



National Audit Office

**REPORT BY THE  
COMPTROLLER AND  
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**HM Revenue & Customs**

# Managing civil tax investigations

# Summary

**1** In 2009-10, HM Revenue and Customs (the Department) collected £435 billion in tax. Protecting tax revenues against fraud and evasion is essential for the tax system to operate fairly and support the Government's economic and social objectives. Most taxpayers seek to comply but a minority deliberately evade their obligations. In 2008-09, the Department estimated that the UK tax gap – the difference between the tax payable if all obligations are fully met and tax actually collected – was around £42 billion. It estimated £15 billion was due to fraud, evasion and criminal attack with the remainder due to error, non-payment and avoidance.

**2** The Department's objective is to improve the extent to which individuals and businesses pay the tax due. It employs various methods to do this, from supporting those who want to comply through to identifying those who evade and imposing civil and criminal sanctions. Civil investigations are an important element of the work to tackle serious non-compliance aimed at recovering tax evaded and imposing financial penalties. They sit alongside criminal investigations, undertaken with a view to prosecution, and a range of other work designed to prevent revenue loss. The Specialist Investigations and Local Compliance Directorates, which form part of the Enforcement and Compliance business area, conduct most civil investigations (Figure 1 on page 12).

**3** The Department's aims, as announced in its 2011-2015 Business Plan, are to be more efficient, more flexible in dealing with its customers and more effective in bringing in revenue. It plans to invest in work against tax avoidance and evasion to bring in an additional £7 billion of tax revenue a year by 2014-15. It plans to achieve this by using its understanding of customer needs and behaviour to focus its efforts where they will have the greatest effect.

**4** This report examines whether the Department is managing its civil investigations efficiently and effectively by making best use of resources to maximise levels of compliance and tax revenue. Part One examines the results of civil investigations and Enforcement and Compliance's approach to managing investigation resources. Part Two assesses whether the system for referring cases of suspected serious non-compliance is operating effectively. Part Three examines the approach to managing civil investigations, focusing on the civil investigation of fraud procedure, a key mechanism for investigating serious fraud and evasion. Part Four evaluates whether the Department is maximising the impact of civil investigations by applying appropriate sanctions, collecting debts promptly and sending strong deterrent messages to potential evaders. Appendix One contains our methodology.

## Key findings

### On managing civil investigation resources

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We examined how the Department monitors the impact of its civil investigations and makes resource allocation decisions. We examined the approach to civil investigations within the broader context of the Department's management of its compliance and enforcement resources.

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**5 The civil investigation directorates have delivered increasing levels of yield [paragraphs 1.10-1.12].** In 2009-10, they generated yield of £8.5 billion, an increase of 49 per cent in real terms since 2007-08. Yield is the estimate of additional tax arising from compliance work. The two directorates have delivered year-on-year increases in yield and, over the same period, reduced their expenditure by 10 per cent in real terms to £567 million. The return on enforcement work has increased from 9:1 to 15:1. These directorates undertake a range of enforcement activities and it is not possible to state the return specifically on civil investigations.

**6 The Department's performance framework has not captured the full impact of civil investigations and other enforcement work [paragraphs 1.5-1.9].** The Department has used yield as its primary measure for monitoring the impact of civil investigations. Yield is the most readily measurable element of performance and provides a hard measure of the value of investigation work. However, used alone, it does not capture the full impact of investigations, such as the effect on taxpayer behaviour, or encourage preventative work to improve compliance. The Department plans to introduce a broader range of performance metrics in 2011 to assess the impact of its enforcement activities in the context of its new strategy for tailoring work according to the needs, abilities and motivations of customers.

**7 Enforcement and Compliance has not had all the management information necessary to manage civil investigation resources effectively [paragraphs 1.13-1.22].** It has monitored progress towards targets but has not established sufficiently detailed information on the cost-effectiveness of different types of enforcement activity or productivity. Limited information on the capacity of investigation teams has restricted its ability to compare performance across directorates. To date, the civil investigation directorates have generally outperformed their yield targets by over 10 per cent. Enforcement and Compliance has set much higher targets for 2010-11 to achieve the Department's three-year target to reduce tax losses. It is also strengthening its management of resources by refining its approach to annual budgeting; rolling-out a case management system to collect more detailed management information; and developing a resource allocation model. The Department is therefore in a transition phase but there is further to go. In particular, a better understanding of the returns on compliance and enforcement activities would inform decisions on how to deploy resources to best effect.

