National Audit Office

Report
by the Comptroller
and Auditor General

HM Revenue & Customs

Annex
Increasing the effectiveness of tax collection: a stocktake of progress since 2010

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HM Revenue & Customs

Annex
Increasing the effectiveness of tax collection: a stocktake of progress since 2010

Report by the Comptroller and Auditor General

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Sir Amyas Morse KCB
Comptroller and Auditor General
National Audit Office

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In this report we consider what HMRC has done in response to key recommendations from NAO and the Committee since 2010.

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Contents

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Overview of HMRC's response to recommendations

Figure 1

Status of recommendations made to HMRC from the Committee and NAO (June 2010 to December 2014)

We have categorised the recommendations by five themes

Recommendations	Accepted and implemented[2]	Accepted and implementation in progress	Rejected	Total
Committee recommendations				
Total[1]	**66**	**14**	**18**	**98**
Settling large tax disputes	7	0	2	9
Tackling marketed tax avoidance	9	5	3	17
Issues of international tax	4	3	6	13
Improving the administration of personal tax	12	0	2	14
Improving customer experience	8	0	1	9
Other areas	26	7	8	41
NAO recommendations				
Total[1]	**115**	**21**	**1**	**137**
Settling large tax disputes	10	0	0	10
Tackling marketed tax avoidance	6	6	0	12
Issues of international tax	1	0	0	1
Improving the administration of personal tax	15	1	0	16
Improving customer experience	10	2	0	12
Other areas	74	12	1	87

Notes

1 Totals do not sum as some recommendations address more than one theme. The table includes cross-government recommendations that refer directly to HMRC. Status of recommendations is at December 2014.

2 Accepted and implemented recommendations include partially accepted recommendations. Accepted and implemented NAO recommendations include 1 recommendation that HMRC accepted and is no longer being implemented. The status of recommendations are as reported by HMRC to its Audit and Risk Committee, adjusted by the NAO where relevant.

Source: National Audit Office analysis of Treasury Minute responses and HM Revenue & Customs information

Introduction

1 This annex accompanies our report *Increasing the effectiveness of tax collection: a stocktake of progress since 2010*.[1] We provide a more detailed explanation of progress of HM Revenue & Customs (HMRC) against its strategic objectives in Annex One. The remainder of this document provides additional detail on how HMRC has responded to the recommendations in the key areas of focus from the National Audit Office (NAO) and the Committee of Public Accounts (the Committee) since 2010. These are:

- Annex Two: Settling large tax disputes
- Annex Three: Tackling marketed tax avoidance
- Annex Four: The Committee's interest in issues of international tax
- Annex Five: Improving the administration of personal tax
- Annex Six: Improving customer experience.

The full list of the Committee's recommendations and HMRC's response to them are available on the NAO website.

1 Comptroller and Auditor General, *Increasing the effectiveness of tax collection: a stocktake of progress since 2010*, Session 2014-15, HC 1029-I, National Audit Office, February 2015.

Annex One

HMRC's progress against its strategic objectives since 2010

Overview

1.1 HM Revenue & Customs (HMRC) has made good progress since 2010 towards delivering its primary objectives. It estimates that it secured compliance revenues of £23.9 billion in 2013-14, over £7 billion more than the baseline set at the beginning of the spending review period, and it has met or exceeded the revenue targets it agreed in each year. Customer service still falls well below the standard HMRC recognises its customers should expect. However, HMRC has improved its performance for answering the phone and processing post, compared to the low point these services reached in 2010-11. Since 2010, HMRC estimates that it has made £775 million of sustainable efficiency savings, reducing its headcount by nearly 8%, shrinking the size of its estate, and reducing its annual spend on technology.

The objectives set for HMRC in the 2010 spending review

1.2 HMRC is the principal revenue collecting department of the UK. Its purpose is to make sure that the money is available to fund the UK's public services and to provide targeted financial support to families and individuals. In doing so, it serves almost every person and every business in the UK.

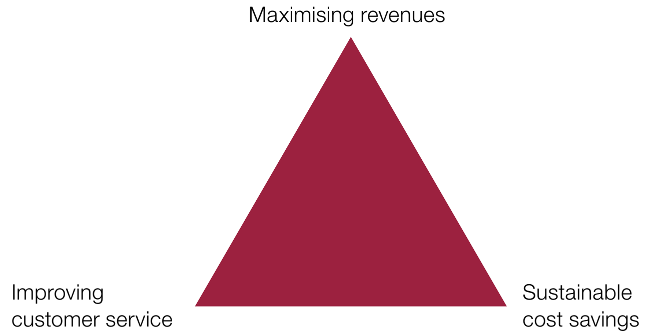
1.3 Since 2010, HMRC has been working to the three strategic objectives shown in **Figure 2**.

1.4 Over the 4 years covered by the 2010 spending review (2011-12 to 2014-15), HMRC committed to:

- **reduce the administration budget** by 33%;
- **reduce spending** by 25%; and
- **generate additional revenue of £7 billion per year by 2014-15**. HMRC reinvested £917 million from the required cost savings over the 4 years to combat tax avoidance, evasion and fraud. This meant creating 2,500 jobs in compliance roles by 2015 to widen coverage and combat the most serious evasion.

Figure 2
HMRC's strategic objectives since 2010

HMRC has had three main objectives



Source: HM Revenue & Customs spending review 2010 summary

1.5 HMRC's plans to deliver these objectives sought to ensure that in achieving the efficiency savings it did not put core activities, such as its compliance work with large businesses, at risk. HMRC also sought to achieve productivity improvements that would be sustainable against a likely picture of declining resources for the future. The aims of its reinvestment programme were to:

- Enhance the focus on large business and organised crime.
- Increase compliance activities in the mass market to reverse a decline in coverage, developing new tools and techniques and increasing the scope and quality of its interventions. This meant developing improved techniques to deal with simple errors and mistakes, designing campaigns to encourage and support voluntary compliance, and deploying investigators to concentrate on evasion and avoidance in order to strengthen its response and enhance its deterrence effects.
- Develop communication tools to help and encourage individuals and small businesses to comply with their tax obligations, and make them aware of the consequences of not doing so.

Developments since 2010 spending review

1.6 The autumn statements in 2012 and 2013 and the 2013 spending review required HMRC to go further. Important components of these settlements included:

- **A commitment to increase revenue by a further £1 billion by the end of 2014-15**, primarily from improving debt management and a project to enhance the way HMRC identifies risk and protects the corporation tax at risk from transfer pricing by multinational businesses.
- **Additional savings of around £900 million** from initiatives to reduce the level of fraud and error in tax credits.
- **The transformation of HMRC to become a more modern, effective, efficient and impartial tax and payments authority**. This included £200 million investment to provide modern, personalised online services for customers.

Progress against the strategic objectives

Maximising revenues

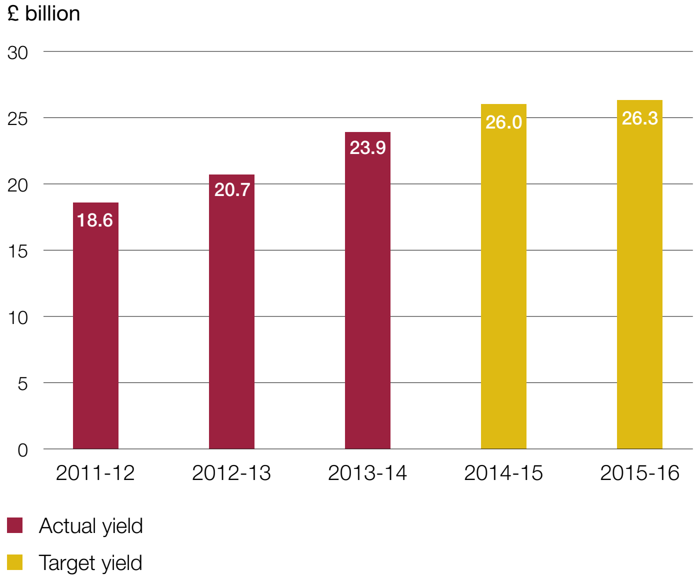
1.7 HMRC tailors its approach to maximising revenues according to risk and customer behaviours, using a combination of new technology, intelligence and analytics to encourage people to pay the tax that is due when it is due and to challenge non-compliance. HMRC estimates its compliance yield increased throughout the 2010 spending review period, reaching £23.9 billion in 2013-14, over £7 billion more than the baseline of £16.6 billion.

1.8 Despite an error in the baseline that HMRC originally set, it met the additional compliance yield targets agreed in the 2010 spending review. In 2011-12, HMRC achieved the required £2 billion increase, when measured against its revised baseline. In 2012-13, it achieved a £4.1 billion increase against its target of £4 billion; and in 2013-14, it generated an increase of £7.3 billion against the target of £5.3 billion. HMRC believes it is on track to meet its 2014-15 target (**Figure 3**). HMRC revised its approach to non-compliance, which has contributed to the increase in estimated yields. This is discussed further at paragraph 1.13.

Figure 3

Compliance yield reported by HMRC since 2011-12 (excluding exceptional items)

HMRC's reported compliance yield has increased since 2011-12



Note

1 The baseline for the period is £16.6 billion.

Source: HM Revenue & Customs, *Annual Report and Accounts 2013-14*, July 2014

Improving customer service

1.9 Since 2010, HMRC has made some improvements to customer service levels while making efficiency savings. Customer service standards are not yet where HMRC wants them to be. However, HMRC has improved its performance for answering the phone and processing post from the low point these services reached in 2010-11. It has also begun initiatives to improve how it deals with peak times in mail and telephone contact. We discuss HMRC's customer service performance further in Annex Six.

1.10 HMRC has also made progress in providing more modern, personalised online services for its customers. It has launched a range of digital exemplar projects, providing online Pay As You Earn (PAYE), paperless Self-Assessment, and the provision of an online tax account for businesses, with a digital service for tax agents to be launched in 2015. It has also improved its management of the flow of cases, bringing personal tax work items fully up to date for the first time since HMRC was formed in 2004 (see Annex Five).

1.11 In December 2013, HMRC launched a plan to accelerate the digitisation of its business, which it updated in November 2014. HMRC is now developing a plan to evaluate the impact of digital transformation on its strategic objectives so that it understands the cumulative impact that digital services are having on costs, customer experience and revenues raised.

