National Audit Office

REPORT BY THE
COMPTROLLER AND
AUDITOR GENERAL

HC 486
SESSION 2010–2011

13 OCTOBER 2010

HM Revenue & Customs

Engaging with tax agents

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Ordered by the House of Commons
to be printed on 11 October 2010

Report by the Comptroller and Auditor General
HC 486 Session 2010–2011
13 October 2010

London: The Stationery Office
£14.75

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

Amyas Morse
Comptroller and
Auditor General

National Audit Office

5 October 2010

Eight million taxpayers receive help from third parties in completing and filing income tax and corporation tax returns each year.

Printed in the UK for the Stationery Office Limited
on behalf of the Controller of Her Majesty's Stationery Office
2393987 10/10 65536

Contents

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This report can be found on the National Audit Office website at www.nao.org.uk/tax-agents-2010

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Summary

1 Eight million taxpayers receive help from third parties in completing and filing income tax and corporation tax returns each year. HM Revenue & Customs (the Department) estimates that third parties are responsible for filing around 65 per cent of self-assessed income tax returns, 78 per cent of Corporation Tax returns, 33 per cent of end-of-year PAYE returns filed by employers and 43 per cent of VAT returns. Around 43,000 professional tax agent firms, ranging from international corporations to sole traders, assist taxpayers with their tax affairs. For this report, we have defined a tax agent as someone authorised and paid to act on another's behalf in their dealings with the Department. We estimate that the market for preparing tax returns in the UK is worth around £2.5 billion. The voluntary sector, including unpaid intermediaries representing friends and family, is outside the scope of this report.

2 The Department recognises that tax agents are an important intermediary between it and its customers and that it needs to develop its relationship with this customer group as part of its overall customer strategy. Part One of this report looks at the action taken by the Department to engage with tax agents. Part Two covers the opportunities to improve taxpayer compliance by working more effectively with tax agents. Part Three sets out how the Department could reduce its costs of interacting with represented taxpayers. In Part Four, we examine the Department's new strategy for engaging with tax agents.

3 Our work on the Department is wide-ranging and includes financial and revenue systems audit as well as value for money reports, all of which focus on key issues in the Department. Some of the issues included in this report are dealt with from a contrasting angle in our work on compliance and enforcement as well as our annual reports on the Department's accounts.

Key Findings

The Department recognises the importance of tax agents, and has taken steps to improve its interactions with them

4 In 2007, the Department took action to improve the experience of agents and the services they use, recognising the importance of this customer group. Initiatives to work more effectively with agents have included the introduction of a priority telephone line for agents with self-assessed income tax and PAYE queries. The Department has also encouraged tax agents to file tax returns online, and in 2008-09, 89 per cent of agents filed self-assessed income tax returns online compared with 54 per cent in 2006-07. The professional bodies representing agents that we spoke

to recognise the positive steps made but consider that the Department's processes, such as for authorising agents to act for clients or for amending taxcodes, still need to improve, while their concerns around the training and expertise of the Department's staff remain. The Department's customer satisfaction survey has shown that tax agents report the lowest satisfaction levels of any of the Department's customers. In 2009-10, agent satisfaction levels were 70 per cent compared to 79 per cent for other customers, having improved from 67 per cent in early 2008.

There is scope to improve tax compliance through tax agents

5 **Good tax agents can have a positive impact on tax compliance.** A taxpayer complies with his or her tax obligations by declaring all liabilities, filing tax returns on time, and paying tax due on time. The Department's research indicates that good agents help their clients get their tax right by, for example, checking that they have included all income on their tax returns, providing advice and support on record keeping and ensuring clients meet filing and payment deadlines. It is possible that without the intervention of tax agents, the level of non-compliance would be higher. The complexities of the tax system, however, mean that even the best tax agents and the Department can sometimes get it wrong.

6 **Even with the beneficial impact of tax agents, their clients still have a substantial proportion of under-declared tax liabilities.** We analysed a sample of around 5,000 cases where the Department had reviewed a self-assessed income tax return to establish where there were under-declared liabilities. The analysis is based on the most recent data available (returns relating to the 2004-05 tax year) and does not account for cases where the taxpayer was found to have a net over-declaration of tax. Over-declarations were not recorded by the Department, and so we have been unable to calculate complete net results. Taking under-declarations only into account, the analysis suggests that self-assessed income tax returns filed by represented taxpayers are more likely to have under-declarations of tax (resulting from errors, failure to take reasonable care or evasion) than returns filed by non-represented taxpayers. Further analysis is needed to explain why represented taxpayers are more likely to under-declare their tax, but a key reason may be that their tax affairs are more complex. The average under-declaration on tax returns filed by represented taxpayers is £900, around 15 per cent of total liabilities on these returns, compared with around £350 for unrepresented taxpayers, around 35-40 per cent of total liabilities on these returns. The analysis indicates that represented taxpayers are not without risk despite the professional help they receive, and that tax agents may need more support to help their clients get their tax right.

7 Following on from our analysis, the Department has estimated that under-declarations associated with represented taxpayers could be more than £2.6 billion for self-assessed income tax and more than £0.9 billion for self-assessed corporation tax for 2007-08. As set out above, these figures do not take account of represented taxpayers that had net over-declarations of tax. More analysis is needed on the reasons for these under-declarations and how the figure breaks down, for example by type of agent. However, the analysis indicates that there could be an opportunity for the Department to increase tax revenues by providing better support to tax agents and by better targeting of poorly-performing agents. A 3 per cent reduction in the average amount of tax under-declared by represented taxpayers could lead to over £100 million additional revenue each year.

8 **The Department has little information on whether individual tax agents are associated with higher or lower levels of compliance.** Our analysis shows that small and medium-sized tax agents appear to be associated with higher rates of under-declared liabilities than the largest 100 firms. Further analysis and data is needed to establish why, and to segment the tax agent customer group further. Lack of up-to-date data means the Department cannot take a tailored approach to its dealings with agents and cannot provide feedback to agents on their performance, make targeted interventions or provide tailored support for tax agents experiencing difficulties.

9 **Evidence from other countries and at home indicates that focusing on high-risk areas can be beneficial.** The Australian Taxation Office has successfully used risk profiling to identify and target agents with clients displaying a pattern of high-risk behaviour and to achieve a reduction in non-compliance. In other areas of the Department's business, making more targeted interventions has helped the Department identify and recover more tax from its investigations. When conducting compliance investigations into large business corporation tax, the Department has increased the levels of under-declared tax recovered by focusing resources on higher-risk cases.

10 **The Department does not set any conditions on firms or individuals wishing to work as tax agents.** Some other countries register tax agents, requiring them to meet minimum requirements if they wish to represent a large number of clients or access 'self-service' facilities. Registration can facilitate performance monitoring and allow tax authorities to apply sanctions such as de-registration. Some of the tax agents we consulted considered there would be real potential for efficiency savings if registration was run properly although there would also be associated costs. The Department is considering introducing a form of registration.

The Department could reduce its costs of dealing with represented taxpayers

11 The full costs of dealing with represented taxpayers are difficult to estimate. The Department does not separately collect information on the cost of working with tax agents, which includes the costs of authorising agents to act for clients, dealing with telephone calls, post or emails from agents, processing tax returns filed by agents, and working with agents during compliance interventions. We estimate the Department spends around £215 million each year on these interactions. The Department would incur most of these costs, and probably more, if it dealt directly with agents' individual customers. However, the Department can reduce the costs of dealing with represented taxpayers by engaging more effectively with agents.

