National Audit Office

Managing tax debt through the pandemic

HM Revenue & Customs

REPORT

by the Comptroller and Auditor General

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Managing tax debt through the pandemic

HM Revenue & Customs

Report by the Comptroller and Auditor General

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Gareth Davies
Comptroller and Auditor General
National Audit Office

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The National Audit Office study team consisted of:

Brian Kennedy, Sarah Pearcey, Isobel Reed, Lucy Weston, and David Williams, under the direction of Andy Morrison.

For further information about the National Audit Office please contact:

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

020 7798 7400

www.nao.org.uk

@NAOorguk

Key facts

£42bn	2.4m	300 FTE
tax debt owed to HM Revenue & Customs (HMRC) as at 30 September 2021	the estimated increase in number of taxpayers in debt as at 30 September 2021 compared with 31 January 2020	shortfall as at September 2021 between planned number of full-time equivalent (FTE) debt management staff and actual FTE debt management staff numbers

£26 billion	increase in tax debt between January 2020 and September 2021
£1.2 billion	HM Revenue & Customs' (HMRC's) estimate of additional tax debt it could collect each year between 2021-22 and 2023-24 with planned increases in staff numbers and use of private sector partners
£0.3 billion	HMRC's estimate of additional tax debt it could collect each year between 2021-22 and 2023-24 by using new tools and powers
18%	reduction in HMRC staff working on debt management under efficiency drives between March 2014 and March 2020
£4.8 billion	value of write-offs and remissions of tax debts in 2018-19 (in 2021-22 prices), the year when this figure was highest

Summary

Introduction

1 The economic impact of the COVID-19 pandemic is unprecedented in recent times. On 20 March 2020, the Chancellor announced that, to help support self-employed people and businesses, payments of Self Assessment Income Tax due on 31 July 2020 and VAT payments due between 20 March and 30 June 2020, would be deferred until 31 January 2021 and 31 March 2021, respectively. This was among the very first actions the government took in response to the economic impact of the pandemic.

2 As the UK's tax authority, HM Revenue & Customs (HMRC) has played a pivotal role in providing financial support to taxpayers during the pandemic. As the economy went into lockdown, HMRC paused most of its debt collection activity and set about creating new employment support schemes. These have provided grants to employers and self-employed people to help protect jobs during the pandemic.

3 The wider economic impact of the pandemic, and HMRC's decision to suspend most debt collection, has led to large increases in the amount of tax owed to HMRC. Tax debt peaked at £67 billion in August 2020, including deferred payments. This was far in excess of levels seen in the previous 10 years. While tax debt has reduced since then, HMRC still faces a significant challenge in clearing the backlog. As the UK emerges from the pandemic, HMRC will need to strike a balance in pursuing debt and allowing taxpayers time to recover their finances.

Scope of this report

4 This report considers how well HMRC has managed tax debt through the pandemic – in particular, whether it has adapted sufficiently to the changing nature and scale of that debt and the wider circumstances that affect taxpayers' ability to repay tax. We consider whether HMRC has:

- adapted its management of tax debt quickly and responsively during the pandemic. Part One assesses the impact of the pandemic on tax debt, the speed and scale of HMRC's response, and how far taxpayers have been able to access HMRC's support;
- understood the impact of the pandemic on taxpayers' ability to pay tax debt. Part Two examines the HMRC's approach to identifying taxpayers' ability to pay, and whether it understands the impact this will have on tax debt over the medium term and the support taxpayers will need; and
- the capacity and capability it needs to manage tax debt. Part Three considers the strengths and weaknesses in HMRC's practices and how far it has the capacity and tools it needs to collect tax debt cost-effectively in the future.

5 This report does not consider HMRC's other COVID-19 interventions designed to support businesses, including the Coronavirus Job Retention Scheme, the Self-Employment Income Support Scheme and Eat Out to Help Out. It does not consider work to collect tax credit debt or how other government departments are managing debts owed to them during the pandemic. We have reported separately on the Bounce Back Loans Scheme.

6 Our audit approach is described in Appendix One, and the evidence base we used is in Appendix Two. Appendix Three summarises the approaches other countries have taken to ease tax debt and the impact it has had.

Key findings

How HM Revenue & Customs has adapted its management of tax debt during the pandemic

7 **Total tax debt was £42 billion in September 2021, more than double the level going into the pandemic.** In response to the pandemic, government policies allowed taxpayers more time to pay VAT and Self Assessment, and government restricted debt collection activity more generally across the economy. Total tax debt increased from around £16 billion in January 2020 to a peak of £67 billion in August 2020. The debt balance has improved as COVID-19 payment extensions have passed and the economy has reopened. As at 30 September 2021, total tax debt stood at £42 billion (paragraphs 1.3 and 1.4 and Figure 1).

8 **Early in the pandemic, HMRC moved quickly to change its debt management approach.** It set up a helpline to provide advice to taxpayers, paused debt collection activity and moved staff to support taxpayers applying for employment support grants. It used the pause to review how it should pursue debt during the pandemic. For example, it changed how it would approach taxpayers, including the tone of communications and the pace of pursuit. It extended access to online repayment tools for taxpayers with larger debts and those owing VAT, improved the terms of repayment arrangements for taxpayers and retrained staff to follow the new principles (paragraphs 1.5, 1.6, 1.8 and 1.9).

9 **HMRC maintained inbound telephone and postal services for people needing debt advice but it could not meet demand at busy times.** While external communications made clear that no debt was at risk of enforcement while deferred, HMRC still aimed to answer calls and respond to post from taxpayers about their tax debts. However, the movement of large numbers of staff to other parts of HMRC's COVID-19 response, and wider pressures on HMRC's customer services, meant that HMRC was frequently unable to answer calls or post within normal service levels (paragraph 1.11).

Understanding taxpayers' ability to repay tax debts

10 **Up to 2.4 million more taxpayers are in debt to HMRC following the pandemic, while those already in debt owe more.** HMRC estimates that up to 6.2 million taxpayers were in debt as at 30 September 2021, compared with 3.8 million taxpayers in debt as at 31 January 2020. However, HMRC does not have a single customer record and its figures double-count taxpayers with debts for more than one tax. The average amount of each tax debt increased by 60%, from around £4,300 at January 2020 to £6,800 at September 2021. The value of debts over two years old increased from £2.5 billion in 2019-20 to £4.4 billion in 2020-21. Older debts are typically more difficult to collect (paragraphs 2.2 to 2.5).

11 **HMRC has prioritised which debts to chase based on its understanding of the likely impact of the pandemic on taxpayers' ability to pay.** It used data from tax returns and its coronavirus support schemes to gauge the probable impact of the pandemic on taxpayers' ability to pay their debts. It categorised debtors into high-, medium- and low-impact groups and sent reminders that were worded according to their likely ability to pay. It split the groups, based on factors including changes in turnover and staffing, as a proxy for the impact of the pandemic. However, some businesses and self-employed people in the low-impact groups might find it more difficult to pay because of higher overall levels of debt and other factors such as a lack of access to COVID-19 grant support. Business taxpayers in the low-impact group had debts around 50% greater than business taxpayers in the high-impact group. Self Assessment taxpayers in the low-impact group did not have access to COVID-19 grants that Self Assessment taxpayers in the high-impact group could draw on. HMRC encourages taxpayers to make contact if they are in difficulty and will always discuss debts on a case-by-case basis (paragraphs 2.8 to 2.12 and Figure 12).

12 **HMRC normally expects taxpayers to clear their debt before the next tax period, but it recognises that this may be unrealistic for many people affected by the pandemic.** Before the pandemic, HMRC generally sought to agree repayment plans that would clear debts before the next tax payment was due, to stop taxpayer debts rising. Its self-serve system only allows payment plans of up to one year. It has recognised that the pandemic means that many taxpayers may need more time to repay their debts and it has made it easier for taxpayers to agree longer arrangements. The average duration of Time to Pay arrangements increased from around five months before the pandemic to 12 months by July 2021. Some taxpayers may be due tax repayments on operating losses incurred during the pandemic but not until relevant tax returns are filed. The Cabinet Office told us that leading debt management practitioners outside government tend to focus on agreeing affordable repayment plans that can be sustained. As well as helping the person in debt, it also reduces the workload of following up failed arrangements (such as extra contacts to chase unpaid debts or renegotiate payment plans). HMRC told us it also seeks to agree affordable repayment plans with taxpayers, although some stakeholders felt it could improve in this regard (paragraphs 2.17 to 2.21 and Figure 13).

13 **HMRC forecasts that total tax debt will fall to £33 billion by March 2022 but this assumes that the pandemic has not changed repayment behaviour.** HMRC forecasts that the debt balance will decrease throughout 2021-22, falling to £32.8 billion by March 2022. The forecast for 2021-22 is based largely on new debt created and the amount collected in 2019-20. The forecast does not attempt to adjust for HMRC's segmentation of taxpayers into high-, medium- and low-impact groups, greater overall levels of indebtedness among taxpayers, or the possibility that some sectors or regions may take longer to recover from the pandemic. Data from April 2021 showed that debt fell faster than forecast initially but repayments have slowed since. In September 2021, HMRC increased the forecast for the debt balance for March 2022 by £3.5 billion from its May 2021 forecast. Our research with stakeholder groups indicates a polarised impact from the pandemic, with some groups shoring up their bank balances while others have been more badly affected. This could explain why the debt balance appeared to reduce quickly initially, before slowing, and suggests that higher overall levels of debt may persist for some time (paragraphs 2.22 to 2.26).

14 HMRC has a limited understanding of how the pandemic will affect the amount of specialist work needed to manage debt. We considered two customer groups where HMRC already had specific processes or work in place to provide additional engagement. These were 'phoenix' companies, where companies are wound up and reformed specifically to avoid paying debts, and where HMRC seeks to intervene to avoid tax losses; and vulnerable taxpayers, where HMRC provides additional support to help them pay their taxes. In both cases, we found that HMRC had a limited understanding of how the pandemic would impact the scale of what HMRC would need to do. For example, phoenix companies are more of a risk following the pandemic because companies have taken on more debt. HMRC uses sources of intelligence to identify risky companies but it has never aggregated this into usable management information. In July 2021, HMRC told us that it was working to develop management information and establish a strategy to tackle corporate insolvency (paragraphs 2.27 to 2.38).

HM Revenue & Customs' capacity and capability to manage debt

15 Debt charities and other stakeholders told us that they regarded HMRC as a leading public sector practitioner in debt management. In our past work to follow up National Audit Office (NAO) and Committee of Public Accounts recommendations, we have found that HMRC has made more effective use of debt collection agencies. It expects these agencies to follow its principles in collecting debts. For example, agencies should adhere to HMRC standards to support vulnerable customers. Stakeholders we spoke to said that HMRC could further develop its approach by focusing on agreeing affordable repayment plans, rather than focusing on the time taken to pay, and that it could point more taxpayers to independent debt advice. HMRC told us it had increased use of these practices during the pandemic – for example, by increasing normal internal Time to Pay authorisation limits from 12 months to 24 months. As part of a wider pilot run by the Money & Pensions Service, HMRC has started referring customers to independent debt advice, although this currently only applies to tax credit debt. Behind the scenes, HMRC's debt management function exhibits many features that we would expect, including regular consideration of risks and detailed data on operations and performance (paragraphs 2.19, 3.2 to 3.7 and Figure 13).

16 HMRC is unlikely to have sufficient capacity in the short term to manage increased levels of tax debt arising from the pandemic. It told us that it intends to recruit 1,000 full-time equivalent (FTE) staff in 2021-22. However, once staff turnover is factored in, this is sufficient only to fill the current shortfall in staff compared to planned levels which is 300 FTE. Assuming HMRC's forecasts are accurate, it will have twice the level of debt to manage at the end of March 2022 compared with before the pandemic. Its latest estimates suggest that the number of taxpayers in debt may have increased by around 60%. New debtors may require more support in the short term to agree payment plans. Maintaining regular contact with taxpayers is often cited as a critical factor in recovering debt (paragraphs 3.8 to 3.10).

17 **In the years leading up to the pandemic, HMRC made efficiency gains but it did not close the gap between new debts and debts collected.** HMRC estimates that a new telephony system and business process reengineering helped it deliver efficiencies equivalent to over 900 FTE staff. Between 31 March 2014 and 31 March 2020, it reduced the number of staff working on debt management by around 880 FTEs (18%). At the same time, it maintained collection levels across most taxes, but only at a level equivalent to around two-thirds of new debt created each year. This suggests that HMRC has the potential to collect more debt with additional capacity. It has also written off more tax debt as uncollectable in recent years. Over the two years from 2018-19 and 2019-20, it wrote off or remitted around £9 billion, around £1 billion more than over the previous two years (paragraphs 3.11 to 3.14).

18 **HMRC's estimates indicate that new powers, tools and increases in capacity, planned before COVID-19, are unlikely to bridge the increase in debt.** It has been implementing new tools, such as improved telephony and self-service, to help it achieve efficiencies. Some improvements have taken a long time to deliver, notably the single customer account, which HMRC has been planning to develop for more than a decade. HMRC is also developing better data analytics and has improved legal powers for collection, including preferential creditor status for some taxes. These new tools and powers are expected to help it bring in around £0.3 billion a year in debt between 2021-22 and 2023-24. Plans to increase capacity are expected to make a bigger difference: HMRC expects to bring in over £1.2 billion a year between 2021-22 and 2023-24 by increasing staff numbers and making greater use of private sector partners. Even with these improvements, HMRC's estimates of the additional debt it will collect fall far short of the increase in debt from the pandemic (paragraphs 3.3, 3.11 and 3.15 to 3.18).

19 **HMRC lacks a sufficiently detailed understanding of its activity to identify the resources needed to optimise debt collection.** It has published the overall return on investment of its debt management function, and tracks and evaluates some specific parts of its work. However, it does not have a comprehensive breakdown of the effectiveness or return on investment of different debt management activities. This means that it is unable to identify where resources have the most impact. HMRC has recognised that it needs to improve its understanding, and it is developing a tool that will help it identify how long each stage of contact with taxpayers takes and what the outcomes are. As its plan for how to deal with debt following the pandemic evolves, HMRC will need to improve its understanding of what good performance looks like. With taxpayer debt increasing, we would expect a greater return on investment (paragraphs 3.7 and 3.21 to 3.24).

Conclusion on value for money

20 The pandemic has left HMRC with a far greater debt balance to deal with than in recent times. At the onset of the first lockdown, HMRC acted quickly, pausing debt collection to reduce pressure on debtors and working to improve its understanding of how the pandemic was affecting taxpayers. It subsequently launched its Return to Collection campaign, which included segmenting tax debtors according to how severely they were being affected by the pandemic so that, when collections restarted, it was able to tailor its approach to their ability to pay. It also adopted an empathetic tone and made it easier for taxpayers to repay debt online. Early indications were encouraging, with taxpayers repaying debt faster than expected and stakeholders welcoming HMRC's understanding tone. However, HMRC also forecasts that higher levels of tax debt will persist. Many taxpayers will need more time and support to repay their debts.

21 HMRC faces several years of managing the impact of the pandemic on tax debt and current staffing is unlikely to be enough to manage the increased workload. It made efficiencies before the pandemic but it did not improve overall levels of debt collection and it was writing off more debt. It has some new tools and powers, but these do not appear likely to make up the shortfall. It estimates that adding staff and private sector capacity would have most success in increasing debt collection. High rates of return indicate that this would be a good investment.

22 While some debtors have been able to repay tax debt quickly during the pandemic (helped by loans and support from other parts of government), there remains an unknown number of taxpayers who have been badly affected and will struggle to repay tax debt. HMRC must build on its initial work and better understand the resources it needs to manage the scale of the challenge it faces. With the number of taxpayers in debt increasing by up to 60%, HMRC is likely to need a substantial increase in capacity. However, with average debts increasing, HMRC should also target a much greater total return from existing and new resources. Understanding this relationship will be fundamental to identifying the resources needed to optimise debt collection following the pandemic.

Recommendations

Working with government

23 HMRC should work with the rest of government, and, in particular, HM Treasury and the Department for Business, Energy & Industrial Strategy to:

a develop and communicate a strategy that sets out how recovering debt should change in light of the pandemic. This may require greater sharing of information to understand the taxpayer's exposure, and identifying different timelines and parameters for chasing debt.

Meeting demand

24 HMRC faces a large increase in debt and the number of taxpayers in debt. Taxpayers are taking more time to pay off debts, which may mean more contact points with HMRC and different rates of escalation. To manage this workload effectively, HMRC should do the following:

b In its planning for the new Spending Review period, HMRC should urgently consider increasing capacity using both recruitment and private sector options. It should explore how it can speed up its training so it can increase capacity more quickly.

c Model the potential scale of work needed to manage debt effectively for different post-pandemic scenarios, in terms of speed and ease of debt collection. Assess whether HMRC has sufficient capacity to meet these scenarios.

d Target much greater levels of return than before the pandemic. Given that taxpayers' average levels of debt are much higher than before the pandemic, HMRC should aim for a significant increase in the total return from new and existing capacity. It should identify how much more resource it will need to bring in to bridge the gap at target rates of return.

e Identify how debt management needs to operate differently to deal with the changed nature and amount of debt. HMRC now has more old debt, and much of the pandemic debt will be difficult to collect quickly. Older debt becomes more difficult to trace as time passes so HMRC will need to establish and maintain contact with as many debtors as possible. Maximising collections may require different decisions about targeting its resources from those it would make in business-as-usual circumstances.

