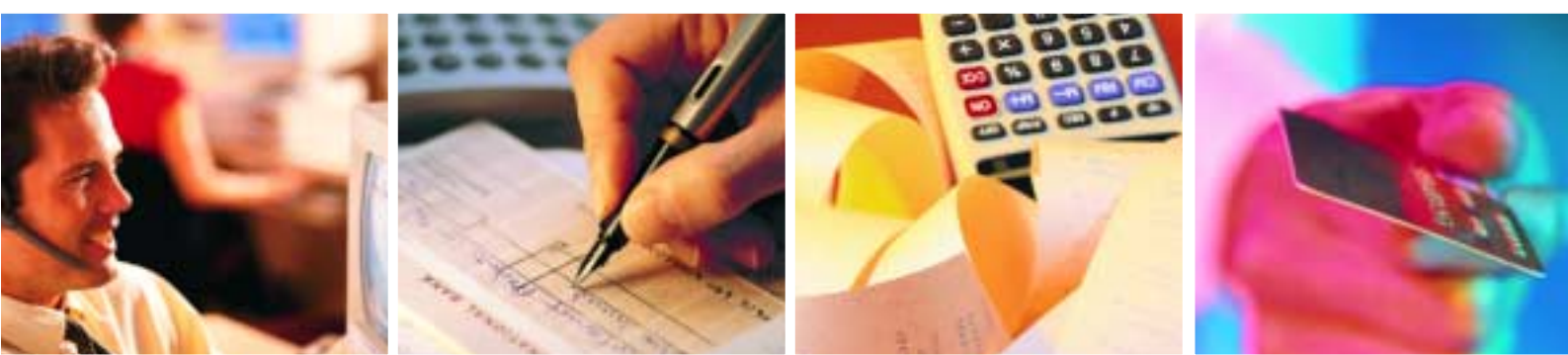


The Recovery of Debt by the Inland Revenue



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
HC 363 Session 2003-2004: 24 March 2004

executive summary

- 1 The Inland Revenue collected £219 billion in tax and National Insurance contributions in 2002-03. Most people and businesses pay their taxes on time but many thousands get into arrears because of financial difficulties or because they are unwilling to pay. At the end of March 2003, taxpayers owed around £14 billion although the total fluctuates throughout the year. A significant proportion of this debt was owed by insolvent businesses and by taxpayers who could not be traced, or was under negotiation or being paid off under instalment arrangements. The amount owed includes outstanding tax, interest, surcharges for late payment and penalties for failure to submit tax returns on time. The largest amounts outstanding are on Pay As You Earn (PAYE which includes National Insurance contributions) and Corporation Tax (paid over by businesses) and self-assessed Income Tax (paid by individuals such as those with an income not taxed at source).
- 2 After initial reminders to taxpayers requesting payment, cases which remain unpaid are followed up by the Department's Receivables Management Service which also chases up outstanding tax returns. In April 2001 the Department brought together all debt management functions into a separate business unit to enable the Receivables Management Service to pursue debts consistently and efficiently. The Service has some 8,000 staff and payroll costs of around £153 million a year.
- 3 The Receivables Management Service attempts to contact most taxpayers through its Telephone Centre to negotiate settlement, before passing cases which have not been settled to one of 143 local recovery offices for follow up action. This action can include negotiating time to pay off the amount owed, seizing goods, and taking the taxpayer to court to recover the amount owed. Where it is not possible to recover a debt using these methods the Service may instigate procedures to wind up a company or bankrupt an individual. If the debt cannot be recovered it may be written off. In the year to October 2002 the Department wrote off £523 million. In the year to March 2003 £275 million was written off in respect of National Insurance contributions.
- 4 This report examines:
 - The Department's performance in collecting debt (Part 1);
 - Whether the Department could collect and enforce debts more quickly and at lower cost (Parts 2 and 3);
 - Whether they could do more to encourage debtors to pay on time (Part 4).

Our study methodology is set out in Appendix 1.

