

**Report of the Comptroller and Auditor General
to the House of Commons**

Vehicle Excise Duty account 2005-06

**Extract of Driver and Vehicle Licensing Agency
Annual Report and Accounts 2005-06. (HC.1395 20 July 2006)**

Report of the Comptroller and Auditor General on the Vehicle Excise Duty account 2005-06

Introduction

1. Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the Driver and Vehicle Licensing Agency's (the Agency) Vehicle Excise Duty (VED) Account on behalf of the House of Commons to ascertain that adequate regulations and procedures have been framed to secure an effective check on the assessment, collection and proper allocation of VED, and that they are duly carried out. I am also required by the Act to examine the correctness of the VED Account and to report the results to the House of Commons. My audit certificate and this report together satisfy these requirements.
2. The basis for the preparation to the VED Account changed this year from a cash to an accruals basis so that it shows also the amount of VED paid in advance as at each year end, some £2.2 billion as at 31 March 2006. This change to the accruals basis is in line with the taxes accounts of HM Revenue and Customs from 2005. An explanation of the financial impact is given in note 10 and accounting policies 1.3.1 and 1.3.7 to the VED Account. In previous years the account was referred to as the Trust Statement.
3. Estimates of the level of VED evasion lie outside the VED financial statements and my audit opinion does not refer to the accuracy of those estimates. As noted on page 39 of the Management Commentary, the VED evasion rate increased from 3.4 percent in 2004 (£129 million) to 3.6 percent in 2005 (£147 million), reversing the previous decrease.
4. Whilst it is recognised that no tax or duty collection system can ensure that all those who have a liability comply with their obligations, the National Audit Office's work in 2005-06 provided an overall assurance that the Agency's regulations and procedures continued to provide an effective check on the assessment, collection and proper allocation of VED, and that they were being duly carried out. In forming this view, I recognise that there is a balance to be struck between resources deployed for enforcement work on the one hand, and the impact of that work on VED evasion levels and desired reduction in the "vehicle underclass", as expressed in the 2007 targets set by the Secretary of State.

Opinion

5. I have given an unqualified audit opinion on the 2005-06 VED Account. My audit certificate is at pages 81 to 82.

Scope of my Report

6. The procedures and regulations for the assessment and allocation of VED are large scale but comparatively straightforward, and are carried out effectively. Consequently, my report deals with aspects of VED collection and focuses on:

- Performance against Secretary of State and Efficiency targets;
- Motorcycle Evasion;
- Using the County Court to enforce Continuous Registration; and
- VED Reminder Notices.

Performance against Secretary of State and Efficiency Targets

7. The Secretary of State has set three targets for the Agency: to -
 - Reduce evasion to 2.5 percent by December 2007;
 - Reduce by January 2007 the vehicle underclass by 50 percent from the baseline published in 2004, based on 2002 survey data; and
 - Improve the accuracy of the vehicles database to 97.5 percent by July 2005;
8. In addition the Agency was set a Gershon efficiency target in July 2004 to increase VED collected by £70 million per annum by 2007-08.

Reducing Evasion

9. The reported loss of VED due to evasion is an estimate derived from a roadside survey of over one million passing vehicles carried out in June each year. The survey in 2005 cost some £233,000. The survey results are used by Department for Transport statisticians to estimate the evasion rate in the total vehicle stock¹. Whilst the statistical methodology used to calculate the estimate of evasion is sound, the approach does have the inherent limitation of being a snapshot of evasion at just one month of the year.
10. The reported loss of VED due to evasion, some £147 million (3.6 percent) as analysed on pages 39 to 43 of the Management Commentary. Currently the roadside survey is annual and, to facilitate year-on-year comparisons, it is carried out at the same time each year. This is currently the only agreed objective source of estimates of VED evasion, although the Agency uses internal estimates based on ANPR and Continuous Registration activity figures for internal management purposes. Hence the evasion level to be reported formally in December 2007 will have to be based on the level recorded in the June 2007 survey. The Agency acknowledges that it may not meet the December 2007 evasion target of 2.5 percent given current arrangements and resource allocations. However, the Agency has set itself a quantified intermediate aim of reducing the June 2006 evasion level to 3 percent (see Management Commentary page 39). Measures designed to achieve this include a new advertising campaign for use throughout the year rather than just during specific months, and the introduction of debt collection agencies to enforce payment of continuous registration late licensing penalties. This latter measure is intended to have a significant deterrent effect beyond those cases subjected to direct enforcement. The results of the June 2006 roadside survey are expected to be finalised in October 2006.

