National Audit Office

REPORT

Managing tax compliance following the pandemic

HM Revenue & Customs

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HC 957

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National Audit Office

Managing tax compliance following 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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Key facts

1,356

average number of full-time equivalent (FTE) compliance staff HM Revenue & Customs (HMRC) redeployed to support its COVID-19 schemes in 2020-21 (peaking at 4,396 FTE in May 2020), reducing the staff available for its core tax compliance work by 12%

£9bn

estimated total reduction in the revenue raised by HMRC's compliance work (compliance yield) across the two pandemic years compared with historical average

2,500

approximate increase in HMRC's compliance staff between 2021-22 and 2022-23

£731.1 billion total tax revenue collected in 2021-22, a 20% increase from 2020-21 after an initial reduction during the pandemic

£30.8 billion HMRC's estimate of its compliance yield in 2021-22, down from a peak of £36.9 billion in 2019-20 in cash terms

29% reduction in compliance cases HMRC closed in 2020-21 compared with 2019-20 (103,000 fewer cases), while it also opened 32% fewer cases (114,000)

30% proportion of compliance yield in 2021-22 from HMRC's 'upstream' work to prevent non-compliance before it happens (up from 22% in 2019-20), for example by using nudges and prompts or changing legislation to close loopholes

Summary

1 HM Revenue & Customs (HMRC) is responsible for administering the UK's tax system. Its objectives include to collect the right tax, to make it easy to get tax right and hard to bend or break the rules, and to maintain taxpayers' consent through fair treatment and protect society from harm. HM Treasury leads on the strategic policy design of the tax system; it agrees HMRC's revenue and efficiency targets, and levels of funding.

2 The COVID-19 pandemic changed the priorities and make-up of HMRC's work. At short notice, it had to implement new COVID-19 support schemes and provide additional support to taxpayers, including more time to pay tax. The need to prioritise direct responses to the pandemic meant redeploying staff from across the department, reducing its overall capacity for tax compliance work. Lockdowns and social distancing affected its ability to conduct investigations in person.

3 A wide range of factors influence levels of tax compliance, some of which were affected by the pandemic. For example, the state of the economy putting pressure on the finances of individuals and businesses, the government changing tax rules and processes at short notice, and taxpayers' perceptions of the fairness of the tax system can all affect how many voluntarily pay the correct tax.

4 HMRC's estimates indicate that without its compliance work at least 10% of taxes owed would not be paid. It records how much its compliance work yields and estimates this normally reduces overall levels of non-compliance to around 5% of taxes owed. HMRC uses two main approaches to improve tax compliance:

- **Upstream** compliance work to encourage voluntary compliance and prevent non-compliance before it happens. It includes legislative changes to close tax loopholes; changes to HMRC processes to reduce opportunities to avoid or evade tax; and operational activities to prevent non-compliance before it occurs. HMRC promotes compliance using education, nudges and prompts to reduce errors and support taxpayers to get their tax affairs right first time.

- **Downstream** compliance work to identify and tackle non-compliance after it has happened. It involves monitoring risks of non-compliance, investigation and follow-up action. These actions include educating the taxpayer to put their tax affairs right, collecting any taxes owed, issuing penalties and, where necessary, pursuing matters through tribunals or through civil or criminal courts. HMRC includes the behavioural impact of this work on future revenue when measuring performance.

5 Before the pandemic, HMRC's strategy increasingly focused on upstream compliance, which it considers more cost-effective and better for customers because it aims to help taxpayers get their tax right first time. HMRC uses downstream activity to respond to non-compliance, including more severe forms such as tax evasion and other criminal activity, and to maintain a strong deterrent effect to encourage other taxpayers to take compliance seriously. The pandemic reduced HMRC's ability to conduct downstream investigations. It now faces a challenge to restore compliance performance following the pandemic.

Scope of this report

6 This report examines the extent to which HMRC is well-placed to manage its compliance work following the pandemic, including new risks and challenges to tax compliance. It covers whether HMRC:

- understood the immediate impacts of the pandemic and organised an effective response;
- has a good understanding of its compliance performance and what this shows about its performance since the start of the pandemic; and
- has a clear vision and plan to manage tax compliance risks following the pandemic.

7 This report focuses on HMRC's tax compliance work. It does not evaluate related areas that we have reported on since 2021, including HMRC's management of debt and of fraud and error in its COVID support schemes.

Key findings

Tax compliance during the pandemic

8 Early in the pandemic, HMRC redeployed compliance staff to the COVID-19 response, reducing capacity for other compliance work. Throughout 2020-21, HMRC had redeployed an average of 1,356 full-time equivalent (FTE) staff from its Customer Compliance Group (CCG) to support its new COVID support schemes. In May 2020, a peak of 4,396 CCG staff were working on the schemes, before reducing over time. A large part of the CCG's staff was required to work on existing priorities such as EU Exit. Compliance staff available for remaining compliance work reduced by 12% in 2020-21 (to 15,581 FTE). HMRC is actively recruiting and training new staff to fill the gap, but in the short term its compliance staff will be less experienced than before the pandemic (paragraphs 1.8 and 1.9).

9 HMRC has conducted substantially less downstream compliance work since the pandemic began, partly due to reduced capacity. In 2020-21, HMRC closed 103,000 (29%) fewer compliance cases compared with the previous year and opened 114,000 (32%) fewer. HMRC's strategy to focus increasingly on upstream compliance and prioritise higher-impact cases meant downstream case numbers were already reducing before 2020. The pandemic reduced downstream activity further. Recognising the pressures on taxpayers, HMRC offered them the option to pause enquiries, except in cases where it suspected fraud or criminal activity. HMRC eased other requirements, such as allowing more scope to file returns digitally. The pandemic accelerated HMRC's strategy to move away from face-to-face casework, as it aims to target investigations more cost-effectively. In-person visits for individuals and small businesses remained 36% lower in 2022 compared with 2019. HMRC has not yet assessed how these changes have affected detection of non-compliance or the behavioural effect on attitudes to paying tax among those it has investigated (paragraphs 1.10 to 1.12).

10 Alongside its response to the pandemic, HMRC needed to continue monitoring and addressing new and emerging risks. The tax system is a continual target for fraud and criminal attacks. HMRC therefore needed to continue monitoring risks of such attacks during the pandemic and addressing any criminal activity. For example, shortly after lockdown in March 2020 the income tax self-assessment repayment system was subject to a new type of attack, involving fraudulent claims. The total value of repayment claims rose by around £1.5 billion (19%) in 2020-21 compared with 2019-20. HMRC stopped around £1.1 billion of these payments before they were made but estimates that between £52 million and £219 million was extracted by fraudsters. HMRC strengthened systems and controls, and claims returned to expected levels by July 2021 (paragraphs 1.14 and 1.15).

11 Tax revenues fell in 2020-21 before reaching record levels in 2021-22, but levels of non-compliance during the pandemic are not yet known. With economic activity significantly reduced in the first year of the pandemic, total tax revenues fell in cash terms from £636.7 billion in 2019-20 to £608.8 billion in 2020-21. With the economy largely reopening in 2021-22, total revenues rose by 20% to a record level of £731.1 billion. This growth was higher than commentators had anticipated because of economic factors, in particular wage growth and inflation. HMRC's latest estimate of the tax gap – which is the difference between taxes theoretically owed and those actually paid – suggests that the tax gap was stable at around 5% of total taxes theoretically owed in 2020-21, equivalent to £32 billion. Tax gap data are not yet available for 2021-22 (paragraphs 1.16 and 1.17).

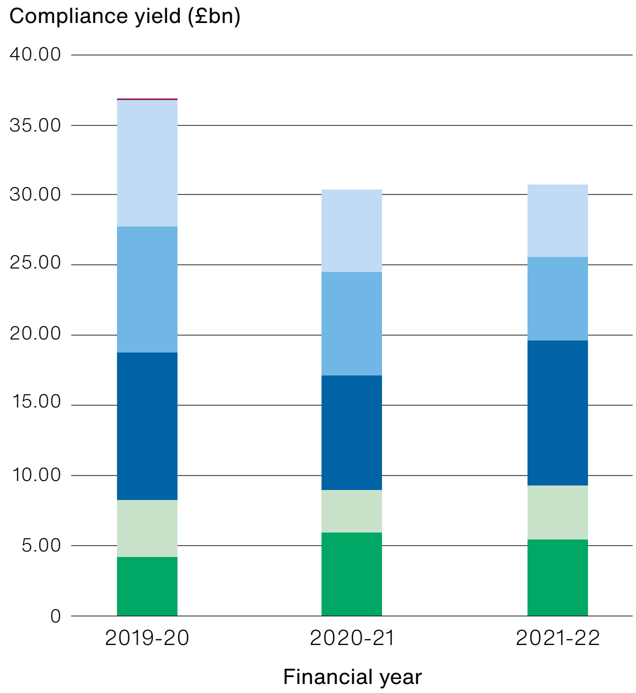
Understanding compliance performance

12 **HMRC's compliance work has raised around £9 billion less revenue (compliance yield) since the pandemic began, compared with historical levels.** In the five years before the pandemic, HMRC estimated that its compliance yield was on average 5.2% of total revenues. Compliance yield as a proportion of total revenues decreased from the previous average of 5.2% to 5.0% in 2020-21, equating to a £1.5 billion reduction. It then fell further to 4.2% in 2021-22 (the lowest level since 2011-12), equating to a £7.5 billion reduction. With revenues reaching record levels in 2021-22, the reduction in compliance yield is likely to be at least partly driven by reduced compliance work, although the impact of wider economic factors on yield is not yet clear (paragraphs 2.6 and 2.7).

13 **Upstream yield makes up an increasing proportion of total yield, up from 22% in 2019-20 to 30% in 2021-22.** Recent trends in the different components of compliance yield are shown in **Figure 1**. Upstream yield increased during the pandemic mainly due to 'product and process yield' improvements. These are policy, legislation or system design changes to improve compliance, for example by closing loopholes. Cash expected from downstream interventions, and the expected impact on customers' future compliance (future revenue benefit) both fell in successive years. The length of time needed to work on compliance cases means the full impact of the pandemic on downstream compliance yield will not become clear for several years (paragraphs 2.8 and 2.9).

Figure 1
Upstream and downstream components of compliance yield, 2019-20 to 2021-22

Upstream compliance yield increased slightly during the COVID-19 pandemic, while downstream yield fell



	2019-20	2020-21	2021-22
Accelerated payments	0.1	0.0	–
Future revenue benefit	9.0	5.9	5.2
Cash expected	9.0	7.4	6.0
Revenue loss prevented	10.6	8.2	10.3
Upstream operational yield	4.1	3.1	3.9
Upstream product and process yield	4.2	5.9	5.4
Total compliance yield	36.9	30.4	30.8

Notes

1 Values are in cash terms and have not been adjusted for inflation. Yield as a percentage of tax revenues is shown in Figure 7.

2 For explanations of each category of compliance yield, see Figure 6.

3 Between 2014-15 and 2020-21, HM Revenue & Customs (HMRC) recognised a separate yield component called 'accelerated payments'. From 2021-22, HMRC includes these within cash expected and upstream product and process yield. These are disputed amounts that people using tax avoidance schemes are required to pay upfront, and an estimate of the behavioural change caused by this policy.

4 2019-20 included an exceptionally large settlement of £4.2 billion of yield, which was spread across Revenue Loss Prevented and Future Revenue Benefit.

5 Figures may not sum exactly due to rounding.

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

14 **Compliance yield has limitations as a performance measure, and we found some areas where HMRC's estimates may be overstated.** Compliance yield is HMRC's primary measure of its performance in bringing in additional tax revenue, and it captures only positive returns. Negative impacts, such as losses from weaknesses in tax systems, are captured under HMRC's annual assessment of the tax gap. HMRC carries out high-level quality-assurance of its upstream yield, but this does not involve detailed accuracy testing. There are inherent uncertainties that may lead to understatement or overstatement. Inconsistencies in the way HMRC applies assumptions about inflation may also lead to understatement or overstatement (paragraphs 2.15 to 2.17 and 2.20). We identified two further aspects of the way HMRC calculates downstream yield that may result in substantive overstatement:

- **HMRC identifies and corrects errors in its downstream yield but does not use its findings to adjust the overall estimate.** In 2021-22, HMRC's quality assurance arrangements found errors in 80 out of 400 downstream compliance cases selected. Errors generally overstated how much tax would be recovered. From cases totalling £736 million, net errors overstated compliance yield by £59.7 million (8% of the value of cases selected). HMRC's testing also found seven cases where it had overcharged taxpayers (none of which were large businesses), by a total of £32.2 million. HMRC subsequently took corrective action to ensure the tax position was remedied. HMRC told us its sampling approach does not allow it to extrapolate errors to compliance yield overall, meaning it does not know how much its compliance yield is overstated or how much it has overcharged taxpayers. Using the approach to extrapolating errors we take in our financial audits of government accounts, we found a wide range of potential error which limited the precision with which an overall error could be estimated. This is because, in 2021-22, HMRC tested only small numbers of cases in some areas where it found high levels of error (paragraphs 2.12 to 2.14).

- **HMRC has not updated its compliance yield assumptions for non-payment of tax debt since 2010.** Levels of tax debt more than doubled in real terms during the pandemic. Caseworkers assess the likelihood of receiving payment when calculating the expected yield, and HMRC also assumes that some expected yield will not be collected in practice because taxpayers go insolvent or are otherwise unable to pay their debt. However, it normally only applies this to the 'cash expected' component of compliance yield for individuals and for small and medium businesses. It has not updated its assumptions about non-payment rates since 2010, despite evidence that rates of non-payment have risen during the pandemic (paragraph 2.17).

15 Although compliance yield reduced during the pandemic, this has not resulted in an increased tax gap estimate. HMRC's latest estimates suggest compliance yield reduced by 0.8% of total tax revenue in 2020-21 but the tax gap remained stable at 5.1% of total taxes theoretically owed. The tax gap estimates for 2020-21 are subject to increased uncertainty due to the pandemic. In theory, changes in compliance yield should affect the level of the tax gap (unless underlying levels of taxpayer compliance also change). In practice, HMRC calculates the tax gap and compliance yield in different ways, based on different time periods, making precise comparisons difficult. Methodological changes can improve or reduce the comparability of the estimates. HMRC made three adjustments to the 2020-21 tax gap to account for the pandemic's impact on the data it uses. This included spreading out a large reduction in self-assessment 'cash expected' yield by matching the reductions more closely to the relevant tax year. HMRC's tax gap methodology states this was to preserve consistency in the time series, but HMRC did not adjust the methodology for prior years as it normally does for changes in the tax gap. Without the change, the tax gap as a proportion of total liabilities would have increased, by 0.1 percentage points. HMRC told us it would describe small movements between years as showing the tax gap to be broadly stable (paragraphs 2.18 to 2.21).