Sustainable cost savings

1.12 Between 2010-11 and 2013-14 HMRC estimates that it has achieved £775 million of sustainable efficiency savings, £52 million more than target. It expects to deliver its target of £966 million in sustainable savings by the end of 2014-15 by:

- improving productivity and performance, enabling staff reductions of 10,000 by 2015 (from approximately 67,000 full-time equivalent employees in 2010);
- reducing the size of HMRC's estate by 300,000m^2 by the end of 2013-14; and
- reducing IT costs by over £87 million a year by the end of 2014-15.

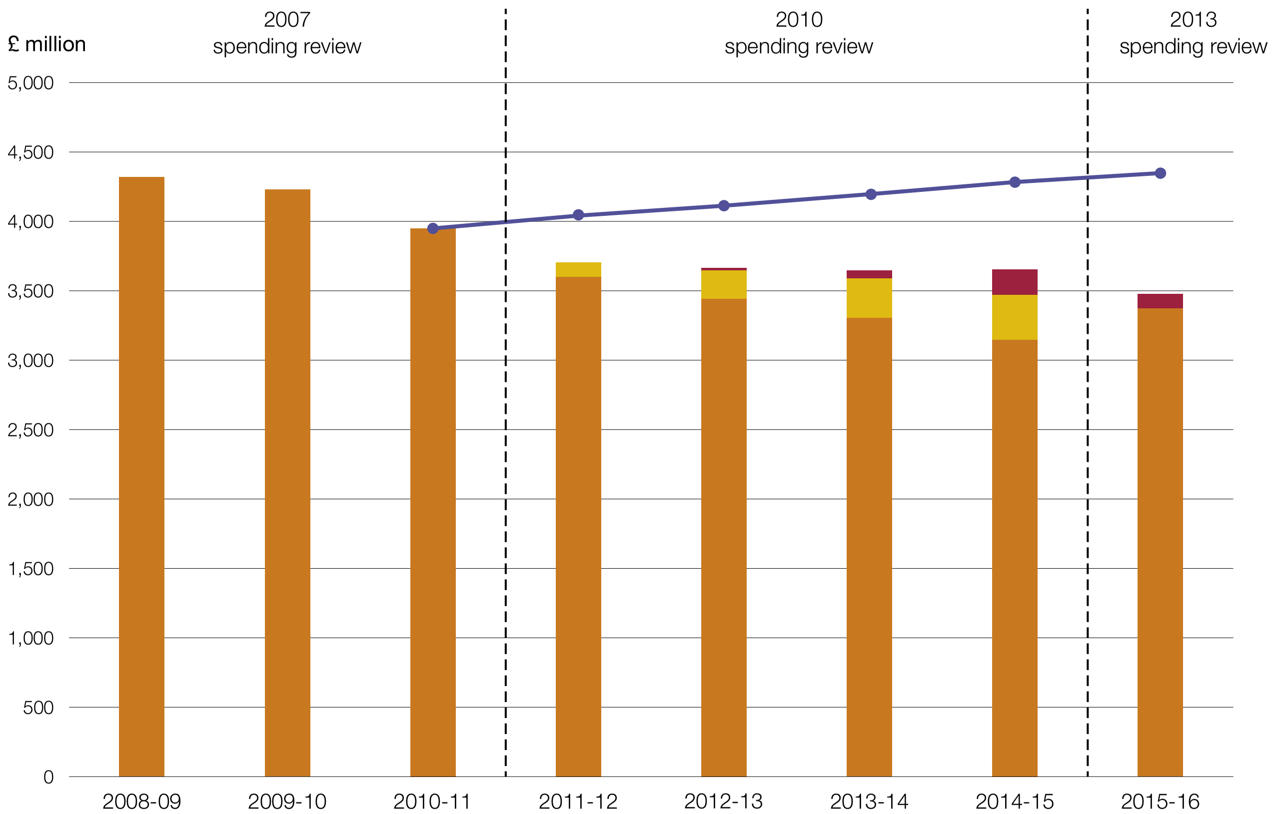
HMRC has revised its approach to non-compliance

1.13 Increasing compliance yields is an important part of how HMRC seeks to maximise tax revenues. HMRC's compliance activity aims to ensure that the full and correct amount of tax is collected, that action is taken to identify and mitigate potential threats, and that offences against the tax system are investigated and, where appropriate, prosecuted. It is now developing a new long-term strategy (**Figure 5** on page 12) which seeks to:

- 'Promote' voluntary compliance by designing better systems and using communications guidance and publicity to help people comply voluntarily.
- 'Prevent' non-compliance by intervening to stop obvious errors and frauds at the point of transaction.
- 'Respond' robustly to non-compliance by focusing resources directly on those who deliberately evade or avoid tax.

1.14 HMRC has increased the number of people working in enforcement and compliance, while reducing its overall headcount. HMRC's full-time equivalent headcount has fallen by more than 5,000 (8%) from 66,900 in March 2011 to 61,400 in March 2014. At the same time HMRC has shifted its focus to compliance work, increasing staff numbers in this area from 25,500 in March 2011 to 27,000 in March 2014, a 6% increase.

Figure 4
HMRC's expenditure 2008-09 to 2015-16



	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16
Other additional funding					20	50	180	100
Reinvestment				100	210	280	330	
Baseline funding	4,320	4,230	3,950	3,600	3,440	3,310	3,150	3,370
2010-11 Budget inflated			3,950	4,040	4,110	4,200	4,280	4,350

Notes

1 Baseline funding is Resource Account: total resource departmental expenditure limit. 2014-15 and 2015-16 are planned expenditure.

2 Additional funding relates to announcements in 2012 and 2013 autumn statements, 2014 budget and Universal Credit. Excludes 2014 autumn statement announcements as yet no formal agreement.

Source: HM Revenue & Customs

Figure 5
HMRC's approach to improve voluntary compliance

HMRC's new long-term strategy aims to improve compliance at each stage of the compliance process

Upstream | At transaction | Downstream

Promote

Design compliance into systems and processes

Scan for risk

Nudge customers

Direct to next steps

Opportunity to **correct**

Prevent

Block mistakes

Prompt compliance

Personalise return

Respond

Personalise response

Self correct and **Self-serve**

Cost-effective **triage**

Hard-edged follow up

Underpinned by flexible, cross-cutting capability in two areas:

Leverage and deter

Agents and third parties, Transparency, Taxpayer responsibilities

Analyse

Strategic use of data, Customer understanding, Early risk scanning, Feedback

Source: HM Revenue & Customs' new strategy for compliance

Annex Two

Settling large tax disputes

Overview

2.1 Since 2010, HMRC has responded positively to criticism from the NAO and the Committee of Public Accounts (the Committee) of its governance of large tax disputes. HMRC has made important changes which have substantially improved transparency and accountability. HMRC has appointed a tax assurance commissioner, which along with other changes to its processes has reduced the risk of perceived conflicts of interest by introducing a clear separation between those working on a case and those responsible for decision-making. HMRC's internal audit has also checked the governance of a sample of cases annually since 2012-13. The tax assurance commissioner has published two annual reports, in 2013 and 2014, describing HMRC's work, its progress in resolving major disputes, and how its new governance arrangements are working. HMRC has published and revised its code of governance. It has also updated and clarified its litigation and settlement strategy and published a detailed commentary to support it.

Why this is important

2.2 HMRC is responsible for UK tax administration. It must identify and collect the correct amount of tax to maximise revenue for the Exchequer. In doing so, HMRC becomes involved in tax disputes with businesses and individuals, concerning, for example, the amount of tax owed to HMRC or when it should be paid.

2.3 Disputes between a tax authority and taxpayers are a normal feature of tax administration that arise in cases of all sizes. They occur partly because tax law is complex and HMRC and taxpayers can disagree on the way it should be applied. In large disputes, there can be significant amounts of tax at stake. For example in 2013-14, the total tax under consideration in the decisions referred to HMRC's commissioners amounted to £3.9 billion.

What the NAO and the Committee found

2.4 Between 2010 and 2012, the Committee took evidence three times from HMRC based on our analysis of how it resolved tax disputes. The Committee had serious concerns about how HMRC had handled some cases involving very large settlements where it had bypassed or overlooked governance arrangements. The Committee accepted that senior tax officials had to be accessible to major stakeholders. However, it believed that when meeting with these stakeholders HMRC did not pay sufficient attention to whether a conflict of interest could be perceived. It called for HMRC to address these weaknesses urgently and be, seen to be, transparent in its dealings with companies with which it is in dispute.

2.5 In 2010, the Committee said that HMRC should consider increasing transparency in large and complex tax cases and to assure Parliament and the public that it is following due process.[2] In 2011, the Committee concluded HMRC had not applied due diligence in some of its tax disputes.[3] It recommended that HMRC must ensure that it has applied all relevant governance checks to cases before settling them.

2.6 In 2012, a further report by the NAO examined in detail how HMRC resolved 5 major tax settlements with multinational companies.[4] While we concluded that all 5 settlements were reasonable, we found weaknesses in the way key decisions had been documented and reiterated the concerns that HMRC had not always followed its own governance processes. We also recommended that HMRC should update its litigation and settlement strategy to set out more clearly the balance between settling individual issues and reaching a wider settlement.

What has changed?

2.7 The NAO's and the Committee's recommendations fell into three main areas:

a the need for better internal governance of the management of tax disputes;

b the need for HMRC to clarify its litigation and settlement strategy; and

c the need to increase independent challenge and transparency.

2 HC Committee of Public Accounts, *HM Revenue and Customs' 2009-10 Accounts*, Eighteenth Report of Session 2010-11, HC 502, February 2011.

3 HC Committee of Public Accounts, *HM Revenue and Customs 2010-11 Accounts: tax disputes*, Sixty-first Report of Session 2010-12, HC 1531, December 2011.

4 Comptroller and Auditor General, *Settling large tax disputes*, Session 2012-13, HC 188, National Audit Office, June 2012.

a Improving the governance of tax disputes

The NAO recommended that HMRC ensure there is "clear separation between the analysis and negotiation, and the approval of large tax settlements … [and this is] fully in place in the resolution of every major tax dispute." Comptroller and Auditor General Report: HM Revenue & Customs 2010-11 Accounts).