12 There are opportunities to make savings by reducing the amount of post the Department receives from agents. The Department spends an estimated £30 million dealing with direct contact from agents, including £18 million dealing with agent post. The Department could reduce post from agents by dealing with their letters more quickly and so avoid the need for progress chasing by agents. It has made improvements to its online services, but could make further savings through encouraging agents to make greater use of existing web services, or it could follow tax authorities in other countries and develop enhanced web services for agents. We estimate that the Department could save around £10 million from reducing postal contact and simplifying the process for authorising agents, which currently costs the Department £4 million each year. Enhanced online services could also save money for tax agents and their customers by reducing the amount of time spent contacting the Department.

The Department is developing a new strategy for dealing with tax agents

13 In 2010, the Department's Board considered a new strategy which sets out the changes it needs to make to reduce costs, increase compliance and improve agent satisfaction. Implementation of the strategy will require a detailed analysis of how it will achieve the expected benefits. Some changes will require investment in new systems and approaches as well as buy-in from the tax agent community.

Conclusion on value for money

14 The Department has made important improvements, but is not yet achieving full value for money from its engagement with tax agents. It could deliver better value for money by increasing the compliance of represented taxpayers, while doing more to minimise the costs of engaging with tax agents. The Department is developing a new strategy and now needs to move forward with a detailed action plan to implement it.

Recommendations

15 In April 2010, we presented a Memorandum to the Department that covered much of the analysis in this report and the recommendations set out below. The Department's new strategy for engaging with tax agents takes forward these recommendations. Given that some recommendations involve expenditure at a time when budgets are being cut, implementation will need to take into account the funding available. However, some improvements may be possible without extra resources and there are opportunities to significantly increase tax revenues.

a **The Department does not currently analyse data on the compliance track record of individual tax agents.** With better use of data, the Department could make more targeted interventions based on risk and either achieve greater tax revenues with the same resources, or potentially the same revenues at a lower cost, freeing up resources for implementing other recommendations. To make progress towards being able to make more targeted interventions the Department will need to:

- make the case for investment to improve its data systems by demonstrating the costs and benefits of making targeted interventions. For example, the Department could run a low-cost pilot based on a sample of tax agents (paragraph 4.5);
- establish a system for regularly collecting and monitoring compliance data and use this information to target its interventions according to the customer track record of each agent (paragraph 2.11 to 2.14); and
- measure the impact of making more risk-based interventions in terms of additional tax collected (paragraph 2.13-2.14).

b **The Department does not tailor its approach to tax agents according to their individual performance record.** The Department should improve tax agent compliance by providing additional support to tax agents experiencing difficulties and applying sanctions where performance is poor. For example, the Department could grant access to enhanced online and telephone services to agents who meet certain standards, better target education and training, and provide feedback to agents on their compliance record. (paragraph 2.12 and 3.11)

c **The Department does not set any conditions on firms or individuals wishing to act as tax agents.** Given the Department is considering introducing registration, it should assess the costs of registration and ensure minimum requirements are relevant and measurable. (paragraphs 2.15 to 2.18).

d **There is scope for the Department to reduce its costs and increase compliance by improving its service to agents through further expansion of e-services and by dealing with post from agents more quickly.** In particular, the Department should:

- take steps to encourage greater use of existing electronic services, by raising awareness and improving usability, for example making electronic changes to records. The Department should also meet its post turnaround targets to remove the need for progress chasing (paragraphs 3.9 to 3.12);
- enhance electronic services further to allow additional transactions online such as taxcode amendments, communication by email, tools to support improved compliance, and self-serve agent authorisation. Electronic transactions should be recordable so that agents can maintain their records (paragraphs 3.9 to 3.12); and
- collect better contact volume and cost data to better understand the scale of development of e-services that can be justified by achievable savings (paragraph 4.5).

e **The Department has recently improved its process for authorising tax agents to act for new customers on self-assessed income tax, but processing times are much longer on other taxes. It costs the Department £4 million a year to process authorisation forms.** The Department should aim to reduce its processing costs and consider further ways of making authorisation simpler and quicker for tax agents. For example, it could build on work underway to improve web guidance on agent authorisation and increase the efficiency of online authorisation or, with registration in place, it could consider the approach taken by New Zealand Inland Revenue which does not process authorisations for trusted agents (paragraphs 3.3 to 3.4).

f **Implementing some of these recommendations would require investment in new systems and processes.** The Department should examine the possibility of building on its relationship with the tax agent community to work together to design new systems and services that would lead to efficiencies for both parties. There may be opportunities for sharing resources and expertise, or even investment costs, perhaps starting with the design of more specialist software (paragraphs 3.12 and 4.6).

Part One

The steps the Department has taken to work more effectively with tax agents

This part looks at what the Department has achieved so far in developing its relationship with tax agents, a key customer group.

Tax agents are important intermediaries between the Department and its customers

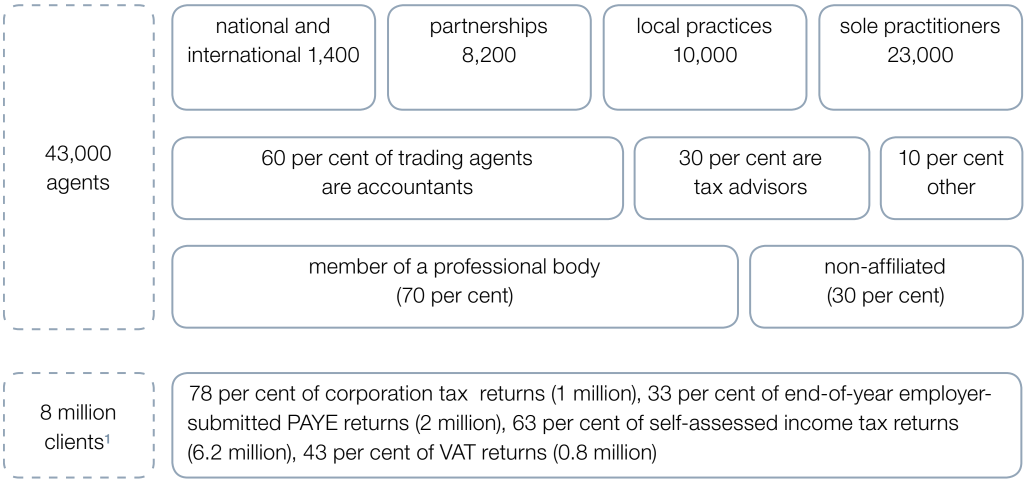
1.1 HM Revenue & Customs (the Department) estimates that around eight million taxpayers receive help from third parties in completing and filing income tax and corporation tax returns each year. Third parties are responsible for filing around 65 per cent of self-assessed income tax returns, 78 per cent of Corporation Tax returns for small and medium sized enterprises, 33 per cent of end-of-year PAYE returns filed by employers and 43 per cent of VAT returns. There are around 43,000 professional tax agent firms, ranging from international corporations to sole traders representing most of these taxpayers (**Figure 1**). Others are assisted by the voluntary sector, including unpaid intermediaries who look after the tax affairs of their friends and family. This report covers professional tax agents, which we have defined as those authorised and paid to act on another's behalf in their dealings with the Department.[1] The analysis in the report covers self-assessed income tax, PAYE, corporation tax and VAT, although we recognise that tax agents will also assist taxpayers on other taxes.

1.2 Taxpayers may choose to use tax agents for a variety of reasons. Some taxpayers may consider they do not have the knowledge to manage their own tax affairs or want assurance that they are paying the right amount of tax, while others simply want to save time. Some taxpayers need help because their tax affairs are more complex. We estimate that the market for preparing tax returns in the UK is worth around £2.5 billion. Many tax agents also charge their clients for tax advice.

