



NATIONAL AUDIT OFFICE

Report by the Comptroller and Auditor General

Inland Revenue Department: Control of Investigation Work

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Comptroller and Auditor General

National Audit Office
21 May 1984

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Inland Revenue Department: Control of Investigation Work

Summary and conclusions

1. This Report deals with investigations (as distinct from routine checking) designed to detect irregularity in compliance with Inland Revenue taxes. It is a sequel to earlier Reports on the management of investigation work in the fields of Value Added Tax and Social Security; and is a further response to the interest of the Committee of Public Accounts in the investigation of non-compliance among the public with requirements of national taxation and benefit systems.
2. The main arms of Inland Revenue's investigation work are:
 - **District Office Inspectors'** investigation, mainly of Schedule D and small company taxpayers' accounts and returns: this occupies 1,525 inspectors, who in the 1983 account year achieved recoveries of £195 million with a cost:yield ratio of 1:6.1.
 - **PAYE Audit** of employers' deductions from pay and contractors' deductions from sub-contract payments: 600 auditors and 100 supervisors are engaged, and their recoveries in 1983 were nearly £44 million with a cost:yield ratio of 1:3.95.
 - **"Black Economy"** investigations, aimed at detecting undeclared paid work: an experiment, using 70 staff, recovered £6.3 million in the year to 30 September 1983, with a cost:yield ratio of 1:4.5; this work is to be expanded by the addition of 850 staff between 1984 and 1988.
 - **Special Offices**, investigating important areas of avoidance and evasion short of serious fraud which are not tackled elsewhere in the department: these employ about 170 staff and in 1983 recovered £54 million with a cost:yield ratio of 1:18.2.
 - **Enquiry Branch**, investigating serious tax fraud in relation to business accounts: it employs about 100 staff, who in 1983 recovered £44 million with a cost:yield ratio of 1:13 and in addition obtained Board's orders for criminal prosecution in 41 cases.
 - **Investigation Office**, investigating primarily abuse of sub-contractors' tax certificates and fraudulent personal allowances and expenses claims: it employs about 90 staff on this work; it also investigates suspected misconduct by Revenue staff; there is no direct tax yield because the Office does not negotiate money settlements. In 1983 Board's orders for criminal prosecution were obtained in 177 cases.
 - **Special Investigation Section**, countering sophisticated artificial avoidance schemes and avoidance schemes where fraud is suspected: these use about 25 expert staff; profits of over £250 million were brought into charge in 1983.

— **Transfer Pricing Work**, involving multi-national companies: this employs up to 10 expert staff; annual yields vary because of the long time scale of these investigations but the average annual increase in taxable profits over the past 10 years has been about £20 million.

3. Where cost:yield ratios are quoted above, they are based only on the tax recovered for the year of investigation and back years, interest and penalties. Exercises undertaken by the Department indicate that improved compliance occurs for a number of years after the investigation: the cost:yield ratios quoted would be doubled if this were taken into account. Where profit adjustments only are quoted this is because the effects on tax assessed cannot be calculated precisely.

District Office Inspectors' investigation

4. Selective investigation of taxpayers' accounts is an integral part of District Office work. The Department have detailed instructions on the selection of cases for investigation on grounds of suspected inaccuracy, and are considering sample checks on their application (paragraphs 2.4–2.5). They are also introducing more systematic means of allocating staff resources and monitoring the areas in which they are used, and the results obtained. The management information system which records the actual use of Inspector time was being introduced progressively in 1983–84 and will have been fully introduced in April 1984 (paragraph 2.7).

5. The bulk of accounts selected for investigation continue to require adjustments, and a rapidly increasing proportion contain blatant inaccuracies. Recoveries from all District Office investigation work have risen sharply and the overall cost:yield ratio moved from 1:4 in 1981 to 1:6.1 in 1983 (paragraph 2.8).

6. The Department have not been able to analyse cost:yield ratios from investigation work as between Schedule D accounts, company accounts and other investigations, or in any other way, as an aid to redirecting investigation effort. They will be able to do so for the year 1983–84 (paragraphs 2.12 and 2.13).

7. In response to PAC comments, Inland Revenue took steps in 1981 to try to monitor compliance by Schedule D taxpayers and the "corrective effect" of selective investigations. Conclusive results from these exercises are not yet available (paragraphs 2.9–2.11).

8. The Department said it was their view that improved work monitoring and staff allocation techniques had contributed towards the increased investigation yield, though of course other factors were also relevant. They expected the production of separate 1983–84 cost:yield ratios for each type of District investigation work to assist further with resource allocation although they would still need a deterrent presence in all areas of evasion. By the end of 1984 they also expected sufficient results from their Schedule D Compliance Exercise to indicate the proportion of these taxpayers who understate their profits and the extent to which tax is evaded (paragraphs 2.13 and 2.14).

PAYE Audit

9. The staff employed to audit employers' and contractors' records of tax deducted from employees and sub-contractors have been increased from 400 in November 1981 to 700 currently, and the Department intend to increase them to about 950 by 1986 (paragraph 3.3).

10. A revision in 1982 of procedures for selecting employers, other than large employers, for PAYE audit visits seems to have directed proportionately less

attention towards high risk employers; and in general the arrangements for matching visit frequency against the likelihood of tax irregularity are not as sophisticated as those used in Customs and Excise for VAT control visits (paragraphs 3.4 and 3.5). Inland Revenue intend to develop their procedures in this area and have instituted pilot arrangements for using DHSS inspection visits as one means of selecting high risk employers (paragraph 3.8).

11. The Department use several methods for selecting large employers to visit. But they have so far not sought any particular balance in the visiting cycles as between one large employer and another or as between large employers generally and other employers (paragraph 3.6); and there is no systematic means of determining appropriate visiting cycles for contractors without associated PAYE schemes (paragraph 3.7).

12. Mandatory instructions to prevent investigation of past years unless fraud or a current year undercharge of over £150 has been disclosed may still result in uneconomic work (paragraph 3.9).

13. There are no arrangements for re-visiting employers on a sample basis as a means of quality control over investigations and to deter collusion (paragraph 3.11).

14. There are no arrangements for planning audit visit programmes in a systematic way or for monitoring progress. In 1983, visits covered 5.5 per cent of employer PAYE schemes and just over one per cent of self-standing contractor tax deduction schemes. Such evidence as there was suggested that the proportion of employers visited in each region varied considerably (paragraphs 3.12–3.14).

15. The overall cost:yield ratios for PAYE audit in 1982 and 1983 were both about 1:4. The Department attributed a slight fall in the 1983 ratio to the large influx of new staff in 1981 and 1982 (paragraphs 3.15–3.16).

16. The Department had not analysed cost:yield ratios in detail but were preparing to analyse relative performance on different employer categories (including sub-contractor schemes) for 1984–85 (paragraph 3.17).

17. The Department currently devote only 8 per cent of PAYE audit resources to large employers' schemes although these account for about half of PAYE taxpayers and produce and audit yield six times as high as other schemes (paragraphs 3.3, 3.6 and 3.7).

18. In commenting on the issues which I raised as a result of my examination of PAYE Audit (paragraph 3.18), the Department said that, despite a high training commitment, PAYE audit results following revision of inspection procedures in 1982 had been highly encouraging. They had been awaiting the first Report (due in July 1984) from the pilot combined survey exercise with DHSS before developing fully a refined and comprehensive selection and control system because, if the pilot scheme were adopted universally, auditors would work mainly on cases reported to them by DHSS inspectors (paragraph 3.19).

19. The Department also told me that they were provisionally revising the audit selection system in 1984 to provide increased efforts for large and high yielding employers; and that they were introducing computerised systems for recording audit inspection results as well as a new and comprehensive Management Information System. This would enable them to take more account of the risk

factor and to maintain closer control over work programmes. They also expected to make more staff available to audit groups and aimed to strengthen the central control over them, with more precise visiting cycles for large multiple concerns and a more balanced approach overall. They would consider granting discretion in examining prior year transactions and the need for a structured quality control when the results of the new Management Information System were known (paragraph 3.20).

