
National Audit Office

## HM REVENUE & CUSTOMS

# Management of Tax Debt

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL | HC 1152 Session 2007-2008 | 20 November 2008

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***Tim Burr***
**Comptroller and Auditor General**
**National Audit Office**

**14 November 2008**

The National Audit Office study team consisted of:

Lee-Anne Murray, Emma Taylor
Heather Thompson, Ben Gatherer,
Chris Henderson and Vicky Gilson, under the direction of Jane Wheeler

This report can be found on the National Audit Office web site at www.nao.org.uk

**For further information about the National Audit Office please contact:**

National Audit Office
Press Office
157-197 Buckingham Palace Road
Victoria
London
SW1W 9SP

Tel: 020 7798 7400

Email: enquiries@nao.gsi.gov.uk

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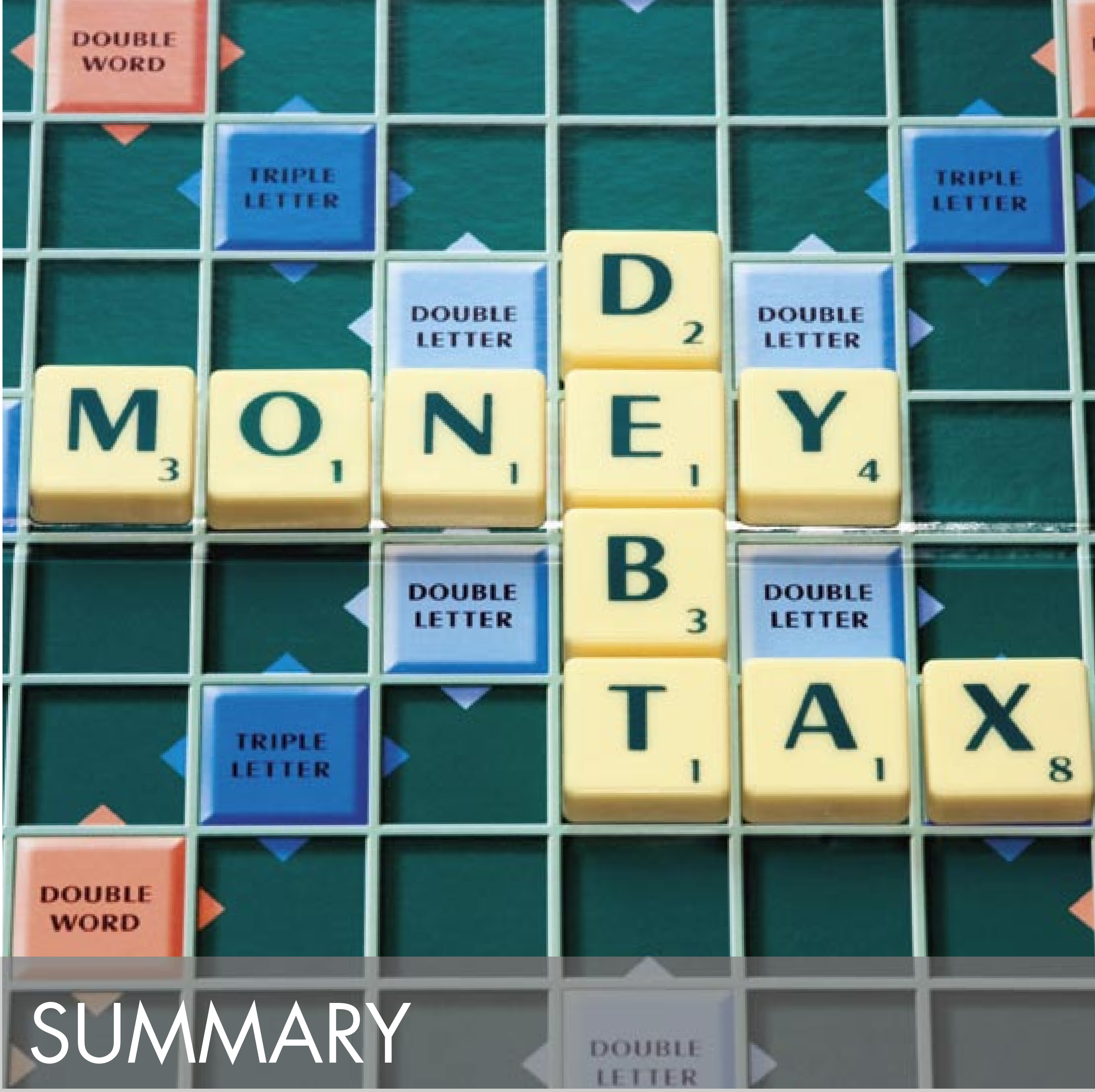



# SUMMARY

**1** HM Revenue & Customs (the Department) collected around £450 billion in tax and National Insurance contributions from some 35 million taxpayers in 2007-08. Although most tax payments are made on time, around one third are not. The level of debt fluctuates on a daily basis. The total level of debt in the Department's Accounts at the end of 2007-08 was £25 billion. The level of debt recorded on the Department's debt management systems in March 2008 was £21.5 billion. The difference is mainly because these systems exclude some debt that is due but is paid almost immediately and there are timing differences in when debt is downloaded from the main tax systems. In this report we analyse trends in debt levels using figures from the debt management systems.

**2** Of the £21.5 billion, £17.3 billion was outstanding tax, interest and penalties (3.8 per cent of total tax receipts) and the remainder was overpayments of benefits and tax credits. £16.2 billion was managed by the Department's Debt Management and Banking Directorate which spent £204 million and employed over 6,200 staff on debt management activities in 2007-08 to collect £63 billion of debt. The remaining £5.3 billion was debt managed by other business areas in the Department.

3 This report examines:

- The Department's performance in managing debt (Part 1)
- How the Department manages and prioritises debts (Part 2)
- The Department's methods for collecting debt (Part 3)
- How it encourages taxpayers to pay on time (Part 4)

4 The report examines the Department's progress in response to previous NAO and Committee of Public Accounts' reports on the former Inland Revenue and HM Customs & Excise. Appendix 1 summarises progress in implementing recommendations. This report covers tax debt owed by businesses, employers and individuals across all taxes. It does not cover tax credits and benefits. The C&AG's Report on the Department's accounts examines its performance in managing tax credits. Our methodology is at Appendix 2.

## Conclusions

5 The Department has improved its management of tax debt since our previous reports, so that tax debt as a proportion of net tax receipts is now lower on most taxes and the age of direct tax debt has reduced. The Department has not reduced the total level of debt as it aimed to do and, **over the last year**, debt as a proportion of net receipts and the age of debt has increased on some taxes. The number of debts has also increased over the last year by 22 per cent, from 13 million to 15.8 million. While the increases reflect how debts are recorded and an overall increase in the number of taxpayers and other trends in consumer debt, they also reflect a change in the Department's priorities to focus more on higher value debts as it seeks to manage with fewer resources. The Department has trialled various initiatives to help manage the increasing workload, including changes to local debt recovery which are in train but have yet to take effect. A more effective penalty regime could help prevent debt arising. The Department is currently consulting on proposed changes.

6 In 2007-08, the Department's Debt Management directorate collected around £310 of debt for every £1 spent, an increase of 10 per cent from 2006-07. The Department has limited information on the relative cost-effectiveness of its activities. The Department could improve the cost-effectiveness of its collection operations by using the Telephone Centre to collect VAT debt which is managed through separate systems. Automatically linking together debts owed by individual taxpayers on different taxes so they are pursued as a single debt would require investment but could save costs in the long run and help the Department pursue smaller debts which it does not prioritise at present.

7 The Department's debt:net receipts ratio is at the lower end of the range for other tax authorities we contacted, while debt it writes off as a percentage of total debt was similar or higher. The measures the Department uses to monitor its performance include some, but not all of the performance indicators used by other organisations. Its debt management approach does not yet include some features that the Committee of Public Accounts and we recommended in 2004 and which have helped other organisations improve debt management. Such features include risk profiling and customer segmentation, managing debt through a single IT system, innovative methods for communicating with customers and a more efficient telephone centre operation. These methods would require funding to implement, but could reduce collection costs and help the Department better manage the growing level of debt as it competes with other organisations in a more difficult economic environment. The Department has undertaken some developmental work and continues to review the case for deploying additional resources in these areas but does not have firm plans for implementation as other Departmental change programmes have taken higher priority within the resources available.

## Recommendations

**8** The Department has developmental work underway in a number of areas to improve management of debt, for example developing a risk-based approach to prioritising debts, measuring the cost-effectiveness of collection activities, using staff more flexibly and introducing communication by voicemail and text. This work takes forward previous recommendations. The funding available for debt management projects has restricted the scale and pace of changes achieved and planned. In this context we have divided our recommendations between those that can be implemented relatively easily and at low cost and those that would require greater resources but could bring significant benefits in the longer term.

### Recommendations that can be implemented at lower cost

**a** The Department measures the average time taken overall to collect debts but not the percentage of debt by value collected within 30 or 90 days as other organisations are seeking to do. **The Department should measure how much debt is collected within these timeframes to help focus on reducing the length of time it takes to collect debt** (paragraph 1.4–1.5).

**b** The Department does not currently know how much tax it collects in each debt recovery activity and so cannot reliably measure the cost-effectiveness of different approaches. **The Department should measure the cost-effectiveness of different collection activities so that it can manage its resources effectively and identify opportunities to improve its processes** (paragraph 3.3).

**c** The Department has improved leaflets and website information to help taxpayers understand their payment obligations but some information is limited or not available. **The Department should provide clearer information on its website and in printed guidance on how to find details of payment helplines and interest charges, and the obligation on taxpayers to submit a tax return if they are sent one, even if they have no tax to pay. It should also provide clearer information on how an individual's tax has been calculated** (Figure 10, paragraph 4.4).

### Recommendations requiring greater resources

**d** The Department generally prioritises pursuit of debt according to value rather than the likely risks of non-collection. The number of debts the Department has to manage is increasing so smaller debts are aging and will become more difficult and expensive to collect. **The Department should use information it holds on customer behaviour, with information from external sources, to build up risk profiles for each customer to prioritise and tailor debt collection action and negotiate payment arrangements. In the interim, the Department should look to prevent the build up of smaller debts and achieve more equitable treatment of taxpayers, thereby reducing the risk that compliance levels could fall if the public perceives that the Department is not actively pursuing certain debts** (paragraphs 2.3–2.5, 2.11–2.15).

**e** The Department manages direct and indirect tax debts on separate IT systems. It cannot automatically link the debts a taxpayer has on different taxes and pursue all debts at the same time and it has difficulty comparing performance across taxes. Nor can it currently use the automated Telephone Centre for collecting VAT debts although a pilot to explore this is planned for late 2008. The Department had a plan to introduce a single IT system but had to defer implementation because of other funding priorities. **The Department should aim to introduce a system that allows it to pursue debts more efficiently, to manage debts by customer so that debts on different taxes are linked and to compare performance across taxes. These changes could either be made progressively or through one new system** (paragraphs 2.6–2.8).

**f** The Telephone Centre operating system does not allow automated switching between inbound and outbound calls and so cannot automatically respond to changing volumes of inbound calls throughout the day. To address this, the Department has considered various options for managing inbound and outbound calls differently but its plans are not yet firm. **The Department should look to introduce new technology to allow greater flexibility in managing workload, increase debt collected and enable staff savings** (paragraph 3.10).

**g** Although the Department's Telephone Centre is open between 8am and 8pm Monday to Friday and for some hours at the weekend, staff work mainly between 9am and 5pm and weekend working is limited. Local recovery officers make most visits during office hours. The Department's research and evidence from other organisations indicates that the Department could collect debt more quickly by extending Telephone Centre opening hours and visiting more debtors outside office hours to improve contact rates. Although some downtime is necessary to update IT systems with new debt information, **the Department should look to expand debt collection work in the evenings and weekends and examine the associated costs and contractual issues involved** (paragraphs 3.10 and 3.12–3.16).

**h** Overseas tax administrations we visited have successfully used different enforcement powers and methods for recovering debt. **The Department should explore the benefits and risks of obtaining a power to recover tax debts from taxpayers' salaries or bank accounts without a court order, and using private debt collection agencies to recover some types of debts. Changes in powers would require changes in legislation to introduce** (paragraphs 3.20–3.25).