¹ The full results of the roadside survey and the estimating methodology are published on the Department's web site.

11. The Agency's advertising is effective in influencing people to pay their VED and maintain their vehicle registration. It may be particularly effective in jogging the memories of those who are inherently compliant but who have simply forgotten to pay. Advertising is more effective in the shorter term and its effect declines rapidly. Hence the nature, extent and particularly the timing of advertising are likely to be significant influences on the level of evasion that is measured by roadside surveys of vehicles. In 2005 the Agency was not able to run its usual advertising campaign prior to the roadside survey because of the general ban on Government advertising prior to the Election in May. This offers a plausible explanation of the increase in the VED evasion rate to 3.6 percent, as recorded in the annual survey in June.
12. Police forces and other agencies are increasingly using Automated Number Plate Recognition (ANPR) cameras to capture data on vehicle movements. This data could at one level offer useful information about the level of VED evasion. However, it is typically targeted at particular risks in such a way that it may be of limited use as a basis for estimating the national evasion level overall. Using the Agency's continuous registration database as a basis for estimating the overall evasion level would necessarily omit unregistered vehicles and those incorrectly declared as SORN but on the road. As the Agency and the Department consider the future of the roadside survey, they need to consider its utility and cost, and the alternative sources of estimates, even if they are only partial and closely targeted. Estimates of the overall evasion rate remain of most value if they add real value to consideration of the options for action against VED evaders.

Reducing the Vehicle Underclass

13. The Agency's measures to tackle VED evasion contribute significantly to government-wide measures to reduce vehicle related crime and crime more generally. There is a correlation between criminal activity and vehicles, one aspect of which is VED evasion. About three-quarters of persistently untaxed vehicles are thought to be used by people involved in some other criminal activity. The extent and nature of the Agency's anti-evasion work includes coordinated work with partners and seeks to serve each others' interests, rather than purely the VED financial impact. Hence the Agency's targets include reduction of the "vehicle underclass", a term which refers to vehicle users who persistently do not comply with their obligations. The agreed definition is: Vehicles that are used on the road with one or more of the following characteristics:
 - Untaxed for at least 3 months
 - Between keepers for at least 3 months
 - Keeper with an unallocated post code (as a rough indicator of vehicles registered to a false name or address)
 - Vehicle Registration Mark that does not appear on the Agency record (an indicator of vehicles with false or tampered number plates)
 - Vehicle Registration Mark registered to a different vehicle type or model (an indicator of vehicles with false or tampered number plates, or vehicles that have been 'imperfectly' falsified)
 - Declared scrapped

14. Performance against the target of halving the vehicle underclass is reported on page 43 of the Management Commentary². The Agency acknowledges that this target too may not be achieved by the deadline of January 2007 because of its close linkage to the target for reducing overall VED evasion. Not achieving the target does not, of course, detract from the social and economic value of the ambition that the targets reflect or the reduction achieved so far.

Improving Vehicle Database Accuracy

15. The Department for Transport and the Agency consider the vehicle database accuracy target to be key to improving performance overall, as was recognised also in my report on "Reducing Vehicle Crime" last year (HC183, 2004-05). The Agency's database accuracy survey in October 2005 showed 97.4 percent traceability of vehicle keepers. 92.4 percent were immediately traceable with the remainder being ultimately traceable. This compares well with performance in 2003 when only 90 percent were traceable. Further increases in traceability will be restricted by failure of customers to notify the Agency of change of name/address and failure to notify the Agency when they buy/sell/scrap their vehicle. However, overall improvements to the 97.4 percent figure are unlikely to be attained without significant reduction in the vehicle underclass population, as the two targets are linked. The longer a vehicle is untaxed the greater the likelihood of the record being out of date.