Understanding taxpayers in debt

25 The pandemic has changed the nature and type of tax debt. Tax debts are larger and more taxpayers are in debt. There has been a polarised impact on taxpayers' ability to pay, and there could be taxpayers who are better able to pay their tax and whom HMRC should pursue more aggressively. HMRC needs to improve its understanding of customers to be able to support them and target activity appropriately. HMRC should do the following:

f Use a wider range of data to better understand how taxpayers' financial positions have changed as a result of the pandemic. HMRC holds a rich source of data from taxes, but some lags significantly behind activity and does not provide insight into any other debts taxpayers may have. It should urgently seek access to wider government information on levels of indebtedness for individual taxpayers (for example, details of business support loans that customers have received). It does not normally draw on commercial data because of the cost, but it would now be justified in trialling the use of this because of the uncertainty that the pandemic has created.

g Extend its segmentation analysis by considering the scale of debt against income, and the sectors in which businesses operate, to be able to identify taxpayers who have done well during the pandemic. Successful applications for grant claims and loans may mean that companies do have cash to pay debts.

h Estimate how the scale of demand from specific pressures, such as new customers, vulnerable customers and companies becoming insolvent, may change, using proxy data sources where necessary. HMRC can then identify pressure points and adapt operational processes where needed, including when to refer customers to specialist teams dealing with vulnerable customers and insolvencies.

Developing tools and capability

26 HMRC is restricted in its ability to increase capacity in the short term. In the long term, it should look to build on its existing plans to develop the tools and powers to better manage the range of taxpayers' needs it encounters. It should do the following:

i In its planning for the new Spending Review period, HMRC should urgently consider whether resources are needed for more tools to support debt management (such as data analytics, the single customer account, and customer-facing systems – for example, online tools for setting up payment arrangements for business customers).

j Develop its understanding of the effectiveness of the different tools and interventions that it already uses and how they interact. Process mapping and data mining techniques can help it better plan a long-term strategy for reducing debt, allocate resources to where they are most effective and put in more resources where needed.

k Adopt good practices from the private sector and from its own handling of debt during the pandemic on a permanent basis. In particular, a clear focus on affordability rather than repayment within a year could help customers maintain payments and reduce the workload of following-up failed arrangements. This should be explicit in HMRC's internal guidance as well as external communications. HMRC should also routinely signpost the availability of independent debt advice and refer customers to debt charities where needed, which could also help reduce the burden on its extra support team.

l Signal in its external communications that it will take a tough approach with companies that deliberately misuse insolvency rules. It has new powers to attach debts to the owners of companies that go bankrupt. As the UK emerges from the pandemic, it can make companies aware of these powers to act as a deterrent.

Part One

How HM Revenue & Customs has adapted its management of taxpayer debt in light of the pandemic

1.1 The COVID-19 pandemic, and subsequent lockdowns, have placed businesses and the self-employed under strain as never before. Many have faced acute cashflow pressures while being unable to operate normally during the pandemic.

1.2 HM Revenue & Customs (HMRC) collects tax on behalf of the government, including chasing payments from taxpayers who do not pay their tax on time. This report considers how HMRC has managed taxpayer debt in light of the COVID-19 pandemic. In this part, we consider HMRC's initial response, including how:

- the pandemic has affected levels of tax debt;
- quickly HMRC responded to debt pressures facing taxpayers;
- far HMRC adapted its practices in light of the pandemic; and
- far taxpayers wanting help with tax debts were able to access support.

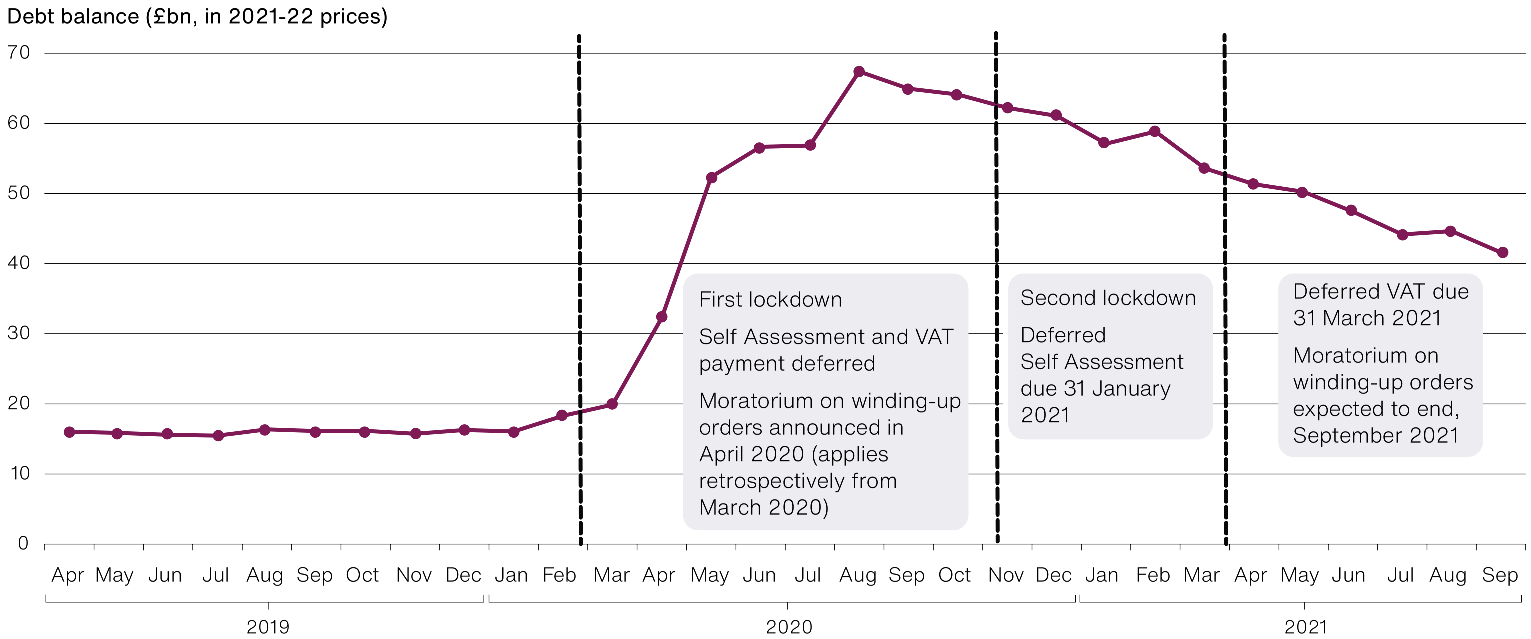
The scale of tax debt increased markedly in the pandemic

1.3 On 20 March 2020, the Chancellor announced that to help support self-employed people and businesses, Self Assessment and VAT payments would be deferred until 31 January 2021 and 31 March 2021 respectively. This was very early in the government's response to the pandemic– before the national lockdown started, and alongside the announcement of other support such as the Coronavirus Job Retention Scheme. The government later passed legislation to limit the pursuit of businesses that owed debt (including tax debt) by introducing a moratorium on the use of winding-up petitions, which limited the action HMRC could take to recover debts.

1.4 **Figure 1** overleaf shows that tax debt increased from around £16 billion in January 2020 to a peak of £67 billion in August, before beginning to decrease again. The debt balance began to increase even before the government lockdown began – between January and March 2020, debts increased by almost £4 billion (compared with very small seasonal changes in normal years).

Figure 1
UK tax debt balance, April 2019 to September 2021

The debt balance increased sharply following government actions in March 2020, peaking at £67 billion in August 2020[1]



● Debt balance	16	16	16	15	16	16	16	16	16	16	18	20	32	52	57	57	67	65	64	62	61	57	59	54	51	50	47	44	45	42

Notes

1 Figures are stated in 2021-22 prices.

2 Data excludes tax credit debt.

3 Between April 2020 and March 2021, the tax debt balance includes amounts that were part of the government's policy on deferrals, although the HM Revenue & Customs debt management team was not actively pursuing this debt.

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

1.5 In addition to the government's actions (paragraph 1.3), HMRC paused proactive debt collection within around two weeks of lockdown and (before the start of lockdown) set up a 'Coronavirus helpline' to provide advice to businesses and self-employed people concerned about not being able to pay their tax due to COVID-19. HMRC continued inbound services for taxpayers initiating contact to pay or enquire about their debt. **Figure 2** overleaf summarises changes to services. **Figure 3** on page 19 sets out the timeline of government announcements and HMRC's initial actions.

1.6 With most debt collection activity paused, HMRC reallocated staff to other activities, notably the new Coronavirus Job Retention Scheme and the Self-Employment Income Support Scheme, which provided grant payments to employers and the self-employed to keep people in employment. Over the course of the pandemic, HMRC reassigned between a quarter and a half of debt management staff to other work.

1.7 Other countries around the world took similar types of action to the UK in deferring some tax payments and suspending some debt collection activity. None reported such large increases in tax debt (Appendix Three). Nine of the eleven countries that responded to our request for information reported an increase in tax debt, with most reporting increases of around a third. In general, this seemed to be because measures were less broad in scope than those that HMRC had put in place – applying to smaller taxes or only to specific taxpayer groups. Eleven countries deferred tax payments due on specific taxes for a limited amount of time. Six countries, including the USA, Australia and Ireland, suspended or made changes to collection activity.

HM Revenue & Customs used the pause in debt collection activity to adapt its approach

1.8 HMRC has kept its debt management approach under continuous review since the start of the pandemic and adapted its approach several times in response to emerging events. HMRC told us that staff often worked long hours and weekends under the difficult conditions imposed by the pandemic.

Figure 2

HM Revenue & Customs (HMRC) debt management practice before and during the COVID-19 pandemic

HMRC paused active debt collection and enforcement activity

Activity	Change during the pandemic	Activity in 2019-20	Activity in 2020-21	Percentage change
Inbound telephony (receiving calls from taxpayers)	No change	2.6 million calls	1.3 million calls[2]	50% reduction
Outbound telephony (making calls to taxpayers)	No outbound calls between 23 March and 29 May 2020	892,000 calls	557,000 calls	38% reduction
Letters to taxpayers	No letters sent between 23 March and 29 May 2020 Tone more empathetic with emphasis on support available	9.2 million letters issued	4.2 million letters issued	54% reduction
Field collections (the HMRC debt management team visits taxpayers to discuss their debt and assess whether they are vulnerable taxpayers)	Field visits stopped between 23 March and 7 October 2020 Once visits resumed, the main focus was to re-establish contact with taxpayers	Almost 394,000 field visits	Around 3,600 field visits	99% reduction
Enforcement action (HMRC issues a winding-up petition against taxpayers unable or unwilling to repay debt owed)[1]	No enforcement action between 23 March 2020 and 19 July 2021[3]	1,811 company insolvencies 1,014 personal bankruptcies	4 company insolvencies 2 personal bankruptcies	Almost 100% reduction for both HMRC-led company insolvencies and HMRC-led personal bankruptcies

Notes

1 In some cases, insolvency action is not initiated by HMRC but brought by another creditor or voluntarily instigated by the taxpayer. In these cases, HMRC does not lead the action but does submit a claim to recover money it is owed. This table shows HMRC-led action only.

2 HMRC attributes the reduction in calls in 2020-21 to the pause in other activity which might prompt a call.

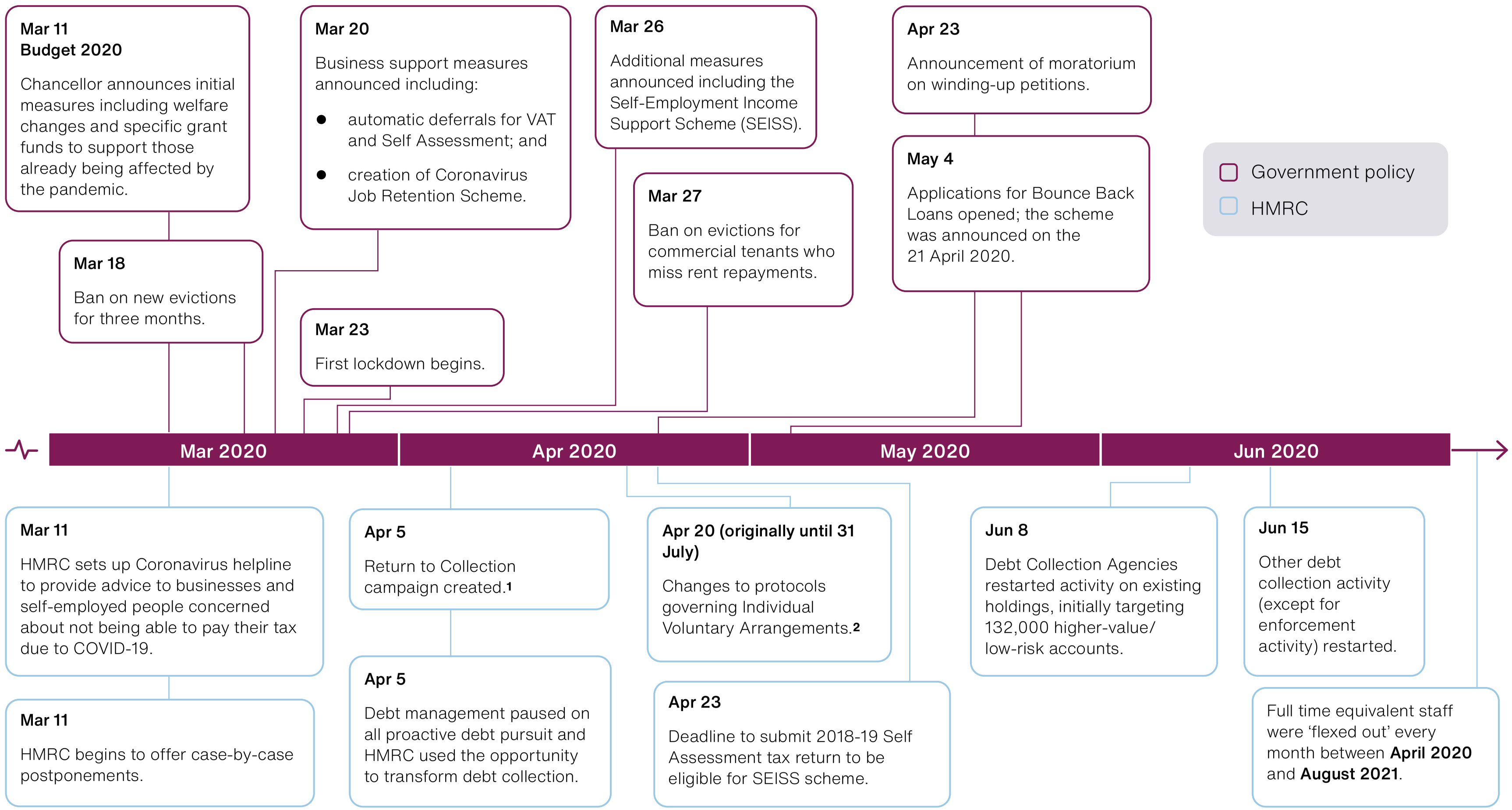
3 Enforcement action from 19 July 2021 consisted of activity such as sending letters to taxpayers. More significant activity (such as court enforcement) was not planned to begin until the Corporate Insolvency and Governance Act moratorium was relaxed, ie after 30 September 2021.

Source: National Audit Office analysis of HM Revenue & Customs information

Figure 3

Timeline of UK government and HM Revenue & Customs (HMRC) action on debt management in response to the COVID-19 pandemic

HMRC acted quickly following government announcements and actions



Notes

1 The Return to Collection campaign was developed by HMRC in response to the pandemic and the related lockdowns.

2 An Individual Voluntary Arrangement is an agreement between a debtor and their creditors to repay their debts. The debtor agrees to make regular payments to an insolvency practitioner, who divides this money between their creditors. The creditors do not take action against the debtor. The change at 20 April 2020 allowed flexibility in the repayments.

Source: National Audit Office summary of HM Revenue & Customs documents and government announcements

1.9 Between May and July 2020, HMRC reviewed its approach to debt management. It worked with the consultancy firm McKinsey to consider the impact of the pandemic and provide analysis to help plan its response. It developed a 'Return to Collection' campaign to deal with tax debt following the pandemic. The campaign covered the whole HMRC debt management process and differed from previous campaigns in a number of ways.

- The campaign separated taxpayers into groups based on the likely impact of the pandemic on their ability to pay tax. This taxpayer 'segmentation' then shaped the frequency and tone of reminder letters that HMRC sent to taxpayers. It also determined the speed with which HMRC escalated action (through various letters before telephoning taxpayers and then passing the case over to field collections and eventually enforcement).
- HMRC made the letters it sent to all taxpayers more supportive in tone. It included key phrases such as "We understand that Coronavirus (COVID-19) may have affected your financial situation. Our records show that we haven't received payment for the above amount. We would like to speak to you to discuss your options and what we can do to support you". These changes were rolled out across 69 taxpayer journeys over four key taxes, most of which included several letters. Qualitative research commissioned by HMRC indicates customers appreciated this approach.
- HMRC extended access to online tools that allowed people with tax debt to pay off that debt in instalments without having to speak directly to HMRC ('Self-Serve Time to Pay' arrangements). For Self Assessment taxpayers, HMRC increased the limit for debts from £10,000 to £30,000. A similar scheme for VAT debts was available between 23 February 2021 and 21 June 2021, and allowed businesses to spread payment of the VAT owed across between 2 and 11 equal monthly payments. As at 30 March 2021, over 120,000 taxpayers had set up Self-Serve Time to Pay arrangements for Self Assessment Income Tax, and over 85,000 taxpayers had enrolled for the VAT scheme. Taxpayers were free to contact HMRC to arrange Time to Pay arrangements outside these criteria if necessary.
- HMRC provided new guidance and training to staff, explaining the changes it was making and why.

1.10 HMRC has needed to manage a much larger volume of debts. The increase in the debt balance was largely due to the government's decision to defer Self Assessment and VAT payment deadlines. HMRC refers to this as 'policy debt' (**Figure 4** on pages 22 and 23). HMRC was unable to pursue policy debt until the deferral periods ended in January and March 2021 respectively.

