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NATIONAL AUDIT OFFICE

HM REVENUE AND CUSTOMS

Filing of Income Tax Self Assessment Returns

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 74 Session 2005-2006 | 22 June 2005

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Filing of Income Tax Self Assessment Returns

A report by the Comptroller and Auditor General

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HM REVENUE AND CUSTOMS

Filing of Income Tax Self Assessment Returns

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John Bourn
Comptroller and Auditor General
National Audit Office

18 May 2005

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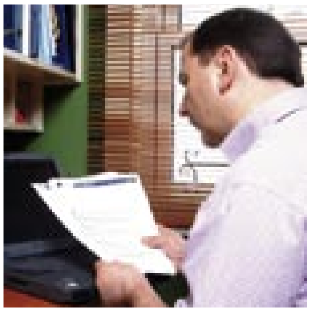

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EXECUTIVE SUMMARY

1 Self Assessment returns enable taxpayers to establish how much Income Tax they should pay and provide HM Revenue and Customs with the information it needs to validate their calculations. For the tax year 2003-04, the Department sent Income Tax Self Assessment forms to 10 million of around 35 million individuals, partnerships and trusts who pay Income Tax. Just over nine out of 10 people filed their completed forms by the 31 January 2005 deadline. HM Revenue and Customs collected £16 billion from Income Tax Self Assessment net of repayments in 2003-04. It has targets for returns filed on time, those filed within 12 months of the deadline, and accuracy rates for both filed returns and for the Department's processing of returns. It uses publicity campaigns to encourage people to file their completed tax forms early, by the deadline and to do so electronically. It has a range of sanctions to encourage taxpayers to file their returns and to penalise them if they do not.

2 Until April 2005, responsibility for operating Income Tax Self Assessment was vested in the Inland Revenue. The Commissioners for Revenue and Customs Act 2005 received Royal Assent on 7th April 2005. The Act provided the legal basis for the new integrated Department, HM Revenue and Customs, which was launched on 18th April 2005. HM Revenue and Customs exercises the functions previously vested in the Inland Revenue and HM Customs and Excise. In this report, references to HM Revenue and Customs, or the Department, cover both the functions of the Inland Revenue up to 18th April 2005 and the new HM Revenue and Customs.

3 This report examines the Department's progress in securing correct Income Tax returns on time from those who should submit them. It covers:

- **The need for tax returns** – why taxpayers should file them on time and accurately **(Part 1)**;
- **Timeliness** – the Department's performance in getting returns in by the deadline and in chasing late returns **(Part 2)**;
- **Accuracy** – of taxpayers in submitting returns and of the Department in processing them **(Part 3)**;
- **Simplicity** – the Department's progress in making the forms easier for people to complete to reduce compliance and processing costs **(Part 4)**.

4 Our study methodology is at Appendix 1. It included modelling the Self Assessment process, comparisons with the processes of revenue departments in seven other countries, assessing the tax forms for ease of use by non-professionals, consulting organisations with a professional interest in tax returns, and holding focus groups with HM Revenue and Customs' staff. We also examined the Department's progress in implementing previous recommendations in the Committee of Public Accounts reports on "Income Tax Self Assessment" (HC 296 2001-2002) and "e-Revenue" (HC 707 2001-2002) (Appendix 2).

Our main findings are:

Previous recommendations by the Committee of Public Accounts

5 HM Revenue and Customs is making progress in implementing the Committee's recent recommendations by making greater use of sanctions to encourage filing of overdue returns, simplifying tax forms to make returns easier for people to complete and increasing the number filed electronically. It is reviewing the effectiveness of the sanctions available to encourage taxpayers to file returns.

Encouraging taxpayers to file on time

6 As at July 2004, an estimated £1.1 billion of Income Tax was outstanding from 1.1 million overdue returns. This estimate is based on the average net amount of £1,000 assessed as due per return filed more than six months late, although the Department prioritises pursuit of cases which it considers highest risk. A significant proportion was outstanding from taxpayers whom the Department could not trace, were living abroad or were insolvent. The percentage of returns filed on time and within 12 months of the due date fell between 1998 and 2001. HM Revenue and Customs has since stemmed the decline and reports it achieved its Public Service Agreement target of 90.6 per cent filed on time by the 31 January 2005 deadline. It has a further target to increase the percentage of returns filed on time to 93 per cent by January 2008. But the Department has also removed over one million taxpayers with very simple tax affairs from the need to file returns for the 2004-05 tax year. As these have a better record of filing on time it will make the new target harder to achieve.

7 The Department has a target to obtain 35 per cent of Self Assessment returns electronically by 2007-08, with an interim target of 25 per cent by 2005-06. It achieved 12 per cent for returns in 2003-04 and met its forecast of 17 per cent (just over 1.6 million) of returns submitted electronically in 2004-05. The Department encourages all taxpayers to file their returns electronically. Taxpayers and their agents can use the internet service (www.hmrc.gov.uk) and their agents can use an electronic lodgement service. To increase take up of online services HM Revenue and Customs targets groups with high potential to file electronically through e-marketing campaigns. Over the weekend of 29 and 30 January 2005, the online filing service did not send an instantaneous success or error message to around 80,000 people when they submitted their completed return, although confirmation followed early on 31 January. HM Revenue and Customs is undertaking a comprehensive review of the problems experienced to identify the causes and to prevent similar occurrences in the future.

8 HM Revenue and Customs has identified the groups of taxpayers at high risk of late filing. These include young male taxpayers, those who are new to filing a tax return, those with no further tax to pay, those in the Construction Industry Scheme and taxpayers in parts of London. It has researched the causes of late filing and has developed an action plan to achieve its target of 93 per cent filing by 31 January 2008, focusing on these groups. It runs national media campaigns to encourage taxpayers to file on time. Before the deadline it writes to those who have not yet filed and telephones some people at high risk of late filing.

9 HM Revenue and Customs issues automatic penalties of up to £100 to taxpayers who have not filed their tax returns by the deadline. But these penalties are limited, by law, to the amount of tax owed which, in our view and confirmed by HM Revenue and Customs research, reduces their effectiveness in getting returns in on time where little or no further tax is payable. Around 60 per cent of taxpayers who file up to six months late have no further tax payable from their return or are due a repayment, so HM Revenue and Customs cannot impose a penalty. In some countries, penalties for late filing are a percentage of the tax owed or are related to the taxpayer's net income.

Encouraging taxpayers to file overdue returns

10 At July 2004, over 260,000 taxpayers had more than one return outstanding, and over 12,000 of these taxpayers had six or more returns outstanding. HM Revenue and Customs pursues overdue returns through its Receivables Management Service which is dealing with around 130,000 taxpayers to obtain their tax returns and recover the tax due and attempting to trace around a further 100,000 of these people. Around 35,000 of those with more than one return outstanding are insolvent or living abroad. The Department undertakes compliance work to identify moonlighters and "ghost" traders. Since April 2002, HM Revenue and Customs' Right Track Teams have identified 89,000 people who are not registered for Self Assessment who should be filing tax returns – those working in the shadow economy or having multiple jobs. A further 19,000 people have voluntarily come forward to notify HM Revenue and Customs of the need to register.

11 **The Department has a range of sanctions to penalise late filers and encourage them to submit their returns including determinations of the tax due, charging interest, automatic and daily penalties and court action.** The main purpose of daily penalties is to get returns in, establish the liability and collect any outstanding debt. Taxpayer awareness of the penalty regime is not high. Research indicates that only one third of taxpayers know that daily penalities may be imposed if they fail to file returns. Under the Spend to Save initiative announced in the 2003 Budget the Department was given additional funding to make greater use of daily penalties to bring in Self Assessment returns from recalcitrant taxpayers and deliver additional tax yield. In about a quarter of cases where the Department has threatened to raise daily penalties it has been sufficient to bring in the outstanding returns. The projected additional Income Tax yield over the three years from 1 March 2003 to 31 March 2006 was £470 million but the Department now projects that the final yield may be less. The projected shortfall in addtional Income Tax yield is partly due to there being fewer taxpayers than the Department expected against whom it needs to take penalty action. With the benefit of additional information and analysis, the Department should have a clearer understanding of the reasons for the projected shortfall and it is continuing to monitor the performance of cases to assess the effect upon compliance, filing and payment behaviours.

12 **HM Revenue and Customs can make an estimate (or determination) of the tax due and pursue the taxpayer for payment of this estimated amount to encourage the taxpayer to submit their outstanding returns and thus reveal their true tax liability.** For the 2002-03 tax year, the Department raised 260,000 determinations totalling £540 million. In July 2004, the Department was pursuing some £330 million of Income Tax due from all determinations issued up to that date on returns that were still outstanding.

Helping taxpayers file accurate returns

13 **The Department estimates that taxpayers make errors in around 32 per cent of tax forms filed. Some are simple mistakes and others are due to more deliberate non-compliance such as fraudulent under or non-declaration of income. HM Revenue and Customs carries out random enquiries on a sample of returns to estimate the overall percentage of returns with errors.** This has shown that around three quarters of the tax liability from inaccurate returns is accounted for by just five per cent of returns. The highest levels of error are in returns from partnerships and sole traders. The Department estimates that around £2.8 billion in the 2000-01 tax year (the most recent result available) was at risk from inaccurate returns, but this is subject to a significant margin of error.[1] Significantly improving the accuracy of this estimate would require examining a much larger random sample of returns. The estimated amount at risk was equivalent to 18 per cent of the net receipts of Income Tax Self Assessment in 2000-01 and around four per cent of the taxes of the Self Assessment population, both deducted at source and Self Assessed.

14 **The Department carries out checks during processing of filed returns to identify and, where possible, correct simple errors and mistakes made by taxpayers and undertakes enquiries into some returns.** Online filing automatically checks for taxpayer errors and calculates the tax. The Department also offers help in completing forms through its enquiry centres, helplines and website. Taxpayer representative groups consider the information on the website is helpful but that some telephone helpline staff often lack the detailed knowledge to respond consistently and accurately to tax enquiries. They have also experienced difficulties in getting through to helplines at peak times. HM Revenue and Customs carries out enquiries into some Self Assessment Income Tax returns which may involve an extensive examination considering all aspects of the taxpayer's tax affairs. Such enquiries help HM Revenue and Customs identify any taxpayer errors as well as more deliberate non-compliance such as fraud.

1 This estimate is subject to a confidence interval of plus or minus 19 per cent (£530 million). The figure underestimates the true extent of tax at risk because not all enquiries will identify all non-disclosed income. The Department is considering whether to uprate the figure to account for non-discovered non-compliance.

15 HM Revenue and Customs consults agents to canvass their opinion about the filing process and the guidance it provides to taxpayers. More generally agents have a role in encouraging their clients to file accurate returns on time. Agents are more likely to file their clients' returns close to the deadline than unrepresented taxpayers. After consulting with representative groups HM Revenue and Customs wrote to certain groups of taxpayers alerting them to the most common mistakes made in completing tax returns. More queries were made concerning the letters than the Department expected from earlier trials because some people interpreted them as suggesting they should put right a specific problem on their previous tax return, rather than as enabling them to avoid these mistakes in future. Once the letter is clarified, it may provide an effective mechanism for improving compliance amongst those groups with a higher risk of errors in their returns.

Accuracy of HM Revenue and Customs' processing of filed returns and tax codes

16 HM Revenue and Customs has a target to achieve accurate processing in 95 per cent of Self Assessment cases. In 2003-04, the Department estimated that it made mistakes in the processing of six per cent of returns (500,000) which may have led to errors in the assessed tax liability. The Department examines a sample of 20,000 processed returns to measure the accuracy of its processing work and to estimate the effect of its mistakes on tax bills. In 2003-04, the Department estimated that total under and over charges to taxpayers resulting from its mistakes were around £120 million (£70 million undercharges and £50 million overcharges). 12 per cent of over charging errors found exceeded £500. Taxpayers without agents may be less well placed to identify HM Revenue and Customs' mistakes in processing returns and in calculating their tax. The Department has improved performance in those offices with a poorer record of accurate processing through its quality assurance and quality control procedures which provide managers with information on common errors. And it has introduced annual quality action plans to improve performance more generally. Around 25 per cent of returns are filed within two weeks of the January 31 deadline, which causes a major peak in workload at the Department and higher risks of internal inaccuracies.

17 The Department estimates it incorrectly imposed in 2004 late filing penalties on around 30,000 taxpayers (three per cent of all taxpayers with penalties imposed and 0.3 per cent of all taxpayers) who had filed by the deadline. Around 20,000 of these were due to mistakes in logging returns on the day of receipt. The Department cannot identify individual taxpayers who have incorrectly received a penalty. The penalty notice tells people what to do if they do not know why they have been sent the notice. Taxpayers without agents may be less well placed to identify or respond to HM Revenue and Customs' mistakes in issuing penalties. In November 2004, the Department improved its system for logging in returns on the day of receipt and tracking the location of returns.

18 An individual's Pay As You Earn tax code determines the deductions from pay that are made for Income Tax during the year, based on an estimate of forecast income. An accurate Pay As You Earn tax code is therefore important to HM Revenue and Customs in collecting the right level of tax through Pay As You Earn and minimising the amount that might become payable on completion of the tax return at the end of the year. With the changes underway to remove the requirement to complete a tax return for some taxpayers, accurate Pay As You Earn tax codes assume even greater importance. The Department measures its accuracy in setting taxpayers' tax codes. In 2003-04, the Department made around two million coding errors and had an accuracy rate of 71 per cent. A third of Departmental errors were due to failure to update a taxpayer's code in line with information the taxpayer had given on their tax return. Other mistakes were made in calculating codes for people with multiple sources of employment income and people with investments. Taxpayers without agents may be less well placed to identify HM Revenue and Customs' mistakes in setting their tax codes. For taxpayers who will not need to file a return from 2004-05 onwards, HM Revenue and Customs will identify those who should receive a short Tax Review Form which asks for details of taxable income and of claims for some kinds of tax relief. It has also introduced a coding tool (for more complex cases) to improve its accuracy in determining Pay As You Earn tax codes by reducing the need for manual calculation of tax codes.

Simplicity of the tax forms

19 **HM Revenue and Customs' tax forms compare well with other countries in terms of clarity and ease of use by those who are not tax professionals.** The Department has introduced a new four page short form for around 1.5 million taxpayers with simple financial affairs. It estimates this will save each taxpayer one hour compared to completing the full tax return resulting in an overall saving of around 1.5 million hours for taxpayers. Piloting of the short form proved it was quicker for taxpayers to complete, and for the Department to capture the data provided and to process, although there have been teething problems with scanning the returned forms. The removal of over one million taxpayers with very simple financial affairs from Self Assessment in 2004-05 will further reduce compliance costs and improve the net revenue yield, as many of these people may have less tax owing than the cost of processing their return. It will also reduce overall operating costs for HM Revenue and Customs. The Department is planning improvements to the main return for people with more complicated tax affairs.

HM Revenue and Customs' processing of tax returns

20 **Operating Income Tax Self Assessment costs HM Revenue and Customs over £220 million a year or around £22 per tax return.** As a broad comparison the cost of processing benefits applications ranges from £17 for the Social Fund to £60 for Income Support applications. Chasing overdue tax returns and carrying out enquiries to confirm whether the right amount of tax is being declared incurs further costs. The Department collects around £70 in Self Assessment Income Tax for every £1 spent operating Self Assessment.

21 **The private sector uses various methods to manage efficiently the processing of large volumes of communications with its customers. These include standard processing times and projected volumes of work to identify processing centres which are over or under capacity.** HM Revenue and Customs is carrying out a trial within its Lothian Area to improve its processing of tax returns by eliminating waste and introducing standardised, quicker, more efficient and more accurate procedures.

22 **Experience of tax authorities in other countries suggests that HM Revenue and Customs might consider more fundamental changes to the filing process to get returns in earlier and reduce operating costs by smoothing the flow of work although any decision on filing dates would be for Ministers.** For example, taxpayers in the United Kingdom have 10 months to file their returns. Other tax authorities typically allow taxpayers only three to four months to file their returns, granting extensions to those who apply for extra time or those who use agents.

Overall Conclusions

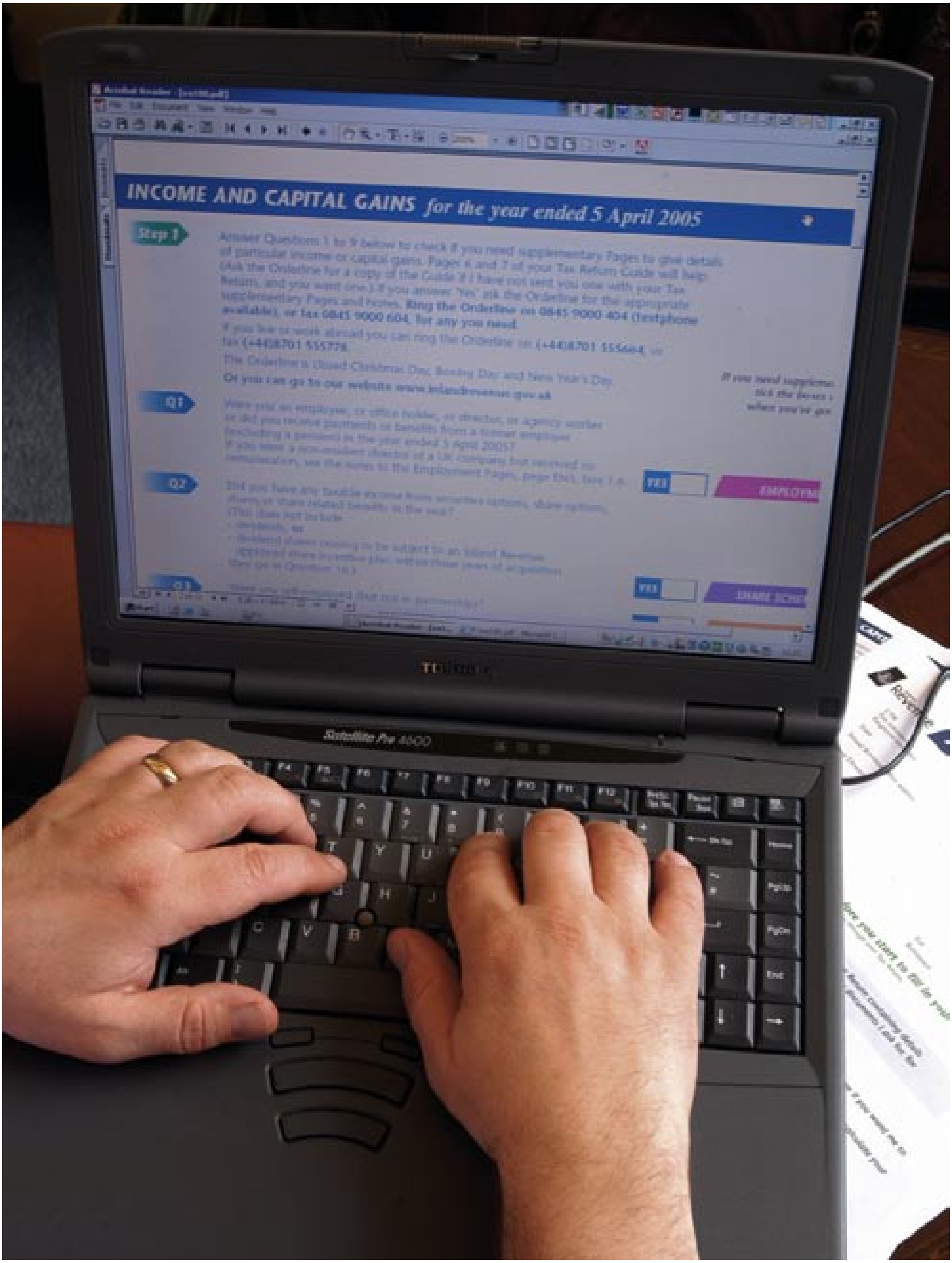
i **Getting tax returns in on time is important as it allows timely assessment and collection of tax as well as minimising the costs of chasing late returns. HM Revenue and Customs has stemmed the fall in people filing their tax returns by the due date and the percentage of taxpayers who filed by the 31 January deadline has now stabilised at just over 90 per cent.** Achieving its higher target of 93 per cent of tax returns filed on time by January 2008 will be a challenge not least because of the removal of some taxpayers, who have a better than average filing record, from the requirement to file. HM Revenue and Customs intends to target those groups at risk of late filing.

ii **The wider review by HM Revenue and Customs of sanctions currently underway provides an opportunity to improve the effectiveness of the penalty regime for late filing of Self Assessment returns.** In particular, the effectiveness of the penalties for deterring late filing are diminished because the Department cannot, by law, impose the automatic penalties if people have no further tax liability; and there are significant numbers of people with two or more outstanding returns who have not yet had daily penalties imposed.