1 The term tax agent is not defined in tax legislation.

Figure 1

The Department estimates there are around 43,000 tax agent firms



NOTE

1 Eight million clients could include some taxpayers who use a tax agent for assistance on more than one tax.

Source: HM Revenue & Customs analysis

1.3 Tax agents are therefore an important intermediary between the Department and its customers. Most professional tax agents have hundreds of clients, so it is efficient for the Department to engage with these intermediaries to ensure that their customers pay the tax due. Recent research by the Department into tax agents' role in the compliance of small and medium sized enterprises has indicated that good agents have a positive impact, helping their clients get their tax right and reducing errors.

1.4 The National Audit Office and the Committee of Public Accounts have previously noted the need for the Department to work closely with tax agents, develop electronic communications and impose effective sanctions for non-compliance in its reports on tackling VAT fraud, helping newly registered businesses and filing company and VAT returns.[2] The Department has made some progress in implementing these recommendations. For example, it now provides tailored support to tax agents through telephone services on some taxes, it consulted with agents when developing online filing and established a team to work with intermediaries to support new and existing businesses. Consultations on Working with Tax Agents covered ways to deal with dishonest tax agents and proposed more frequent disclosure to their professional bodies.[3]

2 HM Revenue & Customs: *Filing VAT and Company Tax returns*, HC 102, 2006-07; HM Revenue & Customs: *Helping newly registered businesses meet their tax obligations*, HC 98, 2006-07; HM Customs & Excise: *Tackling VAT fraud*, HC 357, 2003-04.

3 *Working with Tax Agents: The Next Stage*, HM Revenue & Customs, December 2009.

The Department has recognised the scope for improvement in its interactions with tax agents

1.5 In 2007-08, the Department introduced new initiatives to improve the experience of agents and the services they use, recognising the key role tax agents play and concerns agents had raised with the Department about service standards (**Figure 2**).

Figure 2
Initiatives to work more effectively with tax agents

Initiative	What it aims to do	Date introduced
Dedicated telephone line for agents	Handles calls about Income Tax Self Assessment and PAYE from tax agents. Calls to the line have priority and are taken by an adviser with at least 12 months experience.	Piloted in December 2007 and rolled out nationally in 2008
Agent Account Managers	Agent Account Managers communicate key messages to agents and help them with queries they are unable to resolve through other channels. There were originally 12 individuals in post, numbers had increased to 40 by June 2010.	Piloted in September 2007
Agent toolkits	Support agents in checking their clients' tax returns for completeness and accuracy.	Piloted between May 2009 and January 2010
Joint Learning Initiatives	Training events for agents and Departmental staff focused on changes to compliance checks following new powers legislation in Finance Act 2008.	Around 40 UK-wide events held between October 2009 and March 2010
Compliance Reform Forum	Consultation forum on changes to the Department's compliance activities, focusing on the views of tax agents and their customers.	Workshops held quarterly since February 2007
Working Together	A forum with the main agent representative bodies to improve the Department's operations. Local meetings bring together tax officers and agents while a national steering group, including representatives from the professional bodies meets quarterly.	New working together model rolled out in 2009

Source: National Audit Office review

1.6 Representatives from the professional bodies for tax agents told us that tax agents had been concerned about a number of issues including delays in processing forms for authorising new clients, the quality of technical advice and guidance, and response times of the Department's telephone helplines. They also told us that many tax agents complained of a fall in service standards following the merger between the Inland Revenue and HM Customs and Excise in 2005, when the Department began to centralise activities previously carried out by local offices. For some tax agents, centralisation resulted in fewer opportunities for dialogue with an official in the Department who knew their case. For example, tax agents raised with us the length of time it takes to request taxcode changes, which they perceive to be longer than with the previous local arrangements.

The Department is working more effectively with tax agents

1.7 Some services for tax agents have improved since the introduction of these initiatives. Agents telephoning about self-assessed income tax or PAYE can now speak to an advisor with more than 12 months experience. The Department answered 93 per cent of calls to the dedicated agent telephone line within 20 seconds in 2009-10. The Department has also increased the take-up of online filing among tax agents. The Department also ran 220 workshops between May 2007 and June 2009 for over 11,000 tax agents to encourage take-up of online filing. For the 2008-09 tax year, 89 per cent of represented taxpayers filed income tax returns online, compared with 54 per cent in 2006-07.

1.8 The Department is also working more closely with agents to improve compliance. The Compliance Reform Forum involved agents in changes in the Department's compliance checking activities and campaigns. The Department also developed toolkits to help agents identify errors in their clients' tax returns. Representatives for the professional bodies for tax agents have raised some concerns about their usability and the additional burden they may place on agents and their clients. The Department is taking steps to resolve these concerns and provide more information on how agents should use the toolkits.

1.9 The Department recognises that it can still do more to work effectively with tax agents. The Department's customer satisfaction survey has shown that tax agents report the lowest satisfaction levels of any of the Department's customers. In the six months to March 2010, agent satisfaction levels were 70 per cent, compared to 67 per cent for the six months to June 2008, and compared to an average of 79 per cent for other customer groups.[4] Tax agent representatives told us that the Department has made positive steps, but that processes could improve further. For example, they still find it difficult to track the progress of queries they make on behalf of clients, the online process for authorising agents remains cumbersome and they consider there is scope to improve e-services further. The Department's December 2009 public consultation on working with tax agents looked at how the Department and tax agents could work

4 The figures given here are an aggregated score of four aspects of customer experience: providing a service designed with needs in mind, ease of understanding what to do, ease of getting in touch, and ease of completing processes. As such they are a proxy measure for customer satisfaction.

together to ensure high standards of professionalism.[5] Tax agents consulted were concerned about service standards, the training and expertise of officers and hence their ability to answer queries correctly, and Department errors creating extra work for agents.

1.10 The Department has not yet fully assessed the costs of engaging with tax agents, nor does it separately measure the compliance of represented taxpayers. As a result, it does not know if it is targeting resources to best effect. Parts Two and Three of this report examine the opportunities for improving compliance and reducing costs. Part Four of this report examines the Department's new strategy which it has been developing through 2010 and the steps it will need to take to implement it effectively.

5 *Working with Tax Agents: The Next Stage*, HM Revenue and Customs, December 2009.

Part Two

Improving tax compliance through tax agents

This part examines the level of compliance of represented customers and the steps the Department could take to increase compliance and raise additional revenue.

The Department has little detailed information on the compliance of individual tax agents

2.1 A taxpayer complies with his or her tax obligations by declaring all liabilities, filing tax returns on time and paying any tax due on time. Tax agents can help their clients get their tax right by checking that they have accurately completed their tax returns, by providing advice and support on record keeping, and by keeping up-to-date with developments in tax legislation and the Department's requirements such as filing and payment deadlines.

2.2 Until the late 1990s much of the interaction between the Department and tax agents was at a local level. The Department told us that under these former arrangements, local officers often built up a personal knowledge of which tax agents were more likely to encourage their clients to file and pay on time and to thoroughly check their clients' returns. Greater centralisation has led to a reduction of information about individual tax agents. The Department does not centrally monitor the compliance performance of individual tax agents. This means it cannot identify which tax agents are associated with higher or lower levels of compliance and target compliance activities accordingly.

Even with the beneficial impact of tax agents, their clients have a substantial proportion of under-declared tax liabilities

2.3 In 2008-09, 96 per cent of taxpayers with tax agents filed on time compared with 94 per cent of taxpayers without. The Department does not know whether represented taxpayers are more or less likely to pay tax due on time. We worked with the Department to establish the extent that represented taxpayers pay the right amount of tax. We used the results of the Department's random enquiry programme to look at levels of under-declared tax liabilities for self-assessed income and corporation tax returns.