## On referring cases for civil investigation by specialist teams

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We examined whether the system for escalating potential cases of serious non-compliance was operating effectively.

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**8 The system for escalating cases for investigation has yet to become fully effective [paragraphs 2.4-2.9].** The introduction of the referral system has enabled the Department to refer promptly some 4,000 cases a year to specialist teams to consider the need for criminal and civil investigation. The number of referred cases has fallen by 13 per cent since 2008. In 2008-09, 20 per cent of referrals were adopted by specialist civil investigation teams with the remainder returned to the originating officer to pursue. The Department has not set a benchmark for the expected adoption rate and has not assessed the reasons for rejection, which would provide insight into the quality of referrals. This would help it judge whether the referral system is operating effectively in focusing specialist resources and handling cases appropriately. The Department is introducing changes by March 2011 to increase the throughput and quality of referred cases.

**9 The Department routinely assesses the threats to tax revenue and is exploiting new information from the referral system to refine its understanding of evasion [paragraphs 2.10-2.14].** Enforcement and Compliance assesses continually the risks and threats to the tax system. It uses this knowledge to inform its strategic priorities; take action on threats; inform the choice of compliance campaigns; and identify cases for compliance checks. The Department uses intelligence from various sources and is making increasing use of data from the referral system to improve its risk profiling. Further use of this growing body of empirical evidence would help the Department refine its understanding of the characteristics of serious fraud and there are opportunities to extend its modelling work on attitudes that are driving evasion.

## On managing civil investigations of fraud

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Our analysis focused on the Department's management of civil investigations of fraud, which is a key mechanism for penalising serious fraud.

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**10 The Department could reduce the time taken to complete civil investigations of fraud [paragraphs 3.5-3.11].** The investigations are often complex and involve detailed examination of a person's tax affairs. In 2009-10, the average elapsed time of these investigations was 25 months, compared to an internal target of 18 months. Investigation teams completed 25 per cent of cases within the target time, while 15 per cent of investigations took over three years. There were also wide variations across civil investigation teams in the average elapsed time of completed and live investigations. Our analysis showed the need to exert more management pressure to reduce elapsed times and potential to re-model the civil investigation of fraud process.

**11 While civil investigations of fraud yield good returns, the Department has identified the need to improve their wider effectiveness [paragraphs 3.4, 3.12-3.14].** Investigation teams have made over 900 settlements over the last three years, resulting in yield of £294 million. In 2009-10, the average yield per investigation was £329,000 – nineteen times their cost – reflecting the larger amounts of tax at stake and their potential. The Department reviewed the process but has limited trend data on its effectiveness in encouraging disclosure and cooperation. It is considering how to increase its wider deterrent effect and has identified the need to underpin investigations with a credible threat, including prosecution or the use of insolvency powers, in cases of non-cooperation.

### On maximising the impact of investigations

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Punishing evasion and deterring non-compliance are key components of an effective enforcement regime. Focusing mainly on civil investigations of fraud, we assessed how the Department applies penalties; seeks prompt payment; and promotes awareness of its sanctions.

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**12 The Department needs a clearer picture of the penalties imposed on civil investigations [paragraphs 4.2-4.10].** There are provisions to reduce penalties to reflect taxpayer cooperation and disclosure, and the nature of errors and omissions. The Department has quality assurance arrangements to review penalties imposed on individual cases but has not analysed the level of penalties applied across civil investigations for variations between local offices; types of investigation; or trends over time. On civil investigations of fraud completed in 2009-10, the average penalty was 21 per cent of the tax due. Twenty eight per cent of these investigations involved a penalty of less than 10 per cent, half of which involved no penalty. In June 2010, the Department commissioned a review of the new penalty regime, which came into force for tax returns from April 2008, and is implementing changes to achieve quicker and more consistent penalty decisions.

**13 The Department does not routinely monitor whether tax and penalties due from completed investigations have been collected [paragraphs 4.11-4.14].** The Department usually seeks an upfront payment from taxpayers under investigation and pursues outstanding tax, interest and penalties on settlement. It does not specifically prioritise tax and penalties due from investigations for debt recovery, although that might happen as debts are prioritised by risk and value. It could not trace whether payment had been received on 27 per cent of the outstanding tax due on civil investigations of fraud passed for collection in 2008-09 as it was not possible to reconcile case management and accounting databases. Of the £58 million that could be traced, 84 per cent had been collected. As part of a broader set of metrics planned for 2011, the Department plans to measure the ‘cash collected from interventions’.