Taxpayers were still seeking support with tax debts despite pauses in debt collection activity

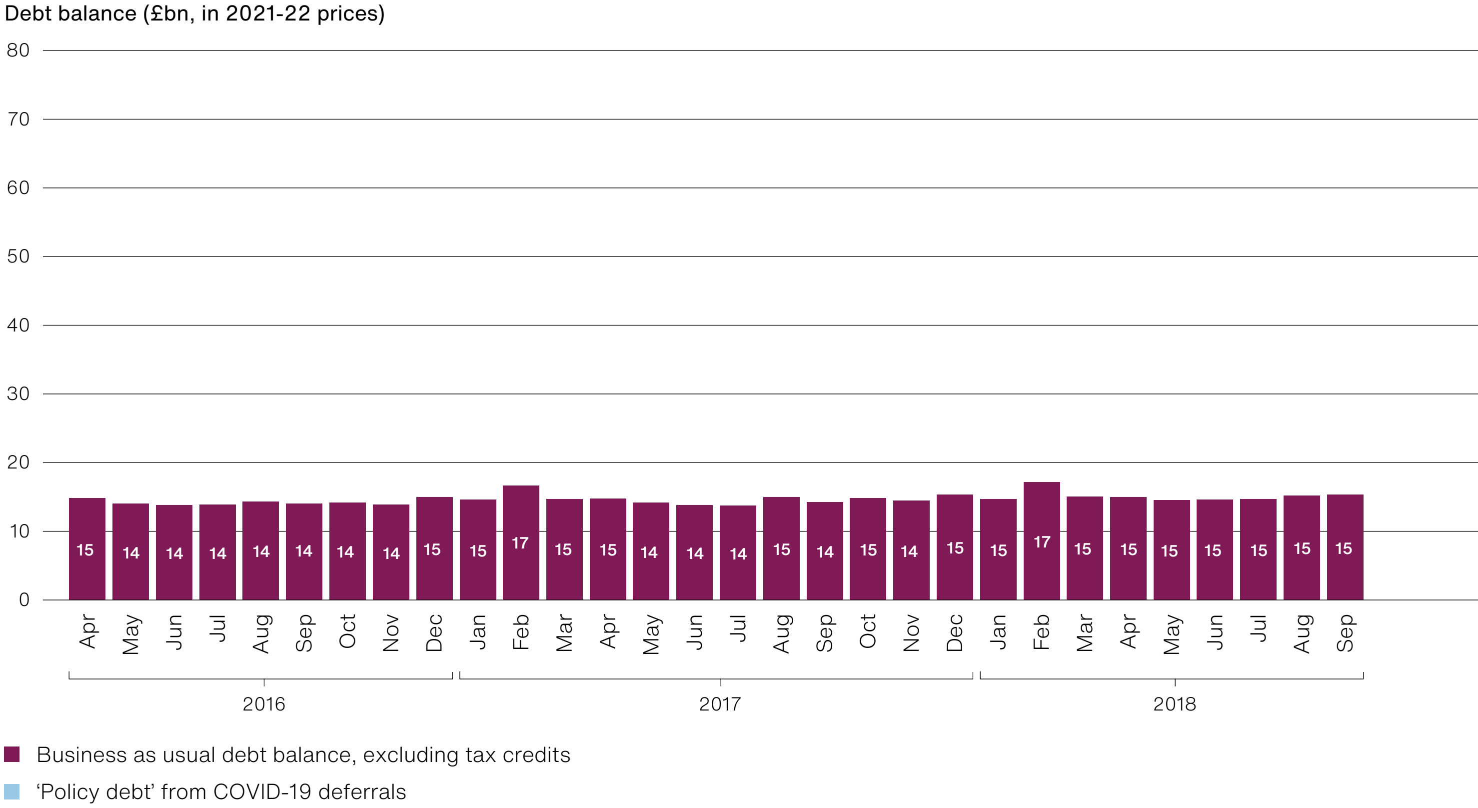
1.11 While HMRC paused much debt collection activity during 2020-21, it kept inbound telephony open so that taxpayers could continue to seek advice. With large numbers of staff released to support other parts of HMRC's COVID-19 response and wider pressures on HMRC's customer services, fewer staff were available to answer calls to the debt helpline. **Figure 5** on page 24 shows that HMRC was frequently unable to answer calls within normal service levels, despite receiving 34% fewer calls than in 2019-20 (2.6 million in 2019-20 versus 1.8 million in 2020-21). In the peak months of January and July, thousands of taxpayers were unable to get through to HMRC. Similarly, HMRC's performance in responding to post from taxpayers deteriorated, particularly for post requiring a response within 15 days (**Figure 6** on page 25).

1.12 In qualitative research commissioned by HMRC, taxpayers reported that difficulty in getting through to HMRC on the phone added to their stress and anxiety over what was owed and also longer delays in repaying HMRC. In our report on HMRC's performance in 2019-20, we noted that customer services had shown declining performance during this period, but this trend was evident before the pandemic.

Figure 4

UK tax debt balance, including the 'policy debt' created by HM Revenue & Customs (HMRC) counting deferred payments in the debt balance, April 2016 to March 2021

Including 'policy debt' as part of the debt balance contributed to a very large increase in the debt balance



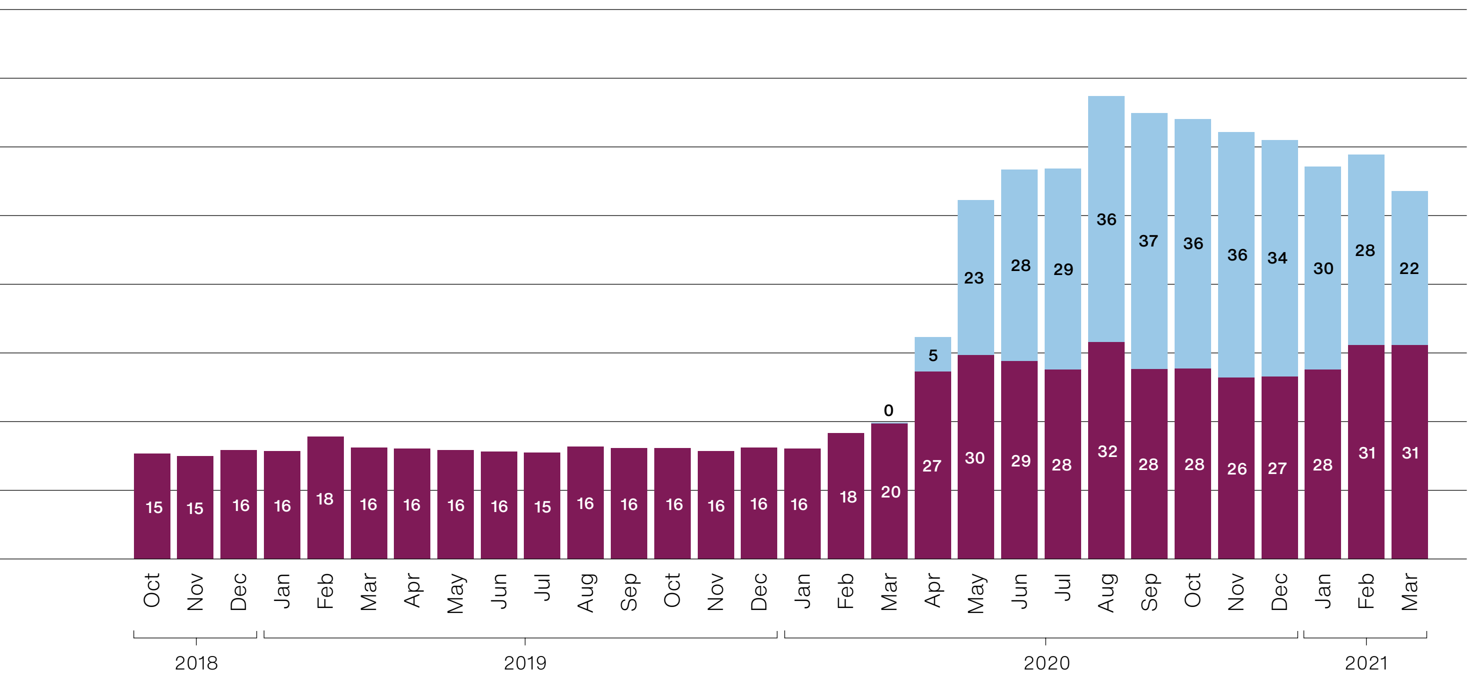
Notes

1 'Policy debt' refers to debt created by including Self Assessment Income Tax and VAT payments that had been deferred to January 2021 and March 2021, respectively, in the debt balance. 'Policy debt' ceased to exist after March 2021 because the deferral period ended and unpaid tax became business as usual debt.

2 Figures are stated in 2021-22 prices.

3 Data excludes tax credit debt.

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



15 15 16 16 18 16 16 16 16 15 16 16 16 16 16 16 18 20 27 30 29 28 32 28 28 26 27 28 31 31
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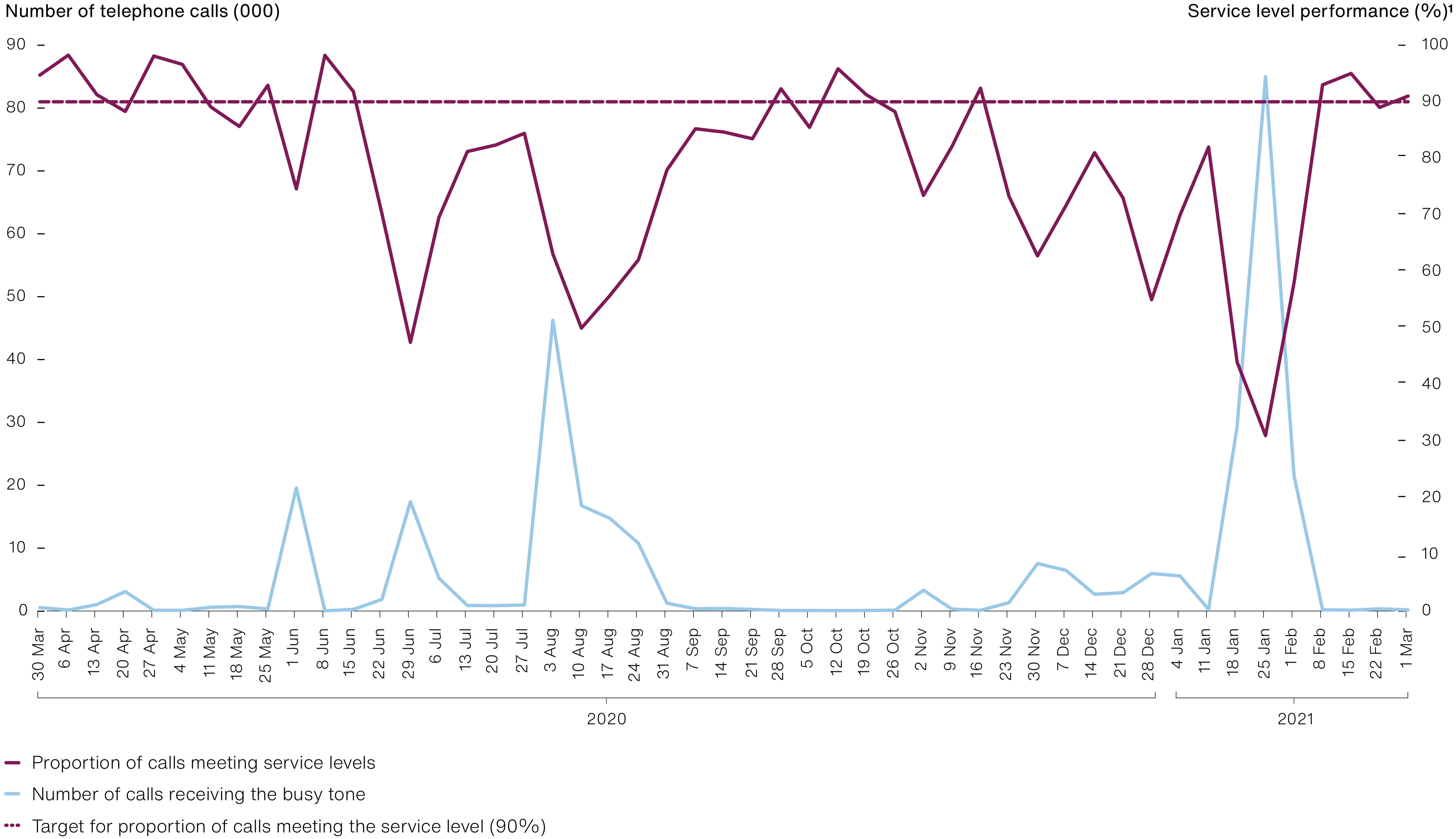
2018
2019
2020
2021

Figure 5

HM Revenue & Customs (HMRC) debt management team's performance in managing telephone calls, March 2020 to February 2021

HMRC's telephony performance was below the expected level throughout 2020-21, and thousands of customers were unable to speak to a member of staff



Note

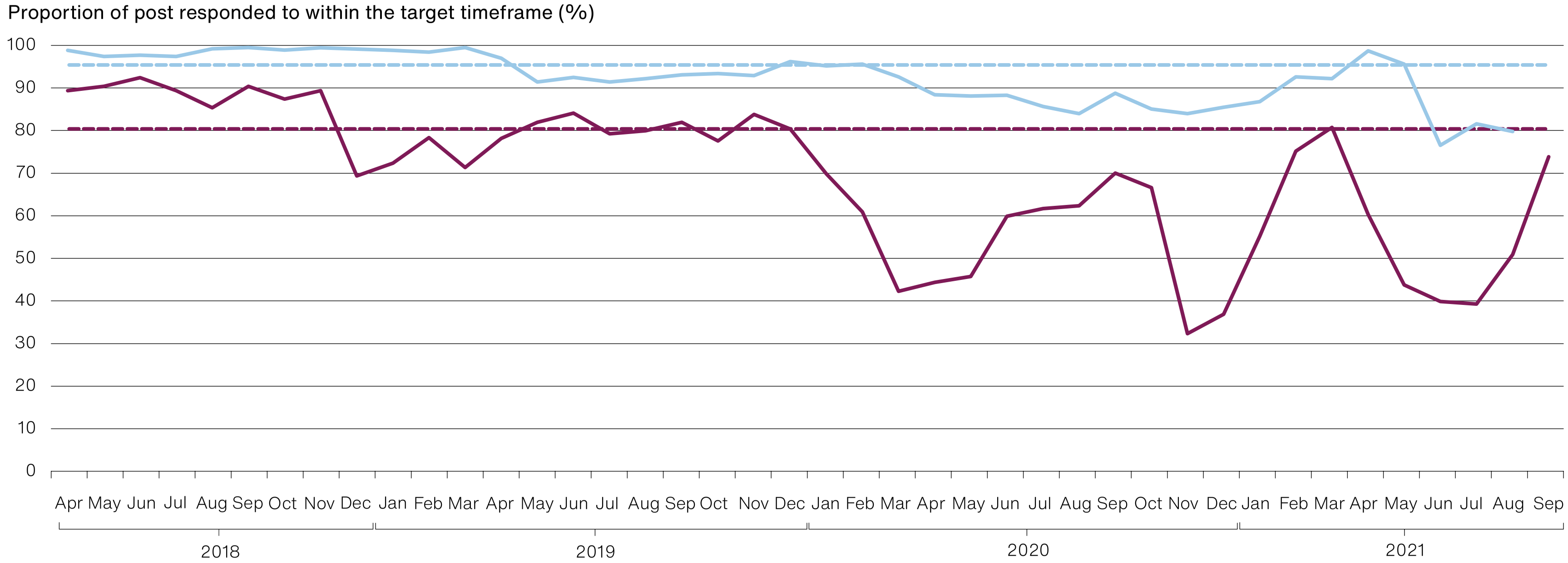
1 The proportion of calls meeting service levels is unique to the debt management team within HMRC. It is calculated as the number of calls answered plus calls in queue, divided by calls made to HMRC.

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

Figure 6

HM Revenue & Customs (HMRC) debt management team's performance in responding to post within target timeframes, April 2018 to June 2021

HMRC's performance in responding to post was worse in 2020-21 than in the previous two years, against the 15-day target in particular



- Performance against 'Priority 1 Post'
- Performance against 'Priority 2 Post'
- Target for 'Priority 1 Post' (80% of post should be responded to within 15 days)
- Target for 'Priority 2 Post' (95% of post should be responded to within 40 days)

Note

1 HMRC assigns the post it receives one of five different priorities. 'Priority 1 Post' should responded to within 15 days and 'Priority 2 Post' within 40 days.

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

Part Two

Understanding taxpayers' ability to repay tax

2.1 As restrictions ease, the government expects taxpayers to begin to pay off their tax debts. Many taxpayers have not had tax debt before, and their ability to repay tax will depend on the further easing of restrictions and the strength of the economic recovery. This part of the report considers:

- how the pandemic has affected the number of taxpayers in debt to HM Revenue and Customs (HMRC);
- whether HMRC has sufficiently developed its understanding of taxpayers' ability to repay tax debt;
- whether HMRC has set clear expectations about the speed at which it will pursue tax debt;
- the realism of HMRC's forecasts for recovering tax debt; and
- whether HMRC has considered the differing needs of taxpayers affected by the pandemic.