iii **There is considerable scope to improve tax yield by improving the accuracy of returns.** Some 32 per cent of tax returns contain accidental or deliberate inaccuracies by the taxpayer. As a result around £2.8 billion is at risk from liabilities not being accurately stated in returns (although this amount is subject to a wide margin of error). The Department targets those at risk of high value errors and is working to improve the accuracy of its targeting. Further improvements in return accuracy could reduce the tax at risk. The distribution of inaccuracies is highly skewed ranging from a few pounds at the low end to a very few with several thousands of pounds at risk. Considering the average amount at risk, a one per cent point reduction in the error rate of returns filed by such taxpayers would reduce the tax at risk by at least £28 million. HM Revenue and Customs could build on the work it has done to identify common mistakes by working more closely with agents.

iv **Taxpayers expect that their returns will be processed accurately by HM Revenue and Customs. This is not always the case.** There were processing errors by the Department in around six per cent of returns filed (500,000 returns). This can lead to inaccurate assessment of tax liabilities, incorrectly applied penalties and inaccurate Pay As You Earn tax codes as well as higher compliance costs to taxpayers and their agents in rectifying the mistakes. The Department is introducing various measures which should improve its accuracy of Pay As You Earn tax codes which will be essential to the success of other measures underway to simplify the reporting obligations of taxpayers with simpler tax affairs. It also needs to improve its accuracy in logging returns and so prevent issuing penalties wrongly rather than relying on taxpayers or their agents to challenge any errors.

v **HM Revenue and Customs' advisory service to taxpayers in the form of guidance, enquiry centres, dealing with people with complex financial affairs and the ease in completing forms, is comparable with the best practice of tax authorities in other countries. But there is scope for HM Revenue and Customs to improve communications with taxpayers in alerting them to commonly made mistakes in completing returns and in providing access to consistent and accurate advice.** HM Revenue and Customs is continuing to improve the main form and supporting guidance. The introduction of the short form is likely to reduce compliance costs for taxpayers and HM Revenue and Customs alike provided that teething problems with scanning documents can be resolved. There is also scope for HM Revenue and Customs to draw on private sector experience in efficient processing, workload smoothing and having standardised work processes and the Department is currently undertaking a trial in its Lothian Area to improve its processing of tax returns.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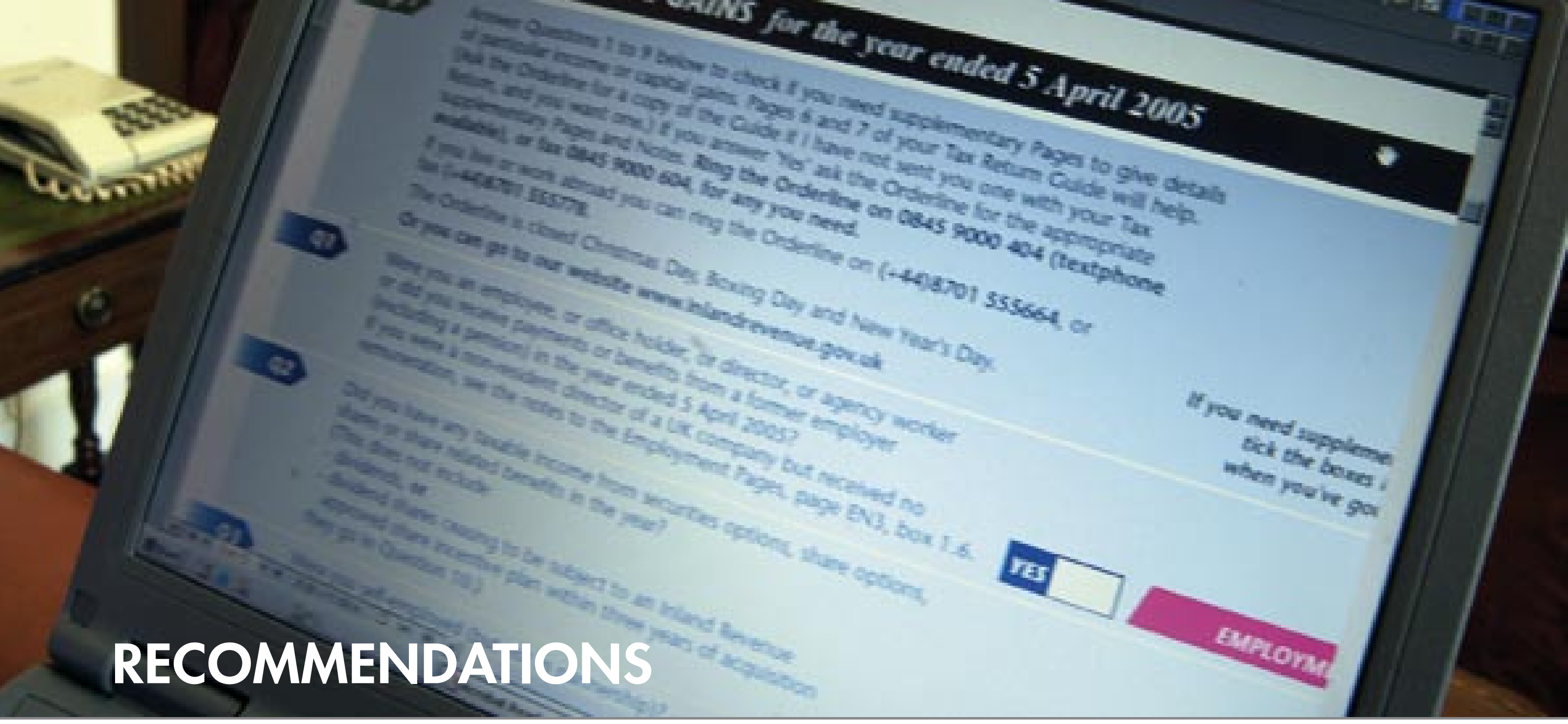


RECOMMENDATIONS

The recommendations are focused around seven areas:

a Achieving the 2008 Public Service Agreement filing target of 93 per cent

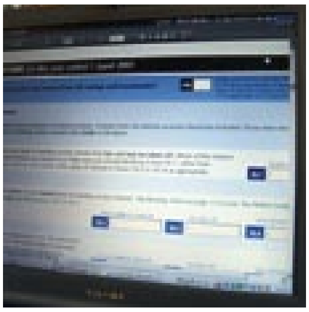
To increase the proportion of taxpayers who file on time the Department has identified and targeted those groups most likely to file late such as those in the Construction Industry Scheme. It needs to assess the potential effects of any improvement in filing on time on the accuracy of filed returns, efficiency and tax yield, and take steps to manage these through monitoring the level of returns filed without errors, internal accuracy in processing returns, total operating costs, costs per return issued, and the amount of tax outstanding from late returns.

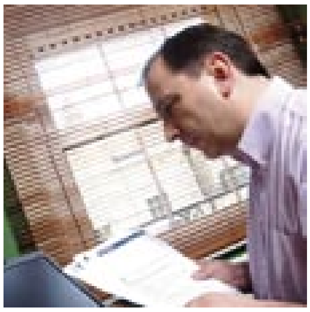
b Using sanctions to encourage filing of returns by the due date

To improve the effectiveness of the sanctions against those who file late or have outstanding tax returns and to deter late filing HM Revenue and Customs, as part of its review of sanctions, should:

- with the help of the National Audit Office, review the Department's processes for imposing daily penalties against those who persistently fail to submit their tax returns taking account of the ongoing results of the Spend to Save initiative[2] on daily penalties in gaining additional Income Tax yield;
- improve its information on the payment of penalties to ensure that penalties are rigorously enforced;
- communicate the risk of penalties directly to taxpayers by targeting its media campaigns to raise awareness. The Department started this in 2005 with media campaigns highlighting fixed penalties for late filing;
- determine whether new or greater sanctions are needed to change taxpayers' behaviour, so that more people file on time, for example, by increasing the scale of the penalty for those with a return outstanding particularly where significant tax amounts are at risk; and
- examine the level of the existing automatic penalties and explore whether a minimum penalty could be set and the penalty be linked to a taxpayer's tax liability.

2 The Department's Spend to Save Initiative was announced in the 2003 Budget. It focused on areas with significant risks to tax receipts and where targeted compliance work was expected to be highly effective.





c Improving the accuracy of HM Revenue and Customs' processing of filed returns

The Department has developed a quality assurance and control process to address high rates of internal errors. Its Quality Monitoring Exercise is also providing information on the main types of processing errors and the consequent effect on tax liabilities notified to taxpayers. It is analysing the information to help reduce the risk of errors, compliance costs (particularly for taxpayers without agents) and losses in tax. The Department should now use that information to drive up accuracy rates.

Pay As You Earn tax coding work is one of the main areas where internal errors occur. The Department is monitoring the type and frequency of its coding errors which are mainly related to failures to update codings following the input of data on tax returns and internal mistakes in coding taxable benefits. The Department should ensure the information on internal accuracy of tax codes and the main types of error is used by regional management to tackle the internal causes of error and improve the overall rate of accuracy.

The Department should improve the accuracy of its recording of when returns are filed to reduce the number of taxpayers who receive automatic penalties in error. In November 2004, it improved its system for logging in returns on the day of receipt and to help track the location of returns. The Department should assess the effect of its improvements during 2005 on the levels of automatic penalties issued correctly and those issued in error. Given the recurrences in issuing automatic penalties to some people who filed by the deadline, the Department should, in future years, record the reasons for cancelling automatic penalties. This will enable it to assess the difference between the number of penalty notices it estimates it has issued wrongly and the number of people affected who have successfully challenged its errors.

d **Improving the Self Assessment form and support for taxpayers**

HM Revenue and Customs, as part of its review of the main tax return form, should improve the clarity of the form and seek to reduce compliance costs for taxpayers by:

- greater use of plain English supported by guidance focused on the needs of specific groups, such as those without agents, Construction Industry Scheme members, those with multiple employments and the newly self employed;
- improved information for taxpayers and staff on the main errors, for example by posting them prominently on its website;
- providing information to taxpayers on the common mistakes made in completing returns and consulting with stakeholder organisations to make sure the letters will achieve the desired effect;
- providing face to face support for those taxpayer groups who cannot use other means, such as the telephone and the internet, either at its enquiry centres or through organised events in the local community;
- providing enhanced training for call centre staff to ensure they can handle enquiries effectively, accurately and consistently and managing capacity to reduce the likelihood of taxpayers not getting through to the helplines.

Removing the obligation to file returns from over one million people with very simple financial affairs has many benefits. There is a risk that such taxpayers may subsequently not notify HM Revenue and Customs of changes to their circumstances which may require them to make a tax return. The Department estimate the risk of lost tax revenue is some £5.5 million a year. The Department should evaluate the benefits and the actual effect on tax revenue after the first year to determine whether more people can be removed from the obligation to file without risk of material loss of revenue and whether taxpayers who have overpaid Income Tax and who are no longer sent a tax return, receive the repayments due to them.

e **Improving management information to evaluate the effectiveness of the Department's processes and sanctions**

HM Revenue and Customs should determine the benefits and costs of generating further information to enable it to manage its processes and meet its responsibilities on filing returns more effectively. This should include:

- developing systems to enable it to track the imposition of penalties and their enforcement;
- monitoring the impact of its errors in processing, coding and imposition of penalties;
- assessing the impact of overdue returns on the amount of tax outstanding and at risk.

f **Reducing operational costs and improving efficiency**

Removing the obligation on people to file returns and the use of e-filing reduces costs both to taxpayers and the Department. The Department has had increasing success in encouraging taxpayers to file electronically. However, in the light of the problems around 80,000 taxpayers had in filing their returns electronically at the end of January 2005, the Department needs to ensure that its service be fully available and accessible at all times and that contingency plans be in place if systems fail. HM Revenue and Customs should, in time, when appropriate IT systems are in place, consider the cost effectiveness of pre-completing parts of the tax return forms for taxpayers as an incentive to file returns electronically, for example, by including on the online version of tax returns the Pay As You Earn information it receives directly from employers.

g Smoothing of workflow of processing tax returns to aid efficiency and accuracy

HM Revenue and Customs should improve efficiency of processing returns by:

- reducing the numerous centres inputting data thereby pooling their resources to achieve economies of scale in handling the volumes of work and peaks in workload;
- evaluating, and adopting where appropriate, the good practice in the private sector and emerging from the trial in its Lothian Area to identify opportunities for savings and ensuring the continuous flow of returns through its processing stages;
- making savings in data capture costs by ensuring that its review of the main tax return includes a requirement in time for the revised core pages to be capable of scanning in the same way as the new short tax return has been designed to be scanned in.

Self Assessment has existed for eight years. While much of the Self Assessment taxpayer population is now more familiar with the process, taxpayers are increasingly filing tax returns later each year. The Department should explore differential filing dates for paper and electronically filed returns although the decision would be for Ministers. Changing the filing deadlines and reducing the period which taxpayers are given to complete their returns could reduce operating costs, by smoothing the peak flow of work associated with paper returns. It would also have the further advantages of enabling the Department:

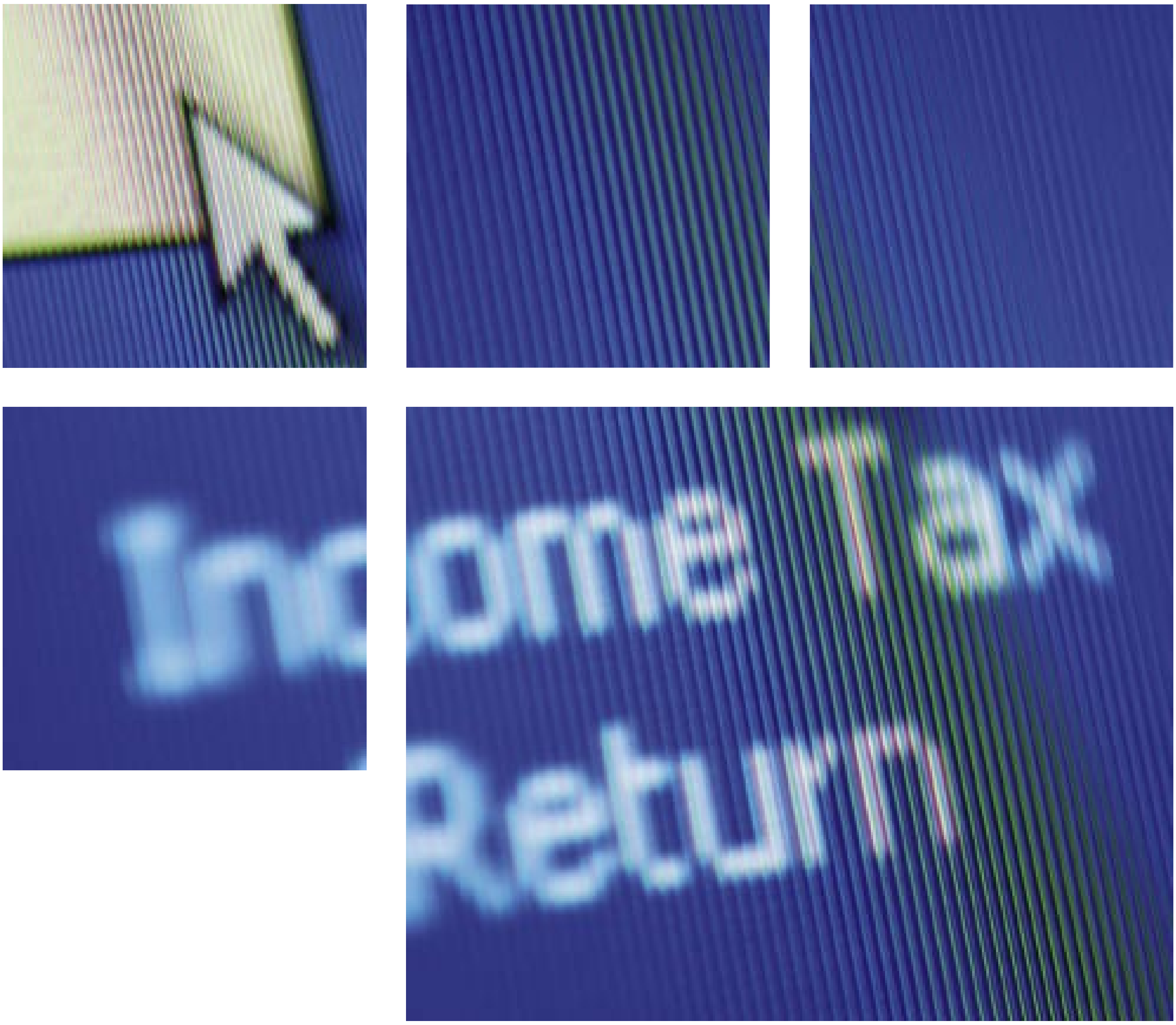
- to take account of any over/underpayment of tax in Pay As You Earn coding for the next tax year, as the coding exercise is performed in mid-January;
- to start debt collection earlier as filed returns could be processed earlier;
- to have more time to process returns accurately (currently 25 percent of returns are filed in the two weeks before the deadline of 31 January and all returns filed by the deadline have to be processed by 31 March).

Any changes in these dates would need consultation with stakeholder groups to convey the benefits for compliant taxpayers, and tested to ensure improved accuracy and efficiency can be delivered.

The Department should also review the optimal timing for sending out paper tax returns and issuing taxpayers with notices to file. While HM Revenue and Customs sends these out in April many employed taxpayers do not complete their form until they receive their P60 form(s) which provide details of earned income. This is not issued until the Summer. A later despatch of returns and notices to file may ensure that most people receive the return at a time when they are in a position to file. This would enable the Department to have finished the processing of previous years' returns and so have a more accurate list of taxpayers who should be included in Self Assessment, and which of those should have a short tax return. It need not delay taxpayers from filing online for those wishing to claim a repayment.

The Recommendations above could result in significant additional revenue or efficiency savings. The National Audit Office is working with HM Revenue and Customs to determine how these may be most effectively achieved.

PART ONE
The need for tax returns



Taxpayers with a number of sources of income and with less straightforward financial affairs are required to complete Self Assessment returns to establish accurately how much Income Tax they should pay. HM Revenue and Customs collected around £16 billion net of repayments through Income Tax Self Assessment in 2003-04. Out of nearly 35 million people who pay Income Tax, around 10 million individuals, partnerships and trusts were sent a 2003-04 tax form by the Department. In 2003-04, over one million taxpayers filed online or by an electronic service used by their agents. The Department has removed over one million taxpayers from the need to file and has moved around a further 1.5 million onto a four page short tax return. It has targets for the percentage filed by the 31 January deadline, for the percentage of taxpayers who file accurate returns and for the percentage of returns which it processes accurately. The average amount of Income Tax assessed as due, over and beyond that deducted at source, is around £1,600 per return.

1.1 There are nearly 35 million Income Taxpayers in the United Kingdom. Some 10 million individuals, partnerships and trusts are required to file Self Assessment returns to establish accurately how much Income Tax they should pay. The Department identifies registered taxpayers who meet the criteria for Self Assessment from a number of sources, such as Pay As You Earn details provided by employers. When HM Revenue and Customs issues a tax return or a notice to file the taxpayer must, by law, complete and return the form. Taxpayers who have untaxed income or capital gains are responsible for notifying the Department if they have not received a Self Assessment form to allow the Department to determine whether they should be issued with one.

1.2 Most taxpayers who receive their income after Income Tax has been deducted from their pay and pension by the Pay As You Earn system and who have very simple financial affairs, have already paid the correct amount of Income Tax. Other taxpayers, who have other sources of income and whose financial affairs are less simple, are required to complete Self Assessment returns. HM Revenue and Customs is responsible for ensuring the right people receive a return and a notice to file and for ensuring taxpayers comply by filing a return and paying any liability.

1.3 Until April 2005, responsibility for operating Income Tax Self Assessment was vested in the Inland Revenue. The Commissioners for Revenue and Customs Act 2005 received Royal Assent on 7th April 2005. The Act provided the legal basis for the new integrated Department, HM Revenue and Customs, which was launched on 18th April 2005. HM Revenue and Customs exercises the functions previously vested in the Inland Revenue and HM Customs and Excise. In this report, references to HM Revenue and Customs, or the Department, cover both the functions of the Inland Revenue up to 18th April 2005 and the new HM Revenue and Customs.

1.4 HM Revenue and Customs introduced Self Assessment for Income Tax and Capital Gains Tax in 1996 with the first returns being issued to taxpayers in April 1997. The core section of the main Self Assessment tax return consists of 10 pages together with a Tax Return Guide and a Tax Calculation Guide. HM Revenue and Customs will send out any supplementary pages and guides that it thinks are likely to be required by the individual taxpayer. The taxpayer may also request any supplementary pages they need. The bulk of returns are issued centrally on 6th April to all those that the Department considers need a return for that year. Taxpayers who have previously filed electronically or, if they are represented, had their return filed using their agents' software, receive a Notice to file a return (Appendix 3).

1.5 The number of individuals, partnerships and trusts having to file Self Assessment returns increased from 8.5 million in 1996-97 to 10 million in 2003-04. HM Revenue and Customs has revised the criteria for including people within Self Assessment and, as a result, has removed over one million individual taxpayers from Self Assessment from 2004-05 onwards. Those who will no longer need to file returns are mainly employees and pensioners with very straightforward affairs who largely pay all their Income Tax due through Pay As You Earn. HM Revenue and Customs' aim in making this change is to reduce obligations on taxpayers. The Department has estimated that the tax at risk from these changes is relatively small - £5.5 million a year.

