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Appropriation Accounts 1998-99
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Departments of the Chancellor of the Exchequer

Confidential

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Contents

Revenue assessment, collection and allocation

1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of the Departments of Customs and Excise and Inland Revenue on behalf of the House of Commons. The purpose of this examination is to establish that adequate regulations and procedures have been framed to secure an effective check on the assessment, collection, and proper allocation of revenue and to satisfy myself that any such regulations and procedures are being duly carried out. The legislation also requires me to examine the correctness of the sums brought to account in respect of such revenue and report the results of this examination to the House of Commons.

2 Both Departments prepare financial statements, which are included in the Departments' Annual Reports. These financial statements are audited by me and presented to Parliament as Command Papers. I issued unqualified audit opinions on both Departments' financial statements for the year ended 31 March 1999. These audit arrangements fulfil the statutory requirement in Section 2 of the 1921 Exchequer and Audit Departments Act to examine the correctness of the sums brought to account.

3 I carry out further work each year to fulfil the statutory requirement under Section 2 of the Act to examine those systems which the Departments have put in place to secure an effective check on the assessment, collection and allocation of revenues. This work includes:

- reviews of quality assurance work and other checks carried out by the Departments on the operation of tax systems;
- ongoing review of the Departments' information technology systems, which are fundamental to the efficient and effective operation of the tax system and the collection of revenue;
- test examinations of individual transactions and balances;

- in depth examinations reported under Section 9 of the National Audit Act 1983, of which the following have been issued over the past year:
  - Inland Revenue: Inheritance Tax: A Progress Report (HC251);
  - HM Customs and Excise: The Red Channel (HC358); and
- consideration of selected issues which I have covered in the following report on the 1998-99 Appropriation Accounts.

On the basis of this work, I remain satisfied as to the adequacy of the regulations and procedure of the two Departments and the way they have been implemented.

HM Customs and Excise

The Department's main stated aim in the UK revenue area is:

"To secure the revenue yield from indirect taxes efficiently, effectively and fairly, while minimising cost to businesses, as a key component of the Government's policy of ensuring sound public finances."

HM Customs and Excise Management Plan 1998-99, page 13

Scope of the report

4 The first section of this report (paragraphs 17 to 26) shows how the Department have deployed their resources in each of the main business areas in 1998-99 and summarises the impact on the Department of the Comprehensive Spending Review announced in July 1998. The remainder of the report reviews the following aspects of the Department's management of the revenue in 1998-99:

- the outturn of revenue and the shortfall against forecast (paragraphs 27 to 47);
- developments in debt management (paragraphs 48 to 70); and
- the arrangements for securing the revenue yield ranging from auditing large VAT traders and dealing with errors and irregularities to tackling more serious fraud and avoidance; including the fines and penalties imposed (paragraphs 71 to 117).

Summary and conclusions

Deployment of resources

5 Departmental expenditure has continued to decline in real terms, but is set to increase in 1999-2000 as a result of the additional net provision made under the Comprehensive Spending Review. These additional resources have been provided to tackle the growing problem of alcohol and tobacco fraud and to undertake a programme of modernisation using call centre technology and electronic document transmission.

Outturn of revenue

6 Although Value Added Tax receipts have risen, reflecting higher household consumption of goods and services, the underlying ratio of VAT to household consumption, having increased last year, fell to its lowest level since it started to decline in 1990-91. The Department achieved their forecast accuracy target, but the improvement noted in 1997-98 was not sustained, and there was a shortfall of more than £1,000 million in VAT receipts. The largest payers of VAT contributed more than 82 per cent of the net VAT receipts, with two thirds of them paying by electronic means. The Department continue to take steps to persuade the remaining one third to adopt automated methods, but the position has not improved since 1997-98.

7 Although the majority of the non-VAT revenues increased as a result of rate and volume increases, falls in receipts from tobacco duty remain of serious concern. The decline in releases for sale of handrolling tobacco continued in 1998-99 and, for the first time since 1995-96, releases of cigarettes, and associated revenue, fell. Other falls in revenue included betting and gaming, following a decline in the turnover of the National Lottery; and Landfill tax, reflecting a fall in the amounts of taxable waste.

8 The Department did not achieve their forecast accuracy target for the non-VAT revenues, although improvements to the models enabled the Department to reach 98.63 per cent of the overall forecast. Within that overall figure there were some significant variations against forecasts for individual regimes, and the Department will need to re-examine the models to improve performance against individual taxes and duties.

Debt Management

9 The majority of revenue debt arises from VAT, as most other taxes and duties are paid over at the point of import or release. The average gross VAT liability arising each month in 1998-99 was about £7,346 million, most of which was paid on time, including some £3,500 million collected by the Department's Large Payers Unit. During 1998-99 £2,751 million was advised to local Debt Management Units for recovery action.

10 Overall, the Department's management of debt improved in 1998-99. Changes to the way in which debt is managed have resulted in tighter control over overdue amounts. The total outstanding VAT liability at 31 March 1999 of £1,517 million was 4.1 per cent (£60 million) higher than the previous year. This is less than the 5.6 per cent increase in VAT trader liability over the same period. The average month-end arrears, as a percentage of payment trader liabilities, rose from 1.9 per cent (£1,391 million) in 1997-98 to 2.0 per cent (£1,494 million) in 1998-99. However, liabilities outstanding for more than six months at 31 March 1999 have decreased by 14.1 per cent from the figure at 31 March 1998.

11 Of the £42,920 million due from large VAT payers, 95.78 per cent was received by due date against a target of 95 per cent. One third of large payers do not pay by electronic means, and the Department are continuing to take steps to persuade these traders to adopt automated methods such as the BACS and CHAPS.

12 The amount of debt under the control of local Debt Management Units at the year end, expressed as a percentage of the total debt managed during the year, decreased from 21.8 per cent at 31 March 1998 to 21.7 per cent at 31 March 1999. Debt under the control of Debt Management Units includes debt that cannot be recovered while other Departmental action is taking place.

13 The Department have powers to remit certain taxes and duties on the grounds of equity or compassion. VAT write offs increased by £99 million in 1998-99 to £571.8 million, of which 92.1 percent was in respect of insolvent traders. The number of VAT write off cases increased from 115,000 in 1997-98 to 118,000 in 1998-99. The decrease in the total number of remissions of taxes and duties in 1998 arose mainly from the administration of Landfill Tax; of 161 VAT remissions, 98 were granted because of errors by individual officers. The value of such errors was £2.4 million (1997: £1.8 million). In every case of personal official error line managers are required to consider whether the error or negligence appears serious enough to require disciplinary action. In one case, the officer involved was the subject of a disciplinary enquiry. In the remaining cases, disciplinary action against individual officers was deemed inappropriate.

Securing the revenue yield

14 The Department have several initiatives in place to tackle the challenges posed by trader error and by deliberate fraud. These initiatives continue to deliver higher numbers and increased values of errors detected, and also contribute to the increases in prosecutions for VAT fraud and smuggling.

15 Cross-Channel smuggling of alcohol and tobacco has continued to increase, with estimates for 1999 being 9 per cent higher than those for 1998. Following the Alcohol and Tobacco Fraud Review, the Chancellor of the Exchequer appointed an independent evaluator whose remit was to examine the way in which smuggling is tackled. The evaluator has reported to the Chancellor, who is considering his advice. The Department have also obtained additional funding from the Comprehensive Spending Review and have deployed additional staff at the frontiers as part of the fight against this type of fraud.

16 The value of penalties issued for VAT civil offences has fallen in 1998-99, but the number written off has increased. On excise smuggling offences, the Department continued to use prosecutions and other legal sanctions and have also sought other means of deterrence.

Deployment of resources

Expenditure by activity

17 Figure 1 shows the Department's expenditure outturn from 1996-97 to 1998-99, and the planned expenditure for 1999-2000. These figures are broken down for each business area, and have been restated at 1998-99 prices. In 1998-99, the Department's total expenditure was £859.7 million, representing a decrease of £9.0 million in real terms compared with 1997-98. This follows the reduction of £16.8 million in real terms between 1996-97 and 1997-98. As a result of the additional provision arising from the Comprehensive Spending Review, planned expenditure shows an increase in real terms of 2.1 per cent from £859.7 million in 1997-98 to £877.6 million in 1999-2000. The decrease of £9.0 million in real terms between 1997-98 and 1998-99 arises from a reduction in both capital expenditure of £6.1 million (or 9.7 per cent) coupled with a decrease in current expenditure of £2.9 million (or 0.4 per cent).

Comparison of HM Customs and Excise expenditure 1996-97 to 1999-2000[1]

Figure 1

	1996-97 Outturn £m[2]	1997-98 Outturn £m[2]	1998-99 Outturn £m[2]	1999-2000 Planned £m[2]
Current expenditure				
UK revenue	451.4	459.0	443.8	456.5
Protection of society	203.4	205.1	218.4	212.4
International trade	132.8	125.6	127.0	124.8
Trade statistics	17.9	16.3	13.9	14.9
Total current expenditure	**805.5**	**806.0**	**803.1**	**808.6**
Capital expenditure	**80.0**	**62.7**	**56.6**	**69.0**
Total Departmental expenditure	**885.5**	**868.7**	**859.7**	**877.6**

(1) Figures all at 1998-99 prices and net of Appropriations-in-Aid.

(2) Staff years, and therefore costings, have been recast for 1998-99 to reflect the Department's new activity framework used in their Resource Management Information System. Figures may be subject to further refinement as information becomes available from the Department's new systems.

Source: HM Customs and Excise

18 Capital expenditure has represented a decreasing proportion of total Departmental spend over a number of years. That trend continued in 1998-99, mainly as a result of rescheduling or postponement of estates projects. However, capital expenditure is expected to increase in 1999-2000 to 7.9 per cent of total spend in real terms (compared with 6.6 per cent in 1998-99) as the Department invest in technological advances as part of the move to modernise government's dealings with the public.

19 The reduction in current expenditure in 1998-99 reflects the fall in the number of staff years deployed, offset by some increases in the costs associated with operational activities – legal, investigative and the storage of seized goods.

Deployment of staff

20 Figure 2 shows the planned and actual staff years deployed between 1997-98 and 1999-2000. The decrease in staff years between 1997-98 and 1998-99 was partly due to the savings in UK revenue and non-core activities from efficiencies in support services, debt management, transaction processing and maintenance of the register. Savings were also achieved in the international trade regime resulting from the movement away from transaction-based processing at the frontier to assurance work inland, and in the trade statistics regime resulting from processing efficiencies. Additional front line staff made available under the

Comprehensive Spending Review to counter the increase in tobacco smuggling activities resulted in a lower than planned reduction in the number of staff years in the UK revenue area. Further increases in this area are planned for 1999-2000.

Comparison of HM Customs and Excise staff resource 1997-98 to 1999-2000

Figure 2

	Staff years[1]				
Activity	**Actual 1997-98[2]**	**Change 1997-98 to 1998-99**	**Actual 1998-99**	**Change 1998-99 to 1999-2000**	**Planned 1999-2000**
Policy	514	-6	508	-29	479
UK revenue	11,667	-316	11,351	+36	11,387
Protection of society	3,852	+4	3,856	0	3,856
International trade	3,207	-86	3,121	-119	3,002
Trade statistics	564	-79	485	+17	502
Non Core activities	5,148	-89	5,059	-333	4,726
Total Department	**24,952**	**-572**	**24,380**	**-428**	**23,952**

(1) Rounded up to nearest whole staff year.

(2) From 1998-99, all the staff year figures have been re-modelled, giving a separate analysis of Policy activity and Non Core activities. 1997-98 figures have been restated.

Source: HM Customs and Excise.

21 The decrease in staff years between 1998-99 outturn and the plan for 1999-2000 is due, in the main, to the planned savings in international trade and non-core activities. The savings in the international trade regime reflect the continued movement away from transaction based processing to inland assurance work. In the non-core area, the Department will use the “Competing for Quality” programme to produce further efficiencies in document processing, general administration, and accounting and financial management. In addition, the Department have entered into a Private Finance Initiative contract with ICL to provide certain of their information technology and communications services, and this has contributed to the planned decrease in non-core staff years.

Comprehensive Spending Review

22 Following the outcome of the government-wide Comprehensive Spending Review, in July 1998 Ministers announced that the Department would receive an additional net provision of £106 million (in cash terms). This funding was spread over the period 1999-2000 to 2001-2002. The additional provision is net of running cost savings and was made on the assumption that the Department would make further efficiency savings and rationalise their IT and estate assets by way of deals under the Private Finance Initiative. In addition to the PFI contract with ICL, the Department are working with the Inland Revenue to transfer both departments' estates to the private sector (the Strategic Transfer of the Estates to the Private Sector or STEPS project) by the end of 2000-01.

23 Although the Department were given some flexibility in the way in which the additional funds are to be used, there are two main areas on which they are expected to focus:

a) tackling alcohol and tobacco fraud in general and cross-Channel smuggling in particular; and

b) a programme of modernisation, to include exploitation of call centre technology and the facilitation of electronic transmission of documents.

In addition, the Comprehensive Spending Review committed the Department to developing further their closer working programme with the Inland Revenue.

Flexible Anti-Smuggling Teams

24 Flexible Anti Smuggling Teams (FAST) have been established throughout the United Kingdom to prevent and deter the importation of prohibited and restricted goods: drugs, fire arms, pornography and endangered wildlife. The majority of the 2,300 FAST officers are deployed in the large ports and airports where the risk of these types of offences is seen to be much higher. Different teams are tasked to investigate passengers and cars, lorries and commercial cargo.

25 The performance of the FASTs for 1997-98 and 1998-99 are analysed in Figure 3. Although not all functions of the FASTs are disclosed, the items detailed represent the highest priorities to the Department in the prohibitions and restrictions area.

Performance of the Flexible Anti-Smuggling Teams for 1997-98 and 1998-99

Figure 3

	1997-98	**1998-99**
Commercial drug seizures		
■ Number	1,279	1,284
■ Street value(1)	£511 million	£464 million
Number of detections of illicit firearms and ammunition	201	166
Number of detections of indecent material featuring children	153	151
Number of detections of cash suspected of being linked to drugs smuggling, put before magistrates within 48 hours	111	120

Note: Flexible Anti-Smuggling Teams are responsible for enforcing a wide range of other prohibitions and restrictions. The items detailed above represent their highest priorities.

(1) Street values of drug detections are estimates made by local FAST managers. These values are adjusted following official analysis.

Source: HM Customs and Excise

26 Increasingly, FASTs are relying on specialist intelligence gathering to develop profiles of high-risk individuals in order to enhance the targeting of offenders. This intelligence includes information from commercial operators, other customs authorities and law enforcement agencies.

Outturn of revenue

Tax and duty receipts

27 There was an overall increase in total net revenue receipts of 4.3 per cent to £94,033 million in 1998-99 (Figure 4). The main increases were in the two largest taxes and two of the relatively new taxes. The two largest taxes, VAT and Hydrocarbon Oils, increased by 2.8 per cent and 10.8 per cent respectively, together raising an additional £3,545 million as compared with 1997-98. Two of the three newest taxes showed significant increases: Insurance Premium Tax raised an additional £201 million, an increase of 19.3 per cent; and Air Passenger Duty raised an additional £344 million, an increase of 69.6 per cent. Landfill Tax, now in its second full year, yielded £28 million less, a decrease of 7.6 per cent reflecting a drop in the amount of reported taxable waste.

Net tax and duty receipts 1998-99

Figure 4

	1997-98 Net receipts £m	1998-99 Net receipts £m	Increase/ (decrease) £m	Increase/ (decrease) %[2]
Value Added Tax	50,865	52,312	1,447	2.8
Hydrocarbon Oils	19,454	21,553	2,099	10.8
Tobacco	8,356	8,207	-149	-1.8
Beer	2,696	2,702	6	0.2
Wine, Cider and Perry	1,499	1,620	121	8.1
Spirits	1,546	1,643	97	6.3
Betting and Gaming	1,559	1,529	-30	-1.9
Insurance Premium Tax	1,044	1,245	201	19.3
Air Passenger Duty	493	837	344	69.6
Landfill Tax	361	333	-28	-7.6
Total UK revenue	**£87,873m**	**£91,981m**	**£4,108m**	**4.7%**
Customs duties and Agricultural levies [1]	2,263m	2,052m	-211m	-9.3%
Total revenue	**£90,136m**	**£94,033m**	**£3,897m**	**4.3%**

(1) Under European Communities' regulations, customs duties and agricultural levies are designated as the Communities' own resources and form part of the United Kingdom's contribution to the Communities' budget.

(2) The percentage change column is calculated on the unrounded figures.

Source: HM Customs and Excise

28 The drinks industry sector yielded more revenue all round, although UK duty paid beer consumption was down by just under 2 per cent. Spirits and wine consumption rose and the increased receipts reflected a full year at the new higher duty rates. Betting and gaming duties fell slightly due to some decline in the turnover of National lottery. Customs duties and Agricultural levies continued to decline as international trade agreements continue to take effect.