Black Economy investigators

20. Since November 1982 Inland Revenue have been conducting a carefully monitored experiment under which 70 Tax Officers have been allocated to try to detect 'moonlighters' and 'ghosts'. The investigation of this area of non-compliance had previously been largely pursued by Districts following up routinely distributed information, and had been reduced because it was insufficiently productive (paragraphs 2.3 and 4.9). The latest cost:yield ratio from the experiment is about 1:4.5 and the Department have judged it a success. They have committed themselves to allocate a further 850 staff to the work (paragraphs 4.7-4.8).

21. The Department considered the new approach under the experiment was more positive than the approach Districts took before. They expected the work, when performed nationwide, to maintain the cost:yield obtained under the experiment. The work was sufficiently cost-effective to justify expansion especially as it was in a significant area of evasion not presently being systematically investigated. They planned to employ the extra staff so that this work was performed in every District Office (paragraphs 4.10 and 4.11).

Special Offices

22. Ten Special Offices throughout the United Kingdom deal with a wide variety of tax investigations covering any suspected large tax irregularities short of serious fraud which are beyond the scope of Districts and outside the fields of other head office investigation units. About half their investigations stem from their own research, and the remainder from other Inland Revenue branches. They give their investigators wide discretion, and place early settlement before maximising recoveries. They all show high cost:yield ratios and the overall ratios for 1982 and 1983 were of the order of 1:19 (paragraphs 5.1, 5.3, 5.5, 5.9-5.10).

23. In response to my enquiry about the scope for extending this highly productive work the Department said that they had expanded the Special Office network as quickly as the various practical restraints (availability of accommodation and staff) had allowed. They were considering the possibility of opening 5 more Offices by 1988 and this would be taken into account in a review of all the investigation work within Technical Division 2 which started in March 1984 (paragraph 5.11).

Enquiry Branch

24. Enquiry Branch also have 10 offices similarly distributed throughout the country. They deal with serious fraud involving business profits (paragraphs 6.1, 6.2, 6.5). Their investigations normally involve substantial amounts of tax and, in line with the Department's practice to deal with tax evaders mainly by financial penalties, they prosecute only in a minority of cases, including the most "heinous" offences (paragraphs 6.6, 6.8). Inland Revenue regard cost:yield ratios in this area as by no means the only useful indicators of effectiveness but they are of the order of 1:13 and they vary considerably between offices (paragraphs 6.9-6.10).

25. Notwithstanding the considerable variations in the yield per office, the Department told me that they would not wish to reduce the size or significantly

increase the area of any office on this account because they considered that there must be a sufficient presence in all parts of the country to deter serious fraud. Physical constraints also made frequent adjustment impracticable. However, the review of specialised investigation work would examine the case and scope for expanding Enquiry Branch work and would take account of any imbalances currently existing. The Department would develop measures of the efficiency and effectiveness of Enquiry Branch as part of the response to the Financial Management Initiative but they did not intend cost:yield ratios to be given any greater prominence than at present (paragraphs 6.11 and 6.12).

Investigation Office

26. Investigation Office, dealing mainly with abuse on the construction industry tax deduction scheme, also has a regional structure of offices. The section is solely concerned with criminal investigation and as soon as it becomes clear in the course of an investigation that a money settlement would be more appropriate the case is referred elsewhere. There are therefore no figures for yields in terms of tax (paragraphs 7.1, 7.2 and 7.5).

27. Procedures for reviewing cases prior to full investigation seemed to me less rigorous than for Enquiry Branch and a substantial proportion of fully investigated cases are rejected for prosecution (paragraphs 7.3–7.7).

28. The Department did not accept my comparison with Enquiry Branch as valid. They said that significant differences arose in practice because the Investigation Office, unlike the Enquiry Branch, normally started their own investigations from scratch, the option of seeking a monetary settlement was not open to them and they tended to deal with elusive, itinerant people. But the question of control of unproductive lines of enquiry would be one of the matters examined in the review of specialised investigation work (paragraph 7.8).

Other specialist investigation sections

29. Other parts of the headquarters Division responsible for specialised investigation work and international taxation employ about 35 senior staff in research and investigations to counter complex avoidance schemes. This is highly expert work, and NAO did not examine it in sufficient depth to comment on its effectiveness (paragraphs 8.1–8.8).

Keith Committee comment and recommendations

30. The Keith Committee consider that, to the extent that perusal of Inland Revenue's enforcement efforts suggests that the chances of escaping detection are good, compliance can be expected to continue to decline (paragraph 9.2). The Committee suggest that investigation producing a high return should be extended but also recognise the need for some policing in areas which do not offer a significant direct yield. They urge particularly the pursuit and prosecution of 'moonlighters' (paragraph 9.3).

31. The Committee suggest that additional staff could be found for investigation by cutting routine activities and by making better use of computers to compare information in tax returns with information from other sources (paragraph 9.4).

Overall deployment of investigation resources

32. While Inland Revenue seek to monitor and analyse the results of their investigation arms, they do not appear to have systematic arrangements for reviewing the balance of coverage and cost-effectiveness of their investigation resources as a whole. Such staff redeployment as has been proposed recently has tended to be to the less cost-effective areas of investigation, though it has accorded with certain Keith Committee views. The distribution of investigation resources over so many arms, each with its own structure of local offices, appears a possible

impediment to a concerted and balanced approach to tax investigation (paragraphs 10.1 and 10.2).

33. The Department told me that they did not accept that these criticisms were justified. They pointed out that there was unified control, at Regional and Head Office levels, of local tax and collection offices (the first three arms in paragraph 2 above); and that the remaining areas of work were all part of one headquarters division under the control of an Under Secretary. They did not try to distribute efforts solely on the basis of cost:yield ratios as other factors, such as the need to maintain balanced coverage and to deter fraud, and staff constraints, all had a part to play. They had however set up a review of specialised investigation work in March 1984. This flowed from the fact that the present structure was, in part, the result of a major Departmental re-organisation in 1976, and it had been recognised then that a review should be required some time afterwards (paragraphs 10.3–10.7).

Inland Revenue Department: Control of Investigation Work

Report

Part 1: Introduction

1.1 In their 22nd Report of the 1981–82 Session, the Committee of Public Accounts (PAC) commented on the varying returns from investigation work carried out by Inland Revenue, Customs and Excise and the Department of Health and Social Security (DHSS), and stressed the need to find resources for investigation work producing high returns. The subsequent Treasury Minute (Cmnd 8759) maintained that, although any increase in manpower for productive investigation must be within the context of the Government's manpower policy, it could be achieved by adjusting other priorities. But such adjustments had to take account of the need to collect all possible revenue, the damage done by evasion and the public acceptability of increased investigation.

1.2 I have since reported, in Volume 9 of the 1981–82 Appropriation Accounts, on the Customs and Excise Department's management of their main area of investigation, VAT control work, and, in a Memorandum to PAC in March 1983, on the main investigation areas of DHSS. PAC took evidence on these subjects and commented on them in their First and Second Reports of Session 1983–84. Much of Inland Revenue's work consists of examination and verification of the figures on which tax assessments are based. This report deals with those areas of Inland Revenue investigation which can be regarded as special programmes for detecting irregularities rather than as routine checking; but it does not consider in detail the most specialised investigation of tax avoidance practices. It describes how Inland Revenue direct and monitor their investigation work, how they assess its effectiveness and what they do to deploy staff to reflect relative cost-effectiveness and other factors.

1.3 The main arms of Inland Revenue's investigations are:

— **District Office Inspectors** investigations, mainly of smaller tax payers' accounts (paragraphs 2.1–2.15).

— **PAYE Audit teams and groups**, examining employers' and contractors' deductions (paragraphs 3.1–3.20).

— **"Black Economy" investigations** (paragraphs 4.1–4.11).

— **Special Offices**, investigating avoidance and evasion short of serious fraud (paragraphs 5.1–5.11).

— **Enquiry Branch**, investigating serious fraud in relation to business accounts (paragraphs 6.1–6.12).

— **Investigation Office**, carrying out criminal investigations, mainly of abuses of the construction industry tax deduction scheme and fraudulent personal allowance and expense claims (paragraphs 7.1–7.8).

— **Specialist Investigation Section** (paragraphs 8.1–8.4).

— **Transfer Pricing Work** (paragraphs 8.5–8.8).