1.6 HM Revenue and Customs has written to these taxpayers to inform them that it plans to stop sending them a Self Assessment return. It may send them a Tax Review Form on average every three years, on which they will have to provide details of their taxable income and certain kinds of tax relief (Appendix 3). The Department issued some 390,000 Tax Review Forms for the tax year 2002-03. It does not monitor when Tax Review Forms are filed by taxpayers, but if the forms are not submitted by the time of the annual coding exercise in early January, HM Revenue and Customs will review the taxpayer's tax position for the year in which it was issued. Some tax reliefs may not be taken into account and some tax deductions may be increased.

Short tax return

1.7 Following HM Revenue and Customs' review of Self Assessment, it has developed a short tax return. This is in response to demands from taxpayers, their agents and HM Revenue and Customs' staff for a new form to address the needs of people with simple affairs, and is consistent with the recommendations of the Treasury Sub Committee on Self Assessment and the report 'Difficult Forms: How Government agencies interact with citizens'.[3]

1.8 The short tax return is a four page form designed for employees, the self employed with turnover of less than £15,000, pensioners, people with property income in the United Kingdom below £15,000 and people receiving saving and investment income, who have simple financial affairs. HM Revenue and Customs issued this return as a pilot exercise to over 400,000 Self Assessment taxpayers in 2003-04 and has sent it to around 1.5 million Self Assessment taxpayers for the 2004-05 tax year (**Figure 1** and Appendix 3). Initial experience of the short tax return indicates no significant difference in the percentage filed on time, compared to the main tax return.

Self Assessment online service

1.9 All taxpayers are encouraged by HM Revenue and Customs to file their tax returns electronically. Taxpayers and agents can use HM Revenue and Customs' internet service (www.hmrc.gov.uk). Agents can also use the Electronic Lodgement Service. The Department has a target to obtain 35 per cent of Self Assessment returns electronically by 2007-08 and an interim target of 25 per cent by 2005-06. The Department met its forecast of 17 per cent electronic returns in 2004-05. This compares with 12 per cent achieved in 2003-04.

3 *'Difficult Forms: How Government agencies interact with citizens'* Report by the Comptroller and Auditor General, HC 1145, Session 2002-03, October 2003.

1 Self Assessment requirements by taxpayer group in 2005-06

Taxpayer category	Type of return to be filed		Number of people
Very simple financial affairs	**Not required** to complete a Self Assessment return		26 million
	■ May receive a **Tax Review Form** at least once every three years, to provide their taxable income and details of claims for some kinds of tax relief	2 million (over a three year period)	
Simple financial affairs	Required to complete a **short Self Assessment return**		1.5 million
More complicated tax affairs	Required to complete the **main Self Assessment return**		7.2 million

Source: National Audit Office analysis of HM Revenue and Customs' data

1.10 HM Revenue and Customs has a relatively low take up of electronic filing compared to tax authorities overseas - 17 per cent compared to 44 per cent in the United States of America and 83 per cent in Australia in 2004. The higher take up in other countries is due to a combination of factors. In some other countries there is encouragement for many people to file a tax return electronically because they are owed a refund of tax (such as Australia where 78 per cent of individual tax assessments resulted in a refund in 2004, and the United States). The e-filing service in these countries offers an incentive of likely earlier repayment of tax refunds. In Australia, returns lodged electronically have a standard to be processed within 14 days, compared to 42 days for returns lodged on paper. In addition to a quicker repayment in Canada, of within as few as 10 working days, Canada also promotes to taxpayers further benefits of electronic filing such as reduced usage of paper and costs of postage as well as helping them file accurate returns. Another difference is issuing returns which are significantly pre-completed by the tax authority and designed for electronic return (such as in Estonia, where take-up is 59 per cent). A further difference is the extent to which returns are lodged by agents on behalf of taxpayers. In Australia, 74 per cent of individual taxpayers are represented by agents, with the overwhelming majority of these returns being filed electronically. HM Revenue and Customs has developed a marketing strategy to increase take up of online services. It is continuing to address issues of public confidence and security to reassure taxpayers who want to file online and evaluates taxpayers' experience of filing online. The Department also targets customer groups with high potential to file electronically through e-marketing campaigns. It expects online filing of Self Assessment returns to provide targeted savings of more than £14 million in 2005-06, rising to over £40 million a year from 2011-12.

1.11 Some taxpayers encountered problems with the online service over the weekend of 29 and 30 January 2005. The service did not send out an instantaneous success or error message to around 80,000 people when they submitted their completed return. The problem was fixed and all the stored messages were sent out early on 31 January. HM Revenue and Customs recognised that people who had tried to file over that weekend and received an error message on 31 January may not have seen it in time to re-submit successfully before the penalty deadline. The Department took timely action to inform users of the problem and explained that it would cancel any late filing penalty for people who resubmitted their return successfully within 14 days. The large number of people wanting to file online and the high volume of users returning to check their delayed success/failure messages, meant the Department was running very close to capacity on its web portal on the filing deadline of 31 January 2005. This resulted in some users having problems in accessing HM Revenue and Customs' electronic tax return.

1.12 HM Revenue and Customs is taking a comprehensive review of the problems experienced at the end of January 2005 to identify the root causes and to prevent similar occurrences in the future. It recognises that to provide confidence in the e-filing process and maintain the increase in take up rates, it needs to ensure that its service be fully available and accessible at all times and that contingency plans be in place if systems fail. These problems emphasise the need for actions to encourage taxpayers to file returns earlier and avoid the peaks in demand.

Help and advice for taxpayers

1.13 HM Revenue and Customs provides help and advice for taxpayers in completing and filing their Self Assessment return. Taxpayers can use HM Revenue and Customs website to obtain information, and contact telephone call centres and helplines for assistance with queries and to seek advice. They may also contact, in writing, their own tax office and visit enquiry centres to discuss their Self Assessment return and seek advice **(Figure 2)**. The Department has published guidance to accompany the tax return and further material such as "Self Assessment – your guide" to answer likely questions, which is also available on the website. (Appendix 3).

Targets for Income Tax Self Assessment returns

1.14 HM Revenue and Customs met three out of four targets covering the timeliness and accuracy for Self Assessment returns in 2003-04 **(Figure 3)**. The target for returns filed by the due date is to increase to 93 per cent by January 2008.

2 Taxpayers can contact HM Revenue and Customs by telephone, in writing, by email, in person and online to receive help and advice

- Contacting HM Revenue and Customs orderline (telephone 0845 9000 404, fax 0845 9000 604 and email saorderline.ir@gtnet.gov.uk) or writing to HM Revenue and Customs (PO Box 37, St Austell Cornwall, PL25 5YN) for supplementary pages to the standard return, for the Comprehensive Tax Calculation Guide and other HM Revenue and Customs leaflets;
- telephoning HM Revenue and Customs helpline (0845 9000 444) for recipients of the main or short tax return;
- contacting HM Revenue and Customs helpline (telephone 0845 605 5999, fax 01274 841288 and email helpdesk@ir-efile.gov.uk) for taxpayers filing online;
- visiting HM Revenue and Customs Enquiry Centres;
- telephoning the number of the Area to which their tax form should be returned; and
- visiting HM Revenue and Customs' website's Self Assessment site (http://www.hmrc.gov.uk/sa/index.htm). The Self Assessment section of the website received 2.4 million hits in 2003-04, and the most popular pages were Forms Area (640,000 hits), Key Dates (530,000 hits) and Guidelines (160,000 hits).

Reading HM Revenue and Customs leaflets such as "Self Assessment: Your guide" (http://www.hmrc.gov.uk/pdfs/sabk8.pdf).

Source: National Audit Office

3 HM Revenue and Customs' targets and results for filing Income Tax Self Assessment returns

Performance indicator (percentages)	2002-03 target	2002-03 result	2003-04 target	2003-04 result	2004-05 target	2004-05 result
Returns filed by 31 January[1]	90.5	90.5	90.6	90.6	90.6	90.6
Returns filed within 12 months of 31 January due date[1]	96.4	96.9	96.9	97.5	97.5	Not yet known
Taxpayers who submit accurate returns[2]	70	70	70	70	70	68
Returns processed accurately by HM Revenue and Customs	95	94	95	94	95	Not yet known

Source: National Audit Office analysis of HM Revenue and Customs' Annual Reports and Random Enquiry Programme

NOTES

1 The targets for returns filed are set to one decimal point. Therefore, HM Revenue and Customs' results for these targets are also given to one decimal point. The target for percentage of returns filed by the due date is 93.0 per cent for January 2008.

2 The results for taxpayer accuracy in filing returns are drawn from the random enquiry programme. The results reported in 2004-05 cover the 2000-01 tax year.

Income Tax Self Assessment receipts

1.15 HM Revenue and Customs collected around £16 billion in receipts net of repayments from Income Tax Self Assessment in 2003-04. Through Self Assessment, Income Tax is raised chiefly from the self employed, business partners, company directors, landlords and those with foreign income, rather than those whose income is mainly or solely from employment or pensions - over one million of whom were removed from Self Assessment from 2004-05 onwards. The Department collected over £100 billion in Income Tax through other processes such as Pay As You Earn in 2003-04. The average net amount assessed as payable, beyond that already deducted at source, was around £1,600 per Self Assessment return in 2003-04.

1.16 Tax returns are processed in 74 regional and local tax offices. The 7,900 whole time equivalent staff resources used on Income Tax Self Assessment processes represented around 11 per cent of the Department's 73,000 whole time equivalent staff resources in 2003-04. Around 64,000 staff work in Strategic Service Delivery, of whom about 40,000 work in local tax offices and 23,000 in national services (call centres, the Receivables Management Service, National Insurance Contributions Office). HM Revenue and Customs' departments responsible for the filing of Income Tax Self Assessment returns are set out in Appendix 4. The 2004 Budget announced the integration of Inland Revenue with HM Customs and Excise which have since formed HM Revenue and Customs. This is intended to lead to a net reduction of 3,200 posts by 2008. As part of the Departmental response to the 2004 Efficiency Review, the Department also has plans in place to achieve gross savings of nearly 13,000 full time equivalent posts by 31 March 2008 against a baseline of approximately 98,000.

The tax gap and the informal economy

1.17 The Department aims to identify people working in the informal economy who are not registered taxpayers ('ghosts') and those taxpayers who are engaged in other employment for which they are not registered or declaring their income, and are not covered by the Pay As You Earn scheme(s) of their employer(s) ('moonlighters'). Measuring the size of the tax gap - the difference between the theoretical Income Tax yield if everyone who should submit a tax return did submit an accurate return and the tax assessed by the returns actually submitted - is very difficult. HM Revenue and Customs does not consider it realistic to establish an accurate estimate of the size of tax gap or to estimate the size of the informal economy. In part, this is because there are no known reliable and practical methods to assess the scale of income concealed by known taxpayers, or to assess the scale of unknown activity within the informal economy. Research work carried out in Canada and New Zealand[4] has sought to address some of these problems and the Swedish Tax Agency has carried out research which estimated the tax gap at some eight per cent in 2000.[5] The Department is undertaking work to improve its understanding of the position, for example, through its random enquiry programme on registered taxpayers who file returns and through joint shadow economy teams to identify groups who are less inclined to comply with filing obligations.

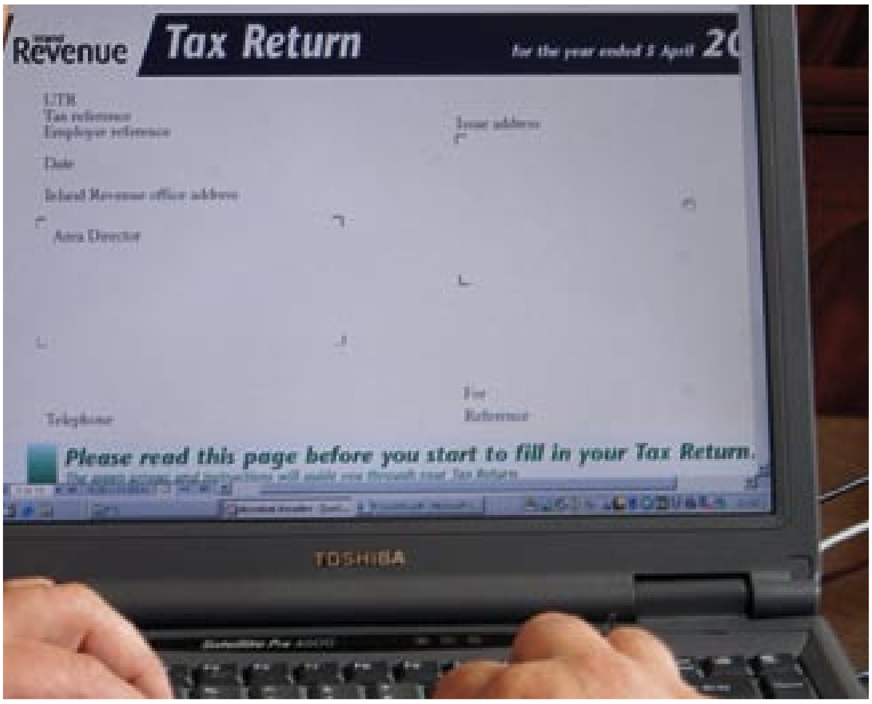
1.18 HM Revenue and Customs undertakes compliance work to identify ghosts and moonlighters. Since April 2001, the Department's Right Track Teams have carried out work to identify ghosts and moonlighters by researching available information and improving local tax offices' understanding of the local population. This should help them target their investigative resources on sectors and individual taxpayers where risks of non-compliance are high. The Right Track Teams were established following the Grabiner Report on the informal economy. They rely upon external and internal information sources to identify ghosts and moonlighters. External sources include informants who are mainly members of the public. Sources include:

- the National Insurance Contributions database – to identify people who have registered for National Insurance Contributions but not for Self Assessment and vice versa;
- the Centre for Revenue Intelligence - all banks and building societies are required to submit to HM Revenue and Customs details of interest payments to account holders, and these details are held on a third party information database maintained by the Centre; and
- the National Criminal Intelligence Service, which provides information through the Department's Special Compliance Office.

4 Tackling fraud against Inland Revenue, Report by the Comptroller and Auditor General, HC 429 2002-03, paragraph 1.13. http://www.nao.org.uk/publications/nao_reports/02-03/0203429.pdf.
5 Taxes in Sweden 2003 – A summary of Taxes in Sweden, Tax Statistical Yearbook, Table 39; http://skatteverket.se/broschyrer/104/10404.pdf.

PART TWO

Timeliness of tax returns



HM Revenue and Customs has reported it achieved its 90.6 per cent target for returns filed by the 31 January 2005 deadline. And it has stemmed the decline in the percentage filed by the deadline that occurred between 1998 and 2001. There has been a continuing decline in rate of filing returns by 30 September each year and after the deadline. HM Revenue and Customs has a target to increase the percentage of returns filed on time from 90.6 per cent to 93 per cent by January 2008. At July 2004, around £1.1 billion of Income Tax was outstanding from the 1.1 million overdue tax returns (based on the average net amount of £1,000 Income Tax assessed as due from returns filed more than six months late). A significant proportion was outstanding from taxpayers whom the Department could not trace, were living abroad, or were insolvent. There is wide variation in rates of on time filing based on factors such as previous filing behaviour, location, and time spent within Self Assessment. The Department has identified the groups of taxpayers at high risk of late filing, researched the causes of late filing and developed an action plan to meet the target. It makes contact with some taxpayers who have not filed as the deadline nears. These campaigns have contributed to stemming the decline in filing.

HM Revenue and Customs issues automatic penalties of up to £100 to taxpayers who have not filed their tax returns by the deadline. But the penalty cannot be charged on around 60 per cent of taxpayers who file up to six months late as they have no further tax owing from their return, have paid all tax due by the deadline, or are due a refund. At July 2004, over 260,000 taxpayers had more than one return outstanding and over 12,000 taxpayers had six or more returns outstanding. Between April 2004 and February 2005, the Department wrote to nearly 17,000 taxpayers with outstanding tax returns to give them 14 days to file their outstanding returns before they would be charged daily penalties. Just over 5,000 filed their returns in the 14 day period, leaving just over 11,000 taxpayers who did not file and were then subject collectively to 29,000 daily penalties on their outstanding returns.

2.1 Following the introduction of Self Assessment, the percentage of taxpayers who filed by the deadline has now stabilised at just over 90 per cent **(Figure 4)**.

2.2 HM Revenue and Customs has a Public Service Agreement for 2005-06 to 2007-08 to improve the percentage of individuals filing their returns by the 31 January deadline from 90.6 per cent to 93 per cent by January 2008. Achieving this target should also provide advantages of reduced costs in chasing late returns and a more accurate assessment of total tax yields due.

2.3 As at July 2004, an estimated £1.1 billion of Income Tax was outstanding from 1.1 million overdue returns.[6] This estimate is based on the average net amount of £1,000 assessed as due per return filed more than six months late, although the Department prioritises pursuit of cases which it considers highest risk. A significant proportion was outstanding from taxpayers whom the Department could not trace, were living abroad, or were insolvent. While the percentage of returns filed on time has now stabilised after an initial decrease, the number of returns filed late has increased - from 670,000 for 1996-97 in January 1998 to 930,000 for 2003-04 in January 2005. The number of individuals receiving first automatic penalties for late filing in February 2005 was one million. This is higher than the number of late returns as some tax forms (such as from partnerships) cover more than one individual taxpayer. The size of the Self Assessment population grew from 8.5 million in 1996-97 to 10 million in 2003-04.

4 HM Revenue and Customs has stemmed the decline in filing by the 31 January deadline

31 January deadline	Percentage of returns filed
1998	92.2
1999	90.9
2000	90.4
2001	89.6
2002	90.6
2003	90.5
2004	90.6
2005	90.6

Source: HM Revenue and Customs

2.4 HM Revenue and Customs generally gives taxpayers greater time and help to file their returns than some overseas tax authorities, as part of its customer service. Taxpayers have up to 10 months to file their returns following receipt (Appendix 3). Other tax authorities typically allow taxpayers only three to four months, but grant extensions to those who apply for extra time or those who use agents. HM Revenue and Customs issues reminders to those who have not filed by December, before the filing deadline. In some tax authorities overseas, separate reminders are issued after the deadline has expired, or may not be issued at all. HM Revenue and Customs offers to carry out the tax calculation service for taxpayers who file paper returns at least four months before the due date. Taxpayers can also assess their own tax using the guidance provided by the Department. Tax calculation is an integral part of the online filing service and is available to all those who file online, at any time of year. In other countries, taxpayers can also assess their tax position themselves using tax calculation services provided by the tax authorities, both for paper and electronic returns. For example, Sweden on its website www.skatteverket.se has a service enabling people to calculate their tax whether filing electronically or on paper forms.

Differences between taxpayer groups in filing by the deadline

2.5 HM Revenue and Customs' Analysis and Research department completed research in 2004 into why on time filing declined over the first four years of Self Assessment. This found wide variation in rates of on time filing based on factors such as previous filing behaviour, location, and time spent within Self Assessment **(Figure 5)**.

6 This is based on the number of returns outstanding for six months or more. The figure for returns outstanding for six months or more including tax returns for the 2003-04 tax year which were required by 31 January 2005, will be available in August 2005.

2.6 HM Revenue and Customs has, using the results of this research, developed an action plan to encourage the timely submission of returns. The research also found variation in filing performance based on occupation types, age, gender, and tax liability:

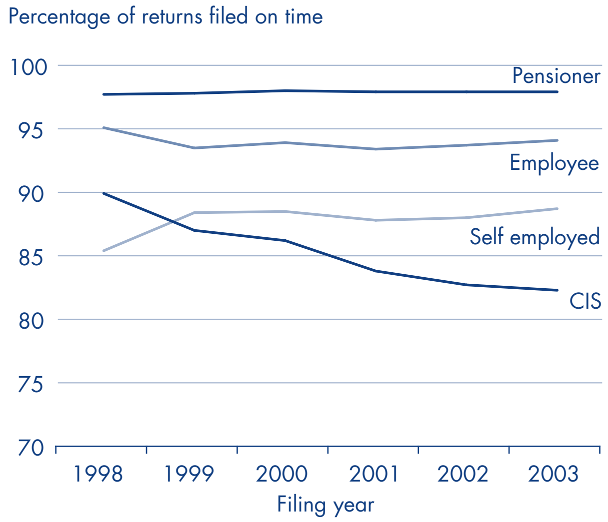
- the filing performance of the self-employed and Construction Industry Scheme participants (for contractors and subcontractors in the construction industry and applies to workers who are self-employed and are not subject to Pay As You Earn) has remained consistently below that of other taxpayer groups **(Figure 6)**;
- males are consistently poorer at filing returns on time than females;
- the declining performance of on time filing of Construction Industry Scheme participants (1.3 million within the Self Assessment population, mostly male and in the younger age groups) explains much of the overall decline in on time filing;
- more than a third of Self Assessment taxpayers (36 per cent) who file up to six months late have no additional tax liability and a further 25 per cent are due a repayment.