**i** The Department currently writes to customers to remind them that payment is due although it is piloting alternative communication methods. **It should introduce new methods of communicating with customers such as text, email or automated telephone messaging in line with good practice by other organisations to reduce the amount of debt arising** (paragraph 4.5).

**j** In response to previous recommendations, the Department has introduced further payment options, including payment by credit card and direct debit for paying in instalments. However, technology and practices of other organisations continue to advance. **The Department should explore the costs and benefits of increasing the range of payment options such as introducing autopayment by telephone with the aim of making paying tax quicker and more convenient for different customer groups** (paragraphs 4.8–4.9).

# PART ONE

# Overall performance in managing debt

**This part examines good practice in measuring performance in managing debt and the Department's performance in managing the level and age of debt.**

**1.1** In 2007-08 the Department collected £451 billion in tax and National Insurance contributions from some 35 million taxpayers ranging from individuals to large multi-national corporations.[1] Most individual taxpayers pay Income Tax through PAYE and any underpayments are collected by adjusting their PAYE code. Most debts occur when payments of self-assessed Income Tax, National Insurance contributions, Corporation Tax, VAT or employers' PAYE are not made on time. In 2007-08, around 30 per cent of taxpayers with a tax liability did not pay on time although often payments are made soon after they are due and therefore do not require any action. Our research estimated that in April 2008 between 830,000 and 1.5 million (2.2 to 4 per cent) of working age adults, including those who pay their Income Tax through PAYE, had a personal or business tax debt with the Department.[2]

**1.2** We last reported on debt management by the Inland Revenue in 2004 and by HM Customs & Excise[3] in 2005. Following the creation of HM Revenue & Customs in 2005, a new Debt Management and Banking directorate was set up. In 2007-08 it spent £204 million and employed over 6,200 full time equivalent staff on debt management activities to collect £63 billion of debt. As part of the Department's drive for efficiency savings the Directorate has reduced its staff numbers by 14 per cent since 2006. The Directorate has also been implementing a change project as part of the Department's wider Transformation Programme.[4] It plans to spend £29 million up to 2011 to facilitate flexible methods of payment and streamline processes. It expects to achieve staff savings of £217 million by 2011. The Department has made some progress in implementing the Committee of Public Accounts' previous recommendations including using more information to trace debtors, improving information for those in debt and introducing payment by credit card and direct debit. On others, it has developmental work underway including prioritising debts according to risk, pursuing more debts through the Telephone Centre and measuring the debt collected within 30 or 90 days. It is also consulting on possible changes in legislation such as seeking additional powers for enforcing debts and changing the penalties it can impose for late payment. Full details of the Department's progress against previous recommendations are at Appendix 1.

## The process for collecting and recovering debts

**1.3** The Department has a standard debt collection process **(Figure 1)** supported by an IT system which automatically routes all direct tax debts through the process. The IT system does not deal with indirect taxes. For most taxes, the Department sends out initial postal reminders requesting payment once it becomes due. Debts which are not paid are referred to the Department's Telephone Centre which attempts to contact debtors to obtain payment, and then transfers unresolved debts to local Debt Pursuit Offices. Some debts are transferred directly to Debt Pursuit Offices. Where an address is incorrect, the Department's Tracing Unit traces up-to-date contact details and missing telephone numbers are traced by an external provider. We cover the operation of Department's collection activities in Part 3.

1 HM Revenue & Customs 2007-08 receipts, reported by the Department as National Statistics. This figure differs from the receipts figure reported in HM Revenue & Customs Accounts for 2007-08 (£457 billion) which is reported on an accruals basis.
2 Ipsos MORI Omnibus Survey, April 2008 – face-to-face survey of 1409 adults, weighted to be nationally representative of the UK working age population.
3 *The recovery of Debt by the Inland Revenue*, HC 363, 2003-04; *Comptroller and Auditor General's Standard report on the Accounts of HM Customs & Excise 2004-05*, HC 447, 2004-05.
4 The Comptroller and Auditor General examined the programme in *HM Revenue & Custom's Transformation Programme,* HC 930 2007-08.

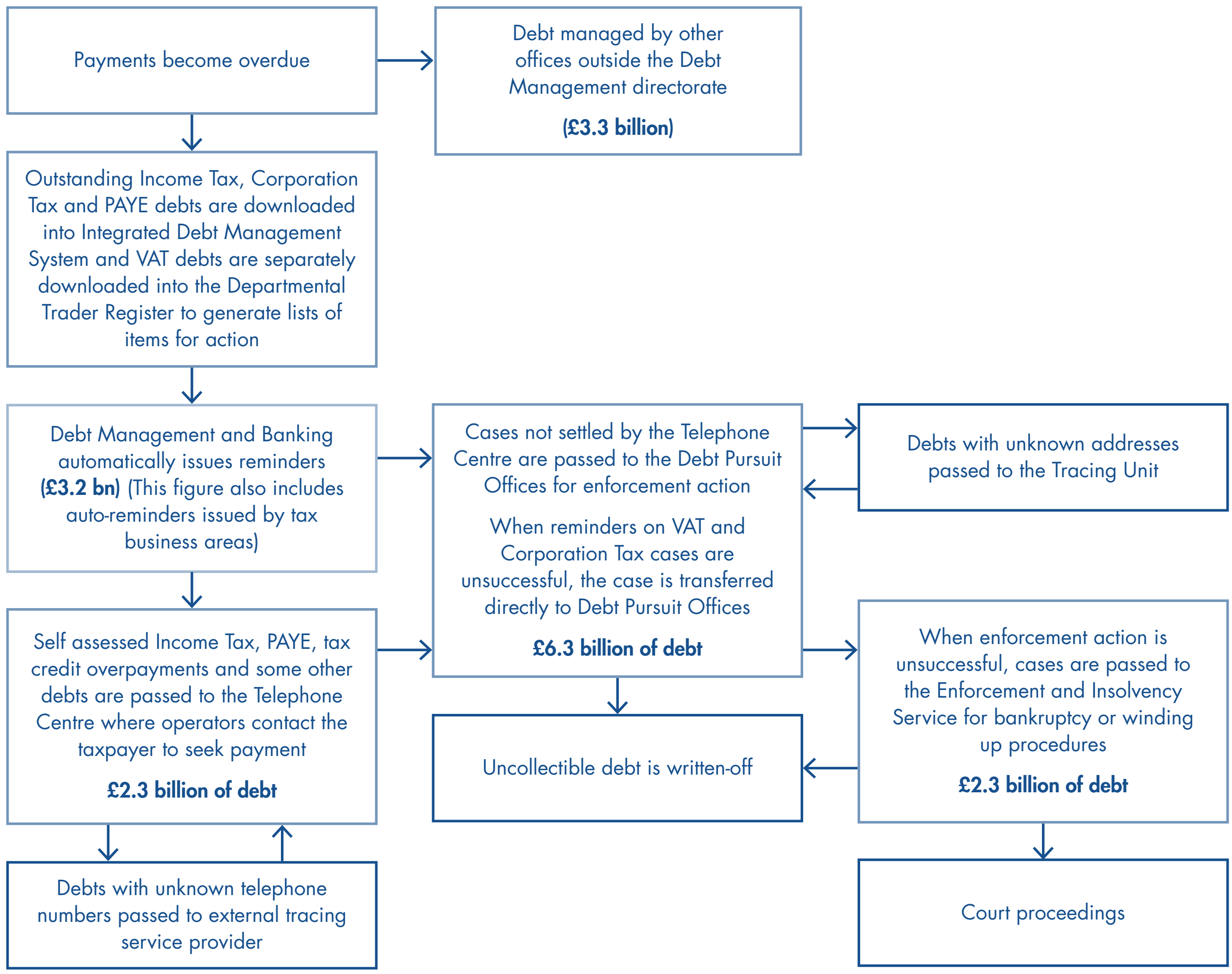
## Measuring performance in managing debt

**1.4** Our previous report recommended improvements in the Department's management information to achieve better performance. The Committee of Public Accounts recommended that the Department should seek to achieve similar clearance rates to the utilities sector, which cleared 90 per cent of debt within 90 days, to prevent the build-up of older debt and associated write-offs and monitor the percentage of debt collected within 30 and 90 days in line with good practice.

**1.5** The Department is looking to develop a measure of how much debt, by value, it collects within 30 days. It does measure the average time taken to collect all debt (17.5 days), including those debts which are collected quickly following reminder letters. Debts that require intervention by the Debt Management and Banking directorate take longer to collect (72.2 days).

**1.6** Debt collection operations in financial services and utilities currently use business-wide and individual customer data and various indicators to monitor performance (**Figure 2 overleaf**). The Department measures performance against some but not all of these indicators.

**1** The Department's approach to collecting debt and the value of debt at each stage in March 2008




*Source: National Audit Office*

NOTE

Figures exclude suspended debt (£0.4 billion managed by the Debt Management and Banking Directorate and £2.0 billion managed by other offices) and debt in specialist collection offices, such as the County Court Unit and New Business Unit (£1.7bn). Figures include tax credit debt.

**1.7** We have used the data currently held by the Department to measure current performance and trends over time in the total levels of tax debt and on different taxes, levels of debt written off and the age profile of debt. Where possible we make comparisons with other organisations. We look at costs of collection in Part 3.

## Levels of debt

**1.8** The debt balance fluctuates on a daily basis as debts are paid and new debts arise. We have analysed trends in debt levels in recent years by comparing the level of debt recorded in the Department's Debt Analysis Matrix in March with the annual net receipts for each tax. We used the Debt Analysis Matrix because it is the management information system used by the Department to operationally manage and regularly report to senior management on its debt levels. The figures in the Matrix in March 2008 were £3.5 billion lower than the figures reported in the Department's 2007-08 Accounts as at 31 March 2008. The main reasons are that the Matrix excludes some debts which were due but which were paid almost immediately and that there are timing differences in when the debt is downloaded to the Matrix from the main tax systems. The majority of the difference related to VAT debt (£2.5 billion) which was due but which had not yet downloaded onto the debt management system.

**2** Key Performance Indicators used by the Department and other organisations

| KPIs used by a range of other organisations | What the Department measures |
|---|---|
| Collection performance | |
| Debtor days = debt balance/receipts x 365 or<br>Debtor days = debt balance/debt raised x 365.<br>Measures the number of days worth of debt outstanding. | The Department measures debtor days using both methods. |
| Aged debt profile – the older the debt, the slower debt is being collected. | The Department can measure tax debt that is more than 3 months, 6 months and 1 year old and for direct taxes, debts more than 2 years and more than 4 years old. |
| Collection efficiency: debt collected/full time equivalent staff. | The Department measures debt collected/full time equivalent staff. |
| Cost performance | |
| Yield-cost ratio by collection activity to monitor the cost effectiveness of different collection actions e.g. telephone centre. | The Department measures the amount of debt collected per £1 spent. It measures cost of collection per debt collected by activity and has work underway to measure the amount of debt collected per £1 spent by collection activity. |
| Average cost of collection per debtor – measure of the cost-effectiveness of the collection process. | Not measured by the Department. |
| Compliance performance | |
| Delinquency ratio: number of delinquent debtors/number of active debtors. Proportion of debtors who have missed several payments. | Not measured by the Department. |
| Bad debt loss ratio: uncollectible debt/total debt – to monitor the proportion of uncollectible debt and possible future write-offs.[1] | The Department measures the amount of debt it writes off.[1] |

*Source: National Audit Office*

NOTE

1 Write-offs are debts that are considered to be irrecoverable because in practice the Department cannot collect them. It also measures remissions which are debts capable of recovery but the Department has decided not to pursue the liability, for example, on the grounds of value for money or official error.

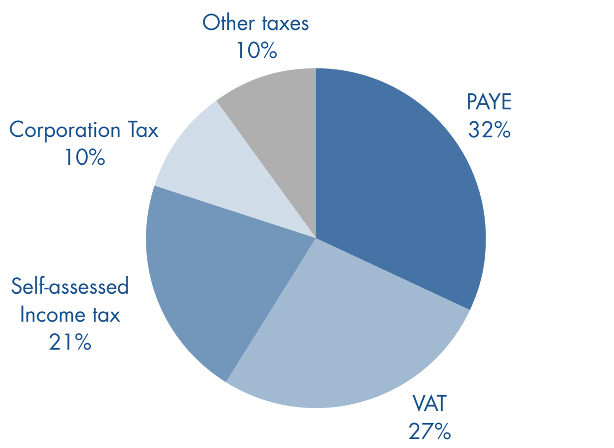
**1.9** In March 2008, the tax debt balance was £17.3 billion on the Matrix and comprised outstanding tax, interest and penalties for late filing and incorrect tax returns. In addition to tax debt, the Department was owed £4.2 billion arising from overpayments of tax credits. We have not covered tax credit debt in this report and have excluded tax credit debt from the data where possible. We examine management of tax credits separately in the C&AG's Report on HMRC's Accounts each year. The Debt Management and Banking directorate set a target to reduce total debt outstanding by 20 per cent from £20.4 billion in 2006 to £16.6 billion by March 2008. In practice the amount increased to £21.5 billion at March 2008, mainly because tax credit debt increased by 57 per cent over the period and Corporation Tax debt by 37 per cent. Of the £21.5 billion, £16.2 billion was managed by the Debt Management and Banking Directorate and the remaining £5.3 billion was managed by other business areas in the Department.