Achieving the Efficiency Target

16. The £70 million target was specified in July 2004 as additional annual revenue from the licensing of vehicles through reduction in tax evasion (not deriving from increases in the rate of VED or numbers of vehicles). The Department for Transport's Efficiency Technical Note states that baseline evasion was 4.8 percent of vehicles on the road using the national annual roadside survey results. The baseline of 4.8 percent relates to the figures from the 2002 survey when evasion was £206 million. Allowing for increases in VED rates, the target of £70 million was achieved in 2004-05, based on the 2004 roadside survey. There is currently no further target for increased VED collection. Additional VED receipts accrue directly to the Exchequer and are not appropriated by the Agency or the Department.
17. The Agency believes that a better alignment of target dates and measurement arrangements would significantly improve clarity of reported progress, and a reappraisal would be beneficial. The NAO encouraged the Agency to take its proposals forward with the Department and HM Treasury.

Motorcycle Evasion

18. The 2005 roadside survey found that motorcyclists remain by far the most likely group to evade VED (estimated at 29.6 percent in the vehicle stock). The Agency's database accuracy exercise shows also that motorcyclists are the least traceable of vehicle keepers. The Agency considers that the main reasons for evasion are:

² The estimate of the extent of the vehicle underclass is undertaken for the Agency by the University College London Jill Dando Institute of Crime Studies, as a key partner in this work.

- Insurance is costly and people therefore ride without insurance and VED;
 - Motorcycles are easy to store off-road where enforcement action cannot be taken;
 - Automated Number Plate Recognition (ANPR) cameras have difficulty reading motorcycle number plates; and
 - On road enforcement (i.e. pulling vehicles over rather than using photographic evidence) is particularly difficult with motorcyclists as they can easily evade physical detention by the enforcement officers.
19. Previous advertising and enforcement operations have not been aimed specifically at motorcyclists. For 2006, the Agency has planned targeted measures including advertisements aimed specifically at motorcyclists; fitting out all the Agency's vans used to seize vehicles so that unregistered motorcycles can be safely towed away; and enforcement and education activities at motorcycle rallies and shows.
20. Compliant taxpayers' continued willingness to comply underpins the success and efficiency of most tax and duty schemes. There is no evidence that high levels of evasion in respect of motorcycles are impacting on levels of evasion generally, and the amount of revenue evaded is relatively small. However, it remains a concern that the long-standing and significantly higher evasion rates amongst motorcyclists may threaten the VED-paying public's confidence in the Agency's even-handedness of treatment and enforcement under the VED regime. The lack of effective action against evading motorcyclists could risk gradually undermining the VED tax base. The Agency and NAO intend to review in due course the effectiveness of the measures listed in the previous paragraph above.

Using the County Court to enforce Continuous Registration

21. I reported last year on the Agency's progress with the enforcement of the Continuous Registration regime that came into force in January 2004. Late Licensing Penalties (LLPs) are issued to those who do not renew their vehicle registration. Over 1.3 million LLPs were issued in 2005-06, of which 465,095 were paid by 31 March 2006, generating £24.1 million for the Department on behalf of HM Treasury. The legislative framework for Continuous Registration results in enforcement of non-payment is through the civil courts, potentially leading to a County Court judgement against the vehicle keeper. In 2005-06 the Agency applied for 18,000 claims each month - an administrative limit agreed with the Department for Constitutional Affairs. This left some 619,000 cases of non-payment in 2005-06 that were not pursued at all through existing procedures, as shown in figure 1 below. Each case costs the Agency £20 in Court fees and that cost is recovered if the judgement is in the Agency's favour and the defendant pays. The Agency's administrative costs incurred in preparing a case for court are not recoverable. The Agency's experience of the Court process is that only some 10 percent of the 216,000 cases led to payment of the penalty and costs. This resulted in a net cost to the Agency of approximately £144,000 per month or £1.7 million for 2005-06.

Figure 1: Action on the 1.3 million Late Liability Penalty Notices issued in 2005-06.

Late Liability Penalty Notices paid: 465,000	
Court Claims: 216,000	Not pursued: 619,000
Paid	

Source: Agency figures

Areas in this figure are proportional to the figures

22. The Agency understand that some credit reference agencies do not take notice of outstanding County Court judgements against individuals in respect of VED, and so the deterrent effect of the Court process is diminished.
23. In a move designed to engender a better deterrent effect and in response to the deficiencies and cost of the County Court process overall, in early 2006 the Agency reduced the number of civil cases put forward each month and in June started a trial using debt collection agencies, supplemented by wheel-clamping teams. The success of this trial will be considered in next year's report and evaluated in comparison with the Court process.
24. Vehicles kept off the road are not subject to VED provided the Agency is in receipt of a Statutory Off Road Notification (SORN). These must be renewed annually to ensure that a keeper of a vehicle has contact with the Agency at least once a year to update the register. The offence relating to using a vehicle on the road while covered by a SORN can only be detected by being caught on the road, and so is not enforceable purely from the Agency's vehicle database records. Potential VED evaders could see being on the road while subject to a SORN as a lesser risk than full non-registration. However, the Agency has not analysed the data from the roadside survey so as to consider the incidence and growth of potential SORN related offences. The NAO has suggested that the Agency and the Department consider undertaking that analysis as a guide to future action.