5 On-time filing percentages by taxpayer groups in 2004

Taxpayer group	Percentage filed on time
Population average	90.6
By previous filing behaviour:	
■ Taxpayers late in filing in the previous two years	39
■ Taxpayers late in filing the previous year only	53
■ Taxpayers who filed on time in the previous year	96
■ Taxpayers who filed on time in the previous two years	97
By location:	
■ Taxpayers in East and East Central London postcode areas (lowest in the United Kingdom)	76
■ Taxpayers in Orkney (highest in the United Kingdom)	95
By time within Self Assessment:	
■ New filers (lowest)	82
■ Taxpayers with five years of filing (highest)	94

Source: HM Revenue and Customs

6 Construction Industry Scheme (CIS) taxpayers have the lowest and declining rate of on time filing for taxpayer groups



Source: HM Revenue and Customs

2.7 We commissioned RAND Europe to build a computer model of HM Revenue and Customs' tax collection process to analyse and segment the return filing performance of the Self Assessment population for the 2002-03 tax year. This confirmed HM Revenue and Customs analysis showing that:

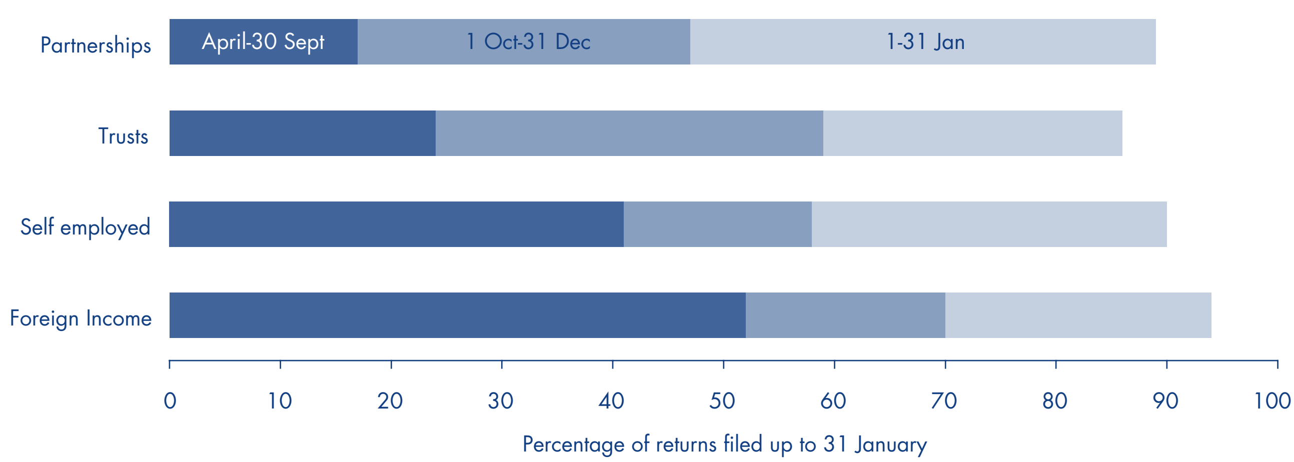
- There were large differences between the types of taxpayer (for example, higher percentages of partnership and trust returns were filed on or after the deadline than self employed and foreign income returns) **(Figure 7)**.
- Pensioners are significantly more likely to file their returns by September 30 and ahead of the 31 January due date than younger Self Assessment taxpayers (61 per cent of Self Assessment taxpayers aged 65 and over filed their returns by the end of September compared with 38 per cent of taxpayers in the 16-34 age range).
- Agents are more likely to file their clients' returns close to the deadline than unrepresented taxpayers. Only 31 per cent of all represented taxpayers' returns had been filed by their agents by the end of September compared to 58 per cent of unrepresented taxpayers' returns. 36 per cent of all represented taxpayers' returns were filed by their agents within the last month before the deadline – January, compared with 22 per cent of unrepresented taxpayers.

2.8 The analysis confirms there is scope for HM Revenue and Customs to continue targeting its initiatives to encourage earlier and on time filing on those groups most likely to file just before or after the deadline. Greater targeting will help the Department in its progress to achieving its new 93 per cent filing target by January 2008.

Improving the timeliness of returns

2.9 For the 1996-97 tax year, the first year of self assessment, 92.2 per cent of taxpayers had filed by the due date. However, for the 1999-2000 tax year, this had declined to 89.6 per cent. There was also a slowdown in the flow of returns filed after the 31 January deadline. The date by which 93 per cent of returns had been filed fell back from 14 March 1998 for 1996-97 returns to 16 May 2002 for 2000-01 returns. HM Revenue and Customs has adopted a variety of approaches to improve the timeliness of return filing. It has made contact by letter or telephone with a number of taxpayers within specific groups who had either previously filed late, were new to self assessment, or were participating in the Department's Construction Industry Scheme. Between December 2001 and January 2002, it made reminder calls to 150,000 Self Assessment taxpayers who had not filed their return. This resulted in contacts with these taxpayers in around 80,000 cases and generated an additional 12,300 on time returns for the 2001-02 tax year. The initiative was repeated in 2002-03 and prompted 13,500 more taxpayers to file on time. These campaigns contributed to arresting the decline in the proportion who filed on time.

7 Shows large differences in filing behaviour between taxpayer groups



Source: National Audit Office

2.10 Those taxpayers which HM Revenue and Customs has removed from Self Assessment from 2004-05 onwards (just over one million people) are also those who have been most likely to file on time (97 per cent filed on time in earlier years). Without these people, the percentage of taxpayers who filed on time in January 2004 would have fallen from 90.6 per cent to 89.8 per cent. To achieve the January 2008 on time filing target of 93 per cent, HM Revenue and Customs estimates, based on the current numbers required to file a return, that it will need to secure 250,000 additional on time filers from the remaining population.

2.11 The Department has also run successive advertising campaigns since 1996-97 with advice from the Central Office of Communications using national television, radio and press coverage to remind taxpayers to file returns and pay any tax owed on time **(Figure 8)**. Reviews of the campaigns (by Research Business International Limited) found that while the campaigns have been successful to varying degrees in raising taxpayer awareness of Self Assessment and e-filing, the campaigns have not succeeded in reversing the reduction in filing by 30 September. This is the last date for filing by which HM Revenue and Customs will guarantee informing

8 HM Revenue and Customs' advertising campaigns 1995-2004

Campaign	Spend	Percentage of returns filed by end September and by end January at the start and end of the campaign	HM Revenue and Customs evaluation
Hector the Inspector 1995-2001	£25m	51.8 per cent - September 1997 92.2 per cent - January 1998 50.0 per cent - September 2000 89.6 per cent - January 2001	It created a high level of Self Assessment awareness in HM Revenue and Customs' three target groups: the Represented (by tax professionals), Unrepresented and Pay As You Earn taxpayers. However this peaked in the first year - 1997. The campaign was withdrawn on the grounds of presenting a stereotypical and inaccurate image of HM Revenue and Customs.
Mrs Doyle 2001-2002	£6m	47.7 per cent - September 2001 90.6 per cent - January 2002 46.0 per cent - September 2002 90.5 per cent - January 2003	This was an interim campaign during Departmental rebranding. It maintained awareness levels and achieved an increase in filing by end January to exceed marginally the 2002 target (90.5 per cent). The campaign encouraged a 94 per cent increase in online filing. However, it did not meet the objective of increasing filing by the end of September.
Adam Hart-Davis 2002-ongoing	£15m	Ongoing campaign: latest results 90.6 per cent - January 2005 44.8 per cent - September 2004	The annual campaigns are split into three phases: encouraging people to file by end September to use HM Revenue and Customs' calculation service; encouraging people to file online; and encouraging people to file by end January. There has been a significant increase in number of online filers (over 400 per cent). The end January target was achieved but there was a continued deterioration in the percentage of taxpayers filing by end September.

Source: National Audit Office analysis of HM Revenue and Customs data.

taxpayers of what tax needs to be paid by the payment date of 31 January the following year. There is scope for the Department to sharpen the focus of its campaigns, for example by highlighting the penalties for late filing, to improve the timeliness of return filing. From a peak of 52 per cent of Self Assessment taxpayers filing their returns by 30 September 1997 for the 1996-97 tax year, the proportion of early filers had declined to 45 per cent by 30 September 2004 for the 2003-04 tax year. Our analysis of filing performance by taxpayer group shows that 41 per cent of Trusts, 42 per cent of self employed Self Assessment taxpayers and 53 per cent of Self Assessment taxpayers in business partnerships had still to file a return at the beginning of January 2004 which means that the Department can expect late surges of paper-based returns and e-filing from these particular groups.

Incentives and penalties to encourage on-time filing of returns

2.12 HM Revenue and Customs has a range of incentives to encourage taxpayers to file tax returns by the due date:

- The 31 January due date after the end of the tax year gives taxpayers 10 months to assemble information and submit their returns. To provide an incentive for taxpayers to file returns by the end of September, HM Revenue and Customs undertakes to perform the tax calculation on behalf of the taxpayer in sufficient time to change correctly the Pay As You Earn coding notice for the following year, enable underpayments of tax of up to £2,000 to be collected in the following year through deductions at source by an adjusted Pay As You Earn code, and to inform the taxpayer of any amounts that they might be due to pay at 31 January. After 30 September, HM Revenue and Customs will still calculate the tax but it does not guarantee that a tax payment calculation will be sent out by 31 January.
- HM Revenue and Customs also provides taxpayers with help to complete their returns and this may take the form of assistance from call centres, enquiry centres, business support teams or home visits for the frail and elderly. Our focus groups with HM Revenue and Customs staff identified how some taxpayers expected enquiry centres to provide a free return completion service as filing deadlines approached, detracting from their ability to help others. HM Revenue and Customs needs to manage an expectation gap in the type and level of service that the centres can provide.

2.13 HM Revenue and Customs also uses a range of measures to encourage taxpayers to file returns on time and penalise late filers **(Figure 9)**.

The use of daily and continuing penalties

2.14 Around one million taxpayers were subject to an automatic penalty of up to £100 for failing to file by the 31 January 2005 deadline for 2003-04 Self Assessment returns. This is similar to the previous year when 950,000 taxpayers were subject to an automatic penalty for failing to file by the 31 January 2004 deadline. By July 2004, just over 260,000 taxpayers had more than one return outstanding since the introduction of Self Assessment **(Figure 10 overleaf)**. And over 12,000 taxpayers had six or more returns outstanding.

2.15 Given that the daily penalty is a very severe sanction, it is important that there are safeguards to protect taxpayers against inappropriate action by the Department. The Department must seek approval from the General Commissioners of HM Revenue and Customs on a case by case basis for their agreement to the imposition of daily penalties and their continued use. The procedure is time consuming and can involve delays as bodies of General Commissioners meet only periodically.

2.16 Daily penalties were introduced in April 2002. As part of a 'Spend to Save' initiative which began in October 2003, the Department has obtained additional funding to increase the number of daily penalties it issues to taxpayers with returns outstanding to encourage them to file. The initiative proposed reviewing 75,000 taxpayers in the first half year of October 2003 to March 2004 for daily penalties, and 150,000 taxpayers in each subsequent year. The Department forecast that overdue returns would be received from 80 per cent of those taxpayers who were subject to daily penalties, compared to 52 per cent of taxpayers not subject to daily penalties. The Department forecast the average yield from the revealed liability in the filed returns would be £1,000.

9 Actions by HM Revenue and Customs on late filing of returns for the 1997-98 and 2002-03 tax years

Penalty	When/why imposed	Number and value 1997-98	Number and value 2002-03
1st Automatic penalty on 1 February	£100 penalty for non filing of returns. However, in legislation, the penalty cannot exceed the value of tax liability shown on the return. If a late return shows £0 liability, or all tax due has been paid, or a repayment is due, the penalty is not levied.	Number – 750,000 Value – Not known[1]	Number – 950,000 Value – Not known[1]
2nd Automatic penalty on 1 August	Additional £100 penalty for non filing of returns. Again, the penalty cannot exceed the value of tax due.	Not known[1]	400,000[1]
12 month penalty	Returns not filed 12 months after the deadline attract a penalty of up to the amount of tax that would have been shown as due on the return.	Not known	Not known
Determinations	Taxpayers who have not filed by the deadline may receive a "Determination of tax due". This must be paid or a return submitted to confirm the amount of tax due for payment. HM Revenue and Customs may issue a determination at any point after the filing deadline is missed, to encourage the taxpayer to submit their outstanding return(s).	Not known[2]	260,000 determinations raised totalling £540 million[2]
Daily penalties	Daily penalties of up to £60 a day can be charged on tax returns that remain outstanding after the imposition of automatic penalties.	Daily penalties not used[3]	6,400 issued £3.1million charged[3]
Interest/Surcharges	Interest is charged on all Self Assessment tax and penalties due from the date on which these should be paid until they are paid. Surcharges (five per cent of tax due) arise on any tax unpaid more than 29 days after it is due. An additional five per cent surcharge is charged on tax unpaid after six months.	Not known[4]	Not known[4]
Court action	If a return is not filed to overturn a determination, court action can be used to collect the tax due as determined and any interest/surcharges.	Note [5]	Note [5]

Source: National Audit Office analysis of HM Revenue and Customs' data

NOTES

1 HM Revenue and Customs does not maintain data on the payment of first and second automatic penalties paid by the applicable deadline or to date, or the value of penalties incurred.

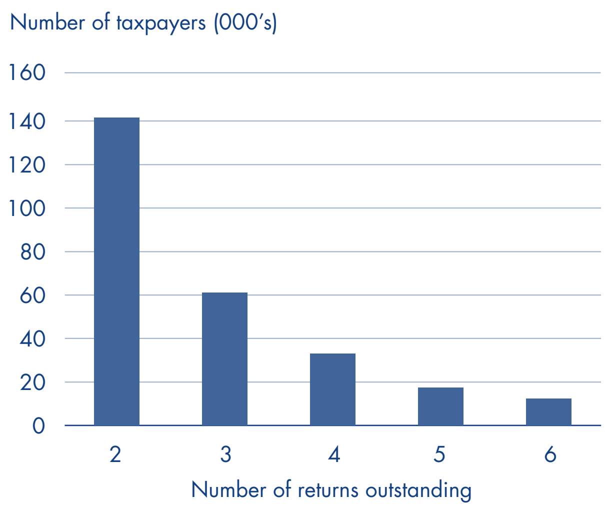
2 HM Revenue and Customs does not hold statistics on determinations broken down by return year before April 2001. From the start of Self Assessment to March 2001, HM Revenue and Customs raised 210,000 determinations. At July 2004, some £330 million of Income Tax was due from determinations on returns that were still outstanding. The Department is pursuing these returns. HM Revenue and Customs does not hold data linking tax paid to determinations raised prior to October 2003. From this time it has collected data on the payment of determinations from a sample of the more serious late filer cases. In these cases, about £12 million was paid on a total of £62 million raised in determinations between October 2003 and July 2004 in respect of the 2001-02 tax year.

3 HM Revenue and Customs does not hold data linking returns received and tax assessed to daily penalties raised prior to October 2003 and does not know the extent to which daily penalties were paid prior to this.

4 HM Revenue and Customs does not monitor the collection of individual components within Self Assessment debt (automatic penalties, determinations, daily penalties, interest or surcharges) because it treats these as part of the overall Self Assessment debt. Instead, targets are set for the percentage of monies collected (comprised of tax owed and all five penalty components). The target for 2004-05 is 75.3 per cent to be collected by the year end.

5 HM Revenue and Customs only has data on court actions from October 2003. From October 2003 to July 2004, it took around 1,250 court actions. This covered all return years.

10 Over 260,000 taxpayers had more than one tax return outstanding at July 2004



Source: National Audit Office analysis of HM Revenue and Customs' data

2.17 The main purpose of daily penalties is to get returns in, establish the liability and collect any outstanding debt. Under the Spend to Save initiative announced in the 2003 Budget the Department was given additional funding to bring in Self Assessment returns from recalcitrant taxpayers and deliver additional yield. In about a quarter of cases where the Department has threatened to bring penalties it has been sufficient to bring in the outstanding returns. The projected additional Income Tax yield over the three years from 1 March 2003 to 31 March 2006 was £470 million but the final yield may be less. The projected shortfall in addtional Income Tax yield is partly due to the Department needing to take penalty action against fewer taxpayers than it expected. Between April 2004 and February 2005 the Department reviewed and contacted 107,000 taxpayers with outstanding returns. It sought directions from the General Commissioners to impose daily penalties on around 27,000 taxpayers covering 47,000 outstanding returns. The Commissioners approved daily penalties on nearly 17,000 of these taxpayers. After gaining approval, the Department warns taxpayers that daily penalties will be raised if they do not file outstanding returns within 14 days. Over 5,000 taxpayers responded by filing their returns within this time and of those 11,000 who did not, around 29,000 daily penalties were raised on their outstanding returns. The Department is evaluating the reasons for the yield from daily penalties initiative being lower than forecast. With the benefit of additional information and analysis, the Department should have a clearer understanding of the reasons for the shortfall and it is continuing to monitor the performance of cases to assess the effect upon compliance, filing and payment behaviours.

2.18 Of just over 260,000 taxpayers with two or more returns outstanding at July 2004, around 130,000 taxpayers were being handled by the Department's Receivables Management Service to obtain their tax returns and recover the tax due. For the remaining 130,000 taxpayers, the Department were trying to trace them, carrying out enforcement action on them, or the taxpayers were living abroad. **Figure 11** gives a breakdown of the status of those with multiple outstanding returns at July 2004. Around 53,000 taxpayers being handled by the Receivables Management Service had yet to be pursued by the Spend to Save daily penalties team and were potentially open to daily penalties, although some may have had determinations raised of the amounts of tax owing. The Department expects to have reviewed the majority of the current stock of taxpayers with two or more returns outstanding by March 2006. With the considerable number of taxpayers still to be reviewed, the Department needs to ensure its processes promptly identify those taxpayers who should be referred to the General Commissioners for a direction so that the Department can impose daily penalties against them.

2.19 While the Department can seek daily penalties of up to £60 per overdue return, the average daily penalty imposed fell from £34 for the 1997-98 tax year to £28 in 2003-04. The reduction reflects, in part, criteria introduced in 2002 to ensure consistency of penalty assessments and use of daily penalties on a wider range of taxpayers. Daily penalties are usually imposed for an initial period. If the taxpayer has still not filed their return by the end of this period, HM Revenue and Customs may impose continuing (open ended) daily penalties for the duration of the failure to file. The Department had charged £13 million in daily penalties between October 2003 and October 2004, indicating an average total charge of over £570 over an average duration of 19 days at £30 a day per return. Daily and continuing penalties imposed between October 2003 and October 2004 had combined charges of just over £14 million and the Department estimates around £6.3 million of these charges had been paid **(Figure 12)**.

11 HM Revenue and Customs actions on taxpayers with multiple overdue returns at July 2004

Action		Two or more returns outstanding
Forwarded to Receivables Management Service to recover their tax and penalty debt and pursue the returns, of which:		132,000
■ County Court Proceedings being taken	(32,500)	
Or, taxpayer has died		
■ Taxpayer being pursued by the Spend to Save daily penalties team	(46,500)	
■ Taxpayer yet to be pursued by the Spend to Save daily penalties team	(53,500)	
Accounting and payment services to trace taxpayer		98,000
Enforcement and Insolvency Service action		19,000
Identification of cases involving United Kingdom		
nationals living abroad		15,000
Other action to trace the taxpayer		770
Total		**265,000**

Source: National Audit Office analysis of HM Revenue and Customs' data. (Figures may not total due to rounding)

12 Results of daily and continuing penalties imposed October 2003 to October 2004

Result	Number of penalties	Total penalties charged (£000)
Daily penalties		
Return received	7,600	4,300
Penalty payment only	1,100	610
Continuing daily penalty raised	1,300	1,400
Enforcement action	3,300	2,100
Awaiting enforcement action	9,000	4,300
Total	**22,000**	**13,000**
Continuing penalties		
Return received	340	440
Penalty payment only	300	190
Enforcement action	220	140
Awaiting enforcement action	440	380
Total	**1,300**	**1,200**

Source: HM Revenue and Customs

NOTES

The Department estimates that around £6.3 million of the penalties charged had been paid, but is not able to break down the charges paid by outcome.

The figures may not total due to rounding.

2.20 The number of taxpayers with an outstanding return is highest just after the 31 January filing deadline. At 31 January 2005, 930,000 returns were outstanding for the 2003-04 tax year. At 31 January 2004, 890,000 returns were outstanding for the 2002-03 tax year, but by June 2004 this had fallen to just over 500,000 returns. The Department is undertaking pilot studies into cases involving outstanding returns and tax debts to improve its understanding of the factors behind non-compliance and how raising further debts through the imposition of penalties might be avoided. The Department began in late 2004 to use the mutual assistance of recovery of debt provisions in the European Union, set out in the Finance Act 2002, to refer daily penalty cases to other member countries to pursue United Kingdom nationals resident in their country.