How the pandemic has affected the number of taxpayers in debt to HM Revenue & Customs

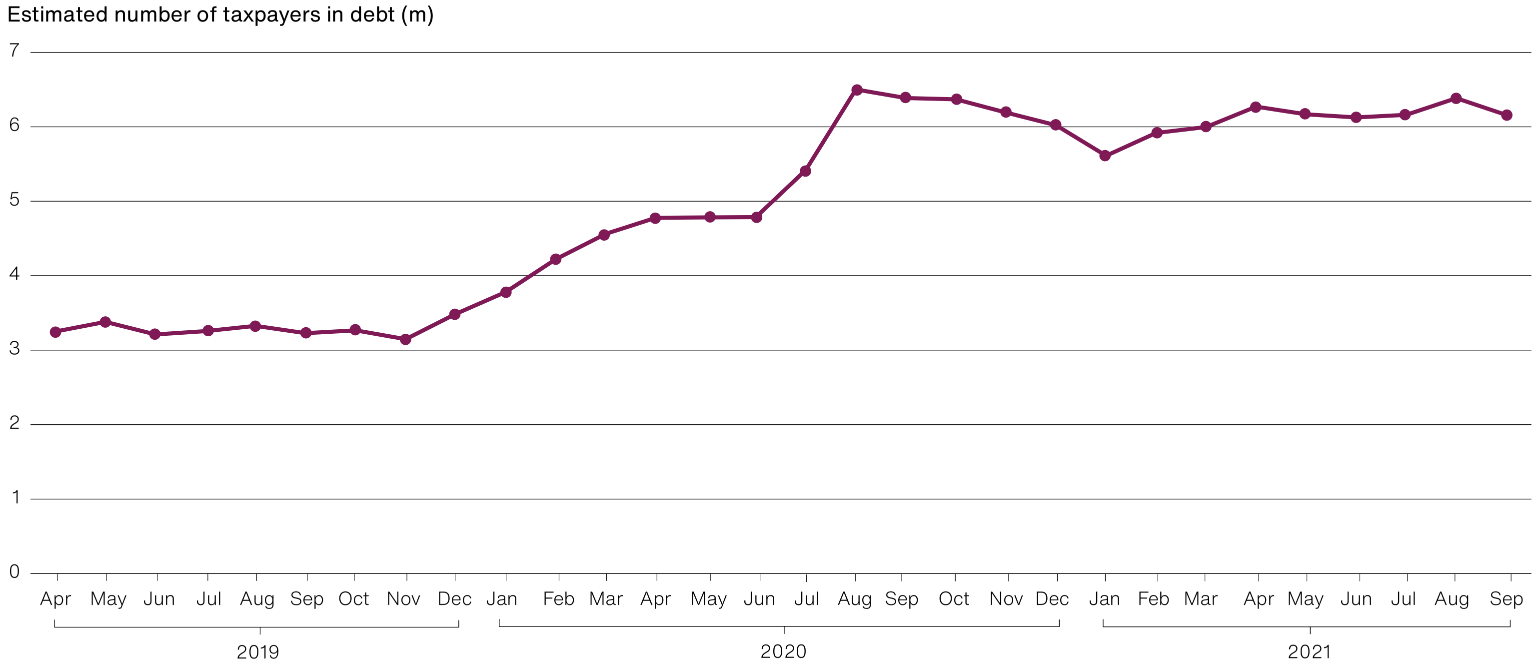
2.2 The pandemic has increased new tax debt sharply and debt carried forward from before the pandemic has got older. As noted in Part One, total tax debt was £42 billion as at 30 September 2021, more than double the level before the pandemic.

2.3 Up to 2.4 million more people had tax debts following the pandemic. HMRC estimates that up to 6.2 million taxpayers were in debt as at 30 September 2021 (excluding those with tax credit debt), compared with up to 3.8 million taxpayers in debt on 31 January 2020 (**Figure 7**). Debts over two years old increased from £2.5 billion in 2019-20 to £4.4 billion in 2020-21 (**Figure 8** on page 28). Older debts are typically more difficult to collect.

Figure 7

Estimated number of UK taxpayers with tax debt, April 2019 to September 2021

HM Revenue & Customs (HMRC) estimates the number of taxpayers in debt has increased during the COVID-19 pandemic



	Apr 2019	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan 2020	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan 2021	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep
● Number of taxpayers in debt (m)	3.25	3.38	3.21	3.26	3.33	3.23	3.27	3.15	3.49	3.78	4.22	4.56	4.78	4.78	4.79	5.42	6.50	6.39	6.37	6.19	6.02	5.61	5.92	6.00	6.27	6.17	6.13	6.16	6.38	6.16

Notes

1 Data excludes taxpayers with tax credit debt.

2 Between April 2020 and March 2021, the data includes taxpayers with debts that were part of the government’s policy on deferrals, although the HMRC debt management team was not actively pursuing the debt.

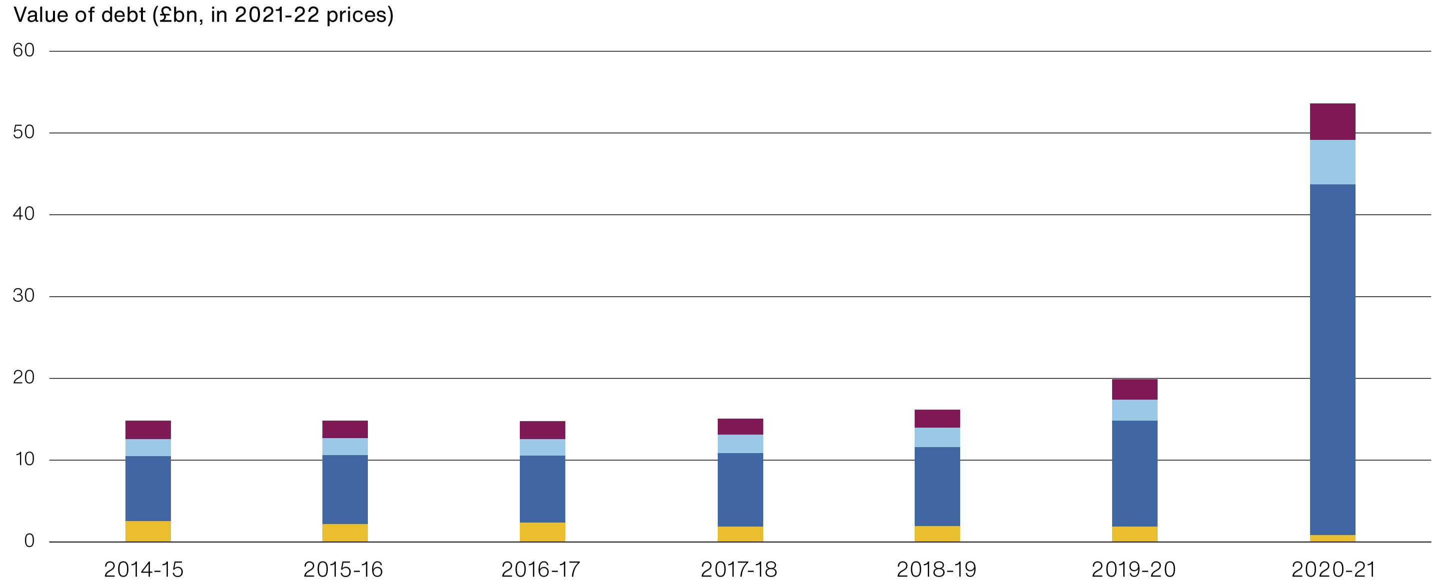
3 Taxpayers may owe debt for more than one type of tax but HMRC’s information technology systems cannot identify taxpayers with debts across multiple taxes. Therefore, calculating average debt per taxpayer across all types of tax will double count some taxpayers and cause the average debt to appear lower than it actually is. Appendix Two shows the number of taxpayers for the main types of tax.

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

Figure 8

UK tax debt owed, by age of debt at the end of the financial year, 2014-15 to 2020-21

Debt less than a year old has shown the largest increase during the COVID-19 pandemic but the value of aged debt is also increasing



	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
More than 2 years (£bn)	2.27	2.14	2.15	1.94	2.18	2.45	4.41
1–2 years (£bn)	2.12	2.04	2.00	2.22	2.39	2.59	5.38
0–1 year (£bn)	7.93	8.48	8.22	8.97	9.63	12.94	42.90
Non-analysed (£bn)	2.55	2.17	2.36	1.92	1.98	1.91	0.88
Total	**14.86**	**14.82**	**14.72**	**15.06**	**16.19**	**19.89**	**53.58**

Notes

1 Figures are stated in 2021-22 prices.

2 'Non-analysed' refers to debt that HM Revenue & Customs (HMRC) does not know the age of because it has not yet analysed it.

3 Data excludes taxpayers with tax credit debt.

4 Numbers may not sum due to rounding.

Source: National Audit Office analysis of HM Revenues & Customs data

2.4 HMRC does not know precisely how many taxpayers are in debt because it does not have single customer records spanning all taxes. It records details for different taxes on different systems, and it has no straightforward way to combine these to report taxpayers' liabilities for all taxes in one place. It has been planning to develop such a tool since 2006. It has reviewed the figures it provided to us to ensure that taxpayers are only counted once for each tax. However, taxpayers with debts for more than one tax will be double-counted when combining totals. In Appendix Two, we set out in more detail the risks of double-counting and the number of customers in debt by type of tax as at September 2021.

2.5 **Figure 9** overleaf shows that the average value of debt per taxpayer (using the largest likely figure for the number of taxpayers in debt) has increased by 60%, from £4,300 at the end of January 2020 to £6,800 at the end of September 2021. This means that debts are likely to take much longer to clear compared with before the pandemic.

2.6 VAT has grown from around a quarter of the debt balance in 2019-20 to account for more than half of it in 2020-21 (**Figure 10** on page 31). HMRC attributes this mostly to the deferral of VAT in 2020-21 (see paragraphs 1.3 and 1.10) and expects it to reduce as deferred VAT is repaid. It told us that 90% of the deferred VAT (and 46% of all VAT debt) is in a repayment plan. At the end of September 2021, VAT accounted for 46% of the debt balance.

2.7 Different taxes are showing different trends. In recent months, debts have declined for VAT as COVID-19 payment extensions have passed and taxpayers have begun paying (what had been) 'policy debt'. Self Assessment Income Tax debt is also falling as former policy debt is repaid, although the trend is more uneven than for VAT. However, Corporation Tax and Pay As You Earn (PAYE) debts have not reduced in 2021. Corporation Tax debt is higher than in January 2021, although it fell slightly across the most recent six months from April to September 2021. PAYE debts have remained around double pre-pandemic levels since November 2020 (**Figure 11** on pages 32 and 33).

HM Revenue & Customs' understanding of taxpayers' ability to repay debt

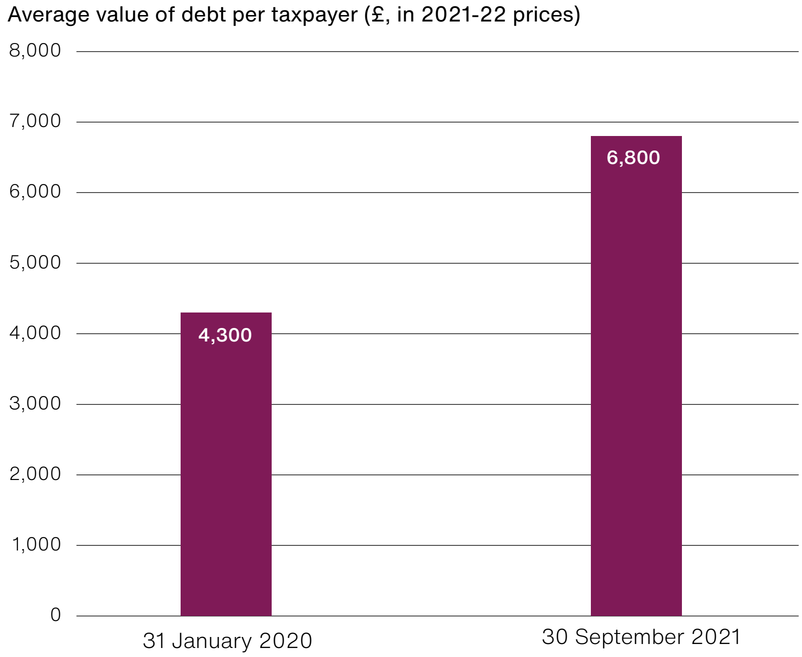
2.8 The pandemic has changed the reasons why taxpayers are in debt and affected their ability to repay debt. The severity of local and national lockdowns, the differing impact of restrictions on different sectors, and access to government support have all affected taxpayers' finances.

2.9 By June 2020, HMRC had begun activity to update its understanding of taxpayers' ability to pay their tax debts. It used data from tax returns and its coronavirus support schemes to gauge the impact of the pandemic on their ability to pay.

Figure 9

Estimated value of UK tax debt per taxpayer, as at January 2020 and September 2021

The estimated average value of debt has increased from £4,300 per taxpayer as at 31 January 2020 to £6,800 per taxpayer as at 30 September 2021, in 2021-22 prices



Notes

1 Numbers have been rounded to nearest hundred.

2 Figures are stated in 2021-22 prices.

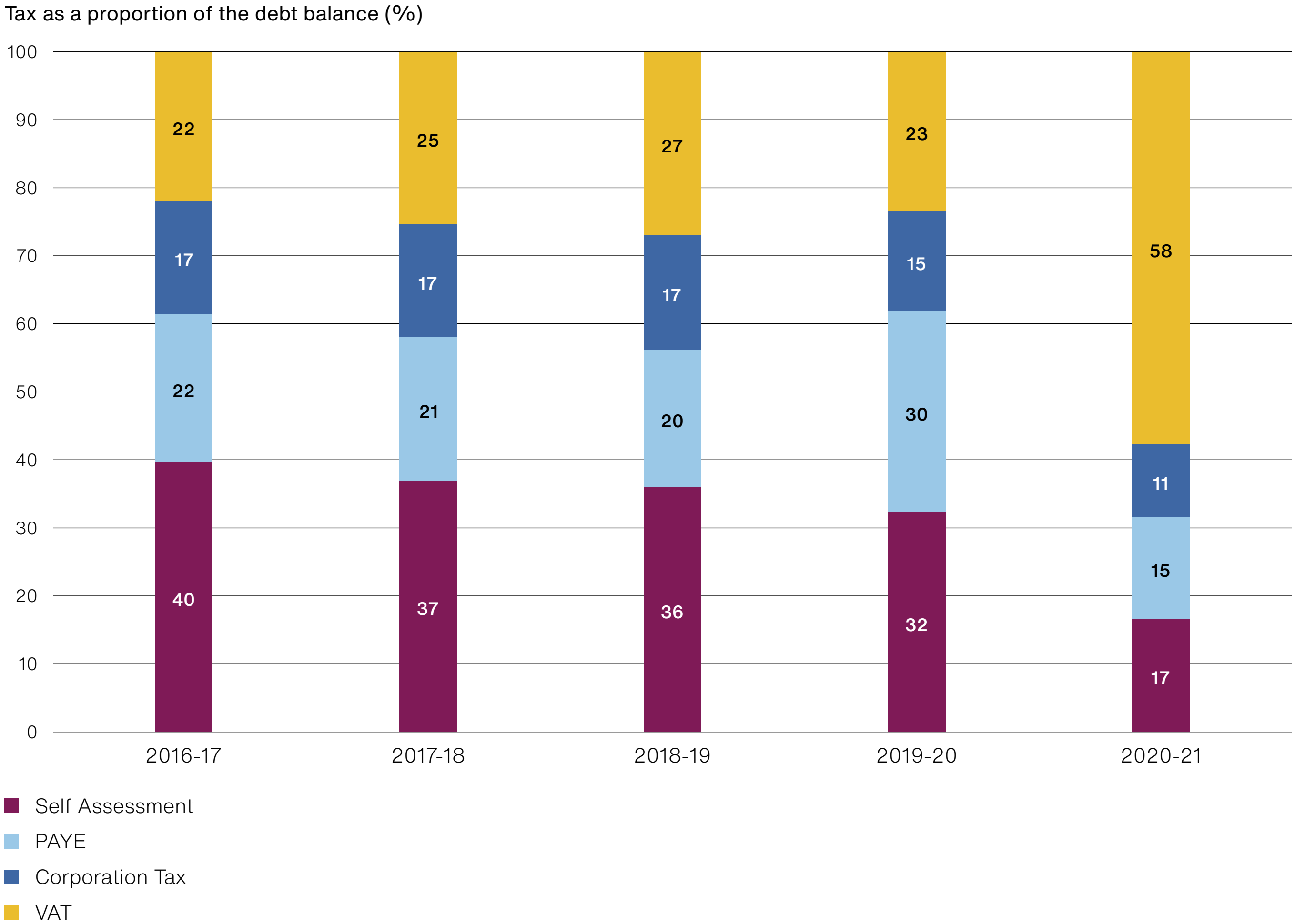
3 Data excludes taxpayers with tax credit debt.

4 Taxpayers may owe debt for more than one type of tax but HM Revenue and Custom's (HMRC's) information technology systems cannot identify taxpayers with debts across multiple taxes. Therefore, calculating average debt per taxpayer across all types of tax will double count some taxpayers and cause the average debt to appear lower than it actually is. Appendix Two shows the average debt for the main types of tax.

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

Figure 10
Proportion of UK tax debt balance accounted for by different types of taxes, 2016-17 to 2020-21

VAT increased from 23% of the balance in 2019-20 to 58% in 2020-21



Notes

1 This chart shows the debt balance accounted for by the four main types of tax only. These four taxes accounted for: 86% of the total debt balance, excluding tax credits, in 2016-17; 87% in 2017-18; 88% in 2018-19; 89% in 2019-20; and 95% in 2020-21.

2 The total debt balance of these four taxes in 2021-22 prices was: £12.6 billion in 2016-17; £13.1 billion in 2017-18; £14.2 billion in 2018-19; £17.7 billion in 2019-20; and £50.9 billion in 2020-21.