16 Criminal prosecutions decreased markedly in the pandemic when many courts were unable to operate. Before the pandemic, the number of prosecutions had reduced as HMRC focused more on serious and complex cases, from around 900 in 2017-18 to around 700 in 2019-20. During the pandemic, there were periods in which many courts were closed or operating with less capacity. In 2020-21, there were just 163 prosecutions, rising slightly to 236 prosecutions in 2021-22. HMRC does not publish targets or expectations for overall numbers of prosecutions. In its 2019-20 annual report, HMRC said that its focus was on achieving the right overall outcome for the UK, rather than chasing arbitrary targets in arrests and prosecutions (paragraphs 2.23 and 2.24).

Managing tax compliance in future

17 It is not yet clear whether the pandemic has affected risks to tax compliance. HMRC's CCG maintains a detailed and comprehensive register focused on current and short-term compliance risks. In its 2021 assessment, HMRC judged that the overall level of risk had so far not changed significantly. However, HMRC quantifies the scale of risk based on the latest data on levels of taxation and estimates of the tax gap, which take one to two years to become available. HMRC told us that some risks are likely to become more significant in the next two iterations of its risk assessment, and that the figures do not yet reflect the full impact of the pandemic. Possible impacts of the pandemic include higher levels of non-payment, and potential changes in taxpayers' willingness and capability to comply (paragraphs 3.2 to 3.4).

18 HMRC's internal planning indicates that it will be challenging to keep the tax gap from growing over the next three years. HMRC's CCG will need to achieve its upper planning estimate for the yield from its core compliance work to meet the yield level it thinks will be needed to maintain the tax gap. If it only achieves its mid-point planning estimate, it will fall short of the required level by £17 billion in total over the three-year period (2022-23 to 2024-25). In practice, the CCG expects to achieve yield somewhere between its upper and mid-point estimates. This will require an improvement in performance compared with the pandemic years. According to HMRC's estimates for the past two years, its core yield was closer to its mid-point estimate and fell short of the level required to maintain the tax gap by £1.5 billion in 2020-21 and £3.4 billion in 2021-22 (paragraphs 3.5 and 3.6).

19 The cost-effectiveness of compliance work reduced during the pandemic, but HMRC expects to recover performance levels from 2024-25. Compliance yield per staff member fell during the pandemic but HMRC expects to recover this over the next five years. Compliance staff generated around £1.1 million a year per staff member across 2020-21 and 2021-22 compared with £1.3 million per staff member on average in the five years before the pandemic. HMRC is recruiting and training new staff to provide capacity and support greater flexibility between tax regimes. HMRC expects the number of compliance staff to increase by around 2,500 (10%) between 2021-22 and 2022-23. However, new staff typically need up to four years to become fully effective. HMRC does not analyse rates of return for different types of compliance intervention, which it could use to understand the relative effectiveness of different activities. It also carried out little evaluation of compliance projects during the pandemic, limiting its understanding of what worked effectively during the period. It plans to rectify this as part of wider changes to compliance standards, accompanied by guidance to support policy design. A key lesson from the COVID employment support schemes is the importance of mitigating compliance risks when formulating policy (paragraphs 3.9 to 3.13).

Conclusion on value for money

20 The COVID-19 pandemic had a significant impact on HMRC's compliance work. In challenging circumstances, HMRC focused its resources on key priorities and redeployed some staff to new support schemes, which left reduced capacity for downstream tax compliance activity. It needed to make reductions to its casework, beyond those it was already making as part of a strategy to focus on upstream compliance. Compliance yield reduced significantly during the pandemic and there is a risk that more non-compliant taxpayers ultimately fail to pay the right tax or escape investigation and prosecution. It is concerning that HMRC's planning indicates that the tax gap may grow following the pandemic. It will take some time to understand fully whether the pandemic has affected tax compliance. The next two years are critical and swift action is likely to be needed to prioritise efforts and stem potential losses.

21 Understanding performance is essential for government and HMRC to deploy resources effectively. There is little doubt that HMRC's compliance work offers good value for money, but its compliance yield measure needs to be sufficiently robust and transparent to instil confidence in the absolute level of returns it can generate. HMRC is taking steps to improve how it quality-assures its measure. Particular areas for improvement include understanding how assumptions affect the range of uncertainty around compliance yield, adjusting for errors across the estimates, and understanding how much it is overcharging or undercharging taxpayers as a result of tax compliance enquiries. With a better-quality measure, HMRC can make more effective trade-offs and achieve better value for money.

Recommendations

22 HMRC can do more to demonstrate that its compliance yield measure has sufficient quality assurance and transparency. These recommendations all have consequential impacts on HMRC's understanding of the resources needed to prevent non-compliance from growing. HMRC should:

a make further improvements to its processes for estimating compliance yield. This should include:

- extending improvements made to quality assurance processes for downstream compliance yield to apply to upstream yield, including assurance work to test underlying evidence;
- reviewing its assumptions in light of the current economic climate, including non-payment rates; and
- updating how it selects and targets the sample of cases to test, so that a robust extrapolation of the errors can be used to calculate to what extent they affect the overall estimate of compliance yield each year.

b estimate and report the likely extent of official error affecting taxpayers – by either overcharging or undercharging them – in carrying out its compliance work. This should include ensuring it has the data needed to make a robust and representative estimate, and to determine whether additional testing is required.

c supplement its published compliance yield figures with more detailed commentary and analysis of trends between the different components of yield, and what these say about performance. This should indicate levels of uncertainty and could include sensitivity analysis of core assumptions used in the compliance yield estimate.

d assess the potential impacts, on taxpayer behaviour and levels of non-compliance, of changes to compliance processes that it introduced or accelerated during the pandemic and has since made permanent, such as fewer face-to-face visits and digital filing of returns.

e analyse the relative rates of return from different types of compliance intervention, and use it to help inform how it prioritises and allocates resources on areas that will be most impactful. This should build on its existing analysis of rates of return.

f ensure that there is more consistent evaluation of the effectiveness of all types of its compliance interventions and use the findings to assess value for money.

Part One

Tax compliance during the COVID-19 pandemic

1.1 HM Revenue & Customs (HMRC) is responsible for administering the UK's tax system. Its objectives include to collect the right tax, to make it easy to get tax right and hard to bend or break the rules, and to maintain taxpayers' consent through fair treatment and protect society from harm. HM Treasury leads on the strategic policy design of the tax system; it agrees HMRC's revenue and efficiency targets, and levels of funding.

1.2 This Part examines:

- how HMRC seeks to ensure taxpayers comply with tax rules;
- the impact of the COVID-19 pandemic on tax compliance and HMRC's work;
- how HMRC responded to maintain compliance during the pandemic; and
- the impact of the pandemic on tax revenues and overall compliance.

Tax compliance

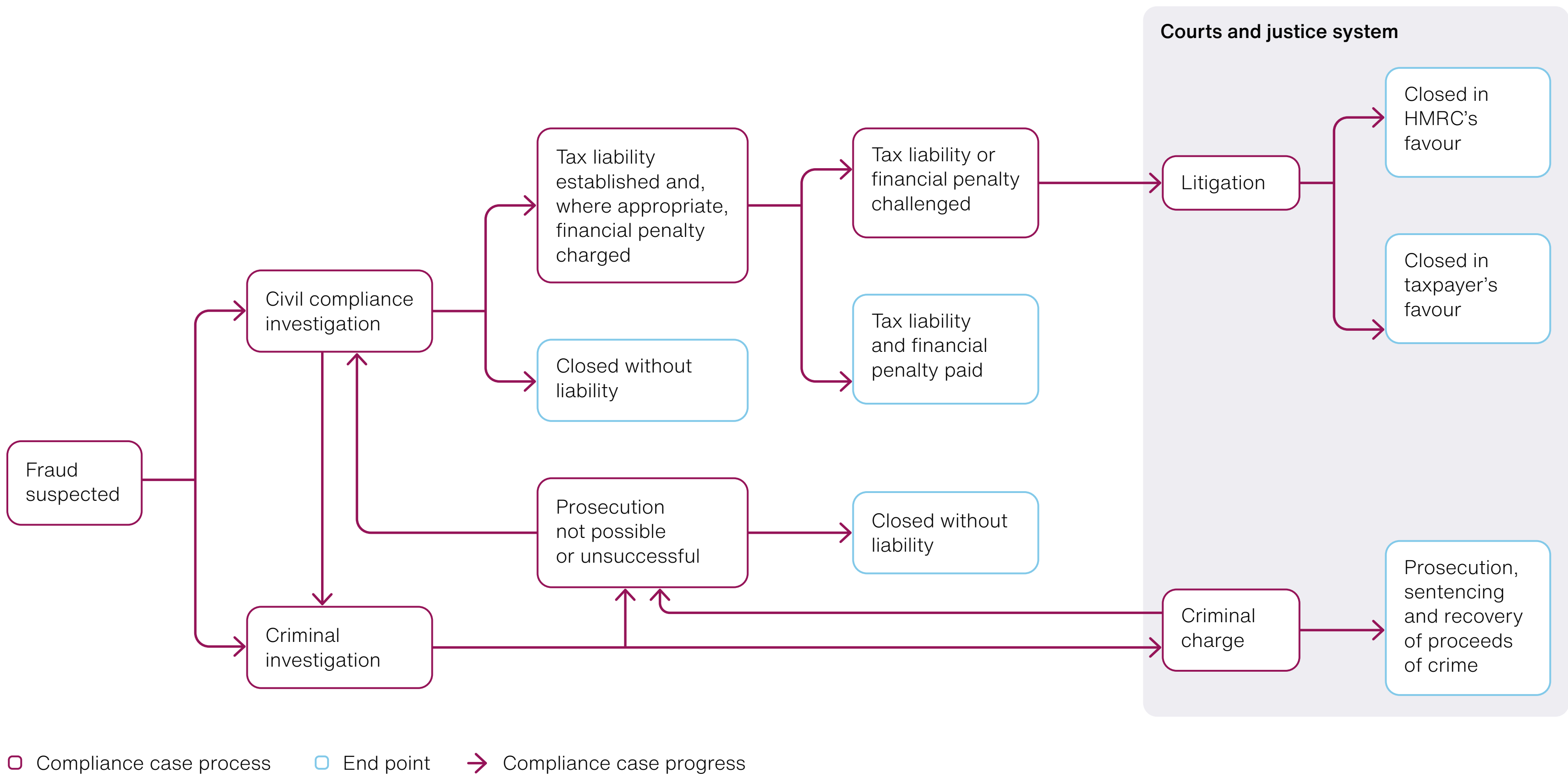
1.3 HMRC's estimates indicate that without its compliance work at least 10% of taxes owed would not be paid. It records how much its compliance work yields and estimates this normally reduces the tax gap (the difference between taxes that are theoretically owed and how much is actually paid) to around 5% of taxes owed. Inevitably some taxpayers make mistakes, others choose not to comply, and some cannot pay because of insolvency. HMRC uses two main approaches to improve tax compliance:

- **Upstream** compliance work to encourage voluntary compliance and prevent non-compliance before it happens. It includes legislative changes to close tax loopholes; changes to HMRC processes to reduce opportunities to avoid or evade tax; and operational activities to prevent non-compliance before it occurs. HMRC promotes compliance using education, nudges and prompts to reduce errors and support taxpayers to get their tax affairs right first time.
- **Downstream** compliance work to identify and tackle non-compliance after it has happened. It involves monitoring risks of non-compliance, investigating areas of high risk and taking follow-up action. This includes educating the taxpayer to put their tax affairs right, collecting any taxes owed, issuing penalties and, where necessary, pursuing matters through tribunals or through civil or criminal courts (such as in cases of suspected fraud, as set out in **Figure 2** overleaf). Alongside revenue owed from past years, HMRC includes the behavioural impact of this work on future revenue when measuring performance.

Figure 2

Simplified overview of HM Revenue & Customs' (HMRC's) tax fraud investigation procedures

Compliance cases where fraud is suspected can progress through civil or criminal investigations, depending on the severity and complexity of the case



Notes

1 The diagram displays the procedure followed by HMRC caseworkers where fraud is suspected. Before this, each case is reviewed by analysts who identify the level and nature of risks.

2 This shows a simplified and stylised picture of the different routes that a compliance case can take. This means that – in practice – cases may move between the criminal and civil routes. For example, criminal investigations aim to progress to prosecution but where this cannot be achieved there will generally be an option to continue with a compliance intervention or civil investigation. In complex cases HMRC may use a blend of civil and criminal investigation to address different elements of the identified risks.

3 Most of HMRC's work to tackle tax fraud involves civil powers. HMRC uses these powers to gather the information required to assess a taxpayer's tax affairs and, if it identifies non-compliance, to collect unpaid tax and where relevant issue a penalty using the processes shown above. In some serious cases of fraud and tax evasion, HMRC can give the taxpayer the option to admit dishonesty, pay tax and penalties, and avoid criminal investigation. Criminal investigation is limited to where fraud is particularly serious or where civil powers are not enough to uncover the truth and recover the tax at stake. HMRC may also choose to pursue a criminal investigation if it considers there to be value in sending a strong deterrent message.

Source: National Audit Office review of HM Revenue & Customs guidance

1.4 HMRC uses a combination of upstream and downstream approaches to reduce non-compliance. Its analytical functions identify risks and target cases for investigation. Compliance work can vary substantially, from detailed enquiries into individual taxpayers, letters to target specific taxpayer groups highlighting common errors, or general measures such as nudges and prompts intended to reach a wider audience at low cost. For example, HMRC estimates that digital prompts raised around £1 billion of revenue in cash terms between 2016-17 and 2021-22, and that in 2021-22 improvements to systems and processes protected £1.4 billion of revenue. Compliance activity also varies depending on the type of taxpayer. For example, HMRC provides a dedicated customer relationship manager for large organisations.

