



National Audit Office

HM Revenue & Customs

Engaging with tax agents

Detailed methodology

OCTOBER 2010

Detailed methodology

1 This document provides a detailed description of the methodology we used for our report Engaging with tax agents (*HC 486, Session 2010-11*). A summarised methodology is in Appendix One of that report.

2 The report examines whether the Department could deliver better value for money by increasing the compliance of represented customers while doing more to minimise the costs of engaging with tax agents. Supporting taxpayers in paying the right amount of tax, will in many cases increase tax revenues. The report covers professional tax agents, which we defined as those authorised and paid to act on another's behalf in their dealings with the Department. We analysed data relating to self-assessed income tax, PAYE, corporation tax and VAT, although we recognise that tax agents will also assist taxpayers on other taxes.

The main elements of our methodology are set out below.

Analysis of data on compliance of represented taxpayers

3 The Department does not currently collect data on the compliance performance of individual tax agents, for example whether their customers are likely to pay the right amount of tax. In the absence of this sort of data, we worked with HM Revenue & Customs (the Department) to analyse the results of the Department's random enquiry programmes for Self Assessment and Corporation Tax to assess levels of under-declared liabilities.

4 The Department uses random enquiry programmes to establish the extent of tax lost due to incorrect 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 programmes detect incorrectly declared tax due to error, failure to take reasonable care or evasion.

5 There are some limitations with the random enquiry programme data. These are discussed below:

- 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 significant changes.

- The random enquiry programme does not record over-declarations of tax. In response to a previous NAO recommendation the Department has set up a process to collect this information and expects to report results in 2010-11¹. In the meantime it has not been possible to examine the level of over-declarations on returns filed by represented customers.
- The random enquiry programme for Corporation Tax includes covers only small and medium-sized enterprises. We did not consider this a significant limitation since large businesses are more likely to manage their tax affairs in-house than use an agent.
- The random enquiry programme for Self Assessed income tax covers all taxpayers except for large partnerships (those with five or more partners).
- Tax agents told us that they sometimes take a commercial decision about whether to challenge the results of an enquiry into their clients' affairs. If a tax agent believes the result is slightly in the Department's favour, they may choose not to take the matter further.

6 Working with the Department we examined three samples of around 5,000 closed self-assessment random enquiry cases each, covering the years 2002-03, 2003-04 and 2004-05², and just under 1300 corporation tax random enquiry cases covering the years 2001–2004 to:

- Calculate (1) the proportion of returns with under-declared liabilities; (2) the average value of under-declared liabilities; and (3) the value of under-declared liabilities as a percentage of total tax liability due through self-assessment or corporation tax. These calculations were made for represented and non-represented taxpayers, as a whole and by customer group.
- Calculate the proportion of returns with under-declared liabilities and the average value of under-declared liabilities of taxpayers represented by the largest accountancy firms with those represented by smaller agents. To do this we took the 'top 100' firms identified by Accountancy Age magazine as a proxy for the largest accountancy firms dealing in tax.³
- Estimate the total tax at risk from inaccurate returns submitted by represented individuals and small and medium-sized enterprises for self-assessed income tax and corporation tax. 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. Adjusting factors were also applied to: (1) account for the fact that random enquiry programmes may not identify all incorrect returns, particularly where the Department cannot verify

¹ *Helping individuals understand and complete their tax forms*, 2006-07, HC 452.

² The sample sizes for income tax self assessment were: 2002-03, 4888; 2003-04, 5032; and 2004-05 4734. The samples selected for businesses filing corporation tax returns with accounting periods ending in 2001, 2002, 2003 and 2004 consisted of 297, 315, 342 and 400 cases respectively.

³ *The Top 50*, Accountancy Age, 18 June 2009.

data supplied by the taxpayer; and (2) to up-rate the data to 2007-08, based on the appropriate GDP series⁴. Uncertainty in the value of the first adjustment, together with the uncertainty inherent in extrapolating from a sample to a population, resulted in a range of £3.5 billion to £16.9 billion for the total tax at risk from represented taxpayers. Total under-declared tax due from represented taxpayers could be higher still – the Department does not currently hold data on under-declarations associated with end-of-year employer PAYE and VAT returns prepared by agents.

Analysis of the Department's data on costs of interacting with tax agents

7 In order to estimate the total cost to the Department of interacting with tax agents we identified the main areas where the Department incurs costs when dealing with represented customers. For each, we calculated volume and unit cost elements by bringing together information from a range of sources, including the Department's own data, a sample of the Department's post, previous Department research on contact patterns and volumes and analysis carried out for previous NAO studies. In some cases, the data available was limited, for example, it did not always cover all relevant taxes. Recognising these limitations, we made various assumptions with the aim of establishing the order of magnitude of the costs involved rather than a precise figure.