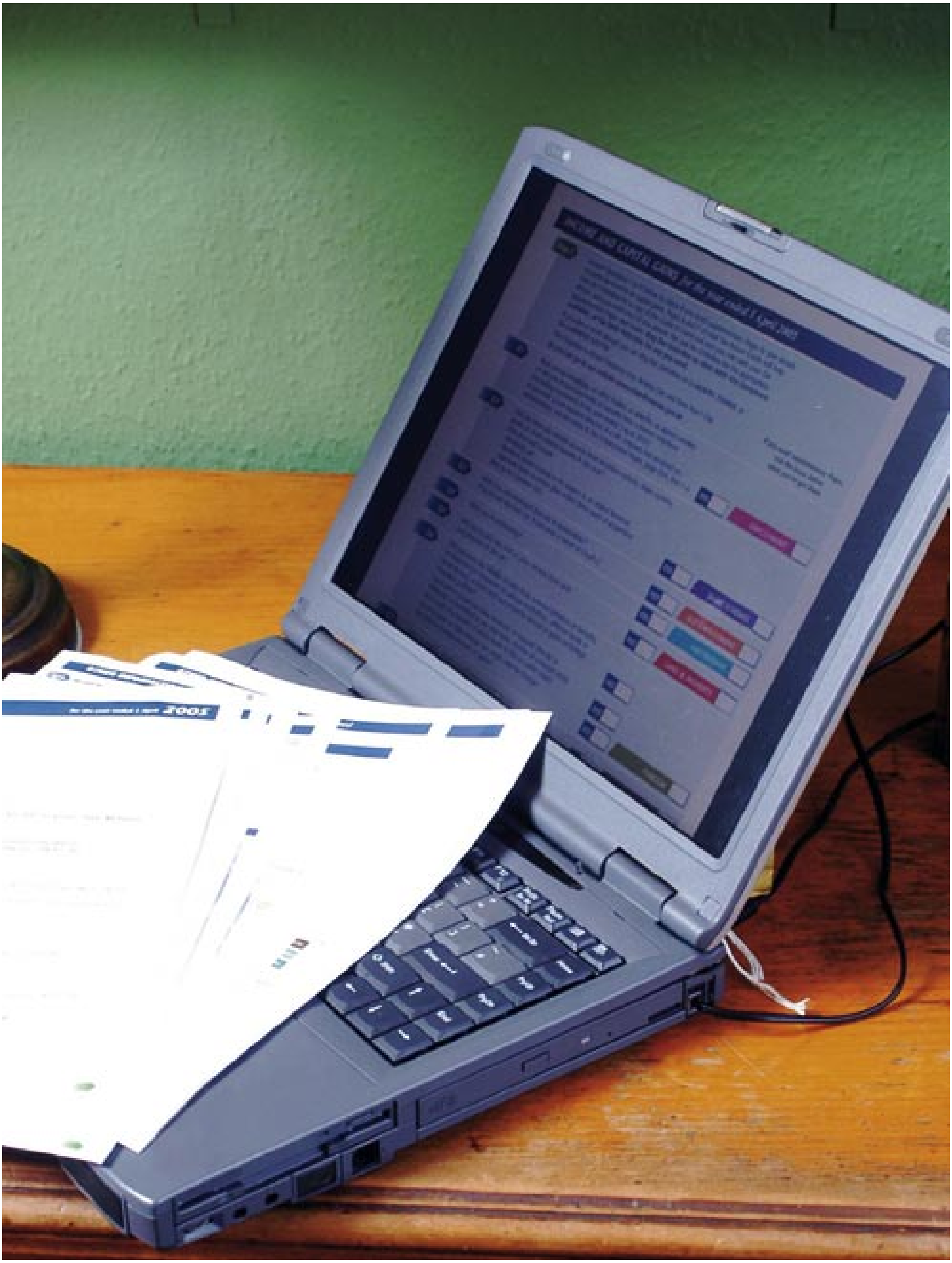
2.21 In response to undertakings given to the Committee of Public Accounts in 2002[7] about the need for improved management information on the effectiveness of sanctions, HM Revenue and Customs is assessing the impact of its penalties. The Department is identifying those returns that are likely to yield a substantial liability and is prioritising action to gather returns for these cases ahead of those likely to yield less tax, where it is cost effective to do so. The Department has not yet developed management information which enables it to monitor the value of sanctions applied against the amount of tax assessed as due on overdue returns subsequently filed after imposing the sanctions, or the cost of implementing the sanctions. Therefore, the Department is unable to determine which of its sanctions are most cost effective in prompting the filing of late returns. The Department needs to disaggregate the value of applied sanctions from the value of tax owed on a case by case basis to identify which of its sanctions are most effective and of most value in prompting taxpayers to file their returns.

2.22 HM Revenue and Customs is undertaking a joint review with HM Treasury in 2005, to develop a new penalties framework. This will shape the new Department's civil penalties policy for non-compliance. The review aims to identify clear consistent principles to underpin a joint approach to sanctions so that their use is effective and consistent. As part of their wider review of sanctions, the Department needs to consider how the sanction of daily penalties can be used most effectively.

2.23 Our analysis has found that imposing the first automatic penalty of up to £100 does not lead to a significant increase in the number of returns filed after the penalty notice is received. This suggests that either late filing taxpayers have factored the cost of the penalty into a decision not to file, or taxpayers with no or little further tax liability or due a repayment, are aware that the penalty will not be imposed or reduced accordingly. As part of its review, HM Revenue and Customs should evaluate the value and structure of its automatic penalties needed to encourage on time filing. Our comparisons with practices used by other tax authorities shows that some apply penalties for late filing which are a percentage of the tax owed or are ranged according to the taxpayer's net income, initially based on the previous year's return until the late return is filed. The latter would be particularly appropriate for wealthy late or non filers to whom a £100 penalty may have no deterrent impact.

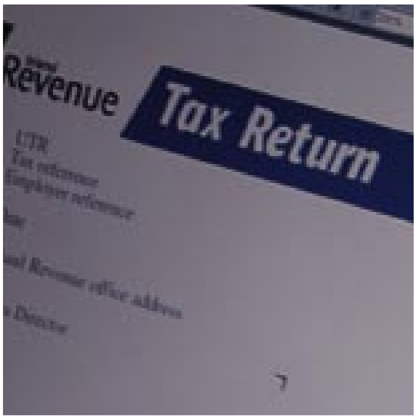
2.24 HM Revenue and Customs has carried out research into Self Assessment taxpayers' awareness of the consequences of missing filing deadlines. Its research found that 76 per cent of the sample of taxpayers knew that the failure to meet the January deadline could result in a £100 automatic penalty. However, only one third of the sample knew that daily penalties of up to £60 could be imposed. Most of these people recollected reading this in the media although HM Revenue and Customs does not cover daily penalties in its own media communications to taxpayers.

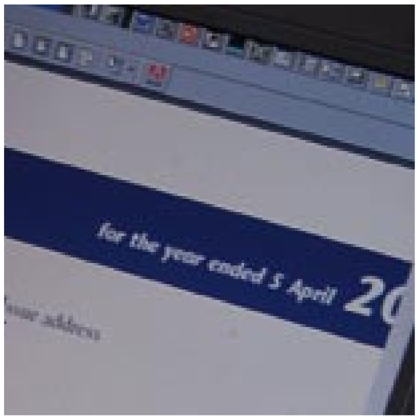
7 Treasury Minute on the 33rd Report from the Committee of Public Accounts 2001-02, Income Tax Self Assessment.

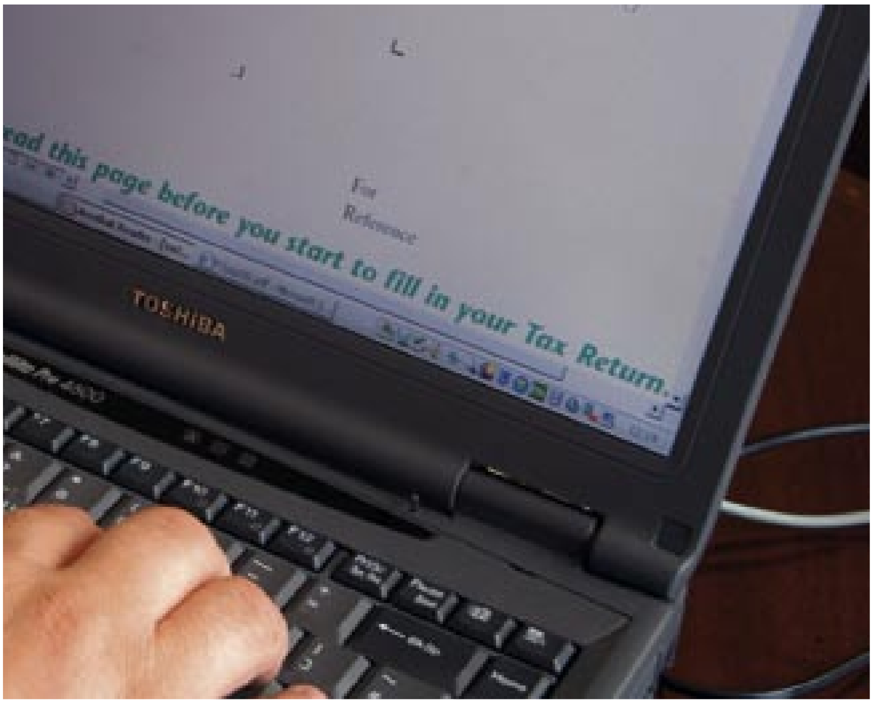


PART THREE

Accuracy of tax returns







HM Revenue and Customs estimates that 32 per cent of tax returns filed by taxpayers contain some errors and mistakes, based on its annual random enquiry programme sample. Around £2.8 billion was at risk from inaccurate returns, from simple mistakes through to fraudulent under or non-declaration of income, based on the most recent estimate for the 2000-01 tax year. This was equivalent to 18 per cent of the total net receipts on Income tax Self Assessment in 2000-01 and around four per cent of the taxes of the Self Assessment population, both deducted at source and Self Assessed. Analysis of previous years' results indicates that around three quarters of tax at risk is accounted for by five per cent of returns. Partnerships and sole traders are the most likely to file inaccurate returns and to have significantly understated tax liabilities. The Department has written to taxpayers and provided guidance on the most common mistakes in completing tax returns. It carries out checks to identify taxpayer mistakes and corrects these. It encourages taxpayers to file online as this checks for errors and performs the tax calculation.

The Department has a target to achieve accurate processing of returns in 95 per cent of cases. In 2003-04, it processed six per cent of returns (around 500,000 a year) with some level of error which may have led to errors in assessed tax liabilities of some £120 million. It has a comprehensive quality control and assurance programme and it has made improvements in those offices with a poorer record in processing accuracy and is working on improving the accuracy of logging in returns. Around 25 per cent of returns are filed within two weeks of the January 31 deadline, which causes a major peak in workload and higher risks of internal inaccuracies. The Department estimates that it incorrectly imposed automatic penalties on some 30,000 taxpayers (three per cent of penalties issued, 0.3 per cent of Self Assessment taxpayers) in early 2004 who filed by the deadline, but has no mechanisms to identify these taxpayers. The Department relies upon taxpayers or their agents to notice its errors, but taxpayers without agents may be less well placed to identify the Department's mistakes and have these corrected.

The Department had an accuracy rate of 71 per cent in 2003-04 in setting taxpayer Pay As You Earn codes and made around two million errors in codings. It is checking Pay As You Earn codes for taxpayers who are being removed from the need to file a return and identifying which taxpayers should then receive a Tax Review Form. It is also introducing mechanisms to improve the setting of Pay As You Earn codes to deduct the right amount of Income Tax through Pay As You Earn by reducing the need for manual calculation of tax codes.

3.1 Filing an accurate return on time is important in ensuring that the taxpayer complies with all their obligations and receives all their entitlements, resulting in the overall payment or repayment of the correct amount of tax. Taxpayers are responsible for submitting an accurate return. Providing an accurate return is also important in keeping processing costs to a minimum. All tax returns should also be promptly logged and the information on the return fully captured and processed by HM Revenue and Customs, so that it accurately assesses the tax payable or repayable and any penalties due, and provides the taxpayer with an accurate Pay As You Earn code. This then provides the data to support HM Revenue and Customs' automated risk assessment processes. For taxpayers with very simple financial affairs, who will no longer automatically be required to complete a tax return, a correct Pay As You Earn code is essential in ensuring the right amount of Income Tax is deducted through Pay As You Earn over the next tax year.

Income Tax at risk from inaccurate returns

3.2 HM Revenue and Customs assesses the accuracy of filed returns using its IT risk assessment system and through an annual random enquiry programme (Appendix 5). Based on the latest results available from the random enquiry programme for the 2000-01 tax year, 68 per cent of returns were filed accurately by registered Self Assessment taxpayers, slightly under the Department's target of 70 per cent of returns. The Department also estimates that £2.8 billion (plus or minus 19 per cent - £530 million) was at risk, due to inaccurate returns. This includes Income Tax, Class IV National Insurance Contributions (by the self employed) and Capital Gains Tax. The estimated amount at risk is equivalent to 18 per cent of the £15 billion net receipts from Income Tax Self Assessment in 2000-01 and around four per cent of the taxes of the Self Assessment population, both deducted at source and Self Assessed. Inaccuracies range from accidental errors made by taxpayers in completing the form through to fraudulent under or non-declaration of income. The average additional yield across all 5,000 enquiries was £330, with the average additional tax yield from those cases found to be non-compliant being £2,100. Sixteen per cent of all settled cases showed significant non-compliance with a yield of £500 or more.

3.3 The Department recognises that its £2.8 billion figure underestimates the true extent of tax at risk as its enquiries will not always find all non-disclosed income. The Department is considering the extent to which the figure should be uprated to include an estimate of undiscovered non-compliance. As the random enquiry programme covers only registered taxpayers, it does not provide any estimate of under-declared income from people working in the informal economy or those taxpayers who are engaged in other employment for which they are not declaring their income (paragraph 1.17). HM Revenue and Customs has separate teams to identify these groups and establish their liability as part of its compliance programme.

3.4 In addition to the 5,000 random enquiry cases examined in the 2000-01 tax year programme, the Department also takes up about 200,000 risk based enquiries every year into business and non-business returns. Local offices of HM Revenue and Customs request further information from the taxpayer to gain greater understanding of the figures and supporting information provided in the return and to check these are correct, including comparison with other sources. The enquiry may involve an extensive examination which considers all aspects of the taxpayer's tax affairs. Such enquiries help HM Revenue and Customs identify any taxpayer errors as well as any deliberate non-compliance such as fraud. In 2003-04, 78 per cent of such enquiries detected taxpayer non-compliance.

Accuracy of returns by taxpayer group

3.5 Analysis of previous years' results of the random enquiry programme indicates that around three quarters of the total tax at risk is accounted for by just five per cent of returns and accuracy rates varied significantly between different taxpayer groups. The random enquiry programme for the 1998-99 tax year, which analysed results by taxpayer group, showed that only half of sole traders' and partnerships' returns subject to a random enquiry were found to be filed accurately **(Figure 13)**. The average amount of under-declared tax was £2,200 per return for partnerships. The single largest underpayment detected from a return was £41,000. The Department's research found no difference in the accuracy of returns between those taxpayers who filed early and those who filed late.

13 Partnerships and sole traders are the most likely to have inaccuracies in their returns resulting in significant underpayment of tax (1998-99 tax year)

Taxpayer type	Percentage of enquiries identifying £0 extra tax due	Percentage of enquiries identifying £1-£250 extra tax due	Percentage of enquiries identifying £251-£500 extra tax due	Percentage of enquiries identifying £501-£1000 extra tax due	Percentage of enquiries identifying £1000 plus extra tax due	Total Percentage
Sole traders	51	14	10	8	17	100
Partnerships	53	7	10	8	22	100
Other	77	8	7	4	5	100
Employee	80	11	4	3	3	100
Director	82	9	3	3	3	100
Pensioner	88	7	2	1	2	100

Source: HM Revenue and Customs random enquiry programme for the 1998-99 tax year

Mistakes made by taxpayers

3.6 Taxpayer mistakes reflect the knowledge, aptitude and attitude of the taxpayer population to tax and the act of filling in a form. They also reflect the nature of the tax return which has to cover a range of financial affairs from the relatively straightforward to the highly complex **(Figure 14 overleaf)**. Focus groups with HM Revenue and Customs staff, revealed that changes to the questions in the tax forms between years may increase the likelihood of errors, when established Self Assessment taxpayers have to change the way they provide information on the form.

Helping taxpayers file accurate returns

3.7 HM Revenue and Customs helps taxpayers file accurate returns through the information and support available on its website, telephone call centres and help lines, enquiry centres, written guidance and through its tax offices. Our consultation with stakeholders indicated that HM Revenue and Customs' website contained comprehensive information to help taxpayers file returns accurately, but taxpayers did not always easily find the information they were seeking. It has also indicated concerns over the depth of knowledge held by staff, particularly in the call centres, affecting the consistency and accuracy of information provided, especially for those with more specific and technical questions. Taxpayers who made more than one call found they had to start their request from the beginning as they were put through to different people. All stakeholders commented on the difficulties of getting through to call centres at peak filing times shortly before the deadline. HM Revenue and Customs has a target to increase, by 2007-08, the accuracy and completeness of information and advice given and actions taken in respect of contact to at least 90 per cent and to increase the proportion of individuals and businesses who said they achieved success at first point of contact to at least 80 per cent.

3.8 HM Revenue and Customs has written to thousands of taxpayers to draw their attention to aspects of their return, such as self employment pages, which are more likely to be completed inaccurately. The letters include a question and answer attachment intended to help the taxpayer complete the return accurately first time and avoid the need for an enquiry. HM Revenue and Customs identified a set of risk rules and the common errors included in the letter, from analysis of filing data to identify risk patterns in the Self Assessment population. It analysed around 3,000 settled full enquiries from its random enquiry programme to establish rules indicating the returns most likely to have under declared tax liabilities or to have high levels of under declared tax liabilities. It sent letters to taxpayers whose previous returns triggered patterns of risk linked to the errors described in its letter.

3.9 The letter has been regarded by some taxpayers, agents and stakeholder groups as misleading, by suggesting to the recipient that specific problems have been identified individually with their personal return rather than from a rule based risk assessment of that return. They are concerned that the letters are causing confusion and anxiety amongst recipients, and pressure on agents who are mistakenly being judged to have made mistakes on their clients' returns. HM Revenue and Customs is consulting stakeholder groups such as agent

14 The most common mistakes taxpayers make in completing a tax return

The most common reasons for tax returns being corrected:

1 Failure to complete a separate supplementary page for each individual employment;

2 Entering the net figure for Employee Personal Pension Premiums instead of the gross figure on the core tax return (Box 14.11). This results in the taxpayer not claiming enough relief where higher tax rates are payable;

3 Entering the figure of Capital Expenditure in Box 3.14 of the Self-Employment pages instead of the figure of Capital Allowances (resulting in the taxpayer claiming excessive relief);

4 Failure to complete a question (question 19) of the core tax return (asking if the taxpayer wishes to claim a repayment) where a repayment is due; and

5 Entering their income from employment (Box 1.8) but not entering any figure for tax deducted from their employment income (1.11 on the employment pages).

The most common reasons for tax returns being rejected:

1 A "yes" tick has been entered on one or more of the questions on page two of the main tax return, which aim to identify which supplementary pages the taxpayer will need, but the taxpayer has not forwarded those supplementary pages with the tax return;

2 Self employed taxpayers failure to complete the relevant Self employment pages, (particularly from Box 3.74 onwards on the Self employment supplementary pages;

3 Detailing information on separate attachments instead of including the information on the Self Assessment Tax Return itself;

4 Entering manuscript notes on the Self Assessment Tax Return for example, "per accounts" or "information to follow" instead of entering actual figures on the form; and

5 Failure to sign and date the Self Assessment Tax Return.

Source: HM Revenue and Customs "Self Assessment – your guide" – http://www.hmrc.gov.uk/pdfs/sabk8.pdf

representatives about these issues. While this approach needs careful handling, once the wording and intent of the letter is clarified, it may provide an effective mechanism for improving taxpayer compliance in groups where the risk of error is known.

3.10 HM Revenue and Customs is taking a range of actions such as online filing checks and other validation checks to help taxpayers file returns accurately **(Figure 15)**. Online filing has advantages in automatically checking for taxpayer errors and performing the tax calculation.

Accuracy in processing returns

3.11 In 2003-04, HM Revenue and Customs accurately processed 94 per cent of Self Assessment returns, compared to its target of 95 per cent. Extrapolated across all Self Assessment returns filed, this indicates around 500,000 taxpayer's returns were processed with some level of errors by HM Revenue and Customs. The Department estimates the gross value of errors in tax assessments resulting from internal inaccuracies in processing filed returns at some £120 million (£70 million undercharges to taxpayers and nearly £50 million overcharges on taxpayers). HM Revenue and Customs generates data on processing accuracy through national Quality Assurance/ Quality Control procedures and an annual Quality Monitoring Exercise **(Figure 16 overleaf)**.