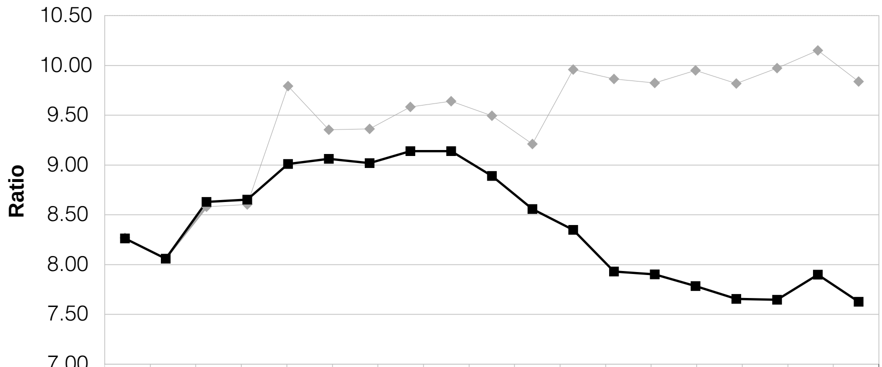
Value Added Tax

29 Net VAT receipts increased by £1,447 million, or 2.8 per cent, to £52,312 million. Gross receipts rose from £84,305 million to £88,150 million, an increase of £3,845 million (4.6 per cent), and repayments increased by £2,398 million (7.2 per cent) to £35,838 million. The improvement in net VAT receipts reflects higher household consumption of goods and services.

30 The two main determinants of VAT receipts are the applicability of the tax (scope and rate) and the level of household consumption. The lag in the collection of VAT receipts means that it is most appropriate to consider household consumption in the calendar year that ends in the fiscal year under review. Household consumption rose by 5.4 per cent, from £498,307 million in 1997 to £525,463 million in 1998, but the ratio of VAT to household consumption fell from 10.2 per cent in 1997-98 to 9.8 per cent in 1998-99. The underlying ratio, which allows for changes to the scope and rate of tax, fell from 7.90 per cent in 1997-98 to 7.63 per cent in 1998-99, its lowest level since it started its decline in 1990-91. The ratio of VAT to household consumption and the associated underlying ratio are depicted in Figure 5.

Ratio of VAT to Household consumption and the associated underlying VAT ratio

Figure 5



	1980-81	1981-82	1982-83	1983-84	1984-85	1986-87	1987-88	1988-89	1989-90	1990-91	1991-92	1992-93	1993-94	1995-96	1996-97	1997-98	1998-99
Ratio	8.27	8.06	8.58	8.60	9.79	9.36	9.58	9.64	9.50	9.21	9.96	9.87	9.82	9.82	9.97	10.15	9.84
Underlying ratio	8.26	8.06	8.63	8.65	9.01	9.02	9.14	9.14	8.89	8.56	8.35	7.93	7.90	7.66	7.65	7.90	7.63

Source: HM Customs and Excise

Hydrocarbon Oils

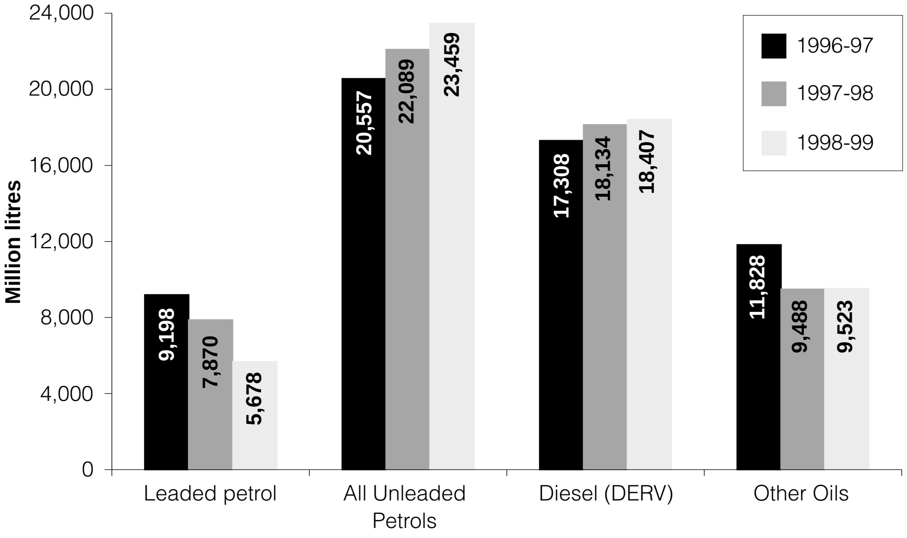
31 Road fuel releases as a whole decreased by 1.2 per cent, from 48.1 billion litres in 1997-98 to 47.5 billion litres in 1998-99, but the distance travelled by all motor vehicles increased by 1.3 per cent to 462 billion vehicle kilometres in 1998-99. Hydrocarbon Oils duty receipts rose by 10.8 per cent between 1997-98 and 1998-99 to £21,553 million. (Figures 6a and 6b). The March 1998 Budget increased duty rates by between 9.2 per cent and 11.8 per cent.

32 Both unleaded petrol and ultra low sulphur diesel increased their share of the market. Newer petrol-engined vehicles run only on unleaded petrol, thereby increasing its market share as older leaded petrol vehicles are taken off the road.

The increase in the share for ultra low sulphur diesel was due to the increase in manufacture of this product, made possible by a duty rate lower than for conventional diesel.

Hydrocarbon Oils releases 1996-97 to 1998-99

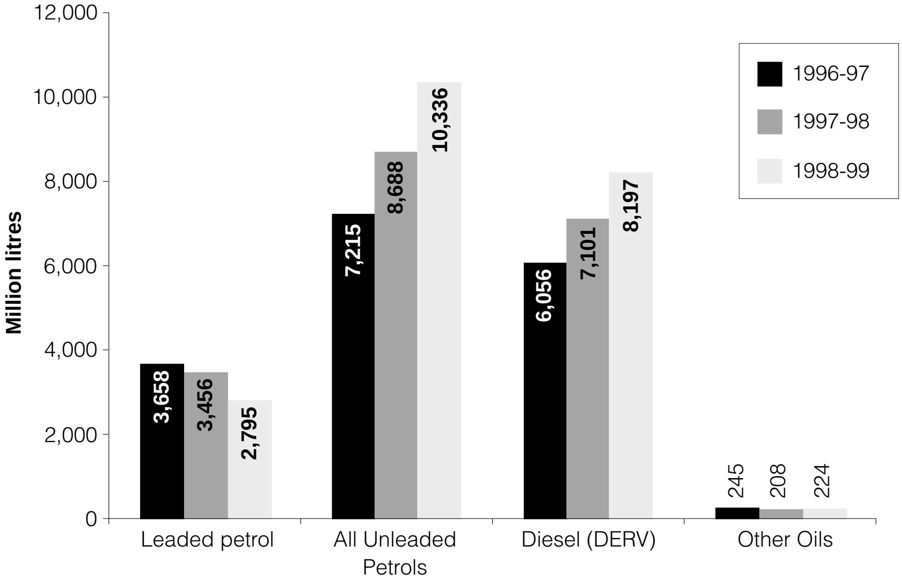
Figure 6a



Source: HM Customs and Excise

Hydrocarbon Oils receipts 1996-97 to 1998-99

Figure 6b



Source: HM Customs and Excise

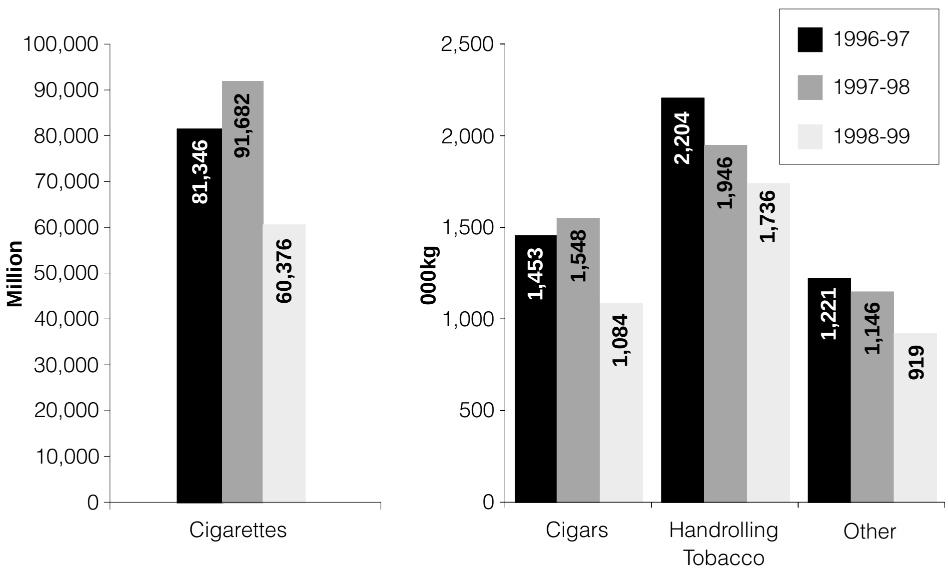
Tobacco

33 Tobacco receipts as a whole decreased by 1.8 per cent between 1997-98 and 1998-99 to £8,207 million (Figure 7b). This decrease was the effect of rises in duty rates, averaging 6.3 per cent for cigarettes in 1998-99, being more than offset by a drop in cigarette releases of 7.5 per cent for the year from March 1998 to February 1999. (Although Figure 7a shows that tobacco releases have decreased by 34 per cent in 1998-99, this is not directly related to tobacco receipts for the same year as duty is collected monthly in arrears.) The duty rise announced in the March 1998 Budget did not take effect until 1 December 1998. This delay allowed tobacco companies to release 41,585 million cigarettes in November 1998 and pay duty at the old rate. Clearances later in the financial year were very low and so the December increase in duty had very little impact on the revenue in 1998-99. For 1999, the Department estimated that £1,055 million was lost through cross-Channel smuggling of tobacco products.

34 There was no increase in the duty rate for hand rolling tobacco in 1998-99. Releases dropped by 10.8 per cent, reflecting the continuing problem of cross channel smuggling, leading to a fall of £10 million in receipts.

Releases of tobacco products 1996-97 to 1998-99

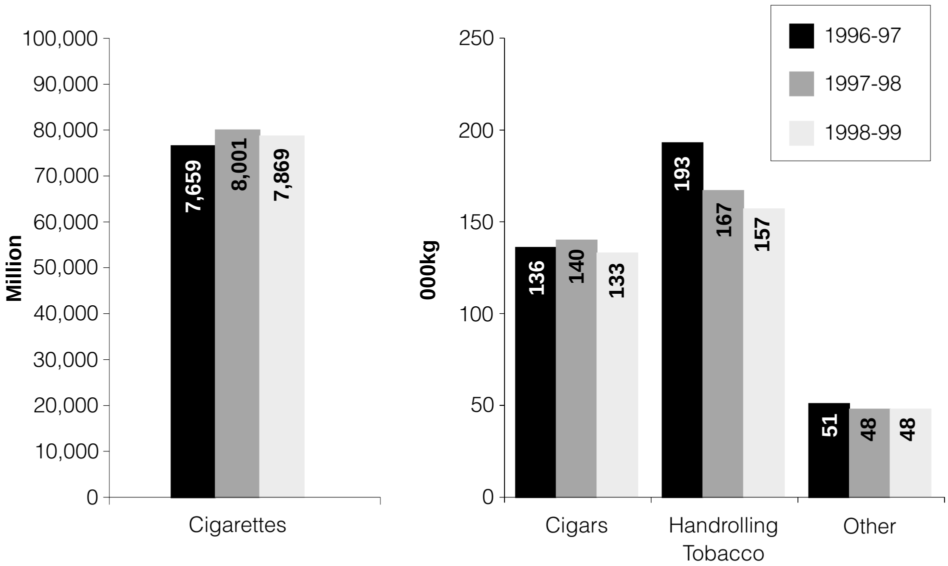
Figure 7a



Source: HM Customs and Excise

Tobacco receipts 1996-97 to 1998-99

Figure 7b



Source: HM Customs and Excise

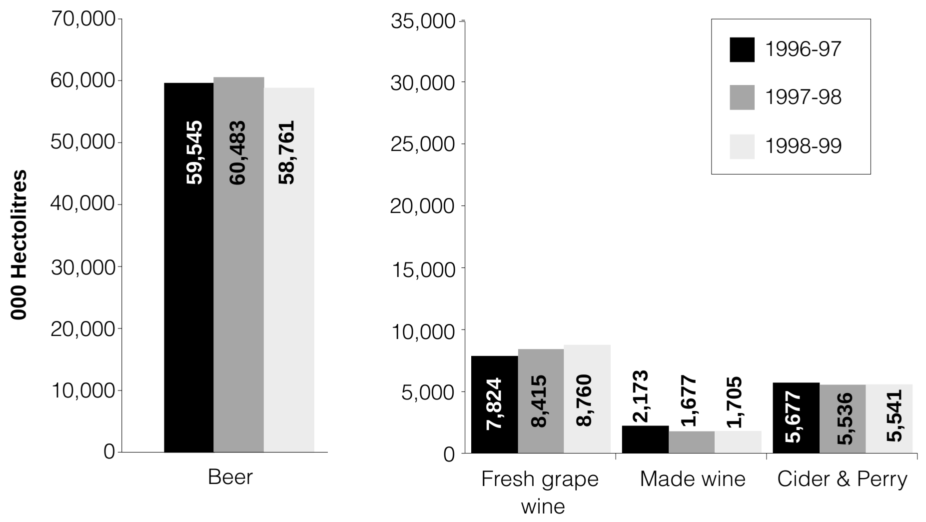
Beer, Wine, Cider and Perry

35 There was a small increase of 0.2 per cent in beer duties collected, from £2,696 million in 1997-98 to £2,702 million in 1998-99. As a result of indexing, duty rates rose by 3.0 per cent on 1 January 1998 and in line with inflation by 3.2 per cent on 1 January 1999. Beer releases dropped by 2.8 per cent in terms of hectolitres released, but only by 1.7 per cent when the strength of beer is taken into account. The Department estimate that the amount of revenue evaded as a result of cross border smuggling of beer has increased from £135 million in 1996 to £215 million in 1999. In total, the Department estimate that £285 million revenue was evaded through cross-channel smuggling of alcoholic drinks in 1999.

36 Wine, Cider and Perry receipts rose by 8.1 per cent between 1997-98 and 1998-99 to £1,620 million. The main feature is the continued increase in the consumption of fresh grape wine, where the rise in the volume of releases was 4.2 per cent (Figures 8a and 8b). Duty rates on wine rose, as a result of indexing by 3.0 per cent on 1 January 1998 and 3.2 per cent on 1 January 1999, for all categories except sparkling cider and lower strength sparkling wine. Duty on lower strength sparkling wine dropped by 20.0 per cent on 17 March 1998, as a step towards aligning the duty rates on sparkling cider and lower strength sparkling wines. This alignment was undertaken over a period of 4 years and followed negotiations with the European Commission over complaints of unfair competition. The alignment process was completed on 9 March 1999 when the duty rate on sparkling cider was increased to the level of that on lower strength sparkling wine.

Beer, Wine, Cider and Perry Releases 1996-97 to 1998-99

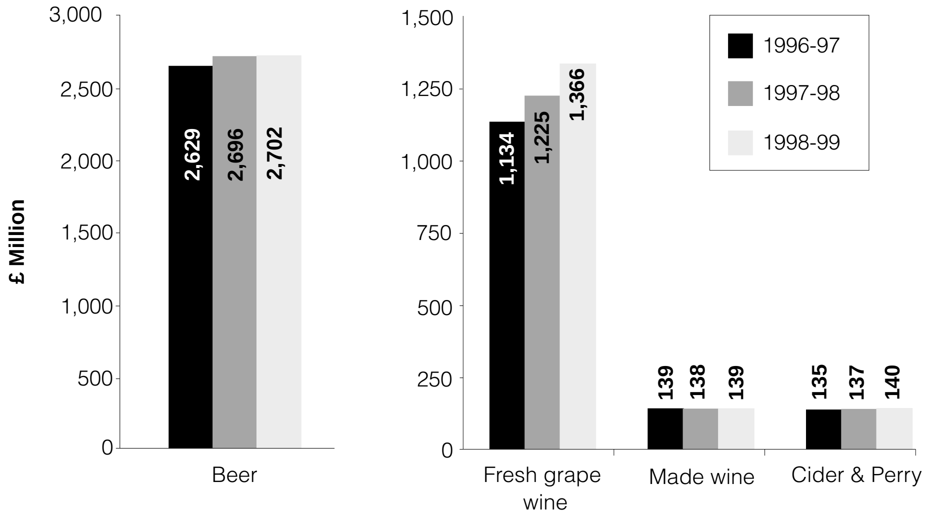
Figure 8a



Source: HM Customs and Excise

Beer, Wine, Cider and Perry Receipts 1996-97 to 1998-99

Figure 8b



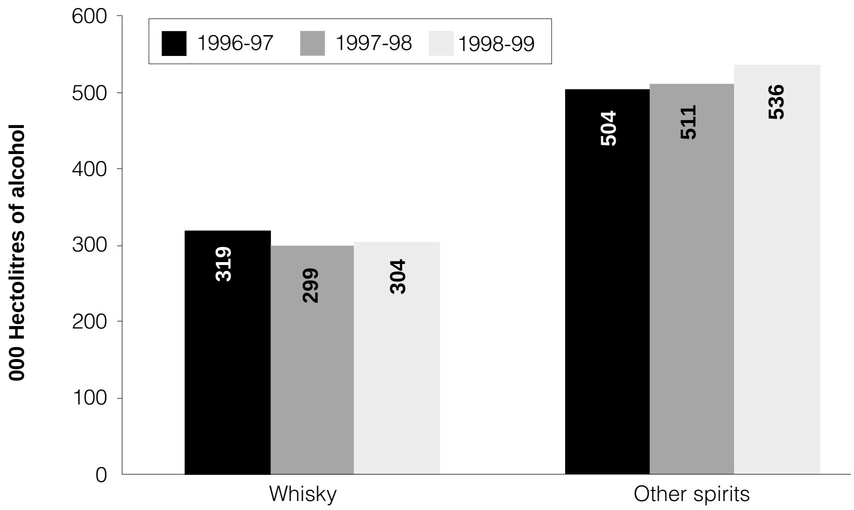
Source: HM Customs and Excise

Spirits

37 Receipts from Spirits duties increased by 6.3 per cent from £1,546 million in 1997-98 to £1,643 million in 1998-99, partly as a result of the indexing of duty rates on 1 January 1998. The duty rate on spirits was unchanged in the March 1998 and March 1999 Budgets. The downward trend in the level of whisky consumption reversed in 1998-99; releases increased from 298,989 hectolitres of alcohol in 1997-98 to 303,689 hectolitres in 1998-99. Releases of other spirits also increased (Figure 9). The overall increase in releases was 3.6 per cent leading to consumption of 839,610 hectolitres. UK production of spirits decreased by 5.8 per cent in the same year as distillers responded to weak export markets and historically high levels of mature stocks.