The Committee concluded that HMRC had not applied due diligence in some of its tax disputes. It recommended that HMRC "must ensure that it has applied all relevant governance checks to cases before settling them with the taxpayer" (HM Revenue & Customs 2010-11 Accounts: tax disputes).

2.8 To improve the governance of tax disputes, HMRC has:

- mandated a clear separation of powers between those working on a settlement case and those responsible for approving it;
- appointed a tax assurance commissioner, who is also the second permanent secretary for HMRC, to oversee large tax settlements. The tax assurance commissioner is responsible for scrutinising the governance arrangements and providing assurance over the resolution of major disputes;
- introduced risk-based arrangements to scrutinise and approve tax settlements, in each part of its business (**Figure 6** overleaf). HMRC refers major disputed points or issues affecting multiple cases to cross-HMRC panels to promote consistency; and
- established independent scrutiny by internal audit of completed settlements.

2.9 These arrangements include a new governance structure for resolving tax disputes. The largest and most significant cases (and a sample of smaller cases) are referred for consideration at the tax disputes resolution board, which makes recommendations to a panel of three commissioners (**Figure 7** on page 17).

In 2011, the Committee concluded that HMRC had "left itself open to suspicion that its relationships with large companies are too cosy". The Committee called for HMRC to "exercise better judgement over how it manages its relationships with large companies, to ensure it avoids the perception of conflicts of interest" (HM Revenue & Customs 2010-11 Accounts: tax disputes).

Figure 6

Changes to the tax disputes resolution governance process

HMRC has introduced various changes to governance arrangements since 2012

Tax dispute process since 2012	Tax dispute process before 2012
Annual reporting on how HMRC resolves tax disputes.	No published reports.
The tax assurance commissioner is responsible for the governance of, and processes to resolve, tax disputes.	No equivalent role existed.
Decisions on sensitive or high-value disputes are made by three commissioners. All cases where the value of tax under consideration is £100 million or more are referred to the commissioners.	Two commissioners signed off cases where the tax under consideration was more than £250 million, or where there was potential for adverse national publicity or for questions to be raised in Parliament, or which presented a significant departure from previous policy.
The tax disputes resolution board (TDRB) considers the largest and most sensitive disputes and makes recommendations for resolution to three commissioners, including the tax assurance commissioner, who have the final decision. These disputes are usually where tax under consideration is at least £100 million; where the maximum potential adjustment is at least £500 million or where the case is sensitive or unusual.	No equivalent board in existence, although the high risk corporates programme provided a similar structure for dealing with business tax disputes.
Internal audit conducts an annual review of the governance around settled cases, sampling from all areas of HMRC.	No systematic annual review.
The Audit and Risk Committee has an enhanced role, which involves considering the findings from the review of settled cases. The Audit and Risk Committee may recommend follow-up action.	No specific oversight of assurance over settled tax cases.
HMRC publishes its code of governance on settling tax disputes, to improve transparency about its processes.	No such code of governance in existence – though, as now, all settlements were required to comply with the litigation and settlement strategy.

Note

1 Below the tax disputes resolution board there are case governance boards within each area of HMRC's business that make decisions on resolving tax disputes in large and sensitive cases which do not fall within TDRB's remit.

Source: HM Revenue & Customs, *How we resolve tax disputes: the Tax Assurance Commissioner's annual report 2012-13*, July 2013; and Comptroller and Auditor General, *HM Revenue & Customs 2010-11 Accounts*, National Audit Office, July 2011

Figure 7
Governance structure for resolving tax disputes

HMRC has a clear structure for escalating significant cases

Three commissioners including tax assurance commissioner

Total cases considered in 2013-14 (48). Of which:

- Cases by tax disputes resolution board in 2013-14 (46).
- Cases that made it to commissioners 2013-14 (44).
- 4 cases were considered twice after further work.
- Included are the 5 sample cases referred from enforcement and compliance disputes resolution board to tax disputes resolution board.

Tax disputes resolution board

Total cases referred to TDRB in 2013-14 (63). Of which:

- Total tax under consideration was at least £100 million (38).
- The maximum potential adjustment relating to the resolution of a dispute on a risk was at least £500 million (5).
- High-risk corporates programme cases (4).
- A sample of cases from the line of business disputes resolution boards (5).

Enforcement and compliance disputes resolution board	Large business disputes resolution board	Specialist personal tax disputes resolution board	Transfer pricing governance
Total cases referred to enforcement and compliance, large business and specialist personal tax disputes resolution boards in 2013-14 (33)			Cases referred to transfer pricing board in 2013-14 (36) Cases referred to the two transfer pricing panels in 2013-14 (80)

HMRC staff – tax case workers

Note

1 Figures in brackets indicate the number of cases that have been escalated through that route in 2013-14.

Source: National Audit Office analysis of HM Revenue & Customs, *How we resolve Tax Disputes: the Tax Assurance Commissioner's Annual Report 2013-14*, July 2013

2.10 The Committee accepted that senior tax officials need to be accessible to major stakeholders, but concluded that when meeting with stakeholders HMRC did not pay sufficient attention to whether a conflict of interest could be perceived. It called for HMRC to address these weaknesses urgently and be seen to be transparent in its dealings with companies with which it is in dispute.

2.11 The role of tax assurance commissioner is designed to guard against perceptions of conflicts of interest. The tax assurance commissioner has neither a role in HMRC's dealings with taxpayers – businesses or individuals – nor line management responsibility for any caseworkers dealing with disputes.

b Clarifying the litigation and settlement strategy

2.12 HMRC's approach to resolving tax disputes is governed by its litigation and settlement strategy. This states that disputes must be resolved consistently with tax law (either by agreement with the customer or following litigation); and consistently with HMRC's objectives of maximising revenues while reducing costs and improving its customers' experience.

In 2012, the NAO recommended that HMRC should update its litigation and settlement strategy "so that it sets out more clearly the extent to which it is acceptable to settle individual issues in the context of a wider settlement." (Comptroller and Auditor General Report: Settling large tax disputes).

2.13 The strategy makes clear that an even-handed approach across taxpayers is vital to securing good compliance on a sustainable basis. It rules out 'package deals', whereby HMRC might be asked to concede one dispute in return for the customer conceding another, irrespective of the merits; or where a number of disputes are settled for a single payment that is not subdivided amongst individual disputes. In 2013, HMRC revised its commentary on the strategy to reflect the new governance arrangements for handling tax disputes and to respond to the NAO's recommendation by clarifying its position on settling individual disputes as part of a multi-dispute case. In exceptional circumstances, HMRC acknowledges that it may not be cost-effective to litigate on a single issue if it puts at risk HMRC's ability to settle on other issues. In some circumstances, HMRC's commissioners can choose not to pursue amounts outstanding if, in their view, it would jeopardise getting the best overall return for the Exchequer.

c Increasing independent challenge and transparency

In 2011 the Committee concluded that "there is little transparency for the taxpayer over the way that tax disputes with large companies are resolved" and "HMRC should consider the scope for increasing transparency in the area of large and complex tax cases and for assuring Parliament and the public" (HM Revenue & Customs' 2009-10 Accounts).

2.14 The Committee took evidence on the handling of large tax settlements in 2010, and said HMRC should consider increasing transparency in the area of large and complex tax cases to assure Parliament and the public that it is following due process.

2.15 The tax assurance commissioner, appointed in 2012, is responsible for providing assurance to Parliament and the public about the governance of large tax cases. He has published annual reports, in 2013 and 2014, describing HMRC's work, its progress in resolving major disputes, and how its new governance arrangements are working. These reports have published: the numbers of referrals to each of HMRC's reviewing panels and to its commissioners; aggregate details of the outcomes; the number of taxpayer requests for reviews; and the number of appeals to a tax tribunal (**Figure 8**).

2.16 HMRC has also updated and published its code of governance for resolving tax disputes annually since 2012. This sets out its aims for resolving tax disputes and the arrangements for doing so.

In 2011, the Committee welcomed HMRC's proposals to introduce independent assessment of cases, including some random sampling of settlements (HM Revenue & Customs 2010-11 Accounts: tax disputes).

Figure 8

Key data from tax assurance commissioner reports 2012-13 and 2013-14

The volume of decisions has decreased since 2011-12 but their total value has increased

	2013-14	**2012-13**	**2011-12**
Tax under consideration[3] in decisions referred to commissioners (£m)	3,869	2,055[1]	
Number of referrals to commissioners	48	22[1]	
Referrals to tax disputes resolution board	63	31[2]	
Requests to review a decision	37,700	39,000	55,800
Appeals to a tax tribunal	7,100	7,600	10,800

Notes

1 For the period October 2012 to March 2013.

2 For the period September 2012 to March 2013.

3 Tax under consideration is a theoretical estimate of what the tax liabilities might be if the taxpayer fully accepted alternative tax position across all identified tax risks.

Source: National Audit Office analysis of HM Revenue & Customs tax assurance commissioner reports and HM Revenue & Customs reviews and appeals data

2.17 HMRC's revised governance arrangements include its internal audit reviewing settled cases. Internal audit piloted the approach to case review in 2012-13. It found HMRC had satisfactorily followed its governance processes in 92% of cases (195 out of 213). Of the 18 cases that did not meet expected standards, internal audit identified errors linked to the processes for applying penalties and calculating future yield. In response, HMRC updated its guidance for applying penalties and recording yield and provided additional training. Internal audit considered that the identified errors were linked to changes made to HMRC's processes during the year and it did not record any further causes for concern.

2.18 In 2013-14, HMRC internal audit reviewed a larger sample of settled cases. It found that 322 out of 414 (78%) had applied satisfactory governance. In the other 92 cases, applying governance processes could be improved, including 3 cases (1%) which fell short of the expected governance standards. This work identified areas where HMRC needed to improve to ensure that procedures are applied consistently. The findings of internal audit and the areas it identifies for improvement are published in the *Tax Assurance Commissioner's Annual Report 2013-14*.