**1.10** The main areas of debt are PAYE (32 per cent of total tax debt on average during 2007-08), VAT (27 per cent) and self-assessed Income Tax (21 per cent) **(Figure 3)**. The level of debt fluctuates throughout the year from £15.6 billion to £18.3 billion, rising after the different deadlines for paying each tax. For example, self-assessed Income Tax debt rises after payment deadlines at 31 January and 31 July and a peak in PAYE debt follows the end-of-year deadline in May.

**1.11** The debt figures exclude 'stoodover' tax, estimated at around £15 billion, which comprises direct tax assessments (for example on Corporation Tax and self-assessed Income Tax) which are not payable while under appeal. The Department cannot legally collect stoodover tax and so does not classify it as debt. The Department includes 'suspended' tax in its debt figures. Estimated at around £2.4 billion, it arises when assessments of indirect taxes (for example VAT) are not yet confirmed. It includes unpaid tax of £1 billion relating to 'Missing Trader' fraud investigations. Missing Trader fraud is a type of VAT fraud, which in its simplest form involves a business obtaining a VAT registration number in the UK for the purposes of purchasing goods free from VAT in another EU member state. The business sells the goods at a VAT inclusive purchase price in the UK and then goes missing or defaults without paying the output tax due to the Department.[5] The amounts are legally collectible and classed as debts, but because of their nature they may not be recovered so we have excluded or shown these amounts separately in some areas of our analysis.

**1.12** The level of tax debt as a proportion of net tax receipts increased from 3.8 per cent in 2004-05 to 4.3 per cent in 2005-06 and fell to 3.8 per cent in 2007-08 **(Figure 4 overleaf)**. The percentage level of Income Tax-related debt (which includes self assessed Income Tax, PAYE, National Insurance contributions and Capital Gains Tax) is lower than in 2002-03 when we reported previously. This debt rose sharply in 2005-06, largely because of PAYE debt, and then fell again as the Department prioritised this area. Corporation Tax debt is also lower than when we previously reported. It fell to 4 per cent in 2005-06. Since then it has increased as the numbers of incorporated businesses and so Corporation Tax debts increased. VAT debt as a proportion of VAT receipts has risen to 5.1 per cent, partly because of 'Missing Trader' debt which is suspended whilst under investigation. Excluding suspended debt, the increase is from 1.3 per cent in 2004-05 to 2.5 per cent in 2007-08.

**3** Proportion of debt by tax – average for 2007-08




*Source: National Audit Office analysis of HM Revenue & Customs tax data*

5 *Comptroller and Auditor General's Standard Report on the Accounts of HM Revenue & Customs 2006-07, HC 626, 2006-07.*

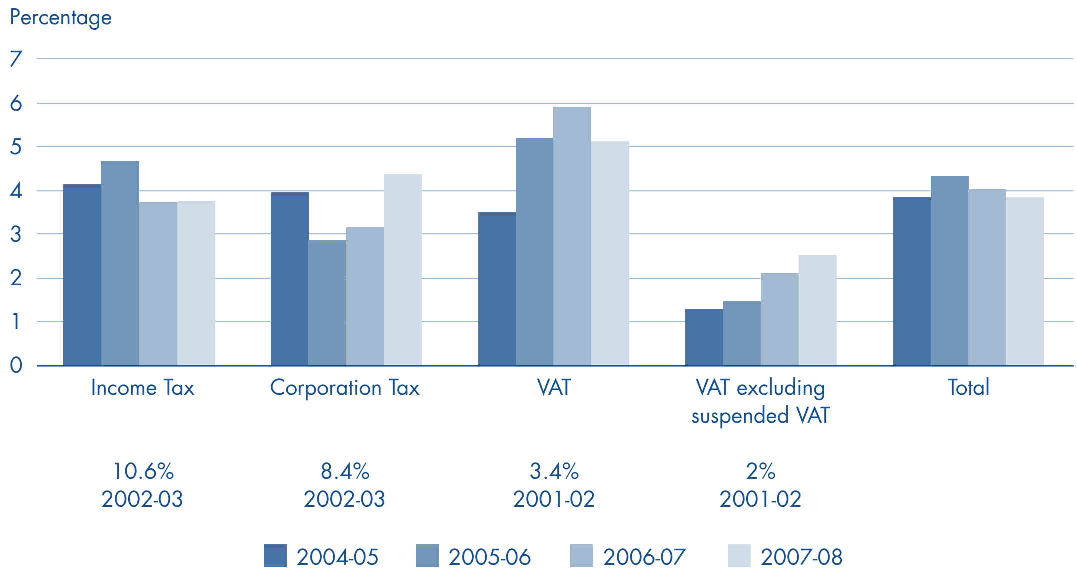
**1.13** The Department writes off debt which in practice it is unable to collect, mainly where taxpayers have become insolvent and so further pursuit is prevented by statute. In 2007-08, the Department wrote off £5.6 billion in tax debt, 1.2 per cent of net tax receipts **(Figure 5)**, compared to £3.1 billion or 0.7 per cent of net receipts in 2005-06. Most of the debt written off in 2007-08 was VAT (£3.6 billion), much of which was associated with 'Missing Trader' fraud.

**1.14** In other countries we visited, tax debt as a percentage of net receipts ranged from 2.7 to 12 per cent **(Figure 6)**. The Department's tax debt as a percentage of receipts is at the lower end of this range (3.4 per cent to 4 per cent throughout the year). Overall, the Department's level of debt written off as a percentage of total debt was similar to or higher than in the countries we visited.

## Age of debt

**1.15** Commercial organisations find that, in a competitive environment, it is important to collect debt as quickly as possible since older debt is more difficult and more expensive to collect. Since 2007, general economic changes in the UK have led to fluctuations in interest rates and a reduction in available credit. Lenders are increasingly focussed on collecting debts within the first 90 days following changes to the banking rules on providing for debt.[6] Much of the debt the Department pursues, for example payments of self-assessed Income Tax and Corporation Tax are due some time after the profits/income to which they relate.

**4** Tax debt as a percentage of net tax receipts




| Position previously reported by National Audit Office | Income Tax | Corporation Tax | VAT | VAT excluding suspended VAT |
|---|---|---|---|---|
| | 10.6% 2002-03 | 8.4% 2002-03 | 3.4% 2001-02 | 2% 2001-02 |

*Source: National Audit Office analysis of HM Revenue & Customs tax data*

NOTES

Comparable tax debt figures from the Department's Debt Analysis Matrix report are available from 2004-05 onwards only. Income Tax figures include self-assessed Income Tax, PAYE, National Insurance contributions and Capital Gains Tax.

For reference, Figure 4 also shows debt figures previously reported by the NAO in the *Standard Report on the Accounts of HM Customs & Excise*, HC 447, 2004-05 (2001-02 VAT figures) and *The Recovery of Debt by the Inland Revenue*, HC 363, 2003-04 (2002-03 Income Tax and Corporation Tax figures). These figures were produced using Management Information systems in operation before the merger of the two departments, and therefore are not directly comparable.

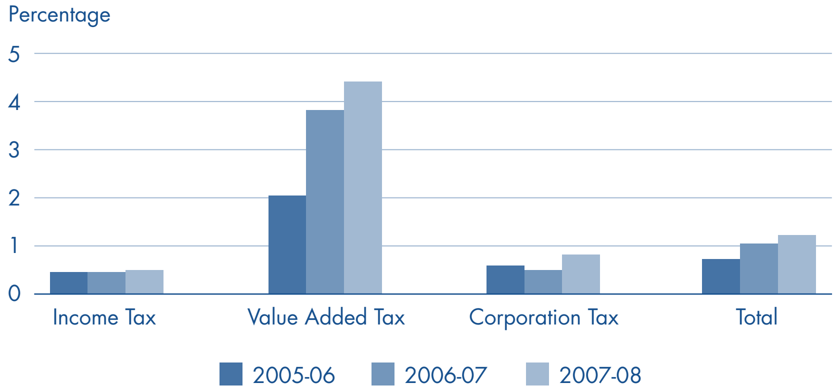
Net receipt figures are HMRC's annual receipts reported by the Department as National Statistics. For 2001-02 and 2002-03 net receipt figures are from HM Customs & Excise and Inland Revenue Trust Statement Accounts for 2001-02 and 2002-03 respectively.

6 The Basel II Accord created international standards in banking laws and regulations which are used by banking regulators to determine how much capital banks need to put aside to guard against financial and operational risks. As part of the Accord, debts older than 90 days attract a higher risk rating and therefore require more capital to be put aside.

**1.16** Nearly a third (£4.5 billion) of the Department's tax debt (excluding suspended VAT) is greater than one year old. Since we last reported on the Inland Revenue the age profile of direct tax debt has improved. 26 per cent of debt was more than one year old in March 2008 compared to 37 per cent in March 2003. The biggest reduction was in PAYE debt over one year old, from 43 per cent to 18 per cent, as the Department prioritised this type of debt. The amount of self-assessed Income Tax debt greater than one year old increased from 38 per cent to 41 per cent. VAT debt over one year old has risen since late 2007 as more Missing Trader debts become collectible following investigation.

**1.17** At March 2008, nine per cent (£1.1 billion) of direct tax debt was between two and four years old, and a further six per cent (£784 million) was over four years old. Most debt over two years old was self-assessed Income Tax debt. Levels of older Corporation Tax and PAYE debt have remained steady or reduced slightly since April 2006. At August 2008, 18 per cent (£777 million) of VAT debt was more than two years old, of which 36 per cent (£279 million) was suspended debt.

**5** Written off debt as a percentage of net tax receipts




*Source: National Audit Office analysis of HM Revenue & Customs tax data*

**6** Total debt as a percentage of net receipts

| Overseas tax administration | Receipts (2007) (billions) | Total debt (2007) (billions) | Debt as a percentage of receipts (%) |
|---|---|---|---|
| Canada ($CA) | 198 | 20 | 10 |
| Netherlands (€) | 201 | 11.3 | 5.6 |
| Republic of Ireland (€) | 48 | 1.28 | 2.7 |
| United Kingdom (£) | 451 | 17.3 | 3.8 |
| USA ($) | 2,400 | 290 | 12 |

*Source: National Audit Office analysis of data provided by overseas tax administrations*

NOTE

These figures give an indication of the range of debt as a percentage of net receipts. It is difficult to directly compare each tax administration because of differences in the types of tax and the way in which tax is collected, different regulations and powers, for example on enforcement and write-offs and levels of tax debt will vary throughout the year.

# PART TWO

# Managing and prioritising debt

**This part examines the Department's projects such as linking debts across taxes and risk profiling to better manage and prioritise increasing volumes of debt.**

## Number of debts

**2.1** The total number of tax debts has risen by 22 per cent from 13.0 million in March 2007 to 15.8 million in March 2008. The number of PAYE debts has more than doubled, partly because the Department is now recording on its IT system some debts that were not previously recorded and because it is transferring some PAYE penalties for late filing onto the system more quickly than it did previously. In 2006, the Government introduced a new Corporation Tax band which led to an increase in Corporation Tax liabilities and consequently, Corporation Tax debts have risen by over 50 per cent. The number of VAT debts has risen by 37 per cent and self-assessed Income Tax debts have risen by six per cent. In particular, the number of lower value debts has increased. For example, an exercise by the Department showed that between April 2006 and September 2007 debts between £500 and £999 increased by 40 per cent and debts between £1,000 and £4,999 increased by 25 per cent.