3.12 HM Revenue and Customs corrects any errors which taxpayers or their agents bring to its attention. But it does not have information on the number of queries or complaints received on the Department's assessment of the tax payable and any balance of tax due for payment. Nor is it able to determine the number of queries or complaints which led to the identification of an internal error that resulted in an inaccurate tax assessment. It also has no information on the value of corrections it has made to tax assessments. Taxpayers without agents may be less able to check the accuracy of the Department's assessment of any balancing payment and to challenge any mistakes. The Department has used quality assurance to improve accuracy levels of the poorer performing area offices **(Figure 17 overleaf)**.

3.13 HM Revenue and Customs determines the Pay As You Earn tax codes for taxpayers who are employees and pensioners, drawing on the information they have provided on the return. The Department provides a coding notice and a guide "Understanding your tax code". Any taxpayer errors or internal errors by HM Revenue and Customs may lead through to errors in the taxpayer's Pay As You Earn code. Tax code calculation is one of the main areas where internal errors occur. Setting the tax code correctly is important in ensuring the right amount of tax is deducted at source for employed and pensioner taxpayers, especially when they are not required to make a return. With more of these taxpayers not needing to file a return, the reliance on correct coding is greater.

15 HM Revenue and Custom's actions to encourage accurate returns

Online filing

- HM Revenue and Customs' has built into its online filing mechanism electronic validation checks for errors. When taxpayers file their Self Assessment return online, the taxpayer will receive an online message indicating that their return has been received and passed these electronic validation checks. If the taxpayer has provided an email address, HM Revenue and Customs sends an email confirming that the return filed has been received and passed validation.
- HM Revenue and Customs has also equipped its online filing mechanism to carry out the tax calculation automatically for taxpayers. This is completed, irrespective of when the taxpayer files their return. This provides the taxpayer with a figure of any tax due for payment by 31 January. The taxpayer will also receive a repayment (where applicable) or an accurate statement sooner than if they file their return on paper.

Validation checks on paper returns

- When a taxpayer files their return on paper, the information provided is input onto HM Revenue and Customs' computer system. If HM Revenue and Customs' spots any obvious mistakes, it will correct them and tell the taxpayer about this. This is usually by correspondence. If the taxpayer does not agree with what HM Revenue and Customs has done, the taxpayer can ask for these to be altered, which HM Revenue and Customs will do if it agrees the alterations are correct.
- From 2004, HM Revenue and Customs has also undertaken minor queries in cases where a mistake was likely to have been made but cannot be corrected without contacting the taxpayer. In this case, HM Revenue and Customs usually contacts the taxpayer by telephone to resolve the query and this helps to reduce processing errors.
- If the taxpayer has carried out the tax calculation themselves, HM Revenue and Customs will check this against its own calculation and send a revised calculation when the taxpayer has made errors. HM Revenue and Customs always calculates the tax position, no matter how late the taxpayer files their return. If the taxpayer files after the 30 September deadline, HM Revenue and Customs does not guarantee to process the return in time to inform the coding for the following year (Pay As You Earn cases only) and to tell the taxpayer how much to pay by 31 January. Therefore, the taxpayer is required to complete this calculation. If the taxpayer does not pay what they owe by 31 January, they risk incurring further interest charges.

A short form for people with simple tax affairs

- The short form is four pages long, much simpler and with simplified guidance, to help taxpayers eligible for the short form, in completing their return accurately. This was available from April 2005.

A full review of the main tax return aimed at its simplification, which could include:

- A reduced information requirement with simplified guidance;
- A shorter Capital Gains section, with mandatory submission of Capital Gains computations;
- Automated transfer of underpayment data from the Pay As You Earn system to the Self Assessment record;
- Redesigning the main tax return for automatic data capture.

Teams to handle the tax returns of people with complex financial affairs

In 2002 HM Revenue and Customs introduced nine Complex Personal Returns Teams to improve customer service and oversight for taxpayers with complex financial affairs. By March 2004, 52,000 individuals had their tax returns handled by these dedicated units compared with 45,000 in the previous year. The Teams secured nearly £47 million in additional revenue in 2003-04, from 3,400 completed compliance enquiries, averaging around £14,000 additional revenue per completed enquiry, and a further £4 million from other activities.

Source: National Audit Office

3.14 The Department measures its accuracy in setting taxpayer codes through its Quality Monitoring Exercise. In 2003-04, its accuracy rate was 71 per cent, which equated to around two million coding errors. Around one third of these errors were due to failure to update the taxpayer's code following capture of the data provided by the taxpayer on their return. Taxpayers with income from more than one employment and those who pay higher rate tax on their investments were also more likely to have coding errors made by the Department. Taxpayers without agents may be less able to check the accuracy of the Department's setting of their tax code and to challenge any mistakes. The Department has a target to increase to at least 85 per cent the proportion of individuals who find their Pay As You Earn coding notices (along with other statements and notices) easy to understand.

3.15 The Department issues Tax Review Forms to taxpayers who do not file returns where it needs information to update their tax codes. It introduced a more comprehensive version of this form in April 2005 to meet the needs of those newly removed from Self Assessment. The Department has introduced a coding tool which aims to assist staff by reducing the need for manual calculation of tax codes and improve accuracy in coding.

16 HM Revenue and Customs' quality assurance and monitoring for processing returns

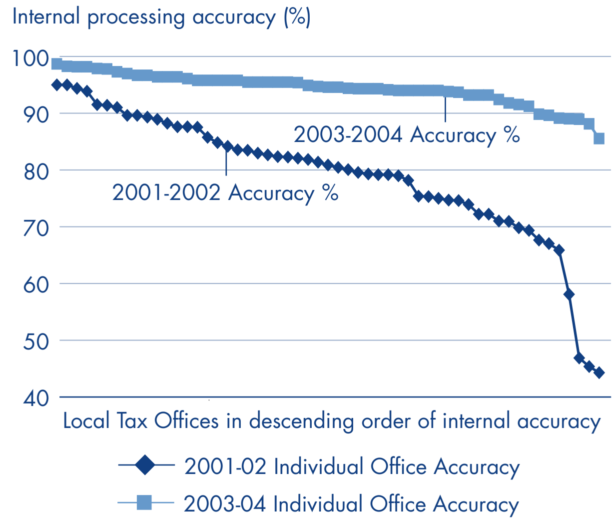
HM Revenue and Customs' quality assurance regime aims to improve the accuracy of work carried out in local offices and to support managers and staff in their work by detecting errors and improving training needs. All Areas within HM Revenue and Customs' local services have a target for the accurate processing of returns. Achievement of the target forms part of the local team bonus.

The quality assurance procedures provide managers with information on recurring errors found from their checks and help identify any staff who require training to improve their accuracy. The findings are used to reduce the risk of further incidences of inaccurate processing, rather than to correct inaccurately processed returns.

The annual quality monitoring exercises are designed to measure performance and involve independent in depth checks on work undertaken. A sample of around 20,000 returns is looked at each year. Any one case fails if a single error is identified in any of pre-determined quality criteria, even where it may have already been corrected. All cases found to have been processed with an inaccuracy are corrected. The exercise identifies internal performance in capturing the income and deductions data provided by the taxpayer on the return, any corrections made or which should have been made, and how accurately any balancing payment is determined (the difference between Income Tax already paid by the taxpayer and the assessed amount that should be paid that year). The Department records the number of internal errors made, what the errors were, why the errors arose, whether corrected, or likely to be corrected and the financial impact. It uses this information to improve computer systems, training and procedures as well as measuring the impact on taxpayers.

Source: National Audit Office

17 HM Revenue and Customs has improved the accuracy of processing filed returns across local offices between 2001-2002 and 2003-2004



Source: National Audit Office analysis of HM Revenue and Customs' data

NOTE

Local Tax Offices deal with a range of returns which, in part, may explain different accuracy performance against the national target.

Accuracy in imposing automatic penalties

3.16 In February 2005, HM Revenue and Customs imposed around one million first automatic penalties on taxpayers who had failed to file their Self Assessment return by the deadline of 31 January 2005. As in earlier years, a number of taxpayers and agents have complained that HM Revenue and Customs had wrongfully imposed the fixed penalty. HM Revenue and Customs estimates it incorrectly imposed 30,000 automatic penalty notices in February 2004. This is three per cent of the 950,000 penalties issued affecting 0.3 per cent of the Self Assessment population. It considers that around two-thirds of these were due to mistakes in logging returns **(Figure 18)**. This compares with its estimate that six per cent of its automatic penalties were incorrectly imposed in February 2002. Its estimates are based on extrapolation from a survey of nine offices which examined the reasons why penalty notices had been subsequently cancelled.

3.17 In response to this recurring problem HM Revenue and Customs has:

- Asked offices to review their processes for logging returns;
- aimed to improve their management of logging returns;
- introduced a logging stamp to confirm the date and office of logging;
- improved batching processes to provide batch numbers following log in; and
- improved its systems for logging in returns, in November 2004, to help reduce the incidence of incorrect penalties and to help it track returns.

3.18 HM Revenue and Customs has no mechanisms to identify those individual taxpayers who have incorrectly received a penalty and it has not contacted taxpayers individually to alert them to this risk. It relies upon

18 HM Revenue and Customs issued an apology for wrongful imposition of penalties in February 2004

2002-03 Tax Returns - First Fixed Rate Penalty Notices

Some taxpayers and their tax advisers have contacted us, querying the receipt of a penalty notice for a late 2002-03 Tax Return. They have said that the Return was filed on time.

We now know that a number of these penalty notices were issued wrongly, and we want to apologise to you and your clients for the inconvenience and additional work we know that these errors will mean.

We have identified the cause as being individual processing errors, so we will be doing all we can to improve our procedures. If you have received a penalty notice and the Return was filed before midnight on 1 February please contact….

We will, of course, consider claims for compensation under Code of Practice 1, for any reasonable costs which have been incurred as a result of our mistake or unreasonable delay.

Source: HM Revenue and Customs website

taxpayers, or their agents, to notice the incorrect penalty. Anyone receiving a penalty notice is invited to contact HM Revenue and Customs if they do not know why they have been sent one. It has put a statement on the penalty notice requesting taxpayers who disagree with the penalty to contact HM Revenue and Customs. Although the Department's errors in issuing penalties attracted significant media coverage in February 2004, its apology and alert on its website were included only in a section, "Working together", aimed at agents, and not in a section which unrepresented taxpayers would be likely to see.

3.19 Where a taxpayer challenges a penalty, HM Revenue and Customs investigates and if it agrees that the return was filed by the deadline, it cancels the penalty and issues an individual apology. Although HM Revenue and Customs has information on complaints referring to penalties and compensation it has paid, it has no specific information on the number of taxpayers who claimed compensation for being wrongly subject to a penalty; the number of claims for compensation agreed, and the amount paid out as a result of its errors.

3.20 HM Revenue and Customs does not know the number of taxpayers who have proceeded to pay the penalty wrongfully imposed on them. It has identified the main reasons for it wrongfully imposing a first fixed penalty as:

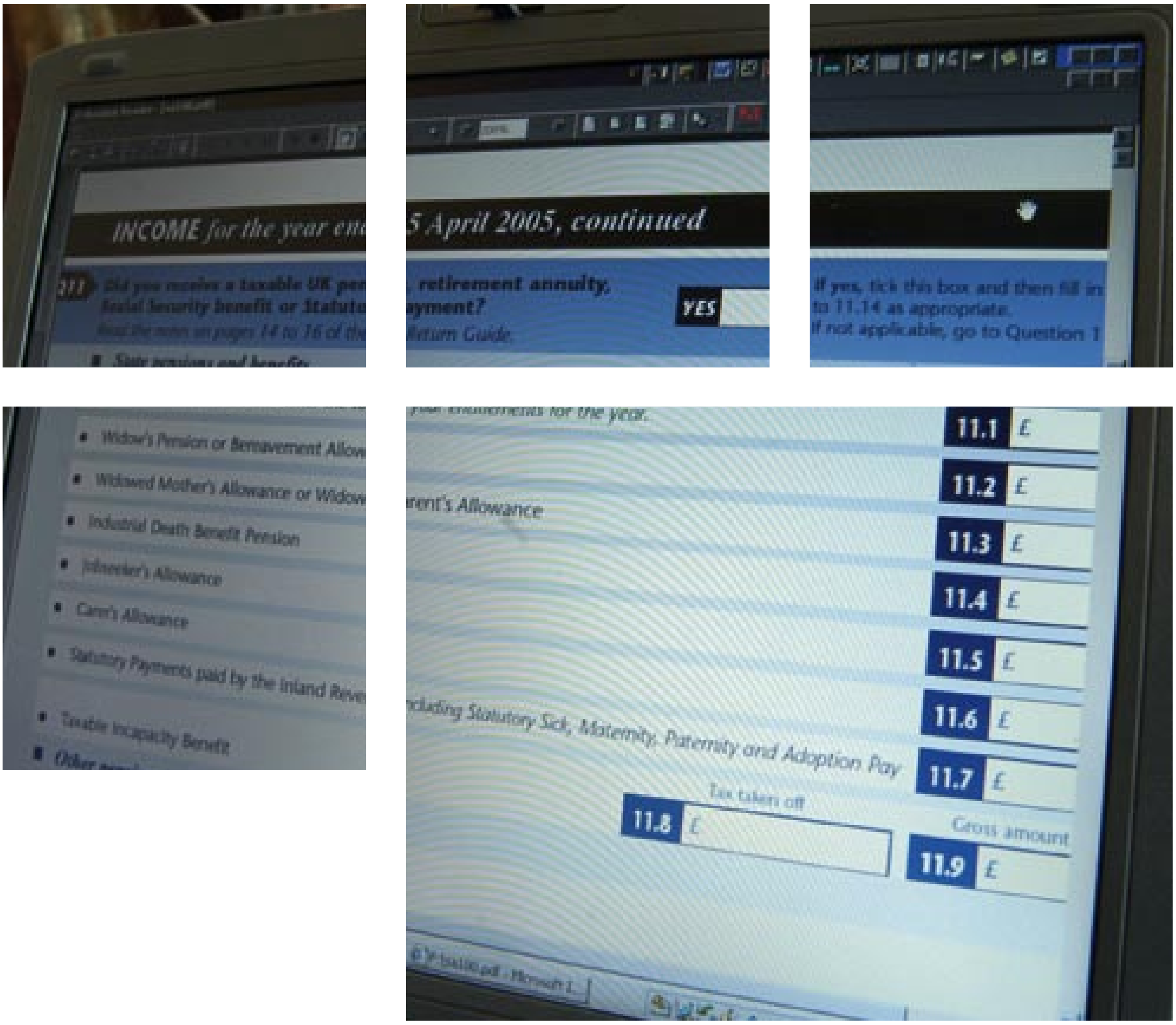
- Failure to log the return on their systems with the correct date of receipt;
- a duplicate record in existence, due to failure to cleanse the database; and
- failure to note the record correctly in closed cases.

3.21 Our sampling work has indicated that HM Revenue and Customs is unable to trace all the returns filed by taxpayers when required to do so. We visited three tax districts to review a stratified sample of filed returns. In our visit to the Coventry tax district, staff were unable to trace 28 of the 75 returns included in the sample and at the Derbyshire district office 21 of the 65 requested returns could not be retrieved. However, all of the 60 returns from HM Revenue and Customs' Chapel Wharf office in Manchester were available. The Coventry staff explained that the problem was due to the change in recording tax returns from a sequential to the batch system. The Coventry district office obtains all the returns from other local branches. The various local offices implemented the batching changes at different times and the system was unable to locate some of the returns filed by taxpayers. HM Revenue and Customs has improved its system for logging in returns on the day of receipt to improve accuracy in recording the location and numbering of returns.

3.22 The Association of Chartered Certified Accountants has carried out annual surveys since 1997 of its members working in tax to find out about their, and their clients', experience of Self Assessment. In their February 2004 survey[8], they found that 61 per cent of respondents had experienced cases of penalty or reminder letters issued to their clients where the return had been submitted on time. Eighty per cent of respondents reported having to spend extra time on their client's Self Assessment returns due to errors on the part of HM Revenue and Customs.

8 Association of Chartered Certified Accountants Members' Survey, Self Assessment 2004, February 2004. A representative sample of 80 members working in taxation throughout the United Kingdom.

PART FOUR
Simplicity of Self Assessment



Operating the Income Tax Self Assessment filing process costs £220 million a year – some £22 per return issued. The Department collects net around £70 in tax due for every £1 spent on operating Self Assessment. Chasing overdue returns and carrying out enquiries into filed returns incurs further costs. Further efficiencies in processing can be made by increasing the extent of automatic data capture from tax returns, encouraging greater use of e-filing and by rationalising the numerous centres inputting data from returns. By 2008 HM Revenue and Customs expects all returns will be processed at a handful of locations to achieve productivity gains. The Department has centralised the processing of its short tax return in one location. These returns are scanned by machine rather than subject to manual data input. It is carrying out a trial within its Lothian Area to improve its processing of tax returns by eliminating waste and introducing standardised, quicker, more efficient and more accurate procedures.

The workload of offices is highly variable through the year. Encouraging a smoother flow of returns from taxpayers and agents would help reduce the risks of internal delay and errors which rise during peak workloads. The workload of call centres is also very variable and during some periods, nearly half of callers are not able to get through. The Department needs to ensure that staffing in its call centres accurately reflects the pattern of calls received to reduce the number of callers who hang up without their calls being answered.

Tax returns are issued in April. Issuing returns a few weeks later would provide HM Revenue and Customs with more time to update its taxpayer database to ensure that returns are issued to the right people. However, taxpayers who wish to file straight away, such as to claim a repayment, could be encouraged to file online. The Department could explore bringing forward the filing date for paper returns to allow it to follow up queries earlier.

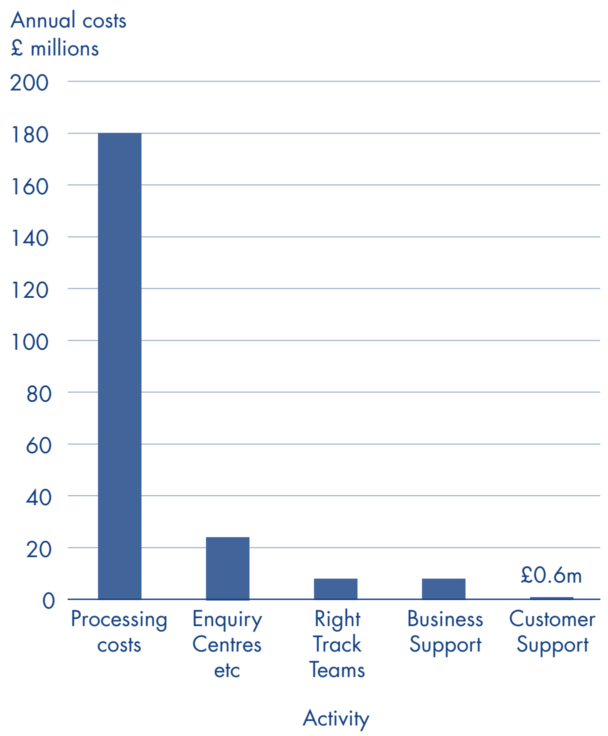
HM Revenue and Customs' tax forms compare well with those of other countries in terms of clarity and ease of use to the non-professional. But the usability of the forms and simplicity of the system could be improved further for taxpayers, for example by having a wider range of languages, replacing technical terms and providing clearer explanations. The short tax return has been well received and is easier and requires less time to complete. The Department is also planning improvements to the main tax return.

4.1 Simplified processes and interactions with taxpayers should reduce costs to taxpayers and improve the percentage who file on time. HM Revenue and Customs needs to balance the need to make the tax form easy to complete against its requirement that taxpayers assess their tax based on full and accurate data. Data are also needed to support HM Revenue and Customs' compliance risk selection process. The Department also needs to balance simplifying the tax return itself against greater complexity in the overall Self Assessment system. For example, while the short tax return simplifies the process for some taxpayers, it introduces another variant into the Self Assessment system.

Costs of operating Income Tax Self Assessment

4.2 HM Revenue and Customs spent £220 million in processing returns and supporting the filing process for the 2003-04 filing year or approximately £22 per return issued. As a comparison the average staff cost of processing benefit applications in 2003-04 was £17 for the Social Fund, £22 for Jobseekers Allowance, £47 for Incapacity Benefit and £60 for Income Support applications.[9] The Department collects around £70 in Self Assessment Income Tax for every £1 spent on operating Self Assessment. **Figure 19** shows that the processing costs of issuing and subsequently logging, capturing and checking filed returns represented over 80 per cent of HM Revenue and Customs' Self Assessment administration costs. Chasing overdue returns and full or aspect enquiries into filed returns incur further costs. The further development of online filing and the introduction of the short tax return should help towards reducing HM Revenue and Customs' processing costs of logging and capturing returns and the costs per return. Online returns are logged and the data captured automatically and the short tax return is scanned, rather than subject to manual input of the data, reducing data capture costs. The removal of over one million people with very simple financial affairs from the need to file a return should also significantly reduce the costs of operating Self Assessment. These people usually have very little additional tax to pay beyond that deducted at source – in many cases less than the average operating cost of £22 per return.