2.19 HMRC's customer charter commits it to provide a service that is even-handed and accurate, based on mutual trust and respect. HMRC tailors its approach to customers according to risk. HMRC reports progress against its charter annually and carries out additional customer surveys:

- In 2013-14, 63% of individuals, small and medium-sized enterprises and tax agents agreed that they trusted HMRC to be fair, an increase of 3% from the previous year.
- In 2013, 87% of large business service and 81% of local compliance customers with a customer relationship manager agreed that HMRC treats their business fairly.

Annex Three

Tackling marketed tax avoidance

Overview

3.1 In responding to the recommendations of the NAO and the Committee of Public Accounts (the Committee), HMRC has improved how it tackles marketed tax avoidance over the last two years. Rather than dealing with marketed avoidance once it is in the system, HMRC has refocused its activities on promoting compliance and deterring avoidance, supplemented by new powers to tackle those who subscribe to avoidance schemes (**Figure 9** overleaf). To coordinate its activities better, HMRC has set up a new counter-avoidance directorate which will have 1,200 staff by the end of 2014-15. This directorate brings together its operational and policy response to marketed avoidance. This gives HMRC better information to identify and manage its avoidance cases and recommend policy changes. HMRC has asked for and received new powers which should allow it to disrupt promoters' behaviour and challenge scheme users more quickly and effectively. These should remove many of the advantages of entering a tax avoidance scheme and increase the risk of doing so. HMRC is also doing more to publicise tribunal victories, including naming the promoters involved, and is consulting on whether it should have the powers to name people who repeatedly use avoidance schemes.

Why this is important

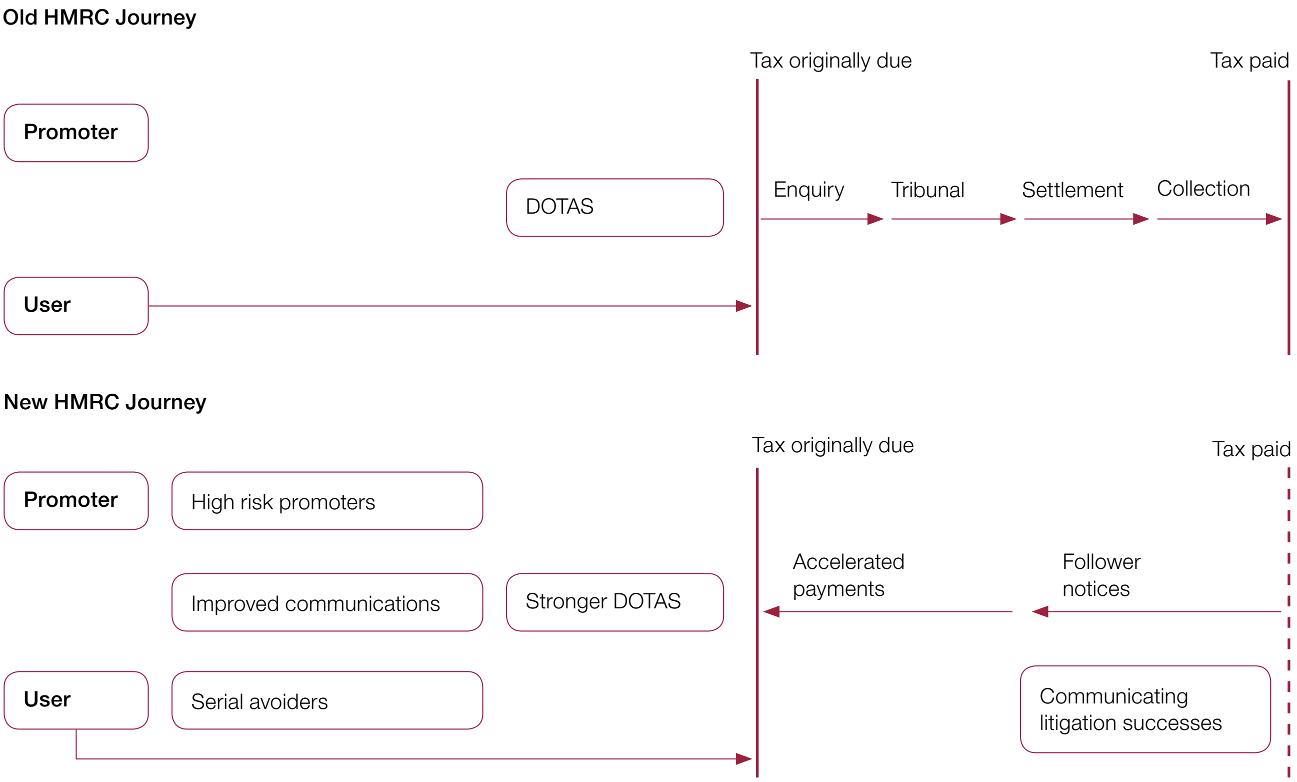
3.2 A fair and efficient tax system is fundamental to securing the revenue to support public services. HMRC aims to close the tax gap, which is the difference between the tax that is collected and the tax that should be collected. HMRC estimated the tax gap in 2012-13 to be £34 billion. Of this, HMRC estimates that £3.1 billion is lost to tax avoidance.

3.3 Marketed tax avoidance is a significant risk to tax revenues. Marketed schemes are those that promoters sell to people or companies. Tax evasion is illegal, involving fraud or delibrate concealment. Tax avoidance can involve contrived, artificial transactions that serve little or no purpose other than to produce a tax advantage; the legality of such activity is often determined through litigation. HMRC estimates that there is around £14 billion of tax at risk from the avoidance schemes it is investigating.

Figure 9

HMRC has changed how it tackles tax avoidance

HMRC now has more tools to tackle the supply of (promoter) and demand for (user) marketed avoidance schemes



Note

1 DOTAS refers to Disclosure of Tax Avoidance Schemes.

Source: National Audit Office analysis of HM Revenue & Customs information

What the NAO and the Committee found

3.4 We reported on how HMRC tackles marketed tax avoidance schemes in 2012, and the Committee held a hearing to take evidence on our findings in December 2012.[5] We found an approach that relied on retrospective investigations and litigation of individual cases which were time-consuming, costly and not always effective. HMRC did not know the cost of its anti-avoidance work, and it had identified a stock of over 40,000 unresolved avoidance cases it was investigating but with no clear view or plan of how to manage or reduce this stock. The Committee concluded that the promoters of avoidance schemes had "run rings around HMRC".

5 Comptroller and Auditor General, *Tax avoidance: tackling marketed avoidance schemes*, Session 2012-13, HC 730, National Audit Office, November 2012.

3.5 We and the Committee proposed that HMRC needed to change the economics of tax avoidance. We reported in 2012 that there was "little evidence that HMRC is making progress in addressing this problem and it must now be vigorous in seeking more effective counter-measures, proposing legislative change where necessary." We recommended that HMRC increase its efforts to understand and influence the market of promoters of avoidance schemes. The Committee found that "promoters are currently winning what appears to be a game of cat and mouse with HMRC and deliberately taking advantage of the time lag between the launch of a scheme and the closure of a scheme by HMRC."[6]

What has changed?

3.6 HMRC has since accepted the conclusions of the NAO and the Committee about its approach to tackling avoidance. It has substantially revised its approach in two main ways:

a improving the coordination of its work to counter marketed tax avoidance schemes; and

b seeking new powers to tackle promoters and scheme users.

a Improving the coordination of work to counter marketed tax avoidance

Counter-avoidance directorate

In 2013, the Committee recommended HMRC "improve its recording and monitoring of the cost of its anti-avoidance work and set out clearly how it will evaluate its anti-avoidance strategy" (Tax avoidance: tackling marketed avoidance schemes).

In 2012, the NAO recommended HMRC "improve its management information and its costing to better direct its anti-avoidance effort". The NAO also recommended HMRC to "create a qualitative framework to evaluate the success of its anti-avoidance work" (Tax avoidance: tackling marketed avoidance schemes).

6 HC Committee of Public Accounts, *Tax avoidance: tackling marketed avoidance schemes*, Twenty-ninth Report of Session 2012-13, HC 788, February 2013.

3.7 To coordinate its activities better, HMRC has set up a new counter-avoidance directorate in November 2013 specifically to deal with tax avoidance. This directorate will have 1,200 staff by the end of 2014-15. In establishing the counter-avoidance directorate, HMRC brought together its operational and policy responses in one team. Prior to this HMRC's operational response was not fully joined-up: the users of schemes were dealt with by local compliance teams, the schemes themselves by the specialist investigations team and related policy issues within the business tax team.

3.8 Establishing a single directorate for its tax avoidance work gives HMRC a better sense of the cost of its work, but it recognises that there is further work to do in this area. HMRC initially expected that it would complete its work to improve its cost and management information by 2014, but it has some work still to do. In July 2014, it provided the Committee with a progress update that it was making good progress in capturing and testing additional data, but that there remained gaps in areas such as resource costs. HMRC told the Committee that the project would ensure that processes are put in place that will capture and analyse data as business as usual, providing the basis of performance measures to monitor HMRC's performance on tackling avoidance.

3.9 HMRC has identified areas where it needs to improve its management information. Bringing its avoidance activity under one directorate gives HMRC a better understanding of the information it holds, and where it could be refined. HMRC is revising its methodology so that it takes a consistent approach to recording the number of open avoidance cases. HMRC has now identified 65,000 avoidance cases under investigation, 24,000 more than when we published our study in November 2012. Changes to the way HMRC records open cases are likely to increase the number still further. For example, stamp duty avoidance cases may involve a husband and wife, but previously HMRC recorded such cases as having one rather than two users.

3.10 HMRC agreed to put in place a framework to assess its anti-avoidance activities, in line with the Committee's recommendations. HMRC initially planned to have a framework in place by April 2014. Recent changes to its approach to tackling avoidance mean it would be difficult to achieve by this date. HMRC will undertake an evaluation by March 2015 to inform the setting of targets for 2015-16 onwards.

Increasing publicity to deter tax avoidance

In 2013, the Committee recommended HMRC to "publicise what it is doing [to tackle marketed avoidance schemes] to make clear that it is serious about addressing this problem" (Tax avoidance: tackling marketed avoidance schemes).

3.11 During this Parliament HMRC has significantly increased its publicity about avoidance activities and is making better use of public information. It regularly publishes descriptions of schemes to warn users that promoters are offering a tax avoidance scheme, rather than good tax advice. **Figure 10** provides examples of how HMRC now communicates its anti-avoidance message.