Headquarters responsibility for directing and controlling this work is concentrated in two divisions. One is the Operations Division (Management Division 4), whose Director is responsible to the Director General, Management Divisions, for District Office procedures, including Selective Investigation, the "Black Economy" investigators and PAYE audit. The other is Technical Division 2, whose Director is responsible to the Director General, Technical Divisions, for other counter evasion and avoidance work, including Special Offices, Enquiry Branch, the Investigation Office, Special Investigations and international tax avoidance. These two Directors are responsible for ensuring a balance between the various investigation areas within their control and for co-ordinating investigation work generally.

Part 2: Selective Investigations by District Office Inspectors

General

2.1 District Inspectors devise investigation plans, covering the whole potential field, for inspectors to carry out as an integral part of normal District Office work. The greater part of such a plan normally relates to the selective investigation of taxpayers' accounts which was introduced in 1976-77. The Department now aim to investigate 3 per cent of Schedule D accounts and 1.3 per cent of smaller company accounts. Nationally some 80 per cent of inspector cases and 70 per cent of related recoveries arise from these areas. The balance of the plan should cover cases expected to arise from examination of returns and information other than accounts — mainly in respect of capital gains, undisclosed investment income or PAYE matters. The Department estimate that some 1,525 inspectors, including trainees and management input, are engaged in all these investigations; they report through the normal District Office/Regional Office/Director of Operations structure.

2.2 In addition to the investigation work carried out by inspectors, Tax Officers in District Offices have always carried out, in varying degrees depending on the time available, compliance work in relation to PAYE taxpayers, involving mainly directors' remuneration, benefits-in-kind, expense payments, gratuities, overseas earnings and payments to agency workers. I have regarded this as routine compliance work and therefore outside the scope of this Report. But it should be noted that the Department have recently been requiring detailed reports on the results achieved from these checks and intend shortly to introduce, under the Financial Management Initiative, formal targets at which District Offices should aim. This work is thus becoming more akin to selective investigation. Districts' reports suggest that in the year to October 1983 it produced about £46

million in extra tax or interest savings. In addition many cases were referred to inspectors in PAYE audit (paragraphs 3.1-3.20) for further enquiry.

2.3 In the past, District Office compliance work has also included the kind of detection of evasion now being undertaken by the "Black Economy" teams (paragraphs 4.1-4.11). But in recent years District Offices have reduced this kind of investigation, having found it less profitable than other work.

Selection of cases for inspectors' investigation

2.4 Accounts for investigation are selected by a senior District Office inspector, guided by an investigation handbook and business and technical notes. Some details of the results of investigations throughout the country are fed back to Districts to aid selection, and consideration is being given to doing this more systematically in future. The main grounds for selection are dissatisfaction with profits shown, queries about personal expenditure or inconsistency between the accounts and other information.

2.5 The Department are trying to develop a means of measuring the extent of non-compliance by traders, initially those taxed under Schedule D (paragraphs 2.9 and 2.10), as an aid in determining the proportion of cases for investigation in depth. They are also considering whether, as part of proposed quality control measures, they should test the operation of the selection procedures.

2.6 Other inspector investigations usually stem from cases referred up by Tax Officers within the District, and information from elsewhere in the Department or from external sources e.g. returns of interest or dividends paid or of share

Schedule D — (i) Company Accounts — (ii)	1983		1982		1981		1980	
	(i)	(ii)	(i)	(ii)	(i)	(ii)	(i)	(ii)
Selective investigation of taxpayers' accounts								
Number of settled investigations as percentage of field	2.9%	1.4%	3.0%	1.2%	2.8%	0.9%	2.7%	0.4%
Percentage of cases investigated which required adjustments	90%		87%		87%		84%	
Percentage of cases which also required interest or penalties or reference to Enquiry Branch	38%		29%		24%		17%	
Recoveries	£m133		£m98		N/A		N/A	
Other Investigations								
Number ('000)	18		15		N/A		N/A	
Recoveries	£m62		£m41		N/A		N/A	
Total recoveries	£m195		£m139		£m89		£m76	
Overall cost:yield ratios	1:6.1		1:5.1		1:4		N/A	

Notes

1. About 6 per cent of the higher yields for 1982 and 1983 compared with 1981 is due to different calculation methods.
2. The yields exclude any forward savings from consequential improved compliance.

or property dealings. The need for other investigations is less predictable than for accounts cases and the investigation plan needs to be flexible in this respect. Only the bigger and more serious investigations require inspector involvement and are reflected in the statistics in paragraph 2.8.

Resource allocation and monitoring

2.7 At the beginning of 1981, Inland Revenue started to experiment with new work measurement and staff allocation techniques for the District Office inspectorate, aimed at better matching of resources to the importance of tasks. The resulting system, incorporating central review of the use of inspector manpower in each District Office between the various categories of work, was introduced in 1982. A complementary information system which requires Inspectors to report the actual use of their time on the different categories of work was, with the agreement of the Trade Union, introduced progressively during 1983–84 and will be fully in use as from April 1984.

Results

2.8 The results of District Office inspectors' investigations in the last 4 years (to 31 October) have been shown in the table (p.8).

Schedule D Compliance Exercise

2.9 In response to comment in PAC's 29th Report of Session 1979–80 about the need for some means of measuring and monitoring the standards of taxpayer compliance, Inland Revenue devised an exercise in which inspectors were asked to judge the likelihood of evasion in a sample of Schedule D cases and to test their judgement by investigating those cases showing demonstrable grounds for enquiry. (Inspectors have power to pursue an enquiry only if they have reason to be dissatisfied with a taxpayer's return and accounts.) The Department saw this not only as giving some indication of the level of non-compliance, but as a means of assessing the marginal yield on such investigations to inform decisions on staff deployment.

2.10 The exercise began in November 1981 with 5,500 Schedule D files chosen at random. Inspectors judged that about 20 per cent of accounts in these cases understated profits, 40 per cent might do so and 40 per cent almost certainly did not. In November 1983, when I enquired about progress, about 55 per cent of the cases taken up for investigation had been completed. The Department were unwilling to draw conclusions from these cases: they considered that they might not be representative as they included a disproportionately high number of relatively quickly resolved cases. They had not yet decided whether to extend this approach to company accounts.

2.11 The Department also started in 1981 a research programme into the "correction effect" of in-depth investigations, by monitoring subsequent profit levels for a sample of taxpayers whose accounts had been so investigated. The exercise has so far shown few indications of further understatement of profits.

Comment

2.12 The cost: yield ratios in paragraph 2.8 above are estimates based on available data. The resource allocation system referred to in paragraph 2.7 should enable more accurate ratios to be produced in future. I therefore asked the Department whether they intended to analyse the results of their selective investigation as between Schedule D and company account investigation work or in any other way, to help to improve further their direction of investigations into the most profitable channels.

2.13 The Department informed me that for the year to April 1984 they intended to produce separate cost:yield ratios for each type of District investigation work. This would enable them to identify areas which were less profitable and would provide information to assist with decisions on resource allocation. They emphasised however that resource allocation could not be decided exclusively by reference to cost:yield ratios. The Department needed to have a deterrent presence in all areas of evasion. The cost:yield ratios would also be analysed geographically and an attempt made to identify the reasons for which some areas performed better than others. So far as they could be identified the lessons learned would be passed on to all Inspectors.

2.14 I also asked the Department the reasons for the large increases in total recoveries in 1982 and 1983 and whether they considered that their improved work measurement and staff allocation system had contributed. The Department told me that because of the numerous factors bearing on investigation yield, and the lack of information available on many of them, any attempt to analyse in detail the reasons for the increase would be both extremely time-consuming and probably inconclusive. They believed that improved work monitoring systems and staff allocation techniques had played their part, but so had inflation, changes in the rate of interest under Section 88 of the Taxes Management Act 1970, increases in the level of experience of investigation staff and improved training and management.

2.15 With regard to taxpayer compliance, I asked the Department when they expected useful results from their Compliance Exercise and what sort of information they now expected it to produce. They told me that they expected the exercise to indicate the proportion of Schedule D taxpayers who understated their profits, and the extent to which tax was evaded. The exercise would also show whether the present selection methods picked up the more productive cases for investigation. So far only 70 per cent of the investigations had been completed and processed; inevitably the higher yielding and less straightforward cases figured more prominently amongst those taking longer to settle. Consequently the Department considered that it would be premature to seek to draw conclusions from the results obtained so far. It expected sufficient investigations to have been completed towards the end of 1984 and would then be able to evaluate the results.