8 In particular, we made the following assumptions:

- Just under 20 per cent of inbound self-assessed income tax, PAYE and VAT post comes from tax agents. This assumption was based on two samples of post carried out by the Department in December 2009 and April 2010.
- The unit costs of processing inbound post and telephone calls from tax agents are based on costs of processing inbound post and telephone calls from the general population. Estimates of 2008-09 unit costs for processing inbound post items and telephone calls received by the Department from the general population were obtained from analysis carried out for the NAO report 'Dealing with the tax obligations of older people' up-rated to 2009-10 prices⁵. The analysis was based on a calculation of staff costs divided by volumes.
- Unit costs for processing emails are less than the cost of processing post. Because of the low volumes of emails received, our estimate of the total cost of dealing with agents is not sensitive to the cost of processing emails.
- Estimates of 2004-05 unit costs for processing returns are in line with analysis carried out to inform the Committee of Public Accounts report on filing of income tax self assessment returns, 2005-06.⁶

4 For more information on the Department's tax gap estimates see *Protecting Tax Revenues*, HM Revenue & Customs, December 2009, *Measuring Tax Gaps 2009*, HM Revenue & Customs, March 2010 and *Measuring Tax Gaps 2010*, HM Revenue & Customs, September 2010.

5 *Dealing with the tax obligations of older people*, 2008-09, HC961. The average earnings index was used to up-rate the unit cost figures.

6 Committee of Public Accounts, *Filing of Income Tax Self Assessment returns*, 23rd report, 2005-06.

9 Because the Department receives most of its contact from agents (both in terms of volume and cost) by post, we also carried out an analysis of the reasons for contact by post. This was based on a sample of 1,437 items carried out in December 2009.

10 Using the cost data we estimated the potential cost savings if volumes of contact from tax agents were to reduce and through a more efficient process for authorising agents. Our report shows that reductions in post could come from achieving a quicker response to agent letters and reducing progress chasing, encouraging agents to use existing services more by raising awareness and improving usability and by enhancing online services. The central scenario shown in **Figure 1** would result in a £13 million cost reduction. We recognise that the analysis was based on limited data and required various assumptions. It is included to give a guide to the scale of savings achievable. Savings would be offset by the costs of setting up and maintaining any new online facilities.

Analysis of the market for preparing tax returns

11 In order to calculate a rough estimate of the size of the market for preparing tax returns in the UK we reviewed prices for preparing tax returns quoted on the internet. The prices quoted were mostly around £100-150 plus VAT for individuals and £600 plus VAT upwards for small businesses. We used these figures in combination with evidence from the Department about the number of individuals and small businesses using agents to submit tax returns.

12 There are a number of limitations with this approach, not least that businesses which publish this information on their websites are unlikely to be representative for the whole population and tax agent representative bodies we spoke to suggested that these values per client seem on the low side and could be for completion of the simplest of returns. We therefore took assurance from another estimate derived from figures published in the journal *Accountancy Age*. *Accountancy Age* conducts a survey and produces an annual report on the size, make-up and fee income (by type of work) of the largest 50 accounting firms in the UK, with supplemental information on the fee income of the next 50 firms⁷. We used this data to estimate the total tax income for the largest 100 firms, which was comparable in order of magnitude to the figure derived from the first calculation.

Interviews with the Department's staff

13 During the course of the study we held semi-structured interviews with the Department's staff in the Business Customer Unit, Knowledge, Analysis and Information, Central Compliance, Local Compliance, Customer Contact, Customer Operations, Personal Tax and Local Audit.

14 We also visited one of the Department's telephone contact centres and a post processing centre to develop our understanding of the reasons agents contact the Department and how staff handle their queries. We visited the Department's operations in Newcastle to learn about how staff process authorisation forms from tax agents.

⁷ *The Top 50, Accountancy Age, 18 June 2009.*

Figure 1

Volume change in each scenario

	Low scenario %	Central scenario %	High scenario %
Post	-20	-50	-60
Calls	–	-20	-50
Agent Authorisation forms	-10	-50	-100

NOTE

1 We assumed no change to the volume of emails or tax returns from tax agents.

Source: National Audit Office analysis

Analysis of the Department's performance data

15 We examined the Department's performance data to establish the trends in the level of service provided to tax agents. In particular, we examined:

- The Department's customer survey which reports on tax agents as a specific customer group. In particular, the survey collects data on agent satisfaction levels.
- The performance of the Department's agent dedicated telephone line. We assessed availability as the percentage of calls answered within 20 seconds, the industry benchmark.
- The Department's turnaround times for processing authorisation forms.

International Comparisons

16 To understand and assess alternative approaches for engaging with tax agents we looked at the approaches taken by tax authorities in other countries. We held semi-structured interviews with representatives from the Australian Taxation Office and New Zealand Inland Revenue, and reviewed qualitative and quantitative information on their tax agent strategy, including indicative costs and measures of success. We recognise that these organisations operate in quite different contexts to the Department, because of the different tax systems, size of the economy and extent of tax agent representation. We therefore looked for high level rather than exact comparisons.

Interviews with tax agents

17 To understand the perspective of the tax agent community we consulted representatives from the Association of Accounting Technicians, Chartered Institute of Taxation and the Institute of Chartered Accountants for England and Wales.