Figure 10

How HMRC communicates its anti-avoidance message to taxpayers

HMRC uses a variety of publications and press notices to deter tax avoidance

Communication	Description	Example
Spotlights	Spotlights feature schemes that are generally those which HMRC considers have the widest implications and where there is the greatest need to warn potential users.	Spotlight 23 outlined the outcome of a case at tribunals. In LM Ferro Ltd v HMRC, a bonus was paid in the form of an award of shares which HMRC considered as an attempt to avoid tax and NI contributions. The outcome confirmed this view that "tax and National Insurance contributions are due no matter how it is dressed it up".
Tempted by tax avoidance?	This publication is primarily a warning to those thinking about using a tax avoidance scheme. It details how to look for the warning signs and if a scheme looks too good to be true then it probably is.	The publication includes real life examples to illustrate the consequences of entering into such schemes. In the case of Brown v InnovatorOne plc the claimants took action against the promoters of 19 failed tax avoidance schemes. This action failed in the High Court and the judge pointed out that not only had they not got the tax result they had wanted but also "exposed themselves to a liability of four times the amount of money they put into the schemes".
Litigation successes	HMRC uses press notices and the media to recognise its litigation successes and to name promoters of unsuccessful schemes.	HMRC is now publicising the results from tribunals, in particular where they have won multiple cases against the same promoter. "HMRC has secured its eighth tribunal win in a row against tax avoidance schemes run by NT Advisors."
Ten things list	The list sets out the risks that people face when they sign up to a tax avoidance scheme.	The risks a promoter will not tell a potential user include: • "Most schemes don't work." • "Your scheme is never HMRC approved."

Source: National Audit Office analysis of HM Revenue & Customs information

3.12 The ‘Spotlight’ articles reflect HMRC’s willingness to make better use of its communications. HMRC began publishing Spotlights in 2009, and had published 25 by the end of 2014. These articles warn users about certain tax avoidance schemes where HMRC believes there is the greatest need to warn users. The content of Spotlights has changed over time. For example, Spotlight 1 gave a fairly factual account of HMRC’s awareness of arrangements by some companies to claim relief for goodwill inappropriately. Spotlight 23 pointed to a specific tribunal decision and named both the user of the scheme and the promoter.

b Seeking new powers to tackle marketed avoidance

In 2012, the NAO concluded that “there was little evidence that HMRC was making progress in tackling marketed avoidance and that it must be more vigorous in seeking more effective counter-measures, proposing legislative changes where necessary” (Tax avoidance: tackling marketed avoidance schemes).

In 2013, the Committee recommended that HMRC “assess the full range of measures available to reduce avoidance” and “identify measures it will introduce to reduce the tax lost to avoidance” (Tax avoidance: tackling marketed avoidance schemes).

In 2012 the NAO recommended that HMRC “analyse the economics of promoting and operating avoidance schemes, and the types of interventions that could change behaviour” (Tax avoidance: tackling marketed avoidance schemes).

3.13 When we reported in 2012, HMRC faced significant areas of challenge:

- The length of time it takes to resolve cases. Litigation is a lengthy process, which is an advantage to scheme users as they are able to retain the tax at dispute until a tax tribunal decision.
- Settling the backlog of cases. Where tribunals find in favour of HMRC, the other scheme users often do not settle as they argue that their arrangements are different.
- Repeat avoiders. There are a minority of people who use multiple tax avoidance schemes regularly.

3.14 HMRC accepted our and the Committee's recommendations to address these issues. It has acted to disrupt the market for tax avoidance schemes and change the economics of promoting and operating avoidance schemes by seeking new powers in five areas:

- An accelerated payment scheme.
- Follower notices to tackle avoidance schemes with multiple users.
- Powers to tackle serial avoiders.
- A stronger disclosure regime.
- Conduct notices and other sanctions on scheme promoters.

1 Accelerated payments

3.15 Legislation was introduced in 2014 which gives HMRC the power to issue accelerated payment notices to those who use tax avoidance schemes. Taxpayers who subscribe to avoidance schemes under investigation will be required to pay the disputed tax until such time as they can prove, normally through litigation, that the scheme complies with tax law. Under this rule, HMRC, rather than the user, can hold the disputed tax until the case is resolved.

3.16 By the end of 2015-16, HMRC intends to send out 43,000 notices for payment, giving users 90 days to pay. It estimates that this new power will raise £5.1 billion by 2018-19 (**Figure 11**), money that HMRC would not otherwise have collected for several years. HMRC anticipates this measure will supress the market for avoidance schemes as this change removes the cash flow advantage formerly enjoyed by scheme users.

Figure 11
Accelerated payments

HMRC estimates that accelerated payment notices for those involved in marketed schemes will raise £5.1 billion by 2018-19

Taxpayer	Number of taxpayers	Exchequer impact
Individuals	33,000	£3.6 billion
Businesses	10,000	£1.5 billion
Total	**43,000**	**£5.1 billion**

Source: Budget 2014 policy costings

2 Follower notices

3.17 A marketed tax avoidance scheme may have several hundred users and there may be many more using variants on similar arrangements. Even where HMRC wins a case in court, scheme users have little incentive to accept that the court's findings are relevant to them. Users could argue that small differences in their circumstances mean that the tax tribunal's decision does not apply to them.

3.18 HMRC obtained new powers in 2014 to help it resolve tax avoidance cases more quickly. It can now issue 'follower notices' to scheme users where, in its view, the issues have already been decided by a court or tribunal. Scheme users can continue their dispute, but do so at the risk of a penalty up to 50% of the disputed tax if they are unsuccessful at tribunal. HMRC has begun issuing follower notices for those schemes where there has been a final judicial ruling, such as 'Working Wheels' (**Figure 12**). HMRC told us it had issued follower notices to 360 taxpayers by the end of December 2014.

3.19 Accelerated payments and follower notices disrupt the business of promoting these schemes as well as the economics of taking part. A scheme's promoter now has to deal with a much higher volume of correspondence and enquiries from HMRC and its clients. Promoters are likely to receive correspondence from almost all users in future. Previously, they dealt with letters and questions from the handful of users selected by HMRC as lead cases.

3 Powers to tackle serial avoiders

3.20 HMRC has announced it will consult on actions it could take to impose additional compliance and reporting requirements and costs on the repeat users of avoidance schemes. HMRC is also consulting on whether it should have powers to publicise the names of those who repeatedly enter into avoidance schemes.

Figure 12

An example of the behaviour HMRC wanted to tackle in asking for additional powers

"Some promoters sell schemes that simply do not work. In a recent case named "Working Wheels", the three taxpayers named claimed losses of £20 million, worth £8 million tax at the then 40% tax rate. That's £8 million the Exchequer has been waiting for since January 2009 – 5 years ago. And that's just 3 out of the 450 people who used this scheme. The judge commented that in this scheme, in which scheme users claimed to be trading as used car salesmen:

> "It was determined pursuant to a plan. A realistic view of the facts shows that the aim was that appellants, 'as though by magic', should appear to have incurred vast fees as a condition of borrowing modest amounts of money they did not need in order to invest it in a 'trade' they had no desire to pursue. The supposed fee for the loan bore no relation to the size of the loan, but was merely the amount of the artificial loss the user wished to generate."

Source: HM Revenue & Customs, *Tackling marketed tax avoidance: summary of responses*, March 2014

4 Stronger disclosure regime

In 2012 the NAO recommended HMRC "strengthen its powers to enforce compliance with DOTAS" (Tax avoidance: tackling marketed avoidance schemes).

In 2013, the Committee noted that HMRC was consulting on strengthening its disclosure regime, and recommended HMRC "model the impact of changes … to measure the effectiveness of DOTAS" (Tax avoidance: tackling marketed avoidance schemes).

3.21 The Disclosure of Tax Avoidance Schemes (DOTAS) is an important part of HMRC's anti-avoidance strategy. This disclosure regime requires the promoters, designers and sellers of certain types of tax avoidance scheme, to tell HMRC about each new scheme they introduce. HMRC issues a scheme reference number which taxpayers who have used the scheme must then record on their tax return. Government has expanded DOTAS over time to include more taxes and more types of avoidance.[7]

3.22 In 2014, HMRC completed an evaluation of DOTAS. In response to this evaluation HMRC consulted on strengthening DOTAS in 2014 and it expects further measures to strengthen DOTAS to be included within the 2015 Finance Bill. These proposed measures include: allowing HMRC to publish summary information about tax avoidance promoters and schemes that are notified under DOTAS; and, updating and extending the descriptions of schemes that must be disclosed. HMRC also plans to establish a DOTAS taskforce to prevent scheme users from avoiding the new rules.

5 Conduct notices and sanctions on scheme promoters

The NAO recommended in 2012 that HMRC should do more to disrupt and influence the market of promoters of avoidance schemes (Tax avoidance: tackling marketed avoidance schemes).

The Committee recommended in 2013 that HMRC "increase transparency by naming and shaming those engaged in the business of tax avoidance and use it to discourage such activity" (Tax avoidance: tackling marketed avoidance schemes).

7 See further, footnote 5 and Comptroller and Auditor General, *Tax Reliefs,* Session 2013-14, HC 1256, National Audit Office, April 2014.

3.23 HMRC explored what new powers it could seek and in 2014 it obtained the power to publish the names of promoters who breach a conduct notice. HMRC intends to use this measure to tackle around 20 promoters who sell schemes that have little chance of working, who rely on failing to disclose relevant material to HMRC, or who provide misleading descriptions of the schemes they promote. HMRC may issue a conduct notice which imposes certain conditions on a promoter. If these conditions are breached, it may issue a monitoring notice subjecting the promoter to a more stringent set of conditions, which include HMRC being able to publish information about that promoter's activities. HMRC has written to a handful of promoters warning them that they will be given a conduct notice if they do not change their behaviour.