3 PAYE is Pay As You Earn.

4 Numbers may not sum due to rounding.

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

Figure 11
UK tax debt balance, by type of tax, April 2019 to September 2021

Debt is reducing at different rates for different tax streams

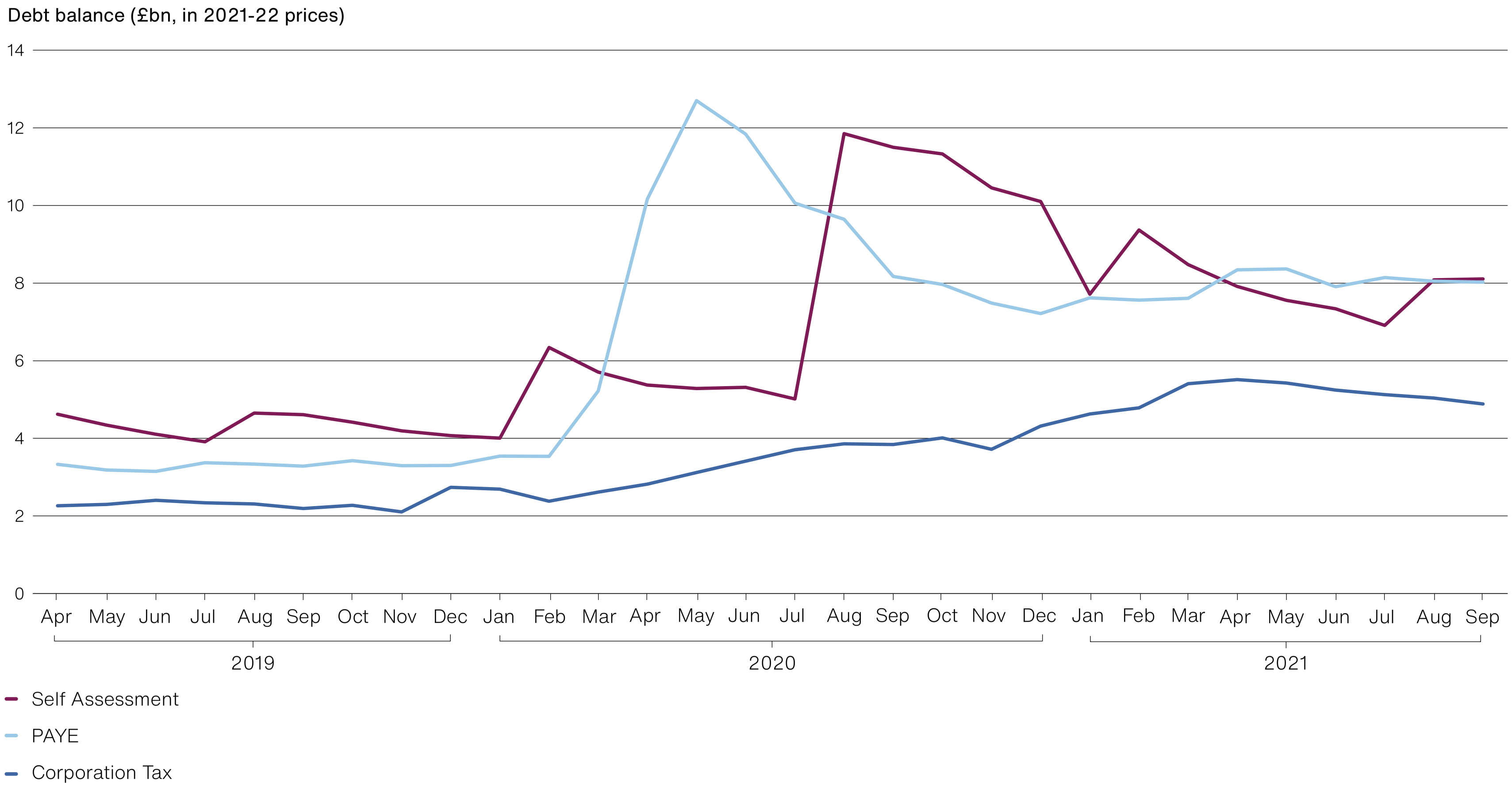
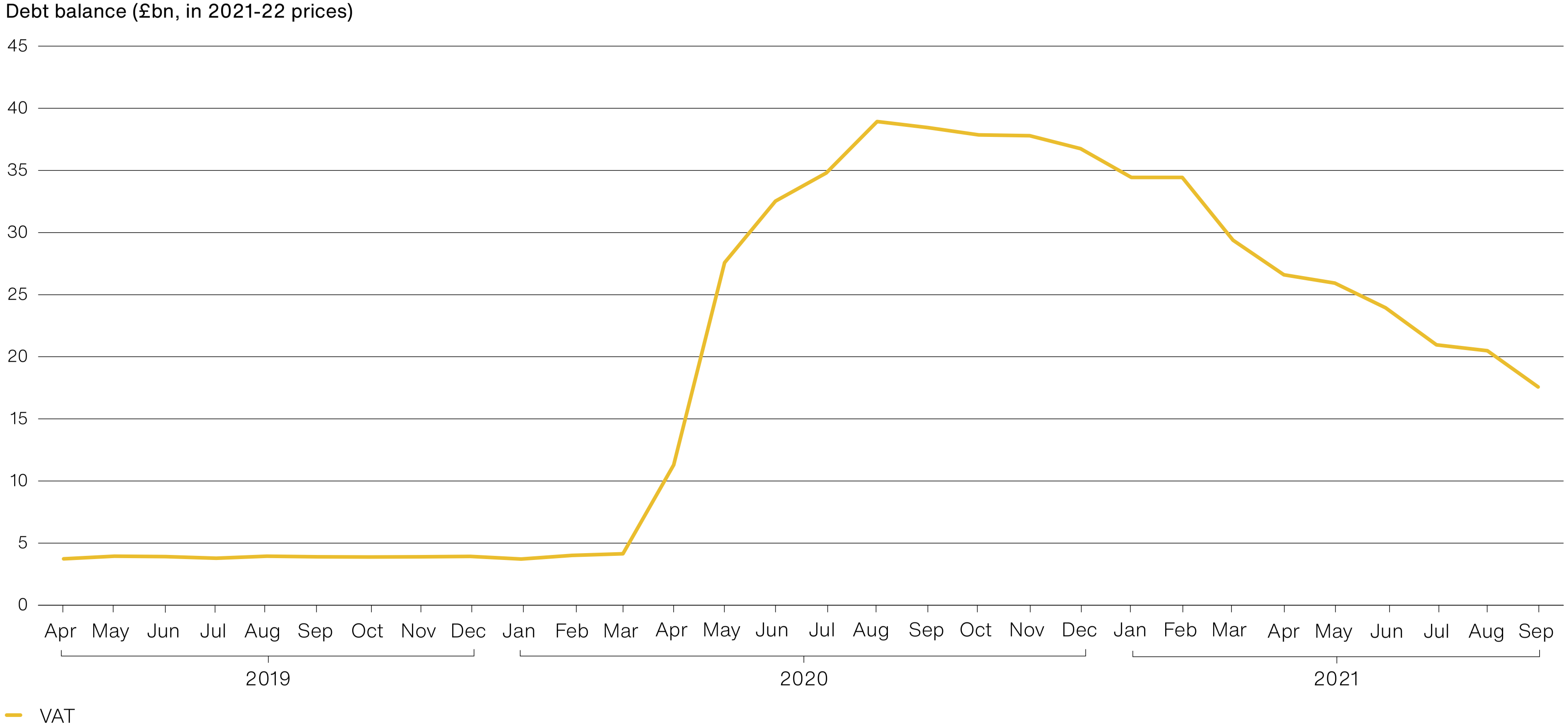


Figure 11 *continued*

UK tax debt balance, by type of tax, April 2019 to September 2021



Notes

1 Figures are stated in 2021-22 prices.

2 PAYE is Pay As You Earn.

3 This chart shows the debt balance accounted for by the four main types of tax only.

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

2.10 **Figure 12** sets out HMRC's segmentation in more detail. HMRC categorised taxpayers as high, medium, or low impact and used this to guide how vigorously it would pursue their debts. For companies, HMRC set the boundaries between the groups based on where it saw significant changes in turnover and staffing, or use of the employment support schemes, as a proxy for impact of the pandemic, rather than an informed view of the companies' needs. HMRC told us it worked to ensure that taxpayers were categorised at the highest possible impact.

2.11 Although HMRC segmented its debts according to the characteristics of the taxpayers, it was unable to identify reliably how many taxpayers were within each segment, or the average debt owed per taxpayer in each segment, because its IT systems cannot readily identify taxpayers with multiple debts. It told us that, instead, it used the number of debts as a proxy measure for taxpayers in debt (although a taxpayer can have multiple debts). Its segmentation showed that, on average, debts owed by businesses in the low-impact group were almost 50% higher in value than debts owed by businesses in the high-impact group (Figure 12). This suggests that businesses HMRC identified as being most able to repay their debt may find repayment more difficult. Self Assessment debts owed in the low- and medium-impact groups were slightly lower on average than debts in the high-impact group. HMRC told us it took a cautious approach to assigning a low impact to taxpayers. However, people ineligible for the Self-Employment Income Support Scheme (SEISS) will have been categorised in the low- or medium-impact groups. It is logical that some taxpayers who were ineligible for grants would be less able to repay their debts.

2.12 HMRC used the segmentation to determine the speed and tone of initial contact with taxpayers, with those deemed low impact contacted earlier than those deemed high impact. Irrespective of the categorisation, all taxpayers can speak to HMRC to determine a payment plan based on their specific circumstances. HMRC also makes it clear in its letters to tax debtors that they should contact HMRC, even if they are unable to pay, to explore payment options.

2.13 HMRC's taxpayer segmentation does not attempt to consider the impact the pandemic may have had on a taxpayer's overall indebtedness, such as whether businesses had taken on Bounce Back Loans. HMRC considered whether business sector was an important factor in repaying debts but concluded that it was not a useful indicator. In summer 2020, HMRC found that the low-impact sectors it targeted had a very similar response rate to businesses in other sectors.

2.14 HMRC has not used the region in which a taxpayer operates to inform its assessment of the likely impact of the pandemic on their ability to repay tax. It has been exploring this option since March 2021, and this work was still ongoing in September 2021. As the economy recovers, segmentation according to size of debt, business sector and region may be more useful in understanding customers' ability to repay debts.

Figure 12

HM Revenue & Customs (HMRC) segmentation of taxpayers to inform how it managed them during the COVID-19 pandemic

HMRC used data that taxpayers had already provided to it to segment taxpayers according to how seriously they had been affected by the pandemic

Taxpayer type	Businesses	Individuals
Relevant taxes	VAT PAYE (collected on behalf of employees) Corporation Tax	Income Tax (paid via Self Assessment).
Information about segments		
High impact	Average value of each debt: £2,100. Criteria: Turnover 40% or less of pre-pandemic turnover; or more than 80% of staff furloughed; or number of staff or value of payroll less than 40% of pre-pandemic figure.	Average value of each debt: £2,200. Criteria: Claimed or attempted to claim support from the Self-Employment Income Support Scheme (SEISS); or income from employment in 2020-21 is less than 50% of total income (employment and self-assessed) in 2019-20.
Medium impact	Average value of each debt: £3,700. Criteria: Turnover between 40% and 80% of pre-pandemic turnover; or 20% to 80% of staff furloughed; or number of staff or value of payroll between 40% and 80% of pre-pandemic figure.	Average value of each debt: £1,800. Criteria: Employment income in 2020-21 is 50% to 100% of total income in 2019-20; or Payment on Account due July 2020 deferred; or had an open debt before the pandemic.
Low impact	Average value of each debt: £3,000. Criteria: Turnover greater than 80% of pre-pandemic turnover; and less than 20% of staff furloughed; and number of staff or value of payroll greater than 80% of pre-pandemic figure.	Average value of each debt: £1,600. Criteria: Eligible but did not claim SEISS; and employment income in 2020-21 greater than 100% of 2019-20 total income; and Payment on Account due July 2020 not deferred.
Unassigned	Average value of each debt: £1,400. Criteria: Used where HMRC does not have enough data to assign an impact; treated the same as the medium impact group.	Average value of each debt: £2,700. Criteria: Used where HMRC does not have enough data to assign an impact; treated the same as the medium impact group.

Notes

1. HMRC is unable to reliably identify how many taxpayers were within each segment or the average debt owed per taxpayer within a segment. Average value of each debt is presented as a proxy, but individual taxpayers can owe more than one debt.
2. Table shows data as at May 2021.
3. Average value of each debt is average value when the debt was initially recorded, not value of debt outstanding.
4. PAYE is Pay As You Earn.
5. Numbers have been rounded to nearest hundred.

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

2.15 HMRC has relied solely on data it has already collected from taxpayers about their income, staffing position, and use of pandemic support schemes. It receives forecasts of future insolvencies from the Insolvency Service and data on trends in bank lending and credit balances, including the use of schemes administered by the British Business Bank from the Department for Business, Energy & Industrial Strategy. However, this data is shared in aggregate and cannot be used to assess the position of individual taxpayers. HMRC does not, in general, make use of third-party information about customers' other loans or debts – for example, customer credit scores – because of the cost of the information.

2.16 HMRC is continuing to refine its approach. From June 2021, it began to extend its segmentation work to include taxpayers' propensity to pay, as well as their ability to pay. These assessments inform how it approaches taxpayers. It is applying the approach to new VAT debts initially and plans to extend the approach to other taxes.

Whether HM Revenue & Customs has set clear expectations about the speed at which it will pursue debt

2.17 With average taxpayer debt increasing substantially during the pandemic (paragraph 2.5), it is likely that many taxpayers will need more time to repay their debts. HMRC's message to taxpayers has been that taxpayers should pay their taxes if they are able to do so – but that it will work with them to agree a payment plan based on their financial position if they are struggling.

2.18 Before the pandemic, HMRC generally sought to agree repayment plans that would clear debts within a year so that debts were settled before the next tax payment was due. Its self-serve system still only allows payment plans of up to one year, despite the impact of the pandemic. Under the Return to Collection campaign, it has planned for longer periods between each reminder letter and steps to escalate enforcement action when debts remain unpaid. It has said publicly that it will look for customers to repay their debt as quickly as possible while maintaining affordable payments. It has not set out deadlines for repayment in most of the letters it has sent to taxpayers. However, we found that some of its guidance to its debt collection staff is less focused on affordability than its public messaging. The guidance to call handlers emphasises that taxpayers should repay their debt in the shortest time possible.

2.19 Taxpayers can agree longer arrangements with HMRC over the telephone. Following the pandemic, HMRC changed internal approval rules so that staff could agree repayment plans with taxpayers for periods up to 24 months rather than 12 months. As at 31 July 2021, 59% of Time to Pay arrangements agreed with taxpayers were for periods of less than one year. The average duration of Time to Pay arrangements had increased from around five months before the pandemic to 12 months in July 2021. Self Assessment and PAYE repayment plans now average more than a year.

2.20 A strong focus on repaying tax within a year may not be appropriate for many taxpayers. The pandemic means that many taxpayers cannot afford to pay back debts quickly. Some may have incurred losses that have not yet flowed through to their tax returns. Self Assessment taxpayers are yet to submit returns for 2020-21 and the government changed the rules in 2021 to allow companies and people with trading losses for periods up until 31 March 2022 to carry back those losses against previous profits for three previous years. Some taxpayers may have less tax debt or be owed repayments once these losses are factored in.

2.21 The Cabinet Office told us that leading practitioners outside government tend to focus on agreeing affordable repayment plans that can be sustained. As well as helping the person in debt, it also reduces the risk of failed arrangements and unnecessary costs (such as extra contacts to chase unpaid debts or renegotiate payment plans).

HM Revenue & Customs' forecast of future tax debt

2.22 HMRC has maintained forecasts of debt throughout the pandemic. From April 2021, the debt balance decreased faster than it expected. This initially positive trend in debt repayments has not been maintained and the number of taxpayers with new debts has continued to increase. HMRC has therefore revised its forecast upwards. In September 2021, its forecast for the March 2022 tax balance was £32.8 billion, up from the £29.3 billion predicted in May 2021.

2.23 HMRC's initial forecast for 2021-22 was based on assumptions that taxpayers' repayment behaviour would not differ significantly compared with before the pandemic. These assumptions appear optimistic and HMRC has yet to adjust its forecasting methods for changed models of behaviour. Key areas include the following assumptions:

- New tax debt created in 2021-22 would be the same as in 2019-20, taking no account of the changed economic position of many taxpayers. As at September 2021, new debt created in the first six months of 2021-22 was more than 50% higher than new debt created in the first six months of 2019-20.

- The Return to Collection campaign would enable HMRC to collect an additional £6 billion (13%) compared with the value of tax debt collected in 2019-20. As at September 2021, HMRC reduced its projection of repayments to £4.1 billion.

2.24 Other aspects of HMRC's forecast also appear optimistic. As at September 2021, HMRC forecast that losses (including write-offs, remissions and insolvencies) would be £0.5 billion higher in 2021-22 than in 2019-20. This appears an optimistic assessment because the moratorium on insolvency action meant that write-offs and remissions were more than £2 billion less in 2020-21 than the figure in 2019-20. This may leave the debt position higher than it should be at year end by including losses that are still likely to occur and will need to be recorded in the future. The forecast does not attempt to adjust for HMRC's segmentation of taxpayers into high-, medium- and low-impact groups, greater overall levels of indebtedness among taxpayers, or the possibility that some sectors or regions may take longer to recover from the pandemic.