**2.2** There are a number of possible reasons for the increase in numbers of tax debts. It can be only partly explained by an increase in the tax base. Between 2006-07 and 2007-08 the number of Income Tax taxpayers increased by one per cent and registered traders by four per cent. More widely, consumer debt has doubled over the last seven years. Some debtor groups may have become more knowledgeable about recovery processes. Coinciding with the rise in its workload, the Department's debt management staff has reduced by 14 per cent since April 2006, as part of the Department's overall staff reductions to reduce headcount by 12,500 by 2008. The Department's prioritisation of higher value debts since August 2007 (see below) is also likely to have contributed to the rise in numbers of debts.

## How the Department prioritises collection of debt

**2.3** The debts the Department manages range widely in value. **Figure 7** shows that higher value debts represent a low percentage of the number of debts but a high proportion of the value. The Department prioritises higher value debts, and then PAYE debt, to manage its workload.

**7** The number of direct tax debts[1] in each value category at 31 March 2008

| Amount (£) | 0-499 | 500-999 | 1,000-4,999 | 5,000-19,999 | 20,000-99,999 | 100,000+ |
|---|---|---|---|---|---|---|
| Percentage of debts in each category | 70 | 16 | 11 | 2 | 0.39 | 0.06 |
| Percentage of debts by value in each category | 9 | 11 | 24 | 18 | 15 | 23 |

*Source: National Audit Office analysis of HMRC data*

NOTE

1 Data includes PAYE, Corporation Tax and self-assessed Income Tax debts. The Department does not have the percentage of debts by value for VAT.

The Department has prioritised debts by value since August 2007 to help it manage increasing debt with fewer resources, and help maintain cashflow to the Exchequer. Previously, the Department prioritised highest value and most recent debt. Automated reminder letters are issued for all debts, irrespective of value.

**2.4** Prioritising collection of debt by value maximises tax collected in the short term. Other organisations such as the Canadian tax authority also prioritise debts by value but combine it with other methods of prioritisation, including age, risk of default and customer type.

**2.5** In focusing on higher value debts, there is a risk that action taken against some taxpayers will be limited to automated reminder letters and that if taxpayers are not treated equitably, compliance in paying on time will fall if the public perceive that the Department pursues some debts more rigorously than others. The experience of the Department, and other organisations that collect debt, suggests that older debts are harder and more expensive to collect. To deal with its high caseload, the Department established a separate unit for small debts and is taking steps to link debts across taxes and identify higher risk debts. We examine these approaches in more detail below.

## Linking debts across taxes

**2.6** We previously recommended[7] that the Department should where appropriate pursue all debts owed on different taxes during initial contact with the debtor. The Department does not in most cases link all of a debtor's liabilities or identify where taxpayers with debts are owed refunds across different taxes because of limitations in its IT systems. The Department does however link and manage jointly high value debts, debts under Time to Pay and debts being submitted for distraint, county court or civil recovery action. Large debt collection operations in financial services, utilities and overseas tax administrations have invested in databases to enable them to view customers' accounts as a whole. The Department has examined how to integrate all taxes onto one IT system, but has decided it does not have sufficient funding for the project.

**2.7** The Department cannot readily establish how many taxpayers have debts on more than one tax. In a trial in early 2008, the Department examined more than 2,000 VAT cases to see if they had debts on other taxes. Twenty seven per cent of the cases, totalling £9.2 million, also had direct tax debts, mainly on PAYE.

**2.8** Managing each debt separately increases the cost of collection because of multiple contacts with the taxpayer and makes it more difficult to prioritise debts. Some debts are individually of low value, but when added to the taxpayer's other debts could become a higher priority. In the trial, the Department found that 56 per cent of lower value VAT debts could be linked with other debts making them higher priority and it pursued £1.1 million of debt sooner than it otherwise would have done. The Department estimates it could pursue an additional £26 million out of around £217 million of VAT debt if it applied the same approach for all lower value VAT debts.

## Managing small debts

**2.9** In March 2008, 70 per cent of direct tax debts were less than £500. In the 2008 trial the Department found that 17 per cent of small debts could be linked. It established the Small Debt Unit following the trial to review all debts under £500 to establish whether they can be linked with debts on other taxes and pursued more quickly. In October 2008, however, it decided to redeploy the unit's resources to collect a wider range of debts.

**2.10** In some circumstances legislation allows the Department to adjust a taxpayer's tax code to collect certain self assessed Income Tax and tax credit debts through PAYE. An exercise by the Department estimated that some 540,000 cases, totalling almost £97 million could be collected in this way. While some small debts are already collected in this way, the Department could make greater use of this approach. It plans to conduct small scale trials in 2008-09 to better understand both the customer reaction and the costs of doing so. Taxpayer groups we consulted suggested that, in collecting debts via the tax code, the Department should clearly explain how the debt has been calculated and provide the opportunity to appeal against adjusting the tax code as a method of recovery.

7 *The recovery of Debt by the Inland Revenue*, HC 363, 2003-04.

## Risk profiling of debts

**2.11** The Committee of Public Accounts and we previously recommended that the Department adopt good practice used by other organisations by developing scoring techniques to categorise taxpayers by risk. Risk scoring combines internal and external data such as socio-economic data and Credit Reference Agency data to gain an insight into the customer's behaviour and level of indebtedness with other lenders and assign a score to debtors. The risk score can be used to group customers with similar characteristics and behaviours and identify the most appropriate collection strategy for each customer grouping. Risk profiling also helps organisations improve their understanding of customer behaviour and improve future compliance. Risk scoring debtors allows organisations to better support those who do not understand their obligations or are in financial crisis, while dealing promptly with debtors who deliberately pay late. Organisations can also identify the total debt at risk because of insolvency or likelihood of default. **Box 1** describes the Netherlands tax authority's approach to risk scoring.

**2.12** In September 2007, the Department began a study for identifying higher risk, lower value debts. In the absence of funding for fully automated risk profiling, it aims to make better use of staff knowledge and its existing internal and external data sources, such as credit reference data, to develop more intelligent, targeted and tailored interventions for those individual debtors who 'can pay'. It has conducted a separate risk modelling exercise to identify and rank VAT debtors who are more likely to pay, mainly using internal data but has not yet started approaching these debtors differently.

**2.13** The Department has tailored its approach on different groups of debtors based on risk as part of other initiatives. For example the Department found that some types of debtor paid reasonably quickly after receiving the first demand and it has used this information to delay further recovery action in such cases so as to deploy resources more effectively.

**2.14** Other organisations have significantly improved their performance through risk profiling. For example, an energy supplier we spoke to used customer-level data to produce scoring models, segmented customers into groups and tested alternative strategies on different groups. They reported reductions in total debt of eight per cent and debt greater than six months old of 28 per cent. Similarly, a debt collection agency reported improvements ranging from 15 to 40 per cent in the amount collected for different debtor groups following the introduction of risk scoring.

**2.15** Risk profiling would also allow the Department to identify more vulnerable taxpayers. For example, the Department could tailor its initial correspondence to the needs of particular taxpayers and could contact taxpayers with relatively small debts but who would need support in paying and discuss payment options at an early stage. This could avoid smaller debts building up to sums that the taxpayer would have no hope of paying.

### BOX 1

**Netherlands Tax Administration's approach to risk modelling**

The Netherlands currently has a 'two-track' debt collection approach. Taxpayers with a previous history of non-compliance are identified and fast-tracked through the system. They plan to introduce a more developed risk processing system during 2009:

**Step 1:** Each taxpayer is assigned **points** according to known criteria, events, behaviours and previous compliance record e.g. the number of times the taxpayer's direct debit bounced, the number of times the taxpayer has been issued payment reminders, summons or distraint warrants, the number of times the tax administration has levied on goods or the number of times the taxpayer applied for a payment arrangement or waiver.

**Step 2:** The points are consolidated to calculate a **credit rating** for each customer so that the more compliant the taxpayer, the higher the credit rating. The rating can change over time according to behaviours and events.

**Step 3:** The credit rating determines the **collection treatment**. The Netherlands plan to have up to five collection tracks. For example, reminders could be issued to taxpayers with high credit ratings. More robust enforcement action such as levying on goods, or enforced direct debit could be used immediately against less compliant taxpayers.

**Step 4: Monitor** the impact on debt recovery performance over time so that it could fine-tune the system by varying either the scoring or the response.

# PART THREE

# The costs and effectiveness of debt collection methods

**This part examines the cost-effectiveness of the tracing unit, the Debt Management Telephone Centre, the local Debt Pursuit Offices and the Enforcement and Insolvency Unit. It also draws on practice in the private sector and overseas tax authorities.**

## Measuring the effectiveness of different collection activities

**3.1** Our previous report[8] concluded that the Department required better information on the amount of debt collected and the average unit cost for different methods of collection to allow the Department to analyse its success and use resources cost-effectively. Although the Department can measure the total debt collected for every £1 spent it cannot yet measure the debt collected from all of its separate activities. Although some private sector organisations are able to measure activity costs, most organisations consulted were, like the Department, in the process of researching and introducing activity-based costing.

**3.2** Following staffing reductions as part of the Department's drive for efficiency savings, Debt Management directorate staff costs of debt collection fell from £184.5 million in 2006-07 to £170 million in 2007-08. The directorate collected £310 of debt for every £1 spent in 2007-08, an increase from £281 in 2006-07.

**3.3** In 2008, the Department started work to develop activity-based costing although it has not yet set a firm timetable. Ahead of results from this work, the Department provided summary data from which we have been able to estimate some indicative costs per debt actioned for the main high level collection activities **(Figure 8)**. The cost of actioning debts by the Telephone Centre is lower because it is designed to process quickly high volumes of simpler debts. Recovery offices and the Enforcement and Insolvency Unit incur higher costs because the debts are more complex. Debts may be subject to one or more interventions before they are collected.

**8** Cost of different collection activities

| Main collection activity | 2007-08 Number of debts actioned[1] (000s) | 2007-08 Cost of activity (£m) | 2007-08 Cost per debt actioned (£) | 2006-07 Cost per debt actioned (£) |
|---|---|---|---|---|
| Telephone Centre | 3,108 | 14.6 | 4.71 | 4.75 |
| Debt Pursuit Offices | 8,032 | 137.6 | 17.13 | 20.16 |
| Enforcement and Insolvency | 335 | 19.9 | 59.63 | 53.51 |
| Overall | 11,475 | 172.1 | 15.01 | 17.07 |

*Source: National Audit Office analysis of HMRC data*

NOTES

1 'Actioned' means that the debt has either been paid in full or time to pay arrangements have been agreed, or it has moved to another stage in the recovery process or the Department has established that there is in fact no debt to pay. The Department does not have information on the number or amount of debt actually collected by each collection activity.

2 Both the number of debts actioned and the cost include tax credit overpayments. It was not possible to exclude these amounts.

8 The recommendations in our previous report, and in the report by the Committee of Public Accounts *The Recovery of Debt by the Inland Revenue* HC 363, 2003-04, were made for Inland Revenue.

## Tracing debtors' addresses and telephone numbers

**3.4** The Committee of Public Accounts[9] noted that the former Inland Revenue wrote off £55 million (at 2002-03 prices) in 2002 because it could not trace the taxpayer and that £300 million of debt over a year old related to cases where the Department did not have up-to-date telephone numbers and addresses. The Committee recommended that the Department should make maximum use of other Departments' records to find taxpayers it cannot trace, and seek a legal power to require taxpayers to provide up-to-date contact details.

**3.5** While some taxpayers, such as VAT registered traders, are legally required to provide up-to-date contact details, many are not. The Department has concluded that it should not seek additional legal powers to require all taxpayers to provide up-to-date contact details because it considers the administrative burden on taxpayers would be too great and because the requirement could be difficult to enforce. It has, however, introduced measures to improve its tracing of debtors' addresses and telephone numbers and can obtain information from the Department for Work and Pensions, Driver and Vehicle Licensing Agency, local authorities and other third parties. The 2008 Review of Information Security at HM Revenue & Customs[10] suggested however that the Department's customers should have greater responsibility for maintaining their records and opportunities to manage this themselves, for example, through an online account.

**3.6** Each year the Department refers to its Tracing Unit over 600,000 cases where it does not have the correct taxpayer address. The Unit uses various information to confirm taxpayers'addresses and has introduced new IT tools and deployed additional staff as part of a Spend to Raise initiative.