19 HM Revenue and Customs' administration costs for Income Tax Self Assessment



Source: National Audit Office analysis - HM Revenue and Customs Income Tax Self Assessment administration costs (2003-04)

4.3 To learn from how other organisations organise large volume processing of information from their customers, we consulted the mortgage lending sector. Although there are significant differences, the sector has a number of parallels with the key characteristics of HM Revenue and Customs in its processing of Self Assessment:

- Mortgage lenders receive high and variable volumes of mortgage applications with peaks of applications before closing dates for mortgage products;
- applications need to be processed promptly, consistently and accurately to provide applicants with a decision on their application and calculation of their mortgage; and
- application forms need to be easy to use and complete for the applicant, while requesting a range of financial and situational information about the applicant.

9 'Helping those in financial hardship: the running of the Social Fund' Report by the Comptroller and Auditor General HC 179 session 2004-05, January 2005.

4.4 The Nationwide Building Society has developed various capacity and resource management tools to meet the above requirements **(Figure 20)**. The impacts achieved include better matching of processing to resources available, greater consistency and quality of processing, faster completion of checks on applications and decisions to the applicants, and reduced expenditure on temporary additional staffing to cover peaks in the receipt of mortgage application forms. HM Revenue and Customs has developed similar features to manage its processing work efficiently. It monitors the profile of returns filed across the year and plans how processing work will be managed. It considers factors such as the staff resources available, other work demands, the time each return is likely to take and the productivity of staff with different levels of experience and ability. It also moves work between locations as necessary.

20 Good practice in processing forms – Nationwide Building Society

- A Resource Management Planner to provide an accurate picture of staff resources available in each time period, and all planned staff absences;
- a Modelling Tool to provide projected volumes of work inflows in each time period;
- standardised work processes being used in all processing centres, including standard processing times required per work item;
- a Capacity Planner to match planned resource availability, projected work volumes and processing times per work item to determine processing centres with over and under capacity in each time period; and
- ability to move work electronically ('virtual' transfers) between processing centres using a networked IT system to match work demands to resources available nationally.

Source: National Audit Office analysis of Nationwide Building Society consultation

4.5 We commissioned RAND Europe to develop a flow chart of HM Revenue and Customs' Self Assessment return filing process, from identifying taxpayers to whom it should issue a tax return through the various filing deadlines to the filing of a completed return. This identified the points of interaction between HM Revenue and Customs and the taxpayer and the 59 separate processes involved. It illustrated how additional complexity is introduced by the need to accommodate a wide range of responses from the taxpayer, including on time filing, and late or non filing, and also in fulfilling wider objectives (e-filing) or reducing the costs of complying with Self Assessment.

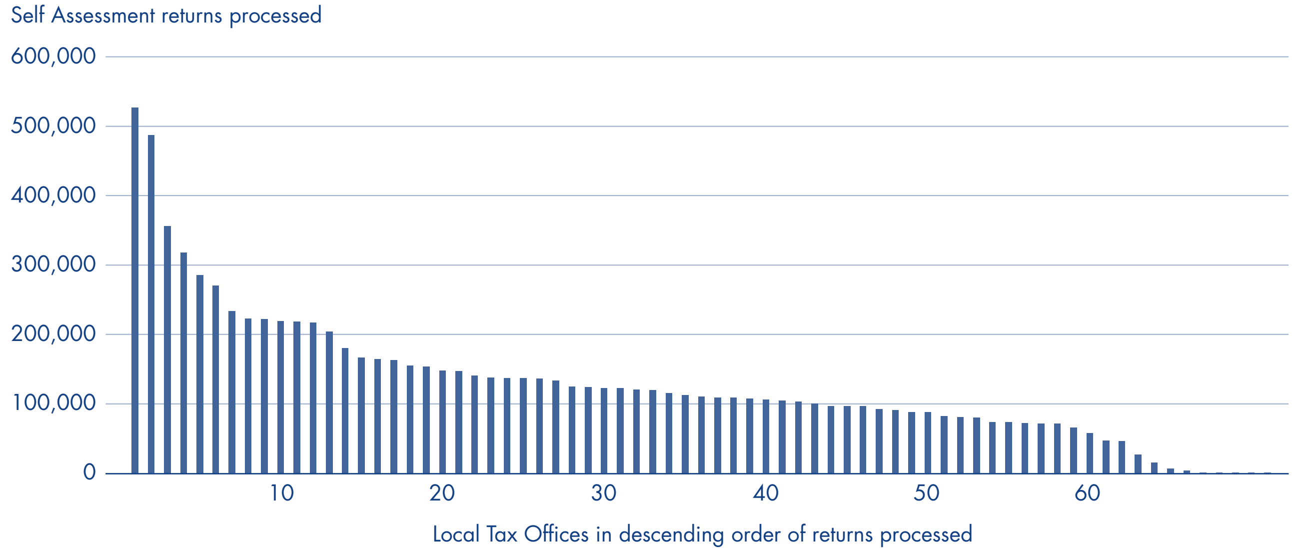
Processing filed returns and taxpayer calls

4.6 HM Revenue and Customs has 74 Area Offices and units. Two offices process around 500,000 returns each. But almost half the offices process less than 100,000 returns, with the smallest processing just five returns **(Figure 21 overleaf)**. The wide distribution of processing work throughout the network of offices contrasts with the approach adopted by some overseas tax authorities. In the United States, tax returns are processed in centralised depots. HM Revenue and Customs has centralised the processing of its short tax return in one location. The returns are scanned by machine rather than subject to manual data input. Although there have been teething problems with this development, the Department can now realise benefits in the speed of data capture and the more efficient and flexible use of staff.

4.7 HM Revenue and Customs' policy is to move to more centralised processing to achieve productivity gains. By 2008 it expects all returns will be processed automatically at a handful of locations. In 2003, it reviewed the work of large Area offices that handle over 50 per cent of the Department's return processing work and is using the results to help design standardised procedures for organising work at the local level. Efficiency savings of between 200-300 staff years are already included in the Department's plans and are expected to be achievable with effect from 2005-06 on the basis of applying the average standard processing times achieved by the three most efficient offices.

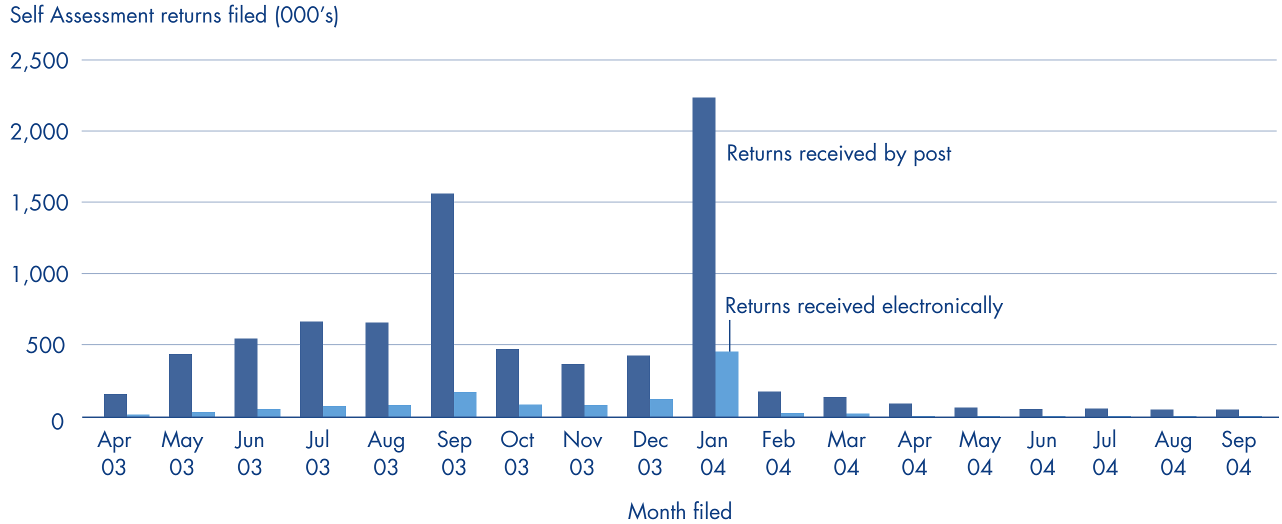
4.8 The workload of offices is highly variable through the year. In January 2004, 2.7 million tax returns were filed (both paper and electronically), creating a significant peak in filing workload across all offices. This contrasts with December 2003, the preceding month, in which just over 500,000 tax returns were filed. Changing the timetabling of returns might improve the timeliness and accuracy of return filing and processing. HM Revenue and Customs experiences major resource constraints in processing filed returns promptly and accurately following the peaks in filing around the September 30 and January 31 deadlines **(Figure 22)**. Our focus groups with HM Revenue and Customs staff and consultation with stakeholders identified the problems these cause in logging in filed returns and

21 Self Assessment returns processed by HM Revenue and Customs local offices in 2003-04



Source: National Audit Office analysis of HM Revenue and Customs tax return processing figures by Area Office

22 The flow of Self Assessment returns for 2002-03 filed during 2003-04



Source: National Audit Office

inputting the data promptly and accurately, and also in assessing the taxpayer's tax liability and determining their Pay As You Earn tax coding for the next year. Measures to encourage a smoother flow of returns from taxpayers and agents throughout the year would help reduce the risks of internal delay and errors which increase during peak workloads.

4.9 The workload of call centres is also very variable. Over 160,000 telephone calls were made to HM Revenue and Customs' call centres in January 2004, but fewer than half (74,000) of calls were answered by call centre staff. This contrasts with the preceding month in December 2003, in which 41,000 calls were made to call centres, but with again only around half (22,000) being answered. This indicates that during some periods, nearly half of callers to the centres are not able to get through. HM Revenue and Customs does not ring these callers back. The Department needs to ensure that staffing in its call centres accurately reflects the pattern of calls received to reduce the number of callers who hang up without their calls being answered. It has a target to increase to at least 80 per cent by 2007-08 the proportion of individuals and businesses who said they achieved success at first point of contact.

4.10 HM Revenue and Customs is carrying out a trial within its Lothian Area to improve its processing of tax returns by eliminating waste (of time and resources) and introducing standardised, quicker, more efficient and more accurate procedures. The trial has identified over complications in the process with unnecessary stages that result in waste, lengthy periods of unproductive time between different stages and a longer overall time to complete processing. It has also confirmed the causes of low accuracy in processing. These include variation in the processes used and complexity. Staff also perceived that lack of knowledge and continuity in their work affected their accuracy. The trial includes designing simplified processing procedures to eliminate waste and unproductive time between stages and to reduce the scope for variation. It also includes introducing concurrent quality checks with rapid feedback of the results to prevent systemic errors.

Issue and filing dates of tax returns

4.11 Most taxpayers in employment within Self Assessment do not complete their return until they have received their form 'P-60', which states their gross and net earnings and tax deducted. The issue of tax returns in April is at least two months before this time. Similarly, many self-employed do not receive the necessary financial statements to enable them to file as soon as the forms are issued in April. This enforced lull allows taxpayers more time to lose returns and for some to forget about filing requirements. Issuing returns a few weeks later would provide HM Revenue and Customs with more time to update its taxpayer database to ensure that returns are issued to the right people. It would also help HM Revenue and Customs eventually to consider in the light of IT system developments the cost effectiveness of pre-populating electronic returns, as begun by some overseas tax authorities, with a range of information it should already hold on taxpayers such as Pay As You Earn. However, some taxpayers will want to claim a repayment, for example, because of a gift aid donation. Delaying the issue of a notice to file or return form might delay that repayment and generate additional work for the Department. In such cases, taxpayers could be encouraged to file online if they wish to claim a repayment straight away.

4.12 Other tax authorities typically allow taxpayers only three to four months to file their returns, granting extensions to those who apply for extra time or those who use agents. Their experience, and the flow of returns to HM Revenue and Customs, suggests that the Department should explore bringing forward the final due date (from 31 January to say, 30 November for paper returns) taking account of the likely peak in returns around the deadline set. Similarly, the filing date for the new short tax return could be brought forward from 31 January to 30 September. This would allow HM Revenue and Customs to follow up queries and errors earlier. The Department would, however, if differential filing dates were introduced, need to ensure there are appropriate incentives/penalties to encourage taxpayers to file by the due date. For example, taxpayers who fail to file their short tax returns would be sent a full tax return the following year.

Ease of use of Self Assessment tax returns for the non-professional

4.13 HM Revenue and Customs commissioned research from BMRB Social Research to assess whether their piloting of the short tax return and removal of taxpayers with very simple financial affairs from the need to file a return had simplified Self Assessment for taxpayers. The research concluded that the short tax return had been well received, being easier and requiring much less time for taxpayers to complete. Taxpayers also found that the one page Tax Review Form, which may be sent on average every three years to those being removed from Self Assessment, was easy to complete. Compared with completing the full tax return, the short tax return could be translated into an overall saving of around 1.5 million hours for the 1.5 million people with simple financial affairs. In response to the research, HM Revenue and Customs is clarifying the eligibility criteria contained in the guidance for taxpayers for both the short tax return and the Tax Review Form and is providing more help to taxpayers to increase the take up of the two per cent who responded to the innovative pilot to allow information on the short return to be filed over the telephone.

4.14 We commissioned a study which compared the ease of use of Self Assessment tax returns for the non-professional in the United States, Canada, Australia and New Zealand with HM Revenue and Customs' main tax return and the new short tax return. Tax returns were assigned a usability score derived from a checklist of 69 features developed in the earlier reports *Difficult Forms: How Government agencies interact with citizens*[10] and *National Audit Office - Improving and reviewing Government forms: a practical guide*.[11] Aspects evaluated were legibility, language, clearness of guidance, spacing and sequencing and ease of submission. A score of 25 or less indicates a form that is easy to use while 70 or more suggests a form that is difficult. The compared tax returns had scores ranging from 42 to 69 with HM Revenue and Customs' short tax return and main tax return being scored at 46 and 57 respectively. **Figure 23** summarises the positive and negative features of the main tax return and short tax return of HM Revenue and Customs.

4.15 Our work has identified a number of features that make a tax form easier or more difficult to use and many positive features are evident in the returns produced by HM Revenue and Customs. Two particular areas with scope for greater ease of use were:

- **Language** – replace technical terms on forms and provide clearer explanations for terms such as "non-qualifying distributions" and "corresponding deficiency relief", and provide the forms in a wider range of languages than just English; and
- **Guidance** - could be clearer by making less use of jargon, more use of examples to support complicated concepts, and more demonstrative ways of describing processes (for example, flowcharts instead of narrative).

4.16 In December 2004, HM Treasury issued guidance to staff in departments who are involved in the design of forms for use by the public.[12] The guidance drew together recommendations from the Committee of Public Accounts to these departments, which the Government has accepted, subject to consistency with data protection requirements and appropriate legal gateways for sharing information.

4.17 HM Revenue and Customs aims to encourage electronic filing of returns by making this a simple mechanism for taxpayers to use. It meets regularly with agents and holds workshops to establish and prioritise their requirements on electronic filing and consults wider users about ease of electronic filing. During 2004-05, an optional online 'exit poll' was completed by nearly 11,000 taxpayers who had filed using HM Revenue and Customs' online tax return. Around 90 per cent of them were 'satisfied' or 'extremely satisfied' with the service and 96 per cent said they would use the service again in the following year.

10 *'Difficult forms: How Goverment agencies interact with citizens'*, Report by the Comptroller and Auditor General, HC 1145 Session 2002-2003, October 2003.
11 *National Audit Office: Improving and reviewing Government forms: a practical guide*, December 2003.
12 HM Treasury DAO(GEN)16/04, 3 December 2004.

23 Positive and negative features of the short tax return and main tax return

Short tax return

Rated highly:

Targeting - Targeted at a pre-segmented taxpayer group and consequently well focused, resulting in a slimmer less daunting package.

Language - It does not have to cover so many forms of income and reliefs, so language is much simpler

Sequencing - Uses a simple numbering system with no part numbers and sub-sections. Routing therefore very simple.

Guidance - Uses a clear spacious layout with informative headings and useful graphics to illustrate where information can be found. Helpline details are clear and repeated often.

Less highly rated:

Design - Machine readable, limiting its tolerance of mistakes and potentially causing problems for some users.

Availability - Pre-determined users by HM Revenue and Customs so not widely available

Main tax return

Rated highly:

Spacing - Generous space is included for providing additional information.

Sequencing - Filter questions are used throughout to help users avoid detailed questions that are not relevant to them.

Phone and web facilities - Helpline numbers are prominently displayed and repeated.

Return features - As long as the user is filing a form sent by HM Revenue and Customs rather than downloaded from the web, the single return address provided obviates the need to work out where to send the form.

Less highly rated:

Bulkiness - bulky form of 12 pages with 135 questions, up to nine supplements and supported by 35 pages of guidance.

Language - While needing to define and capture information precisely, technical terms are reproduced directly on the form but are not always clearly explained in the guidance or require the user to obtain other documents.

Guidance - While the opening sections are user friendly, later stages require the user to cope with dense text in small font with technical explanations.

Source: National Audit Office

4.18 Some overseas authorities pre-populate tax returns with data already held on individuals. Pre-population may yield improvements in returns being filed promptly and reduce the opportunity for non-compliance. The effectiveness of pre-population depends on the quality of the information held by the tax authority. Canada uses information it already holds about the taxpayer to help older taxpayers who file by telephone to reduce the complexity of filing for this group. Taxpayers in Australia who are filing electronically for the second and subsequent years and using the same computer, are presented on their electronic form with previous personal details they provided, which they can edit if needed. The Australian Tax Office is trialling links with related agents to enable direct transfer of taxpayer specific information to the electronic forms. HM Revenue and Customs is unable to carry out pre-population because it cannot update taxpayer records in time for the issue of returns in April as it does not receive the information for pre-population, for example, Pay As You Earn details, until May to July. The extent to which HM Revenue and Customs can pre-populate electronic returns with information held on Pay As You Earn, tax credits, bank/building society interest and dividends is restricted by the lack of read across between the databases holding this information. Before adopting pre-population HM Revenue and Customs would need to improve the accuracy of data on its databases and its ability to compare and exchange data on different databases. Once this is achieved, HM Revenue and Customs would be able to pre-populate the online version of taxpayers' returns with the information held on its databases as these become available. This would serve as a further incentive for taxpayers to file online.

APPENDIX 1

National Audit Office methodology

Advisory panel

1 We established an Advisory Panel to provide expert advice on the scope, issues, methodologies, emerging findings, and recommendations. We designed the membership of the panel to provide a valuable spectrum of external insights and expertise. We would like to thank each of the members for their time and help in taking part in our panel and the contributions they provided. Panel members are shown below.

Modelling the Income Tax Self Assessment system

2 We appointed RAND Europe to model the Income Tax Self Assessment filing process at HM Revenue and Customs. Their work included a workshop with a range of HM Revenue and Customs staff to gain their inputs into the development of flowcharts to represent the filing process. RAND Europe then developed a software program to model the filing of Income Tax Self Assessment returns. The model illustrates and clarifies the process; quantifies the number of different types of taxpayers involved at each stage of the process; and enables assessment of the impact of changes.

Private sector practices

3 We consulted Nationwide Building Society to identify their business operations in collecting, processing and checking the large volumes of information on mortgage application forms. Our aim was to gain insights into how they organise and undertake these activities and communicate with their customers. We identified good practices that could be adopted by HM Revenue and Customs in its administration of tax returns. We would like to thank Nationwide Building Society for their helpful contributions and the Council of Mortgage Lenders for their help in facilitating this exercise.

Revenue Departments overseas

4 We appointed RAND Europe to report on the Income Tax filing systems in the Revenue Departments of seven countries and to identify good practices. We would like to thank each Department below for their time and help in our examination.

The advisory panel, from left to right: **John Marshall;** Cross Cutting Policy – Income Tax Self Assessment Review Team, HM Revenue and Customs. **John Whiting;** Tax Partner, PricewaterhouseCoopers. **Paddy Linford;** Service Delivery Support, HM Revenue and Customs. **Mike Warburton;** Senior Tax Partner, Grant Thornton. **Anne Redston;** Chair of Personal Taxes, Chartered Institute of Taxation. **Rosie Stockford;** Personal Tax Manager, Grant Thornton. **Nick Kirby;** Senior Researcher, Money Research Group, Which? **Anne Stewart;** Service Delivery Support, HM Revenue and Customs. **Terry Hawes;** Director, E-Services Programme, HM Revenue and Customs. **Christina Morton;** Public Service Agreement 1 Delivery Planning Manager, HM Revenue and Customs. **Chas Roy-Chowdhury;** Head of Taxation, Association of Chartered Certified Accountants.

