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

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).