Part 3: PAYE Audit

General

3.1 Schedule E income tax and National Insurance (NI) contributions are collected by employers and paid to Inland Revenue and DHSS respectively under some one million approved PAYE deduction schemes. Some employers have more than one such scheme. Inland Revenue also have arrangements under which main contractors must, for each sub-contractor, either ensure that he has been authorised to receive payments gross, or deduct 30 per cent from payments to him and remit these to the Department. About 200,000 contractors are potentially liable to report to Inland Revenue under this system but about half make a "nil" return.

3.2 Employers' and contractors' compliance under all these schemes is examined by the Department's PAYE audit, who normally question NI matters only where they follow from PAYE investigation. DHSS have their own inspectors for checking NI contributions although greater co-ordination between the two groups is being considered (paragraph 3.8). The main aims of PAYE audit are to discourage fraud and educate employers into better administration.

3.3 At 31 October 1983, there were about 600 PAYE auditors and 100 supervisors. Most of these staff were in teams attached to some 77 of the Department's Collection Offices. But 38 were in 4 groups attached to the London headquarters branch and 4 groups attached to Regional Offices. These groups audit the larger employers. Two further groups, involving 10 staff and established in August 1983, specialise in clothes manufacturing employers (the "Rag Trade") in the London area: they were not fully complemented until September 1983 and did not contribute to the results for the year ended 31 October 1983 (paragraph 3.15). The 700 PAYE auditors have risen from 400 in November 1981 and are to be increased to about 950 by 1986. Under a re-organisation of the Department's Collection Offices approved in 1982 and designed to reduce their number from 256 to 135 by 1986, the PAYE audit teams are to be integrated into 90 combined Collection/PAYE Audit offices.

Selection of employers and contractors to be visited

3.4 Some 10 per cent of PAYE audit visits are initiated by special request from a District Office headquarters branch or other source — generally where irregularity is suspected. But, since March 1975, most employers visited by Collection Office teams have been selected by taking a large sample from those with a common last digit in their registered number, a different digit being nominated for each successive sample. Until 1982, the sample criteria embraced all employers in specified high risk categories with 10 or more PAYE deduction cards, 40 per cent of other employers with 10 or more cards and 5 per cent of employers with fewer than 10 cards. In 1982, the sample criteria were revised to cover all employers with 10 or more cards, high-risk employers with fewer than 10 cards, and 5 per cent of the remainder.

3.5 It seemed to me that the revised sample criteria must have reduced the proportion of visits made to high-risk

employers with high average yields. My Report on the Revenue Departments 1981-82 Appropriation Accounts (Volume 9) described how Customs and Excise had sought to improve the cost-effectiveness of their standard VAT control visits by varying and constantly refining the period between visits according to the perceived risk of lost tax. I note that their results in 1982-83 showed a dramatic improvement in cost: yield ratios.

3.6 The large employer groupings visited by the 8 PAYE audit groups are generally widely dispersed multiple concerns, although they include some smaller companies requiring special attention. At the end of 1983 these concerns amounted to some 1,200 employers, each with up to 500 separate PAYE schemes and between them they employed about half of all PAYE taxpayers. The audit groups have developed a number of techniques for selecting employers to visit. The London groups, for example, expect their 1984 cases to come from:

— re-inspection of employers having irregularities when inspected 6-7 years ago	25%
— cases referred by PAYE audit teams	20%
— cases selected at random from published lists of large companies	20%
— cases reported from specialist branches, District Offices etc	20%
— cases selected according to special themes by trade or activity	15%

The Department have not yet sought to ensure a balance in visiting cycles as between one large employer and another or as between large employers generally and other employers.

3.7 66,000 sub-contractor schemes are currently associated with PAYE schemes; and in these cases both types of scheme are audited together. 35,000 sub-contractor schemes are free-standing and are classed as part of the inspectable field which the audit teams work through without any specified programme or cycle for visits.

3.8 Inland Revenue introduced a pilot scheme in July 1983 to co-ordinate their PAYE audit with the DHSS inspectorate. This provides for additional checks by a DHSS team on its first visit to an employer, to indicate whether priority should be given to an early visit by a PAYE audit team. Inland Revenue expect a two-fold benefit: a reduction in duplicated DHSS and Inland Revenue visits to compliant employers; and an increase in the average yield per PAYE audit case through a reduction in unproductive visits. If the pilot scheme is successful the majority of audit visits may eventually be derived from this source.

Working methods and quality control

3.9 Until new procedures were introduced in 1982, PAYE audits covered up to 6 years' transactions. The new procedures confine the examination initially to current year transactions. But it is extended to cover up to 6 prior years' transactions where total underpayments of tax and NI contributions, or of sub-contractor deductions, exceed £150; and also where fraud is suspected. There is no provision for discretion in applying these criteria, even when the extra

work of investigating old records might not be cost-effective, for example because the average error per employee is small.

3.10 Where the auditors find errors they normally agree the amounts involved with the employer or contractor. A charge is then raised against him and it is for him to decide whether to seek to recover any undercharged tax from his employees or sub-contractors. In the case of a large employer, with many homogeneous schemes, this charge may be extrapolated from errors found on visits to a sample of his schemes. An audit group may also use an audit team as its agent to examine an employer's scheme in a remote area; and will then incorporate the results in the agreed charge against the employer.

3.11 In all cases the team or group leader should examine each auditor's papers on conclusion of a visit to monitor performance. He may sometimes accompany an auditor on more complex visits, for training or annual staff reporting purposes and will be present at all settlement interviews. There is no provision for sample follow-up visits to further test the quality of the audit and to deter possible collusion between auditor and employer.

Planning visit programmes and monitoring progress

3.12 Audit teams (but not groups) are required to notify the headquarters branch of the inspectable fields, i.e. the number of employers with the nominated last digit who are to be visited under the current selection scheme. But they are left (as are groups) to devise and monitor their own programmes for covering the employers in their field. There are no records at headquarters or elsewhere of approved programmes which would allow progress with inspections to be monitored against plans. And there appears to be insufficient information available about the characteristics of employers in each team's area to enable probable audit times to be estimated and soundly-based visit programmes drawn up.

3.13 The teams and groups report monthly on the number of visits completed and in hand and the recoveries achieved. This gives the headquarters branch some measure of progress and relative effectiveness. My analysis of these reports suggested that there were wide discrepancies between regions in the number of visits per officer; and the proportion of total schemes in each region inspected in 1982 varied between 2.17 per cent and 4.35 per cent. These figures are unreliable as a precise measure of relative achievement by teams as the total of schemes on which they are based includes large employers inspected by audit groups and employers with fewer than 10 deduction cards, many of whom are not intended to be inspected. But I found no evidence of systematic enquiry into the reasons for these

variations. The headquarters branch had raised some questions with the Regional Officers responsible, but it had no information about measures taken to redress apparent inadequacies in coverage in particular areas.

3.14 In the two most recent account years, the following visits had been completed. (see table below)

Results of visits

3.15 Statistics produced by the headquarters branch showed that, in both the 1982 and the 1983 account years, about two thirds of visits to employers found compliance satisfactory. About 80 per cent of sub-contractor schemes visited were satisfactory. In most cases of error, examination of prior years' records was required. The yield from PAYE audit over recent account years has been as follows:

	1983 £m	1982 £m	1981 £m	1980 £m
Total recoveries (including PAYE, sub-contractor income tax, NI, penalties)	43.8	31.1	20.3	16.2
Cost:yield ratios	1:3.95	1:4.05	1:3.2	N/A

The above yields include adjustments in respect of both prior and current years, but take no account of forward consequential revenue: the Department consider that compliance is generally maintained for about 5 years following a visit and that the real benefit could be approximately double the yield shown.

3.16 The Department attributed the slight fall in the cost: yield ratio in 1983 to an influx of untrained staff. The majority of new staff (170 out of 264) had been taken on during the year ended October 1982 but the Department told me that the learning process lasted for two years.