Consumption of whisky and other spirits 1996-97 to 1998-99

Figure 9



Source: HM Customs and Excise

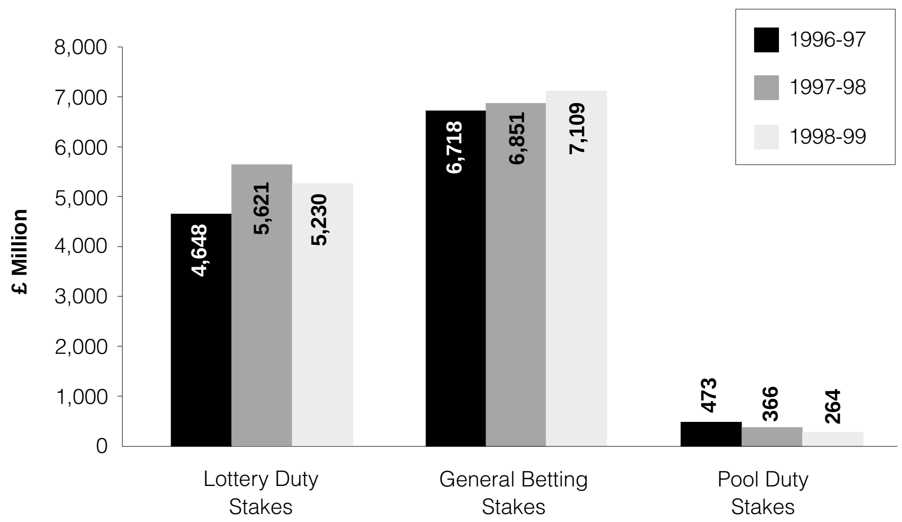
Betting and Gaming

38 Overall, income from gambling decreased by 1.9 per cent. National Lottery receipts fell by 7.0 per cent to £628 million and Pool duty receipts fell by 27.9 per cent to £70 million (Figure 10b). The fall in Lottery receipts reflects some decline in turnover. Camelot, the National Lottery operator, has cited increased competition, fewer rollover draws and pressure on retail spending as the reason for the drop in sales.

39 Pools receipts have shown a steady decline since the introduction of the Lottery (Figure 10b). Stakes on the Pools totalled £911 million in 1994-95 prior to the introduction of the lottery in November 1994, but dropped to £264 million by 1998-99 (Figure 10a). The decline in the popularity of the Pools, the closest competition to the lottery, has continued unabated despite reductions in the rate of Pool betting duty from 37.5 per cent prior to 6 May 1995 to 26.5 per cent from 5 May 1996. On 28 March 1999 the rate was again reduced to 17.5 per cent. This compares with the Lottery duty rate of 12 per cent of gross stakes.

Betting and aming stakes 1996-97 to 1998-99

Figure 10a

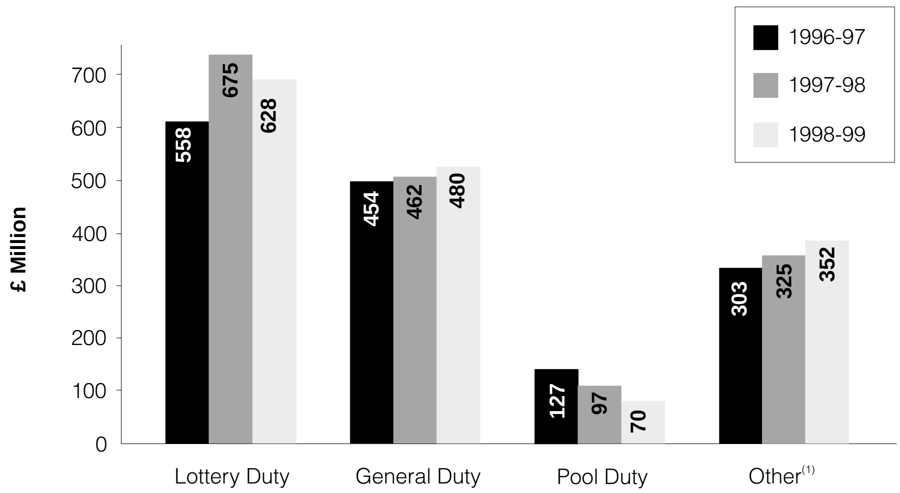


Source: HM Customs and Excise

40 Amusement machine licence duty rates were raised in the 1998 budget, as was gaming duty. This produced the expected extra revenue for the former but the latter was down slightly on the 1997-98 yield. General betting duty receipts increased by £17 million in 1998-99 to £480 million. The first five months of 1999-2000 show no effects of the move offshore of some telephone betting but this may become apparent later in the year.

Betting and aming receipts 1996-97 to 1998-99

Figure 10b



Source: HM Customs and Excise

(1) Including Amusement Machine Licence Duty

Insurance Premium Tax, Air Passenger Duty and Landfill Tax

Insurance Premium Tax

41 Receipts of Insurance Premium Tax rose by £201 million to £1,245 million, an increase of 19.3 per cent (Figure 11). The standard rate of tax rose from 2.5 per cent of relevant premiums to 4 per cent, in April 1997, an increase of 60.0 per cent. A higher rate of tax of 17.5 per cent was also introduced on insurance sold by certain suppliers of goods and services. Because of agreed accounting arrangements with traders, 1998-99 was the first full year of taxes collected at the increased rate and widened scope and the yield also contained a part year effect of a subsequent increase in the scope of the higher rate (to all travel insurance) from August 1998.

Air Passenger Duty

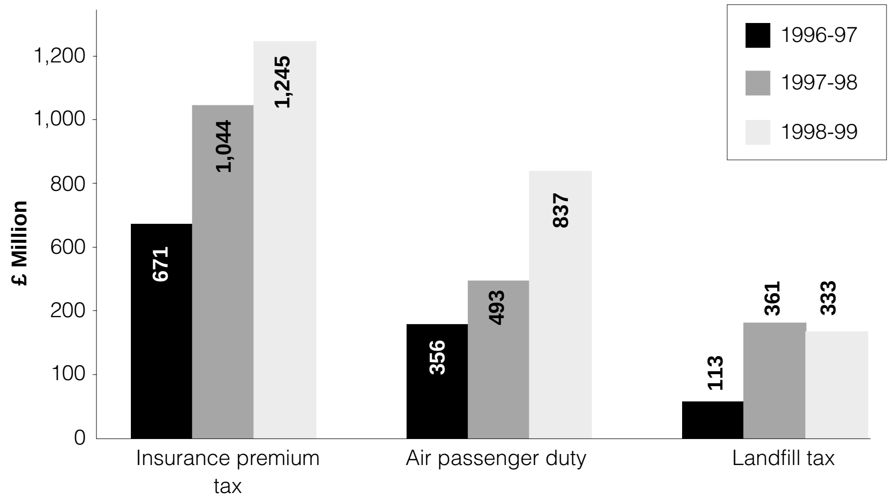
42 Receipts of Air Passenger Duty continue to rise considerably – by 69.6 per cent following increases in both the duty rates and the number of eligible passengers (Figure 11). In November 1997, rates rose from £5 to £10 per passenger for intra-European Union flights, and from £10 to £20 per passenger for flights elsewhere. The number of passengers from UK airports in respect of whom tax was paid in 1998-99, the first full year of the new rates, was 63.1 million, a rise of 7.7 per cent from the equivalent figure of 58.6 million in 1997-98. Taking account of relative numbers, the average increase in duty per passenger between 1997-98 and 1998-99 was 57.2 per cent.

Landfill Tax

43 The landfill tax came into force on 1 October 1996. Outturn for 1998-99, the second full year of this tax, was £333 million compared with £361 million in 1997-98 (Figure 11). In 1998-99, the operators made contributions to environmental bodies, and claimed 90 per cent or £68.8 million as tax credits, a rise of £1.8 million compared with the previous year. Taxable quantities of waste have decreased by 9.4 per cent to 80,293 tonnes and the number of registered operators is down by 30 to 1,093.

Receipts of Insurance Premium Tax, Air Passenger Duty and andf ill Tax 1996-97 to 1998-99

Figure 11



Source: HM Customs and Excise

Note: Landfill tax was introduced on 1 October 1996.

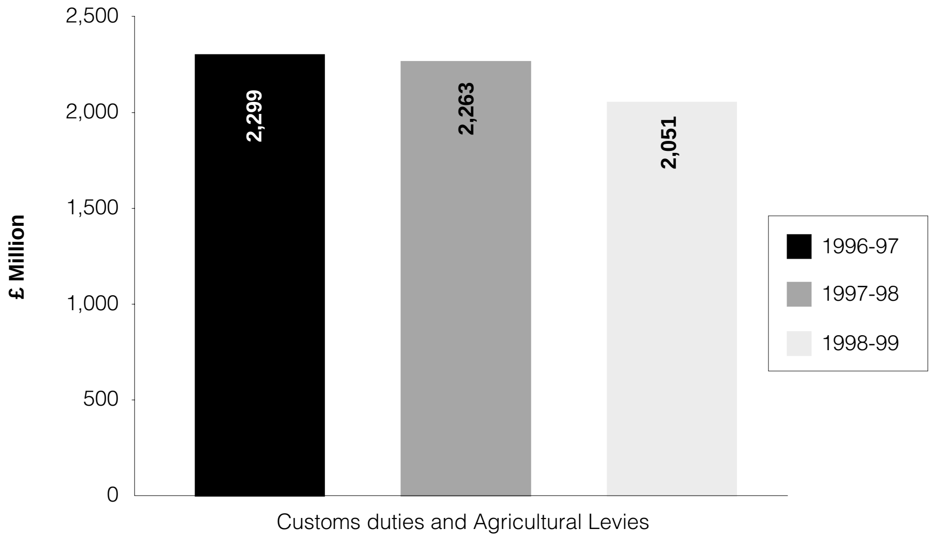
Customs duties and Agricultural levies

44 These duties fell further (Figure 12) following the continued influence of trade agreements such as the General Agreement on Tariffs and Trade (GATT) which facilitate trade by reducing the duties to be paid on imported goods, such as chemicals and manufactured goods. In March 1997, the World Trade Organisation approved the Information Technology Agreement (ITA) to take effect from

1 July 1997. This has progressively reduced tariffs on imports of Information Technology products with a view to eliminating them by 1 January 2000. The two main determinants of the duty received in the year are the sterling value of goods imported and the average tariffs applied. The sterling value of goods imported from outside the European Union remained relatively stable for 1997-98 and 1998-99. The overall reduction in tariffs was the major contributing factor to the fall in revenues from customs duties.

Receipts of Customs duties and Agricultural levies 1996-97 to 1998-99

Figure 12



Source: HM Customs and Excise

Outturn against forecast

45 For VAT, the Department met their forecast accuracy target of 3 per cent with outturn at £52,312 million being 1.91 per cent lower than the forecast. The improvement in forecasting in 1997-98 has not been sustained. The shortfall of more than £1,000 million in VAT receipts against the forecast for 1998-99 contrasts with an excess of £354 million in 1997-98. The Committee of Public Accounts in their Report on the 1996-97 Appropriation Accounts (HC 717, 1997-98), noted that VAT receipts in 1996-97 were £1,200 million less than forecast. The Department informed the Committee that they would review the target. The Committee concluded that the Department should set an accuracy target no broader than the one per cent target set for non-VAT taxes and duties. The Department have not published targets for 1999-2000.

46 The monetary and percentage variances for Other Taxes and Duties were an underachievement of £580 million and 1.37 per cent respectively. The percentage was outside the accuracy target of 1 per cent, which is an improvement over the 4 per cent shortfall reported in 1997-98. The most significant shortfall was for Tobacco duty, which was £733 million or 8.2 per cent below forecast (Figure 13). The external research project to develop a new forecasting model should be completed and in place for the November 1999 pre-Budget exercise.

Outturn against forecast for 1998-99

Figure 13

Tax/Duty	Outturn £m	Forecast £m	Achievement against Forecast £m	%
Value Added Tax	**52,312**	**53,328**	**-1,017**	**-1.9**
Hydrocarbon oil	21,553	21,475	+78	+ 0.4
Tobacco	8,207	8,940	- 733	- 8.2
Beer, wine, cider and perry	4,322	4,368	- 45	- 1.7
Spirits	1,643	1,568	+75	+4.8
Betting and gaming	1,529	1,576	- 47	- 3.0
Insurance premium tax	1,245	1,284	-39	- 3.0
Air passenger duty	837	748	+89	+11.9
Landfill tax	333	377	-44	- 11.7
Customs duties	2,052	1,965	+87	+4.4
Other Taxes and Duties	**41,721**	**42,301**	**-580**	**-1.4**

Source: HM Customs and Excise

47 The Department provided the following explanations for the forecast errors (Figure 13):

a) Tobacco

The forecast made in March 1998 included the effect of higher than inflation duty rate increases partly offset by the projected increase in smuggling leading to a forecast decline in consumption of between two and three per cent a year. In practice, smuggling growth accelerated and the outturn was lower than the previous year despite duty increases of over 8 per cent.

b) Beer, wine, cider and perry

The shortfall against forecast was entirely due to beer duty, as the other duties exceeded their forecasts. The Department expected a small increase of under 0.5 per cent in beer consumption with a corresponding small increase in receipts, but duty paid consumption actually fell in 1998-99.

c) Spirits

The forecast was based on the recent trend of declining whisky consumption. A further, small decline was forecast, though the duty was raised in line with inflation. In the event, whisky consumption recovered to some degree (by 1.6 per cent) and consumption of other spirits rose by 4.8 per cent.

d) Betting and gaming

The betting and gaming forecast allowed for a modest increase of less than 2 per cent in receipts, lower than consumer expenditure growth. In the event receipts were weak, especially for the lottery, and the outturn was lower than the previous year.

e) Insurance premium tax

This is a relatively new tax and the Department have only a short set of historical data upon which to build meaningful forecasts. In addition, 1998-99 was the first full year after a tax increase. Although car insurance premiums continued to rise, house insurance premiums have remained static.

f) Air Passenger Duty

There were some deficiencies in the forecasting equation. The one per cent growth in taxable passenger numbers included in the forecast proved to be too low, with 1998-99 showing an 8.2 per cent increase over 1997-98. (The increase in 1997-98 over 1996-97 was 9.7 per cent.) 1998-99 was the first full year of receipts at the increased duty rates.

g) Landfill tax

The revenue forecast for landfill tax was based on available data on quantities of waste disposed of at landfill before the introduction of the tax (which was known to be of limited reliability) and the limited data available since introduction. Outturn at £333 million was 11.7 per cent lower than the forecast.

h) Customs Duties

The outturn was 4.4 per cent higher than forecast as compared with 4.2 per cent lower than forecast in 1997-98. The forecasting equation is based on Treasury estimates of total imports. The composition of imports is difficult to determine, but its impact on forecasting is important because different types of import are treated differently under the various tariffs within customs duties.

Debt management

"To keep to a minimum the outstanding revenue debt of payment traders"

HM Customs and Excise Management Plan 1998-99, page 19.

Age analysis of outstanding VAT liability

48 The outstanding VAT liability at 31 March 1999 is set out in Figure 14. The total outstanding VAT liability increased by £59.9 million from £1,457 million at 31 March 1998, to £1,517 million at 31 March 1999.

Outstanding VAT liability[1]

Figure 14

	Total debt		**Debt over six months**	
	March 1998 £m	**March 1999 £m**	**March 1998 £m**	**March 1999 £m**
Insolvent	5.1	4.8	3.4	3.2
Missing	68.3	50.1	43.3	35.2
De-registered	155.7	145.3	114.2	103.2
Repayment	112.2	106.2	39.7	21.9
Civil recovery	93.5	92.0	41.2	42.0
Time-to-pay	60.4	74.3	13.9	14.1
Manual control	177.1	160.4	120.8	73.4
Local office	520.8	491.1	170.1	167.8
Other[2]	755.6	392.6	4.4	12.5
Less: adjustments[3]	(491.8)			
Totals	**£1,456.9m**	**£1,516.8m**	**£551.0m**	**£473.3m**
Percentage over 6 months			**37.8%**	**31.2%**

(1) Figures exclude penalties and interest.