2.4 The Department uses random enquiry programmes to establish the extent of tax lost due to incorrect tax returns. In conducting its random enquiry programmes, the Department randomly selects taxpayers to check they have declared the right amount of tax on their tax return. The Department collects any under-declared tax from the taxpayer, with interest and penalties, and refunds any overpayments. The random enquiry programme for self-assessed income tax covers all self-assessment taxpayers except large partnerships.[6] The random enquiry programme for corporation tax covers small and medium-sized businesses.

2.5 The random enquiry programmes detect incorrectly declared tax, which may be due to error, failure to take reasonable care, or evasion. The most recent data available from the random enquiry programme for self-assessed income tax returns is from 2004-05 and for corporation tax returns from 2004 because there is a time lag between taxpayers filing their returns and the Department concluding its enquiries on those returns. Data is not available from the random enquiry programmes for later tax years, so it is not possible to directly assess more recent trends in under-declarations. The Department considers that other indicators, such as tax receipts, suggest there have not been any significant changes. The Department did not measure over-declarations of tax detected as part of the 2004-05 random enquiry programme, but in response to a previous NAO recommendation,[7] it has begun collecting this information. In the meantime, it has not been possible to examine the level of over-declarations on returns filed by represented taxpayers.

2.6 We analysed the sample of around 5,000 cases where the Department had reviewed tax returns to establish where there were under-declared liabilities. We found that self-assessed income tax returns filed by represented taxpayers appear to be associated with higher levels of under-declared tax liabilities than returns filed by non-represented taxpayers. In the sample, covering returns for 2004-05, 37 per cent of self-assessed income tax returns from represented taxpayers had under-declared tax liabilities compared to 26 per cent of returns filed by unrepresented taxpayers. The sample results are statistically significant and we also analysed equivalent data for the previous two years and found that the results were broadly consistent over the three-year period. Analysis of the Department's enquiries into corporation tax returns revealed under-declared tax liabilities on 43 per cent of tax returns filed by represented businesses in the sample, compared with 36 per cent for returns filed by unrepresented businesses in the years 2001-04, but owing to a smaller sample size, these results are not statistically significant.

6 Large partnerships are defined as those with five or more partners.
7 *Helping individuals understand and complete their tax forms*, HC 452, 2006-2007.

2.7 In 2004-05 the average under-declared self-assessed income tax liability detected by an enquiry into represented taxpayers was just under £900 compared to around £350 for unrepresented taxpayers.[8] There was, however, little difference between the average value of under-declared tax liabilities on corporation tax returns from represented and unrepresented taxpayers, at around £3,450 for represented taxpayers and £3,360 for unrepresented taxpayers. We also analysed under-declared liabilities as a percentage of total self-assessed income tax or corporation tax liability due, net of tax taken at source (**Figure 3**). The analysis indicates that tax returns from represented taxpayers do have substantial levels of under-declarations even when the size of the total liabilities are taken into account, but that the level of under-declared liabilities on returns from unrepresented taxpayers is greater still.

2.8 **Figure 4** overleaf shows the proportion of returns with under-declared liabilities for 2004-05 broken down by customer group. Self-employed taxpayers and partnerships filed a larger proportion of returns with under-declared liabilities.[9] Within each of these groups, represented taxpayers filed more returns with under-declared liabilities.

Figure 3
Total under-declared tax as a percentage of total tax liability due, net of tax taken at source, through self-assessed income tax or corporation tax

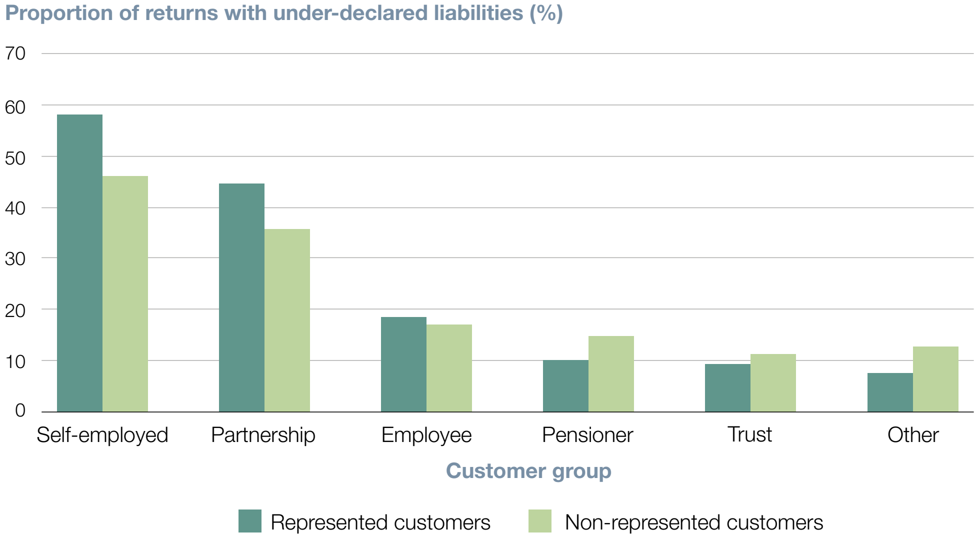
	Total under-declared tax as a percentage of total tax liability due from self-assessed income tax returns filed in			Total under-declared tax as a percentage of total tax liability due from corporation tax returns filed in
	2002-03	**2003-04**	**2004-05**	**2002-05**
Represented Taxpayers	15.2	14.7	Unavailable	11.1
Unrepresented Taxpayers	39.8	35.3	Unavailable	22.2

Source: National Audit Office analysis

8 These are not annualised figures. The under-declared tax discovered by a particular enquiry can cover a number of years.

9 The difference between the proportion of returns with under-declared liabilities for represented and unrepresented customers is statistically significant for the self-employed group, but not for partnerships owing to the smaller sample size in this case.

Figure 4
Proportion of self-assessed income tax returns with under-declared liabilities 2004-05



NOTE

1 Sample of around 5,000 self-assessed income tax cases in the Department's random enquiry programme were examined for 2004-05. Total numbers of cases: self-employed, 1,955; partnerships, 299; employees, 1,575; pensioners, 498; trusts 137; other 270.

Source: National Audit Office analysis

2.9 The analysis suggests that self-assessed income tax returns filed by represented taxpayers are more likely to have under-declared tax liabilities than returns filed by unrepresented taxpayers, but further analysis is needed to explain why. A likely explanation is that tax agents are more likely to represent those with complex tax affairs. For example, self-employed taxpayers often have more complex tax affairs and, in our sample, they were more likely to engage an agent. As shown in Figure 4, self-employed taxpayers file a larger proportion of returns with under-declared liabilities. The analysis also suggests that average under-declarations are higher for represented taxpayers than for unrepresented taxpayers. One reason for this may be that tax agents represent taxpayers with greater tax liabilities, and as shown in Figure 3, the picture is reversed when the under-declaration is expressed as a percentage of total tax owed. We have no evidence that tax agents are supporting non-compliance, and the Department's research into the tax agent role indicates that while agent quality standards vary, there are good tax agents who have a positive impact on overall compliance levels, for example by checking that their clients have included all relevant information about their finances. However, the data does suggest that represented taxpayers are not without risk despite the professional help they receive, and that tax agents may need more support to help their clients get their tax right.

2.10 The Department used the random enquiry data to estimate the total tax at risk attributable to incorrect returns from represented taxpayers in self assessment and represented small and medium-sized companies for corporation tax. The results showed that under-declarations associated with represented taxpayers could be between £2.6 and £10.5 billion for self-assessed income tax, and between £0.9 billion and £6.4 billion for corporation tax in 2007-08. The main principles of the analysis used to reach these figures are in **Figure 5**. Total under-declared tax liabilities from represented taxpayers could be higher still – data is not currently available to calculate under-declarations associated with end-of-year employer PAYE and VAT returns prepared by agents. However, these figures do not take account of over-declarations, and we recognise that if it were not for the work of good agents in ensuring clients get their tax right, the level of under-declarations could be larger. Nevertheless, the analysis indicates there could be an opportunity to increase tax revenues by providing better support to tax agents and by better targeting of poorly-performing agents. The extent of under-declaration varies considerably among taxpayers, but this analysis suggests that a 3 per cent reduction in the average amount under-declared by represented taxpayers could produce additional revenue of over £100 million.