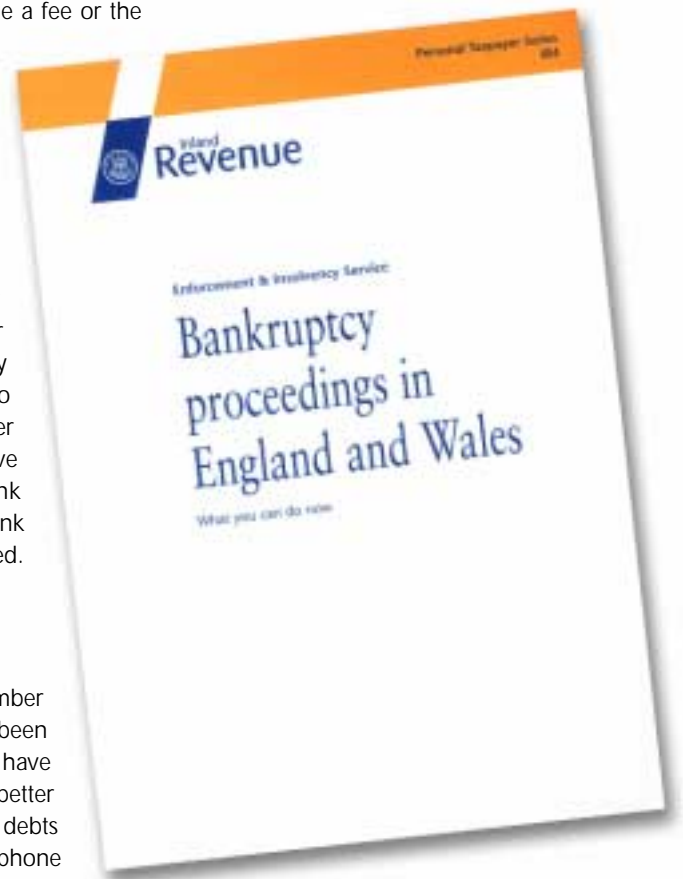
- 5 A review completed in 2001 recommended that the debt management and banking operations of the Department and HM Customs and Excise should be combined to achieve efficiency savings. In July 2003 the Chancellor announced a major review of the organisations dealing with tax policy and administration (HM Customs and Excise and the Inland Revenue) chaired by the Permanent Secretary to the Treasury, Gus O'Donnell. The primary purpose of the review is to make public service delivery more effective and efficient, examining ways to enhance service delivery through closer working or organisational change, possibly by restructuring the Departments. Another project being considered by the Cabinet Office is looking at developing a debt management function for the whole of Government which is examining the scope for consolidating all amounts owed by and to individuals in their dealings with Government. The practices and recommendations set out in this report are relevant to these wider initiatives.

- 6 From our work, we conclude that the Department have made significant improvements in recent years to the way that they collect and enforce debts. There are opportunities to improve performance further by providing more information, advice and support to taxpayers to help them comply, by making it easier for taxpayers to settle debts, and by improving the effectiveness of the Department's collection and enforcement methods to recover debts more quickly.

Measures to improve debt collection and enforcement

- 7 The Department have systems for collecting debts which match the best used by other tax authorities we visited but they could develop these further. A review commissioned by the Department confirmed that the decision to set up the Telephone Centre was fundamentally sound because it costs significantly less to recover debt than other methods and enables the Department to make contact with taxpayers early in the process. The Telephone Centre employs around 285 staff at a cost of almost £9 million a year and makes initial contact with the taxpayer to collect the debt and any outstanding tax return. Given the substantial investment the Department have made in the Telephone Centre they should make better use of it by:
 - *Routing through the Centre debts totalling over £3 billion a year which are currently handled by more expensive methods.* This includes individual debts of more than £5,000 on self-assessed Income Tax which are dealt with by local recovery offices, Class 2 National Insurance debt and various debts, such as overdue penalties, collected using manual systems. During 2005, the Department intend that all self-assessed Income Tax cases will be handled by the Telephone Centre.
 - *Pursuing all debts owed on different tax streams during initial contact with the debtor where appropriate.* The Department use separate computer systems to recover debts and taxpayers may be approached separately for each, for example, a sole trader with employees who owes self-assessed Income Tax, Class 2 National Insurance contributions and Pay As You Earn (PAYE). It may be more effective and efficient to use computer systems to consolidate relevant information for each debtor.
 - *Moving to the Telephone Centre some of the work carried out in local recovery offices such as initial telephone calls to enquire why promises to pay have not been kept.*