1.5 For several years before the pandemic, HMRC's strategy increasingly focused on upstream compliance, which it considers more cost-effective and better for customers because it aims to help taxpayers get their tax right first time. In 2021 around two-thirds of its action plans tackling the main risks to tax revenue involved an upstream preventative measure. However, HMRC also recognises that downstream activity remains necessary to respond effectively to non-compliance, including more severe forms such as tax evasion and other criminal activity, and to maintain a strong deterrent effect to encourage other taxpayers to take compliance seriously.

Impact of the pandemic and HMRC's early response

1.6 A wide range of factors influence levels of tax compliance, some of which were affected by the pandemic. For example, the state of the economy putting pressure on the finances of individuals and businesses, the government changing tax rules and processes at short notice, and taxpayers' perceptions of the fairness of the tax system can all affect how many voluntarily pay the correct tax.

1.7 The pandemic also changed the priorities and make-up of HMRC's work. HMRC was one of several departments providing government support during the pandemic. At short notice, it had to implement new COVID support schemes and provide additional support to taxpayers, including more time to pay tax. This happened alongside major fiscal events and changes to HMRC's own operations and casework in response to the pandemic, such as home-working (**Figure 3** on pages 18 and 19). The need to prioritise direct responses to the pandemic meant redeploying staff from across the department, and reduced HMRC's overall capacity for tax compliance work. Lockdowns and social distancing restricted its ability to conduct investigations in person.

Figure 3

Timeline of key changes and decisions affecting HM Revenue & Customs' (HMRC's) compliance work during the COVID-19 pandemic, 2020 to 2021

HMRC took early action to respond to the pandemic, including pausing some downstream casework and redeploying staff to new support schemes

First Lockdown

Restrictions eased

Second Lockdown

2020

Spring Budget 2020 (March)

March
CJRS; SEISS 1 & 2 announced

March
HMRC staff start to work remotely where possible

March
Guidance issued to caseworkers – face-to-face visits paused

March
Casework partially paused in struggling sectors[4]

March
Small businesses and individuals given option to put enquiries "on hold"

April
Part of compliance staff redeployed to customer support for COVID-19 schemes

May
Updated visiting guidance for caseworkers produced – face-to-face visits re-commenced where authorised

July
VAT and stamp duty reliefs; Eat out to Help out announced

July
Most of redeployed staff moved back to compliance and assurance[5]

September
SEISS 3 & 4 announced

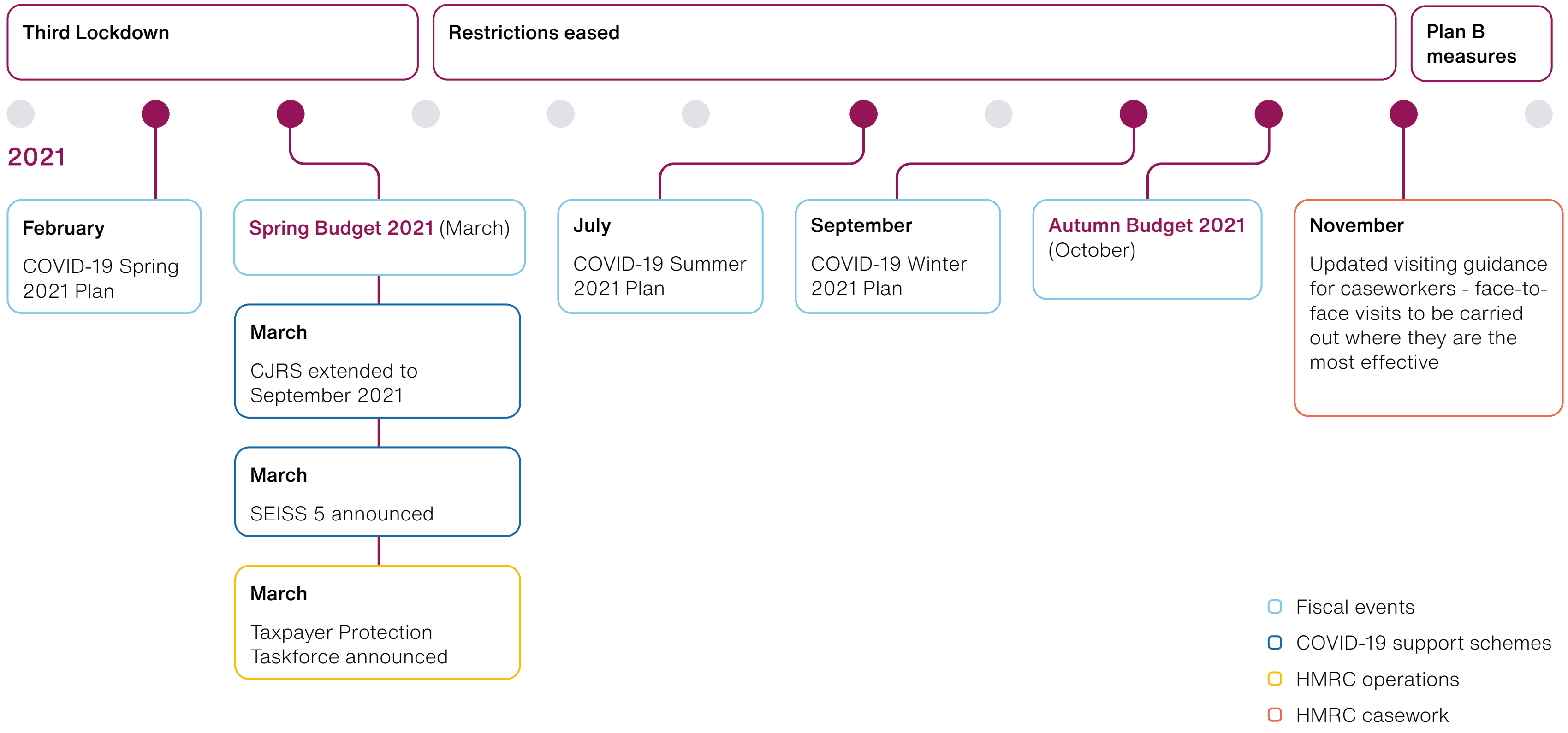
Spending Review 2020 (November)

December
CJRS extended to April 2021

- Fiscal events
- COVID-19 support schemes
- HMRC operations
- HMRC casework

Figure 3 *continued*

Timeline of key changes and decisions affecting HM Revenue & Customs' (HMRC's) compliance work during the COVID-19 pandemic, 2020 to 2021



Notes

1 The first, second and third lockdowns refer to the periods of time under government restrictions brought in to limit the spread of the COVID-19 pandemic. Plan B measures included the introduction of mandatory face coverings and asking people to work from home where possible. The periods where restrictions were eased still included some restrictions and areas of uncertainty for taxpayers and HMRC.

2 CJRS refers to the Coronavirus Job Retention Scheme, which was introduced in March 2020.

3 SEISS refers to the Self-Employment Income Support Scheme, which was introduced in March 2020.

4 The guidance that HMRC issued to caseworkers in March 2020 asked them to not open cases in sectors struggling due to the pandemic unless fraud or criminal activity was suspected. These sectors were leisure, tourism, hospitality, and work involving doctors, nurses, care homes or other frontline workers.

5 Following the peak in staff redeployment in May 2020, the majority of these staff – but not all – were moved back to other parts of the business.

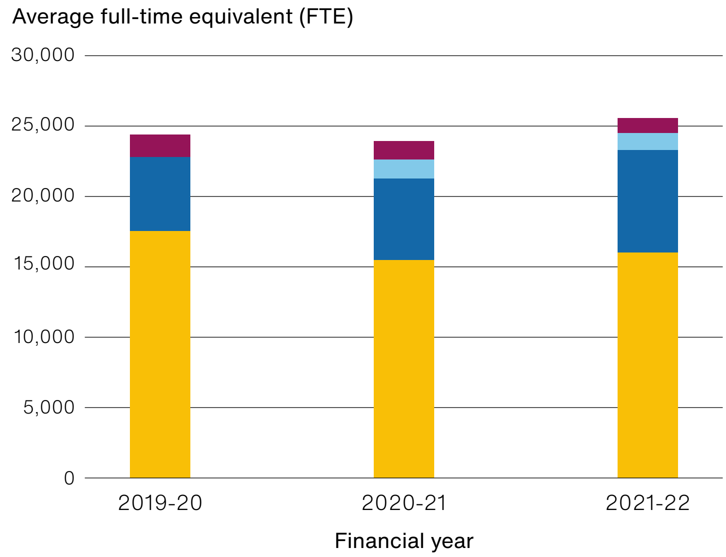
Source: National Audit Office review of HM Revenue & Customs documentation

1.8 Early in the pandemic, HMRC redeployed compliance staff to the COVID-19 response, reducing capacity for other compliance work. HMRC's Customer Compliance Group (CCG) put in place a dedicated steering group to monitor the response to COVID-19 and adapt its work accordingly. Throughout 2020-21, HMRC had redeployed an average of 1,356 full-time equivalent (FTE) CCG staff to support its new COVID support schemes. In May 2020, a peak of 4,396 CCG staff were working on the schemes, before reducing over time. A large part of the CCG's staff (averaging 7,101 during 2020-21) were ringfenced and required to work on existing statutory priorities, including EU Exit and specific compliance activities announced by the government at fiscal events. This effectively reduced compliance staff available for non-ringfenced compliance activity by 12% to 15,581 FTE (**Figure 4**).

Figure 4

Staffing levels in HM Revenue & Customs' (HMRC's) Customer Compliance Group (CCG) 2019-20 to 2021-22

The need to prioritise responding to the pandemic left fewer staff available for other compliance work



	2019-20	2020-21	2021-22
EU Exit	1,585	1,317	1,053
COVID-19 response	–	1,356	1,237
Fiscal events	5,256	5,784	7,279
Non-ringfenced	17,623	15,581	16,089

Notes

1 A Full-Time Equivalent (FTE) is a unit of measurement equivalent to one member of staff. The chart presents the average number of FTEs deployed in each financial year.

2 Non-ringfenced staff are staff which can be deployed by the CCG for other compliance work.

3 Within the annual averages were fluctuations at the early stages of the pandemic. The redeployment of staff peaked in May 2020 when 4,396 FTEs were redeployed to COVID-19 support.

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

1.9 HMRC is actively recruiting and training new staff to replace compliance resources allocated elsewhere and is forecasting an overall increase of 10% in 2022-23. Even so, a larger proportion of compliance staff will have limited experience in the short term. We examine HMRC's staff planning in more detail in Part Three.

Managing with reduced capacity for tax compliance work

1.10 During the pandemic, HMRC opened and closed substantially fewer downstream compliance cases. In 2020-21, HMRC closed 103,000 (29%) fewer compliance cases compared with the previous year and opened 114,000 (32%) fewer. During the same period, the number of criminal investigations it closed fell by 408 (47%). This partly reflected HMRC's strategy to focus increasingly on upstream efforts to ensure taxpayers comply in the first place, and to prioritise larger and higher-impact cases. It was already reducing downstream case numbers before 2020. However, the reduction was more significant during the pandemic. It also reflected: the need for HMRC to manage with fewer staff; its recognition of the pressures on taxpayers (HMRC offered them the option to pause enquiries, except in cases where it suspected fraud or criminal activity); and external factors such as court closures and requirements on social distancing or personal protective equipment (PPE). Tax professionals and representative bodies told us HMRC appeared overly stretched, and that it had opened far fewer criminal fraud investigations during the pandemic than they would have expected.

1.11 HMRC initially reduced face-to-face visits in response to lockdowns and social distancing requirements but has not returned in-person investigation work to pre-pandemic levels. For example, in-person visits for the Individuals and Small Businesses Compliance directorate remained 36% lower in 2021-22 compared with June 2019-20. HMRC considers this in line with its pre-pandemic ambition to target investigations more cost-effectively on higher-risk cases and use desk-based interventions where these are most appropriate. However, HMRC could not provide us with the number it had expected to undertake without the pandemic. HMRC has not yet assessed how this change has affected detection of non-compliance or the behavioural effect on attitudes to paying tax among those it has investigated.

1.12 HMRC eased several requirements on taxpayers and made changes to its administrative processes during the pandemic, including measures to make processes more efficient. It introduced several easements such as deferred filing requirements and offering more scope for taxpayers to file returns or make applications digitally. It also made changes to streamline and digitise its compliance processes, such as automating some renewals of credit claims. HMRC told us the measures involved a governance process to ensure they had a clear policy purpose, appropriate duration and provided suitable support for taxpayers, but it has not assessed their impact in practice. HMRC has since made permanent around one in five of these administrative easements.

1.13 Sector representatives we interviewed welcomed HMRC's efforts to be customer-led in its enquiries and streamline processes to make it easier to comply. However, they cautioned that there were still challenges for individuals and smaller businesses that needed to use HMRC's standard helpline, where resourcing pressures were felt more acutely. HMRC acknowledged that individuals and small businesses would be hardest hit by staffing changes. The average time customers spent on hold to the helpline doubled from six minutes in 2019-20 to 12 minutes during the pandemic.

Responding to risks during the pandemic

1.14 Alongside its response to the pandemic, HMRC needed to continue monitoring and addressing new and emerging risks. The operational and economic impacts of the pandemic took place in a tax system which is a continual target for fraud and criminal attacks. HMRC therefore needed to maintain a base level of resource to monitor risks of such attacks to address any criminal activity it identified.

1.15 For example, shortly after lockdown in March 2020 HMRC was subject to a new type of attack on its income tax self-assessment repayment system involving fraudulent claims. This saw the total value of claims rise by around £1.5 billion, to £9.4 billion in 2020-21 (£7.9 billion in 2019-20). HMRC suspended around £1.1 billion of these payments before they were made, but between £52 million and £219 million was extracted by fraudsters. HMRC strengthened its systems and controls, and claims returned to expected levels by July 2021.

Impact of the pandemic on tax revenues and overall compliance

1.16 A wide range of factors affect tax revenue, including the economy, tax rates and reliefs, and HMRC's compliance activity. **Figure 5** overleaf shows how revenues have changed in cash terms since 2011-12, including during the pandemic.

