National Audit Office

Managing tax debt through the pandemic

HM Revenue & Customs

REPORT

by the Comptroller and Auditor General

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Key facts

£42bn

tax debt owed to HM Revenue & Customs (HMRC) as at 30 September 2021

2.4m

the estimated increase in number of taxpayers in debt as at 30 September 2021 compared with 31 January 2020

300 FTE

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.