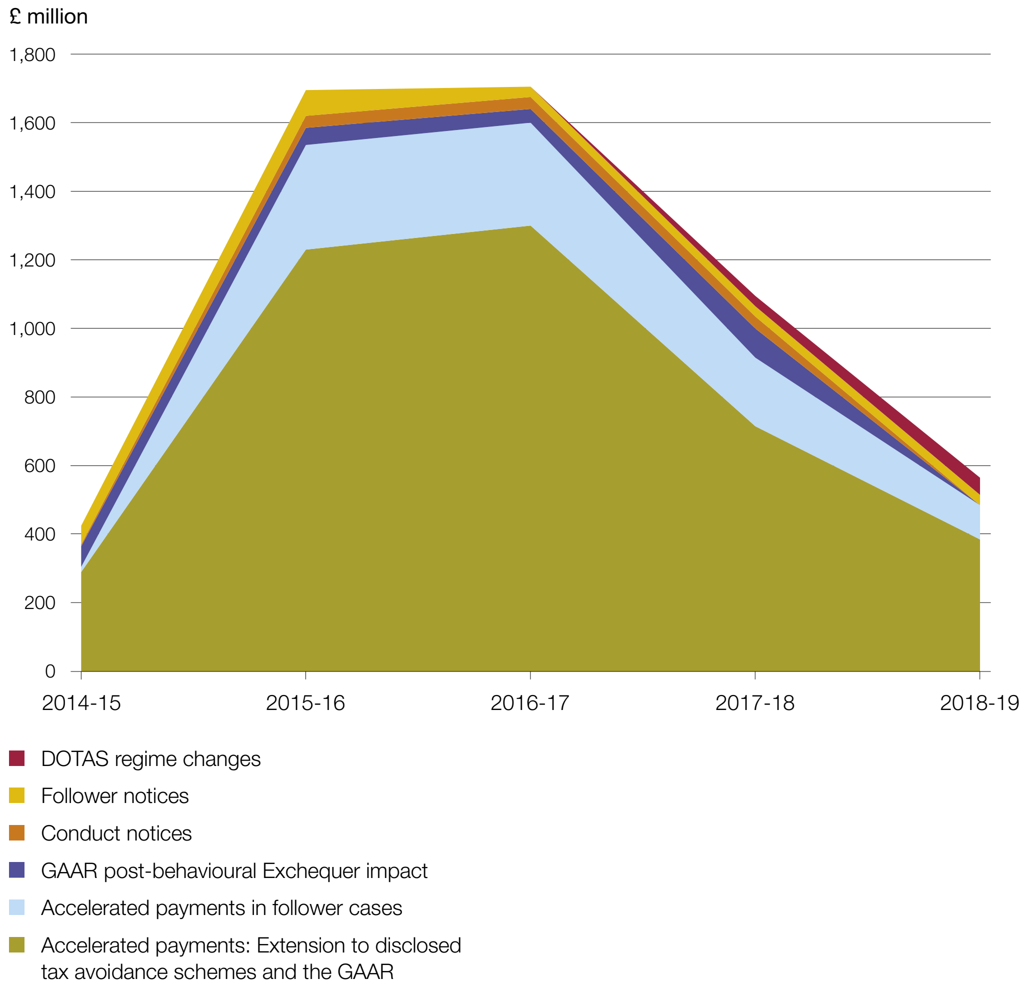
General anti-abuse rule

3.24 In addition, Government introduced a 'general anti-abuse rule' (GAAR) designed to tackle abusive tax avoidance schemes where the current law is unable to defeat arrangements that achieve a tax outcome the legislation had not intended. HMRC will need to prove to the court whether a particular arrangement is abusive, rather than for the taxpayer to prove that it is not. The rule is subject to a 'double reasonableness' test as a taxpayer safeguard. An independent panel will provide non-binding advice on whether it is appropriate for HMRC to proceed with a GAAR challenge. The GAAR was announced in March 2012 and took effect in July 2013 (March 2014 for National Insurance contributions), meaning that HMRC is likely to be considering the first cases where GAAR could apply in 2015.

Figure 13

Expected compliance revenue from anti-avoidance measures discussed in this chapter

HMRC's new measures to tackle anti-avoidance are expected to increase tax revenue by between £0.4 billion and £1.6 billion each year



Source: National Audit Office analysis of HM Treaury budget publications

Annex Four

The Committee's interest in issues of international tax

Overview

4.1 HMRC and HM Treasury have sought to address the recommendation of the Committee of Public Accounts (the Committee) that they should lead on international tax reform to tackle cross-border avoidance and evasion. They have supported the Organisation for Economic Co-operation and Development's (OECD's) Action Plan on *Base Erosion and Profit Shifting (BEPS)* and used the UK's presidency of the G8, in 2013, to call for new standards of transparency for multinational corporations.

4.2 HMRC has taken steps to tackle tax practices which the Committee has called into question, although their impact is yet to be demonstrated. It has invested in its capacity to challenge transfer pricing and will implement new legislation to address avoidance by multinational companies.

4.3 By November 2014, HMRC had secured £1.2 billion in tax from UK holders of Swiss bank accounts. After a slow start, HMRC appears to be on track to meet its revised forecast of tax yield from the UK-Swiss agreement.

Why this is important

4.4 International tax law and the tax practices of multinational companies have a significant bearing on the amount of tax paid in the UK. The Committee has taken a strong interest throughout this parliament in promoting a fair and efficient tax system in the UK and challenging what it considers to be harmful tax practices. The Committee's work has highlighted that some issues are international in nature and require a more coordinated approach between tax administrations worldwide.[8] There has been significant global debate and interest in international tax issues, in which the Committee has been influential.

8 HC Committee of Public Accounts, *Tax avoidance: the role of large accountancy firms*, Forty-fourth Report of Session 2012-13, HC 870, April 2013.

What the Committee found

4.5 In October 2014, the Committee held a conference on the impact of globalisation on taxation. The opening address of the conference set out the Committee's views:

> "Who pays tax and who avoids paying tax – whether it's legal or not – has become a major issue of public debate and public concern. It is unfair and offensive to many people that companies and individuals can take advantage of expensive advice to choose how much tax they pay on the money they make, or the profits they earn. Paying tax should cease to be a voluntary gesture for the rich and the powerful and a civic obligation for the rest of us. We should all pay our fair share of tax. Exploiting the complexity of our tax rules to avoid paying a fair share of tax is therefore morally reprehensible. We are both bewildered and shocked at sheer lengths that some companies … will go to get out of paying their fair share of tax on the profits they make in the jurisdictions in which they do business."[9]

4.6 This debate extends beyond issues of tax administration and raises questions about the need for reform of tax law which fall outside our remit. We have therefore not sought to evaluate the adequacy of international tax law in our value-for-money work.

What has changed?

4.7 The Committee's main concerns have been in three areas: the need to reform international tax rules; whether HMRC does enough to challenge artificial tax arrangements by multinational companies; and whether it could do more to share information on potential tax evasion with other tax authorities.

Reforming international tax rules

In December 2012, the Committee called on HMRC to work with HM Treasury to "lead international efforts … to reform the way in which multinational corporations are able to transfer earnings overseas and thereby potentially avoid tax payments" (HM Revenue & Customs: Annual Report and Accounts 2011-12).

It reiterated its call for urgent reform of international tax rules in April 2013 (Tax avoidance: the role of large accountancy firms).

9 Committee of Public Accounts conference, Impact of globalisation on taxation, 30 October 2014.

4.8 HMRC, along with HM Treasury and other parts of government, have supported and contributed to international action to reform tax law and protect the tax base. The government has:

- contributed €550,000 to support the OECD to deliver its objectives to tackle BEPS by December 2015. The OECD is working with both G20 nations and developing countries to reduce the complexity of international tax law, and to limit the extent to which multinational corporations can use tax law to artificially minimise their tax liabilities;
- used its presidency of the G8, in 2013, to call for companies to declare who owns them and to adhere to new standards of transparency over where multinationals are paying their tax and making their profits; and
- worked with France, Germany, Italy and Spain (the G5) to pilot a common approach to the automatic exchange of financial account information. This led to the OECD developing a new global common reporting standard which was adopted by the G20. Government consulted on the new standard during 2014 to gather views on its adoption into UK law.

4.9 HMRC and HM Treasury jointly manage the UK input into the OECD project on BEPS. HMRC has set up internal working groups to deal with particular actions arising from this project. These groups bring together policy leads, sector specialists and technical specialists. HMRC and HM Treasury have also consulted with external stakeholders on the BEPS project.

HMRC's challenge of artificial tax arrangements by multinational companies

4.10 HMRC has taken steps to tackle tax practices which the Committee has called into question, although their impact is yet to be demonstrated.

In 2012, the Committee recommended that HMRC "direct more effort into challenging artificial arrangements, be more willing to prosecute improper corporate arrangements, and make more information available to the public about this aspect of its work" (HM Revenue & Customs: Annual Report and Accounts 2011-12).

4.11 In 2012, the government gave HMRC an extra £29 million to help it challenge abusive transfer pricing and strengthen its risk assessment capability across large business. HMRC is using the funding to employ additional staff, although the roles require specialist knowledge and HMRC has said it will take some time to fully recruit and train staff. The average duration of open enquiries into transfer pricing fell from 20.8 months in March 2012 to 18.6 months by March 2013. HMRC publishes statistics on transfer pricing and reports that its investigations yielded £2 billion between 2010-11 and 2012-13.

4.12 HMRC expects that the OECD will recommend further changes to transfer pricing rules through its BEPS project, which will address multinational business structures designed to avoid tax. For example, new rules to align taxing rights with economic activity. HMRC supports these proposed changes.

4.13 Government introduced new rules with effect from 2013, to counter both the diversion of UK profits and the accumulation of profits earned abroad which should come back to the UK parent company and be taxable. The Committee expressed scepticism about how these new Controlled Foreign Company rules will work. In December 2013, the Committee reported that it believed the rules to be weaker and in November 2014 it questioned the impact of the changes. HMRC told us that it is too early to assess the impact of the new rules. Due to the time lag between the end of an accounting period and when companies must return information, HMRC are only beginning to see tax returns where the new rules apply.

4.14 The government announced a new diverted profits tax at autumn statement 2014 to address companies that divert their profits out of the UK. Legislation will be included in the 2015 Finance Bill. The new tax will affect companies who enter into contrived arrangements to divert profits from the UK by avoiding a UK taxable presence or by other contrived arrangements. The diverted profits will be subject to tax of 25% from 1 April 2015.