**3.7** Since 2005-06, the Department has reduced the total value of cases awaiting tracing by 52 per cent, from £366 million to £177 million. In 2007-08, the Department spent £10 million on tracing. It estimates that it collected £114 million more debt in 2007 by increasing tracing activity. The Unit is meeting most of its targets, successfully tracing over 90 per cent of direct tax cases referred to the Unit. It has not set targets for tracing VAT debtors. The Department wrote off over £300 million in 2007 **(Figure 9)** because it could not trace debtors, over three times the amount it wrote off in 2002. Of this, £210 million related to direct taxes. In 2008, the Department wrote off £178 million of indirect taxes, of which £139 million related to VAT. It attributes the increase in write-offs since 2002 to increased tracing activity and a greater focus on high value debts, enabling the Department to identify and write off higher levels of untraceable debt.

**3.8** The Department does not have data on how many debtors have an incorrect or missing telephone number. Other organisations including water companies and banks have high numbers of incorrect telephone numbers: a medium-sized bank said it had inaccurate telephone numbers on up to 50 per cent of cases. The Department has a contract with an external provider to trace missing telephone numbers. The Department does not know how much it costs to trace each telephone number. The estimated success rate in tracing numbers is around 19 per cent although the contract does not specify a target. If the external provider cannot trace a number, a Debt Pursuit officer visits the taxpayer's home or business address to pursue collection.

## Using the Telephone Centre to collect debt

**3.9** The Committee of Public Accounts and we previously recommended that the Inland Revenue should route all its tax debts through the automated Telephone Centre and that this would be an important step to ensure that the new HM Revenue & Customs had systems in place for managing debts efficiently across its customer base. The Department's Telephone Centre now deals with all self-assessed Income Tax debt (except very high value debts) and all PAYE debt as well as the Construction Industry Scheme and tax credit overpayments. The Department plans to start routing Corporation Tax

**9** Level of write offs because the Department could not trace the debtor

| | 2002 (£m) | 2006 (£m) | 2007 (£m) | 2008 (£m) |
|---|---|---|---|---|
| Direct tax write-offs | 63 | 77 | 210 | Not yet available |
| Indirect tax write-offs | 22 | 95 | 126 | 178 |
| Total write-offs | 85 | 172 | 336 | – |

*Source: National Audit Office Analysis of HMRC data*

NOTE

All figures are in real terms. Write off figures based on data at the end of October for direct taxes and end of March for indirect taxes. Direct tax write-offs include National Insurance Contributions for 2006 onwards.

9 Committee of Public Accounts 49th Report, *The Recovery of Debt by the Inland Revenue*, HC 363 2003-04.

10 *Review of Information Security at HM Revenue & Customs*, Kieran Poynter, June 2008, paragraph xII.19.

debts through the Telephone Centre by the end of 2008. The Centre does not collect VAT debts. In total, 620 full time equivalent staff work in the Telephone Centre which costs around £15 million a year to run. It deals with 2.4 million calls a year, and it actioned around 1.1 million cases in 2007-08, an increase of 28 per cent over 2006-07. Action taken may involve collecting the debt or passing the case to the Debt Pursuit Office or tracing unit. Although the Department measures the amount of debt it collects in total, it does not separately identify how much debt is collected by the Telephone Centre.

**3.10** The Telephone Centre is designed to process high volumes of simpler debt cases. It costs the Department around £4 to action each debt through the Telephone Centre, compared to around £17 for Debt Pursuit Offices (Figure 8). We estimate that increasing the number of debts the Telephone Centre actions by 15 per cent (with a corresponding reduction in the number of debts actioned by pursuit offices) could save around £6 million a year in collection costs. Using the Telephone Centre to action higher volumes of debts more quickly would also increase cashflow to the Exchequer. Initial research by the Department has identified various ways to increase the cost-effectiveness of the Telephone Centre, although it has yet to assess the likely benefits and costs and the level of funding that can be made available:

- Using staff time more effectively by minimising downtime by updating the IT system outside Telephone Centre opening hours, training staff to handle a wider range of taxes and by routing calls more intelligently to advisers with appropriate skills for the type of call. These changes would allow the Department to collect debt more quickly and make savings. It is exploring the costs of extending system availability with its IT partners.
- Increasing the staffing outside normal office hours to better match when certain customers are most likely to be contactable by telephone. One organisation we consulted said that it reached the right person in 16 per cent of cases during normal office hours, rising to 27 per cent between 18.00 and 20.00. The Department also found that its contact rates increased from 42 per cent in normal office hours, to 47 per cent in the evening and 45 per cent at the weekend. The Department plans to increase staff working outside normal office hours by the end of 2008.
- Using the Telephone Centre to collect VAT debt and to make follow-up telephone calls on self-assessed Income Tax and PAYE where, for example, a promise to pay has not been kept. In April 2008, the Department started exploring implementation of these changes which could reduce the costs of Debt Pursuit Offices which currently perform this work. It is investigating ways to fund system changes which will enable the Telephone Centre to make follow-up telephone calls, and is planning a pilot on collecting VAT through the Telephone Centre in late 2008.
- Maximising call centre availability by introducing new technology which would switch staff automatically between inbound and outbound calls according to inbound call volumes. At present, the systems are switched manually between in and outbound calls around twice a day to cope with demand. The Department estimates that staff spend nine per cent of their time waiting for the system to be changed. The Department expects to have automatic switching functionality in place by April 2009 as it introduces Voice over Internet Protocol.[11]

## Local debt recovery

**3.11** The Department has a network of local Debt Pursuit Offices which deal with debts the Telephone Centre is unable to collect as well as other debts which are sent straight to them. The Department is currently rationalising its network to increase business efficiency and to realise estates savings as part of a wider departmental estates rationalisation. It is considering closing around two thirds of Debt Pursuit Offices. At September 2008, the Debt Management directorate had withdrawn from 17 of 147 locations.

**3.12** Local debt recovery includes visiting debtors, seizing goods, serving legal papers and attending Court or Commissioners' hearings as well as collecting and processing payments and providing local help and advice to help ensure future payment compliance. The Department conducted around 576,000 face-to-face visits in 2007-08 with an average return of £1,100. The effectiveness of face-to-face visits depends on whether the officer makes contact with the debtor. Most visits currently take place during normal office hours which may be suitable for some debtors but not others. The Department recognises that the contact rates achieved on visits with debtors is low, particularly on self-assessed Income Tax and in inner cities. The Department estimates that in 2007-08, on around 45 per cent of visits, staff made face to face contact with the debtor, spoke to someone else who knew the debtor or acquired a telephone number from the address. In over half of the remaining visits, the officer left a letter without being able to confirm the address was correct.

11 Voice over Internet Protocol is used to transmit voice conversations using the internet.

**3.13** The Department developed the Fieldforce project to improve the efficiency and effectiveness of face-to-face visits. In January 2008, there were some 6.8 million debts on hand across all Debt Pursuit Offices. The Department plans to centralise some administrative work such as preparing case files for county court claims, but face-to-face visits and court attendances require local presence. The Department considered outsourcing face-to-face visits but decided to develop an in-house approach – Fieldforce. Pilot work conducted in 2006 identified improvements through creating a specialised workforce, increasing flexible working, centralising support and using remote technology. Contact rates[12] on the pilot increased from 65 per cent to 70 per cent and officers collected on average £1,250 per visit compared with a national average of £1,100. The Department identified three options for taking Fieldforce forward, with escalating benefits depending on increases in the contact rate. It is implementing a cost neutral option which aims to increase cashflow by £29 million over five years.

**3.14** The Department started to roll out Fieldforce across the country in autumn 2007 and by September 2008 it had been operational in only one out of 12 geographical areas for more than six months. The Department aims to increase visits which result in contact with the debtor by 0.2 visits per day to 5.5 by improving support for staff and improving quality control. Full implementation would increase visits to 7.8 per day. Our benchmarking work identified a debt collection agency who said that their bailiffs make on average 15 contact visits per day. The difference between the contact rates achieved by these bailiffs and the Department's distraint officers may in part reflect differences in the nature of the work they carry out. For example, the Department's officers aim to educate and support debtors in paying on time, which some bailiffs may not do, depending on the sorts of debts they are recovering. The daily visit rate achieved by the private sector bailiffs indicate the opportunities for potentially greater levels of contact with more flexible working hours.

**3.15** The Department has had to resolve various issues. Internal applications for both Fieldforce officers and support staff were lower than expected and may have been influenced by staff concerns about wider staff reductions, the Department's policy on remote and mobile working and related issues around pay and allowances. Fewer Fieldforce officers than expected volunteered for flexible working (offered without paid overtime) and in April 2008, 90 per cent of visits in an operational Fieldforce area were conducted during office hours rather than at other times of day. In London recruitment was suspended pending resolution of the Department's policy on remote working. The Department has now agreed the remote and mobile policy with the Trade Union although some implementation issues have still to be resolved. It expects this will help encourage more flexible working by emphasising benefits both to the business in terms of collecting more debt and to staff in terms of work-life balance.

**3.16** The Department has estimated that Fieldforce could bring potentially greater benefits if funding can be made available. It estimated it could increase cashflow by a further £385 million by introducing more IT to enable staff to work remotely, facilities for doorstep direct debit payments, automating support work and satellite navigation to help staff travel more efficiently between visits. It is introducing satellite navigation for all Fieldforce staff and has identified a potential IT solution which could cost an estimated £8.3 million over five years.

## Enforcement of debt through insolvency

**3.17** The Department's Enforcement and Insolvency Service is responsible for settling the debts of individuals and businesses where Debt Pursuit Offices have been unable to do so. It contacts the taxpayer to issue a statutory warning[13] that the Department may petition for bankruptcy or liquidation if the taxpayer does not arrange payment or dispute the debt. If a taxpayer is made insolvent, the Department receives a share of any assets recovered and writes off the remainder of the debt. By pursuing insolvency, the Department also prevents further debt accruing.

**3.18** In 2007-08, the Service took on £5.7 billion of debt from Debt Pursuit Offices. It recovered £1.1 billion in the same year. Its success in recovering debt varies across taxes. In 2007-08, it recovered 26 per cent of its workload on direct taxes, up from 24 per cent in 2006-07, compared to a 20 per cent target. The percentage of VAT debt recovered is lower at five per cent, which the Department attributes to greater levels of VAT being written off because of 'Missing Trader' fraud. The Department recovers most of the debt when bankruptcy action prompts the taxpayer to settle. A relatively small amount is recovered directly through bankruptcy, although the Department does not record this data because of administrative costs. The Department estimates that it recovers around four pence for every £1 of debt through bankruptcy, in line with the return achieved by other organisations. Because of the low return on insolvencies, other tax authorities we visited used other enforcement methods to recover debts as described in paragraph 3.21 and 3.23.

12 The Department defines the 'contact rate' as face to face contact with the debtor, speaking to someone else who knows the debtor or acquiring the telephone number from the address.

13 Statutory Demand notices issued for bankruptcy proceedings and Seven Day Warning Letters issued for liquidation of companies.

**3.19** The Department achieves a higher return, estimated at 60 pence for every £1 of debt, when the debtor proposes a Voluntary Arrangement[14] with its creditors. The Department collected £41 million through Voluntary Arrangements in 2007-08 and the number of Voluntary Arrangements increased from around 4,000 in 2001 to around 10,000 in 2007-08. Other organisations have experienced an increase in Voluntary Arrangements and report that around a third fail. Since 2007, the number of all Voluntary Arrangements in England and Wales has fallen by 12 per cent.[15] The Department does not record information on how many of its Voluntary Arrangements fail but expects this information to be available in 2009.

## Other enforcement methods

**3.20** Our previous report recommended that the former Inland Revenue explore the benefits and implications of requiring companies with a poor payment record to provide bank guarantees and/or set up separate bank accounts into which taxes deducted should be immediately transferred. The Department's enforcement powers vary across taxes because it has inherited them from the former Inland Revenue and HM Customs & Excise. As part of the Department's review to align powers across the Department[16], it consulted on whether it should have the power to collect debts by securing taxpayers' assets in the same way that it currently collects debts by removing goods. Many respondents were concerned that the proposal would have insufficient safeguards and could create hardship. The Department plans to announce the results of its consultation by the end of 2008.

**3.21** Other overseas tax administrations have stronger enforcement powers. For example, the Netherlands tax authority can recover tax debts from the taxpayer's salary at source and can arrange a direct debit on the taxpayer's bank account. Taxpayers unable to pay because of hardship can apply for the tax to be waived. Similarly, the US Internal Revenue Service can establish a claim against debtor's property as security against the debt, called a 'lien'. They find it a powerful tool and most debtors get in contact quite quickly as it appears on the debtors' credit records and is a public record. The Irish Revenue has power to serve an order on a bank requiring it to use positive balances on the debtor's account to pay outstanding tax directly to the Revenue. It collects around 25 per cent of the amounts specified on such orders. The Department can only recover tax debts from a debtor's salary at source or from their bank account through county court action.