2.25 Our research with stakeholder groups indicates a polarised impact from the pandemic. Some people and businesses have improved their financial position during the pandemic, while others have been more severely affected:

- The Bank of England found that 36% of households in their 2021 survey had accumulated additional savings because of the pandemic, while 18% had depleted their savings. High-income households were more likely to have increased their savings, while low-income households were more likely to have decreased their savings.[1]
- In March 2021, the Money Advice Trust reported that 31% of adults were financially worse off as a direct result of the pandemic.[2]
- The Financial Conduct Authority's Financial Lives report published in February 2021 found that 61% of those who were self-employed said that their financial situation overall had worsened between March 2020 and October 2020. It reported that 71% of self-employed people experienced a reduction in revenues between March and October 2020 and 9% ceased trading altogether.[3]
- In its March 2021 Economic and Fiscal Outlook, the Office for Budget Responsibility forecast a long-term reduction in income from self-employment.[4]

1 Bank of England, data from NMG household survey conducted in 2021. A summary of survey findings is available at: www.bankofengland.co.uk/quarterly-bulletin/2021/2021-q2/household-debt-and-covid
2 Money Advice Trust, *The cost of Covid: Exploring the impact of Coronavirus on household finances*, March 2021. Available at: https://moneyadvicetrust.org/media/documents/The_cost_of_covid.pdf
3 Financial Conduct Authority, *Financial Lives 2020 survey: the impact of coronavirus*, February 2021. Available at: www.fca.org.uk/publications/research/financial-lives-2020-survey-impact-coronavirus
4 The Office for Budgetary Responsibility, *Economic and Fiscal Outlook,* March 2021. Available at: https://obr.uk/efo/economic-and-fiscal-outlook-march-2021

- The British Chambers of Commerce quarterly economic survey routinely asks businesses about their cashflow, which it regards as a key indicator of business health. In the survey carried out in May and June 2020 (just after the first lockdown began), around two-thirds of businesses reported worsening cashflow. The latest figures (covering July to September 2021) show 22% firms reporting a decrease and 44% reporting no change in cashflow. This demonstrates the ongoing impact of the pandemic on businesses.[5]

- Furthermore, the British Chambers of Commerce told us that businesses were more likely to borrow since the pandemic began than they were in 2018, and that when they do borrow, businesses are now more likely to borrow to manage cashflow than to expand or invest in their businesses. In January 2021, 63% of businesses surveyed on the impact of COVID-19 and who planned to borrow were doing so for cashflow reasons, compared with 49% of businesses surveyed in April 2018.[6]

2.26 It may take some time after the withdrawal of government support for HMRC to get a good understanding of which taxpayers experienced the most serious impact. Some external stakeholders have estimated the level of support people will need. The Money & Pensions Service expects that the number of people in need of debt advice (defined as regularly missing bill payments) will rise to 7 million from a pre-pandemic baseline of 5.3 million.

HM Revenue & Customs' understanding of the differing needs of taxpayers

2.27 The impact of the pandemic has been felt differently by different groups and has changed some of the risks that HMRC faces in collecting debt. We considered two particular groups of taxpayers to test HMRC's understanding of the support and attention it will need to provide. These groups are:

- 'phoenix' companies, where individuals carry on the same trade through a series of companies that are wound up, usually to avoid paying debts, including tax debts; and

- vulnerable taxpayers who may need extra support in resolving their tax issues.

2.28 In both cases, we found that HMRC had a limited understanding of the likely impact of the pandemic on the scale of activity needed.

5 British Chambers of Commerce, *Quarterly Economic Survey Quarter 2 2020 Press Release*, July 2020. Available at: www.britishchambers.org.uk/news/2020/07/bcc-quarterly-economic-survey-q2-2020-chancellor-must-set-out-roadmap-to-recovery-as-uk-economy-endures-historic-setback. British Chambers of Commerce, *Quarterly Economic Survey Quarter 3 2021 Press Release*, October 2021. Available at: www.britishchambers.org.uk/news/2021/10/quarterly-economic-survey-q3-economy-under-strain

6 British Chambers of Commerce, *Credit 'apathy' restricting potential growth opportunities for SMEs*, 2018. Available at: www.britishchambers.org.uk/news/2018/07/bcc-credit-apathy-restricting-potential-growth-opportunities-for-smes. British Chamber of Commerce, *COVID-19 and Brexit survey*, conducted January 2021.

a) Phoenix companies

2.29 Companies that become insolvent or cease to trade are often unable to pay the tax debt they owe. Some company owners abuse these rules by declaring their company insolvent to avoid paying debts, only to continue the business with a new company. These are known as 'phoenix companies'. The risk of phoenix companies increased during the pandemic because many companies have needed to take on more debt, including some loans from government that are not secured against company assets, such as Bounce Back Loans or Coronavirus Business Interruption Loans.

2.30 HMRC has long identified phoenix companies as an issue. It gained new powers in 2020 to pursue company directors for company debt where it considers that they are declaring insolvency simply to avoid paying tax but it has yet to test these powers. Specific steps it can take include:

- seeking security from companies where there is a serious risk that tax due will go unpaid;
- being able to attach company debts to individuals who served as directors under specific circumstances; and
- referring directors to the Insolvency Service for consideration that they be disqualified from acting as directors of future companies.

2.31 During the pandemic, HMRC's ability to tackle cases of insolvency was limited, particularly by the moratorium on winding-up petitions. Between March 2020 and June 2021, it submitted only two individual bankruptcy cases and 10 company winding-up applications to the court (of which two individual bankruptcy cases and five company winding-up applications were granted), compared with an average of over 1,800 a year for both individual and company cases granted by the courts in each of the preceding four years. These figures indicate a significant backlog of work, even without the impact of the pandemic on the rate of insolvencies. It also increases the risk that phoenix activity goes undetected. However, we found that HMRC held no data on the scale of phoenix activity in the past. Without active tracking of the numbers, it cannot monitor how fast the risk is changing.

2.32 While HMRC cannot identify the number of companies or scale of debt it thinks is at risk, it told us in July 2021 that it was commissioning more work to understand the scale of the problem since the pandemic (particularly around use of the Coronavirus Job Retention Scheme).

2.33 HMRC is including phoenix activity in its first formal compliance debt strategy, although this is currently in draft. Its aims are to:

- identify the worst offenders early and optimise the use of HMRC's powers to change behaviour, prevent recidivism and maximise impact on the worst offenders;
- ensure that new phoenix activity is stopped, reduce HMRC's exposure to losses and maximise recovery from all associated parties; and
- make consistent, comprehensive use of all tools and upstream interventions available.

b) Vulnerable taxpayers

2.34 The adverse impact of the pandemic on people's mental health, levels of domestic abuse and substance abuse has been widely documented. Financial pressures can be both a contributory factor and a consequence.

2.35 HMRC has established an Extra Support Team to help vulnerable taxpayers. This team covers all aspects of a taxpayer's interaction with HMRC and includes specialists who work with taxpayers in debt. Customer service advisers identify and refer people to the Extra Support Team. Guidance and training set out six areas that may indicate that a taxpayer needs extra support, and advisers must decide whether to support the taxpayer themselves or bring in the Extra Support Team.[7] On receiving a referral, the Extra Support Team will work with the taxpayer until the issue is resolved. In the case of a debt, this would be when the taxpayer is able to pay off their debt or set up a Time to Pay arrangement.

2.36 The number of debt management specialists in the Extra Support Team has declined despite large increases in caseload. The average number of full-time equivalent (FTE) debt management specialists working in the Extra Support Team over the period from April 2017 to March 2020 was 19.7. The team's workload more than doubled over that period – from 1,149 cases in 2017-18 to 2,867 cases in 2019-20. In 2020-21, HMRC had just under 19 FTE debt specialists working in the Extra Support Team. In 2020-21, they dealt with just 200 cases – an expected reduction given the low level of activity the wider debt management team was carrying out.

7 The six areas are: access (how well the customer can access services); confidence; capability (for example, if they have low literacy or information technology skills); mental or emotional state; intricacy of the case; or any other reasons identified by HMRC.

2.37 HMRC has not estimated how the number of vulnerable taxpayers with debt is likely to change as a result of the pandemic. It seems likely that the Extra Support Team will face an increased workload from vulnerable taxpayers struggling with debt. The Financial Conduct Authority reported a 15% increase in the number of adults who met one of their characteristics of vulnerability between March 2020 and October 2020.[8] HMRC has told us it will make changes to staffing to meet demand in the future once this is known.

2.38 HMRC will need to ensure that all customer service staff are sufficiently trained to identify and support vulnerable taxpayers. In August 2021, the Cabinet Office debt management function launched a new toolkit to help the government deal with vulnerable taxpayers. HMRC is already using at least one of the specific elements of this toolkit but will need to review its practices against the new guidance.

8 Financial Conduct Authority (FCA), *Financial Lives 2020 survey: the impact of coronavirus*, February 2021. Available at: www.fca.org.uk/publications/research/financial-lives-2020-survey-impact-coronavirus

Increase from 24 million to 27.7 million. The FCA characteristics of vulnerability are:

- Health: health conditions or illnesses that affect the ability to carry out day-to-day tasks.
- Life events: life events such as bereavement, job loss or relationship breakdown.
- Resilience: low ability to withstand financial or emotional shocks.
- Capability: low knowledge of financial matters or low confidence in managing money, and low capability in other relevant areas such as literacy or digital skills.

Part Three

HM Revenue and Customs' capability and capacity to manage tax debt

3.1 Levels of tax debt are likely to remain high for several years following the pandemic. In this part, we examine whether HM Revenue & Customs (HMRC) has the capability, capacity and tools to manage greater levels of tax debt effectively. In particular, we consider evidence that HMRC:

- manages debt services effectively, including the views of stakeholders;
- understands the capacity it needs to optimise the level of debt it can collect and how the pandemic has changed this balance;
- understands how new tools will affect its capacity and the resources it needs, and how it can respond promptly to changes in demand; and
- understands the resources needed to maximise cost-effectiveness.

HM Revenue & Customs' capability to manage tax debt effectively

3.2 We last reported on HMRC's management of tax debt in 2008, and, in 2014, we reported on the management of debt across government.[9] In responding to National Audit Office (NAO) and Committee of Public Accounts recommendations, HMRC has developed and maintained its debt strategy, taken action to improve its understanding of taxpayers' risks, including the risk of insolvency, and developed its use of private-sector debt collection agencies. HMRC calculated that using debt collection agencies helped it recover additional debt worth £766 million between 2015-16 and 2019-20. It expects debt collection agencies to follow its principles in collecting debts – for example, in the way it manages and supports vulnerable customers. HMRC does not send private-sector bailiffs to people's homes although its officers can seize and sell goods as a last resort.

3.3 Other improvements have taken more time to make. HMRC still does not have a single customer account showing a taxpayer's financial position across all taxes, despite more than a decade passing since our recommendation.

9 Comptroller and Auditor General, HM Revenue & Customs, *Management of tax debt*, Session 2007-2008, HC 1152, National Audit Office, November 2008. Comptroller and Auditor General, Cross-government, *Managing debt owed to central government*, Session 2013-14, HC 967, National Audit Office, February 2014.

3.4 Debt charities and other stakeholders have a generally positive view of HMRC's approach to debt management. HMRC is widely regarded as among the best debt practitioners in the public sector. Areas of strength include its provision of dedicated support to vulnerable customers and the availability of repayment plans (**Figure 13**).

3.5 Stakeholders identified some areas where HMRC's practices could improve (Figure 13). While stakeholders recognised the value of the Extra Support Team for customers it identified as vulnerable, they were concerned that HMRC did not do enough to identify vulnerable taxpayers in the first place. Stakeholders also told us that they wanted to see HMRC referring customers to independent debt advice as a matter of course. HMRC has recognised that it could do more to support customers in financial hardship. In January 2020 it joined a pilot scheme run by the Money & Pensions Service which created a portal for creditors such as HMRC to provide their debtors with a referral to an appropriate provider of advice, such as a debt charity. While the pandemic delayed HMRC's implementation of this pilot, in December 2020 it began offering this service to tax credit debtors. It plans to extend the service to Self Assessment customers in England from early 2022. HMRC also abides by the government's Debt Respite Scheme (Breathing Space), which allows debtors to pause debt pursuit activity for 60 days if an independent debt adviser agrees that they are eligible.

3.6 The Cabinet Office told us that, under the regulatory requirements of the Financial Conduct Authority, lenders in the private sector increasingly aim to ensure that their creditors can afford to adhere to any repayment plans they agree (for example, by completing the Standard Financial Statement with the creditor to identify all the costs and debts they need to manage). The Cabinet Office also told us that, despite initial scepticism within the private sector, this approach tends to be successful because the debtor can adhere to the repayment plan and does not need repeated contact with the creditor. Before the pandemic, HMRC tended to ask its taxpayers to keep their repayment plans within a 12-month limit, so that the debt could be repaid before the following year's tax was due (that is, the focus was on timeframe rather than affordability). It relaxed this guideline during the pandemic, and the average length of Time to Pay arrangements increased from around five months before the pandemic to 12 months in July 2021 (paragraph 2.19).

3.7 Behind the scenes, HMRC's debt management function exhibits many features we would expect. We saw evidence of clear governance structures and regular consideration of risks. There was detailed data on operations and performance, which was used to guide decision-making in a timely manner. HMRC's approach to campaigns, and particularly the Return to Collection campaign, has been strong in terms of using and learning from behavioural insights. It has been conducting randomised control trials on debt management since 2012 to improve the impact of its interventions. However, early work on the Return to Collection campaign in October and November 2020 had to be halted because of the second national lockdown. An internal audit report on the Return to Collection campaign highlighted the phased approach to the campaign and the 'test and learn' way of working as effective at developing and delivering the campaign.

Figure 13

Stakeholders' views of HM Revenue & Customs (HMRC) debt management practice before and during the COVID-19 pandemic

HMRC was generally regarded positively compared with other public sector creditors, but stakeholders' perceptions also included areas where they felt HMRC could improve

Good practice	Areas for improvement
HMRC is seen as a leading practitioner within government debt collection.	HMRC still lags behind best practice overall, and as seen in the private sector.
There have been specific efforts by HMRC to improve practice and put a greater emphasis on fairness and affordability. This has included the establishment of the Extra Support Team – a dedicated team to support taxpayers in vulnerable circumstances.	People who would benefit from the Extra Support Team are not always referred to it. All HMRC staff should have training and guidance to be able to identify vulnerable taxpayers, rather than relying on taxpayers to disclose their vulnerability.
The Time to Pay scheme has created a clear route for people struggling to pay debts to HMRC to secure a payment plan to repay over time. There is a sense that HMRC is more willing than other government departments to negotiate affordable repayment plans.	HMRC repayment plans are based on a time limit to repay, rather than an assessment of what is affordable each month. HMRC should review its policy to seek repayment within a year and focus instead on agreeing affordable arrangements with customers, taking into account their other debts. It could also show greater flexibility, including when people's circumstances change during the period of an agreed repayment plan. HMRC should do more to make taxpayers aware of the availability of independent debt advice and encourage them to seek it if needed, as is best practice in the private sector.

Notes

1 The comments here represent the views of stakeholders with whom we engaged during the course of this report. A list of stakeholders whom we consulted is included in Appendix Two to this report.

2 HMRC told us that its debt management staff do receive training on how to identify vulnerable taxpayers. However, it identified that some staff felt they needed a refresher course (having completed the training more than a year previously), and also wished to receive periodic training to maintain their knowledge in this area.

3 Stakeholders' views were provided after the COVID-19 pandemic began, but their views are largely informed by practice before the pandemic.

Source: National Audit Office interviews with stakeholders and written evidence provided by stakeholders

HM Revenue & Customs' capacity to manage debt following the pandemic

3.8 Assuming HMRC's forecasts are accurate, it will have around twice the amount of debt to manage in 2022-23 compared with levels before the pandemic (paragraph 2.22). HMRC estimates that up to 2.4 million more taxpayers were in debt as at 30 September 2021, representing a large increase (63%) on the 3.8 million tax debtors it had on 31 January 2020.

3.9 HMRC is unlikely to be able to keep up with the increase in workload. New debtors are likely to require more support in the short term to agree payment plans, and, with average debts substantially increasing, the likelihood is that taxpayers will need more contact points with HMRC over the life of their debts. HMRC regards maintaining regular contact with taxpayers in debt as an important factor in recovering money owed.

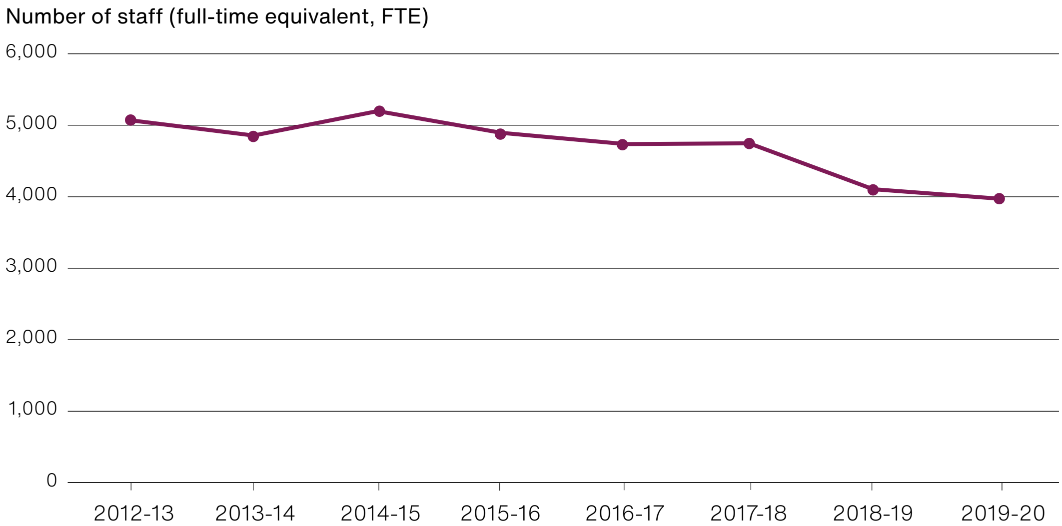
3.10 While HMRC's workload looks set to increase significantly, it is making limited changes to capacity in the short term. Budget 2020 confirmed funds to bring in additional capacity of 600 full-time equivalent (FTE) staff for a three-year period starting in 2021-22. HMRC told us that it plans to recruit and train around 1,000 new FTE staff in 2021-22. However, it also told us that this resource would be needed to replace existing staff as they leave and to close a gap between planned and actual staffing. This shortfall was around 300 FTEs in September 2021, or 7% of staff in post as at the end of September 2021. This falls a long way short of the increase in value of debt and number of debtors that HMRC is facing as a result of the pandemic.

3.11 Between 31 March 2014 and 31 March 2020, HMRC reduced the numbers of staff working on debt management by 18% or 882 FTE, from 4,857 to 3,975 FTE (**Figure 14**). It made the largest reductions in call centre operations, as it modernised its telephony to enable greater flexibility in handling calls. HMRC estimates that a new telephony system and business process reengineering helped it deliver efficiency savings of over 900 FTE. These reductions continued a long-term reduction in debt management staff numbers. When we reported on debt management in 2008, HMRC employed over 6,200 staff.