(2) The "Other" category largely consists of the current liability of traders who settle their account with HM Customs and Excise through the bank by credit transfer.

(3) The adjustment for the March 1998 figures reflects the timing differences between recording the liabilities and the accompanying payments. For March 1999, this adjustment has been allocated to the relevant categories of debt.

Source: HM Customs and Excise

49 Total debts over six months' old decreased by 14.1 per cent from £551.0 million at 31 March 1998 to £473.3 million at 31 March 1999. The largest movement was in the category of 'manual control' debt, which decreased by £47.4 million on the March 1998 figure. A major factor in the decrease of debt in this category was the withdrawal of a £45.1 million assessment in May 1998.

50 The age of the outstanding liabilities shown in Figure 14 is not determined by the length of time in the categories shown, but according to when the liability arose. The age profile of outstanding VAT liability can be influenced by significant individual cases. For example, on 31 March 1999:

- two outstanding liabilities totalling £9.4 million were associated with an ongoing appeal case;
- one outstanding liability of £18.9 million relates to an investigation and criminal prosecution case; and
- one liability of £1.4 million arose as a result of an investigation, where the trader was convicted and is still in prison. Administrators are currently considering the liquidation of the trader's assets.

51 The National Audit Office examined a sample of 40 cases totalling £145 million of which £136 million related to liabilities that had been outstanding for longer than six months. Thirty-four cases were fully satisfactory and showed that the reasons for the age of the outstanding debt were valid because, for example, they were under appeal or the subject of an investigation. Of the remaining six cases:

- Liabilities in four cases, totalling £48.2 million, were not arrears of VAT but rather repayments made by the Department. In three of the cases, the necessary documentation underlying these repayments had not been processed as the full claims were still under negotiation in the Tribunal system. The fourth case related to an early repayment of input VAT.
- In one case, the liability of £0.7 million was due to the trader erroneously rendering a duplicate return on deregistration.
- One case involving £1.7 million showed that the debt should have been offset against another registration.

Performance measure

52 The Department measure debt management performance with their national arrears indicator. This states the average month-end debt as a percentage of payment traders' liabilities for the 12 month period. The results for the last three years are set out in Figure 15. In the previous two years, when the measure related only to VAT and Insurance Premium Tax, the Department exceeded the target by 0.1 percentage points. In 1998-99, when the measure included VAT, Insurance Premium Tax and Landfill Tax, they matched the target.

National arrears indicator

Figure 15

	1996-97	1997-98	1998-99
Average month-end arrears as a percentage of annual liability declared by payment traders	2.2%	1.9%	2.0%
Target(1)	2.3%	2.0%	2.0%

(1) Both the target and outturn figures for 1996-97 and 1997-98 include VAT and Insurance Premium Tax. The 1998-99 figures include VAT, Insurance Premium Tax and Landfill Tax. Landfill tax represents approximately 0.5% of the average month and arrears.

Source: HM Customs and Excise

53 The current performance measure uses information from the mainframe general ledger, and as such, cannot be allocated to individual Collections to permit detailed analyses of their performance. From 1 April 1999, however, the Department are using data held on the local debt management systems to calculate the VAT arrears element of the performance measure. This will enable individual analysis and the results will be combined for the national measure.

54 The target for 1999-2000 will be reduced to 1.2 per cent to take account of the lower outstanding debt figures shown on the local debt management systems. In addition, the performance measure will be extended to include VAT, Insurance Premium Tax, Landfill Tax, Air Passenger Duty, Beer Duty and Wine, Cider and Perry Duty.

55 Two further supporting measures trialled during 1998-99 will also be introduced from 1 April 1999. These are:

- to discharge 96 per cent of debt advised; and

- to review suspended debt on a monthly basis.

The Large Payers Unit

56 The centralised Large Payers Unit, which is responsible for ensuring the timely payment of amounts owing from large payers, have reviewed their risk criteria and are now proactively targeting the more non-compliant traders under their control. Large payers are those traders whose individual net VAT liability over a 12 month period exceeds £300,000. For 1999-2000, in accordance with the Department's whole business approach, the management of large payers has been expanded to include other tax regimes. Trials of the whole business approach, covering Insurance Premium Tax and Landfill Tax, are underway and results of the initial systems' set up are expected by March 2000. Benefits of this approach will be evaluated throughout 2000-01, with a final evaluation at the end of the year.

57 The number of large payers has increased from approximately 13,000 in 1997-98 to 14,300 in 1998-99, and is estimated to reach 15,000 in 1999-2000. Of the 14,300 large payers in 1998-99, approximately 3,400 are payment on account traders, each of whose total VAT liability exceeds £2 million in any twelve month period. They contributed £31,510 million of VAT during 1998-99, which equates to 73 per cent of the total VAT liability due from large payers, or 60 per cent of the total VAT outturn.

58 Throughout 1998-99, a total of £42,920 million was due from large payers. The Large Payers Unit has a published target of collecting 95 per cent of the tax due from large payers by the due date, and a supplementary target of less than one per cent of the tax to remain outstanding by the due date plus 30 days. The results for the current year exceeded the targets, but showed a slight decrease on 1997-98: 95.78 per cent of the tax due was recovered by the due date (95.81 per cent in 1997-98) and 0.26 per cent of the debt was older than 30 days (0.06 per cent in 1997-98). These results were achieved, despite the increase in the number of traders monitored, by further efficiencies achieved through the review of working practices and continuing improvement of the computer systems.

Local debt management units

59 When a VAT liability is overdue, it is notified to one of the 28 local Debt Management Units. Debts arising from traders under the control of the Large Payers Unit are also notified to local Debt Management Units, if initial contact by the Large Payers Unit does not recover the debt. The amount of debt managed by local Debt Management Units during the last four years is set out in Figure 16.

60 In October 1998, the Department made improvements to the way that VAT debts are advised to local Debt Management Units. Debts which were previously under manual control because, for example, they were under appeal, are now advised electronically to the Debt Management Units. These changes have contributed to the increase in value of debt managed by the Debt Management Units during the year from £3,031 million in 1997-98 to £3,413 million in 1998-99.

61 At the end of 1998-99 the debt on hand in local Debt Management Units, as a percentage of the debt managed, remained relatively stable at 21.7 per cent (1997-98: 21.8 per cent). This was achieved despite an increase of £382 million (12.6 per cent) in the amount of debt managed by the Debt Management Units during this period.

Debts under local Debt Management Unit control(1)

Figure 16

	Debt on hand at 31 March				Total debt managed during the year	Debt on hand at 31 March as a percentage of debt managed during the year(2)
	Enforceable debt	Time-to-pay	Unenforce-able debt	Total		
Year	£m	£m	£m	£m	£m	%
1995-96	343	86	181	610	2,903	21.0
1996-97	382	75	186	643	3,181	20.2
1997-98	391	81	190	662	3,031	21.8
1998-99	445	84	212(3)	741	3,413	21.7

(1) Debts under local control include outstanding penalties and interest.
(2) The total debt managed each year by the Debt Management units was calculated by adding the total debt advised during the year to the debt carried forward from the previous year.
(3) See analysis in Figure 17.

Source: HM Customs and Excise

62 Of the £741 million debt under the control of local Debt Management Units at 31 March 1999, £84 million (or 11.3 per cent) was subject to time-to-pay arrangements. The Department will consider time-to-pay applications from traders who are experiencing genuine short-term difficulties. The length of these arrangements will depend on the individual circumstances of the case. Debt Management Units are encouraged to keep time-to-pay agreements short so that those given this facility do not gain a commercial advantage over those businesses which pay taxes on time. In the course of the 1998-99 audit, the National Audit Office examined a sample of 50 time-to-pay cases. They found in only one of the cases that instalment payments could have been pursued at an earlier stage.

63 In some circumstances it may be inappropriate to pursue recovery action on an outstanding debt for a period of time – for example, when it is under appeal. In previous years, some unenforceable cases were not being advised promptly to Debt Management Units, and the Department found that as a result, not all debts were being monitored effectively. This led to the change whereby all debt is now automatically notified to the Debt Management Units, whether enforceable or not, so as to improve the control over outstanding liabilities

64 Figure 16 shows that £212 million (or 28.6 per cent of debt on hand at Debt Management Units at 31 March 1999) was considered unenforceable. Figure 17 shows that of the total unenforceable debt:

a) 52 per cent related to assessments and penalties which were under review - debt collection is normally suspended until the trader either agrees to the assessment, or submits a return for a different amount, which must then be agreed by the Department; and

b) missing traders accounted for 21 per cent of unenforceable debt, a decline of 6 percentage points from 27 per cent at 31 March 1998 – unless the trader is located, the debt will have to be written off.

c) 'other' debts increased by 7 percentage points from 11 per cent at 31 March 1998 to 18 per cent at 31 March 1999. This is due to an increase of £5 million in debt where insolvency cases are being processed, and a £13.5 million increase in debt that is under investigation.

Analysis of unenforceable debt at 31 March 1999

Figure 17

	Value £m		**Percentage of unenforceable debt (%)**	
Reason	**March 1998**	**March 1999**	**March 1998**	**March 1999**
Assessments and penalties under review	101	111	53	52
Missing traders	51	45	27	21
Disputed debts	17	18	9	9
Other	21	38	11	18
Total	**190**	**212**	**100**	**100**

Source: HM Customs and Excise

Write-offs and remissions

65 Write-offs arise when the Department considers that a debt, although collectable, is unlikely to be recovered. Remissions arise where the Department make a decision, on the grounds of equity or compassion, not to recover tax due or to refund the trader where a charge has been made. Every case is considered on its merits. During the 1998 calendar year, the overall value of write-offs and remissions was £631.3 million, an increase of 20.6 per cent on the previous year (Figure 18). The number of VAT write-off cases increased from some 115,000 in 1997 to 118,000 in 1998.

Analysis of write-offs and remissions

Figure 18

	1996 £m	**1997 £m**	**1998 £m**
VAT write-offs	**465.9**	**472.5**	**571.8**
■ Insolvent traders	429.6	439.6	526.6
■ Missing traders	22.7	19.2	23.4
■ Other	13.6	13.7	21.8
Customs and other duties write-offs	**2.1**	**3.0**	**3.4**
Penalties and costs write-offs	**38.3**	**39.7**	**50.5**
Remissions	**9.7**	**8.2**	**5.6**
■ VAT	6.5	4.7	4.7
■ Other duties	2.7	3.2	0.7
■ Penalties and costs	0.5	0.3	0.2
Total	**£516.0m**	**£523.4m**	**£631.3m**

Source: HM Customs and Excise

Write-offs

66 Insolvent traders accounted for 92.1 per cent of VAT write-offs in 1998, compared with 93.0 per cent in 1997. Write-offs due to insolvency gave rise to £87 million of the £99 million increase in VAT write-offs during the current year. The Department are currently investigating the reasons for the increase in the amount written off due to insolvency. The increase in penalties written off is discussed in paragraph 116 below.

67 The Department are informed by Insolvency Practitioners when a trader is insolvent. Local Insolvency Units check this information before the debt is written off. Any money relating to that debt and collected following removal of the debt from the VAT mainframe is credited to an account known as "further recovery after write-off". Further recovery after write-off from insolvencies amounted to £42 million in 1997-98 with a further £43 million recovered in 1998-99, due to the Department's continued efforts to chase outstanding debts from insolvent traders.

Remissions

68 In 1998 the value of remissions leading to loss of revenue decreased by £2.6 million to £5.6 million. The total number of remissions decreased by 31, from 245 in 1997 to 214 in 1998. Of this total, 45 VAT remissions with a value of £11.9 million (35 in 1997, valued at £4.9 million) led to no actual loss of revenue because output tax, if recovered by the trader, would have been matched by input tax recovered by the customer.

69 Of the 169 cases that led to loss of revenue in 1998, 99 were caused by the mistakes of individual officials (103 out of 210 in 1997). The total value of these remissions was £2.5 million (1997: £1.8 million). In all cases involving official error, line managers are required to consider whether the error or negligence appears serious enough to require disciplinary action. In 1997, action was taken against officials in three cases totalling £93,000. In 1998, in one case with a value of £14,000, the officer involved was the subject of a disciplinary enquiry. In the remaining cases, disciplinary action against individual officers was deemed inappropriate.

70 The decrease in remissions for the current year is due almost totally to the £2.5 million reduction in 'Other duties'. Remissions under this category cover Excise duties, Air Passenger Duty, Insurance Premium Tax and Landfill Tax. The 1997 figure arose mainly due to the introduction of Landfill Tax and the initial problems faced by the Department in issuing the large requests for Contaminated Land Exemption Certificates within the 30-day target. These certificates are given in respect of waste arising from the clearance of land contaminated by past industrial or other activity, which may be exempt from the tax. Some traders paid Landfill Tax when they should not have done so, and the taxes were subsequently remitted. This situation has now been rectified and is reflected in the 1998 figure of £0.7 million. In addition, an exceptional excise case amounting to £0.9 million in 1997 aided in distorting the prior year figures.

Securing the revenue yield

Large Traders

71 The Department set up a joint working group to take forward the recommendations made by the Comptroller and Auditor General in his report 'HM Customs and Excise: Checking Large Traders' VAT Liability', which was published in March 1997. The joint working group's recommendations were issued in January 1998, and were trialled from 1 April 1998. The three main issues reported on were:

- measuring the success of large trader work;
- the identification of risks and the allocation of resources; and
- the conduct of large trader audit work.

Large traders are those who present a high concentration of risks to the revenue because of the high amounts of VAT passing through their systems and/or the complexity both of those systems and of the companies' trading activities.

72 VAT receipts from large traders decreased from 34.5 per cent of the total VAT collected in 1995-96 to 29.3 per cent in 1998-99. The Department have investigated the reasons for the continuing downward trend and have identified a number of sectoral and legislative influences. An example has been the contracting out of local authority services to private companies. This has significantly reduced the local authority VAT liability while increasing the proportion of VAT paid by smaller businesses. This distorts the comparative yield between large and smaller businesses as they are currently defined by the Department.

73 During 1998-99, the Department trialled a measure for estimating in any one month the future revenue benefit of carrying out assurance work over the following twelve months. They calculated the net future revenue benefit for 1998-99 as £237 million, whereas the actual additional net revenue discovered as a result of assurance work in 1998-99 was £436 million. This measure, which the Department regard as fundamental to their assurance programme, is aimed at preventing future revenue loss.

74 In line with the Committee of Public Accounts' wish to see better estimation of revenue flows to provide a basis for more meaningful monitoring and measurement of performance, the Department started a project to analyse the trends in tax payments by large payers. The initial analysis concentrated on particular trader characteristics – for example, retailers that had caused concern because of reported falls in sales, traders that also make payments of excise duty and traders that have the highest net VAT yield. In looking at the major excise sectors, the aim was to see whether the Department could establish a link between excise payments and VAT payments. This sectoral analysis is still in its early stages, and the Department should obtain increased benefits as the data series builds up over time and better analyses of trends become possible.

75 The National Audit Office concluded, in their report on VAT large traders, that there were some variations between Collections in the resources deployed on the audit of large traders assessed as presenting similar risks to revenue. The joint working group reviewed the methods used by the local offices to deploy resources for the audit of large traders, and devised a new risk matrix with the objective of minimising inconsistencies between traders of similar risks. The risk matrix was completed for all large traders and, to identify additional traders that had not previously been classified as large traders, all other traders with an annual tax throughput of more than £7 million. Large traders were then ranked in risk order for each Collection and resources were then allocated accordingly.

76 The Department have created specialist units in most Collections, which are responsible for visits to large traders. A centralised Large Business Unit has been set up, which is responsible for setting national assurance policies and ensuring consistent treatment of large traders across the country. A whole business approach for Large Businesses, which will enable assurance activity to be performed jointly on all taxes and duties, is due to be implemented from 1 April 2000. Assurance activity will initially be focused on the very largest businesses.

77 The Committee of Public Accounts were keen to ensure that new audit standards were fully understood by all large trader staff. From 1 April 1998, the changes in audit standards, including the requirement to document and test traders' systems and procedures, are covered in the audit and accountancy update courses run by the Department. In addition, the Department's Management Consultancy Services was used to identify any areas of concern in the monitoring of large VAT traders, including deficiencies in the guidance issued to staff. In our 1998-99 audit we found some deficiencies in the application of the Large Trader Audit Standard. Management attention was drawn to cases where there appeared to be a need for better use of a systems-based approach to auditing large traders and for additional planning documentation. The Department are undertaking a review of the Departmental Audit Standard to improve the guidance to staff.

VAT errors and irregularity

78 Figure 19 shows the value of net errors, analysed between voluntary declarations and those identified by officers, who made 194,000 visits to traders in 1998-99. In 1998-99, the Department identified average net errors (both net under-declarations and net over-declarations) over £500 in 48 per cent of risk based visits against a national target of 46 per cent. Only Anglia, Northern England and Southern England Collections failed to achieve the target.