VED Reminder Notices

25. The Agency sends VED renewal reminders to vehicle keepers recorded on the vehicle database. However, late payers and VED evaders in the previous period are not subject to a specific tailored reminder process and this may affect the likelihood of repeated late payment or evasion in subsequent periods. The Agency has not researched specifically the impact on VED evasion rates of changing the timing of reminders and early or special reminders for previous late payers/non-payers. The category of evaders who were not taken to Court and not followed up in any other way, may deserve consideration for a special, and firmer set of reminders in the run up to the next renewal date. There is potentially a reputational and credibility issue if repeat non-payers sense that nothing further will happen and that the Agency has apparently lost interest. The Agency is hopeful that the use of debt collection agencies will address this perception. The Agency also recognises that a reminder process that is too simple could risk continuing to issue reminders after a vehicle has changed hands, which could generate complaints from some former vehicle keepers.

Market research has indicated that those "soft" (innocently forgetful) evaders caught out by the continuous registration penalty process are unlikely to do it again. There is also a question for the Agency as to whether a special reminder is likely to have any effect on "hard" (wilful) evaders. The Agency has agreed to consider NAO's suggestion to trial a reminders exercise and consider its effectiveness.

Conclusions

26. The Agency changed successfully this year to the accruals accounting basis for Vehicle Excise Duty, in line with other tax accounts. Total VED income for 2005-06 was £4.95 billion and the account shows also some £2.2 billion paid in advance as at 31 March 2006.
27. The VED evasion rate increased from 3.4 percent in 2004 to 3.6 percent in 2005 (£147 million), reversing the previous decrease. The Agency believes this was partly as a result of the cancellation of advertising usually planned to precede the roadside survey. The Agency acknowledges that it may not meet the December 2007 evasion target of 2.5 percent and has set itself an intermediate aim of reducing the June 2006 evasion level to 3 percent. The Agency also acknowledges that halving the vehicle underclass is unlikely to be achieved by the target date of January 2007.
28. The accuracy of the Agency's vehicle database is key to improving performance overall and traceability of vehicle keepers measured in October 2005 compares well with 2003. Further increases in traceability will be restricted by failure of customers to notify the Agency of changes, and overall improvements are unlikely without significant reduction in the vehicle underclass population.
29. The Government published in July 2004 efficiency target including reducing VED evasion by £70 million per annum by 2007-08. However, this was achieved in 2004-05, based on the June 2004 survey results.
30. The Agency believes that a better alignment of target dates and measurement arrangements would significantly improve clarity of reported progress, and a reappraisal would be beneficial. The NAO encouraged the Agency to take its proposals forward with the Department and HM Treasury.
31. Compliant taxpayers' continued willingness to comply underpins the success and efficiency of most tax and duty schemes. It remains a concern that the long-standing and significantly higher evasion rates amongst motorcyclists may threaten the VED-paying public's confidence in the Agency's even-handedness of treatment and enforcement under the VED regime. The lack of effective action against evading motorcyclists could risk gradually undermining the VED tax base.
32. In 2005-06, Late Licensing Penalty notices and subsequent County Court action left some 619,000 Penalty non-payment cases (48 percent) that were not pursued at all, and only some 10 percent of the 216,000 cases taken to Court led to payment. The Agency in 2006 reduced the volume of Court cases and in June started a trial using debt collection agencies, supplemented by wheel-clamping teams. The success of this trial will be evaluated next year.

Comptroller and Auditor General's report on VED 2005-06

33. There is potentially a reputational and credibility issue if repeat non-payers of VED sense that nothing further will happen to them, and the Agency is hopeful that the use of debt collection agencies will address this perception. The Agency has also agreed to consider NAO's suggestion of a trial of further reminders targeted at longer term non-payers, and to consider its effectiveness.

John Bourn

Comptroller & Auditor General

4 July 2006