Figure 5
Estimation of the total tax at risk

To estimate the total tax at risk, the value of under-declared tax liabilities on tax returns filed by represented taxpayers in the two random enquiry programme samples was extrapolated for the whole population of represented self-assessed income tax and corporation taxpayers. This resulted in an estimate of total tax at risk of at least £2.6 billion for self-assessed income tax and at least £0.9 billion for corporation tax.

However, these figures do not account for the fact that random enquiries may not identify all incorrect returns, particularly where the Department cannot verify data supplied by the taxpayer. An adjusting factor can be applied to correct for this. The value of the adjusting factor affects the level of tax at risk calculated, and this, together with the uncertainty inherent in extrapolating from a sample to a population, results in a range of £2.6 to £10.5 billion for self-assessed income tax, and £0.9 billion to £6.4 billion for corporation tax.[1]

NOTE

1 The central estimates are £5.7 billion for self-assessed income tax and £2.8 billion for corporation tax.

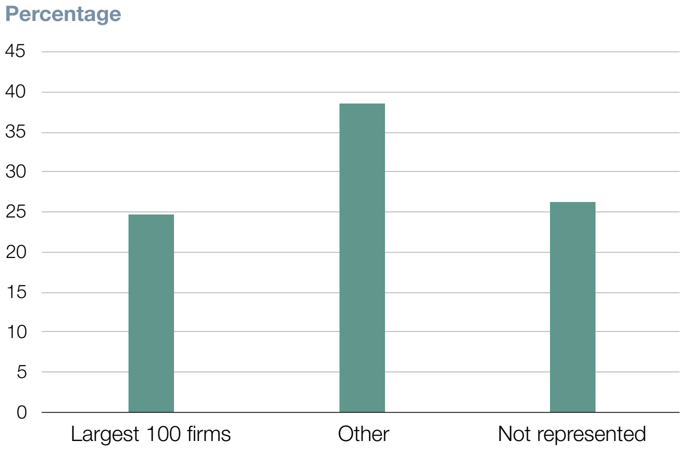
Source: National Audit Office review of the Department's methodology

Focusing on higher-risk agents might be beneficial but more data is needed

2.11 The Department cannot currently identify which individual or groups of tax agents are associated with higher or lower levels of compliance. Our analysis of the Department's random enquiry programme shows that the customers of smaller tax agents are associated with higher rates of under-declared self-assessed income tax liabilities than the largest 100 firms. **Figure 6** shows that, for example, 38 per cent of self-assessed income tax returns filed by clients of smaller firms had under-declared liabilities, while tax was correctly or over-declared on the remaining 62 per cent of those returns. The average under-declared tax liabilities are £355, £575 and £917 for unrepresented taxpayers, taxpayers represented by the largest 100 firms, and taxpayers represented by smaller firms, respectively, although the differences between these values are not statistically significant. Further analysis is needed into why taxpayers represented by small agents appear to have higher levels of under-declared liabilities due to error, failure to take reasonable care, or evasion. It may be that smaller agents have less experience or capacity but that their clients are just as complex as those of larger firms.

Figure 6

Proportion of Self Assessment cases with under-declared liabilities 2004-05, by agent size



NOTES

1 Analysis based on self-assessed income tax returns filed by 236 taxpayers represented by the top 100 firms, 2,640 taxpayers represented by other firms and 1807 unrepresented taxpayers.

2 The difference between the percentage of under-declarations on returns filed by the largest 100 firms and other firms is statistically significant.

Source: National Audit Office analysis

2.12 Lack of up-to-date quantitative information on the compliance performance of individual agents means that the Department cannot take a tailored approach to its dealings with agents. There are a number of things the Department would be able to do if it had better information that allowed it to segment the tax agent population. In particular, the Department could:

- provide feedback to tax agents on their performance, how they compared with other tax agents and make suggestions for how they should aim to improve performance. Metrics could include achievement of filing or payment deadlines or levels of under-declarations. Other countries have found that feedback can incentivise some agents to perform better in the future as it highlights how their performance compares to others and alerts them that the Department is aware of any poor performance and may take action;
- grant access to enhanced online facilities to agents who meet certain standards of performance. Such facilities could include the ability to change tax code notices or claim repayments online (see Part Three);
- make more targeted interventions that could range from asking tax agents questions, sending reminders to agents with a track record of late filing or payment to launching full investigations. The Department would also be able to obtain better information on what interventions to improve tax agent compliance will result in the best returns; and
- provide targeted education, training and support to tax agents in need of it.

Better information would also allow the Department to monitor trends and compare represented and non-represented taxpayers. For example, although the Department has introduced initiatives to work more effectively with agents (Part One), it has not been able to demonstrate quantitatively that these have led to improvements in compliance.

2.13 The absence of data makes it difficult to demonstrate the benefits of segmenting the agent population and making targeted interventions. But other countries do have more information and are already using it to address compliance issues. In particular, the Australian Taxation Office uses risk profiling to identify agents with clients demonstrating a pattern of high-risk behaviour. It told us that in 2009-10 its approach resulted in a reduction of 19 per cent in claims to offset expenses against taxable income, which, in its view, often indicate non-compliance. It used an analytical model to monitor expenses offset against taxable income on tax returns filed by agents. Agents associated with particularly high levels of expenses were subject to a review of their practices and of their clients' tax returns. Although it has not carried out a formal evaluation, New Zealand Inland Revenue told us it found that simply providing feedback to agents where performance in meeting filing-on-time deadlines was below standard helped improve performance. The Organisation for Economic Co-operation and Development also recognised the benefits of identifying and targeting high-risk tax agents as part of a 2008 study into the role of tax intermediaries.[10]

10 Study into the role of tax intermediaries, Organisation for Economic Co-operation and Development, 2008.

2.14 Taking a more tailored approach could increase tax revenues. The Department's experience in segmenting other customer groups to focus on high-risk areas has allowed it to collect more tax. For example, in response to National Audit Office recommendations and other initiatives, the Department's Large Business Service has improved its targeting of resources on high risk corporation tax cases, increasing the amount of under-declared tax recovered by 37 per cent between 2006-07 and 2008-09.[11]

Registration of tax agents could provide greater assurance over the legitimacy of those claiming to be tax agents and facilitate monitoring of performance

2.15 Currently, those wishing to act as tax agents must obtain an agent 'code' by writing to the Department with their name and address and obtain authorisation from the taxpayer they wish to represent via an online or paper form. (Authorisation is discussed in more detail in Part Three). But tax agents do not need to meet any criteria to demonstrate their competence or credentials to act on another's behalf or go through a formal procedure of registration that sets conditions or criteria around applications to act as an agent.

2.16 There are potential advantages to a more robust registration system. Assurance that the Department is dealing with a reputable and reasonably competent individual would be particularly valuable when an agent represents a large number of clients with substantial amounts of tax at stake, or if permitting agents access to self-service facilities. Where the Department identifies poorly-performing tax agents, sanctions could include deregistration, subject to appropriate safeguards.