3.17 The headquarters branch had not analysed cost: yield ratios in any detail since the start of the two stage examination system in 1982 (paragraph 3.4) but they were preparing a computer recording system which would provide information for different employer categories (including sub-contractor schemes) for 1984-85 onwards from which the cost:yield ratios could be calculated and then analysed. They were able to supply analyses which suggested that the audit groups responsible for large employers appeared to be some 6 times as cost-effective as the audit teams; and that there were substantial variations between regions, which the branch attributed to structural and geographical factors and to varying proportions of trainees.

Table

Year to 31 October	Employers visited	Proportion of total employers	Visits by groups to large employers	Sub-Con-tractor schemes visited	Proportion of total sub-contractor schemes	Free-standing sub-contractor schemes visited	Proportion of total free-standing schemes
1982	34,000	3.4%	1,800	3,800	3.8%	434	1.2%
1983	55,000	5.5%	2,000	6,200	6.2%	488	1.3%

Comments

3.18 The results of my examination of PAYE audit seemed to me to raise the following issues, which were largely inter-related:

- (a) whether Inland Revenue might adopt, for PAYE audit visits to other than large employers, a system similar to the Customs and Excise standard VAT control visits, which relates the period between visits to the Department's assessment of the risk of under-collection;
- (b) whether the visit selection methods used for large employers and contractors with free-standing tax deduction schemes provided adequate balance and used staff to best effect;
- (c) whether, in view of the high relative cost: yield ratios achieved by audit groups, and the fact that they covered half of PAYE taxpayers, the allocation to them of only 8 per cent of total PAYE audit resources was adequate;
- (d) whether current arrangements provided satisfactory means of planning and monitoring the work programmes of audit teams and audit groups;
- (e) whether team and group leaders might be directed to exercise discretion in examining prior year records where no culpability was involved, the benefit to individual taxpayers was small and more cost-effective use might be made of investigators' time;
- (f) whether existing supervision methods provided adequate control of quality, or whether there was a need for a structured quality control approach following the principles Inland Revenue were introducing into District Offices.

3.19 In commenting on these points, Inland Revenue informed me that in April 1982 revised inspection procedures were introduced aimed at improving coverage and yield. Despite the fact that 50 per cent of the staff had been under training the results flowing from the change of practice had been highly encouraging with the annual rate of completed inspections almost trebling whilst the yield had more than doubled. Whilst however they were alive to the need to review Audit procedures still further they had been awaiting the results of the Pilot Exercise for Combined Survey visits with DHSS (a first report is expected in July 1984) before developing fully a refined and comprehensive selection and control system since, if the pilot scheme was adopted uni-

versally, Auditors would work mainly on cases reported to them by DHSS Inspectors.

3.20 They added that in the interim they had nevertheless been able to make considerable progress and they made the following comments on the specific points in (a) — (f) of paragraph 3.18 above:

(a) and (b) They did not have the equivalent of the VAT self-assessment form which provided a direct indication of likely irregularity in a particular case. The Revenue's assessment of risk based on trade class and size was necessarily less specific to a particular employer and they could not therefore introduce a system comparable to VAT standard control visits. The audit selection system was being revised provisionally and from July 1984 there would be increased Auditor effort on the larger and higher yielding employers. A computerised system for recording audit inspection results was being introduced in April 1984 as well as a new and comprehensive Management Information System (MIS) which was part of the Department's response to the Financial Management Initiative. The revised selection procedures and computerisation of statistics would enable them to take more account of the risk factor in arranging visits to all types of employers and contractors with free standing tax deduction schemes. Overall the measures taken should provide the basis for a more sophisticated control of the Audit operation and enable resources to be deployed in a more cost-effective manner.

(c) The need to allocate further resources to Group Audit had been under consideration and it was expected that the extra staff would become available this year. The organisation of the Groups was being reviewed with a view to strengthening central control and to formulating a more precise visiting cycle for the large multiple concerns to achieve a more balanced approach with all employers.

(d) The computerisation of the statistics and the new MIS would enable them to maintain closer control of the work programmes of Auditors.

(e) and (f) The possibility of granting discretion to team and group leaders in examining prior years and the need for a structured quality control were questions they would prefer to consider more closely when the results of the new MIS were known.

Part 4: "Black Economy" Experimental Investigations

General

4.1 Inland Revenue told the Committee of Public Accounts in April 1982 that they had devoted 70 staff to experimental work in the field of undeclared extra jobs ("moonlighting"), to help work out the most cost-effective techniques for dealing with this problem (PAC 22nd Report, 1981-82, Evidence Q2353). It appears that the Department also intended the experimental work to cover the problem of potential taxpayers who were not on their records at all ("ghosts").

4.2 The experiment was conducted initially by assigning the work to a geographically distributed selection of Tax Officers Higher Grade within District Offices, although 14 of the 70 staff were transferred to 5 of the Board's Special Offices (see paragraphs 5.1-5.11 below). The transferred staff were not given different work, but the Department thought it useful to see how co-location with other investigation staff would affect performance. Some of the remaining 56 staff were subsequently re-grouped into 6 teams of 4 each under inspectors located in District Offices.

Selection of cases for examination

4.3 The selected staff have been given provisional instructions on ways of identifying potential evaders from a variety of sources, including local and official information, information from taxpayers and classified telephone directories. The instructions have been supplemented by guidance notes and seminars. During this experimental stage, individual investigators have largely been left to decide which cases to pursue, and to what depth, but they can seek local management guidance in difficult cases. They are asked to bear in mind the need to operate as cost-effectively as possible.

Working methods, monitoring and quality control

4.4 The work consists of following up leads both at the desk and by making enquiries around the Districts to which they are attached. Where a case involves only limited secondary activities by the taxpayer, the investigators should themselves adjust the taxpayer's code or make an assessment to reflect the additional liability. In the absence of records, they are advised against seeking too much precision and generally to make a reasonable estimate of the net value of the extra income. In bigger cases, mainly involving "ghosts", the facts have to be referred to an inspector in the relevant District Office who is urged to give such cases high priority.

4.5 While they enjoy some independence, the investigators still come under the normal District or Special Office management system and their supervising inspectors are expected to help expedite cases under examination and in settlement with a view to maximising turn-over and yield. In addition, the headquarters branch have taken a close interest in this work and have visited every investigator at least once to review and discuss his work.

Results

4.6 As might be expected, results have varied considerably between investigators. The headquarters branch, partly to

experiment with groups of investigators, transferred operations from 5 of the lower yielding districts after the first six months of the experiment. While conscious of the need to avoid stifling initiative, headquarters have disseminated and encouraged the use of successful methods developed by some of the investigators.

4.7 There has been a steady increase in reported yields. For the 12 months to 30 September 1983, the total yield was £6.3 million and the cost: yield ratio was 1:4.5. This ratio sought to take all costs into account but ignored the probable forward yield from improved taxpayer compliance. The average size of settlements was £461 for cases handled exclusively by the investigators and £1,743 for those referred to inspectors. There was no significant difference between the performance of staff in District Offices and those in Special Offices and it was too early to see the effect on performance of staff re-deployed as groups.

Additional Resources

4.8 In November 1983 Ministers authorised the deployment on this work of an additional 850 staff (720 Tax Officers Higher Grade and 130 Inspectors), on a progressive basis between 1984 and 1988.

Comment

4.9 As indicated in paragraph 2.3 it has always been a function of District Offices to pursue information received which indicates cases of non-compliance. But Districts had in recent years reduced their efforts in this field because they found them unprofitable. While the approach of the "Black Economy" Investigators is rather different their cost:yield ratio of 1:4.5 is nevertheless lower than any other area of investigation except PAYE Audit. I therefore asked Inland Revenue whether they had any grounds for expecting a much larger and more widely selected body of staff applying this investigation technique to maintain or improve the cost: yield ratio, or to prove an effective deterrent to "Black Economy" evasion. I also asked what changes in organisation or methods of work were proposed for the increasing investigation staff.

4.10 The Department told me that District compliance work in this field had largely been done in response to information received. In more recent years the amount of information distributed had been reduced and for this reason District efforts in this area had decreased. The work done in the "Black Economy" experiment involved a more positive approach, with encouragement to seek out information leading to the discovery of non-compliance. Because the areas covered in the experiment represented a cross section of the whole country they expected this work to maintain the cost/yield ratio when performed nationwide, after newly-assigned staff had become experienced. The Department were confident that the nationwide pursuit of non-compliance would have a deterrent effect, but they had no method by which the extent of the deterrent could be calculated. Whilst the Department accepted that this work was at the lower end of the range of cost-effectiveness, the figure had nevertheless shown a steady upward trend since the experiment began. Overall the work was judged to be suffi-

ciently cost-effective to justify expansion, especially so because this was a significant area of evasion which was not presently being systematically investigated.