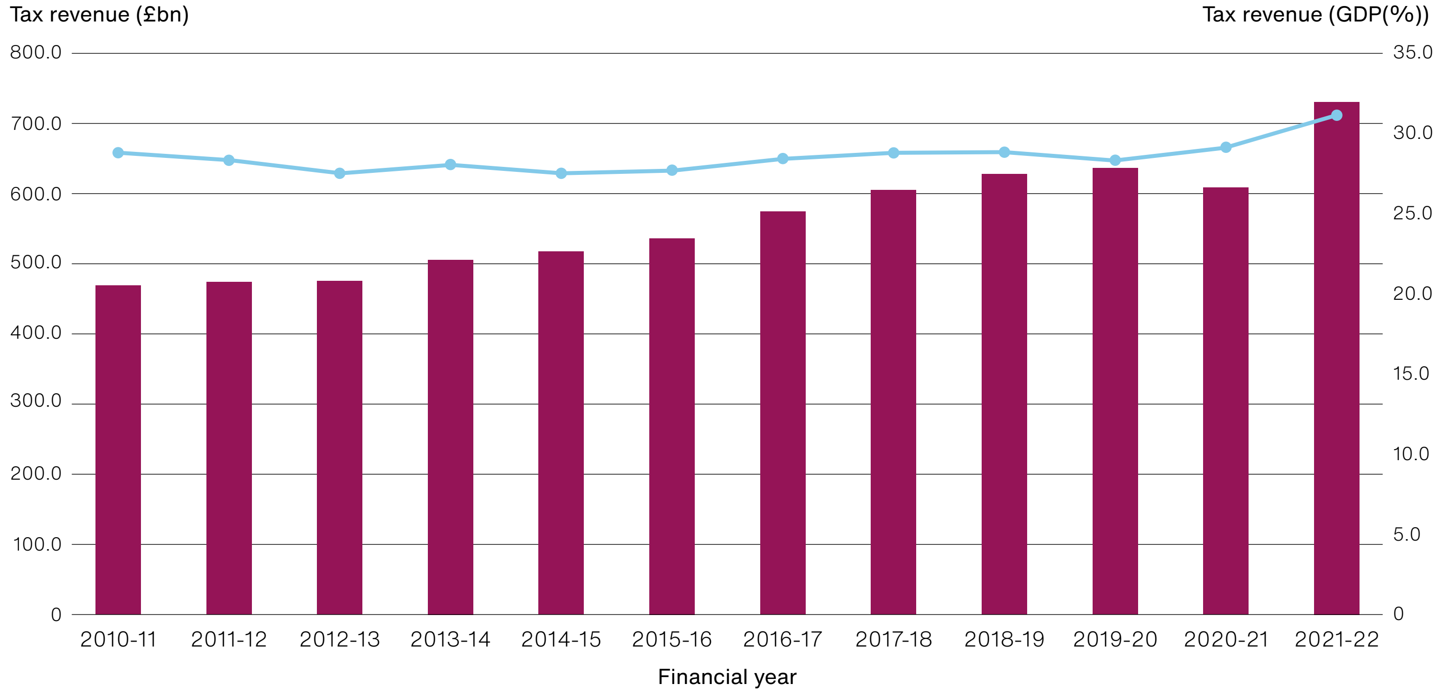
- With economic activity significantly reduced in the first year of the pandemic, total tax revenues fell by £27.9 billion in cash terms from £636.7 billion in 2019-20 to £608.8 billion in 2020-21. However, since GDP decreased more than tax revenues, this meant that tax revenue as a proportion of GDP increased during the period.
- With the economy largely reopening in 2021-22, total revenues rose by £122.3 billion (20%) to a record level of £731.1 billion. This growth was higher than commentators had anticipated. Commentators generally considered it to be driven by economic factors, in particular wage growth and inflation, but these factors do not explain the entire increase.

1.17 It is not yet known whether the increase in revenues means tax compliance improved. HMRC's latest estimate of the tax gap – which is the difference between taxes theoretically owed and those actually paid – suggests that the tax gap was stable in 2020-21 at around 5% of total taxes theoretically owed, equivalent to £32 billion. Tax gap data are not yet available for 2021-22. HMRC told us it would have a better picture of levels of compliance in the pandemic over the next few years, as more tax returns are filed.

Figure 5

Tax revenue from 2010-11 to 2021-22

Tax revenue decreased during the COVID-19 pandemic, but in 2021-22 it recovered and reached record levels in cash terms



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Tax revenue (£bn)	469.7	474.2	475.6	505.8	517.7	536.8	574.9	605.8	627.9	636.7	608.8	731.1
Tax revenue (GDP (%))	28.8	28.4	27.5	28.1	27.5	27.7	28.4	28.8	28.8	28.3	29.1	31.1

Notes

1 Values are in cash terms and have not been adjusted for inflation, to align with conventional reporting of tax revenues. To illustrate how revenue has changed over time in relation to the size of the economy, we have also included it as a proportion of GDP.

2 The chart shows the total tax revenue collected by the Exchequer for a specific tax year. This will include an element of receipts that are not due until some time after the tax liability has been generated.

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

Part Two

Understanding compliance performance

2.1 This Part examines:

- how HM Revenue & Customs (HMRC) estimates compliance yield, its most direct measure of compliance performance;
- what compliance yield and other measures indicate about HMRC's performance at managing compliance in recent years, including during the COVID-19 pandemic; and
- how HMRC considers wider measures of its performance, including criminal convictions and prosecutions.

Compliance yield

2.2 Compliance yield is HMRC's most direct measure of its compliance performance. HMRC defines it as the revenue collected and protected that would have otherwise been lost to the Exchequer if not for its interventions. In the 2021 Spending Review, HMRC was allocated an additional £292 million to ensure that taxpayers pay what they owe. This includes £124 million between 2022-23 and 2024-25 to increase HMRC's compliance and debt management capacity, announced in the 2022 Spring Statement as part of a longer-term £161 million commitment. The government expected these investments to yield an additional £3 billion between 2021-22 and 2026-27.

2.3 Compliance yield comprises thousands of individual records. There are five main types of compliance yield, which cover: the direct proceeds of HMRC's casework on specific taxpayers after it identifies past non-compliance; the effect such cases have on ensuring those taxpayers comply in future; and the impact of its upstream work to help taxpayers get their tax affairs right first time (**Figure 6** on pages 26 and 27). HMRC treats instances where taxpayers comply voluntarily as compliance yield, if this represents a behavioural change it can attribute to its interventions.

Figure 6

Compliance yield components and the activities and behaviours they relate to, 2021-22

Compliance yield consists of different types of HM Revenue & Customs (HMRC) activity and taxpayer behaviours

Component	Type of HMRC activity	Type of taxpayer behaviour	Explanation	Number of yield records	Yield in 2021-22
Cash expected	Downstream	Non-compliant	Non-compliant behaviour caught after the fact, and additional taxes and penalties collected. **For example**, HMRC identifies errors in self-assessments through its casework, and the taxpayers agree to pay the tax and penalty due.	**Downstream:** Hundreds of thousands of individual yield records, ranging from many small cases to a small number of very large ones[1]	£5.98bn (19.4% of total)
Revenue loss prevented	Downstream	Non-compliant	Non-compliant behaviour identified and corrected before cash is paid out (such as rebates). **For example**, an attack on online repayment systems is identified and fraudulent claims are stopped before they are processed.		£10.35bn (33.6% of total)
Future revenue benefit	Downstream	Compliant	Taxpayers previously found to be non-compliant (typically where 'cash expected' or 'revenue loss prevented' have been recognised) are now compliant as a result. **For example**, following an error identified in a tax return, the taxpayer agrees and takes action to correct the error for future returns. HMRC estimates the impact on the future returns.		£5.16bn (16.8% of total)
Upstream operational yield	Upstream	Compliant	Increase in compliant behaviour because of HMRC work to help taxpayers comply first time. **For example**, HMRC helps taxpayers avoid common errors by providing new guidance or digital nudges and prompts, leading to additional revenues.	126 in 2021-22[2]	£3.89bn (12.6% of total)
Upstream product and process yield	Upstream	Compliant	Increase in compliant behaviour due to policy or legislative changes, or to improved processes and systems. This type of yield is mostly (96%) generated outside HMRC's Customer Compliance Group. **For example**, a legal change may close a loophole which was previously exploited for tax avoidance, leading to additional revenue.	27 in 2021-22[2]	£5.42bn (17.6% of total)

Figure 6 *continued*

Compliance yield components and the activities and behaviours they relate to, 2021-22

Notes

1 Downstream compliance activity refers to work to identify and tackle non-compliance after it has happened. A case may contain multiple records that can apply to several years' tax returns and may record yield against two or all three downstream components – for example, immediate amounts recovered recorded as cash expected with the future impact recognised as future revenue benefit. Compliance yield is reported at the point the liability is established, whereas the case will not close until all records are finalised. The total number of cases will therefore be difficult to reconcile to the compliance yield reported in a given year, but HMRC's casework system shows hundreds of thousands of individual records.

2 Upstream compliance activity refers to work which encourages voluntary compliance and prevents non-compliance before it happens. Records include the impact of legislative changes or campaigns that can affect thousands of taxpayers. Each yield record covers an intervention as applied to an individual compliance directorate. Interventions covering multiple directorates will therefore have a record for each directorate.

Source: National Audit Office review of HM Revenue & Customs data and documentation

2.4 Different directorates within HMRC generate compliance yield. HMRC's Customer Compliance Group (CCG) – which contains the operational directorates that deal directly with non-compliance – contributes the majority (76% in 2021-22). The rest is primarily upstream product and process activity, including policy changes and legislation, customer service and Border Force activity, and Making Tax Digital.[1]

2.5 The various directorates within CCG target different customer groups and behaviours. Yield varies across these directorates, reflecting differences in the size and nature of their customer groups and targeted behaviour. Some directorates, such as Large Business, typically involve a smaller number of high-value cases, which can change from year to year depending on when they conclude. HMRC estimates that 27% of total yield in 2020-2021 and 2021-22 came from large cases (cases worth more than £10 million), down from 38% in 2019-20, which included an exceptionally large single settlement of £4.2 billion.

Impact of the pandemic on compliance yield

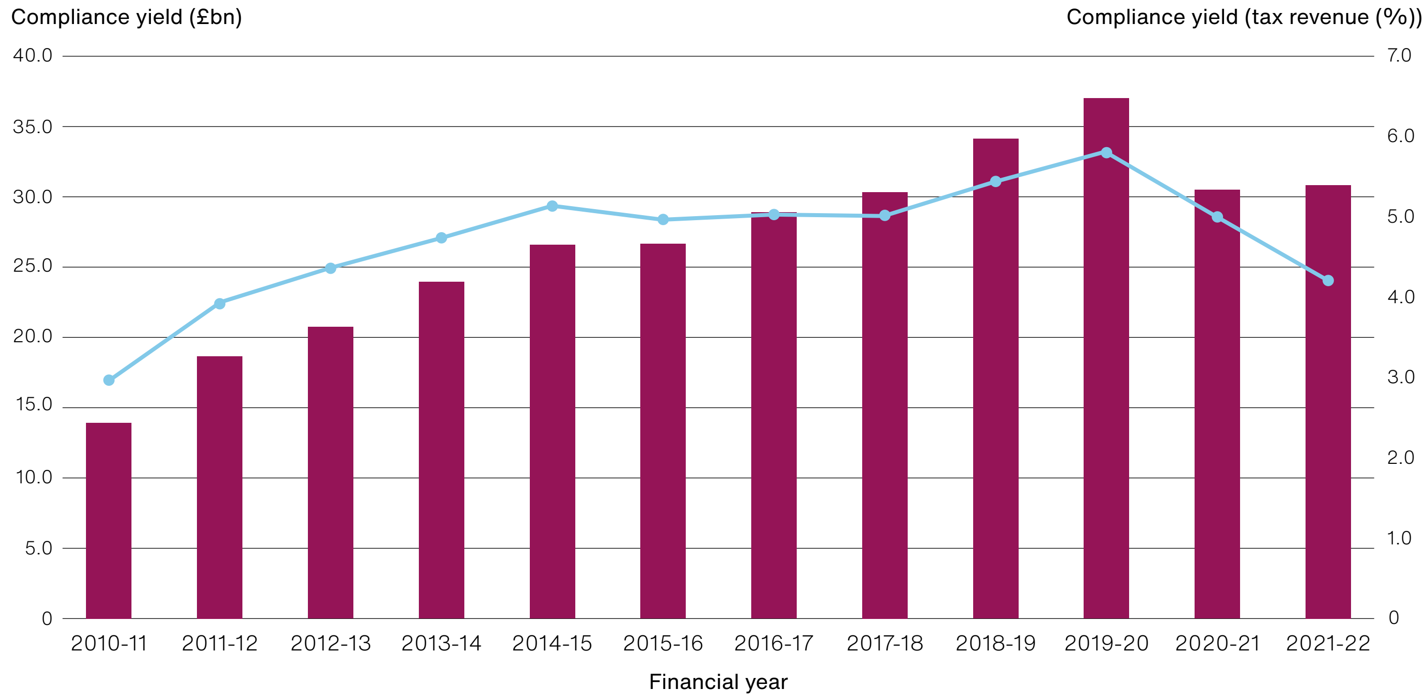
2.6 HMRC's compliance work has raised around £9 billion less since the pandemic began, compared with its previous performance. In the five years before the pandemic, HMRC estimated that its compliance yield was on average 5.2% of total revenues. In the first year of the pandemic tax revenues and compliance yield both fell. Compliance yield was £30.4 billion in 2020-21, 9% less than HMRC initially expected for the year and an 18% drop in cash terms from the previous year (**Figure 7** overleaf).[2] As a proportion of total revenues, compliance yield fell from the previous average of 5.2% to 5.0% in 2020-21, equivalent to a £1.5 billion reduction.

1 Making Tax Digital is HMRC's programme to digitise the tax system so it is more efficient and effective and to make it easier for taxpayers to get their tax right.

2 Excluding an exceptional settlement of £4.2 billion in 2019-20, the cash terms reduction in total compliance yield would be 7%.

Figure 7
Compliance yield compared with total tax revenue between 2010-11 and 2021-22

Compliance yield has fallen as a proportion of total tax revenue since the start of the COVID-19 pandemic



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Compliance yield (£bn)	13.9	18.6	20.7	23.9	26.6	26.6	28.9	30.3	34.1	36.9	30.5	30.8
Compliance yield (tax revenue (%))	3.0	3.9	4.4	4.7	5.1	5.0	5.0	5.0	5.4	5.8	5.0	4.2

Notes

1 Values are in cash terms and have not been adjusted for inflation, to align with conventional reporting of tax revenues. To illustrate how compliance yield performance has changed over time, we have also included it as a proportion of overall tax revenue on a secondary axis.