Working with other tax authorities to secure revenues

4.15 We also examined HMRC's progress in recovering tax through the UK-Switzerland tax agreement, which has addressed UK resident individuals holding money in Swiss bank accounts.

In 2013, the Committee recommended that HMRC "continue to press the Swiss authorities to provide accurate and complete information about amounts held there by UK taxpayers, and pursue more vigorously the amounts owed in unpaid tax" (HMRC tax collection: annual report and accounts, 2012-13).

4.16 The government reached agreement with the Swiss authorities in October 2011 to tackle offshore evasion by UK residents who hold Swiss bank accounts. In 2012, HMRC estimated that the agreement would generate £5 billion for the exchequer by March 2016 but reduced its estimate to £1.7 billion by March 2016 the following year. HMRC had secured £1.2 billion by November 2014. As part of this work, HMRC contacted over 22,000 individuals to provide them with an opportunity to self-certify if their tax affairs were in order or to provide a voluntary disclosure. The next instalment of this withholding tax is scheduled to be received by the end of March 2015. HMRC has also gained new data as a result of its agreement with the Swiss authorities, which it plans to use to validate its own analysis and to support negotiations over new tax agreements with other countries.

4.17 HMRC is continuing to investigate 3,600 UK taxpayers whose Swiss account details were leaked by a former employee of HSBC, known as the Largarde List. In November 2014, the Committee raised concern about HMRC's slow progress in acting on this information. HMRC has recouped £136 million from these investigations to November 2014. It does not have an estimate of the final expected yield.

Annex Five

Improving the administration of personal tax

Overview

5.1 In 2011, the Committee for Public Accounts (the Committee) drew a commitment from HMRC that it would stabilise the National Insurance and PAYE Service (NPS) and clear the backlog of open cases by the end of March 2013. HMRC met this commitment and managed the process robustly, taking reasonable decisions along the way of what was and wasn't achievable. Its work to stabilise Pay As You Earn (PAYE) cost £78.9 million and HMRC chose not to collect around £953 million of tax to keep workloads manageable. We reported that during 2013-14 HMRC used the NPS system more effectively to automate tasks, and that HMRC now had the capacity to handle the volume of work it generated. NPS was an outlier against HMRC's track record of developing and implementing technological changes effectively. HMRC's actions to resolve the problems NPS created demonstrated sound management of a challenging situation.

5.2 In its implementation of real time information (RTI), we found that HMRC had learned the lessons from NPS and phased the new system's introduction, starting with a pilot during 2012-13. This allowed HMRC to test how the system functioned before it went live. HMRC also has listened to taxpayers and tried to understand and respond to concerns about the burden of RTI on small businesses. Now that the Committee's concerns have been addressed, the combined effect of NPS and RTI has significantly modernised and improved the way PAYE is administered and the quality of data available to HMRC.

Why this is important

5.3 PAYE is HMRC's largest single tax collection process. For many people PAYE is their only contact with income tax. It relies on employers deducting the correct amount from a taxpayer's income and paying it to HMRC. The PAYE system aims to collect the correct amounts evenly during the year. Errors can have a big impact on taxpayers who will experience uncertainty and inconvenience, and in some cases suffer financial hardship. In 2013-14, HMRC collected £162.1 billion in income tax and £106.7 billion in National Insurance contributions, most of which was collected through PAYE.

5.4 Before the start of this parliament, HMRC had significant problems when it introduced a new system to modernise the collection of PAYE. NPS combined an individual's tax records into a single taxpayer account. The PAYE service was severely impaired during the implementation of NPS, affecting millions of taxpayers.

5.5 RTI was the next phase of HMRC's modernisation of the PAYE system. RTI aims to improve the timeliness and accuracy of the data HMRC collects about what income tax is due and collected under PAYE. It requires employers to submit a record of the income and the tax deducted each time they make a payment to their employees.

What the NAO and the Committee found

5.6 At the start of this parliament HMRC was completing the final phase of its project to modernise income tax collection through the PAYE system. The NPS combined an individual's employment and pension income into a single record. HMRC had previously held these records separately, which increased the likelihood of HMRC issuing an inaccurate tax code or collecting too much or too little tax.

5.7 We have reported annually on the administration of PAYE during this parliament, and each time the Committee has taken further evidence from HMRC on its progress.[10] We reported that failings in HMRC's processes had led to significant data problems when it implemented NPS. This led to errors in the tax codes people received and an inability to reconcile tax records. HMRC was slow to tell people about these problems. By December 2009, it had identified that up to 7 million people had under- or overpaid income tax during 2008-09, but did not begin to tell them until September 2010. Many customers attempted to contact HMRC, which further impacted on the service HMRC could provide. When we reported on *Managing and replacing the Aspire contract* in 2014 we found that this level of performance was not typical and that HMRC had a strong track record of delivering technology projects.[11]

5.8 These issues led the Committee to conclude that HMRC failed in its duty to process PAYE accurately and on time.[12] In 2013[13] and 2014,[14] we and the Committee reported on the much more successful implementation of the Department's RTI project.

10 See reports by Comptroller and Auditor General on HMRC's annual reports and accounts.
11 Comptroller and Auditor General, *Managing and replacing the Aspire contract*, Session 2014-15, HC 444, National Audit Office, July 2014.
12 HC Committee of Public Accounts, *HM Revenue and Customs' 2009-10 Accounts*, Eighteenth Report of Session 2010-11, HC 502, February 2011.
13 HC Committee of Public Accounts, *HMRC Tax Collection: Annual Report & Accounts 2012-13*, Thirty-fourth Report of Session 2013-14, HC 666, December 2013.
14 Comptroller and Auditor General, *HM Revenue & Customs 2013-14 Accounts*, National Audit Office, June 2014.

What has changed?

Improving the administration of tax through the Pay As You Earn system

National Insurance and PAYE Service NPS

In 2010, the NAO recommended that HMRC should set a clear timetable to stabilise the performance of NPS and clear the backlog of open cases (HM Revenue & Customs' 2009-10 Accounts).

In 2011, the Committee recommended HMRC "set a clear operational standard to process all PAYE cases within 12 months of the end of the tax year". It also recommended that "taxpayers are told of their individual under and overpayments as soon as practical" (HM Revenue & Customs' 2009-10 Accounts).

5.9 When HMRC introduced NPS in 2009, it experienced significant difficulties in administering PAYE. There were problems with the quality of data that HMRC transferred from its old system. HMRC did not validate the data before transfer. There were also issues with the specification of the NPS system. This resulted in difficulties with the timeliness and accuracy of PAYE processing, with HMRC issuing a significant number of incorrect tax codes. HMRC also built up a large backlog of PAYE cases, delaying the repayment and collection of tax. By December 2009, it had identified that around 7 million people had paid too much or too little tax during 2008-09, but did not begin to tell them until September 2010. HMRC experienced significant reputational damage during this period and the Committee concluded it had failed in its duty to process PAYE accurately and on time and deliver an acceptable service to taxpayers.

5.10 HMRC used two programmes to stabilise PAYE: one to stabilise the NPS system; and the other to clear the backlog of open cases. HMRC stabilised NPS through system improvements and temporary measures to manage workloads. It introduced a more rigorous process to test each implementation phase of NPS to confirm the system was working as intended and generating accurate data. It also put in place plans to process all PAYE cases within 12 months of the end of the tax year from March 2013. This was dependent on clearing backlogs.

In 2011, the Committee acknowledged HMRC's "administration of PAYE has improved, but it still has a huge backlog of records for manual reconciliation". It recommended that HMRC "maintain its programme to deal with the backlog by 2013 and not let it slip" (HM Revenue & Customs: PAYE, tax credit debt and cost reduction).

5.11 HMRC completed its stabilisation programme by the end of March 2013, in line with the Committee's recommendation (**Figure 14**). We reported in 2013-14 that HMRC was using the system to more effectively automate tasks, meaning it had the capacity to clear cases requiring manual intervention.

5.12 HMRC spent £78.9 million in stabilising PAYE, and chose not to collect around £953 million of tax to keep workloads manageable. HMRC also chose to forego the recovery of underpayments of income tax from 250,000 pensioners where their tax codes for 2008-09 and 2009-10 did not reflect that they were receiving a state pension as well as other income. HMRC judged that this group of people could reasonably have claimed a concession as it had not used information in a timely manner.

5.13 We think that given the gravity of the problems HMRC made sensible trade-offs between its need to stabilise the tax system and remove the backlog, to provide a fair service to customers and to minimise the loss of revenue.

Real time information (RTI)

In 2011, the NAO recommended that HMRC should draw on its experience of NPS and "thoroughly test the adequacy of its plans for implementing real time information, and in particular its capacity to manage the risks presented by poor data quality" (HM Revenue & Customs 2010-11 Accounts in tax disputes).

5.14 Following NPS, the next phase of HMRC's modernisation of administering PAYE was the implementation of RTI. It offers HMRC the prospect of tracking changes in income and employment in-year, ensuring that individuals remain on the correct tax code. This should reduce the time it takes HMRC to complete end-of-year reconciliations and increase the amount of automation that is possible.

Figure 14
HMRC performance against its commitment to stabilise NPS by March 2013

HMRC aimed to stabilise NPS by completing	Target date	Achieved
Outstanding end-of-year reconciliations from 2008-09 and 2009-10 (6.7 million)	31 March 2012	Yes
Outstanding reconciliations from 2003-04 to 2007-08	31 December 2012	Yes
End-of-year reconciliations for 2010-11 and 2011-12 within accelerated processing timetable	31 March 2013	Yes

Source: Comptroller and Auditor General, *HM Revenue & Customs 2012-13 Accounts*, National Audit Office, July 2013

5.15 HMRC ran a pilot of RTI for one year starting in April 2012 before introducing it for all employers in 2013-14. The pilot was successful in testing functionality and system performance, while identifying issues for HMRC to address. It identified that the system created duplicate employer records in some circumstances, which could lead to incorrect tax codes being issued. HMRC developed methods to address the data quality issues identified in the pilot.

In 2011, the Committee recommended HMRC "take advantage of the pilot phase of RTI to assess the impact on small and medium-sized employers" (HM Revenue & Customs: PAYE, tax credit debt and cost reduction).