4.11 The Department also told me that they saw the control of compliance in this area as a fundamental part of the responsibility of any District Office. They thought it impor-

tant that all District staff should be alive to the need to detect non-compliance and that all potential sources of information in District files should be exploited. Accordingly their plans for deploying the extra staff would aim to ensure that this work was performed in every District Office.

Part 5: Special Offices

General

5.1 The first 3 Special Offices were opened in 1976 and there are now 3 in London, 6 elsewhere in England and one in Edinburgh. They deal with cases of avoidance and evasion which are outside the scope or responsibility of other parts of the Department. They do not normally undertake potential criminal investigations, which are the province of Enquiry Branch (paragraphs 6.1–6.12). Special Offices normally consist of a Group Leader (Senior Principal level) supported by 5 other Inspectors at Senior Principal /Principal level, 5 Inspectors at Senior Executive Officer /Higher Executive Officer level and 6 clerical and support staff. The group leaders report to an Assistant Director.

5.2 Although each Special Office is assigned a geographical area for the purpose of liaison with tax districts, they can and do pick up cases detected by their own research wherever they arise. All are prepared to tackle anything within Special Offices' ambit, but some have also tended to develop expertise in particular areas of avoidance and evasion. Thus Edinburgh deals with offshore oil workers, one London office deals with pornography and another with the entertainment industry.

Selection of cases for enquiry

5.3 About half of Special Office cases stem from their own research: for example from media references or from earlier investigations. Many others are referred from PAYE audit teams or headquarters branches. Typical cases include taxpayers with interests divided between different businesses, companies or trusts; wealthy "ghosts"; and tax anomalies affecting workers in a particular industry.

5.4 Because of the nature of the work the offices cannot be given specific objectives or performance targets, and no lower limit is set for the size of cases or projects, but normally the Inspectors at Principal and Senior Principal level undertake only investigations in which tax of at least £50,000 is at risk; and the more flagrant the avoidance or evasion the higher the priority for investigation. They do not consciously seek to cover all aspects of possible evasion, but consider that a reasonable mix occurs naturally. The probable cost of an investigation is not an important consideration as the offices can rarely forecast how long an investigation will take or its ultimate yield.

Works methods, monitoring and quality control

5.5 All prospective cases are reviewed before the Group Leader accepts them for full investigation, to estimate the tax at risk and the likelihood of success. Investigators are given wide discretion in their work but generally seek early settlement, including penalties where appropriate, even if this means foregoing tax which might be recovered through more exhaustive investigation.

5.6 The Group Leader is expected to monitor investigations but he may delegate this to team leaders where staff are split into small groups. But Group Leaders carry out a four monthly review of all cases. Some of the major cases are also monitored by the Assistant Director. Settlements are

referred for approval to the Group Leader and those over £50,000 involving interest and penalties, to the Assistant Director.

5.7 No central records are maintained of the progress of cases at Special Offices but each office is visited at least once a year by the Assistant Director who, among other tasks, reviews all cases over 3 years old. Inland Revenue do not consider this sort of work suitable for control by any form of targeting; and they regard the review of cases during progress and for approval of settlements as giving sufficient control over technical quality.

Results

5.8 Brief details of cases registered and settled are circulated between Special Offices for information and to help avoid duplication. In addition each office makes an annual report and these are summarised by the Assistant Director into a composite report giving analyses of cases in progress and settlements, by category and source of enquiry.

5.9 The yields from Special Office investigations in recent account years have been:

	1983	1982	1981	1980
Offices open	10	8	7	6
Yield, including interest and penalties	£m54.4	£m50.1	£m28.8	£m20.5
Number of cases	519	433	344	N/A
Average yield per case	£104,000	£115,000	£84,000	N/A
Cost:yield ratio	1:18	1:20	1:19	N/A

5.10 The marginal drop in cost:yield in 1983 may reflect the opening in the year of two new offices in Bristol and London. While there were significant variations in yield between the different offices, reflecting in part some major settlements, all the well-established offices have maintained high yields during the last three years. The main categories of settlement in 1983 were those involving employers' liability (£16 million), capital gains tax and development land tax (£7 million), and company tax avoidance (£6 million).

Comment

5.11 This is clearly a highly productive area of investigation which appears to be well directed and managed, partly, perhaps, because its staff is fairly small. Since the cost:yield ratio has been maintained notwithstanding a substantial rise in cases investigated, I asked Inland Revenue whether they considered that there was significant scope for further extension of this work. They told me that since 1976 the Special Office network had grown as quickly as the various practical constraints (such as the availability of accommodation, and of staff) had allowed, and that their first priority was to bring the three most recently opened offices up to strength. They stated that the possibility of opening 5 more Special Offices by 1988 had been under consideration and this would be taken into account in the review of all investigation work within Technical Division 2 which started in March of this year (paragraph 10.5).

Part 6: Enquiry Branch

General

6.1 The Enquiry Branch has existed since 1920. Like the Special Offices, it has 10 offices throughout the country, each headed by a Group Leader (Senior Principal level). The offices are broadly similar in structure and size. The staff gradings tend to be higher than in Special Offices and they include qualified accountants: the total technical complement consists of 69 fully trained inspectors and 30 accountants. The Group Leaders report to a headquarters senior staff of an Assistant Director, 2 Principal Inspectors and a Senior Principal Accountant. These arrangements have been virtually unchanged for at least 15 years.

Selection of cases for enquiry

6.2 Enquiry Branch deals with cases suspected to involve serious fraud in relation to business accounts. Cases for possible investigation are referred to the branch mainly by District Offices but also by Special Offices, PAYE Audit, other head office investigation units and Custom and Excise. Some are generated by earlier investigations and by the Branch's own research. Cases are not usually referred to Enquiry Branch unless they involve under-stated income of at least £50,000 (recently increased from £20,000); they will be taken up if there are reasonable grounds for suspecting:

- a substantial loss of tax by internal manipulation of business records;
- the honesty or competence of practising accountants, solicitors, or taxpayers of special status; in this category the £50,000 under-stated income limitation does not apply;
- irregularities involving groups of companies with liabilities spreading over several Districts or with special features;
- submission to Districts of false certificates of disclosure.

6.3 No clear case of serious fraud is rejected by Enquiry Branch but more speculative cases are accepted only if the prospects of success are reasonable: the main criterion for selection is the seriousness of the suspected frauds and the probable amount of tax evaded. The Branch would not normally take on a case in the absence of hard evidence; but it would not discontinue a case because the yield began to seem less promising.

Work methods, monitoring and quality control

6.4 Potential cases are reviewed to determine whether they should be registered for full investigation, the Group Leader playing a major part. Generally Enquiry Branch offices are able to cope with the work load of referred cases. But headquarters consider that there is plenty of scope for additional work in the London area and in Scotland if further resources become available.

6.5 Investigations are carried out by inspectors, helped by accountants when necessary, although some specialist cases are handled by accountants alone. An investigation usually starts with an interview with the taxpayer and his professional advisers at which the Department's policy in relation

to tax evasion is brought to his notice. While no undertaking not to prosecute can be given, the Board's power to make a monetary settlement is referred to, as is the fact that the Department is influenced by the taxpayer making a full confession and providing full facilities for investigation. Where the taxpayer makes a disclosure in response to formal questions put to him, an investigation report is prepared by his accountants and submitted to Enquiry Branch for checking. Where the taxpayer denies any irregularities, the complete investigation is normally undertaken by Enquiry Branch. Enquiry Branch has generally been less likely than Special Office to settle before all possible lines of enquiry have been exhausted but in recent years they have adopted a more flexible policy and they consider that this has resulted in increases in cases handled and overall yield.