**3.22** In our previous report, we recommended that the Department consider selling on some of the hardest to collect debt where it is cost-effective to do so. Organisations we consulted in our benchmarking work now pass debts to external collection agencies (where an organisation pays an agency commission for debts collected) or debt buyers (where the debt is sold) sooner than before to collect debts as quickly as possible. For example, one bank places debt with an agency after 180 days, and another sells debt after six months.

**3.23** The US Internal Revenue Service and the Australian Tax Office have used private sector debt collection agencies. In 2006, the Australian Tax Office passed 11,000 low value, non complex business debts totalling (AUS)$60 million to an agency, which collected around (AUS)$21 million. It has now implemented the programme on a larger scale, passing primarily low value debts to agencies to seek payment in full or a payment arrangement. All other enforcement action is taken by the Australian Tax Office.

**3.24** The Internal Revenue Service has used two private debt collection agencies since September 2006. It collected $31 million in 2006-07 by resolving around nine per cent of more than 100,000 low-value cases sent to them. This amount was less than the $46 million originally planned, partly because there were fewer easy-to-collect debts and partly because the programme has not expanded in the way the Internal Revenue Service planned.

**3.25** Both tax authorities faced parliamentary and media criticism on passing taxpayer information to external agencies, although the number of taxpayer complaints was low in both cases. The Internal Revenue Service found it time consuming to manage the contracts and to ensure that the agencies complied with its standards.

14 Voluntary Arrangements, in which a debtor and all its creditors make a formal agreement regarding payment of debts, were introduced in the UK by the Insolvency Act 1986 to support viable businesses experiencing temporary financial difficulties.

15 The Insolvency Service, *Insolvency Statistics Second Quarter 2008*, 1 August 2008. In April-September 2008, Voluntary Arrangements in England and Wales fell by 12 per cent against the same period in 2007.

16 *Modernising Powers, Deterrents and Safeguards, Payments, Repayments and Debt: The Developing Programme of Work*, 25 June 2007.

# PART FOUR

# Preventing debt arising

**This part examines the reasons taxpayers get into debt, the information available to them, payment arrangements and the penalties used by the Department to encourage payment on time.**

## Level of debt arising

**4.1** In 2007-08 around 30 per cent of taxpayers with a tax liability did not pay on time. Since 2003-04 the number of employers paying PAYE on time has increased from 53 per cent to 65 per cent, while the numbers of individuals and companies paying on time has fallen slightly. Preventing debt from arising in the first place can be more cost-effective than seeking to recover debt.

## Reasons why taxpayers get into debt

**4.2** We commissioned Ipsos MORI to interview current or former tax debtors to better understand attitudes to debt and why people get into tax debt. The 26 interviews, together with research undertaken by the Department, show that there are various reasons why taxpayers do not pay tax on time. Small businesses may have difficulties in managing their cashflow, particularly where they need to pay tax in a lump sum or if monthly payments are due before they receive payment from customers. Taxpayers may also miss payments because they are not aware of deadlines, have difficulty keeping records to calculate what they owe or if other debts take priority over tax. Businesses which have become insolvent may also owe tax. Taxpayers with multiple incomes (including pensioners and students) may have arrears because they have unknowingly been paying the wrong amount of tax. Debt also arises because of unexpected crises in people's lives such as serious illness or family breakdown.

**4.3** Some people do not pay their tax on time in the hope that they will not be pursued further. This group may repeatedly dispute the amount they owe or avoid contact with the Department. Some do not pay on time as a way of actively managing cashflow **(Box 2)** because they view tax payments as less important than paying suppliers. Others do not see being in tax debt as undesirable. For example, one former self-assessed Income Tax debtor told us:

"I don't think there's the stigma that there used to be, not at all. There's hardly anybody I know that isn't in debt in some form or another."

**BOX 2**

**Example of how some taxpayers avoid paying tax on time to manage their cashflow**

Matthew owns a small business that acts as an agent, sourcing and selling stock between producers and suppliers. After business increased, he decided to change status from sole trader to a limited company. He got into Corporation Tax debt in 2002 after changing economic conditions meant that the larger companies he dealt with moved from a 30 day to 90 day invoicing period and 'renegotiation' of back-dated sales led to a smaller than expected turnover. The change in timing meant that cashflow became a problem, and he started to use the money saved for tax to pay his suppliers. *"If my suppliers don't trust me to pay what I owe, they will use someone else."* Tax was a secondary concern.

*Source: Ipsos MORI research for National Audit Office*

## Clearer information for taxpayers

**4.4** The Committee of Public Accounts' previous report[17] found that the Department's leaflets were out of date and that the website did not provide important information on helplines and sources of advice. It recommended better information for taxpayers about payment and debt recovery arrangements. The Department has improved the information available in leaflets on some taxes and on the internet to help taxpayers to know when tax is due, how to pay and the implications if they don't pay. It has also made improvements to the layout, search function and navigation of its website. **Figure 10** shows improvements made by the Department and areas where our research showed taxpayers would benefit from clearer information, including information on how tax debt is calculated.

**10** Information for taxpayers

| Area | Good information provided | Areas where information could be improved |
|---|---|---|
| Information provided in paper form or on the website | Clear information on payment dates and deadlines, payment options and penalties. There is a 'what to do if I have problems paying' section on the website with information on availability of time to pay, factsheets on enforcement methods and links to voluntary organisations which may be able to provide help and advice. | Information on interest rates charged on overdue taxes are in a different section of the website to tax-specific penalty information. |
| | Leaflets on some taxes (for example, tax credits) contain clearer information for people with problems paying. | On other taxes (for example VAT, Corporation Tax), leaflets with information for people with problems paying are more limited although more extensive information is available on the website. |
| Telephone payment helplines | The 'how to pay' helpline **0845 366 7816** and the Self Assessment Payment Helpline **0845 366 1204** are open 8.00–20.00 Mon-Fri and 8.00–16.00 Sat. The National Advice Service Payment helpline **0845 010 9000** for VAT and other indirect taxes is open 8.00–20.00 Mon–Fri. | Links to the payment helpline from other areas of the website (for example Corporation Tax, PAYE) are difficult to find. Printed guidance on Self Assessment does not provide the Self Assessment Payment Helpline number. |
| Online Services | Registered taxpayers can receive email reminders for major taxes. | This option is not available for Corporation Tax. |
| | Email reminders of tax filing and payment dates are available from the Business Link website. | Concerns about how reliable the reminders are. |
| Specific information about a taxpayer's affairs | Registered Self Assessment and Corporation Tax taxpayers can view their account details online including historical details of amounts paid. | Online account not available for VAT or PAYE taxpayers. |
| | Statement of Account for self assessed income taxpayers shows more clearly what taxpayers owe. | Self Assessment Income Tax return could be clearer that taxpayers must submit a return if they are sent one even if they have no tax to pay. If they do not file a return, the Department's assessment of tax owed will become a debt until the return is filed or debt paid. |
| | Agents can view registered clients' account details online. | Some language used is difficult to understand, eg a 'determination' where the Department has raised an assessment for the estimated tax due in the absence of a return. |
| | | It is difficult for some taxpayers to understand how tax has been calculated. |

*Source: National Audit Office*

17 Committee of Public Accounts 49th report, *The Recovery of Debt by the Inland Revenue*, 2003-04.

**4.5** The Department currently contacts taxpayers by letter or telephone about paying tax due. Leading debt collection organisations are expanding the ways in which they contact customers. We spoke to a large water company, debt collection agency and a bank that all use SMS text messaging. A large energy company is trialling interactive voice recognition software[18] and SMS text messaging with customers who don't respond to other types of contact. It said contact rates for SMS were around 12 per cent compared with two per cent for voice recognition software. At around 5p per text, more than 10,000 messages can be sent instantly for approximately £500 (against, for example, £2,300 on postage for 10,000 letters). Other organisations use automated telephone messaging to remind customers that payments are due and to encourage debtors to contact them. For example, a large utility company we consulted said that 20 to 25 per cent of debtors called back after text or voicemail with a payment rate of eight to ten per cent. A debt collection agency told us that over 70 per cent of its telephone collection activity involves leaving automated messages. In October 2008, the Department began piloting voicemail for a small sample of low value debts and is also considering exploring how it could use text.

## Alternative payment methods

**4.6** Payment options vary **(Figure 11)** and are determined by the legislation for each tax. Some payment options, such as payment over the internet by debit card are not currently available for all taxes. Payment over the internet is increasing; online transactions have increased by 44 per cent in the last year.

**4.7** Over 40 per cent of payments are by direct debit, the Department's preferred payment method. VAT taxpayers can set up direct debits online. From July 2008, taxpayers have been able to set up direct debits by telephone for other taxes. The Department expects to offer online direct debit services on all taxes from late 2008.

**4.8** In 2004, the Committee of Public Accounts recommended that the Department explore the benefits and implications of providing the facility to pay by credit card. In 2008 the Government introduced legislation to accept payment by credit card and to pass on the merchants' handling charge to the taxpayer at the time of payment. The Department currently expects to introduce payment by credit card over the telephone by the end of 2008 and online in early 2009.

**11** The payment methods available for each tax

| | Self-assessed Income Tax | PAYE | Corporation Tax | VAT |
|---|---|---|---|---|
| Internet/telephone banking (BACS Direct Credit) | Yes | Yes | Yes | Yes |
| Debit card over the internet ("Billpay") | Yes | Yes | No | From Oct 2008 |
| Debit card over the telephone | Yes | Yes | Yes | Yes |
| Bank Giro (by cheque or cash at bank branch) | Yes | Yes | Yes | Yes |
| Post Office (by cheque, cash or debit card) | Yes | Yes | Yes | No |
| Cheque sent by post to Accounts Office | Yes | Yes | Yes | Yes |
| CHAPS | n/a | Yes | Yes | Yes |
| Paymaster (for employers who have an account with Office of Paymaster General e.g. Govt depts, health authorities) | n/a | Yes | Yes | Yes |
| Credit card | From late 2008 | From late 2008 | From late 2008 | Yes |

*Source: National Audit Office review of HMRC website*

NOTE
BACS – Bank Automated Clearing System; CHAPS – Clearinghouse Automated Payment System (for same day payment).

18 Interactive voice recognition software directs callers with voice prompts to select from a defined set of choices. Customers can make choices using either the number pad on the telephone or by stating their choices out loud.

**4.9** Other organisations offer various payment methods which the Department currently does not. Large utility companies use autopayment, where callers can make payments using the telephone keypad rather than speaking to an operator. Autopayment reduces the number of staff required to answer calls and process payments and can also appeal to customers who prefer not to speak to an operator. Utility companies offer Paypoint and many local authorities accept council tax payments through Payzone, both of which allow customers to pay household bills at shops such as newsagents. Payments are usually made in cash, helping customers without bank accounts to pay. The Department has no plans to offer these payment methods.

## Timing of payments

**4.10** Taxes have different statutory payment dates which can make it complicated for taxpayers to remember deadlines, understand their total tax liability and schedule payments, especially when there is a time lag between money being earned and tax being due. Most employers pay PAYE monthly, VAT is usually paid quarterly and self-assessed Income Tax every six months or annually and Corporation Tax annually. Many taxpayers are liable for more than one tax, for example the Department estimates that 850,000 companies have both Corporation Tax and VAT liabilities. Of these, 600,000 operate at least one PAYE scheme. 200,000 unincorporated businesses have Income Tax, PAYE and VAT liabilities.

**4.11** A recent review by the OECD[19] of programmes to reduce the administrative burden of tax regulations suggested that countries could consider aligning VAT and other periodic tax liabilities. Tax authorities in Australia, Denmark and Sweden are integrating business tax obligations to reduce costs and inconvenience of complying with complex tax regulations. The Department's research found that small businesses would not welcome the same payment date on different taxes as this would disrupt their cashflow. Several debtors Ipsos MORI spoke to on our behalf would prefer a monthly tax payment schedule to align with other business payments but this option is not open to all taxpayers. The Department consulted on flexible payment schemes in June 2007[20] and following responses, it developed proposals to enable Income and Corporation Taxpayers to pay using regular monthly instalments. Further consultation is planned for late 2008.