2 The figures include two unusual and exceptionally large settlements in 2018-19 and 2019-20 accounting for £1.6 billion and £4.2 billion of yield respectively.

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

2.7 In 2021-22, total tax revenues recovered to record levels but, at £30.8 billion, compliance yield remained similar in cash terms to 2020-21. As a proportion of total revenues, compliance yield fell to 4.2% in 2021-22 (the lowest level since 2011-12), equating to a £7.5 billion difference from the historical average. With revenues reaching record levels, the reduction in compliance yield is likely to be at least partly driven by reduced compliance work, although the impact of wider economic factors on yield is not yet clear.

2.8 The components of compliance yield have followed different trends during the pandemic (**Figure 8** on pages 30 and 31):

- Upstream yield increased by £1.1 billion (13%) in cash terms between 2019-20 and 2021-22, increasing as a share of total yield from 22% in 2019-20 to 30% in 2021-22. The increase was mainly due to 'product and process yield' improvements, which are policy, legislation or system design changes to improve compliance, for example by closing loopholes. Upstream product and process yield can be recorded for up to five years after the action it relates to, meaning it may largely reflect the results of interventions before the pandemic. Upstream 'operational yield' fell by £1.0 billion in 2020-21 before partially recovering in 2021-22.

- Downstream compliance yield fell by £7.1 billion (25%) in cash terms between 2019-20 and 2021-22.[3] Downstream yield most directly reflects the impact of HMRC's recent investigation and enforcement casework, including on the more severe forms of fraud and criminal attacks. 'Revenue losses prevented', which measures losses avoided by, for example, stopping fraudulent repayment claims before they are paid, returned to nearly the same level in 2021-22 as before the pandemic. However, the two other components – cash expected and future revenue benefits from compliance interventions – fell in successive years. These will take longer to recover because they depend on casework. Some cases, particularly larger and more complex investigations, can take many years to complete.

These differences between components of compliance yield – including respective degrees of uncertainty in the estimates – are not visible in the overall yield figure.

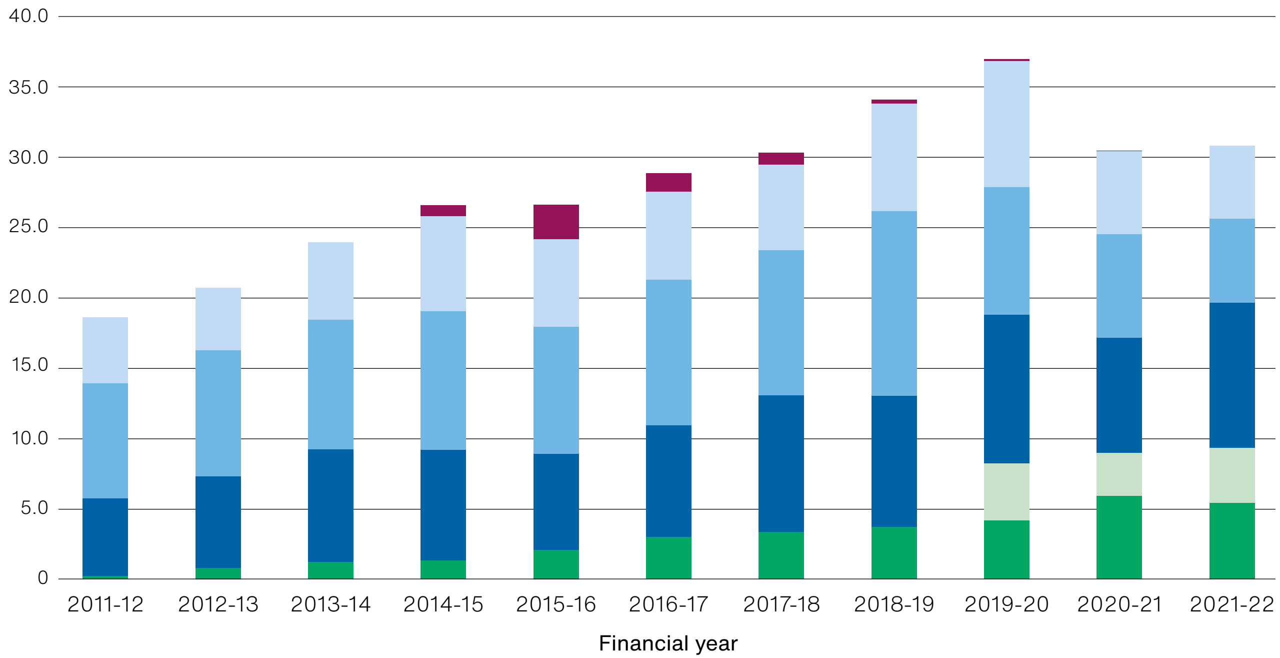
2.9 The full impact of the pandemic on compliance yield will not become clear for several years. This is because of the lag between HMRC conducting its compliance casework or upstream activities and the period over which it can recognise the yield from it. For example, an investigation may take several years of work before it concludes and a settlement is reached, after which the future compliant behaviour of that taxpayer may be recognised as yield for another five years. Reduced casework during the pandemic is likely to continue to affect downstream compliance yield for several more years. HMRC estimates that the amount of future revenue benefit it will carry forward to future years based on its casework in 2020-21 was less than half of the level in 2019-20.

3 Excluding an exceptional settlement of £4.2 billion in 2019-20, the cash terms reduction in downstream compliance yield would be 12%.

Figure 8

Compliance yield by component, 2011-12 to 2021-22

Yield from the downstream elements of HM Revenue & Customs' (HMRC's) compliance work reduced during the COVID-19 pandemic



	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Accelerated payments	–	–	–	0.8	2.4	1.3	0.8	0.3	0.1	0.0	–
Future revenue benefit	4.7	4.4	5.5	6.7	6.2	6.3	6.1	7.6	9.0	5.9	5.2
Cash expected	8.2	9.0	9.2	9.8	9.0	10.3	10.3	13.1	9.0	7.4	6.0
Revenue loss prevented	5.5	6.5	8.0	7.9	6.8	7.9	9.7	9.3	10.6	8.2	10.3
Upstream operational yield	–	–	–	–	–	–	–	–	4.1	3.1	3.9
Upstream product and process yield	0.2	0.8	1.2	1.3	2.1	3.0	3.4	3.7	4.2	5.9	5.4

Figure 8 *continued*

Compliance yield by component, 2011-12 to 2021-22

Notes

1 Values are in cash terms and have not been adjusted for inflation, to align with conventional reporting of tax revenues. Other figures in this report show how the compliance yield compares against total tax revenue for a better comparison of levels over time.

2 Up to and including 2018-19, HMRC did not recognise upstream operational yield (which comes from operational measures to prompt and support taxpayers to get their tax affairs right first time) as a separate category, instead recording it within cash expected. The individual trends up to and after this year therefore cannot be directly compared.

3 Between 2014-15 and 2020-21, HMRC recognised a separate yield component called 'accelerated payments'. From 2021-22, HMRC includes these within cash expected and upstream product and process yield. These are disputed amounts that people using tax avoidance schemes are required to pay upfront, and an estimate of the behavioural change caused by this policy.

4 The figures include two unusual and exceptionally large settlements in 2018-19 and 2019-20 accounting for £1.6 billion and £4.2 billion of yield respectively, which was spread across Revenue Loss Prevented and Future Revenue Benefit.

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

Robustness of HMRC's compliance yield estimates

Governance and data

2.10 Since 2015, HMRC has been funded to maintain existing levels of compliance performance. Because compliance yield is calculated by adding together thousands of individual records from teams across HMRC, it is important that records are valid and calculated accurately for the overall estimate to be robust. HMRC sets expectations on how different types of yield should be calculated and has governance and assurance processes in place intended to check claims are accurate.

2.11 In recent years, HMRC has taken steps to improve its quality assurance arrangements for compliance yield. For example:

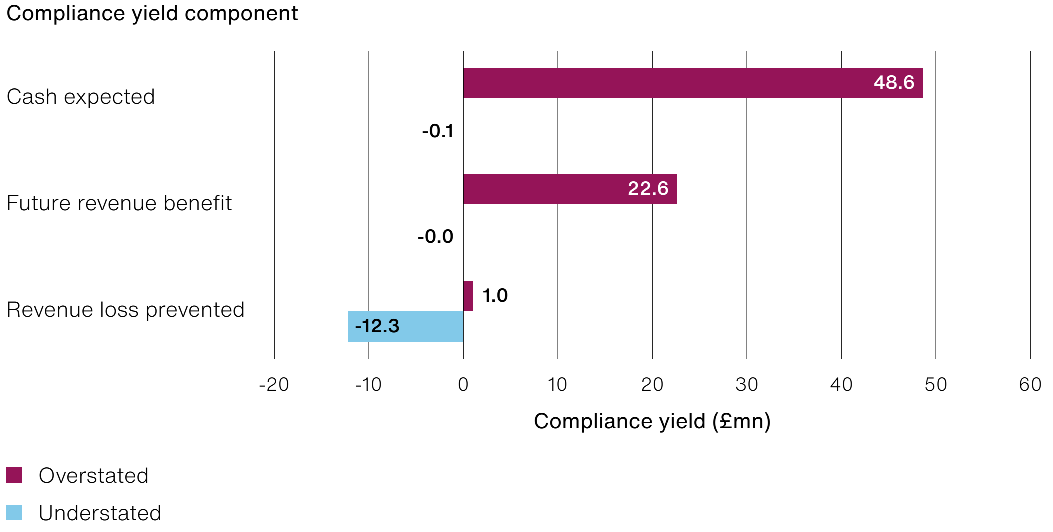
- Since the CCG was established in 2016, it has had a dedicated assurance team to support the quality of its compliance work and yield claims. It does this by identifying issues and sharing good practice across the organisation.
- The CCG's assurance team has managed the Tax Settlement Assurance Programme (TSAP) since 2016. This is a large-scale programme of internal testing, and HMRC updated its approach in 2021 to ensure it was effective at identifying errors or other issues. The programme tests 400 yield records for randomly selected taxpayers and shares findings with the CCG leadership team as well as internal audit. HMRC also reports common errors to its directorates to reduce these in future. We examined 11 records reviewed as part of TSAP and found that the review was successful in identifying quality issues in these cases.
- HMRC has updated its governance processes for challenging and assuring how its upstream yield claims are estimated. These processes focus on the key assumptions and overall methodology for each claim. HMRC has also made changes to how it records and reports compliance yield in response to our past recommendations and to align with good practice set out by the Organisation for Economic Co-operation and Development (OECD).

2.12 In 2021-22, HMRC's TSAP testing found errors in the yield recorded for 80 out of 400 taxpayer cases selected for review. Errors were generally skewed towards overstating the amount of tax that would be recovered. These resulted in a net overstatement of £59.7 million (8%) across records totalling £736 million of yield (**Figure 9**). Errors can arise for a variety of reasons including data input errors, incorrect calculations, or incorrect decisions on what should or should not be included. HMRC's testing also found seven cases where it had overcharged taxpayers, by a total of £32.2 million.[4] HMRC subsequently took corrective action to ensure the tax position was remedied.

Figure 9

Value of errors found by HM Revenue & Customs' (HMRC's) Tax Settlement Assurance Programme, 2021-22

HMRC's testing found errors amounting to a net overstated yield of £59.7 million



Notes

1 This represents the overstated and understated value of compliance yield arising from errors identified in the 2021-22 testing of 400 randomly sampled taxpayers. Some cases may have had multiple errors.

2 The sampling covers taxpayers on HMRC's system. Each taxpayer may have a number of yield claims attached, for example covering different taxes. The sample is based on these yield claims, but where a single taxpayer has been sampled more than once it will be replaced by another. So the final sample will include 400 distinct taxpayers, but will not cover all aspects of the cases attached to these taxpayers. This is to ensure that the sample also covers a greater variety of tax regimes.

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

4 Taxpayer groups affected by overpayments were individuals, wealthy individuals, and small- and medium-sized businesses.

2.13 HMRC does not use its findings to adjust the overall compliance yield estimate. It corrects individual errors it identifies in its testing programme, including compensating the small number of taxpayers it found had been overcharged. In exceptional cases where multiple errors are found across a project area, it may initiate a wider review. HMRC told us its sampling approach is designed to provide coverage of its different directorates and identify common errors so that they can be reduced in future, and that the approach does not allow it to extrapolate errors identified to understand how much its compliance yield is overstated or how much it has overcharged taxpayers. Using the approach we take in our financial audits of government accounts, we found a wide range of potential error which limited the precision with which an overall error could be estimated. This is because, in 2021-22, HMRC tested only small numbers of cases in some areas where it found high levels of error. Other than large businesses, for which HMRC typically finds few errors, this included the following:

- Claims of between £10 million and £100 million: HMRC tested eight out of 52 yield records. Three of these records had large errors, in total overstating yield by £65 million (36% of the total value of tested cases). HMRC did not conduct further testing to explore whether similar errors were more widespread.
- Cases with zero or negative yield: HMRC tested 19 out of more than 100,000 yield records. Two such records of zero yield should in fact have recognised yield totalling £39,900 (an understatement of 18% of the total value of tested cases).

2.14 The fact that HMRC does not extrapolate its errors has implications for taxpayers and its own performance measurement and planning. A better understanding of the likely extent of errors in the full population of yield records would help HMRC determine whether it has sufficient resources to stop the tax gap from increasing. It could help HMRC allocate resources more effectively, for example if certain areas or taxpayer groups were particularly overstated or understated. It would also allow HMRC to understand the extent to which taxpayers have been overcharged, or undercharged, due to official error, and whether further sampling or targeted testing is needed to identify and correct overpayments.

2.15 HMRC's TSAP testing and internal audit testing cover downstream casework only, and do not apply to HMRC's upstream compliance estimates, which are an increasingly important part of HMRC's activity and carry inherent uncertainty. Upstream yield estimates that HMRC assesses as higher-risk are subject to a quality assurance review by challenge boards, but only at a high level to ensure the approach taken and methods used are reasonable and applied correctly. There is no independent testing of the underlying evidence or data.