2.17 A number of other countries do register tax agents. In Australia, paid tax agents are required to register with the Tax Practitioners Board, an independent statutory body which regulates the registration of tax agents.[12] Registration with this Board involves making an application, verifying qualifications and paying a fee. In New Zealand, registration allows an agent access to certain electronic services. In the US, tax agents are currently registered in some states only. There is some evidence that registration has helped improve compliance. The Government Accountability Office found that in Oregon, a state with a particularly stringent regulatory regime, tax returns filed by an agent are more likely to be accurate and require smaller adjustment if in error than in other US states. The Government Accountability Office estimated that this form of registration may have led to Oregon State raising additional taxes of up to $390 million in tax in 2001.[13]

11 *Management of Large Business Corporation Tax*, HC 614, 2006-2007.
12 The national Tax Practitioners Board, independent of the Australian Tax Office was established in March 2010 and replaced the previous state based tax board.
13 *Tax preparers,* Report to the Committee on Finance, U.S. Senate, GAO-08-781, Government Accountability Office, August 2008.

2.18 The Department has considered registration and has been concerned it could involve an expensive regulatory regime, but is now considering alternative forms of registration which might still deliver benefits. Registration would inevitably involve some administration costs, and the Department would need to do further work to confirm these would be outweighed by the benefits. For example, experience in other countries indicates that the administrative costs of striking poorly performing agents off the register might be significant. Costs could be minimised by mandating registration only for agents representing larger numbers of clients rather than those representing friends and family.

Part Three

Reducing the Department's costs of dealing with represented taxpayers

This part examines the Department's costs in engaging with tax agents.

Costs to the Department of dealing with represented taxpayers are difficult to estimate

3.1 The Department does not separately collect information on its costs of interacting with represented taxpayers, and the Department's systems do not easily allow cost information to be broken down by customer group. Using information provided by the Department, we estimated that the total direct staff cost to the Department of interacting with represented taxpayers could be around £215 million (**Figure 7**).

3.2 The Department would probably incur most of these costs, and potentially more, if it dealt directly with the individual clients who tax agents represent. In particular, most of the estimated cost is for processing tax returns submitted by agents, which the Department needs to process whether or not agents file the returns on behalf of their clients. Taxpayers would probably get in touch with the Department themselves with their queries if an agent did not represent them. However, agent behaviour influences the scale of these costs. For example, if agents help their clients prepare a tax return correctly, the Department collects the right amount of tax first time without the need for re-work or compliance intervention. Where agents help their clients understand and meet their tax obligations, or use electronic services to transact with the Department, phone calls or letters to the Department are avoided. Eighty nine per cent of agents filed tax returns online in 2008-09, up from 54 per cent in 2007-08 and compared to 51 per cent of unrepresented taxpayers, saving the Department processing costs.

Figure 7
Estimated costs to the Department of interacting with represented taxpayers

Interacting with represented taxpayers through tax agents	The cost to the Department
Authorising agents to act	
Agents need to apply to the Department to represent each new client. They can make the application online or by completing a paper form.	The Department receives nearly two million forms each year from tax agents requesting authorisation to act on behalf of clients, 27 per cent online and 73 per cent by post. Both online and paper applications require some manual intervention to update the taxpayer's records. The Department estimates that processing authorisation forms costs it around **£4 million** each year.
Dealing with agent queries	
Agents contact the Department with queries about their clients' tax affairs. Reasons for contact include seeking a repayment, correcting a tax code and progress chasing.	We estimate the Department receives two million items of post, around one million telephone calls and 200,000 emails from tax agents each year. (The Department can only receive email in limited circumstances). In response to a letter, phone call or email, the Department may need to amend the taxpayer's record and, in some cases, provide a written response. We estimate the Department spends around **£26 million** dealing with queries each year.
Consultation and support	
The Department consults with agents over proposed changes and provides support to agents to help them manage their clients' tax affairs.	The Department runs a number of fora and seminars to engage with tax agents. It currently provides 40 agent account managers to support tax agents and resolve complaints and carries out research to understand the agent population. In 2008-09 it spent around **£1 million** on this support.
Processing tax returns	
Tax agents file their clients' tax returns.	In 2009-10 tax agents submitted 3.5 million VAT returns, over one million Corporation Tax returns, six million income tax self assessment returns and over two million PAYE end of year returns. Processing these returns cost the Department around **£184 million**.
Compliance	
Taxpayers with tax debts or who are subject to an enquiry to determine whether they have paid the right amount of tax may involve their agent or hire an agent specifically for this purpose.	Each year the Department subjects around 2 per cent of tax returns to a formal enquiry and follows up outstanding tax debts. It has not been possible with the data available to estimate the cost of interacting with agents during these compliance activities as the Department does not separately record how much time is spent dealing with agents rather than directly with their clients. Much of these costs will come from dealing with contacts from agents representing clients with tax debts or those subject to investigations.

NOTES
1 Cost estimates include staff costs only.
2 The estimate of the volume of post from agents assumes agents submit just under 20 per cent of post the Department receives relating to Income Tax Self Assessment, PAYE, VAT and Corporation Tax. This estimated percentage is based on a sample carried out by the Department in April 2010.

Source: National Audit Office review

There are inefficiencies in the way the Department deals with tax agents

3.3 Agents are frustrated with the agent authorisation process which costs the Department £4 million each year. To complete the online authorisation process, agents need to make three separate interactions with the Department (**Figure 8**). Consequently, many agents prefer to use the paper authorisation process, finding it simpler. The Department receives nearly two million agent authorisation forms each year. Since 2009, the Department has processed applications for authorising new clients for self-assessed income tax within 24 hours. However, this is the Department's internal processing time – it may be further days before the agent can access client information online. On other taxes, processing times are much longer. The Department achieved turnaround times of seven days for paper authorisation forms and 24 days for online forms in 2009 for these other taxes. In 2009-10, system problems led to an increase in turnaround times to 34 days for paper forms and 67 days for online forms, although prior to these problems occurring, processing times for both paper and online forms compared favourably to the previous year's performance.