3.12 Data limitations make it difficult to assess precisely how much debt HMRC has collected and the impact of reductions in staff numbers. As **Figure 15** on page 48 shows, the values of new debt and debt collected both declined by over £8 billion in real terms between 2016-17 and 2017-18. Timing differences affecting Pay As You Earn (PAYE) Real Time Information (RTI) data are likely to have overstated historic debt and collections by several billion a year. HMRC has not restated earlier years, so it is unclear how far the drop is due to corrections and how much is due to changes in its performance.

Figure 14
Number of staff in the HM Revenue & Customs (HMRC) debt management team, 2012-13 to 2019-20

The number of staff decreased after 2014-15



	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
Number of staff in the debt management team (FTE)	5,072	4,857	5,198	4,895	4,737	4,748	4,105	3,975

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

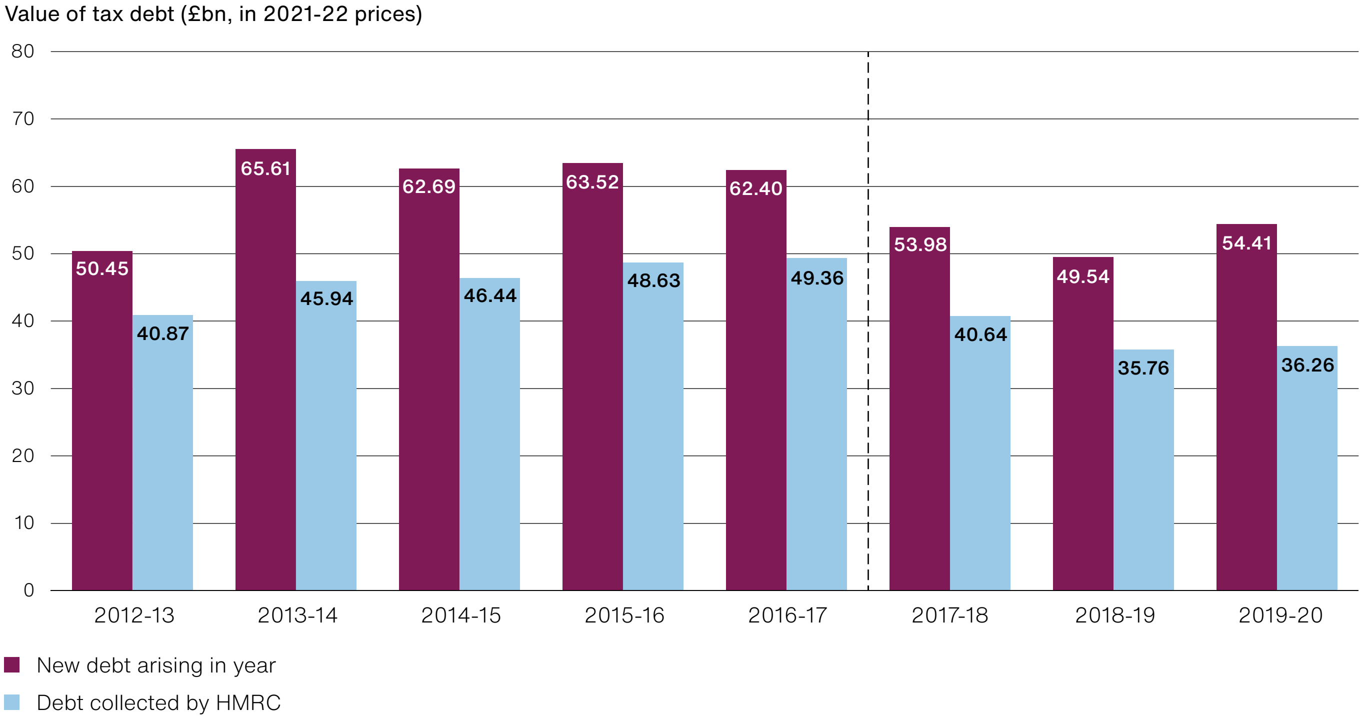
3.13 HMRC has maintained collection levels across most taxes while reducing staff numbers, but the level suggests that even before the pandemic it had significant potential to collect more debt with additional capacity. Excluding collection of PAYE RTI tax debts, HMRC was collecting debt at a level equivalent to around two-thirds of new debts created across other taxes in most years (**Figure 16** on page 49).

3.14 While HMRC has managed to make efficiencies and maintain collection rates across most taxes, it has still needed to write off more tax debt as uncollectable in recent years. **Figure 17** on page 50 shows that the value of debt write-offs and remissions has increased in the past two years. In 2018-19 and 2019-20 combined, HMRC wrote off or remitted around £9.2 billion in tax debt, compared with a total of £8.4 billion in the previous two years. Write-offs and remissions normally relate to older debts that HMRC has determined are uncollectable or where it considers that deploying resources to collect the debt does not represent value for money.

Figure 15

New UK tax debt and tax debt collected by the HM Revenue & Customs (HMRC) debt management team, 2012-13 to 2019-20

New tax and tax debt collected both decreased after 2016-17 following a change in HMRC processes[1]



Notes

1 In November 2016 HMRC began to change its Real Time Information banking processes for Pay As You Earn (PAYE) to allow it to clear more liabilities before they became debts. The 2017-18 financial year was the first year where the full effect of the changes was apparent. This means that both debt collected and new debt are lower after 2016-17.

2 Figures are stated in 2021-22 prices.

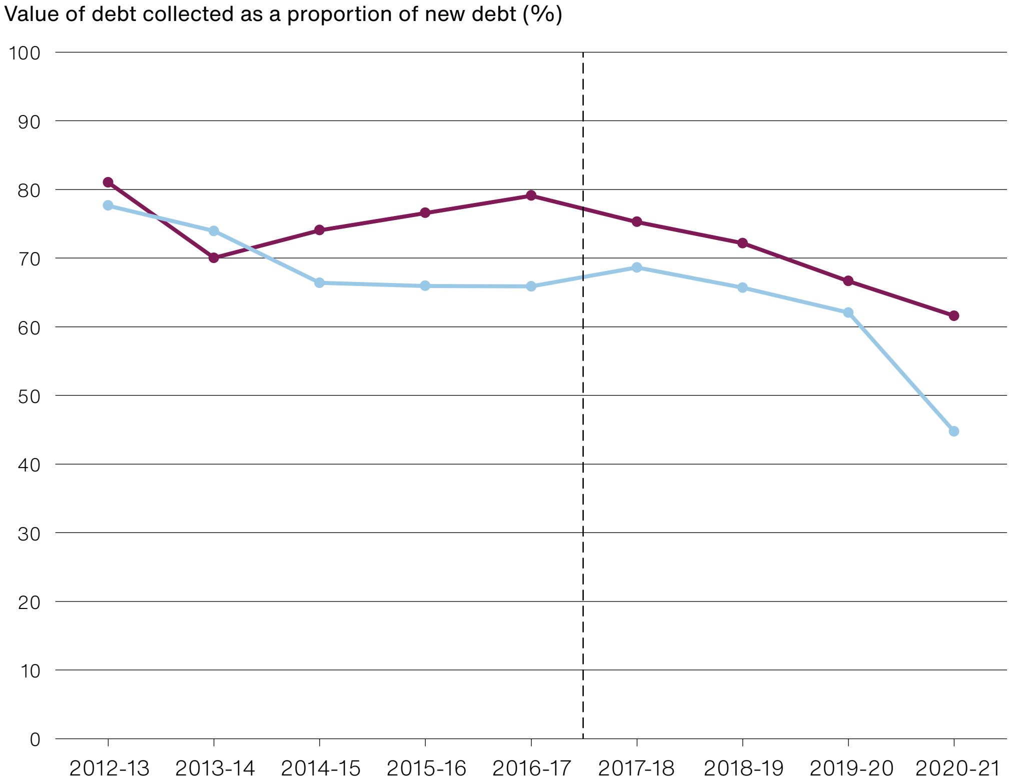
3 Data excludes tax credit debt.

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

Figure 16

Value of UK tax debts collected by HM Revenue & Customs (HMRC) as a proportion of new tax debt, 2012-13 to 2020-21

Debt collected as a proportion of new debt overall declined after 2016-17. Pay As You Earn (PAYE) Real Time Information (RTI) banking process changed in 2016-17 but there is still a downward trend when PAYE RTI is excluded



	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Debt collected as a proportion of new debt	81	70	74	77	79	75	72	67	62
Debt collected as a proportion of new debt, excluding PAYE RTI	78	74	66	66	66	69	66	62	45

Notes

1 In November 2016 HMRC began to change its RTI banking processes for PAYE to allow it to clear more liabilities before they became debts. The 2017-18 financial year is the first year that the full effect of the changes was apparent. This means that real-time information PAYE debt before and after 2016-17 are not comparable, and the line excluding RTI is a better indicator of HMRC's trend performance.

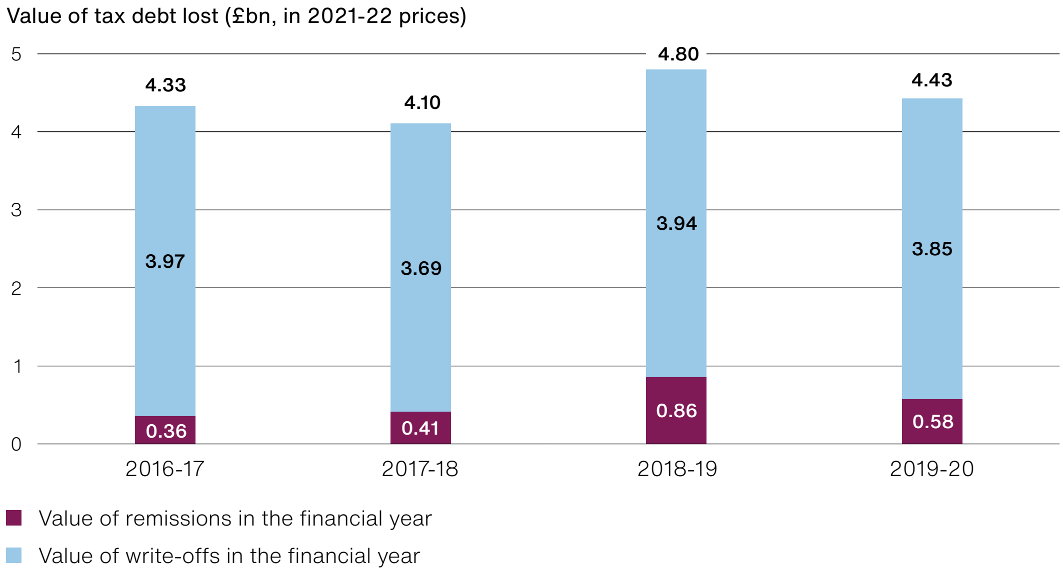
2 "Debt collected as a proportion of new debt, excluding PAYE RTI" includes non-RTI PAYE, Self Assessment, Corporation Tax, VAT and other (lower-value) taxes. It excludes tax credits.

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

Figure 17

UK tax debt written off and remitted by HM Revenue & Customs (HMRC), 2016-17 to 2019-20

Write-offs and remissions have fluctuated but shown an overall increase since 2016-17



Notes

1 Write-offs and remissions normally relate to older debts that HMRC has determined are uncollectable (write-offs) or when pursuing them further does not represent value for money (remissions).

2 Figures are stated in 2021-22 prices.

3 Data excludes tax credit debt.

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

Understanding the tools and resources needed to manage debt

3.15 As part of its wider transformation programme, HMRC has targeted various improvements in its ability to collect debt. These have included both operational measures and new tools and powers. HMRC has:

- offered a new digital self-service system for the self-employed to Time to Pay arrangements;
- developed its understanding of taxpayers and used this to improve the effectiveness of communications and targeted campaigns – for example, it has developed a process to identify companies at high risk of insolvency; and
- put in place new powers to pursue debt and work with other government departments and debt collection agencies – for example, preferential creditor status, which means that VAT tax debts, and PAYE that companies are holding on behalf of employees, are paid earlier in an insolvency.

3.16 These tools take time to implement, particularly those requiring changes to IT systems. Before the pandemic, HMRC estimated that the tools and powers would bring in an average of around £0.3 billion per year in the three years from 2021-22 to 2023-24, with the largest amounts coming from the HMRC's new preferential creditor status (**Figure 18** on pages 52 and 53).

3.17 HMRC expected that measures to increase capacity would secure more in additional debt collected than new tools and powers. It estimated that additional capacity from recruiting more staff and making greater use of debt collection agencies would add an average of around £1.2 billion per year over the three years from 2021-22 to 2023-24.

3.18 Assuming that the HMRC forecasts hold true, the new tools and added capacity are unlikely to be sufficient to manage debt following the pandemic. In 2022-23 the tools, powers and capacity together were expected to bring in £1.7 billion, and this would not be sufficient to return debt collection to historic levels. HMRC will need to look again at its forecasts in light of the pandemic and consider how best to bridge the increase in debt. In the short term the most viable solutions are likely to be steps to further increase capacity because new tools and powers take time to develop.

3.19 In the short term, HMRC has some options available to increase its capacity. HMRC can flex in staff from other parts of the Customer Services Group to support debt management if needed, although this would adversely affect other services. HMRC also has flexibility about how much debt it places with debt collection agencies. In 2019-20, it reported that private sector debt collection agencies had collected £466.8 million, with more than £18 returned for every £1 of recovery cost. The Crown Commercial Service is in the process of negotiating new contracts for using debt collection agencies for all public sector bodies (including HMRC), which will come into force in 2022.

3.20 In the longer term, HMRC has identified several initiatives it could implement to improve debt recovery. These include expanding self-serve Time to Pay arrangements, providing better payment plans (particularly for Self Assessment taxpayers) and being able to set off tax debts against repayments owed across multiple taxes. However, HMRC does not yet have funding for these plans.

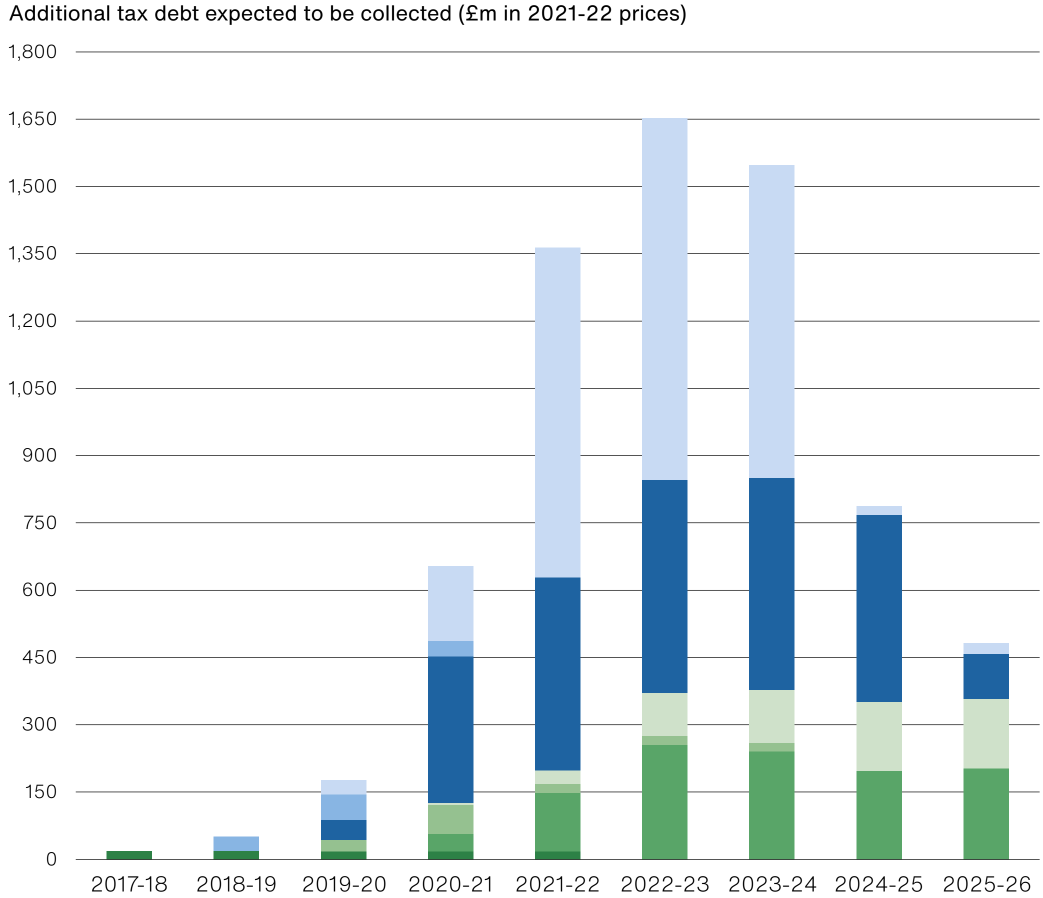
HM Revenue & Customs' understanding of the resources needed to maximise its cost-effectiveness

3.21 In 2019-20, HMRC published for the first time the return on investment of its debt management function as £205 collected for every £1 spent, equivalent to £7.8 million per full-time member of staff in debt management. The rate of return can be heavily affected by the amount of debt that is available to collect and the extent to which taxpayers respond to low-cost interventions, such as reminder letters. In 2020-21, HMRC's rate of return from its debt management function has increased to £19 million per FTE, but this includes debt payments deferred by policy announcements and that were never really overdue.