VAT errors between 1996-97 and 1998-99

Figure 19

	1996-97 Actual £m	1997-98 Actual £m	1998-99 Actual £m
Voluntary disclosures			
Under-declarations	326	374	387
Over-declarations	695	660	1,022
Net voluntary disclosures	-369	-286	-635
Identified by Officers			
Under-declarations	2,160	1,964	2,064
Over-declarations	651	483	492
Net identified by officers	1,509	1,481	1,572
Counterbalancing errors[1]	560	380	433

Source: HM Customs and Excise

(1) Counterbalancing errors are errors where under-declarations equal over-declarations, and there is therefore no net revenue impact.

79 The value of voluntary over-declarations increased from £660 million in 1997-98 to £1,022 million in 1998-99. During the current year, the Department lost a judicial review on appeal to the Court of Appeal and repayments totalling £352 million were made to the trader. If this exceptional case is excluded from the comparison, the voluntary over-declarations for 1998-99 would be £670 million. This is more in line with the figure reported in the previous year.

80 In 1998-99, the Department used some 5,139 staff years on VAT and Insurance Premium Tax assurance work at a cost of approximately £165.5 million. Total under-declaration errors of £2,569 million were identified, giving a unit cost of 6.44 pence for each pound of under-declared tax. This compares with a unit cost of 6.61 pence in 1997-98 (adjusted to 1998-99 prices).

VAT fraud

81 The high priority frauds facing the Department include concerted actions to evade VAT, Intra-European Union frauds and frauds involving professions such as accountancy, the law and insolvency. Attacks on the system include repayment frauds, 'missing' trader frauds and bogus registrations. The Department have seen the involvement of criminal organisations in large scale VAT frauds, especially with regard to international and intra-European trade. These frauds have been mostly in the computer components and mobile phones sectors.

82 At present, the Department cannot estimate the national level of fraud. VAT Policy Directorate started considering possible ways of calculating this estimate, but work has been put on hold pending consideration of the various methodologies by the new Fraud and Intelligence Unit, which is taking over responsibility for fraud policy.

VAT avoidance

83 In 1996, a central VAT Avoidance unit was established in an attempt to reduce the impact of tax avoidance schemes on VAT revenue due. In July 1997, additional frontline resources were made available to provide specialist avoidance advice and investigation skills. These staff are deployed throughout the Collections.

84 The specialist avoidance staff are tasked with performing assurance visits as well as identifying and resolving avoidance schemes as they arise. Specialist avoidance officers spent a significant amount of time in the early stages publicising VAT avoidance issues, and the Department believe that there has been a marked increase in the awareness of these issues amongst general assurance staff. As a result, assurance staff are more likely to identify avoidance issues when conducting their visits.

85 The Department identified £142.7 million of VAT avoided during 1998-99 against a target of £100 to £125 million. There are no comparative figures as this was the first full year of operation.

Shadow Economy and Cash Teams

86 Shadow Economy teams are responsible for targeting unregistered traders who are trading above the VAT threshold. The aim is to ensure registration of these traders in line with the Government's objectives for a fair tax system that mean no sector or individual should bear an unfair burden, or enjoy unfair advantages. As part of the closer working initiative, HM Customs and Excise and Inland Revenue have established five joint Shadow Economy Teams, operating on a trial basis since 1 April 1998. As Figure 20 shows, the Shadow Economy teams exceeded the targets set for them. They were responsible for 3,843 new VAT registrations providing £34.3 million additional revenue. This indicates that the initiative has been successful and it is likely that more joint teams will be established in the future.

Performance Statistics for the Shadow Economy teams for 1998-99

Figure 20

Performance Measure	Target	Actual
New Registrations	3,510	3,843
Additional Revenue	£28.0 m	£34.3 m

Source: HM Customs and Excise

87 The Department have also established Cash teams to review high-risk, non-compliant registered traders' operations and activities in order to determine whether the turnover declared in their VAT returns is accurate. These businesses operate in the retail and service sectors for cash transactions, where there are greater opportunities for evasion. During 1998-99, the Cash teams raised additional assessments of £48 million. This contributes to the overall VAT assurance performance measures as there are no targets set specifically for the Cash teams.

88 In order to facilitate a more flexible approach to tackling problems of tax evasion in the cash economy, the Department are moving towards a more integrated deployment and management of the Shadow Economy and Cash teams. This allows the teams to provide a rapid, flexible response to new risks and trends as they arise. The teams also work closely with other agencies, including Inland Revenue, when there are common interests in undertaking the investigation.

Excise and Customs duties errors and irregularity

Risk-based visits

89 The total net errors identified from risk based visits amounted to £88.7 million in 1998-99. After capping exceptional cases at a set maximum value, so that reported results are not influenced by these exceptional values, the capped net errors for excise duties, identified from risk-based visits, was £49.3 million against a target of £52.0 million. Errors were capped based on individual duty capping limits, ranging from £200,000 to £2.5 million. This is a new measure of performance and so cannot be compared with the prior year's results. However, only eight Collections met their local targets, and Eastern England Collection only achieved 34 per cent of their target.

Import under-declarations

90 In 1998-99, the Department detected a total of import under-declarations amounting to £397 million. The total includes 6 exceptional cases totalling £163.7 million, ranging from £10.3 million to £77.3 million. The results reflect £229 million capped import under-declarations exceeding £500, compared with a target of £200 million. Cases have been capped at £2.5 million for the current year to remove the distorting effect of particularly large cases on reported performance. Analysis of the Collection results by the National Audit Office identified that all except three Collections met their targets, and two Collections exceeded their targets by significant amounts.

Alcohol and Tobacco Fraud Review

91 The report of the Alcohol and Tobacco Fraud Review, commissioned by the Chancellor of the Exchequer in his July 1997 Budget, was published as part of the outcome of the Comprehensive Spending Review in July 1998. The recommendations contained within the report amount to a package of measures to tackle alcohol and tobacco fraud and smuggling. The Department were allocated £35 million over the three financial years from 1999-2000 to implement the recommendations of the review. Money was also made available in 1998-99 so that an early start could be made on the implementation. This included allocating 145 additional staff, the majority of whom are front line anti-smuggling officers, to the main Channel ports by December 1998. The remainder were appointed to other ports and inland by April 1999.

92 In his 1999 Budget, the Chancellor emphasised that fraud and smuggling presented a serious threat to the Government's revenue objectives. The Department have been set a target of an increase of £80 million in the revenue value of detected alcohol and tobacco fraud by 31 March 2002. This is in addition to the separate target for the National Investigation Services detections of organised fraudsters. The Chancellor announced that he would appoint an independent evaluator to examine the way in which the issue of smuggling was being addressed. Martin Taylor, now Chairman of WH Smith, was appointed in August 1999. He has now given advice to the Chancellor, who is considering it.

Excise smuggling

93 In June 1999, the Department carried out a survey to provide estimates of the revenue evaded and revenue which would be lost in 1999 as a result of cross-Channel smuggling of excise goods. As in the previous survey in June 1998, the Department based the survey on a sample of passengers from a selection of ports on the south and east coasts. Each selected passenger was questioned on the volume of excise goods they were bringing into the United Kingdom and their vehicle and baggage was examined. Amounts identified as smuggled were translated into averages per passenger and analysed according to geographical location and mode of transport. These averages were then applied to total adult passenger numbers based on information obtained from the International Passenger Survey. Volumes of smuggled goods were then translated into annual estimated revenue losses. The results do not include any estimates for goods imported in freight or by air.

HM Customs & Excise' estimates of cross-Channel smuggling of excise goods[1]

Figure 21

	1998		1999	
Product	**Revenue evaded (Revised) £m**	**Revenue lost[2] (Revised) £m**	**Revenue evaded £m**	**Revenue lost[2] £m**
Alcoholic drinks	305	230	285	215
Tobacco and cigarettes	935	935	1,055	1,055
Total	**£1,240m**	**£1,165m**	**£1,340m**	**£1,270m**

(1) Figures have been rounded to the nearest £5 million. They exclude any amounts for revenue lost on alcohol and tobacco products smuggled in freight consignments.

(2) Revenue lost is the Department's estimate of the revenue that would have been collected in the United Kingdom, based on the assumption that between 70 per cent and 80 per cent of all alcohol, and 100 per cent of tobacco products, purchased abroad, substitutes for similar legitimate purchases on the home market.

Source: HM Customs and Excise

94 Figure 21 compares the 1999 figures for alcoholic drinks, tobacco and cigarettes with the 1998 figures which have been revised to take into account recent revisions to the International Passenger Survey. Taking this into account, the decrease in the estimate of revenue lost through alcohol smuggling is 7 per cent whilst revenue lost through tobacco smuggling is estimated to have increased by 13 per cent.

Cross-Channel excise smuggling – summary of detections and prosecutions

Figure 22a

	Total Detections	High value Detections	Prosecution cases
1997-98	**8,767**	**567**	**531**
1998-99	**7,546**	**393[2]**	**575**
Cumulative	**16,313**	**960**	**1,106**

Cross-Channel excise smuggling – cumulative detections and prosecutions 1997-98 and 1998-99

Figure 22b

Collection	Total Detections	High value Detections[2] Number	High value Detections[2] %	Prosecution cases[3] Number	Prosecution cases[3] Ratio to detections
South East England	**10,486**	**367**	**3.5%**	**434**	**1:24**
Scotland	878	83	9.5%	13	1:68
Northern England	684	65	9.5%	72	1:10
Eastern England	625	53	8.5%	60	1:10
Thames Valley	533	57	10.7%	54	1:10
Anglia	507	30	5.9%	51	1:10
Central England	608	61	10.0%	65	1:9
North West England	471	52	11.0%	57	1:8
Southern England	448	39	8.7%	68	1:7
Northern Ireland	206	14	6.8%	33	1:6
Wales & West Borders	261	39	14.9%	52	1:5
South London & Thames	354	78	22.0%	86	1:4
London Central	252	22	8.7%	61	1:4
Total Other Collections	**5,837**	**593**	**9.8%**	**672**	**1:9**
Total	**16,313**	**960**	**5.9**	**1,106**	**1:15**

(1) London Airports Collection is not included in the analysis.
(2) The threshold for reporting high-value detections has been raised from £10,000 in 1997-98 to £50,000 in 1998-99. It will be increased to £75,000 in 1999-2000.
(3) 'Number of prosecution cases' refers to cases coming before the Courts in the particular year. A prosecution case can involve more than one defendant and sometimes more than one detection. Most detections are of relatively small amounts and are dealt with by seizure only.

Source: HM Customs and Excise

95 In 1998-99, the Department detected excise revenue evaded amounting to £393 million compared with the target of £184 million. Included in the actual outturn figure is one exceptional case of £92 million, but even after excluding this from the analysis, the Department still exceeded target by 63 per cent. All but one

Collection (Northern Ireland) exceeded their local targets. This is the first year that the measure has been used, and we can therefore make no comparison with previous performance.

96 Figure 22 shows the cross-Channel excise smuggling detections made during 1998-99, as well as the number of prosecution cases undertaken. The Department made 7,546 detections amounting to £110.5 million during the year, with 389 being over £50,000. 575 cases were prosecuted by Excise Verification Officers in 1998-99. This was up by 44 cases on 1997-98 and illustrates the greater involvement of these officers in larger and more complex investigations into excise fraud.

IMPEX

97 Subject to proper approval and the production of the correct documentation, traders can legitimately store and move excise goods without payment of duty. If these 'duty suspended' goods are sent for export from the UK, or to another approved UK excise warehouse, then no duty is payable. Excise duties only become payable when the goods are sent for consumption on the home market. An initiative know as IMPEX was set up in 1996-97 to address the increasing fraudulent abuse of warehousing and transit arrangements for duty suspended goods.

98 During 1998-99, IMPEX teams detected £243.5 million of duty evaded (£238.2 million for alcohol and £5.3 million for tobacco) against a target of £85 million. This result reflects the increase in excise smuggling, as well as the success of using risk profiling to target the IMPEX effort.

99 As one of a range of measures to tackle alcohol and tobacco fraud, the Department are setting up a register of owners of goods in duty suspension. Legislation has been introduced requiring all warehouse keepers and owners of goods in duty suspension to be registered on a UK database. The database is referred to as ARIES (Approvals Risk Information for the Excise System) and was completed on 1 October 1999. The system will then be developed to capture information on all movements of duty suspended goods within and out from the UK based on documentation and computer records already maintained by traders. It is expected that this further capability will be introduced in April 2000. The final step in developing this system will be to incorporate a risk analysis function so that suspicious movements can be more easily targeted. This latter function is unlikely to be ready before the end of 2000.

100 To assist in the identification of suspect movements of goods throughout the European Union, a commitment has been made by delegates of the member states to the Excise Committee of the European Commission to put in place an early warning system by 1 April 2000. It is intended that the system, once in place, will identify suspect shipments at their point of origin and relaying this information to a co-ordination point within the country of destination who will commission appropriate assurance activity.

101 The early warning system is an interim measure prior to the development of an EU-wide computer system, known as the Excise Movement Control System (EMCS), to track all duty suspended excise goods movements. The system will not be ready for a number of years. The project is currently being scoped by Alcatel on behalf of the European Commission.

Drawback Claims

102 The Report on the 1997-98 Appropriation Accounts (HC I-XVI, 1998-99) highlighted the fact that the introduction of the IMPEX initiative led to a significant decrease in the levels of drawback claims on beer and cigarettes. Duty drawback is the process whereby, at the time the goods are due for export, the trader reclaims any duty that has previously been paid on them. Centralisation of the drawback processing centre in Glasgow, the resulting standardisation of documentation required from traders and the review process has ensured that these diminished levels of drawback on beer have been maintained. Levels of drawback claims from 1996-97 to 1998-99 are shown in Figure 23.

Drawback claims in 1996-97 to 1998-99

Figure 23

Duty	**1996-97 £m**	**1997-98 £m**	**1998-99 £m**
Hydrocarbon Oils	21.3	25.4	36.4
Wine/Made wine	13.3	16.5	22.9
Cigarettes	2.8	0.1	22.5
Beer	42.8	5.2	5.0
Cider & Perry	0.2	0.2	0.1
Spirits	11.6	6.8	8.7
Total	**£92.0m**	**£54.2m**	**£95.6m**

Source: HM Customs and Excise

103 £20.3 million of the increase in tobacco drawback relates to one tobacco manufacturer, who exported excess stocks of cigarettes which had been released in the false anticipation of an immediate increase in duty rates in the March 1998 Budget.

104 The Department believe the increase in Hydrocarbon Oils drawback claims arises from an improvement in the UK market for ultra low sulphur diesel, which attracts a lower rate of duty than conventional diesel. Producers have responded to this change in market conditions by exporting greater quantities of conventional diesel and reclaiming the duty on it. While the overall volume of diesel released for consumption has remained relatively steady at 18 billion litres, in 1998-99 ultra low sulphur diesel represented 21% of the total compared with only 5 per cent in 1997-98.

105 Levels of drawback claims for Wine and Made wine have again increased. This continues to be due to one large trader who operates a warehousing system whereby all goods that leave the warehouse are "duty paid". The trader then has to reclaim duty on all goods that are exported; it is believed that these goods are largely exported for sale within the EU. All of these claims have been dealt with in a single Collection. A comparison of drawback claims for wine in 1997-98 and 1998-99 illustrates this effect whilst also showing that the level of all other claims has remained stable (Figure 24).

Wine Drawback claims 1996-97 to 1998-99

Figure 24

	1996-97 £m	1997-98 £m	1998-99 £m
Collection concerned	5.3	12.3	18.9
All other Collections	8.0	4.2	4.0
Total	**£13.3m**	**£16.5m**	**£22.9m**

Source: HM Customs and Excise

Results of NIS investigations

106 One objective of the National Investigation Service fraud work is to identify weaknesses in the control regime which allows the fraud to be perpetrated, and to make recommendations for improving these controls. The total number of cases taken on by the National Investigation Service increased by 27 per cent from 178 in 1996-97 to 226 in 1998-99. This represents an 11 per cent increase in VAT cases and a 42 per cent increase in excise and customs cases. The National Audit Office have examined a sample of 40 of the 226 criminal fraud cases investigated by the National Investigation Service in 1998-99. In addition, we followed up 39 cases examined by us in 1997-98 and a further 39 cases from 1996-97. The examination was carried out through a questionnaire sent to the senior officer involved in each case, and the responses are analysed in Figure 25.

107 From our sample, we concluded that approximately two-thirds of investigations will be closed successfully, while almost one in five will be dropped. Over the past three years the Department have increased their efforts in obtaining custody of transgressors' assets. This occurred in over half of the VAT cases in 1998-99 (compared with one in twenty cases in 1996-97) and in 41 per cent of the excise and customs cases (compared with just over one-tenth of the 1996-97 cases).

108 Revenue evasion prevented is the measure used to indicate the value of the revenue that would have been lost had the fraud not been detected and stopped. It is based on the actual revenue evaded, which is then extrapolated across three years. This is an attempt to estimate the full revenue value of a fraud case, based on its average life-span. The average revenue evasion prevented per fiscal case in 1998-99 was £5.3 million for VAT (£9.9 million in 1996-97)and £9.6 million for excise and customs (£12.3 million in 1996-97). 26 non-fiscal excise and customs cases, such as cases involving pornography or the importation of other prohibited goods, are excluded from this average as they do not give rise to evaded revenue.