- 8 We found that the Telephone Centre had a backlog of 91,000 cases over six months old at the end of July 2003 which needed to be traced on self-assessed Income Tax. Following action by the Department the backlog had been reduced to 1,000 cases by the end of January 2004.
- 9 On PAYE, the Receivables Management Service has started to use the past history of employers to determine the most appropriate type of action to collect a debt. It recognises that there is much more to do in this area. For example credit card and utility companies use a range of techniques such as behavioural and collection scoring in order to group their customers into debtor types and then design methods for collecting the debts suited to each. Difficult to recover debts may be passed onto debt collection agencies which charge a fee or the debt may be sold on where cost effective. The private sector also shares information on the payment histories of individuals on a regular basis which gives them a wider and up to date view of individuals' financial circumstances. This enables private sector companies to identify those who are able to pay, and also points to the potential recovery actions which could be taken.
- 10 In cases where companies have gone into liquidation, the Department have to write off the debt because it is no longer recoverable. The most recent figures show write offs of over £575 million. They are starting to take earlier action to identify businesses heading for difficulty which could raise up to £50 million a year. Some tax authorities overseas use other measures to protect revenue, which the Department do not have the legislative powers to apply. These include using bank guarantees and requiring companies to put taxes into separate bank accounts in the Department's name as soon as these are deducted.



Better information to improve performance

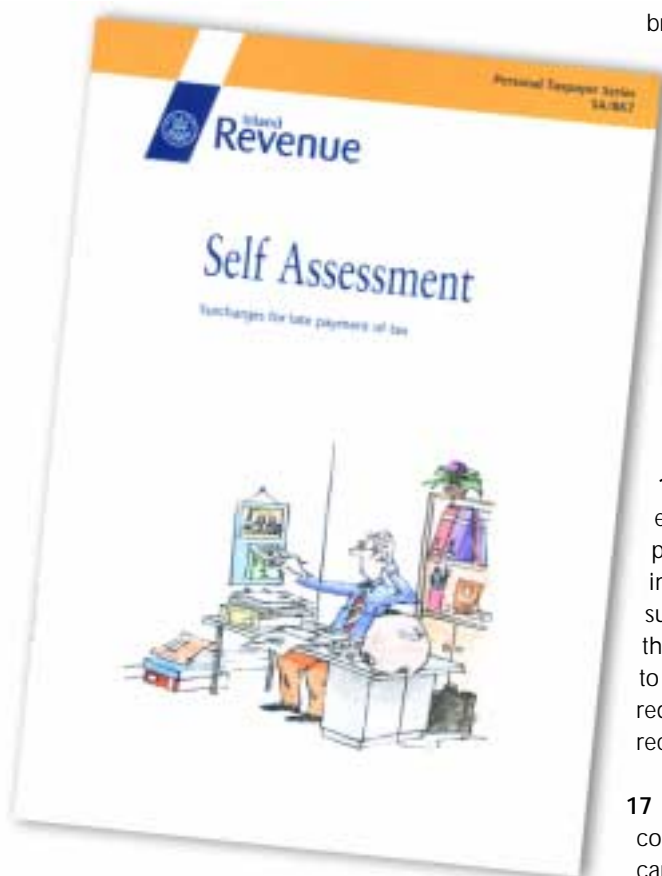
- 11 The performance of the Telephone Centre is assessed on the number of debt cases it actions which includes cases where payment has been obtained, promises to pay have been made and where cases have been passed onto the local recovery office for further action. A better measure of success would be the number and values of the debts collected as a percentage of the total passing through the Telephone Centre. The Department plan to introduce this by 2005.
- 12 Where the Telephone Centre is unsuccessful in recovering a debt, letters will be generated automatically by the Department's computer systems warning the taxpayer that further action may be taken. The local recovery offices may also write to the taxpayer, telephone or visit the taxpayer, to establish the nature of the problem. Seizure of the taxpayers' moveable assets (such as motor vehicles) known as distraint in England, Wales and Northern Ireland, or Court proceedings may then follow. The number of distraint and court proceedings increased from 155,416 in 2001-02 to 180,622 in 2002-03 because enforcement action was taken more quickly thereby increasing throughput. The Receivables Management Service however does not have sufficient reliable management information to predict the most effective methods to use in individual cases. It regards distraint as the most useful because people often pay if warned that this action will be taken. Better management information would help the Receivables Management Service to analyse the success of each of the recovery methods and allow it to determine more accurately appropriate recovery strategies for each case.