In 2013, the Committee recommended HMRC "analyse the information it has from its customers to help it understand the problems faced by smaller businesses … so that it can continue to provide them with effective support" (HMRC Tax Collection – Annual Report and Accounts 2012-13).

5.16 HMRC has monitored the burden on smaller businesses and adapted its processes. The gradual roll-out of RTI allowed HMRC to gather feedback from business. HMRC also commissioned research to understand employers' experience of moving to RTI. HMRC's research from January 2014 found that most employers report no change in the burden of running payroll under RTI.

5.17 HMRC has responded to concerns about the burdens on small businesses. In March 2013, HMRC announced a one-year relaxation of some rules for employers with up to 49 employees. It used this period to work with businesses on areas of specific concerns. It extended the temporary relaxation to April 2016 for existing micro-businesses with up to 9 employees.

Future improvements to the administration of PAYE

5.18 The NPS and RTI systems have allowed HMRC to do more to keep taxpayer records up to date in-year than its previous computer systems. NPS combined data from separate areas of its business to give a single record of each taxpayer's employment and pension income. RTI gives HMRC the capability to update records throughout the year.

5.19 NPS and RTI will support HMRC as it modernises its business and provides a better service with fewer and better targeted resources. HMRC sees digital services as vital to achieving this. HMRC's ability to offer automated online services will build on the data and information available through the modernisations of the PAYE system already achieved.

Annex Six

Improving customer experience

Overview

6.1 Responding to criticism from the Committee for Public Accounts (the Committee), HMRC has now taken action in areas where it had previously said it could not make progress, such as reducing the costs for customers of calling its helplines. HMRC has improved its customer service standards, but acknowledges it still has a long way to go. The Committee has recognised and welcomed a change in HMRC's attitude to customer service. In 2013, the Committee reported that in the past HMRC had considered it too difficult to implement recommendations to improve services and reach standards that are commonplace elsewhere. The Committee noted a change in approach from HMRC and recognition that better customer service is an essential part of its strategy to collect revenues while also reducing costs. The quality of service that HMRC provides remains a widespread concern to customers and stakeholders and is an area the Committee may wish to return to in the new Parliament.

Why this is important

6.2 HMRC interacts with more than 45 million people and 4.9 million business customers, predominantly in the collection of tax. One of HMRC's strategic objectives is to improve the service it provides to customers. HMRC aims to improve customer experience by reducing the cost of engaging with HMRC and by making its processes and products more simple and straightforward.

6.3 People do not have a choice about whether or not they interact with HMRC. This places an even greater obligation on HMRC to provide a good service and deliver the standards of customer service that people expect from other businesses. Good customer service can also reduce costs to HMRC – as it will have fewer repeat calls or letters – and reduces the time and effort people need to spend to pay the correct amount of tax.

What the NAO and the Committee found

6.4 The NAO and the Committee reported on HMRC's customer service performance in 2012 and 2013.[15,16] The Committee regularly asks HMRC about this performance when taking evidence on other subjects. We found that HMRC had improved its customer service from a low point in 2010. Despite this customers were still not getting a good service. HMRC had not met all its targets despite them being lower and covering fewer areas than those of other organisations. Most HMRC telephone helplines were more expensive 0845 numbers. The Committee concluded that HMRC has an "abysmal record on customer service but has given us welcome commitments for how it plans to improve".

What has changed?

6.5 The Committee has recognised and welcomed a change in HMRC's attitude to customer service. In its report *HMRC: Customer service* (2013), the Committee found that in the past HMRC had considered it too difficult to implement recommendations to improve services and reach standards that are commonplace elsewhere. The Committee noted an attitude change from HMRC and recognition that better customer service is an essential part of its strategy to collect revenues while also reducing costs.

Customer service performance

In 2012, the NAO concluded that despite some welcome improvements, "HMRC has acknowledged that its performance in providing services to the public has been unacceptable" (HMRC: Customer service performance).

In 2013, the Committee reported that "while there is much to do, we welcome the commitments HMRC has now given us to improve the service taxpayers receive" (HMRC: Customer service).

6.6 HMRC has improved its customer service performance from the low levels it experienced in 2010-11 (**Figure 15** overleaf). HMRC's main customer performance measures are the percentage of telephone calls answered and the percentage of post cleared within 15 days. In 2010-11, HMRC answered 51% of post within 15 days and answered only 48% of telephone calls.

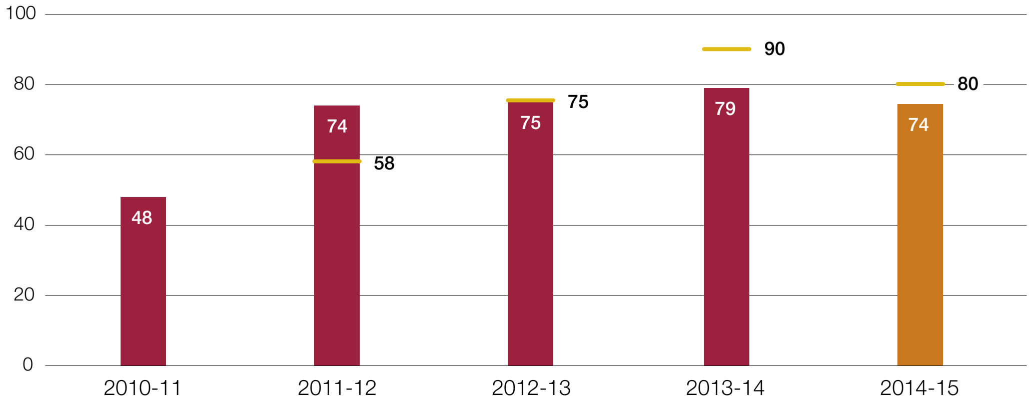
15 Comptroller and Auditor General, *Customer service performance*, Session 2012-13, HC 795, National Audit Office, December 2012.

16 HC Committee of Public Accounts, *HMRC: Customer service*, Thirty-sixth Report of Session 2012-13, HC 869, March 2013.

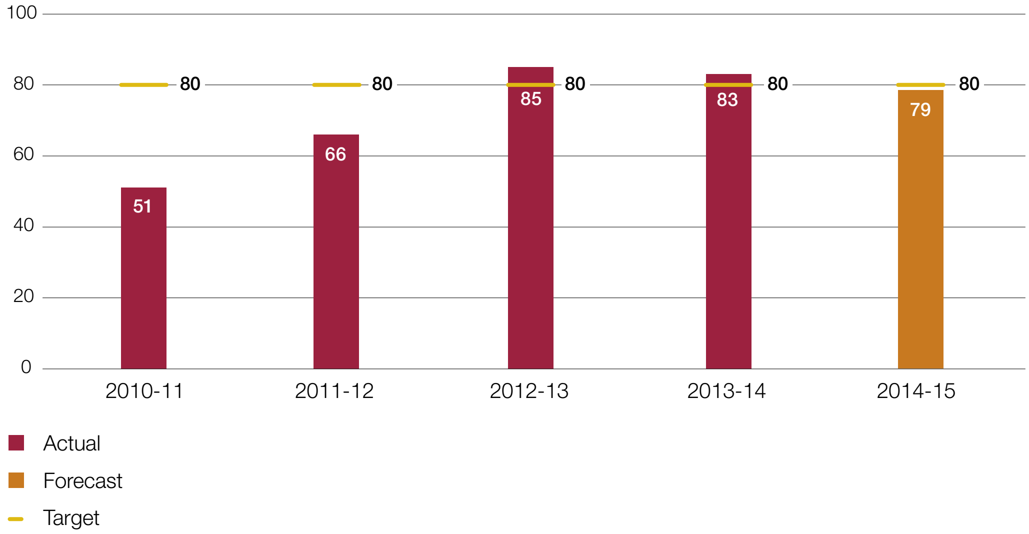
Figure 15
HMRC customer service performance (2010-11 to 2014-15)

HMRC has improved against its key measures of customer service performance for telephones and post since 2010

Percentage of calls answered



Percentage of post answered within 15 days



Source: HM Revenue & Customs, *Annual Report and Accounts 2013-14*, July 2014; HM Revenue & Customs, *Annual Report and Accounts 2012-13*, July 2013; and Comptroller and Auditor General, *Customer service performance*, Session 2012-13, HC 795, National Audit Office, December 2012

6.7 Recent customer service performance has varied. Performance has improved since 2010-11 but HMRC does not expect to meet its 2014-15 targets. HMRC achieved its target to answer 80% of post within 15 days in 2012-13 and 2013-14, but a dip in performance this year means it will not now meet its target. HMRC has attributed this lower performance to diverting some staff dealing with customer post to support tax credits renewals. HMRC has previously worked towards answering 90% of telephone calls, but has not come close to this level of performance. For 2014-15 it has revised this target to 80% of calls answered, but it does not expect it will be able to achieve this.

6.8 HMRC is deploying staff more flexibly to manage call peak periods. As a temporary measure in 2012-13, HMRC recruited 1,000 additional staff for its contact centres. In the longer term, HMRC is training and allocating staff to answer calls during peak periods. HMRC first redeployed staff in this way during the self-assessment peak in January 2014 and the tax credit peak in 2014.

Reducing the cost for customers calling HMRC

In 2012, the NAO recommended that HMRC should provide "alternatives to 0845 numbers, to reduce the cost to customers". The NAO also recommended that HMRC should "build on work to design services more around customers" and consider offering call-back options (HMRC: Customer service performance).

6.9 HMRC signed a telephony contract in 2008 with Cable & Wireless. This contract was based on HMRC receiving a minimum of 400 million minutes of customer calls to 0845 numbers each year. These are business rate numbers and are more expensive for callers than UK-wide numbers, such as 03. This contract expired in June 2013.

6.10 HMRC has entered into a new telephony contract and changed to 03 numbers that are less expensive. It first changed to 03 numbers at the start of 2013 and closed all its 0845 numbers by the end of December 2014. HMRC estimated customers will save £13 million annually by replacing its 0845 numbers with cheaper 03 numbers.

6.11 Customers can not always get through to HMRC. It trialled a call-back service on its Child Benefit helpline, from April to July 2013, and 59% of mobile callers accepted the offer of a call-back. Following the introduction of a new telephony platform HMRC plan to introduce this service for Tax Credits and Child Benefit customers in early 2015.

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