6.6 Inland Revenue's policy is, in the main, not to prosecute the tax evader but to seek penalties according to the gravity of the offence. Enquiry Branch's practice is therefore to give the taxpayer an opportunity, in all but the most "heinous" cases, of following a course — full confession and access to his records — which will normally result in a money settlement rather than criminal proceedings. As a result, only about 80 cases out of 800–900 on hand at any given time in Enquiry Branch are treated for the substantial part of the investigation as likely prosecution cases, and these require significantly more work than the remainder. Until 1983, prosecution had to be authorised by the Board itself, but it can now be authorised at Under-Secretary level. 26 cases in 1982 and 44 cases in 1983 were submitted and prosecutions were ordered in 22 and 41 cases respectively. Nearly all the prosecutions were successful.

6.7 The Group Leader of each Enquiry Branch office is expected to keep closely in touch with all the cases in hand and to take part in difficult interviews, including some where settlements are negotiated. The two Principal Inspectors visit each of their offices twice a year and review a number of working cases for each investigator. All settlements must be referred to the Group Leader, and those over £50,000 to the Principal Inspector. Progress reports on cases are required from each investigator 3 times a year and these are summarised and sent to headquarters. Headquarters produce a detailed record of open cases showing time in process and stage reached, and are thus able to watch progress closely. The average time taken on a case has been reduced over recent years from 3 years to 2 years.

Results

6.8 Overall yields in recent years have been as follows:

	1983	1982	1981	1980
Number of settlements	444	418	438	400
Yield due to Enquiry Branch intervention (about $\frac{1}{3}$ represents interest and penalties)	£m44.2	£m35.4	£m22.8	£m18.9
Average settlement (including amounts not directly due to Enquiry Branch intervention)	£124,000	£118,000	£73,000	£57,000

Comment

6.9 Although the Department produce cost:yield ratios for Enquiry Branch, they do not regard them as a major consideration for much of the Branch's work. The ratios were 1:11 for 1982 and 1:13 for 1983, but these must be treated with caution as they exclude court costs and the cost of solicitors' advice. On the other hand they ignore beneficial effects on future compliance.

6.10 The yield per office has varied considerably, notwithstanding broadly similar staff complements. The yields of the London and Edinburgh offices in 1982 and 1983 were on average about two and a half times greater than those elsewhere. The catchment areas were reviewed in 1982 and aligned with regional boundaries as far as practicable. I asked Inland Revenue whether they considered that further adjustments of the boundaries or staffing were needed to produce more even coverage, which might improve the average yield.

6.11 They told me that they would not wish to reduce the size or significantly increase the area of any office, because there must be a sufficient presence in all parts of the country to deter serious fraud. They said that the figures for Scotland were distorted by results achieved in two particular industries and that the higher yields of the London offices reflected in part the fact that a tax offence committed in a prosperous part of the country was likely to produce a greater loss of tax than the same offence committed in an area where incomes and economic activity were lower. It was implicit in that response that they did not regard yields in

terms of tax as the only factor in determining whether a fraud was serious enough to warrant Enquiry Branch investigation. Accommodation, personnel and other constraints made it impracticable to constantly adjust the sizes and catchment areas of offices to match changes in the incidence of serious fraud in different parts of the country, but it was possible for an office which was temporarily lightly loaded to take on cases which arose within the catchment areas of other offices. However the review of specialised investigation work (paragraph 10.5) would be examining the case and scope for expansion of Enquiry Branch work generally and this would take into account imbalances that might currently exist.

6.12 I also asked whether the Department would think it worthwhile giving greater weight to cost:yield ratios or other indicators of cost effectiveness for Enquiry Branch work, when making comparisons with other areas of investigation. They told me that, although they calculated cost:yield ratios, in their view the role of Enquiry Branch was not only to act as a direct revenue producer but also, and essentially, to deter fraud by being seen to combat it vigorously and successfully wherever it arose; and that the ultimate measure of success of such an agency had to be qualitative rather than quantitative. They said that measures of the efficiency and effectiveness of Enquiry Branch would be developed, in common with all other parts of the Department, as part of their response to the Financial Management Initiative, but that they did not intend the cost:yield ratio to be given any greater prominence than it was at present.

Part 7: Investigation Office

General

7.1 The Investigation Office is responsible for investigating misuse of certificates issued under the construction industry's tax deduction scheme for sub-contract work; fraudulent personal allowance and Schedule E expense claims; and "internal" investigations, outside the scope of this Report, of misconduct by Inland Revenue staff. The office has a complement of nearly 100 investigators, about 90 of whom are engaged on work within the scope of this Report, with a few supporting staff. The investigators are graded from Executive Officer to Principal. About half the staff are in 5 groups in the London Office (at Surbiton) and the rest are in 4 provincial locations. There is a small Collator and Intelligence Unit in Central London and the Office is headed by a Senior Principal.

Selection of Cases

7.2 Increasingly, with fewer PAYE allowances and reliefs, the Office's main role is the investigation to criminal standard of proof of fraud by contractors and sub-contractors in the construction industry. Monetary settlements are not appropriate; and if they were, few miscreants would have the means to pay. The Inland Revenue consider prosecution in this area to be an essential deterrent against flagrant abuse. Cost-effectiveness cannot therefore be the main concern. A computer centre at Liverpool controls the sub-contractor scheme records and performs certain checks on contractors' returns. It refers suspect cases to the headquarters branch responsible for the scheme. This branch then refers appropriate cases to the Investigation Office for criminal investigation. The Office receives other cases through District Offices and local PAYE Audit offices and these three sources account for about 50 per cent of its sub-contractor work. The remainder arises from leads picked up on earlier investigations or from their own intelligence work, use of the Section's collator system and visits to Districts.

Work Methods

7.3 Referred cases are vetted centrally at Senior Executive Officer level to check that they merit criminal investigation. In other cases the investigating office concerned looks for prima facie evidence of fraud. Just over 20 per cent of cases investigated result in prosecution, which is usually successful. Other cases are referred back to Districts, who may raise charges against the contractor under a special (Regulation 12) procedure or pursue tax due from a sub-contractor.

7.4 Cases are investigated mainly by interviewing contractors and/or sub-contractors. In doing so investigators must apply "Judge's Rules"; this normally requires them to work in pairs, and to take statements. Where, on completion of an investigation, the evidence points to a criminal prosecution, legal advice is sought as to the competence of proceedings. Prosecutions are ordered at senior principal level or above.

Results

7.5 For most of the Investigation Office's cases prosecution is the normal sanction, and the Office itself does not negotiate monetary settlements. Recoveries from cases passed back to Districts for local action, are probably no more than about £2 million a year. But tax known to have been evaded in sub-contractor cases completed during the year to 31 October 1983 amounted to about £18 million (£16 million in 1982).

7.6 In the year ended 31 October 1983 202 cases in which it was considered that either the evidence was right for prosecution or further work could bring it up to that standard were submitted to line management for prosecution approval, and around 25 per cent were rejected. The remainder resulted in the prosecution of 158 individuals (108 in 1982) and these represented about three quarters of all the Department's prosecutions.

Comment

7.7 It seemed to me that the procedures for reviewing cases prior to full investigation were less rigorous than for Enquiry Branch investigations. In view, also, of the substantial proportion of fully investigated cases rejected for prosecution, I asked whether Inland Revenue were satisfied that their control over these investigations ensured that unproductive lines of enquiry were terminated at the earliest practicable stage.

7.8 The Department told me that they did not accept that my comparison with Enquiry Branch was valid. Enquiry Branch dealt with a different type of taxpayer and different type of tax offence, and had far greater scope in selecting what to investigate and how to investigate it. They made three points. Firstly, that much of Enquiry Branch's work came from cases submitted to them by Districts, in which a substantial amount of investigation had already been carried out. Secondly, that having decided to take up a case the option was usually open to Enquiry Branch to investigate to civil standards of proof with a view to a monetary settlement as opposed to conducting a full criminal investigation. Thirdly, that Enquiry Branch usually dealt with people of substance with well established businesses. By contrast, Investigation Office started their own investigations from scratch; the option of seeking a monetary settlement on the basis of civil standards of proof was not open to them — all their investigations had prosecution as the sole objective; and they tended to deal with elusive, itinerant people who had dissipated the fruits of their frauds by the time the Revenue caught up with them. They added, however, that the question of control of unproductive lines of enquiry would be one of the matters to be examined in the review of specialised investigation work referred to in paragraph 10.5 below.