Assumptions

2.16 Many of HMRC's yield claims estimates rely on assumptions (for example, about taxpayers' future behaviour) and are therefore subject to varying degrees of uncertainty. For example, around one-third of the value of upstream operational estimates in 2021-22 was based on assumptions from desk research, rather than analysis of an observable impact. Its estimates carry a high level of uncertainty and increased risk of bias, which could overstate or understate the figures. HMRC does not provide an indication of this uncertainty in its reporting of compliance yield. By comparison, its tax gap publications now include an uncertainty rating alongside each estimate. This is also in line with recommendations made in our previous report on financial modelling in government, and with the government's Aqua Book guidance on producing high-quality analysis.

2.17 While we did not seek to test the assumptions used in individual estimates, we examined two overarching assumptions that HMRC applies to one or more components of compliance yield. For each, we considered the basis for the assumption and whether HMRC applies it in a reasonable and consistent way.

- **Non-payment:** HMRC cannot secure all compliance yield because some taxpayers are unable to pay their liabilities, for example due to debt or insolvency. Caseworkers assess likelihood of payment when calculating the expected yield, and HMRC also applies a standard 10% impairment to the 'cash expected' component of compliance yield for most individuals and small and medium businesses.[5] In 2020-21, it also made a one-off 9% impairment to the 'future revenue benefit' component brought forward from previous years, to recognise the severe impact of the pandemic on tax receipts. However:
  - HMRC has not provided a justification for only impairing parts of the cash expected component and not future revenue benefit, except for the one-off 2020-21 adjustment. It is also not clear how its estimates for upstream yield reflect the effect of non-payment; and
  - HMRC has not updated its assumptions about non-payment, despite evidence that levels of tax debt more than doubled in real terms and non-payment rates increased during the pandemic. HMRC told us its assumption was based on the best available evidence in 2010, but it was unable to explain which tax years this research covered and how impairments have changed since then. For example, our analysis of HMRC's accounts found that its provision over the two years of the pandemic for debts it expects will never be repaid was around one-third higher than historical levels. HMRC also assumed in 2021-22 that non-payment rates for self-assessed income tax in Scotland and Wales would be 13%–15%.

5 Which therefore reduces the estimate by 10%.

- **Inflation and growth:** Upstream yield and future revenue benefit can be recognised for up to five years after the intervention if there is supporting evidence. When HMRC recognises the impacts of upstream work in those future years, it updates its assessment including considering the effect of inflation and economic growth on the overall tax base. HMRC told us it bases its assumptions on the Office for Budget Responsibility's fiscal forecasts and updates these annually. However, it does not update its future revenue benefit figures in the same way, meaning claims brought forward from previous years will not reflect any changes in inflation.

Compliance yield and the tax gap

2.18 The tax gap is HMRC's estimate of the difference between total taxes theoretically owed and those actually paid, and therefore indicates the overall level of non-compliance. HMRC's latest estimate suggests that the tax gap stayed stable in 2020-21 at 5.1% of total taxes theoretically owed. Tax gap data are not yet available for 2021-22.

2.19 The revenue from HMRC's compliance activity offsets some of the revenue that would otherwise be lost if only voluntary tax revenues were collected. Compliance yield therefore, in theory, either reduces the tax gap or stops it from increasing. During the past few years, the tax gap and compliance yield have moved in opposite directions, consistent with this principle. However, HMRC's latest estimates suggest that the large drop in compliance yield in 2020-21 (0.8% of total tax revenue) did not adversely affect the tax gap (**Figure 10** on page 37). The tax gap estimates for 2020-21 are subject to increased uncertainty due to the pandemic and may be subject to change as HMRC revises its estimates in the coming years.

2.20 In practice, HMRC's estimates of compliance yield and the tax gap are difficult to compare directly in a single year. This is because the figures are calculated in different ways and relate to different time periods:

- **Timing:** HMRC estimates the tax gap based on the year that taxpayers undertook the economic activity that is subject to taxation. For example, corporation tax is based on the year that companies generate their profits. Compliance yield is instead based on when a tax liability is created, which may be a year or more later depending on the type of tax and the duration of downstream compliance investigations.

- **Methodology:** Compliance yield is a 'bottom-up' measure made up of individual estimates of the impact of specific interventions. By contrast, parts of the tax gap are calculated 'top-down' using economic data to estimate what the theoretical tax liability should be – for example, VAT is estimated using official statistics on consumption of goods and services. Top-down estimates will therefore reflect wider changes in voluntary compliance that will not be captured in the compliance yield estimate. Our 2020 report on tackling the tax gap provides more detail on how the measure is calculated.[6]

- **Coverage:** Compliance yield is designed to measure the positive returns from HMRC's work, and so does not reflect negative impacts that would affect the tax gap. For example, it would not reflect losses resulting from weaknesses in tax systems, or cases where policy changes had an adverse effect on compliance. Compliance yield also includes any penalties levied and interest accrued, which would not affect the tax gap.

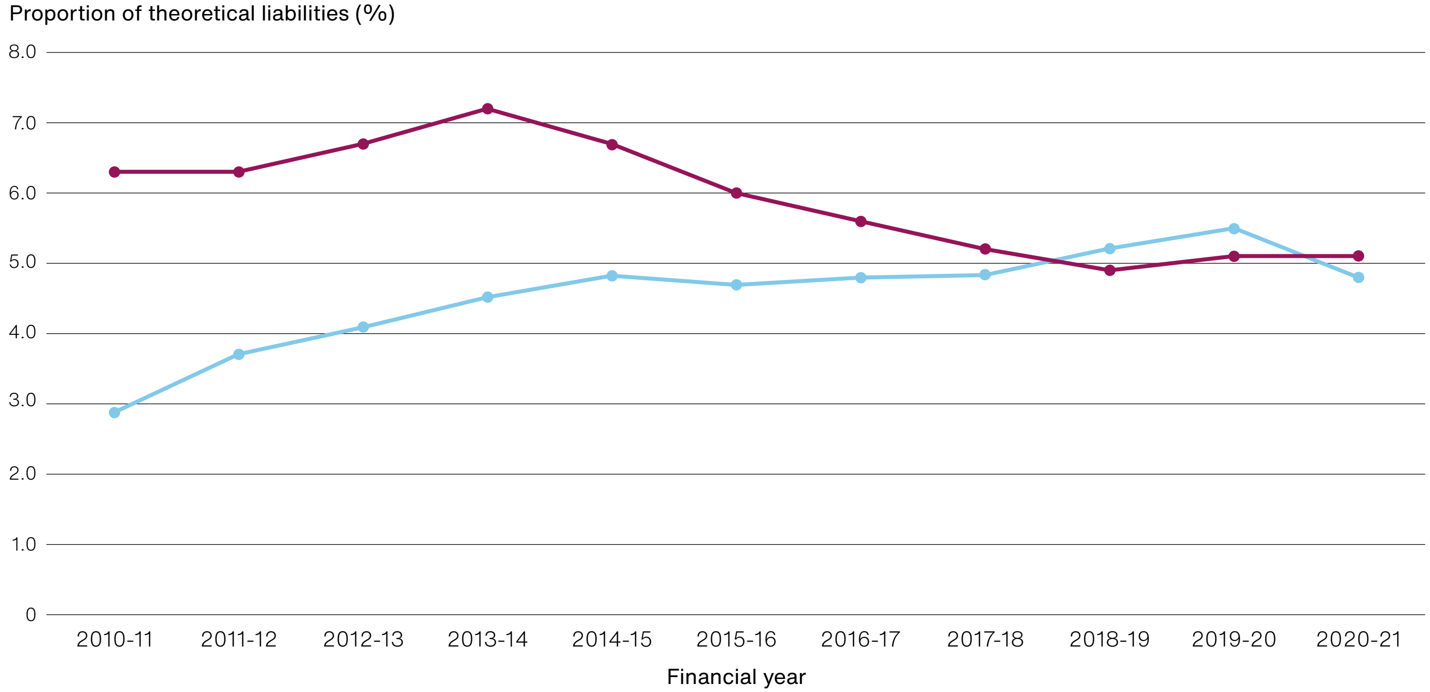
2.21 Methodological changes can improve or reduce the comparability of the estimates. HMRC made three adjustments to the 2020-21 tax gap to account for the pandemic's impact on the data it uses. This included spreading out a large reduction in self-assessment 'cash expected' yield during the pandemic. It matched the reductions more closely to the relevant tax year but, in a departure from its normal approach, did not change the methodology for previous years.

- HMRC's established methodology for the self-assessment income tax gap is to estimate the value of non-compliance in the liabilities generated each year and subtract the 'cash expected' component of compliance yield recovered in the relevant year. HMRC describes this as a simplified methodology. It told us that it would ideally assign compliance yield results to the year in which the relevant tax liability applied, but that the simplified methodology does not have a significant impact in years when economic conditions and compliance activity are relatively stable. In 2020-21, cash expected yield relating to self-assessment was significantly lower than in previous years. Rather than assigning the full value of this decline to the 2020-21 self-assessment tax gap estimate, HMRC analysed which years' liabilities were affected by the compliance enquiries closed in 2020-21 and assigned the impact to each of the relevant years. This reduced the headline tax gap in 2020-21 by £0.7 billion (0.1 percentage points) and increased the tax gap for earlier years by the same amount in total, with the largest increases being £0.2 billion in 2016-17 and £0.1 billion in 2017-18 compared with the established methodology.

6 Comptroller and Auditor General, *Tackling the tax gap*, Session 2019–2021, HC 372, National Audit Office, July 2020.

Figure 10
Compliance yield and tax gap estimates as a proportion of total theoretical tax liabilities, 2010-11 to 2020-21

In the first year of the COVID-19 pandemic the tax gap remained stable despite a decrease in compliance yield



	2010-11	2011-12	2012-13	2013-14	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21
Tax gap (%)	6.3	6.3	6.7	7.2	6.7	6.0	5.6	5.2	4.9	5.1	5.1
Compliance yield (%)	2.9	3.7	4.1	4.5	4.8	4.7	4.8	4.8	5.2	5.5	4.8

Notes

1 Compliance yield is the defined by HM Revenue & Customs (HMRC) as the revenue collected and protected that would otherwise have been lost to the Exchequer if not for its interventions.

2 The tax gap is HMRC's estimate of the difference between the total taxes theoretically owed and those actually paid.

3 Total theoretical liabilities are HMRC's estimate of the total amount of tax theoretically owed. The tax gap is generally presented as a proportion of this.

4 HMRC's tax gap estimates are not yet available for 2021-22.

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

- HMRC's tax gap methodology states it made the change to preserve consistency in the time series, but HMRC did not adjust the methodology for prior years as it normally does for changes in the tax gap. Without the adjustment for self-assessment compliance yield, the tax gap as a proportion of total liabilities would have increased for a second year in a row, by 0.1 percentage points. HMRC told us it would describe small movements between years as showing the tax gap to be broadly stable. It is unclear whether HMRC will adopt the revised methodology from now on.

Other measures of performance

Criminal convictions and prosecutions

2.22 Criminal investigation, with a view to prosecution, is an important part of HMRC's compliance strategy. HMRC's approach is to conduct criminal investigations and seek criminal prosecutions if it is in the public interest, particularly where the behaviour displayed is very serious or a criminal prosecution will act as a strong deterrent.

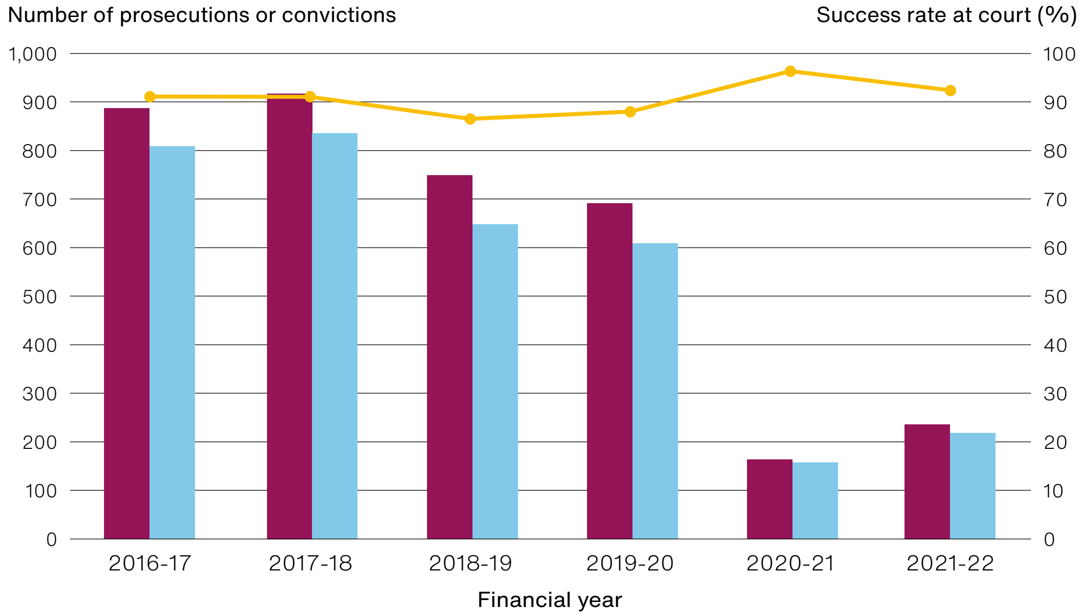
2.23 In 2016-17, HMRC had set a target of 100 prosecutions per year for serious and complex tax crime by 2020-21, but it has more recently removed all targets for prosecution volumes. The target was driven by commitments made in the Summer Budget 2015 and reflected a specific focus on serious and complex cases as part of HMRC's wider criminal justice activity. HMRC published the numbers of prosecutions in this area only once, in its 2018-19 annual report, when it reported 42 prosecutions against a target of 30. However, HMRC also identified that there was a risk it would not reach its overall target of 100 prosecutions per year by 2020-21. HMRC has not reported its performance against this target from 2019-20 onwards.