Figure 18

Additional tax debt HM Revenue & Customs (HMRC) expects to recover from new tools, powers and additional capacity, 2017-18 to 2025-26

HMRC expects to recover £6.7 billion of additional tax debt between 2017-18 and 2025-26 (in particular from additional capacity), but this is far less than the £26 billion increase in the debt balance from the COVID-19 pandemic



	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25	2025-26
Total (£m)	**18**	**51**	**176**	**654**	**1,364**	**1,652**	**1,547**	**787**	**481**
Additional capacity for debt recovery (£m)			31	167	735	806	697	19	24
Aged debt taskforce (£m)		32	58	34					
Private sector funding (£m)			43	327	431	476	472	417	100
Supporting customers and making it easier to pay (£m)				5	30	95	118	154	155
Dynamic coding-out (£m)			26	64	20	20	20		
Preferential creditor status (£m)				39	130	255	240	197	202
Insolvency analytics (£m)	18	18	18	18	18				

Figure 18 *continued*

Additional tax debt HM Revenue & Customs (HMRC) expects to recover from new tools, powers and additional capacity, 2017-18 to 2025-26

Notes

1 Figures are stated in 2021-22 prices.

2 The debt balance increased by around £26 billion (from £16 billion to £42 billion) between January 2020 and September 2021.

3 Green-shaded bars denote additional debt expected to be recovered through the use of new tools and powers. Blue-shaded bars denote additional debt expected to be recovered through the use of additional capacity.

4 'Additional capacity for debt recovery' and the 'Aged debt taskforce' refer to funding for HMRC to employ additional staff for specific debt management activities for a limited period of time (in particular, relating to pursuing debt from taxpayers who choose not to pay and work to recover older debts, respectively).

5 'Private sector funding' is additional funding for HMRC to engage private sector debt collection agencies.

6 The 'dynamic coding out' is a tool that allows HMRC to make adjustments in real time.

7 'Preferential creditor status' is a power that means, when a taxpayer is made bankrupt or a business becomes insolvent, HMRC can claim the tax it is owed before some of the other creditors owed money.

8 'Insolvency analytics' are a set of tools to help HMRC understand the different tax debts owed by a single customer.

9 Data excludes tools, powers and additional capacity intended to collect additional tax credit debt.

10 Numbers may not sum due to rounding.

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

3.22 We found that HMRC had limited understanding of the relationship between staff activity on particular interventions and debt collected. It is working to develop better analytics on which aspects of debt collection are the most effective in terms of elapsed time, amount of input required from HMRC, and the outcomes at each stage of contact with taxpayers. HMRC told us that the first stage of this work is almost complete, and will initially look at the period from March 2020 to February 2021.

3.23 HMRC will need to understand the relationship between staff numbers and debt collected if it is to identify the staff it needs to maximise revenue cost-effectively. It was not able to provide us with a definitive view of the number of staff working in debt management at any one time. It has two different datasets with figures varying by an average of 13% of debt management operations staff numbers (equivalent to more than 400 FTE) between April 2020 and August 2021. The figures can differ because staff are redeployed to deal with customer service pressures and this is not always recorded.

3.24 Looking at historic data can offer some insight into the relationship between staff numbers and debts collected. In its successful bid for funding for additional staffing as part of Budget 2020, HMRC estimated that for each pound it spent on increasing its staff capacity, it would collect an additional £18 of debt. As we set out in Part Two, the pandemic has increased the average value of debt considerably. We would therefore expect a higher rate of return from each successful debt agreement post-pandemic. Determining the resources needed to optimise tax revenue will take time and depend on HMRC monitoring more closely how it deploys its staff and the impact of its interventions. With the number of taxpayers increasing by around 60%, HMRC is likely to need a substantial increase in capacity. However, with average debts increasing, HMRC should target a much greater return from existing and new resources. Understanding this will be fundamental to identifying the level of resources needed to optimise debt collection following the pandemic.

Appendix One

Our audit approach

1 This report examines the role of HM Revenue & Customs (HMRC) in managing tax debt, particularly as this has risen during 2020-21. The report considers how well placed HMRC is to reduce the level of debt, considering the impact of the pandemic and HMRC's existing capacity and capability. Our key audit questions were:

- How has HMRC adapted its management of tax debt in light of the pandemic?
- Does HMRC understand the impact of the pandemic on taxpayers' ability to pay tax debt?
- Does HMRC have the capacity and capability it needs to manage tax debt?

2 Our audit approach is summarised in **Figure 19**.

Figure 19
Our audit approach

The objective of government

In March 2020, shortly after the COVID-19 pandemic began, government deferred tax debt payments and suspended insolvency action as part of a package of financial support to keep businesses afloat and people in work. Tax debt tripled to £68 billion by August 2020, before reducing to £42 billion at 30 September 2021. HM Revenue & Customs (HMRC) paused its debt collection work in March 2020 and used the time to improve its understanding of customers in debt, with the aim of being able to target those most able to pay when the pause in debt collections was over.

How this will be achieved

HMRC uses a variety of methods – from letters and calls to face-to-face visits and enforcement activity – to collect debt that it is owed. It uses data it holds on taxpayers to target activity. The COVID-19 pandemic has changed the amount of debt HMRC has to collect, and provided an opportunity to make changes to how it is collected and how HMRC targets taxpayers.

Our study

This study considers the impact on the tax debt balance of government actions in response to the COVID-19 pandemic, in particular the early decision to defer the payment of VAT and Self Assessment and HMRC's decision to pause debt collection activity.

Our evaluative criteria

Did HMRC understand how the pandemic affected customers' ability to pay tax debt, including whether it updated its model for understanding customers' ability and willingness to pay, and whether it considered all debts customers had (not just tax debt)?

Did HMRC adapt its approach to debt management, including changing its services to reflect the changing needs of customers, the effectiveness of its communications and whether it identified any groups of customers with specific needs?

Does HMRC have the capacity, capability and tools to respond to increased levels of indebtedness efficiently and effectively, including a forecast of the future tax debt and plans to ensure that it will have the workforce and tools it will need?

Our evidence

(see Appendix Two for details)

As part of our fieldwork for this review, we:

- reviewed a range of documents, including ministerial submissions, plans and strategies, management performance reports, customer journey maps and communications and internal audit papers;
- analysed data, including current and historic data on the value and volume of tax debt, the debt management workforce in HMRC, forecasts of future debt and historic and forecast insolvencies;
- interviewed officials from government departments and public bodies, and from stakeholder and sector organisations;
- collected and analysed data from our national audit counterparts in other countries regarding the changing value of, and steps taken to manage, tax debt.

Our conclusions

The pandemic has left HMRC with a far greater debt balance to deal with than in recent times. At the onset of the first lockdown, HMRC acted quickly, pausing debt collection to reduce pressure on debtors and working to improve its understanding of how the pandemic was affecting taxpayers. It subsequently launched its Return to Collection campaign, which included segmenting tax debtors according to how severely they were being affected by the pandemic so that, when collections restarted, it was able to tailor its approach to their ability to pay. It also adopted an empathetic tone and made it easier for taxpayers to repay debt online. Early indications were encouraging, with taxpayers repaying debt faster than expected and stakeholders welcoming HMRC's more understanding tone. However, HMRC also forecasts that higher levels of tax debt will persist. Many taxpayers will need more time and support to repay their debts.

HMRC faces several years of managing the impact of the pandemic on tax debt and current staffing is unlikely to be enough to manage the increased workload. HMRC made efficiencies before the pandemic, but it did not improve overall levels of debt collection and it was writing off more debt. It has some new tools and powers, but these do not appear likely to make up the shortfall. HMRC estimates that adding staff and private sector capacity would have most success in increasing debt collection. High rates of return indicate that this would be a good investment.

While some debtors have been able to repay tax debt quickly during the pandemic (helped by loans and support from other parts of government), there remains an unknown number of taxpayers who have been badly affected and will struggle to repay tax debt. HMRC must build on its initial work and better understand the resources it needs to manage the scale of the challenge it faces. With the number of taxpayers in debt increasing by up to 60%, HMRC is likely to need a substantial increase in capacity. However, with average debts increasing, HMRC should also target a much greater return on investment from existing and new resources. Understanding this relationship will be fundamental to identifying the resources needed to optimise debt collection following the pandemic.

Appendix Two

Our evidence base

1 Our conclusions on HM Revenue & Customs' (HMRC's) management of tax debt were reached based on our analysis of evidence collected between March and September 2021. Our overall audit approach is outlined in Appendix One.

Using our back catalogue

2 In designing and carrying out our work, we took account of previous National Audit Office (NAO) analysis examining debt management, following up on our previous recommendations and using the learning from this work to inform our evaluative criteria. Key reports we reviewed included:

a *HM Revenue & Customs: Management of Tax Debt*, published in 2008;

b *Managing debt owed to central government*, published in 2014; and

c *Tackling problem debt*, published in 2018.

Departmental meetings and information

3 We met with key officials from HMRC involved in the management of tax debt and the design and delivery of the Return to Collection campaign. Specifically:

- the senior responsible owners for debt management, and the key staff members supporting them;
- staff from key teams, including collections, enforcement and the Extra Support Team; and
- staff from HMRC's Knowledge, Analysis and Innovation Team to discuss the monitoring and evaluation of debt management and particularly the Return to Collection campaign.

4 We reviewed relevant documents, including options papers, ministerial submissions and strategy documents, taxpayer journey maps and communications, performance dashboards and internal audit papers.

5 We met with key officials from HM Treasury who have oversight of HMRC's management of tax debt. We also met with key officials in the Cabinet Office who run the cross-government debt management function, and we reviewed relevant documentation including strategy documents; summaries of external submissions; and performance data collected from departments.

6 We spoke or corresponded with officials at other government departments and arm's-length bodies, including the Insolvency Service; Department for Work & Pensions; Department for Business, Energy & Industrial Strategy; and the Money and Pensions Service.

Stakeholders and experts

7 We reviewed key external reports and data sources, including those published by the Office for Budget Responsibility, the Bank of England and the Financial Conduct Authority.

8 We engaged with organisations supporting business, individuals and those in debt including the British Chambers of Commerce; Citizens Advice; the Confederation of British Industry; the Joseph Rowntree Foundation; the Low Incomes Tax Reform Group; the Money Advice Trust; The Money Charity; Resolution Foundation; StepChange Debt Charity; and the Local Government Association.

9 Through our Tax Centre with the University of Birmingham, we discussed issues of particular importance to collecting tax debt and understanding taxpayer behaviour, drawing on academic research. Contributors included:

- Kim Scharf, Professor of Economics, Head of the Economics Department at the University of Birmingham and Editor of International Tax and Public Finance;
- Dr Claire Crawford, University of Birmingham and Institute for Fiscal Studies; and
- Andy Lymer, Professor of Taxation and Personal Finance and Head of the Department of Accounting at Aston Business School.

International comparison

10 We engaged with our national audit counterparts in other countries to better understand the different ways in which their respective governments were implementing measures within the tax system designed to help taxpayers but which would likely have an impact on the tax debt balance. See Appendix Three for more details.

Data

11 Our analysis relies on data provided by HMRC, particularly its internal reporting on debt and staff numbers. We have reconciled this data to other sources where possible, including checking the data on tax debt in previous years that HMRC has provided to audited figures in the annual accounts. Where we have encountered issues with the quality of the data available, these are set out in the main body of the report.

12 When comparing financial data over multiple years, we often present values in the prices of the current year (that is, we present the data in 'real terms'). This makes it easier to compare differences over time by removing the effects of inflation. To make this adjustment, we apply HM Treasury's Gross Domestic Product (GDP) deflator. The COVID-19 pandemic's associated lockdowns and government spend resulted in atypical movement of the GDP deflator in 2020-21. We found that this did not change the trends in the data or the conclusions we would have reached.

Limitations

13 In reaching our independent views, we are aware of the following limitations to our review of HMRC's management of tax debt and the value for money conclusion we draw:

- We conducted all our feedback remotely and, in the context of the pandemic, could not supplement our fieldwork with site visits.
- The unprecedented nature of the pandemic, combined with the delay between when activity takes place and when tax falls due, means that the impact on tax debts is still developing and cannot easily be predicted.

14 There were also limitations with the HMRC data, which meant that some of the data (and our analysis) are estimates. In particular, taxpayers may owe debt for more than one type of tax but HMRC's IT systems cannot identify taxpayers with debts across multiple taxes. Therefore, calculating average debt per taxpayer across all types of tax will double-count some taxpayers and cause the average debt to appear lower than it actually is. **Figure 20** shows data broken down by the main types of tax, which does not include double-counting. It also shows items of debt (rather than number of customers) to provide an indication of scale of debt and the workload HMRC has to manage.

Figure 20

Number of customers in debt, number of items of debt and average value of debt, by type of tax, as at September 2021

There is variation in both value and volume across different types of tax

Type of tax	Number of customers with debt[2]	Average value of debt owed per customer[3]	Number of items of debt[2]	Average value of item of debt[3]
		(£)		(£)
Self Assessment	3,913,000	2,100	12,435,000	700
PAYE	757,000	10,600	18,313,000	400
Corporation Tax	665,000	7,300	1,125,000	4,300
VAT	730,000	24,100	2,927,000	6,000
Total[1]	**6,158,000**	**6,800**	**38,223,000**	**1,100**

Notes

1 Total includes all types of tax debt, not just those listed above, excluding tax credit debt.

2 Number of customers and number of items are rounded to nearest 1000.

3 Average value of debt is rounded to nearest 100.

4 PAYE is Pay As You Earn.

5 Taxpayers may owe debt for more than one type of tax but HM Revenue & Customs' information technology systems cannot identify taxpayers with debts across multiple taxes. Therefore, calculating average debt per taxpayer across all types of tax will double count some taxpayers and cause the average debt to appear lower than it actually is.

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

Appendix Three

International comparisons

1 We contacted other Supreme Audit Institutions to understand what other countries had done to relax, pause, or otherwise change the requirement to pay tax or tax debt during the pandemic and what impact these actions had had on levels of tax debt.

2 We have characterised the responses given to identify how many countries carried out similar actions to HM Revenue & Customs. This included identifying how many countries:

- allowed taxpayers to defer tax payments when they fell due, which in some cases incurred interest penalties and not in others;
- extended deadlines for filing tax returns;
- suspended or removed penalties for late payment of tax owed;
- paused, or allowed taxpayers to pause, existing arrangements to pay back tax debt; or
- paused or suspended usual activity to collect existing tax debts.

3 **Figure 21** on pages 61 and 62 sets out a summary of the substantive responses we received. We did not receive a substantive response from every country we contacted, including France and Germany.

4 The specific questions we asked were:

- How does the tax authority in your country define tax debt?
- What did your tax authority do to relax, pause or otherwise change the requirement to pay tax/tax debt during the pandemic? Did this vary by tax or by type of taxpayer? How long did the change in requirements last?
- Does your country report the tax debt owed to it? What was your country's tax debt balance before the pandemic? What is your tax debt balance now?
- How much debt has been cancelled or written off as a result of the pandemic?

Figure 21

Actions taken by, and change in tax debt in, other countries during the COVID-19 pandemic

Available data indicate that all countries in our sample took action to support taxpayers during the pandemic, and 9 of the 11 providing data experienced a subsequent increase in the tax debt balance, but none saw the tax debt balance increase at the same rate as the UK

Country	Tax payments deferred – details of extent	Were any filing deadlines extended?	Were any late penalties suspended?	Were any existing payment plans paused?	Were any tax debt collection activities suspended?	What was the change in tax debt?
						(%)
Australia	Deferred due dates for payment of activity statements and some income tax returns Deferrals for impacted clients			Yes	Yes	+31.99
Bulgaria	Corporate income tax extended three months Income taxes extended three months	Yes				
Croatia						
Cyprus	VAT payments delayed multiple times Personal income tax Corporate income tax	Yes				
Czech Republic			Yes		Yes	
Estonia			Yes			+26.37
Finland				Yes	Yes	+25.77
Ireland					Yes	+28.90
Kosovo	Personal Income Tax (PIT) Corporate Income Tax (CIT) Declaration and payment of tax dues and pensions contributions Quarterly statement of tax and contributions for individual businesses Quarterly statement of advance payment for corporations Declaration and payment of PIT, CIT, and VAT has been extended for all taxpayers					+22.77
Latvia	Postponed tax payment term for a period of up to three years. This support is valid from 22 March 2020 till 30 June 2021 and applies to all tax payments in the state budget		Yes			+6.90

Figure 21 *continued*

Actions taken by, and change in tax debt in, other countries during the COVID-19 pandemic

Country	Tax payments deferred – details of extent	Were any filing deadlines extended?	Were any late penalties suspended?	Were any existing payment plans paused?	Were any tax debt collection activities suspended?	What was the change in tax debt?
						(%)
Malta	Tax Deferral Scheme: Any company (big or small) and self-employed persons, who suffered a drop of 25% or more in sales, could delay taxes until May 2022					
Moldova	Income tax Real estate tax Land tax Local taxes	Yes			Yes	+36.47
Norway	Wealth tax delayed one year Passenger flight tax paused					+90.77
Poland						
Slovenia	Any taxpayer who performs business activities can apply for 24-month deferment. This applies to all tax liabilities and to contributions for social security			Yes		-15.44
South Africa	Deferrals for PAYE liabilities, Provisional Tax, Customs and Excise Duties, Carbon Tax, tax payments for businesses with gross income above R100m Refunds for two-monthly VAT	Yes		Yes		+34.64
Spain	Deferral of payment of tax liability corresponding to tax returns and self-assessments whose deadline for submission and payment is from 1 April to 30 April 2021. Time limit of six months					-2.00
USA		Yes		Yes	Yes	

Notes

1 The percentage changes have all been calculated by comparing tax debt changes over a year pre- and post- the start of the pandemic. However, the years in question are not consistent and include year-end dates in December, January, March and June. Data should not be used to directly compare the impact of the pandemic on tax debt but they give an indicative illustration of scale.

2 The UK tax debt balance increased by £26 billion (from £16 billion to £42 billion) in 2021-22 real terms between January 2020 and September 2021, equivalent to 159%.

3 Blank cells denote that no data were provided.

Source: National Audit Office analysis of responses from other Supreme Audit Institutions and government websites

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