- 13 The Receivables Management Service has been benchmarking its processes with Tax Authorities in other countries to identify areas for improvement. With better management information, such as that set out in Appendix 2, the Service could adopt a wider range of practices used by other bodies in the public and private sectors to improve performance and test the effectiveness of their practices.

Matching workload and resources

- 14 Over £3 billion on PAYE, Corporation Tax and self-assessed Income Tax was more than one year old at 31 March 2003. Under the Spend to Save initiative announced in Budget 2003, the Department have been given additional funding for an extra 75 staff to reduce the backlog of debt on these taxes which should bring in an extra £85 million a year in tax revenue by 2007-08. Given the amount of debt that is outstanding over one year old, it will be important for the Department to review, following the first year's experience on the Spend to Save initiative, the scope for further reductions.

- 15 Local offices which deal with the highest volume of debt have cleared a lower percentage of debt cases than others. To address this problem, the Receivables Management Service shifted part of the workload on self-assessed Income Tax to other parts of the organisation. It has also piloted the clustering of local offices to spread the workloads more evenly in an area and has decided to extend this approach to all local offices.



Approaches to encourage prompt payment

- 16 There are a number of approaches used by the Department to encourage taxpayers to pay promptly. These include providing a range of payment methods to make the payment of taxes as easy as possible, imposing surcharges and interest on late payments, providing information, support and advice to taxpayers on their responsibilities and what to do if they have a problem. Encouraging taxpayers to pay their taxes on time helps to improve compliance rates thereby preventing the build up of debt and reducing the Department's costs of collection, as well as securing earlier receipt of sums owed.
- 17 The Department want more taxpayers to pay electronically because it is convenient and efficient. The Telephone Centre has been able to accept debit card payments since 2003 and local recovery offices will also be able to do so from mid 2005. The Department do not accept credit card payments but are considering the implications of offering this method of payment, including how the costs of any handling fees would be met.
- 18 The Department will consider giving taxpayers additional time to pay in cases of financial hardship. Taxpayers and those who advise them, would be better equipped to deal constructively with the Department if they knew more about the criteria for the acceptance of time to pay arrangements. In the United States of America, taxpayers can consult the Internal Revenue Service website to determine whether they are eligible for time to pay arrangements and can calculate the monthly instalments required to pay off a debt.