109 Figure 25 shows revenue evasion prevented for the three years 1996-97 to 1998-99. Of the £1,521 million reported for 1998-99, £496 million relates to VAT. Nine exceptional cases accounted for £416 million. The remaining cases contributed about £1 million each, which is consistent with both 1996-97 and 1997-98. Exceptional cases in those years totalled £762 million (2 cases) and £87 million (3 cases) respectively.

110 On excise and customs duties, 27 exceptional cases accounted for £387 million of the £1,025 million revenue evasion prevented in 1998-99, which compares with £351 million (23 cases) in 1996-97 and £1,315 million (33 cases) in 1997-98. The remaining cases increased to 79 in 1998-99, rising from 60 in 1996-97 and 63 in 1997-98. The average revenue evasion prevented in these cases was £2.4 million in 1998-99 (£1.9 million in 1996-97 and £2.1 million in 1997-98).

Results of NIS investigations from 1996-97 to 1998-99

Figure 25

	1996-97	1997-98	1998-99
Total number of cases	**178**	**202**	**226**
Revenue evasion prevented	**£1,978 million**	**£2,083 million**	**£1,521 million**
VAT			
Number of cases	**85**	**82**	**94**
Changes in controls:			
Recommended	(1)	38%	77%
Actioned	(1)	19%	8%
Custody of assets	5%	50%	69%
Funds recovered[3]	40%	44%	31%
Closed with punitive action	65%	50%	(2)
Awaiting trial	5%	19%	(2)
Dropped	20%	12%	(2)
Investigation ongoing	10%	19%	(2)
Excise and customs duties			
Number of cases	**93**	**120**	**132**
Changes in controls:			
Recommended	(1)	61%	44%
Actioned	(1)	48%	22%
Custody of assets	11%	57%	49%
Funds recovered[3]	53%	57%	30%
Closed with punitive action	63%	56%	(2)
Awaiting trial	11%	9%	(2)
Dropped	15%	22%	(2)
Investigation ongoing	11%	13%	(2)

Note: The above percentages are based on the sample of cases examined by the National Audit Office.

(1) The information on changes in controls for 1996-97 is not available.

(2) Due to the length of time needed for investigating and prosecuting cases, the majority of current year cases are ongoing and any data for 1998-99 is therefore not directly comparable with the previous years' figures.

(3) Due to the length of time involved in pursuing cases, funds will be recovered in years subsequent to the start of the case. Amounts are received net of allowable expenses such as receivers' costs.

Source: HM Customs and Excise

Penalties

111 In 1998-99, a total of £186.2 million worth of VAT sanctions were issued (Figure 26), reflecting an increase on 1997-98 of £16.1 million. Although penalties issued decreased by £3.4 million, surcharges increased by £9.6 million and interest £9.9 million.

Figure 26 **Value of VAT penalties, surchages and interest issued, paid and written off during 1997-98 and 1998-99**

	1997-98						1998-99				
	Opening Balance £m	Issued £m	Payable £m	Paid £m	Written off £m	Carried Forward(1) £m	Issued £m	Payable £m	Paid £m	Written off £m	Carried Forward(1) £m
Penalties	18	24	42	10	6	26	21	47	10	12	25
Surcharges	69	103	172	77	26	69	112	181	81	34	66
Interest	32	43	75	33	7	35	53	88	37	12	39
Totals	£119m	£170m	£289m	£120m	£39m	£130m	£186m	£316m	£128m	£58m	£130m
Percentage of payable amount				42%	13%	45%			41%	18%	41%

(1) The carried forward amount is collectable in the following year.

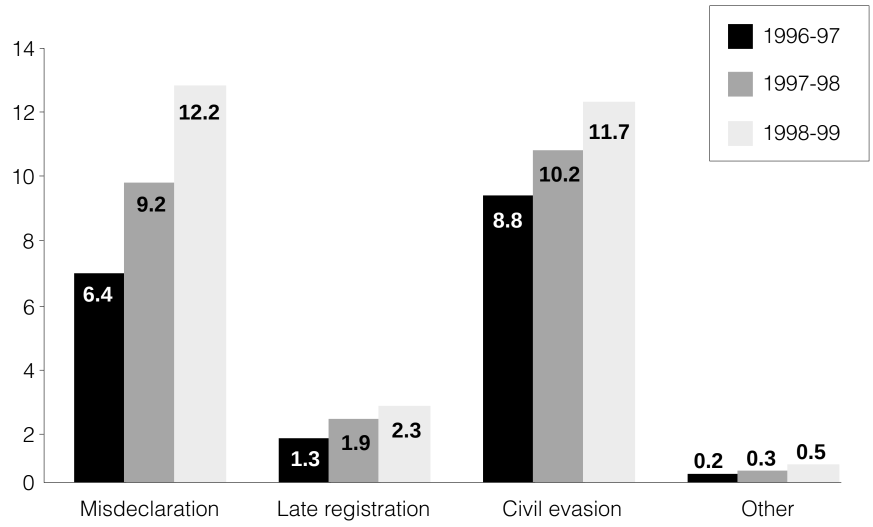
Source: HM Customs and Excise

112 The Department do not have details of recoverability and write-off for individual penalties due to system constraints, but overall totals are included in Figure 26. These show that, of the total sums payable during the year, 41 per cent were paid, 18 per cent were written off and 41 per cent were carried forward for payment in the following year. This compares with figures for 1997-98 of 42 per cent, 13 per cent and 45 per cent respectively.

113 Further information on the numbers and values of penalties issued between 1996-97 and 1998-99 is provided in Figure 27. Misdeclaration penalties, which are imposed when a trader under-declares tax on a VAT return, have continued to rise at approximately £3 million per year since 1996-97. This excludes one exceptional penalty, in 1997-98, of £6.7 million that was withdrawn during 1998-99 when the underlying assessment, on which it was based, was successfully appealed against by the trader. This exceptional penalty has been removed from the analysis to enable a more meaningful comparison to be made for the three years presented.

Type and value of penalties 1996-97 to 1998-99

Figure 27



Note: An exceptional misdeclaration penalty in 1997-98 of £6.7 million, which was rescinded on appeal in 1998-99, has been excluded from the figures so as to make the results more comparable.

Source: HM Customs and Excise

114 During 1998-99, the Large Payers Unit issued a total of 7,021 default surcharge liability notices, of which 4,927 were warnings that carried no immediate financial penalty. The remaining 2,094 had a penalty value of £21 million, which represents less than 0.05 per cent of VAT paid by large payers. On traders' requests for reconsideration due to reasonable excuses for late payment, the Department withdrew 2,003 of the total number of default notices issued, which included surcharge penalties to the value of £10 million. The National Audit Office tested a sample of cases and were satisfied that the surcharges were either paid by the trader or withdrawn for valid reasons.

115 The Department have found that civil penalties tend to be effective only when imposed on registered traders. As most smuggling is carried out by non-registered individuals, the Department have sought alternative forms of deterrence. For example, closer working with the Benefits Agency has allowed for the possible suspension of benefits for those unemployed people caught smuggling and a tougher policy on seizure and restoration of assets has targetted the disruption of smugglers' activities.

116 In addition, the Department has enlisted the aid of Camelot (the operator of the National Lottery) in limiting the trade in smuggled goods. Businesses selling smuggled alcohol and tobacco products will be disqualified from selling lottery products and thus lose the profit on lottery sales, as well as on other trade which is generated through the presence of a lottery terminal.

117 The Department currently has a project underway to identify the scope for a common system of charging interest on all outstanding debt, and the potential for convergence of penalty systems across all the Department's taxes and duties. Work on the project has slowed down. Convergence and standardisation will require extensive changes to be made to existing systems and, with a number of other high-priority projects currently underway, resources to make such changes will not be available in the short to medium term

Inland Revenue: Administration

118 The examination of the Inland Revenue under Section 2 of the Exchequer and Audit Departments Act 1921 was designed to obtain assurance that the Department had established adequate regulation and procedure to secure an effective check over revenue and that tax systems continued to operate effectively. In addition to direct examination of the Department's information technology installations, selected tax systems and individual transactions and balances, the National Audit Office also drew assurance from a number of other sources, including the work of the Department's Internal Audit Office, its Security Unit, and its quality monitoring teams.

119 This report sets out the key issues arising from our examination of the Inland Revenue in 1998-99. These include:

- progress on the collection of taxes and duties (paragraphs 120 to 123);
- the accuracy of work on pay as you earn (PAYE) (paragraphs 124 to 129);
- progress on income tax self assessment (paragraphs 130 to 156);
- the introduction of self assessment for corporation tax (paragraphs 157 to 184); and
- the operation of the experimental call centre at East Kilbride, introduced in response to the Modernising Government initiative (paragraphs 185 to 206).

Tax receipts and administrative costs

120 Figure 28 shows the net receipts from the taxes and duties collected by the Inland Revenue in 1998-99 and the cost of collection, compared with previous years.

Inland Revenue: tax receipts and administrative costs 1994-95 to 1998-99

Figure 28

	Net Receipts[1]					Administrative Costs[2]
	1994-95 £ billion	**1995-96 £ billion**	**1996-97 £ billion**	**1997-98 £ billion**	**1998-99 £ billion**	**1998-99 percent**
Income tax	63.1	68.1	69.1	76.8	86.6	1.64
Corporation tax	19.4	23.6	27.8	30.4	30.0	0.71
Capital gains tax	0.9	0.8	1.1	1.5	2.0	1.61
Inheritance tax	1.4	1.5	1.5	1.7	1.8	1.57
Stamp duties	1.8	2.0	2.5	3.4	4.6	0.13
Petroleum revenue tax	0.7	0.9	1.7	1.0	0.5	0.64
Windfall tax[3]	-	-	-	2.6	2.6	-
Total tax receipts (£ billion)	**87.3**	**96.9**	**103.7**	**117.4**	**128.1**	**1.33**
Cost of collection (£ billion)	**1.58**	**1.65**	**1.63**	**1.65**	**1.70**	
Cost as a % of tax collected	**1.81%**	**1.70%**	**1.57%**	**1.41%**	**1.33%**	

Notes: 1. These receipts are shown net after allowing for tax reliefs and allowances and for repayments. Repayments in 1998-99 were £14.7 billion. The receipts include interest and penalties.

2. The total administrative costs expressed as a percentage of net receipts of tax are broadly apportioned across the heads of duty.

3. The cost of administering the windfall tax was negligible in relation to the amount of tax collected.

Source: Inland Revenue Financial Statements (Cm 4477)

121 Net receipts of revenue were some £128 billion, 9 per cent higher than in 1997-98. The main increases over 1997-98 were £9.8 billion for income tax, £1.2 billion for stamp duties and £0.5 billion for capital gains tax. The increases were due to a variety of factors.

- PAYE receipts rose by some £5.7 billion (8.5 per cent), largely from the continued growth in earnings. The increase was tempered by an indexed rise in personal tax allowances.

- The abolition of the payment of dividend tax credits for pension funds and the life company pension business in the 1997 July budget led to a fall in income tax repayments of £2.4 billion (28 per cent) and a corresponding rise in net income tax receipts.

- Tax deducted at source from interest paid by banks and building societies rose by some £997 million (48 per cent) because interest rates in 1998-99 were higher than in the previous year. Changes in the timing of payments relating to tax deducted from interest by building societies de-mutualised in 1997-98 were also a factor.

- Capital gains tax receipts rose because the volume of share disposals increased by 12 per cent and equity prices grew by 20 per cent.

- The rise in equity values and an increased volume of share transactions, combined with the continued strength of the housing market and a rise in the rate of stamp duty on properties worth £250,000 or more, accounted for the significant rise in stamp duty receipts.

122 By contrast, there was a reduction of £500 million in the amount of petroleum revenue tax collected. This was due to a combination of lower oil prices in 1998 and a decline in production of oilfields liable to the tax.

123 In 1998-99, the Inland Revenue spent £1,702 million on the administration of the tax system. Administrative costs as a percentage of net receipts fell from 1.41 per cent in 1997-98 to 1.33 per cent in 1998-99, the lowest level since 1952-53, when it was 1.25 per cent. This continuing downward trend of the cost of collection in percentage terms mainly reflected higher tax yields but also the Inland Revenue's continued control of costs.

PAYE processing

124 To improve the quality of processing work in local offices the Department has put in place monitoring systems involving in-depth checks of all work done during the year on samples of non-self assessment PAYE tax cases. Sample selection, planning and coordination is carried out centrally, while fieldwork, which involves reperformance of the selected cases, is undertaken by quality monitoring officers selected from the Department's Regional Executive Offices. The tests for accuracy are stringent. A case will fail if there is a single error with a tax consequence even if that error has been subsequently corrected.

125 The quality monitoring exercise in 1998-99 indicated that, overall, local tax office staff handled 87.4 per cent of manually processed cases accurately in every respect first time. This exceeded the Department's target of 87 per cent. Figure 29 shows that the accuracy level achieved in the Department's Regional Executive

Offices which deal with PAYE ranged from 82.1 per cent to 90.4 per cent. Three Offices failed to meet their targets in 1998-99 compared with five in the previous year. The results of the quality monitoring exercise were validated by the Department's Internal Audit Office. We also accompanied quality monitoring officers on three visits to confirm that the work was performed to an acceptable standard.

Results of the Department's quality monitoring exercise on the accuracy of PAYE processing, excluding cases processed wholly by computer

Figure 29

Region	Target %	1997-98 Result %	+/-	Target %	1998-99 Result %	+/-	1999-2000 Target %
East	87	84.7	2.0	85	89.1	2.0	89
North	87	86.0	2.8	86	86.5	2.7	87
N Ireland	84	86.0	2.1	86	82.1	3.0	86
N West	89	87.7	2.5	88	86.7	1.8	88
Scotland	89	85.3	1.8	86	86.0	1.0	86
S East	88	89.6	2.8	90	88.4	1.7	90
S West	87	88.7	2.2	89	90.4	1.8	90
S Yorks	86	83.9	3.5	86	87.6	2.4	88
Wales & Mids	85	85.7	3.3	86	88.1	2.1	88
National weighted average	87	86.3	1.1	87	87.4	0.7	88

Note: 1. Results are accurate within a confidence interval of +/- the figure shown.

2. The Department's overall accuracy target for 1998-99, including cases processed wholly by computer was 95%. This target was met.

Source: Inland Revenue

126 Based on the results of the quality monitoring work for 1998-99, the Department estimated that PAYE taxpayers not covered by the self assessment system were in total overcharged by some £59 million and undercharged by some £80 million. Comparable figures for the previous year were £81 million and £87 million respectively. The net undercharge of £21million in 1998-99 represented approximately 0.03 per cent of the £72.7 billion collected through PAYE during the year.

127 The Department has analysed the results of the quality monitoring exercise and passed this analysis to its Regional Executive Offices, along with suggestions of how improvements in performance could be achieved. As in previous years, the most common errors were found to be in codings or assessments involving car and other benefits.

128 We also examined a separate sample of 75 PAYE taxpayer records to obtain assurance on the Department's management of other risks, such as the handling of receipts. We found that difficulties experienced with the introduction of the Contributions Agency's National Insurance Recording System had led to delays in processing end of year returns from employers of tax and national insurance contributions deducted from employees under the PAYE system in 1997-98. As a result, the Department had only been able to finalise the tax position of some 83 per cent of taxpayers by 31 March 1999, against a target of 88 per cent. These delays limited the Department's ability to provide an effective service to taxpayers and meant that any over- or under-payments of tax would remain uncorrected for longer than normal.

129 My separate report on the National Insurance Fund Account for 1998-99 will cover the Inland Revenue's progress in addressing the delays in implementing the new National Insurance Recording System.

Income tax self assessment

Introduction

130 Self assessment, which was introduced for tax years from 1996-97 onwards, affects around a third of the United Kingdom's 26 million taxpayers. These include the self-employed, partnerships and trusts as well as employed taxpayers with complex affairs. The Department issues tax returns annually on which taxpayers record their income and expenses for the year, together with any claims for allowances and tax already paid on income. The information on these returns then forms the basis for calculation of the tax due for the year. There is provision for tax to be paid in three instalments. Two payments on account are made ahead of calculation of the final liability, and the final balance is due on 31 January following the tax year, which is also the final date for submission of the completed return.

131 There are slightly different arrangements for those taxpayers with less than £1,000 tax due. Payments on account are not necessary, and employed taxpayers can have any additional tax collected through the PAYE system with the rest of their tax, by an adjustment to their tax code.

132 My reports on the accounts for 1996-97 and 1997-98 included reviews of the Inland Revenue's implementation of the self assessment system. This section of the report outlines the progress made in addressing some of the issues identified and reviews the quality monitoring process which has been introduced to assess the accuracy of processing of tax returns submitted.

Progress on previous issues

(i) Management Information

133 My report on the accounts for 1997-98 described the difficulties encountered by the Department in introducing the self assessment management information system. These difficulties were largely resolved during 1998-99, giving the Department more accurate and timely data on progress throughout its network of local tax offices, and a more accurate profile of the flow of returns from taxpayers throughout the year.