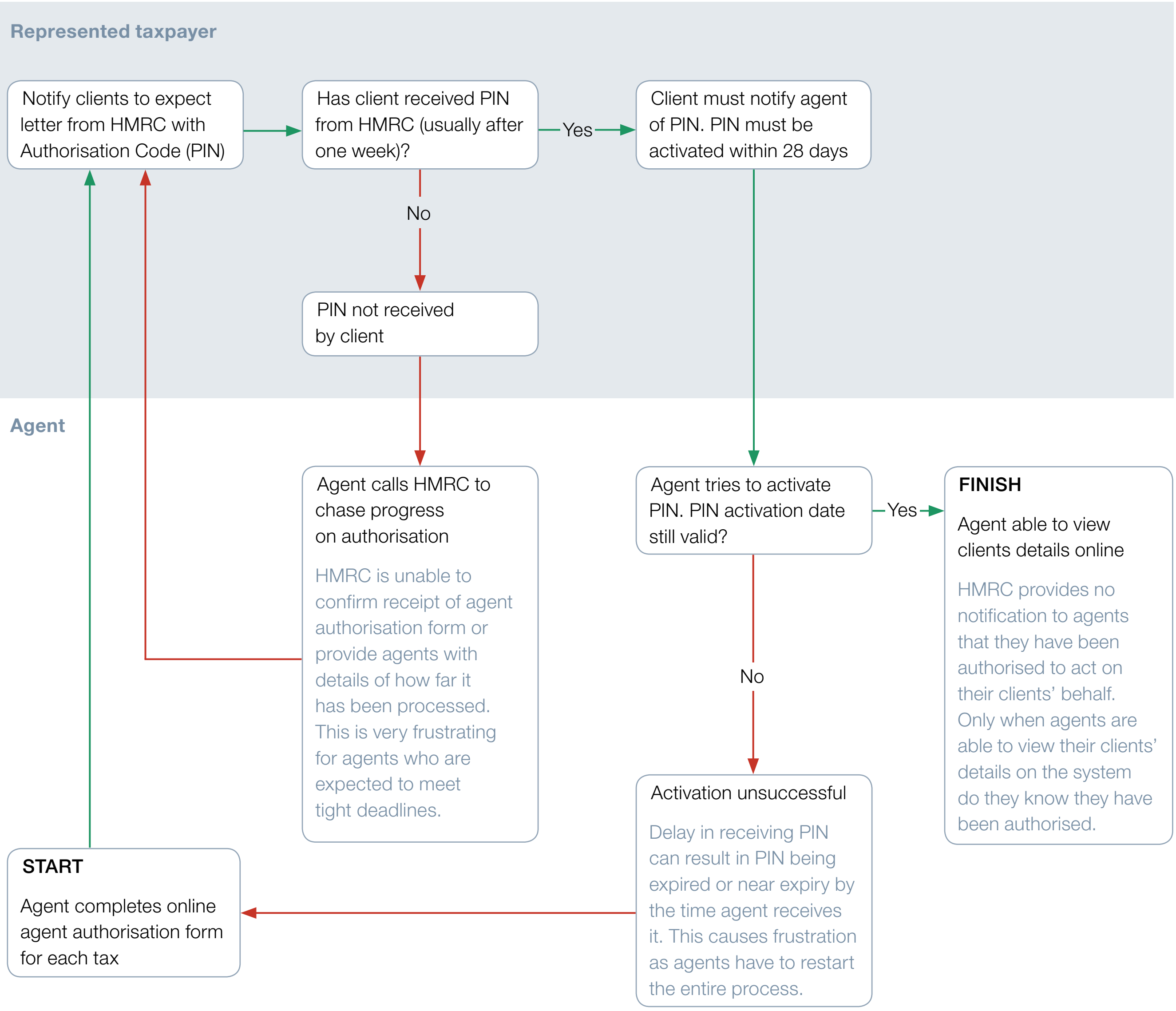
3.4 The Department's approach contrasts with that of the New Zealand Inland Revenue which does not process authorisation forms for trusted agents. Instead, it requires agents to keep a signed authorisation form for any new client and performs random audits on agents to check the correct documentation is in place.

3.5 We estimate that the Department spends around £30 million each year dealing with agents' queries about their clients' tax affairs. Most of this cost is for dealing with post rather than telephone calls or emails (**Figure 9** on page 28). Representatives from professional bodies told us that some agents prefer to contact the Department by post because they can keep a copy of the letter on file to show their clients what action they have taken. Agents can sometimes record telephone calls, but they may still need to write a note for their files. Some agents consider that their more complex queries cannot be resolved by telephone. The Department is looking to expand email but currently, agents can only email the Department in certain circumstances, such as when their query relates to VAT or a change of circumstance for PAYE. The National Audit Office previously recommended the Department explore expanding email.[14]

14 *Helping individuals understand and complete their tax forms*, HC 452, 2006-2007.

Figure 8

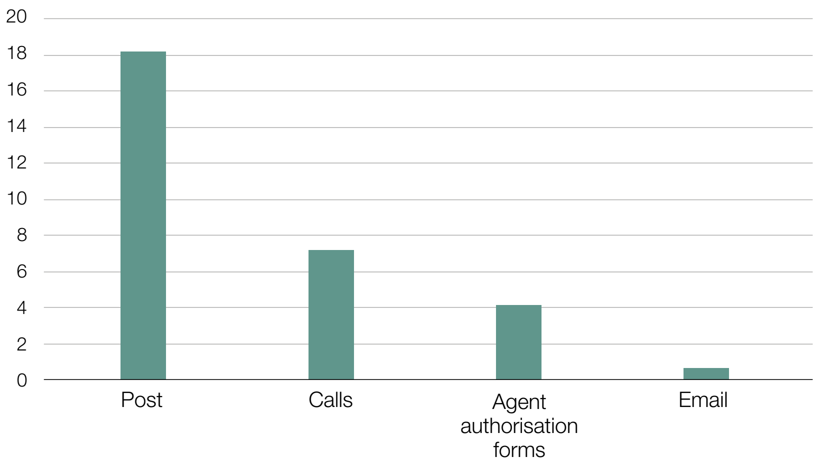
The steps agents need to take to obtain authorisation online to act for each client



Source: National Audit Office

Figure 9

Estimated costs of dealing with direct contact from tax agents



NOTES

1 This analysis is based on estimates of unit costs of £6.70 for processing and dealing with post, £3.60 for telephone calls, £2.00 for agent authorisation forms, and £4.50 for emails.

2 Cost estimates include staff costs only.

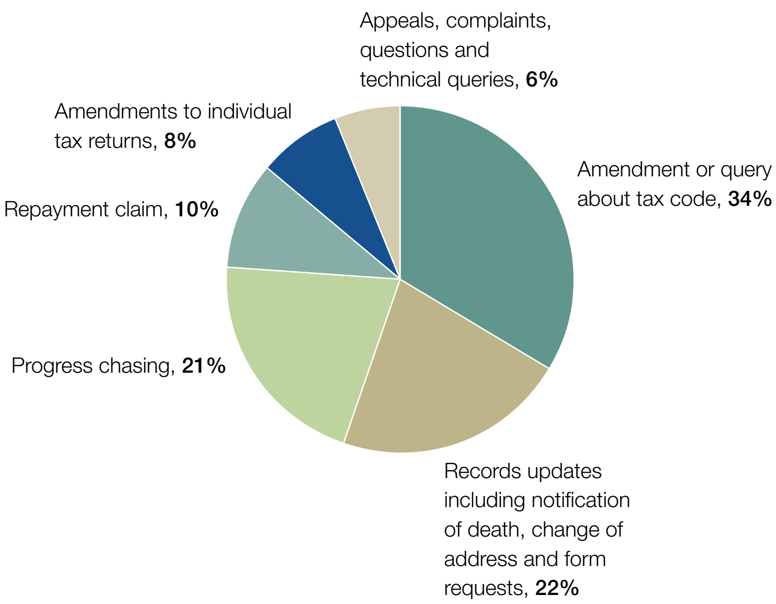
3 The estimate of the volume of post from agents assumes agents submit just under 20 per cent of post the Department receives relating to self-assessed income tax, PAYE, VAT and Corporation Tax. This estimated percentage is based on a sample carried out by the Department in April 2010 covering self-assessed income tax and PAYE.

Source: National Audit Office analysis

3.6 Information on the reasons for contact between the Department and agents is limited, which makes it difficult to identify what can be eliminated or dealt with in different ways. We asked the Department to carry out a small survey of around 1,400 items of post examining the purpose of agents' letters to the Department (**Figure 10**). The Department surveyed correspondence on self-assessed income tax or PAYE which cover the greatest volumes of agent post. We estimated that up to 30 per cent of postal contact covered amendments to tax returns or records updates such as changes of address. Tax agents can currently carry out these transactions online using existing web services.

3.7 Delays in responding to queries can generate further post. We estimated that around 20 per cent of post is from agents checking what progress the Department has made on queries they raised previously. In 2009-10 the Department responded to 55 per cent of post within 15 days (against a target of 80 per cent) and 85 per cent of post within 40 days (against a target of 90 per cent). The Department is streamlining its processing of post with the aim of improving response times and reducing the volume of progress chasing post it receives.

Figure 10
Reasons for agent contact by post



NOTE

1 Analysis based on a sample of 1,437 items of post relating to self-assessed income tax and PAYE received by Bristol processing centre in December 2009.