- 19 Helping taxpayers understand how their tax has been calculated is important in securing prompt payment of any sums due. The Department recognise that self-assessed taxpayers, whose affairs are complex, can find it difficult to understand the statement of account which sets out the calculation of tax and the amount owed and, in consultation with representative organisations, are looking to redesign it.
- 20 The Receivables Management Service provides a range of support and advice to help taxpayers understand their responsibilities for filing returns and paying their tax on time. This includes giving advice to taxpayers; making available a range of leaflets on dealing with tax debts; and seconding a member of staff to a voluntary sector organisation that advises taxpayers on debts. The Service recognises that some of its leaflets are out of date and plans to publish new versions in 2004. It could also provide more information and support for those who advise taxpayers on how to deal with debts and improve the Department's website by learning from tax authorities in other countries such as Australia, New Zealand and the United States which have well designed websites with helpful information to those who may be in financial difficulty.
- 21 To deter taxpayers from filing their tax returns and paying their taxes late, the Department can charge penalties and interest. Payments of PAYE should be made by the 19th of each month. The Department monitor payments received by the 23rd of each month but only 52 per cent of employers meet this target. The Committee of Public Accounts in their 29th report of Session 2002-03 recommended that the Department should aim higher than their current target of 50 per cent. The Department find that compliance levels increase when the final payment is made for the year in April. This is because the Department cannot charge interest when employers are late in paying each month except in April each year when interest is applied if the final payment for the year is not made on time. From April 2004 it will be mandatory for employers with 250 or more employees to pay their PAYE electronically. This is expected to improve compliance levels.
- 22 Tax authorities overseas and financial institutions use other measures to encourage payment on time, which the Department do not have legislative powers to apply in the UK. For example, a common practice used by financial institutions and the tax authority in the Netherlands is to charge for sending reminders to settle a debt. The Department issue over six million reminders a year. The tax authorities in the United States of America, Ireland and Norway also issue tax clearance certificates, which confirm that a taxpayer's affairs are in order, to encourage payment on time. These certificates are needed when a taxpayer seeks a Government contract or when obtaining a licence such as an excise or road transport licence. The certificates can also help to change taxpayers' attitudes to paying tax.

Recommendations



23 Our recommendations are designed to help the Department further improve their approach by identifying opportunities to reduce the levels of debt owed; to collect debts more quickly or reduce collection costs. The recommendations in paragraphs 24 to 26 below suggest improvements which the Department could introduce, building on their work to date. The Department would need to do further work to assess the savings that could be achieved from adopting the recommendations. The recommendations in paragraph 27 identify measures worthy of further consideration but which would require legislation to introduce.

24 To improve debt collection the Department should:

- have the capacity to route all types of debt through the Telephone Centre automatically;
- where appropriate pursue all debts owed on different tax streams during initial contact with the debtor;
- move to the Telephone Centre some of the work carried out in local offices, for example following up on cases where promises to pay have not been kept or where enforcement action has commenced;
- continue to move work between local offices and other parts of the Receivables Management Service to match workload more closely to resources;
- draw on the first year's experience of their Spend to Save initiative to assess the benefits of allocating additional resources to the recovery of debts over one year old;
- use scoring techniques to categorise debtors with appropriate recovery actions for each;
- use their information on taxpayers to predict those that are likely to get into debt and take early action to advise and support them.

25 To improve management information as an aid to better performance the Department should:

- develop systems to provide information needed to manage debt effectively (Appendix 2);
- periodically assess the cost effectiveness of the Telephone Centre and of campaigns for collecting debt and set targets for improving amounts collected; promises to pay kept and instalment arrangements maintained;
- analyse the success of different methods for recovering debt from different types of debtor as a basis for targeting future actions;
- upgrade computer debt management systems to help staff quickly and easily identify amounts owed by debtors across all tax streams.

26 To provide more help for taxpayers who are in debt, the Department should:

- clarify for taxpayers the criteria for granting time to pay;
- improve the statement of account so that taxpayers can easily understand the amounts they owe;
- as a matter of urgency, give taxpayers better information about payment and debt recovery arrangements.

27 The Department may wish to explore the benefits and implications of the practices listed below which are used elsewhere in the private sector or by tax authorities overseas. However these would require changes in legislation to introduce:

- providing the facility to pay by credit card and passing on handling costs to customers;
- applying penalties for all employers who are late in paying PAYE during the year;
- requiring companies with poor payment records to provide bank guarantees and/or set up separate bank accounts in the Department's name in which taxes deducted should be immediately transferred to help protect the revenue from losses from bankruptcy;
- charging for reminder letters to taxpayers who do not settle debts on time but have the ability to pay;
- selling on some of the hardest to collect debt to other organisations where it is cost effective;
- issuing tax clearance certificates where appropriate to compliant taxpayers who pay their taxes on time.