(ii) Statements of Account

134 The Department sends statements to self assessment taxpayers periodically showing the amount of tax due for the year, any payments on account made, the balance of tax outstanding, and any interest, penalties or surcharges incurred. I noted in my report on last year's account that the design of the statements of account had been criticised for not being user-friendly. Despite some changes being made, the statements had continued to be the subject of adverse comment from taxpayers and their professional advisers. The Department is continuing to make changes to the layout of statements which are intended to address the criticisms. The first of these changes was made on statements issued in December 1999. Further and more far-reaching changes to improve clarity and presentation are planned for June 2000. The Department will continue to monitor the impact of all these changes and is also considering more fundamental options for change, in consultation with representative bodies.

Processing tax returns

135 After logging the receipt of a self assessment return, Inland Revenue staff enter the data supplied by the taxpayer into the self assessment computer system, which calculates the individual's tax liability and any repayment or further balancing payment due.

136 To ensure that the right amount of tax is notified to the taxpayer, staff must perform a number of operations accurately and in accordance with the procedures laid down in manuals and desk instructions. As processing is carried out in more than 500 offices throughout the country, the Department needs assurance about the consistency of processing and decision-making. Inconsistencies may result in the wrong amount of tax being collected from taxpayers, or in unequal treatment of taxpayers with similar circumstances. Quality monitoring procedures, which compare the actions taken by staff in various locations with agreed standards and best practice, provide assurance that the Department's regulation and procedure are duly carried out, and if not, enable prompt remedial action to be taken.

Development and implementation of quality monitoring

137 In 1998-99, the Inland Revenue piloted a system of quality monitoring for self assessment processing work, which was designed to produce reliable statistics at a national level. To achieve this, the Department selected two members of staff from each of its ten Regional Executive Offices, who were familiar with the self assessment processing routines, and trained them as quality monitoring officers. They then reviewed the returns received from a centrally selected nationwide sample of 3,400 taxpayers, comparing the processing work carried out in individual network offices against fifteen predefined quality criteria (see Figure 30).

Criteria used by quality monitoring officers when reviewing the processing work carried out in individual offices

Figure 30

1. Was receipt of the return logged on to the computer system in sufficient time to ensure correct penalty action taken, if appropriate?
2. Was the return input for the correct taxpayer for the correct year?
3. Was all numerical information captured correctly?
4. Were any repairs (corrections) determined accurately, in accordance with the information available?
5. Were all repairs (corrections) made in accordance with official guidance, and were there any additional items which should have been repaired?
6. Was non-tax information included on the return input to the computer system correctly?
7. Were any taxpayer amendments received actioned correctly?
8. If a repayment was due, was it dealt with in accordance with the taxpayer's wishes?
9. If the taxpayer asked the Department to adjust the payment on account, was the request actioned timeously and correctly?
10. If the computer system highlighted the need for the PAYE code to be checked, was the correct action taken?
11. If a balancing payment for less than £1,000 was due, and should have been collected by amending the taxpayer's PAYE code, was this dealt with correctly?
12. Did the current year PAYE coding correctly reflect all the information provided by the taxpayer?
13. Did the coding for the subsequent year correctly reflect all the information provided by the taxpayer?
14. Did the self assessment record correctly identify the type of return and supplementary pages required for the taxpayer?
15. Were the self assessment and PAYE records for the taxpayer updated accurately in respect of the personal and business details notified?

138 In order to provide assurance on the validity of the results, the Inland Revenue's Internal Audit Office reperformed the work carried out on more than 600 of the returns selected for the quality monitoring exercise and compared their own marks with those given by quality monitoring officers. We examined the validation programme carried out by the Internal Audit Office by reviewing the methodology adopted and the analysis of the results. We concluded that the quality monitoring process was comprehensive and robust, and should provide a reliable measure of the quality of work performed in network offices.

Quality monitoring results

139 The key points to emerge from the quality monitoring exercise were:

- over 99.8 per cent of returns were logged on the correct date, for the correct taxpayer and the correct year;
- 94 per cent of returns had been logged and input to the computer system without any errors that would affect the tax liability for 1997-98 by more than £1;
- around 92 per cent of repairs (corrections) made by Inland Revenue staff in order to correct obvious errors in the information declared on returns were appropriate;
- repayments due had been actioned in accordance with the taxpayer's wishes in 91 per cent of cases;
- the treatment of claims to adjust payments on account was correct in 80 per cent of cases; and
- overall, information affecting PAYE tax codes for both current and subsequent years was processed accurately in 65 per cent of cases; within this criterion, the amendment of PAYE tax codes to collect balancing payments was dealt with correctly in 73 per cent of cases.

The Department told us that any resultant over- or under-payment of tax arising from errors in the processing of information affecting PAYE tax codes should be corrected automatically when taxpayers filed their next tax return and would be reflected in their next statement of account.

Action taken by the Department

140 The results of the quality monitoring exercise were collated by the Department's Business Operations Division. Action has been taken centrally to determine the cause of processing errors and to identify corrective measures. For example, in the case of errors in setting PAYE tax codes, which could lead to an over- or under-recovery of tax in subsequent years and the need for further adjustments, the Department is examining the manual processing arrangements and the computerised checks on the integrity of codings to assess the scope for changes to improve the accuracy of operations. The Department also circulated an analysis of the overall results to its Regional Executive Offices, along with suggestions on how improvements in performance could be achieved.

141 In contrast to quality monitoring for PAYE (paragraphs 124 to 129 above), the sample selected provided a statistically valid result for processing accuracy at national level but was not large enough to provide a statistically valid result at Regional Executive Office level. A quality monitoring exercise which would provide such an analysis at a regional level would require a sample size of around 16,000 taxpayers, rather than the 3,400 included in the sample for 1998-99.

142 The Department told us that extending the national quality monitoring work would require significant additional resources to extract a representative sample and to carry out the check, and that the larger sample might not necessarily provide any better management information about the nature or type of errors made. It had, however, instructed processing offices to select and check small local random samples of tax returns in September 1999 and January 2000. These arrangements would provide assurance to Regional Directors that appropriate standards were being maintained. The process would help establish why errors were occurring and would enable prompt remedial action to be taken. These arrangements, which will continue as part of a national quality assurance package to be launched in March 2000, while not providing statistically valid results with which regional performance could be compared, would, nevertheless, provide results which were useful at the local level.

Accuracy target for processing 1998-99 returns

143 On the basis of its pilot quality monitoring exercise, the Department has set an overall processing accuracy target of 77 per cent for 1999-00. Success in meeting this target will be assessed through quality monitoring reviews, using the process piloted and validated during 1998-99. The overall accuracy target of 77 per cent has been set on the basis of the accuracy achieved in processing 1997-98 tax returns, which, for the relevant criteria, was 73.5%.

144 We asked the Department whether there would be benefit in setting separate targets to encourage staff to focus on raising standards in areas shown to be prone to error, while maintaining high levels of accuracy in other areas. The Department told us that it needed to be mindful of setting too high a number of targets which might dilute and dissipate effort. It had therefore set a higher overall target for self assessment processing accuracy which could only be achieved by offices concentrating on improving aspects prone to error. In addition, it was looking centrally at processes to improve accuracy and focusing additional training resources into those areas where staff made most errors. The national quality assurance package, to be launched in March 2000, would assist offices with the detection of errors and identification of training needs and so help to improve the quality of work being done.

Activities to combat non-compliance

145 Under self assessment, non-compliant taxpayers are targeted through enquiry procedures which normally allow the Department to enquire into the information underlying any return submitted for a period of 12 months from the 31 January filing date.

146 For businesses, there are two categories of enquiry.

- A **full enquiry**, which examines all aspects of a return and includes a review of the underlying records, where appropriate.

- An **aspect enquiry**, which examines particular entries on the return from a technical viewpoint, and may result in adjustments being made to those items. An aspect enquiry will not normally require a review of all the supporting books and records.

147 The Department does not have the resources to enquire into all self assessment returns, nor indeed would it be cost effective to do so. Enquiries are therefore carried out on a sample of cases, which are selected by three main methods.

- A random sample of returns is selected centrally each year. Staff in local tax offices are required to open full enquiries into these cases when the completed returns are received.

- Specific types of income or relief, which are deemed to be high risk, lead to the return being automatically listed for mandatory review to assess whether an inquiry should be opened.

- An automated risk assessment system has been developed to assist staff in the selection of other suitable cases for enquiry. The system assesses the degree of risk associated with each return, based on predetermined criteria. Staff then review the output from this system to identify specific cases worthy of enquiry.

148 This more formalised approach to the risk assessment of taxpayer returns is intended to promote greater consistency in case selection across the country. With the exception of the randomly selected cases, the new arrangements are intended to ensure that available compliance resources are focused on areas of higher risk. The main objective of the random programme is to provide coverage across the whole population and a deterrent to non-compliance in that everyone submitting a return has a chance of their return being subject to an enquiry. It should also allow the Department to improve its risk targeting by providing an indication of the overall level of non-compliance in the taxpayer population and the potential amount of tax at risk.

149 For 1998-99 the Department set targets for the number of business enquiries to be initiated. For full enquiries the target was 1.3 per cent of returns received while for aspect enquiries the target was 2.5 per cent of returns received. The Department did not set a target for the number of non- business enquiries to be initiated although it set an indicative level of the number of cases which it expected to be selected for enquiry.

150 Figure 31 shows the national level of enquiries initiated in 1998-99. While the targets for business enquiries were largely met, the number of non-business cases opened was substantially less than forecast. As the Department had only set an indicative figure for non-business cases, these enquiry cases were not accorded the same level of priority as cases where targets had been set.

Self assessment enquiry work 1998-99

Figure 31

Type of enquiry	Forecast number of cases	Number of cases opened	% of forecast achieved	Tax yield from cases closed £m
Business - aspect	82,000	77,500	94.6	73.1
Business - full	43,500	43,700	100.5	24.6
Total Business	125,500	121,200	96.6	97.7
Non-business	608,325	247,900	40.8	81.0

Source: Inland Revenue

151 The estimated additional tax yield from enquiries closed during 1998-99 was £179 million. The Department told me that it was not yet in a position to draw firm conclusions on yield as it had not completed all the enquiries opened in the first year of self assessment. It was monitoring a number of indicators, including yield, on compliance performance, and would modify its targeting, as necessary.

152 The Department also selected a random sample of over 6,000 returns. As noted at paragraph 148 above, one of the purposes of this exercise is to obtain an indication of the likely overall level of non-compliance in the taxpayer population and the potential amount of tax at risk. At the time of our examination, the Department had not completed all its random inquiries; we shall therefore examine the results of this work in our future programme.

153 The Department has developed a national quality programme for self assessment enquiries, and has set a target of 85 per cent of work in compliance cases to be carried out to a “satisfactory” standard, or better. A validation programme, to ensure consistency of marking across the country, has been introduced, and has been reviewed by the Department’s Internal Audit Office, who concluded that the process is working satisfactorily. A marking of 84 per cent was achieved, narrowly missing the target.

Conclusions

154 We endorse the Department’s work to develop and implement quality monitoring for self assessment processing. It provided important management information about the accuracy of processing self assessment tax returns in 1998-99. The work also identified areas where accuracy could be improved, such as the amendment of PAYE tax codes to recover underpayments and to reflect information provided by the taxpayer on the return.

155 Under the new arrangements for self assessment, which adopts a "process now – check later" approach, tax returns are not subject to such detailed checks on receipt as was previously the case. The compliance programme for self assessment is therefore fundamental to the success of the system and it is important that compliance resources are targeted to best effect.

156 Our initial review of the system suggests that the framework which has been put in place should help focus attention on the perceived areas of higher risk, while monitoring the overall level of non-compliance by investigating a random sample of returns. The Department aims to validate its approach by monitoring the impact and efficiency of compliance work on a regular basis, and intends to use the results of this work to inform its targeting structure.

Implementation of corporation tax self assessment

Introduction

157 In November 1997, the Chancellor of the Exchequer announced that self assessment for corporation tax would come into effect in respect of all company accounting periods ending on or after 1 July 1999. Other reforms, including the introduction of a revised system for corporation tax payments, under which large companies would pay their tax in quarterly instalments, were announced at the same time.

158 The Department's objectives for self assessment, which is central to its change programme, are to increase taxpayer understanding and compliance, to improve the flow of funds to the Exchequer and to produce cost and resource savings. In the case of corporation tax, however, the existing system - pay and file - had already delivered much of the streamlining of processes and greater use of information technology which self assessment has brought to income tax work. So the introduction of self assessment for companies has not required major organisational changes within the Department, and will not lead to significant savings in the cost of administering corporation tax.

159 Nevertheless, the Inland Revenue expects a number of advantages to arise from the introduction of corporation tax self assessment, including:

- some further streamlining of processes, allowing them to take a more focused approach to compliance work, which may result in increased revenue yield;

- a closer similarity between the tax rules for incorporated and unincorporated businesses and between company tax and income tax, thus reducing the overall complexity of the tax regimes and the scope for avoidance;

- the disclosure in company self assessments of arms-length prices for international transactions; and

- improved cashflow to the Exchequer as a result of quarterly payments.

160 The legislation to support corporation tax self assessment was included in the Finance Acts of 1994 to 1996, along with that covering income tax self assessment. Following the Chancellor of the Exchequer's announcement in 1997, much of the original legislation was consolidated in the Finance Act 1998.

Key features of corporation tax self assessment

161 The Department estimated that implementation of corporation tax self assessment, together with the necessary computer support, would cost £36 million over the period 1996-97 to 2005-06 and would generate administrative savings of nearly £17 million over the same period. These savings largely relate to the costs which would otherwise have been incurred to upgrade the pay and file computer system. Although this system was introduced as recently as 1993, it was not Year 2000 compliant and its database and archive capacities were considered too small to last much beyond March 2000.

162 As corporation tax self assessment is an evolution of the current pay and file system, its impact will not be as significant as the introduction of income tax self assessment. Nevertheless, it will affect around one million taxpayers, including 40,000 public limited companies, 936,000 private limited companies and 54,000 clubs and unincorporated associations. These taxpayers account for corporation tax receipts of over £30 billion annually.

163 Companies will normally be required to calculate and pay the tax due for a specified accounting period within nine months of the end of the period, and to submit a return within 12 months of the end of the period. The return must include their self assessment of the tax liability for the period and the information necessary to support the return, for example accounts.

164 A flat rate penalty of £100 will be imposed if the return is submitted less than three months after the due date or £200 if the return is submitted later than that. These penalties will be increased to £500 and £1,000, where a company has also been in default in the previous two accounting periods. A tax-related penalty, equivalent to ten or twenty per cent of any unpaid tax liability, will be payable where the return is submitted later than 18 months or two years respectively.

165 A new feature of corporation tax self assessment affects companies with profits in excess of £1.5 million. These companies will have to estimate their current year tax liability and pay quarterly instalments based on that estimate. If a company subsequently realises that the quarterly instalments it has made are insufficient it will be allowed to make top-up payments and, if they were too large, to reclaim all or part of any instalment paid. Once a company has filed its tax return, interest will be calculated on any over or under payments, and penalties may also be charged if a company has deliberately underestimated its instalment payments.

166 Group payment arrangements have been introduced to help groups containing large companies to manage uncertainties over the amount of any individual company's tax liability. Although groups will still have to pay the right amount of tax at the right times, they will be able to estimate what is due for all the participating companies in the group rather than for each company individually. The arrangements will also mitigate the effect on a group of the differential interest rates on over and under-paid tax.

167 Although corporation tax self assessment maintains much of the pay and file framework and has considerable similarities to income tax self assessment, there are some differences. Figure 32 compares the main elements of the three systems and highlights the differences.

Figure 32 **Corporation tax self assessment : similarities and differences to pay and file and income tax self assessment**

	Corporation tax pay and file	Corporation tax self assessment	Income tax self assessment
Responsibility for submitting a return within the specified time rests with the taxpayer.	Yes	Yes	Yes
Penalties imposed for late submission of returns.	Yes	Yes	Yes
Responsibility for assessing tax liability passes to the taxpayer.	No[1]	Yes	Yes
Tax is chargeable for accounting periods, of not more than 12 months, the closing date of which is decided by the taxpayer.	Yes	Yes	No
A taxpayer can opt for Revenue calculation of their liability.	N/A	No	Yes
The Revenue has 12 months in which to open an enquiry into the return, and does not have to give reasons for its enquiries. Some cases will be selected at random.	No	Yes	Yes
The Revenue may require the production of documents and information, without reference to the Commissioners. Penalties may be imposed for failure to comply.	No	Yes	Yes
The taxpayer can ask the Commissioners to order the Revenue to close an enquiry.	No	Yes	Yes
The Revenue retain the right to make a discovery assessment if the self assessment is subsequently shown to be inadequate through negligence or fraud.	Yes	Yes	Yes
If no return is filed, the Revenue have the power to make a determination of the company's tax liability.	Yes[2]	Yes	Yes
There is a single fixed date for payment of tax - nine months after the end of the accounting period.	Yes	Yes	No
Surcharges will be imposed for late payment.	No	No	Yes
Interest is chargeable on any over or under payments.	Yes	Yes	Yes

Notes:
1. Pay and file requires a computation of the tax liability rather than a formal self assessment.
2. Under pay and file the determination takes the form of an estimated assessment.

Information technology support

168 In order to reduce costs, and to provide maximum continuity with pay and file, the Department's approach to introducing corporation tax self assessment has been one of minimum change, and the legislation, business design and computer support were all developed under this remit. The Department therefore rejected the options of supporting the new regime with the same information technology system used for income tax self assessment, or of developing an entirely new computer system, and decided instead to re-engineer and enhance the existing pay and file system, moving the processing on to a more modern, flexible hardware platform.