2.24 The total number of compliance cases resulting in criminal prosecutions – not only those for serious and complex tax crime – decreased markedly in the pandemic, when many courts were unable to operate. Before the pandemic, the number of prosecutions had reduced as HMRC focused more on serious and complex cases, but numbers fell significantly further in 2020-21 before rising slightly in 2021-22 (**Figure 11**). During the pandemic, there were periods in which many courts were closed or operating with less capacity. HMRC has reported publicly that these delays affected the number of cases reaching prosecution, but that it expects numbers to increase in 2022 and 2023. However, it told us delays in the criminal justice system, including the 2022 barristers' strike, were having an impact, and that some cases could be delayed by 18 months. HMRC does not publish targets or expectations for overall numbers of prosecutions. In its 2019-20 annual report, HMRC said that its focus is on the right overall outcome for the UK, rather than chasing arbitrary targets in arrests and prosecutions.

Figure 11

Number of compliance-related prosecutions and convictions, 2016-17 to 2021-22

The total number of criminal prosecutions and convictions decreased markedly in the COVID-19 pandemic



	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22
Prosecutions	887	917	749	691	163	236
Convictions	808	835	648	608	157	218
Success rate (%)	91	91	87	88	96	92

Notes

1 Success rate at court is the proportion of prosecutions which result in convictions.

2 Since 2019-20, in response to a National Audit Office recommendation, HM Revenue & Customs has published several metrics on a quarterly basis, including total number of prosecutions and success rate at court.

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

Wider understanding of performance

2.25 While compliance yield, the tax gap and prosecutions are important indicators of performance, they offer limited insight into HMRC's operational performance, since they do not capture important aspects of efficiency and effectiveness, such as speed and accuracy of casework or the quality of customer experience. A good performance framework uses a range of input, output and outcome measures to offer a rounded and balanced view of performance.

2.26 HMRC is implementing a new integrated performance framework which covers these areas and a range of other measures. The framework is based on a logic model with clear links between its overall strategic objectives, high-level outcomes, and specific operational inputs, activities and outputs.[7] This new framework should allow a fuller understanding of performance as HMRC continues to develop it. However, the framework does not yet include detail on how all measures are to be monitored, nor do all measures have specific targets or benchmarks to assess HMRC's performance against.

7 A logic model is a way for an organisation to articulate how each of its activities is contributing to its overall objectives.

Part Three

Managing tax compliance in future

3.1 This Part examines:

- HM Revenue & Customs' (HMRC's) overall assessment of risks to tax compliance in the short and long term, and how this has been affected by the COVID-19 pandemic;
- the scale of the challenge HMRC faces to manage tax compliance following the pandemic, and its projections for the future; and
- HMRC's plan for tax compliance following the pandemic.

HMRC's understanding of compliance risks

3.2 HMRC's Customer Compliance Group (CCG) maintains a detailed and comprehensive register – the Strategic Picture of Risk – focused on current compliance risks and ones which may become significant in the coming two years. This informs short-term planning by the CCG's senior management. The register is supplemented by HMRC's 'risk treatment plans', which set out how HMRC intends to mitigate the risks it has identified. HMRC has expanded its data analytics capacity to better identify risks and target its activity.

3.3 It is not yet clear how the pandemic has affected tax compliance risks. HMRC's latest assessment suggests that the overall scale of risks to compliance had not so far changed significantly. In its 2021 Strategic Picture of Risk, HMRC judged that the overall level of risk had risen only slightly, estimating the total value of individual risks as having increased by 1% in cash terms. However, HMRC told us that some risks are likely to become more significant in the next two iterations, and that the figures do not yet fully reflect the impact of the pandemic. In particular:

- because compliance yield has fallen while the overall level of risk has not, HMRC assesses that the extent to which these risks result in losses to the Exchequer in practice may grow; and
- some risks are likely to become more significant because the economic impacts of the pandemic, alongside other challenges such as high levels of inflation, continue to be felt by individuals and businesses. It is also the result of some taxes not becoming due for a year or two after the economic activity they relate to. HMRC quantifies the scale of these risks based on the latest data on levels of taxation and estimates of the tax gap, which take one to two years to become available.

3.4 While HMRC's assessment of total risk has not yet changed significantly, some individual areas of risk have seen increases while others have reduced. This includes movements between different types of tax or groups of taxpayers, some areas of fraud and error and rising debt levels. At the same time, some risks decreased, including some specific areas of tax evasion and deliberate avoidance. Examples of how risks have been affected by the pandemic include the following:

- **Debt and non-payment:** Before the pandemic, changes in debt levels for VAT and Corporation Tax had increased HMRC's estimate of the tax gap for those taxes due to the risk of non-payment, but HMRC considered there was no change in underlying risk because they were temporary issues (for example, the VAT tax gap in 2020-21 returned to its previous level). However, levels of debt owed by taxpayers to HMRC more than doubled in real terms in 2020-21 and remain well above pre-pandemic levels, at around £42 billion. We reported in 2021 on the challenges for HMRC in managing high debt balances and returning them to the levels seen before the pandemic.[8] If large debts persist, this may signal a higher risk of losses to the Exchequer.
- **Fraud, error and failure to take reasonable care**: HMRC's 2021 assessment observed increasing risk in some areas of tax evasion, error or failure to take reasonable care. HMRC considered that this risk might increase further if the pandemic has an impact on taxpayers' attitudes that affects their willingness or capability to be tax-compliant. HMRC identified potential factors including loss of stability of tax habits due to changes in personal situations, reduced bandwidth due to financial or other strains, and changes in people's perceptions of HMRC.

Scale of the challenge

3.5 HMRC is funded to maintain the tax gap, a measure which is indicative of overall levels of non-compliance, over the medium to long term. HMRC uses the Office for Budget Responsibility's (OBR's) fiscal forecasts and assumptions to assess the level of core compliance yield needed to keep the tax gap from growing. Core compliance yield measures the impact of HMRC's core compliance work to maintain the tax gap, excluding yield generated from areas of new or temporary spend. HMRC's CCG uses this estimate and the potential range of yield its core compliance work may generate for planning purposes, to help it understand the resourcing decisions needed to meet the level required.

8 Comptroller and Auditor General, *Managing tax debt through the pandemic*, Session 2021-22, HC 799, National Audit Office, November 2021.

3.6 HMRC's internal planning indicates that it will be challenging to keep the tax gap from increasing over the next three years (2022-23 to 2024-25). The CCG will need to achieve its upper planning estimate for the yield from its core compliance work to keep on track (**Figure 12** overleaf). The gap between the required level and its mid-point planning estimate equates to around £17 billion in total over the three-year period in cash terms. In practice, the CCG told us it expects to achieve yield somewhere between its upper and mid-point estimates. This will require an improvement in performance compared with the pandemic years and will depend on the impacts of HMRC's compliance approach during the pandemic, the timing of compliance work and recruitment of new staff. According to HMRC's estimates for the past two years, its core compliance yield was closer to its mid-point estimate and fell short of the required level by £1.5 billion in 2020-21 and £3.4 billion in 2021-22. We consider HMRC's plans to increase its capacity and improve performance in the next section.

3.7 HMRC's latest planning estimates were made in spring 2022. The 2022 Autumn Statement included new forecasts and resources for HMRC's compliance work, which HMRC has not yet reflected in its planning estimates and projections. These are likely to have implications for HMRC's expectations for compliance yield and the tax gap. In particular:

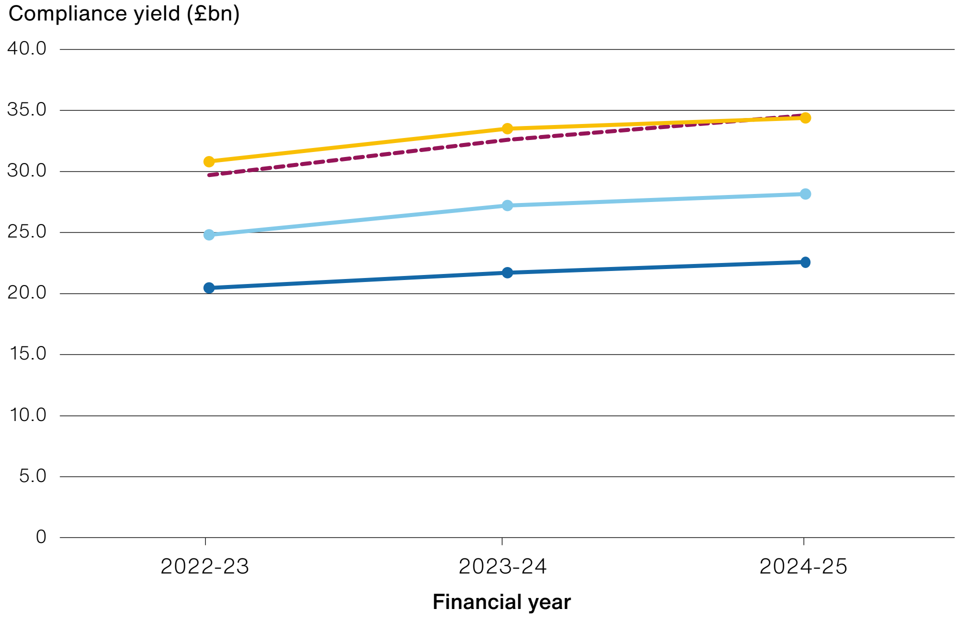
- the OBR updated its fiscal forecasts for the next few years, projecting that economic growth will be lower – including a period of recession – and inflation will be considerably higher compared with its previous forecasts in March 2022. High inflation may create additional pressures for taxpayers, and research indicates that tax compliance typically reduces during recessions. The scale of the challenge for HMRC to manage its compliance work and stop the tax gap from growing may therefore increase further; and

- in the Autumn Statement, the government allocated £79 million over the next five years to HMRC. This is to enable it to allocate additional staff to tackle more cases of serious tax fraud and to address tax compliance risks among wealthy taxpayers, in order to reduce the tax gap in these areas. The government expects this to generate £725 million of additional tax revenues over the five years. Resources and yield from additional funding are normally excluded from HMRC's projections for its core compliance work.

Figure 12

HM Revenue & Customs' (HMRC's) planning estimates for yield from its Customer Compliance Group (CCG), 2022-23 to 2024-25

HMRC's internal planning indicates the CCG will need to achieve its upper planning estimate of compliance yield to maintain the tax gap



	2022-23	2023-24	2024-25
Upper planning estimate	30.8	33.5	34.4
Mid-point planning estimate	24.8	27.2	28.2
Lower planning estimate	20.5	21.7	22.6
Requirement to maintain the tax gap	29.7	32.6	34.6

Notes

1 Figures reflect CCG yield only and HMRC produces them solely for planning purposes.

2 The values represent the CCG's planning estimates as at March 2022. The CCG expects to achieve yield somewhere between the upper and mid-point estimate.

3 The 'requirement to maintain the tax gap' is the estimated level of compliance yield HMRC expects will be required to maintain the tax gap. HMRC assumes that to prevent the tax gap from increasing it needs to deliver a baseline level of compliance yield through core compliance work, which excludes exceptional and non-standard compliance activity. Compliance yield delivered on top of this core expectation would help reduce the tax gap. If HMRC delivers less than the core expectation the tax gap is expected to increase.

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

HMRC's plan for tax compliance following the pandemic

Staff numbers and casework following the pandemic

3.8 HMRC's compliance casework remained below pre-pandemic levels in 2021-22. Overall, fewer cases were opened and closed during the pandemic, leading to a reduced volume of cases processed in 2020-21 (paragraph 1.10). Case volumes started to rise in 2021-22 but remained lower than in 2019-20. HMRC told us that it partly mitigated the impact on compliance yield by increasing its focus on higher-value cases.

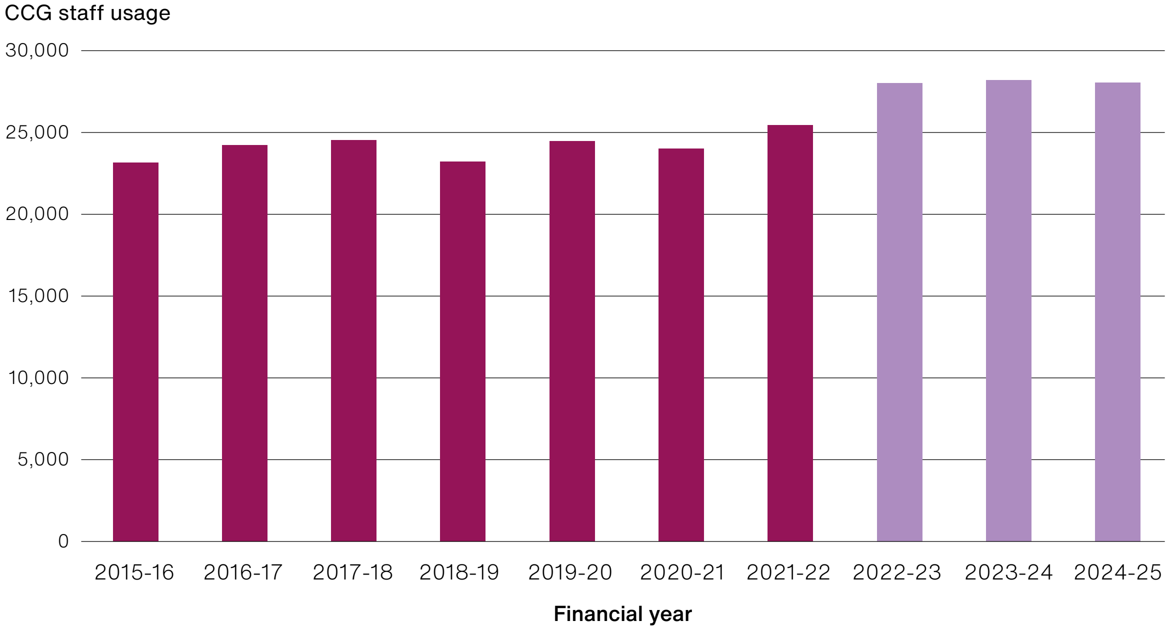
3.9 HMRC is recruiting and training new staff to provide capacity to build its compliance work back up and support greater flexibility between tax regimes. This includes a new training unit to train tax graduates, who can then be deployed where they are most needed. It has also focused on improving the professional skills of existing staff. HMRC expects these efforts to help it manage workloads more efficiently in future, with less reliance on external recruitment. However, it will take time because new staff typically need up to four years to become fully effective. **Figure 13** overleaf shows that HMRC expects to have around 2,500 (10%) more compliance staff in 2022-23 than in 2021-22. HMRC expects to maintain higher levels of staff deployment until at least 2024-25.