Part 8: Other Specialist Investigation Units

General

8.1 There are two other sections of the Department's Technical Division 2. One is engaged in countering major artificial tax avoidance arrangements and schemes, and the other in monitoring transfer pricing arrangements operated by multinational corporations. These are highly complex activities relating to large amounts of potential revenue.

Special Investigations Section

8.2 This section has about 25 investigators, mainly of Principal and Senior Principal grading, mostly based in Central London and reporting to an Assistant Director. Just over half are engaged on countering complex avoidance schemes, often involving challenges through the Courts. Frequently millions of pounds are at issue.

8.3 One unit of the section provides a (statutory) clearance service for taxpayers in connection with a variety of proposed transactions and securities, and will challenge any completed transactions which were designed to obtain an improper tax advantage. Another unit investigates the tax implications of the transfer of assets abroad by individuals.

8.4 Cases are referred to the section from a variety of sources, most coming from District Offices and other branches of the Department.

Transfer Pricing Work

8.5 One of the functions of Technical Division (International) — part of Technical Division 2 — is to investigate arrangements, such as transfer pricing within multinational corporations other than oil companies, which are likely to result in understatements of profits taxable in the United Kingdom: the most important work of this nature was

centralised at Head Office in 1974. The division also advises Districts on these matters. Taxation of oil companies is handled by the Oil Taxation Office on which I reported in Volume 9 of the 1980–81 Appropriation Accounts.

8.6 At present 7 officers, mainly of Principal and Senior Principal grades, are engaged in this work. In recent years Technical Division (International) has been heavily committed to providing technical support to Policy Divisions in their consideration of proposed legislation on international tax avoidance. When this pressure is reduced — probably not before the end of 1984 — it should be possible to devote extra resources to this very productive investigation work.

8.7 In their normal investigations the investigators frequently exchange information under tax treaties with other national revenue authorities and many cases are protracted. The cases they handle arise from various sources but most emanate from District Offices or direct investigation within Head Office. The yields from the work are often substantial. With an average of 6 investigators over the 10 years of its existence it has increased profits by about £200 million in something over 100 cases.

Comment

8.8 This is highly expert investigation work, which may have long time scales and for which it is often difficult to assess the tax yield on a simple annual basis. It is clearly essential if complicated company taxation law is to have the full effect that Parliament intends. But it seemed to me that any judgement about its effectiveness required a much deeper study than was appropriate to the more general purposes of this Report.

Part 9: Keith Committee Comments and Recommendations

9.1 The Committee on Enforcement Powers of the Revenue Departments, chaired by Lord Keith, have produced three volumes of Report so far and promise a fourth. I have reported separately on recommendations of the Committee, other than on investigation work, which bear on matters in which PAC have shown recent interest. I comment here only on matters relating to investigation work.

9.2 The Committee received and reported evidence that the estimate of the "Black Economy" at $7\frac{1}{2}$ per cent of Gross Domestic Product is "not implausible" and that it is probably increasing, particularly through "moonlighting". They consider that the principal deterrent is fear of detection and its consequences; and that, to the extent that perusal of Revenue's enforcement efforts suggests that the chances of escaping detection are good, a continuing decline in compliance can be expected.

9.3 The Committee concur with PAC's proposition that investigation ought to go ahead by means of the provision of more staff if it promises a high return. But they also agree

with the Treasury view that some presence is required in circumstances which do not offer a direct yield, so that the integrity of the system is upheld and seen to operate equitably. They express particular concern about the extent to which payments to casuals and "moonlighters" are not pursued because inspectors consider this the least cost-effective area. They consider that prosecution policy should be responsive to the prevailing climate of offences and that suitable cases of "moonlighting", involving both self and spare time employment, should be sought out and prosecuted.

9.4 The Committee recognise that some of the measures they favour are staff intensive and that account must be taken of competing claims to manpower resources. But they consider that some staff are devoted to labour-intensive routine activities which assist enforcement only indirectly, and that these might be better employed on the Department's monitoring and control function. They also advocate an urgent study to assess the scope for computers to compare miscellaneous information returns with individuals' tax returns.

Part 10: Overall Deployment of Investigation Resources

10.1. The foregoing paragraphs indicate the extent to which Inland Revenue monitor and analyse the operation of, and results achieved by, their various arms of investigation. While clearly much is done to monitor individual fields, I have found no evidence of systematic reviewing of the Department's investigation effort and resources as a whole, as a basis for redeploying staff either to reflect relative cost-effectiveness or to ensure a particular balance in the offensive against different forms of non-compliance. Such redeployment as has been proposed recently has tended to be to areas where direct cost-effectiveness appears relatively low, although it has been in line with the Keith Committee's view that a proper balance requires more PAYE audit and "Black Economy" investigation.

10.2 It also seemed to me that the distribution of investigation resources between so many separate arms, most with their own geographically dispersed structure of offices, might impede the balanced approach to tax investigation and prosecution advocated by the Keith Committee. I therefore asked Inland Revenue whether they intended to carry out any general review of the structure of their investigation areas or had any further plans for controlling and adjusting the balance of investigation effort.

10.3 The Department told me that they did not accept that there was a lack of systematic control of their investigative effect. It was misleading to regard the investigation arms described in paragraph 1.3 as eight separate areas of work. In fact they fell into two categories: the first three areas formed one category and the last five another.

10.4 The first three areas (Accounts Investigation and PAYE Audit) represented work which was an essential part of the normal operation of the Tax and Collection District networks, the first and third areas being handled by Tax Districts and the second by Collection Offices. It was the responsibility of each District Inspector, with the guidance as appropriate of Regional management, to work out his own investigation programme. The first and third areas of investigation, although carried out by differently graded officers, using different techniques as appropriate, were essentially homogeneous. This work was rather different from the continuing task in the second area, of inspecting employers' PAYE, but liaison at local level existed to the extent that it was called for. There was unified control of Tax and Collection Offices at Regional level and these three areas of investigation likewise came under the responsibility of a single Head Office division, controlled by the Director of Operations.

10.5 The last five areas, in contrast, were all highly selective areas of work, each calling for staff with specialised skills or training. Hence they were all handled by relatively small work units, all of which were part of a single Head Office division (Technical Division 2) in the charge of a

single Under Secretary. The geographical dispersal of some of the units within this Head Office division was an operational necessity, and was not found to hinder co-ordination and co-operation. In many cases the outposts of different units were co-located, and there was a great deal of informal local contact, as well as formal consultation at senior level. The bringing together under unified control of the work done in these areas was in fact one of the objectives of the reorganisation carried out following a management review in 1976. It was recognised at that time that a further study would be called for at a later date to review in the light of experience the way in which this concentration of specialised investigation work was operating; such a review had recently been set up to consider whether this investigation work was organised in the most effective manner, and the case and scope for employing more resources to maximise its effectiveness. The Committee charged with this task had begun its work, and aimed to report by the end of September 1984.

10.6 On the general issue of redeploying staff to reflect cost-effectiveness, the Department told me that the direct yields in terms of tax, although extremely important, could not be the sole criterion in determining the distribution of their investigation resources: the (unquantifiable) deterrent effect of being seen to be active in combating all forms of tax evasion and avoidance was also a very important factor. When occasion arose, decisions were consciously taken — for example to prosecute instead of seeking a money settlement — which reduced *direct* cost-effectiveness but were judged likely to encourage better compliance by the general body of taxpayers. They also commented that there was only limited scope for redeploying staff between the different investigation arms: the investigations which produced the best results in terms of direct cost-effectiveness were carried out by Inspectors of Taxes, predominantly fully trained, who were the Department's scarcest resource. They said that the staff being redeployed from other duties to "Black Economy" investigations and the like were in general of lower grades and different staff groups, and did not have the basic training and expertise to tackle the higher yielding work.

10.7 The Department's view was that cost:yield ratios were not the only consideration they had to bear in mind when organising their investigation effort. They had to pay regard also to the need to spread their resources over all areas of the Department's work. But, having said that, they pointed to the fact that the Department's yield (tax, interest and penalties) from investigation work quadrupled between 1978 and 1983, representing a 2½ fold increase in real terms, whereas the increase in staff resources devoted to investigation work over that period was only about half. The Department said that these figures suggested that the Board had been satisfactorily fulfilling their obligation to deploy their resources in a systematic way and to adopt a balanced approach to investigation work.