Country	Revenue Department	Website
Australia	Australian Taxation Office	www.ato.gov.au
Canada	Canada Revenue Agency	www.cra-arc.gc.ca/menu-e.html
Estonia	Rahandusministeerium	www.fin.ee/?lang=en
Netherlands	Ministerie van Financien	www.minfin.nl
New Zealand	Inland Revenue	www.ird.govt.nz
Sweden	Skatteverket	www.skatteverket.se/
United States of America	Internal Revenue Service	www.irs.gov

5 The consultants examined the Revenue Departments' practices to encourage and enable all taxpayers to file complete and accurate Income Tax returns on time and to simplify tax forms to minimise the demands on taxpayers.

Sample review

6 We examined a sample of returns to illustrate the actions taken by HM Revenue and Customs at each stage following receipt from the taxpayer. The sample was selected broadly to represent the tax return population and include particular risk areas such as partnerships and trusts. The sample covered paper and electronic returns, short and main tax returns, different taxpayer groups, different timings of return and returns completed by the taxpayer and those completed by agents. The sample was drawn by the Department's Analysis and Research Team from its database of Self Assessment taxpayers. The sample of returns was drawn from the Tax Offices in Coventry, Nottingham and Chapel Wharf and Nottingham Trust Office.

Staff focus groups

7 We held a focus group with HM Revenue and Customs Area Directors, one with Service Managers and one with operational staff. Staff were drawn from different geographic regions, with up to nine staff at each group. We would like to thank those who took part. The groups explored:

Area Directors:

- Their strategy for developing Self Assessment filing up to 2007-08;
- the impacts on filing of wider initiatives to improve efficiency;
- how Areas monitor, measure and report on performance, and manage internal quality and quality of service to customers relating to filing; and
- the main operational challenges Areas face and good practices in place;

Service managers and operational staff:

- responsibilities and activities of local offices, relating to filing of tax returns;
- the range of local priorities, targets, aims and performance achieved;
- local examples of good practices/initiatives and their impacts;
- key challenges and barriers faced; and
- risks to meeting priorities, achieving targets and aims and how these are managed.

Stakeholder consultation

8 We consulted a number of organisations with a professional interest in the subject of filing Income Tax Self Assessment returns to identify and discuss the issues of greatest importance to their members and to gain an external perspective on the issues examined in our study. We would like to thank the organisations below for their time and help.

Stakeholder	Website
Association of Chartered Certified Accountants	www.accaglobal.com
Association of Taxation Technicians	www.att.org.uk
Chartered Institute of Taxation	www.tax.org.uk
Federation of Small Businesses	www.fsb.org.uk
Institute of Chartered Accountants of Scotland	www.icas.org.uk/cms
Institute of Chartered Accountants in England and Wales	www.icaew.co.uk
Low Incomes Tax Reform Group	www.litrg.org.uk
Taxaid	www.taxaid.org.uk

Usability of forms

9 We appointed Jonquil Lowe, freelance financial researcher, to assess the usability of HM Revenue and Customs' main tax return and short tax return to the non-professional, along with Self Assessment forms in Australia, Canada, New Zealand and the United States of America. The assessment compared each form with a checklist developed in earlier work by the National Audit Office: "Difficult forms – How government agencies interact with citizens" (http://www.nao.org.uk/publications/nao_reports/02-03/02031145.pdf) and "Improving and reviewing government forms: a practical guide" http://www.nao.org.uk/publications/nao_reports/02-03/02031145_good_practice_guide.pdf.

Jonquil Lowe also undertook a literature search on tax advisers' views of HM Revenue and Customs' Self Assessment tax returns.

APPENDIX 2

HM Revenue and Customs' progress in implementing recommendations from the Committee of Public Accounts

1 The Committee of Public Accounts reports "Income Tax Self Assessment" (HC 296 2001-2002) and "e-Revenue" (HC 707 2001-2002) made recommendations related to the filing of tax returns. The Department's progress on each recommendation is below.

Recommendation by the Committee of Public Accounts	Action taken by HM Revenue and Customs
Income Tax Self Assessment	
The Department should speed up the work they are doing to assess the sums lost or at risk in specific taxes and measure their performance in reducing them (Conclusion i) **Action: Ongoing**	HM Revenue and Customs has developed compliance measures for the main customer groups to gain insight into their relative risks. It has introduced a random enquiry programme to improve understanding and assessment of risk, inform the development of resources and deepen understanding about the level of unreported income. The Department has developed approaches to understand that part of the tax gap associated with people and entities who operate wholly outside of the formal economy. It has introduced measures which include a national publicity campaign, expansion of the "hotline", and increased use of reports of suspicion of tax evasion to the National Criminal Intelligence Service. The new department will have a hidden economy compliance strategy that will recognise the wide range of people who make up the hidden economy. It has improved understanding of different parts of the hidden economy by seconding an officer to research the barriers that prevent people joining the formal economy.
The Department should consider the greater use of sanctions to encourage filing on time and set a firm target for achieving compliance. (Conclusion ii) **Action: Ongoing**	The Department's taxpayer payment and filing initiative is continuing and has been expanded to cover payment as well as filing. In October 2003, the Department began a spend to save initiative to increase the use and profile of daily penalties on late Self Assessment returns. HM Revenue and Customs' receivables management service is considering how sanctions may be used more effectively and consistently. The Department has targets for filing by the deadline (90.6 per cent) and within 12 months (97.5 per cent) and for payment (89.5 per cent by the deadline and 98.7 per cent within 12 months).
The Department should regularly reassess the effectiveness of each of the sanctions available (Conclusion iii) **Action: Ongoing**	The Department is reviewing the impact of its penalties on filing behaviour. A cross cutting policy team is reviewing the penalty structure for the new Department to ensure consistency. Its Analysis and Research function is carrying out ongoing work into evaluation techniques.

Recommendation by the Committee of Public Accounts	Action taken by HM Revenue and Customs
Income Tax Self Assessment *(continued)*	
The Department should provide access to modern systems to assist intelligence and enquiries into tax returns to ensure compliance (Conclusion iv) **Action: Ongoing**	In April 2004, the Department introduced a support system for Risk Intelligence and Analysis Teams. It added new information sources to its data warehouse in 2003-04, including information from auctioneers and stockbrokers, and details about payments to labour providers. It is planning further enhancements. The Department has commissioned a study of self-assessment filing and payment to improve knowledge of the behaviour of different customer groups and understand from them what would most effectively improve their compliance. The Department completed its research on filing behaviour in October 2002. The Department has recognised that the need for detailed management information will become greater, with the increase in the filing on time target to 93 per cent by 2008, to enable it to direct and to assess interventions and initiatives. Following the increase in the filing on time target, the Department commissioned consultants to review all management information and analysis available to provide a fresh perspective of non compliant groups. The Department completed research into the e-filing/non e-filing behaviour of taxpayers in March 2004. The results of this research are feeding into e-service development and marketing.
The Department should complete research into the scale of the risk arising from non-compliance and measure performance in reducing this risk (Conclusion v) **Action: Ongoing**	The Department is using information gained through the random enquiry programme to identify the relative risk posed by different taxpayer groups and to identify new risk indicators. It has a new programme to measure the relative proportions of the tax gap by different areas of non-compliance. The Department's Analysis and Research is assessing the extent of 'ghost' and 'moonlight' activity.
The Department should seek more direct evidence from customers of real progress in reducing compliance costs (Conclusion vi) **Action: Ongoing**	The Department's 'working together' team has enabled agents to meet inspectors and to highlight in some 40 workshops the problems they are having with HM Revenue and Customs' systems and procedures. Problems which cannot be solved at a local level are escalated to find a solution. In April 2002, the Department began research into compliance costs. It commissioned research on the pilot of the short tax return and refinement processes, including assessment of the reduction in compliance costs.
e-Revenue	
The Department should set more specific targets for each e-service (Conclusion i) **Action: Delivered**	HM Revenue and Customs has a Public Service Agreement target for 25 per cent of Self Assessment returns to be filed electronically by 2005-06 and 35 per cent by 2007-08.
The Department should make more time for controlled piloting before implementing e-systems (Conclusion ii) **Action: Delivered**	HM Revenue and Customs is carrying out controlled piloting where it considers this appropriate. For example, when the secure portal to its website was enhanced to allow taxpayers to view their liabilities and payments and the date of receipt of tax returns. This provided assurance that the correct data were displayed to the right people and that security was not compromised.
The Department should develop new systems in close consultation with users (Conclusion iii) **Action: Ongoing**	HM Revenue and Customs is continuing to work closely with users. Its activities include telephone surveys of people contacting its Electronic Business Helpdesk, online exit polls and feedback facilities and market research. For example, customers who file online using the Department's online tax return can complete an exit poll. During 2004-05, around 90 per cent of them were 'satisfied' or 'extremely satisfied' with the service and 96 per cent said they would use the service again in the following year.

Recommendation by the Committee of Public Accounts	Action taken by HM Revenue and Customs
e-Revenue *(continued)*	
The Department should develop a strategy to improve access to e-services (Conclusion iv) **Action: Delivered**	The Department's 'channels' strategy recognises that its services must reflect the varying needs and behaviours of different customer sectors. The Department wants to guide people to the channels that best meet their needs at the lowest costs, while maintaining or improving customer satisfaction. Generally that will be via online services.
The Department should maintain close contact with agents to encourage take up of the internet service (Conclusion v) **Action: Ongoing**	HM Revenue and Customs meets regularly with agents. This includes formal meetings to explain services, address concerns and explore opportunities to improve services, and workshops to establish and prioritise their requirements. The Department has enhanced its internet service for agents which has been well received. Further enhancements will be introduced over the next 12-18 months. 540,000 Self Assessment returns were filed by agents over the internet in 2004-05 up from 38,000 in 2002-03.
The Department should investigate security weaknesses in the internet service to address issues of public confidence as well as technical problems (Conclusion vi) **Action: Ongoing**	HM Revenue and Customs takes the security of its online services very seriously. It has a rigorous IT security policy, monitors services continually and uses third party IT security specialists to carry out 'healthcheck' assurance reviews. It continues to address issues of public confidence, and information about security is generally included in marketing information issued to reassure customers who want to file online.
The Department should complete formal evaluations of its IT projects (Conclusion vii) **Action: Delivered**	HM Revenue and Customs has completed project evaluation reviews for all 13 projects.
The Department should prepare rigorous business cases for all future e-services (Conclusion vii) **Action: Delivered**	HM Revenue and Customs has prepared a business case for its e-services programme. This has been approved by the Department's approval bodies.

APPENDIX 3

The Self Assessment System

1 HM Revenue and Customs introduced Self Assessment for income tax and capital gains tax in 1996 with the first returns being issued to taxpayers in April 1997. Taxpayers who are sent, or request, the main Self Assessment tax return receive a basic core return of 10 pages. Taxpayers may also request any supplementary pages they need, or HM Revenue and Customs may send directly to the taxpayer the supplementary pages likely to be needed. Taxpayers may use an order line (0845 9000 404) or obtain supplementary pages from the website www.hmrc.gov.uk. **Figure 24** shows the supplementary pages which taxpayers may be required to complete. Taxpayers also receive a Tax Return Guide and a Tax Calculation Guide, unless they are represented by an agent. In 2002-03, 350,000 taxpayers requested an Income Tax Self Assessment return from HM Revenue and Customs. Full returns are sent to individuals, Partnerships and Trusts.

24 Taxpayers may have to complete a number of supplementary pages to their main Self Assessment returns

Employment	Share schemes	Self-employment
Partnership	Land and property	Foreign
Trusts etc	Capital gains	Non-residence etc

Source: HM Revenue and Customs

Removing taxpayers from Self Assessment

2 During 2004-05, taxpayers who filed their 2003-04 return and who had very simple financial affairs received a letter from HM Revenue and Customs notifying them that HM Revenue and Customs did not plan to send them a Self Assessment return from then on **(Figure 25)**. Such taxpayers may receive a Tax Review Form from HM Revenue and Customs, normally every three years, on which they will have to provide their taxable income and details of whether they wish to claim some kinds of tax relief.

The Short Tax Return for the 2004-05 tax year onwards

3 The short tax return is a four page form mainly for employees, the self employed with turnover of less than £15,000, pensioners, people with property income in the United Kingdom of below £15,000 and people receiving saving and investment income, who have simple financial affairs. HM Revenue and Customs issued this return as a pilot exercise to over 400,000 Self Assessment taxpayers in 2003-04 and sent it to around 1.5 million Self Assessment taxpayers for the 2004-05 tax year. The Short Return is not sent to those whose previous return was e-filed.

The main Self Assessment return

4 People will need to complete a main Self Assessment return if they meet the criteria set by HM Revenue and Customs. If they are not selected to receive a Short Return, they will need to complete the main Self Assessment Tax Return. The main categories are shown in **Figure 26**.

25 People who will not receive a Self Assessment tax form from 2004-05 onwards

Types of taxpayer with very simple financial affairs	Number of taxpayers
People paying higher rate Income Tax (40 per cent), but earning less than £100,000 a year from their employment(s)	650,000
People paying standard rate Income Tax (22 per cent) from their employment(s)	350,000
Pensioners and people on a low income	100,000
Total	**1,100,000**

Source: HM Revenue and Customs' estimates based on Self Assessment returns received for 2001-02

26 Some types of people who have to complete a main Self Assessment return include

- Self employed people including business partners;
- Company directors;
- Ministers of religion;
- people who earn more than £100,000 a year;
- employees who have a net income of £2,500 a year or more from letting any property or land they own and any others with letting income;
- people who receive other untaxed income and the tax due on it cannot be collected through a Pay As You Earn tax code;
- people who receive year on year income from a trust or settlement or any income from the estate of a deceased person;
- people with taxable foreign income; and
- people who are a Name or member of Lloyd's;

The full categories of people who need to return a Self Assessment return are available on HM Revenue and Customs website: http://www.hmrc.gov.uk/sa/guidelines.htm

Key dates and deadlines

5 Taxpayers have a number of key dates and deadlines for filing their Tax Returns to HM Revenue and Customs **(Figure 27 overleaf)**.

Determinations and daily and continuing penalties

6 Taxpayers who have not filed their Tax Return by the filing date may receive a notice from HM Revenue and Customs "Determination of tax due", giving HM Revenue and Customs' estimate of the taxpayer's tax bill for the year. The taxpayer has no right of appeal against such a determination. The full amount of tax due shown in the determination can only be changed by the taxpayer sending in their tax return. Failure to pay in full the amount shown as due from a determination is treated in just the same way as a failure to pay in full the amount of tax assessed as due following filing of the tax return.

7 HM Revenue and Customs may apply to the General Commissioners for Income Tax for permission to impose a daily penalty of up to £60 for each Tax Return that a taxpayer is overdue in filing. If HM Revenue and Customs takes this action within six months of the due filing date, the taxpayer does not have the second fixed penalty of £100 imposed.

8 Taxpayers may appeal against a penalty for a late return if they consider they have a good reason for not filing by the deadline. Taxpayers should appeal to the General Commissioners for Income Tax within 30 days of receiving a penalty notice, and notify HM Revenue and Customs of their appeal. Details of the General Commissioners for Income Tax are on their website: http://www.courtservice.gov.uk/tribunals/gcit/index.htm. HM Revenue and Customs has accepted circumstances such as a taxpayer's failure to receive the tax return initially, the loss or delay of their completed return in the post, a loss of tax records, serious illness and bereavement as good reasons for not filing by the deadline.

27 Key dates and deadlines

Key Dates	What Happens/Why Is This Date Important?
6 April	This is when a new tax year starts. HM Revenue and Customs will send out a Main or Short Tax Return or Notice to Complete a Tax Return.
30 September	Taxpayers should send back a paper Tax Return if they want HM Revenue and Customs to: ■ Calculate their tax; ■ inform them what tax needs to be paid by 31 January of the following year; and ■ ensure that the following year's coding correctly reflects the information provided in the return and collect tax through their Pay As You Earn tax code, where an amount is owed of less than £2,000.
5 October	Taxpayers who have untaxed income or capital gains should notify HM Revenue and Customs, if they have not previously received a return. If the taxpayer misses this date, they should still inform HM Revenue and Customs as soon as possible, as the amount of tax unpaid by the following 31 January will affect any penalties the taxpayer is liable to pay.
23 December	Taxpayers who have not yet filed their Tax Return receive a reminder letter from HM Revenue and Customs to file their return, receive a blank personalised payment slip, a reminder to pay the tax due by 31 January and instructions on how to pay. Taxpayers who have filed their return, but where this has not been processed by HM Revenue and Customs to determine the amount of tax due, also receive a blank personalised payment slip and a reminder to pay the tax due by 31 January.
30 December	If a taxpayer files their Tax Return over the Internet (or agents using the Electronic Lodgement Service) they must send it back by this date if they want HM Revenue and Customs to collect tax through their Pay As You Earn tax code, where an amount owed is less than £2,000.
31 January	Deadline for sending back the completed Tax Return to HM Revenue and Customs. (Unless the taxpayer did not receive their Tax Return by 31 October of the previous year).
Late February	Taxpayers who did not file by the 31 January deadline receive a Notice from HM Revenue and Customs informing them of an automatic penalty they must pay of up to £100, depending on the amount of tax due.
Late March	Taxpayers who receive a Notice of the automatic penalty for late filing must pay the penalty. Interest is charged after this time.
31 July	Taxpayers who have still not filed their previous year's return become liable for a further penalty of up to £100, depending on the amount of tax due.
Mid August	Taxpayers who had still not filed their previous year's Tax Return by 31 July receive a notice informing them of the second automatic penalty.
February (next year)	Taxpayers whose returns are 12 months overdue become liable for a penalty of up to the amount of tax that would have been shown to be due on the return.

Source: National Audit Office

APPENDIX 4

HM Revenue and Customs' departments responsible for the filing of Income Tax Self Assessment returns

Department	Responsibilities
Analysis and Research	Provides statistical information about direct taxes, annual analysis of enquiries into samples of taxpayers, analysis and costing of tax changes and the effects of tax changes on taxpayers.
Complex Personal Returns Teams (part of Service Delivery Support)	Deals with taxpayers whose affairs are particularly complex because of substantial assets or high income. HM Revenue and Customs received Spend to Save funds in 2004 for additional Complex Personal Returns staff to expand the customer base and increase compliance activity.
e-Services Programme	Delivers, promotes, supports and develops HM Revenue and Customs' on-line services, including Self Assessment and Pay As You Earn for employers.
Marketing and Communications	Deals with the Department's Media relations.
Revenue Policy	Develops tax returns for ease of completion and the incentives and penalties to encourage people to file on time. It includes Cross-Cutting Policy which is responsible for co-ordinating issues that affect more than one area of policy work.
Strategic Service Delivery - Local Tax Offices	Sends out returns to taxpayers, processes and sifts returned information and carries out enquiries into completed returns submitted by taxpayers.
Strategic Service Delivery - Contact and Enquiry Centres	Handles about 20 million calls from the public a year providing telephone helpline services and a variety of different enquiries about, for example, Self Assessment and Pay As You Earn.
Receivables Management Service	Pursues overdue tax returns and payments.
Business Services	The 'owner' of Computerised Environment for Self Assessment, the Income Tax Self Assessment mainframe and associated components, outputs, guidance and processes. The teams take the intelligent customer role, providing an interface between the business and the IT supplier.

APPENDIX 5

HM Revenue and Customs' random enquiry programme

HM Revenue and Customs targets enquiries on the hard core of non compliant taxpayer groups. In addition to its programme of random enquiries, HM Revenue and Customs carries out enquiries into a number of returns selected on the basis of the results from its initial checking process.

The random enquiry programme examines a statistically controlled sample of Self Assessment taxpayers each year, reflecting customer behaviour and compliance. For the 2000-01 tax year, 5,000 returns were subject to a random enquiry.

The enquiry begins with each return selected being subject to a full programme of checks including:

- Looking at all the information provided by the taxpayer in the return;
- looking at all the supporting information the taxpayer sent with their return; and
- comparing the information with those from other sources.

If HM Revenue and Customs considers that the return may be incorrect, or something requires fuller information, it will carry out further enquiries which may take some time to complete. Therefore, there is a time lag in compiling data on the accuracy of filed returns. The most recent result in 2005 is actually based on the 2000-01 tax year (tax returns completed by taxpayers between April 2001 and January 2002).

If HM Revenue and Customs finds nothing wrong with a tax return, it writes and lets the taxpayer know. If it finds something is wrong with a tax return, this may mean:

- the taxpayer does not owe as much tax as was stated in the tax return - HM Revenue and Customs will amend the self assessment to the correct reduced figure;
- the taxpayer has paid too much tax - HM Revenue and Customs will repay the taxpayer and pay interest from the date of payment to the date of repayment; and
- the taxpayer owes more tax than was stated in the tax return – HM Revenue and Customs will ask the taxpayer to make a payment on account.

HM Revenue and Customs will seek a penalty for an incorrect tax return if the tax is understated and it considers the error was due to negligence or fraud. When calculating a penalty, HM Revenue and Customs considers the seriousness of the taxpayer's errors or omissions.

The taxpayer has the right to ask the Appeals Commissioners to hear an appeal against HM Revenue and Customs' decisions and penalty determination.