3.10 While staff numbers available for core compliance work fell during the pandemic, the compliance yield per staff member also fell in most compliance directorates (**Figure 14** on page 47). Differences between directorates and customer groups, and resulting yield, are explained in paragraph 2.5. On average, compliance staff generated £1.1 million a year each during the pandemic compared with an average of £1.3 million in the period before the pandemic (in 2021 prices). HMRC forecasts marginal improvements in the next few years, with performance levels in real terms starting to recover by 2024-25. However, its planning estimates indicate it is unlikely to achieve pre-pandemic levels in real terms by 2024-25. HMRC does not systematically analyse rates of return for different types of compliance intervention, which it could use to understand the relative effectiveness of different activities. HMRC is targeting total compliance yield of £36 billion in 2022-23 from all of its activities. Based on its planning estimates, this will require 27% to be generated outside of the CCG, compared with 22% during the pandemic and 14% in 2019-20.

Figure 13

HM Revenue & Customs' (HMRC's) compliance staff usage, actual and forecast, 2015-16 to 2024-25

HMRC expects to deploy around 2,500 more compliance staff in 2022-23 than in 2021-22



	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Staff usage	23,144	24,226	24,526	23,222	24,474	24,027	25,451	–	–	–
Staff usage (forecast)	–	–	–	–	–	–	–	28,002	28,197	28,039

Notes

1 Figures reflect Customer Compliance Group (CCG) staff only. They include staff not working directly on tax compliance, which from 2020-21 onwards includes those working on the COVID support schemes.

2 Figures from 2022-23 onwards are taken from HMRC's projections of staff usage.

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

Figure 14

Compliance yield per member of staff, Customer Compliance Group (CCG) directorates (2021 prices)

Productivity decreased in HM Revenue & Customs' (HMRC's) CCG during the COVID-19 pandemic and it will take some time to restore performance

Directorate	Average productivity (£mn of annual compliance yield per member of staff, 2021 prices)		
	Pre-pandemic period: 2015-16 – 2019-20	Pandemic period: 2020-21 – 2021-22	Forecasts post-pandemic: 2022-23 – 2024-25 (planning estimate)
	(£mn)	(£mn)	(£mn)
Large Business	4.73	3.78	3.96
Wealthy and Mid-sized Business Compliance	1.26	1.45	1.47
Individuals and Small Business Compliance	0.58	0.60	0.53
Other CCG directorates	1.27	0.73	0.65
All CCG	**1.30**	**1.08**	**1.08**

Notes

1 These figures cover only staff use and compliance yield related to HMRC's CCG. By comparison, the figures included in HMRC's annual report and accounts reflect staffing and compliance yield from HMRC in its entirety.

2 Figures are in real terms and have been adjusted to 2021 values using the GDP deflator, in order to provide meaningful comparisons of performance over time. See Appendix One for detail.

3 Figures are taken from the CCG's business planning. Figures up to 2021-22 represent actual outturns and the figures from 2022-23 onwards represent HMRC's mid-point planning estimates made as at 2021-22, based on forecast levels of inflation and tax revenues. If HMRC were to achieve its upper planning estimates for compliance yield, its overall productivity would in real terms be similar to levels from before the pandemic.

4 These figures are based on total compliance yield recorded in CCG, which includes a range of different types of activity as well as penalties and interest accrued on settled cases. It also includes some upstream activity. Some staff were redeployed to support the COVID-19 response and did not work on tax compliance. To account for this, we have removed the annual full-time equivalent staff redeployed to COVID-19 support schemes. In 2021-22, most such staff were moved to a new directorate, which is excluded from this Figure.

5 Productivity figures can be affected by the transfer of work between directorates, meaning year-on-year comparisons for individual directorates cannot be made accurately.

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

Plans to improve compliance following the pandemic

3.11 HMRC is taking steps to ensure it more consistently considers the impact on tax compliance of any changes it introduces. A key lesson from the COVID employment support schemes is that close working between tax policy and operations can help to reduce risks of non-compliance.[9]

3.12 HMRC has introduced a set of principles and standards, accompanied by guidance for the rest of the department to support policy and change design. The compliance principles and standards are led by its CCG, and HMRC intends these to help its teams more consistently 'design in' compliance at the outset when making changes. This should include all changes where compliance should be considered, including both operational measures (such as improving IT systems or customer-facing forms) and when designing new policies. These principles and standards are new, and their effectiveness will depend on the extent to which they are understood and used throughout HMRC.

3.13 HMRC evaluates all interventions claiming upstream compliance yield using a range of methods depending on the type of intervention. It also expects most downstream projects to be evaluated as part of a wider evaluation programme and intends to embed evaluation design as a routine part of its plan for new interventions and compliance projects. However, its internal audit function found that only around 26% of projects had a final evaluation completed in the three years to January 2022. HMRC told us that it has since improved its processes and that a much higher proportion of evaluations due are being completed. The CCG has also conducted evaluations of less than half of its 'risk treatment plans', which set out planned actions to address identified compliance risks. HMRC paused evaluation activity during the pandemic due to reduced capacity, limiting its understanding of what worked effectively during the period.

3.14 To maximise the impact of how HMRC manages its resources, it needs to understand how much it spends on different types of compliance activity and the relative effectiveness of different areas of its work. It analyses compliance yield and staff numbers by risk and directorate. However, HMRC does not have figures to separately analyse and systematically compare the costs of its upstream and downstream work, and therefore cannot identify all rates of return for different activities. Its overall compliance yield figures cover a range of activities, from direct compliance investigation and enforcement to educational activities and other measures designed to prompt taxpayers to comply first time. HMRC has not disaggregated the different activities or assessed the marginal returns of adding resource to different types of intervention. It is therefore less able to judge the trade-offs between types of upstream and downstream interventions. This will be important to achieve the balance most likely to improve compliance following the pandemic.

9 Comptroller and Auditor General, *Implementing employment support schemes in response to the COVID-19 pandemic*, Session 2019–2021, HC 862, National Audit Office, October 2020.

Appendix One

Our evidence base

1 This report presents our independent conclusions on whether HM Revenue & Customs (HMRC) is well placed to manage tax compliance following the COVID-19 pandemic, including future risks and challenges. Our conclusions were reached following an analysis of evidence collected primarily between May and November 2022.

Interviews and consultation

2 We conducted 30 virtual interviews and meetings with representatives from HMRC, HM Treasury, the Office for Budget Responsibility (OBR), and wider stakeholders to inform our audit:

- **Walkthroughs and meetings with HMRC and HM Treasury**. We interviewed officials from HMRC and HM Treasury to discuss the objectives of HMRC's compliance work, strategy development and response to the COVID-19 pandemic. During fieldwork, we also held regular meetings with HMRC, in order to triangulate our understanding of other evidence sources.
- **Meeting with the OBR.** We interviewed officials from the OBR to understand how it works with HMRC on its planning estimates of compliance yield and the tax gap; and to understand how it seeks independent assurance on the 'upstream product and process' component of HMRC's compliance yield measure.
- **Scoping discussions with tax experts and academics**. During scoping and early fieldwork, we consulted academics specialising in tax to discuss HMRC's performance measures, in particular compliance yield and the tax gap, and their experience with what data may be available. We spoke to representatives from:
    - Institute for Fiscal Studies (IFS);
    - Birmingham University's Tax Centre; and
    - Exeter University's Tax Administration Research Centre.

- **Semi-structured interviews with stakeholders and experts**. We met with other stakeholders to discuss: the impact of the pandemic on tax compliance; the impact of HMRC's tax compliance work on individuals and businesses; the reliability and usefulness of HMRC's performance measures; and areas of future risk for tax compliance. We spoke to representatives from the following organisations:
  - Chartered Institute of Taxation (CIOT) & Low Incomes Tax Reform Group (LITRG);
  - Credit Industry Fraud Avoidance System (CIFAS);
  - Tax Justice UK;
  - Tax Aid; and
  - Confederation of British Industry (CBI).

3 **Consultation of Supreme Audit Institutions (SAIs):** As part of scoping our study, we consulted SAIs from other countries to understand their perspectives on tax compliance during and following the COVID-19 pandemic. We employed a total sampling approach by distributing several questions on these topics to the SAIs of all 38 members of the Organisation for Economic Co-operation and Development (OECD). Thirteen members responded to our consultation. We analysed their responses using a thematic approach, meaning the overall findings were synthesised by theme and fed into the scoping of the report, but did not directly form part of our evidence base.

Document and literature review

4 We undertook document and literature review to assess how HMRC designs and delivers its compliance strategy, monitors risks and performs from an operational perspective.

5 We conducted desk research of publicly available evidence. This included:

- a literature review to understand academic views and analysis of tax compliance and compliance yield, including how compliance may be affected by circumstances such as changes in the economy. This informed our assessment of risks, and of the challenges to HMRC's assumptions on how to structure its compliance work;
- a review of previous National Audit Office reports on tax compliance, and enquiry work to identify previous recommendations, findings, and consistent themes; and
- a review of HMRC's annual report and accounts to understand HMRC's overall strategy and workforce planning.

6 We also reviewed documentation provided by HMRC and separately by its internal audit function that is not available in the public domain. This included strategic and risk documentation, board minutes and workforce pandemic planning reports. It also included evidence and findings from internal audit reports and internal quality assurance work. This evidence also fed into our review of HMRC's compliance yield estimate.

Review of the compliance yield estimate

7 To assess the governance and robustness of the compliance yield estimate, we used a structured review of governance documentation and assumptions. The review considered the governance and assurance structures in place, quality arrangements and challenge, and the robustness of assumptions.

8 To review the robustness of the estimate, we focused on the quality of input data and robustness of assumptions used:

- For downstream yield data quality, we reviewed internal audit findings and HMRC's own testing produced by its Tax Settlement Assurance Programme (TSAP), which tests 400 cases a year. To test the reliability of the findings from this work, we reviewed the TSAP sampling methodology that HMRC uses, and conducted walkthroughs of 11 randomly selected cases to understand how HMRC tests cases and the effectiveness with which it identifies errors.
- To examine how HMRC could extrapolate the errors it finds in its TSAP testing and understand the implications for overall compliance yield, we used the approach we take to evaluating errors in our financial audits of government accounts. This estimates a 'most likely error' as well as the associated lower and upper limits at the 95% confidence level. HMRC stratifies its testing sample by value of the yield recorded.
    - For directorates other than Large Business, we grouped these together and extrapolated errors on the same stratified basis that HMRC uses. The evaluation uses a standard mean difference estimation for the individual strata. We used stratified statistical formulae to calculate the error limits.
    - For the Large Business directorate, HMRC typically finds few errors meaning a different level of risk, and we therefore evaluated this separately. The number of items tested was not big enough to evaluate by strata, so we used a single mean difference estimation for the overall population. We used standard statistical formulae to calculate the error limits.
    - Low sample sizes for Large Business and two of the strata among the other directorates meant wide error limits, which we have included in our reporting.

- For upstream yield data quality, no equivalent of the TSAP existed. Instead, we reviewed the systems in place to quality assure and challenge yield estimates for HMRC's upstream work. We also conducted walkthroughs of three selected upstream yield claims representing each of the three different evaluation types that HMRC uses.
- While we did not seek to test the assumptions used in individual estimates, we examined two overarching assumptions that HMRC applies to one or more components of compliance yield. We reviewed what information HMRC had on these. In the case of assumptions on non-payment by taxpayers due to insolvency or debt, in the absence of clear documentation and rationale for the assumptions, we consulted evidence from our financial audits of HMRC's annual reports and accounts to identify credible options for non-payment rates.

9 The 'cash expected' component of the yield is referred to by HMRC as 'cash collected'. For the sake of consistency, this report consistently refers to it as cash expected, which is in line with how HMRC presents it in its annual report.

Quantitative analysis

10 We reviewed public data, accounts information and management information provided by HMRC. This included:

a analysis of headline estimates of the tax gap, compliance yield and tax revenues to assess the elasticities of yield and revenue over time. This informed our understanding of the effectiveness of compliance work done by HMRC and the reliability of its estimates;

b analysis of HMRC management information used by its Customer Compliance Group (CCG) covering compliance yield, to assess how the yield was spread across directorates, tax regimes, and yield components; and

c estimating the CCG's compliance yield as a proportion of the HMRC total by reconciling the management information totals to the headline figures presented in the accounts.

11 We analysed financial information from HMRC on the resources associated with its compliance work and analysed the CCG's internal business planning data to assess actual and forecast staffing ('Staff Year Usage') and compliance yield figures. These data are not quality-assured and cannot be directly reconciled to the overall values in the accounts. We used this to:

a understand how the CCG's planning estimates of core compliance yield performance compare with its expectations of what will be needed to stop the tax gap from increasing; and

b compare compliance yield against staffing levels to estimate a return on investment over time.

12 For the purposes of this report, tax revenue figures and compliance yield estimates are generally presented in cash terms to align with established convention when reporting tax revenues. To illustrate the effect of changes in the economy, we have also presented revenue as a proportion of GDP and compliance yield as a proportion of the tax revenue.

13 To estimate staff productivity, financial data were adjusted for inflation using the most up-to-date version of the GDP deflator published by HM Treasury (September 2022), in order to provide meaningful comparisons of performance over time. Where this has been done, values are stated in 2021 prices and this has been clearly indicated. However, the compliance yield estimate is itself a combination of yield claims stated in cash terms at different points in time. For example, 'future revenue benefit' scored in a year will be the value put in by the caseworker when the case was completed, which is likely to have been in an earlier year. This means that it is difficult to estimate the real-terms value of compliance yield in any year as a whole. For consistency, we have therefore treated estimates of the compliance yield as cash terms in the year it was scored and included in HMRC's annual report, and have deflated to 2021 prices as described above.

14 We analysed staff data HMRC used for planning purposes as at March 2022 using full-time equivalents (FTEs) and 'Staff Year Usage' (SYU) for CCG's core directorates that routinely record compliance yield. This excludes the new Customer Experience, Professionalism and EU/UK Transition (CEPET) team. The SYU data used in HMRC's planning do not adjust its directorates' staffing levels during the pandemic to account for redeployment to the COVID support schemes. We therefore adjusted the staff levels when making estimates of staff productivity (Figure 14) to avoid underestimating productivity during the pandemic. We did this by estimating the average FTEs redeployed by each directorate each year and removed this from the estimated SYU.

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