longer the communication is withheld the greater the build-up of debt since 6 April 2008. If such delays do continue until December, it would be appropriate to write-off the amounts for 2008–09 and start with a clean sheet from 6 April 2009.

Self-assessment

We could write a complete report on Self Assessment issues; we have restrained ourselves and would only mention one running sore of the SA system. A pensioner whose sole income is derived from the State Retirement Pension (SRP) and is above the personal allowance threshold is put into the Self Assessment system. This is administrative overkill and was never anticipated when the SA system was devised. The resolution of this problem is down to better procedures between the DWP and HMRC and we would welcome a recommendation from Members that those two departments should jointly sit down with us and adopt one of the solutions that we have advocated.

This would also have the additional benefit of ensuring that Pension Credit claims would be increased as the Self Assessment tax suffered on the SRP would be brought within the PAYE system and would automatically be picked up by the DWP. At present the DWP do not take Self Assessment tax into account when computing entitlement to Pension Credit, even though the law requires them to do so.

October 2008