## Surcharges and interest for taxpayers who don't pay on time

**4.12** The Department charges interest and/or applies surcharges on tax that is not paid on time. At October 2008 the interest rate charged by the Department was 6.5 per cent for most taxes which is low compared to some forms of borrowing. The surcharges the Department imposes for late payment also vary by tax **(Figure 12 overleaf)**. In June 2008, the Department began consultation on interest and penalty regimes aimed at achieving greater alignment of rules across the taxes with a view to introducing new legislation in 2009.[21]

**4.13** Research with taxpayers suggests that the escalating charges on late payment of VAT can be effective in incentivising payment on time. One taxpayer commented:

> “The actions were effective, partly because of what I felt was a ridiculous charge for not making the payments on time. I make sure that I make those payment dates. It's just not worthwhile not doing that…I suppose if I didn't send them a cheque, I'm sure they'd be on my doorstep fairly quickly.”

Other taxpayers surveyed by the Department did not consider that the five per cent charge for late payments of self-assessed Income Tax was a sufficient deterrent as current borrowing rates are similar. In particular, the charge is not imposed until 28 days after the due date. One taxpayer noted:

> “It's better to owe them [the Department] than the bank…I always pay, before the end of February, because they say it's interest free up until then.”

Taxpayer groups we consulted considered that penalties would not incentivise payment on time for some taxpayers in real financial distress.

19 OECD Forum on Tax Administration: Taxpayer Services Group, *Programs to reduce the administrative burden of tax regulations in selected countries*, January 2008.
20 *Modernising Powers, Deterrents and Safeguards: Payments, Repayments and Debt: The Developing Programme of work*, 25 June 2007.
21 *Interest – Working Towards a Harmonised Regime*, 19 June 2008. *Modernising Powers, Deterrents and Safeguards: Meeting the obligations to file returns and pay tax on time*, 19 June 2008.

**4.14** In our previous report, we recommended that the Department introduce penalties for all employers who are late in paying PAYE during the year.[22] In 2008, the Department consulted on changes to penalties for late payment.[23] Proposals include applying a fixed sum penalty immediately or shortly after the due date for self-assessed Income Tax and possible changes to the PAYE penalty regime with the aim of encouraging employers to pay their in-year PAYE on time. The Department has also consulted on ways to improve the collection of National Insurance contributions from the self-employed.[24] The Department estimates that 60 per cent of Class 2 contributions are paid within 28 days of the date of quarterly bills, compared with 99.5 per cent of those paid by direct debit. Given the low weekly rate of Class 2 contributions, the Department considers it difficult to design effective and proportionate penalties. It is considering making it easier for taxpayers to pay on time by improving information and changing the timing of payments as well as by introducing interest charges on late payments.

**4.15** The Australian Tax Office imposes an interest charge on any tax debts that remain unpaid. The charge is applied daily at compounding rates well above the cost of finance. The New Zealand tax authority charges a reduced penalty if the taxpayer enters into a Time to Pay arrangement before the due date to encourage taxpayers to get in touch before they get into debt. The Department is consulting on proposals to charge reduced penalties if the debtor enters into a Time to Pay arrangement by the due date.[25]

**4.16** Some organisations incentivise customers to pay in a way that reduces the risk of late payment, such as offering a discount to those who pay by direct debit or charging extra if customers do not have a direct debit arrangement. In 2004-05, the Australian Tax Office offered small businesses and individuals a one-off opportunity to clear outstanding tax debts. 450,000 debtors with an associated debt of ($AUS)1.5 billion were offered reduced interest if they set up a direct debit from their bank account, filed all outstanding returns and paid on time in future. At the same time, they took firmer action with those debtors who did not respond to their offer. Almost 128,000 taxpayers finalised their debts with payments totalling ($AUS)864 million.

## Working with others to prevent debt arising

**4.17** The Department works with representative bodies to identify ways to help taxpayers to comply with obligations to pay their tax on time. For example, a sub-group of the Department's employer forum meets to consider debt issues and the Department has also established a voluntary sector liaison group and attends the Money Advice Liaison Group, a discussion forum comprising creditors, debt collection agencies and debt advisers. Members of our advisory panel told us that the Department consults more on debt issues than previously. The Department works closely with the OECD's Centre for Tax Policy and Administration, for example co-hosting a conference on debt analysis, and aims to learn lessons from other organisations that collect debt.

**12** Surcharges for late payment

| Tax | Surcharges | Numbers of surcharges issued in 2007-08 |
|---|---|---|
| Self-assessed Income Tax | Five per cent charge is added to tax unpaid 28 days after the due date. An additional five per cent charge is made if the tax remains unpaid six months after the due date. | 482,599 |
| PAYE | Large employers and others paying electronically can incur surcharges for late in-year payment.<br>No surcharge payable in-year for other late payments of PAYE. Interest payable at end of year for late in-year payments. | 512 |
| Corporation Tax | No specific surcharges for late payment. | N/A |
| VAT | Escalating charges depending on the number of occasions that payments are late. | 330,000 |

*Source: National Audit Office review of HMRC website and HMRC data*

22 *The recovery of Debt by the Inland Revenue*, HC 363, 2003-04.
23 Modernising Powers, Deterrents and Safeguards: *Meeting the obligations to file returns and pay tax on time*, 19 Jun 2008.
24 Modernising Powers, Deterrents and Safeguards: *Improving the collection of National Insurance Contributions from the self-employed*, 12 March 2008.
25 Modernising Powers, Deterrents and Safeguards: *Meeting the obligations to file returns and pay tax on time*, 19 June 2008.

# APPENDIX ONE

# Progress against previous Committee of Public Accounts Recommendations

**This Appendix summarises the Department's progress against the recommendations made in the Committee of Public Accounts' report *The Recovery of Debt by the Inland Revenue, 49th Report* 2003-04 and on *VAT debt from the Customs and Excise Standard Report* HC 447, 2004-05.**

## Part One – Overall performance in managing tax debt

| Recommendation | Treasury Minute response, January 2005 | Current position |
|---|---|---|
| The Department should seek to achieve similar debt clearance rates to the utilities sector. | The Department noted the recommendation. It said that it prioritised high value debts and takes early action in pursuing cases, but has to balance this against the overall volume of cases. | The Department has not developed performance indicators which would help it compare clearance rates against the utility sector (paragraph 1.4). |
| The Department's performance measures should include, for all types of tax and national insurance contribution debt, the percentage of taxpayers who pay on time, the percentage of debt collected within 30 days and the percentage collected within 90 days. | The Department agreed with the recommendation. It had service delivery targets for the percentage of taxpayers that paid on time across the major direct taxes. It was reviewing its performance measures and expected to include 30 and 90 day and six month targets. | The Department continues to measure percentage of taxpayers who pay on time across the major taxes.<br><br>The Department can measure average time taken to collect debt but not the percentage of debt collected within 30 and 90 days (paragraph 1.4–1.5 and Figure 2). |
| | **Treasury Minute response, February 2006** | |
| The Department needs to establish clear procedures to review uncollectible debt cases regularly, with targets set for their resolution. | The Department accepted the recommendation. It had reviewed collection procedures and issued improved guidance. Improvements to the computer system ensured all debt was brought into debt management. The Department was developing performance measures aimed at more effectively managing the uncollectible elements of debt during 2006-07. | The Department does not have performance measures aimed at uncollectible debt. |
| The Department should promptly notify and record all VAT debt on the Trader Register so that it can actively manage it. | The Department accepted the recommendation. The majority of VAT debt was downloaded promptly onto the Trader Register, although there were some minor management information issues remaining. | All indirect tax debts are downloaded onto the Trader Register promptly. |
| The Department should see how its performance on the collection of VAT debt now compares with that of other EU member states. | The Department is part of the OECD's Tax Administration Compliance Sub-Group to share knowledge and best practice with other tax authorities. | A Study Group on the European Organisation of Supreme Audit Institutions (EUROSAI) chaired by the UK National Audit Office presented a report *Benchmarking of Tax Administrations: Report of the EUROSAI Study Group* in June 2008 to the EUROSAI Congress. The report develops a categorisation of performance measures which reflect the activities of most tax administrations' core activities and uses VAT as a case example to illustrate benchmarking in practice: www.eurosai.org. |

## Part Two – Managing and prioritising debt

| Recommendation | Treasury Minute response, January 2005 | Current position |
|---|---|---|
| The Department should analyse the debt record of different types of taxpayer and use risk scoring techniques to identify the need for early action to support those taxpayers who are more likely to get into debt. | The Department agreed with the recommendation and said that the Integrated Debt Management System was the first step towards risk profiling. It planned to introduce more sophisticated risk profiling in line with best practice but it would need to be considered against other priorities. | The Department does not routinely risk score. It started a risk scoring study in 2007 for identifying higher risk, lower value debts. The project is in its early stages (paragraphs 2.12–2.13). |

## Part Three – The costs and effectiveness of debt collection methods

| Recommendation | Treasury Minute response, January 2005 | Current position |
|---|---|---|
| The Department should make maximum use of other Departments' records to find taxpayers it cannot trace and seek a legal power to require taxpayers to provide up to date contact details. | The Department noted the recommendation. It said it had a number of information gateways with other government departments and within its existing powers and that it was taking steps to improve its tracing service by bringing together all available data services into one unit. The first tranche of improvements were delivered in July 2004.<br><br>It was also involved in cross-departmental work which looked at how taxpayer contact details are provided and maintained across government. It was planning to consult on its powers to obtain information. | The Tracing Unit has more sources of internal and external data and is meeting most of its targets (paragraphs 3.5 and 3.6).<br><br>The Department has concluded that it should not seek additional legal powers to require all taxpayers to provide up-to-date contact details because it considers the administrative burden on taxpayers would be too great and because the requirement could be difficult to enforce (paragraph 3.5).<br><br>The Department consulted on requiring third parties, such as agents, accountants, banks and utility companies, to provide them with contact details in the consultation paper Payments, Repayments and Debt: the Developing Programme of Work. HMRC are continuing to develop this suggestion with a view to further consultation.<br><br>The *2008 Review of Information Security at HM Revenue & Customs* (Keiran Poynter, June 2008) suggested that the Department's customers should have greater responsibility for maintaining their records and managing them themselves (paragraph 3.5). |
| To improve efficiency, all debts should initially be pursued through the Department's Telephone Centre. All debts should moreover be handled through the Department's Integrated Debt Management System. | The Department agreed with the recommendation. In October 2004 tax credits were moved on the Integrated Debt Management System. It expected that by mid 2005 all major taxes would be handled on this system. It also said that the Telephone Centre would initially pursue the vast majority of debts, although some, on a risk basis, would be sent directly to local offices. | All direct tax debts are now included on the Integrated Debt Management System. The Telephone Centre initially pursues most taxes, except Corporation Tax and some high value self-assessed Income Tax debts. Indirect taxes, including VAT, are handled on another system and are not pursued through the Telephone Centre (paragraph 3.9). |
| The Department should seek additional powers for enforcing debts, similar to those of other tax authorities. | The Department planned to consult on the suitability of its powers, although it felt that distraint and magistrates/county court action could be very effective with different taxpayer groups.<br><br>It planned to improve risk profiling over the following two to three years to enable it to identify the most appropriate course of action for different debtor groups and allow earlier intervention in some cases. | The Department consulted on extending its powers in June 2007 (*Payments, Repayments and Debt: the Developing Programme of Work*). The proposals included looking at direct attachment of a debtor's assets or property without a court order. (paragraph 3.20).<br><br>It started a risk profiling study in 2007 which is in its early stages (paragraph 2.12–2.13). |

## Part Four – Preventing debt arising

| Recommendation | Treasury Minute response, January 2005 | Current position |
|---|---|---|
| The Department should provide up to date and accurate information and advice to those in debt on its website and in leaflets in different languages. | The Department agreed with the recommendation and had withdrawn a number of out of date leaflets. It planned to consult with the voluntary sector and review the information on its website. | The Department has updated information in leaflets and on its website. It is reviewing language requirements for leaflets (paragraph 4.4). |
| The Department should provide the facility to pay by credit card, passing on any service charge to taxpayers who use this method. It should be able to require payment by direct debit where a taxpayer has previously defaulted on a bill. | The Department noted the Committee's recommendation. It stated that it offered an extensive range of payment methods which were continuously reviewed. It had recently extended payment by debit card and was considering credit card payments. | Following consultation, in 2008 the Government introduced legislation to accept payment by credit card and to pass on the merchants' handling charge to the taxpayer at the time of payment. Payment by credit card over the telephone will be possible by the end of 2008 and online in early 2009 (paragraph 4.8).<br><br>VAT taxpayers can set up direct debits online. From July 2008, taxpayers have been able to set up direct debits by telephone for other taxes. The Department expects to offer online direct debit services on all taxes from late 2008 (paragraph 4.7). |
| The Department should impose a surcharge on persistent late payers and oblige them to pay the tax and contributions they deduct from their employees into a designated bank account. | Since May 2004 it had been a legal requirement for all large employers (over 250 employees) to make electronic payments.<br><br>The Department planned to consult on the suitability of its existing powers in January 2005, which would include the requirement to provide information, interest and surcharge regimes, penalties and rights of appeal. | The Department issued a consultation paper *Payments, Repayments and Debt: the Developing Programme of Work* in June 2007. It is following this up with a number of focussed consultations, including one on penalties for late payment and rules on charging interest in late 2008, with a view to introducing new legislation in 2009 (paragraph 4.12 and 4.14). |

# APPENDIX TWO

# Scope and Methodology

## Scope of the study

**1** The study focused on the Department's management of tax debt. We examined whether the Department manages and prioritises debt effectively, whether it collects and enforces debt effectively and efficiently and whether it is effective in preventing debt arising. We examined the progress made by the Department in implementing previous National Audit Office and Public Accounts Committee recommendations (see Appendix 1) and whether performance has improved since earlier reports on debt management.[26]

## Methodology

**2** Our fieldwork took place between January and May 2008 and comprised the following methodologies:

- Analysis of the Department's performance data.
- Interviews, visits and process familiarisation.
- Customer interviews.
- Performance and process benchmarking.
- Comparative analysis of overseas tax authorities.
- Document review.
- Advisory panel.