169 The re-engineered information technology system is called the Company Tax system (COTAX). It will support both the old pay and file and new corporation tax self assessment regimes, for appropriate accounting periods. New functions are also being introduced allowing the Inland Revenue to:

- make repairs, where a return is obviously incorrect;
- issue "discovery" assessments, where a previously finalised return is found to be incomplete through negligence or fraud;
- issue determinations, where no completed return is submitted; and
- make Revenue and taxpayer amendments to a self assessment.

170 However, the "minimum change" remit means that, unlike the system supporting income tax self assessment, COTAX will not provide automated risk assessment of company returns to assist inspectors in targeting higher risk taxpayers for enquiry. In contrast to the income tax self assessment return, the current corporation tax return does not include any standardised accounting information, and it would be difficult to introduce a risk assessment facility without such information. The Department will therefore continue to rely on inspectors' experience and judgement to select cases for enquiry. The Department is working on the data and risk assessment processes necessary to run such a system in the future, but this is a long-term initiative. It is also examining the feasibility of electronic filing of company tax returns but this is unlikely to be in place until 2003-04 at the earliest.

Implementation

171 The COTAX system will be available to around 10,000 staff in the Inland Revenue's network of local tax offices and was originally due to be implemented in June 1999, to coincide with the start of the new regime on 1 July. Following the announcement, in November 1997, of the introduction of quarterly instalments and group payment arrangements, the Department decided that this timetable could no longer be met, and delivery of the core system was postponed for five months until November 1999. The software necessary to support the new quarterly instalment and group payment functions was developed as a separate sub-system.

172 The complete COTAX system is being implemented in two stages:

- November 1999 - COTAX 1, including the re-engineering of the pay and file functions, additional functions to handle the change to self assessment and the recording of quarterly instalments.

- April 2000 - COTAX 2, including functions for reviewing the quarterly instalments paid and calculating interest, where necessary, and all the functions necessary for handling group payment arrangements.

173 In the light of this delay, the Department has taken a number of steps to maintain an effective check over the assessment and collection of tax.

- Although the first Corporation tax self assessment returns are not due until July 2000, some companies may nevertheless submit their returns earlier. The Department issued instructions to staff to stockpile returns received prior to November 1999 until they could process them on the new COTAX system.

- Temporary enhancements were made to the existing pay and file information technology system to record quarterly instalment payments received prior to November 1999.

- Enhancements were also made to the existing system to make it Year 2000 compliant, in order to provide backup in the event of difficulties with COTAX when it went live in November.

Testing

174 In implementing a new information technology system, there are a number of risks to be managed before commencement of live running, including the reliable transfer of existing data to the new system and the ability of the new system to process data accurately. Failure to manage implementation effectively could weaken control over the assessment and collection of revenue and, at the extreme, put tax at risk.

175 Although there are around one million taxpayers currently liable to corporation tax, there were approximately 1.7 million taxpayer records on the pay and file database, including dormant companies and other non-current records. The Department considered the conversion and transfer of these data on to the new system to be the most complex part of the COTAX exercise. Since January 1999, a number of trials have been undertaken, using a 'clone' of the COTAX system, to test the ability of the automatic conversion processes to transfer the existing data onto the new system accurately. Results produced by the conversion programme during the most recent trial, in July 1999, indicated that the 117 million separate items of data involved would be transferred with a high degree of accuracy. A small number of errors caused by both software problems and corrupt data in the pay and file system were corrected and further trials were due to continue up until the live transfer in November 1999.

176 Business assurance testing also took place in July, focusing on the re-engineered pay and file functions and involving the testing of around 60 pay and file cases selected at two network offices. These cases were then worked again, using a 'clone' of the COTAX system and the results compared. No significant difficulties were encountered and over 99 per cent of the outcomes were identical under pay and file and COTAX. Although the trial was not designed to test the new system under load, valuable insight was gained in terms of application performance, where some problems were encountered with the database configuration and the integration of different software modules. Many of these were resolved during the trial and the remainder are being dealt with as part of the continuing system testing activities.

177 As regards load testing, on the basis of data from pay and file, COTAX has been designed to handle 8,000 concurrent users and 2,000 simultaneous transmissions of data to the system. The latter is considered to be the key constraint and simulation exercises have been run to test the system's ability to handle this level of traffic. The Department told us that the ability of COTAX to handle this load can only be assessed accurately once the system went live. To manage the risk, the system would be limited initially to 1,500 concurrent users.

178 The Department also carried out a trial for two weeks commencing on 27 September involving six network offices including Cumbernauld Accounts Office. This trial was intended to involve live working of cases within the selected offices to test the functionality of the new system. The trial was completed successfully, and users considered COTAX to be an improvement on pay and file. Some issues were identified for attention, such as users being "timed out" of the system without warning if there had been no activity within a specified timescale. Although it was not possible to correct any difficulties identified before national implementation, the trial has enabled the Department to advise staff on how to cope with them, until the system can be amended.

Training and guidance

179 The Department set up a training focus group, including representatives of the trade unions as well as Head Office and Training Office staff, to identify training needs and to oversee the implementation and evaluation of a training programme. A series of workshops were held for local office managers in February and March 1999 to provide them with an overview of the major changes and to discuss their implications. Similar workshops for other staff commenced in May and were due to be completed in September 1999.

180 A detailed technical training programme has been devised covering the introduction of corporation tax self assessment, the COTAX computer system and other company tax changes. This commenced in October 1999 and is to continue until June 2001.

181 During the development of the corporation tax self assessment system, the Department consulted widely with industry and the tax profession, through its Self Assessment Consultative Committee. While there are some concerns about operational and practical issues that are likely to arise, the Department's willingness to discuss both the draft legislation and its external guidance has generally been welcomed. The Department's external guidance, particularly its general guide to corporation tax self assessment has been seen as comprehensive and of a high standard. Similarly, the guidance on the group payment arrangements and the effort that the Inland Revenue put into getting them right has been welcomed within industry and the tax profession.

Conclusions

182 The new arrangements for administering corporation tax being introduced by the Department do not involve a radical departure from existing arrangements and, as such, should continue to provide a framework which secures an effective check over the assessment and collection of the tax. However, the corporation tax self assessment project is still in its early stages, with the new COTAX computer system and the detailed training programme still to be implemented fully. It is not until this work is completed that it will be possible to assess the effectiveness of the new regime in practice.

183 The minimum change strategy that the Department has adopted and the re-engineering of the existing pay and file computer system should help minimise the risk of disruption and increase the prospects of a successful transition to the new self assessment system. The Department has taken steps to manage the risks involved with delays in implementing the new computer system.

184 The Department's minimum change strategy has meant that it has not been practicable to include an automated risk assessment system for compliance work similar to that used for income tax self assessment. The Department will continue to rely on its existing approach for the present, but work is under way to develop a corporation tax risk assessment system to meet the needs of compliance staff.

Call centre experiment

Introduction

185 One of the five key commitments of the Modernising Government White Paper is to use new technology to meet the needs of citizens. As part of the Inland Revenue's response to this challenge, it is examining the potential for establishing a series of call centres which will allow taxpayers to deal with their affairs by telephone at hours which are convenient to them.

186 In August 1998, the Inland Revenue established an experimental call centre in East Kilbride for approximately 2 million employees and pensioners whose tax affairs are handled by the Centre 1 District. It is open from 8am to 8pm, well beyond the traditional working hours of the Department. The main objective of the experiment is to establish whether it would be effective to introduce dedicated call centres nation-wide which could be relied upon to deliver:

- improved customer service;
- assistance to taxpayers to help them comply fully with tax laws;
- cost savings; and
- better management information.

187 The call centre employs around 200 staff, of whom 130 are telephone advisers who are either experienced Inland Revenue staff or have undergone a six month training course. The services it provides include processing changes of address, claims for personal allowances, and requests for repayments of tax. The total costs of the experimental call centre up to October 1999 were £11.8 million.

188 Our examination of the experimental call centre focused on the procedures and controls that the Department has put in place to ensure that tax revenues are safeguarded, taxpayer confidentiality is protected, and their records accurately maintained. We also examined the Department's progress in establishing an efficient service to taxpayers.

189 The Department is currently assessing the success of the call centre in meeting its objectives and a report on the experiment will be issued in early 2000, when a business case for introducing a national network of call centres will be considered.

Risk management

190 Increased use of information technology and paperless systems presents different types of risk than traditional clerical systems with paper-based records. With telephone-based systems for example, there is a greater risk of confidential information relating to taxpayers being disclosed inadvertently to third parties. The Department has adopted an active, rather than a reactive, approach to security and confidentiality and has addressed the risk by continually emphasising the importance of taxpayer confidentiality to call centre advisers, both orally, and through messages and warnings broadcast on the call indicator board. Callers are required to provide key information for verification purposes and advisers have strict instructions to only speak with taxpayers in person and not to disclose taxpayer details to callers.

191 A review conducted in April 1999 detected shortcomings in some of the security procedures. Since then, a new computer application has been implemented in which the adviser is prompted to complete an on-screen checklist to confirm that security checks have been completed before proceeding to view the taxpayer's records. Our examination confirmed that these arrangements were working in practice.

192 To minimise the risk of inappropriate amendments being made to taxpayers' records on the basis of fraudulent instructions, a warning message advises callers that their calls are being recorded. A note of the purpose of a call, the advice given, and the action taken is also added by the adviser to the taxpayer's records. These notes can be then be viewed on screen by other call centre advisers or their managers when dealing with subsequent queries.

193 The Department's Internal Audit Office noted that when the call centre first went into operation, the electronic notes were not always updated immediately, giving rise to some discrepancies between the information available to the front-line call centre staff and support staff. A bespoke computer application implemented in March 1999 has resolved this problem and electronic notes are now available immediately to the call centre's support staff. The internal auditors also found that there were inconsistencies in the quality of the electronic notes made by advisers. The Inland Revenue has addressed this through additional training, quality monitoring, and assurance processes. Our review confirmed that improvements have been made.

194 To counter the risk that fraudulent tax repayments could be initiated by call centre staff, all such repayments require separate approval by a tax inspector in the Centre 1 District. Approval to make a repayment is only given when the required documentation has been provided by the taxpayer.

195 As noted at paragraphs 124 and 136 above, as part of its risk management strategy, the Department operates quality monitoring systems to provide assurance on the quality of clerical work in its network of local tax offices. The call centre has introduced a quality monitoring programme, but it is not yet possible for the Department to compare the quality of work of the call centre with that of its wider office network. The Department plans to address this in the next quality monitoring exercise.

196 Where business operations are heavily dependent on the effective operation of information technology systems, a major breakdown could cause significant disruption and, in the Inland Revenue's case, could put tax revenues at risk. The call centre has prepared a business continuity plan which, together with its testing and maintenance strategy, is now in the process of implementation. There are currently 60 dedicated work-stations available at a backup site to cover in the event of failure at the call centre and the plan calls for annual testing. Work can also be passed to other offices, which can also update records for cases handled by the call centre, in the event of a disaster, providing further cover in the event of disruption.

Customer service

197 The information systems designed for the call centre record details of every incoming and outgoing call including the time and date, the duration of the call, and the services provided to the caller. Other recorded information includes the elapsed time until the call is answered or abandoned, or if the caller received a busy signal. The call centre's aim is to answer 90 per cent of calls within 15 seconds, which is more stringent than the target for responses at switchboards at the Department's local offices. Progress towards this goal is continuously monitored through its on-line information systems. Figure 33 shows the call centre's progress towards achieving this aim.

Experimental call centre - performance against the aim of answering 90 per cent of calls in 15 seconds for the seven months to June 1999

Figure 33

Month	Daily maximum	Daily minimum	Average	Number of Days over 90%	Calls connected
December 1998	96%	72%	91%	17	54,000
January 1999	86%	1%	14%	0	103,000
February 1999	82%	14%	33%	0	74,000
March 1999	30%	2%	6%	0	106,000
April 1999	96%	3%	68%	6	62,000
May 1999	96%	60%	86%	11	79,000
June 1999	95%	61%	80%	6	81,000
July 1999	95%	17%	80%	4	69,000
August 1999	97%	41%	84%	9	72,000
September 1999	95%	54%	89%	9	78,000
October 1999	98%	63%	84%	16	65,000

Source: Inland Revenue experimental call centre

198 To date, the aim of a 90% response within 15 seconds has not been consistently achieved, notably during peak periods where both the number and duration of calls was greater than had been anticipated when the call centre was established. However, the Department told us that it always recognised that the call centre was an experiment and did not expect to achieve this goal until the end of the experimental year. While there have been peak times of day and peak periods of the year when the number of calls far exceeded the number of available advisers, the performance of the call centre has improved significantly since April 1999, in large part due to the introduction of active resource management. The Department is exploring the implications for resources of high target levels of availability and peaks in demand as part of its work to evaluate the benefits of extending the experiment.

199 In January 1999, over 50 per cent of calls were abandoned during peak hours. The Department attributed this to the high work load associated with enquiries about annual PAYE tax code numbers (and the restriction of Married Couple's Allowance in particular) and to questions from taxpayers about their income tax self assessment statements. Between late February and early April 1999, the proportion of abandoned calls varied between 10 and 50 per cent during peak hours.

200 Difficulties in managing call volumes during peak periods were compounded by information needed to predict call volumes not being readily available. The computer application designed to provide this information was implemented in March 1999, some five months after the start of the experiment. The Department has recognised that improved management of peak period demand is crucial to the maintenance of acceptable customer service standards. Steps that have been taken to reduce call waiting times include recruiting additional staff, introducing an evening shift and re-deploying support staff to answer calls during peak periods. Additional training has also been provided which has reduced call durations significantly, while maintaining the quality and courtesy of the service provided.

201 The Department's ability to provide an effective service is also affected by the availability of information technology systems. The availability for all applications, including the bespoke application used by telephone advisers and the national systems that record taxpayer details, has ranged from 93 per cent to 99.8 per cent per month. Furthermore, the call centre has experienced several incidents of computer downtime. In March and April 1999, prior to a system change being made, there were 16 instances of computer downtime where at least one application suffered a loss of service of 50 hours or more. Although this could have resulted in both reduced service to the taxpayer and a loss of information against which to evaluate the call centre experiment, in most cases advisers were able to continue to take calls and made manual notes which were entered into the computer system later.

202 The Department has not yet established a target for the availability of call centre information technology systems. In view of the importance of information technology to the successful operation of the call centre, a high level of availability should be required. To help achieve this, consideration should be given to introducing routine maintenance by the system contractor rather than providing maintenance only when required, as at present.

203 Compliments and complaints received from taxpayers are collected, categorised and reported monthly. Complaints are investigated fully and responded to and trends are reported to line managers on a regular basis. In July 1998, the Department conducted a customer survey which established that 94 per cent of callers rated the service as good or better. The survey was repeated in October 1999 and, when the results are available, they will be compared to this baseline. The Department has also participated in a benchmarking study with 16 other public and private call centres in which the performance was compared across a whole range of criteria measuring both customer service and also the reliability of technical advice. The latest results show that the East Kilbride call centre was ranked fourth overall, which the Department considers is a good performance for a relatively new service. The Department intends to carry out a monthly benchmarking exercise until the end of March 2000.

Evaluation of the experiment

204 The call centre is one possible element of a re-structuring programme which is expected to achieve cost savings for the Department and to reduce the cost of compliance with tax laws for the taxpayer. The Department is currently evaluating the costs and benefits of the experiment and the case for extending the use of call centres. Cost savings are expected to be achieved from improved accuracy, reduced cost of telephone work, improved call handling and from economies of scale. The cost of compliance for the taxpayer is expected to be reduced by improving accessibility and the Department is currently developing indicators to measure this over the longer term.

Conclusions

205 The establishment of the experimental call centre at East Kilbride is an important feature of the Department's programme to implement the Modernising Government initiative. The Inland Revenue has assessed the risks associated with this new approach to dealing with taxpayers and has put procedures in place to manage those risks, although there is scope to refine the approach to quality monitoring to enable the results to be compared with the Department's office network.

206 The experiment has been successful in identifying important issues which will need to be evaluated before deciding whether to extend this type of service nationally. These include weighing the value of challenging customer service targets against the costs of managing significant peaks in demand, securing a high level of information technology availability, measuring the quality of the advice or service provided, and assessing the added value of this approach. The Inland Revenue has assembled a range of evidence from various sources to evaluate the experiment with a view to making an informed decision on the way forward early in 2000.

Office for National Statistics

207 The Account shows expenditure of £5.12 million charged, and Appropriations-in-Aid of £3.29 million applied, to sections A and B in respect of other statistics. However, the words "and other" were erroneously omitted from the ambit of the 1999 Spring Supplementary Estimates (HC 237 of 1998-99) and the subsequent Appropriation Act. There is therefore no proper Parliamentary authority for other statistics, and the excess arises because payments in the year of £5.12 million are *ultra vires* . The Treasury have confirmed that the receipts from the ultra vires activity can be appropriated-in-aid rather than surrendered to the Consolidated Fund. It is proposed, therefore, to ask Parliament to authorise £5,122,000 of the surplus on the Vote to be applied towards meeting the excess, leaving a token sum of £1,000 to be voted as a further supply grant.

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