**14 The Department has used campaigns to raise awareness of its enforcement activities in targeted high risk areas [paragraphs 4.15-4.18].** The Department has focused its campaigns on specific high risk groups, such as offshore evasion and health professionals. New legislation has allowed the Department to make arrangements to publicly name those caught deliberately evading tax and to monitor more closely their future compliance.

### Conclusion on value for money

**15** Over the last three years the return on the Department's civil investigation directorates has increased from 9:1 to 15:1, reflecting a reduction in resources deployed and increasing levels of revenue generated. These directorates have also delivered a range of other activities to prevent future tax losses and improve taxpayer compliance. The Department is making important changes to gain a better understanding of its performance and strengthen management of enforcement resources. These improvements in performance and work underway represent significant steps towards achieving value for money. Greater value could be obtained from exploiting more fully the potential of civil investigations by ensuring dedicated investigation resources are deployed more closely to the risks; concluding cases more quickly; and strengthening their deterrent effect. The Department also needs to better understand the relative returns and costs of different enforcement activities, including civil investigations, and their wider impact on compliance and taxpayer behaviour. The Department has begun to assess the impact of different resourcing levels on yield. This information, along with a better understanding of the capacity of investigation teams, will help the Department make more informed decisions on deploying resources and demonstrate its achievement of value for money.

### Recommendations

**16** Our recommendations aim to help the Department improve the efficiency and effectiveness of its civil investigations and refine further its approach to managing resources.

**a Enforcement and Compliance is not yet able to determine the most cost-effective use of resources.** It has taken steps to strengthen its management of resources, including developing a resource allocation model, but could go further by:

- building a better understanding of the return on different enforcement activities to assess the most cost-effective mix. To achieve this, it should develop more consistent data across directorates on the costs and impact of different activities. This involves developing a broader range of quantifiable outputs and, over the longer term, better measures of the impact on taxpayer behaviours and compliance; and
- assessing the performance and capacity of investigation teams by developing quality and efficiency metrics and establishing clear accountabilities for performance at operational level within directorates.

- b** **There is scope to improve the effectiveness of the referral system and improve the quality of cases referred for investigation.** Enforcement and Compliance should:
- in addition to proposed changes to the system, establish better management information to develop its understanding of the effectiveness of the system and treatment of cases;
  - use the growing body of empirical evidence, including feedback on completed investigations, to extend its modelling of evasion behaviours; and
  - assess the potential from its new risk modelling to generate more suspected cases of serious evasion specifically for specialist investigation teams.
- c** **Civil investigations of fraud have delivered good returns, but there is scope for them to achieve more.** Our analysis shows there is scope to strengthen the process. The Department should:
- reduce the average time taken to complete investigations by: ensuring disclosure reports are commensurate to the size and complexity of the investigation; seeking to work more closely with tax agents to improve the quality and completeness of disclosure reports; and ensuring a clearer focus in following up disclosure reports, identifying where interventions will add most value; and
  - ensure that the civil investigation of fraud procedure is widely understood by taxpayers and agents, and there is a credible deterrence to non-cooperation. It should monitor the level of voluntary disclosures and non-compliance, alongside time taken and penalty rates, to better assess the effectiveness of the process.
- d** **The Department does not have a clear picture of the penalties imposed on civil investigations.** It should rigorously apply its new penalty rules for those found to have evaded their obligations and strengthen arrangements to ensure that penalty reductions under the civil investigation of fraud procedure are applied consistently across directorates. It should also collect better management information on the application of penalties on all civil investigations to enable periodic review of the level of penalties and analysis of the factors influencing the penalty rates, such as voluntary disclosure and taxpayer cooperation.

- e** **The Department cannot easily trace whether debts from completed investigations have been paid in full.** It should strengthen its management of investigation debt by:

  - assessing how it could track cases as they are passed between different databases or periodically assessing a sample of cases;
  - ensuring that investigation debts are identifiable and given appropriate weighting in risk profiling, and extending the campaigns approach to investigation debts; and
  - developing closer liaison between debt management and investigation teams so that debt recovery actions are based on a better understanding of the taxpayer's financial position.
  
- f** **Maximising the deterrent effect from investigations is an important element of achieving value for money.** The Department should seek to raise awareness of its enforcement work and powers by targeting specialist or trade publications and developing closer partnerships with professional bodies and training institutes.