Source: National Audit Office analysis

3.8 The Department is continuing to engage with the tax agent community to discuss the implementation of efficiency savings. It has recently proposed that certain forms issued to customers will no longer be copied their tax agents. The Department estimates that reducing the amount of correspondence it copies to agents could save up to £1.25 million in 2010-11. Some tax agents are concerned that the accuracy of their clients' tax affairs will be reduced if they do not receive copies of these forms, while others see this as a sensible efficiency measure. The Department will be working with representatives of the tax agent community to see if the savings can be realised without reducing the standard of service their clients receive and to explore ways of supporting customers who have appointed an agent.

The Department could reduce costs by encouraging and enabling agents to use e-services

3.9 A number of overseas tax administrations provide or are developing sophisticated online systems to interact with tax agents (Appendix Two). The Australian Taxation Office introduced a dedicated online 'portal' for tax agents in 2002. Tax agents can use the portal to send secure messages to the tax office, receive an electronic response, and complete and submit a range of online forms, add clients and make other transactions. In New Zealand, tax agents with more than 10 clients can apply for access to electronic services enabling them to view account balances, transaction details and due dates for clients' accounts.

3.10 The Australian Taxation Office and New Zealand Inland Revenue provide these e-services as part of a broader programme to engage and support tax agents. New Zealand expects its new e-service facilities to reduce calls from tax agents by up to 25 per cent. Although it currently receives relatively little post from tax agents, it forecasts a reduction in post of up to ten per cent. The Australian Taxation Office estimates that its tax agent portal saved the organisation AU$17million (£10 million) in 2009-10 through lower call volumes. It spent around AU$34 million setting up the tax agent portal and incurs annual operating costs of AU$4 million (£2.3 million).[15] Benefits exceeded costs after five and a half years.

3.11 From our analysis of the Department's costs, we estimate that the Department could save around £10 million a year by reducing the costs of authorising agents by 50 per cent and migrating half of agent post online. Firstly, a quicker response to agents' queries would reduce the need for a fifth of letters. The Department could further reduce volumes of post from agents by up to 30 per cent by encouraging agents to use existing services more by raising awareness and improving usability. The Department could also increase the number of transactions that are possible using its website – we estimate that 34 per cent of post from agents is about queries or amendments to taxcodes. Agents told us they would like to be able to deal with these changes online. Savings would be offset by the costs of developing new online services.

3.12 Although the Department may be able to make some of these savings without a substantial investment, to maximise the savings available the Department would need to invest in enhanced e-services. The Department would need to do further work to confirm that costs would be outweighed by achievable savings. Tax agents could also benefit from improvements to e-services. Eighty-four per cent of tax agents using the Australian Taxation Office portal reported a reduction in the time spent contacting the Australian Taxation Office. In some cases, efficiencies for tax agents could lead to lower charges for customers or better service.

15 Conversion between Australian dollars and British pounds calculated using an exchange rate of AU$1 = £0.59 as at June 2010.

Part Four

The Department's new strategy

This part examines the Department's new strategy which it is currently developing.

In 2010 the Department's Board considered a new strategy for engaging with tax agents

4.1 When forming a new strategy for engaging with tax agents, the Department was able to draw on the work of this NAO study as we set out our initial findings and conclusions in a Memorandum we presented to the Department in April 2010. The Memorandum included the results of our analyses on the costs to the Department of engaging with tax agents, the compliance of represented taxpayers and our review of the approaches taken by the Australian Taxation Office and New Zealand Inland Revenue. The Memorandum set out our view on how the Department should change to improve services for tax agents, which formed the basis of the recommendations in this report.

4.2 In August 2010 the Department's Board considered a new strategy for engaging with tax agents. The strategy acknowledges that the Department can do more to reduce the costs of engaging with tax agents, increase compliance of represented taxpayers and improve agent satisfaction. It sets a direction which could allow the Department to work more effectively with tax agents, based on the following aims:

- Segmentation: The strategy considers segmenting the tax agent customer group and tailoring its services accordingly. Segmentation would distinguish between non-profit, friends and family, and paid tax agents.
- Registration: Introducing registration for paid tax agents could give greater assurance over legitimacy and security.
- Self-service portal: If registration is introduced, agents could have increased rights and access, including facilities to amend tax codes and manage payments more effectively. The range of services offered has been refined in discussion with agent representatives.

- The Department would create knowledge about agent performance through an understanding of the filing, payment and compliance profiles of their clients and use this knowledge to support and improve the performance of agents whose client portfolio performance is below standard. For those agents who do not improve, the Department would remove access to its self-serve systems, and consider reporting poor work to the relevant representative body. In more serious cases it might seek access to supporting client papers, charge a penalty, refuse to deal with them, or prosecute.

To implement the strategy, the Department now needs to agree an action plan

4.3 A strategy for tax agents is an essential first step to give the Department a long term vision for its work with tax agents, and to allow the Department to allocate resources appropriately. It sets out the outcomes the Department aims to deliver in the next three years and by 2015 in terms of how it will operate differently. The Department has also estimated the resources it will require to implement its strategy. It estimates it will require a capital investment of around £10 million as well as over £13 million from one-off staff reduction costs through the move to self-service.

4.4 To take this work forward, the Department now needs to agree an action plan setting out the steps necessary to implement the strategy, a timescale for change, and a more detailed analysis of the resources required. It will also need to give consideration to the issues discussed below.

The Department needs a more detailed analysis of whether the strategy will achieve the expected benefits

4.5 Our analysis has indicated that the Department could make savings by reducing post from agents and there are opportunities to raise additional revenue through improved compliance. The Department carried out similar work to inform its strategy and has also estimated financial benefits from an increase in tax revenues and savings through reduced contact with agents. In both cases the estimates of the scale of achievable benefits are based on the limited data available and require some assumptions. The Department should now take the analysis forward and collect more information on the costs and benefits of making targeted compliance interventions as well as further data around volumes of post and reasons for contact. For example, further work is required to analyse the reasons for contact between the Department and agents to identify where contact can be eliminated or dealt with in different ways. Low-cost pilots to develop our findings could help establish the case for greater investment.

Buy-in from the tax agent community is essential

4.6 The Department will need to work closely with the tax agent community to learn and benefit from their views and ideas, and gain their commitment for change. There may be opportunities for sharing resources and expertise with the tax agent community, or even investment costs, perhaps starting with the design of more specialist software. For example, the Department and tax agents have already worked together successfully on the compliance reform forum (discussed in Part One) so the Department could explore joint engaging with tax agents or their representative bodies on more ambitious projects.

Appendix One

Methodology

We have published a full explanation of our methodology on the NAO website.

Method	Purpose
Analysis of the Department's data on compliance of represented taxpayers. This included analysis of the Department's random enquiry programmes on self-assessed income tax and corporation tax for 2002-05.	To estimate compliance rates and levels for represented taxpayers and to estimate the total tax at risk from inaccurate returns filed by represented individuals and businesses.
Analysis of the Department's data on costs of engaging with tax agents.	To estimate the total cost to the Department of engaging with tax agents and to identify opportunities for cost savings for the Department and efficiencies for tax agents and their clients.
Analysis of relevant performance data including the Department's customer survey, the performance of the Department's agent dedicated telephone line and the Department's turnaround times for processing agent authorisation forms.	To assess the Department's performance in dealing with tax agents.
Semi-structured interviews with Department staff, site visits and document review.	To inform our understanding of the Department's relationship with tax agents, including, for example, the reasons agents contact the Department, and how staff handle their queries.
International comparisons with Australian Taxation Office and New Zealand Inland Revenue.	To understand and assess alternative approaches for engaging with tax agents, indicative costs and measures of success.
Interviews with external stakeholders including representatives from the professional bodies for tax agents.	To inform our understanding of how agents perceive the Department and identify scope for improvements that would benefit both the Department and tax agents.

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ISBN 978-0-10-296548-3

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