## Analysis of the Department's performance data

**3** We conducted a comprehensive analysis of the Department's information on debt recovery and management. Our analysis covered debt across all taxes and in particular self-assessed Income Tax, Corporation Tax, PAYE and VAT. We did not cover stoodover tax, which comprises direct tax assessments which are not payable whilst under appeal. The Department cannot legally collect stoodover tax and so does not classify it as debt. Suspended debt, which arises when assessments of indirect taxes are not yet confirmed has been excluded where possible. As we examine management of tax credits in the C&AG's Report on HMRC's Accounts[27] each year we have not covered the management of tax credit debt in this report and excluded tax credit debt from the data where possible. We analysed:

- Monthly activity, operational and management reports, including the Department's Debt Analysis Matrix, their primary monthly reporting tool.
- Financial information from the audit of the Trust Statement.
- Standard reports taken from the Department's debt systems, for example on write offs.
- Key performance indicator source data where available.
- Reports from the Telephone Centre, Tracing Unit and the Enforcement and Insolvency Unit and examples of performance measurement by Debt Pursuit Offices.

**4** We tried to obtain data dating back to 2002-03, to compare the position against our previous report. It was not always possible because of different accounting systems and because the Department has a number of IT and reporting systems which compile data differently. We uplifted all debt trend figures to 2007-08 prices using GDP deflators.[28]

26 *The Recovery of Debt by the Inland Revenue*, HC 363, 2003-04; Committee of Public Accounts' report *The Recovery of Debt by the Inland Revenue*, 49th Report, 2003-04; *Comptroller and Auditor General's Standard Report on the Accounts of HM Customs and Excise*, HC 447, 2004-05.
27 *Report by the Comptroller and Auditor General on HM Revenue & Customs 2007-08 Accounts*, HC 674, 2007-08.
28 GDP deflators HM Treasury.

5 We conducted financial and statistical analysis on:

- Trends in the value of debt as a percentage of revenue, value of debt by tax, age profile of debt and amount and reason for debt written off.
- Trends in volumes of current and new debts by tax and value.
- Trends in payment on time by tax.
- Trends in debt collected for every £1 spent by collection activity and performance trends in the different collection activities.
- Trends in staff and running costs.

## Interviews, visits and process familiarisation

6 We conducted around 25 semi-structured interviews with staff members involved in debt management and collection, including those in process and strategy, finance and operations, the Fieldforce programme, transformation programme, internal audit, tax stream process owners and the Department's individual and business customer units. We interviewed senior, policy, operational and front line staff members.

7 We also interviewed external stakeholders who represent the Department's customers, such as TaxAid, Confederation of British Industry, National Debt Line, Low Income Tax Reform Group, Institute of Credit Management and the Money Advice Liaison Group. We also spoke to the OECD's Centre for Tax Policy and Administration and attended a joint HMRC/OECD International Symposium on the use of analytics in debt management in November 2007.

8 We visited several operational sites: one of the Debt Management Telephone Centres, Tracing Unit, Enforcement and Insolvency Unit, five Debt Pursuit Offices and the Small Debt Unit. During our visits, we interviewed senior and operational staff, observed operational activities such as telephone calls to collect debts and tracing activity. We held small informal group interviews with operational staff to obtain a front line view of debt management. We accompanied staff on visits to debtors and to county court hearings.

9 We reviewed around 30 debtor cases files. Our aim was to familiarise ourselves with the IT systems and processes used by staff to collect debt and to gain an understanding of how taxpayers end up in debt and how debt builds up. We used a pro-forma to review each case to ensure consistency, which included: amount of debt, number of open debts/penalties, history, debts on other taxes, ease of finding taxpayer information on other taxes, number of contacts with the debtor and action taken by the Department.

10 The information gathered in interviews, visits and process familiarisation was used to understand the context of relevant performance data, to critically assess reports and business cases and to inform and triangulate findings from the customer research by Ipsos MORI (see paragraphs 11–14) and benchmarking work by Professor Wilson (paragraphs 15–20).

## Customer interviews

11 We commissioned market research consultants Ipsos MORI to conduct face to face interviews with 16 former (in the last two years) tax debtors, 11 current tax debtors and three tax agents. We wanted to explore the reasons individuals and small and medium sized businesses got into debt and how the interventions made by the Department affected the recovery of that debt, as well as some overall views about tax and the Department. The interviews took place between late March and May 2008 and lasted between 45 minutes and an hour. Ipsos MORI talked to a wide range of people: directors and managers of small and medium sized businesses, former proprietors of nursing homes, people starting construction businesses or moving out on their own as sole traders in the finance, graphic design and fashion industries.

12 The interviews covered:

- awareness of obligations, deadlines, payment options;
- reasons associated with difficulties in paying and help offered by the Department and other groups;
- customers' experiences of being in debt to HMRC;
- attitudes to debt and the extent to which tax debt is seen differently to other debts; and
- possible steps HMRC could take to help people avoid getting into debt.

13 Ipsos MORI recruiters identified participants by seeking referrals from contacts such as personal connections or from work places or other social organisations because there was no sample available from the Department. This method was successful in finding those who had been in debt, but generated few leads for current debtors. Ipsos MORI included a question on the Ipsos MORI Omnibus; a weekly nationally representative survey of around 2,000 adults aged 15 or over. As well as helping them to recruit more people currently in debt, the survey also provided representative statistics of the number of taxpayers in tax debt in the UK.

14 We used this work to back up findings from our literature research, interviews and the views of taxpayer representative groups.

## Performance and process benchmarking

**15** To understand how the Department compares to private sector and other revenue collecting government departments, we commissioned Professor Nick Wilson to benchmark the Department's debt collection processes against a number of comparator private sector organisations. Professor Wilson is Chair of Credit Management at Leeds University Business School, Director of the Credit Management Research Centre and an Honorary Fellow of the Institute of Credit Management.

**16** Professor Wilson explored current revenue collection practices, trends and innovations across nine organisations, including major financial services companies, energy companies, a water company and a debt collection agency. He distilled his findings into a best practice model which he compared against the Department's current debt collection process, organisation and infrastructure to identify areas for improvement.

**17** Fieldwork took place between March and May 2008 and comprised semi-structured interviews with nine organisations, a one-day in-depth workshop with the Department and a benchmarking workshop. The workshop was attended by five organisations including the Department to share common challenges, new practices and management of change within the different organisations.

**18** Professor Wilson looked at:

- Recording and updating of customer information.
- Using customer data (and other organisations' data) to determine the right intervention for the right debtor, at the right time and cost.
- The use of activity-based costing and process mapping to determine the cost effectiveness of debt paths and collection strategies.
- The use and effectiveness of different contact strategies for different debts.
- Approaches to enforcements and litigation.
- Benchmarking in-house versus out-sourcing of debt collection by debtor/debt type.
- Performance management.

**19** Professor Wilson's work helped us to put the Department's performance in a comparative context. His report was used to cross check findings from our own literature reviews, international comparisons and interviews with internal and external stakeholders. It also provided us with a valuable insight into how other organisations measure performance and provided context for our performance data analysis.

**20** We have drawn on Professor Wilson's work wherever it was possible to make comparisons with the Department. It is, however, difficult to benchmark the Department against other debt collectors because the nature, aim and customer-base of the organisations are different. For example, the type of business influences the age profile of debt. Financial services organisations aim to collect or write off and sell on debts as quickly as possible to avoid bad debt provision on their balance sheet and will not do business with these customers again. The Department does not need to write-off debt quickly – but it can and does write-off debts which it considers are no longer collectible, perhaps where a debtor is insolvent. Water companies, like the Department, cannot choose their customers and unless they move to another area, most remain customers whether they pay their bills or not. Water companies can no longer usually cut off a customer's water supply. It is not in their interests to write-off debts as they may be able to collect payments over a longer period of time.

## Comparative analysis of overseas tax authorities

**21** We visited four tax authorities in other countries to examine their approach to debt collection and performance in managing debt. Preliminary research led us to understand that other tax authorities' approaches had moved on since our previous report. We chose four tax authorities which were comparable to the Department in terms of size, range of functions and tax base and which had made significant progress since our last report. We used this work alongside Professor Wilson's analysis of private sector practice to put the Department's performance in context and to assess the scope for improvement.

**22** We visited the Canada Revenue Agency, the Netherlands Tax and Customs Administration, the Irish Revenue and the United States Internal Revenue Service. All visits took place in April 2008. In each country, we used a mix of standard interview questions and country-specific questions based on desk research and our previous report. We interviewed a mix of policy and operational staff. Areas covered included:

- Changes since previous report.
- Updating and using taxpayer information.
- Debt collection process.
- Use of risk scoring and contact strategies.
- Management information and performance measurement.
- Payment methods.
- Penalties and surcharges.
- Debt levels and trends.
- Efforts to prevent debt arising.

**23** We also did some desk-based research on other comparator tax authorities, such as the Australian Taxation Office and the New Zealand Inland Revenue, including reports on the Australian Taxation Office's *Administration of Debt Collection – Micro-Businesses, Audit Report 42*, 2006-07 and the Inspector-General's report *Review into the Tax Office's Small Business Debt Collection Practices*, 12 April 2005.

## Document review

**24** We reviewed internal Departmental documents relating to debt:

- Progress against PSAs and other strategic objectives.
- Strategy documents, including analysis of performance data.
- Business cases, project plans and evaluations of the pilots and initiatives relating to debt.
- Information available to taxpayers from the Department, including the website, hard copy leaflets and samples of letters to taxpayers.
- The Department's research on taxpayers.

**25** We also reviewed literature from other organisations, such as TaxAid, the Low Incomes Tax Reform Group, the Legal Services Research Centre on taxpayer attitudes and reasons for getting into debt. We reviewed reports on tax administrations and debt by OECD. All literature was generated in the last three years and was analysed against findings from all other methodologies.

## Advisory Panel

**26** We invited experts in credit management and tax debt and taxpayer representative groups, to sit on our Advisory Panel. Members were:

- Barry Stamp — Institute of Credit Management
- Sebastian Hordern — Confederation of British Industry
- Rosina Pullman — TaxAid
- John Kerr — Adjudicator's Office
- Kelly Hayworth — Low Incomes Tax Reform Group
- Deborah Shields — National Debtline
- Anthony Sharp — Money Advice Liaison Group
- Chas Roy-Chowdhury — Association of Chartered Certified Accountants

Representatives from the Department also attended.

**27** The role of the Advisory Panel was to bring to bear a wider body of expertise and knowledge to our report. The Panel identified areas where we could add most value, shared their views on the Department and suggestions for improvement from their experience and flag up any important omissions from our study. The Panel met twice, once when we were in the early stages of fieldwork and later when we presented our draft findings to them. We also consulted them separately on particular areas of expertise. We are very grateful for their input.

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