



House of Commons  
Committee of Public Accounts

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# HMRC Tax Collection: Annual Report & Accounts 2012–13

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Thirty-fourth Report of Session 2013–14

*Report, together with formal minutes, oral and  
written evidence*

*Ordered by the House of Commons  
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## Committee of Public Accounts

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Powers of the Committee of Public Accounts are set out in House of Commons Standing Orders, principally in SO No 148. These are available on the Internet via [www.parliament.uk](http://www.parliament.uk).

### Publications

The Reports and evidence of the Committee are published by The Stationery Office by Order of the House. All publications of the Committee (including press notices) are on the internet at [www.parliament.uk/pac](http://www.parliament.uk/pac). A list of Reports of the Committee in the present Parliament is at the back of this volume. Additional written evidence may be published on the internet only.

### Committee staff

The current staff of the Committee is Adrian Jenner (Clerk), Claire Cozens (Committee Specialist), James McQuade (Senior Committee Assistant), Ian Blair and Yvonne Platt (Committee Assistants) and Alex Paterson (Media Officer).

### Contacts

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## Summary

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In pursuing unpaid tax, HM Revenue & Customs (HMRC) has not clearly demonstrated that it is on the side of the majority of taxpayers who pay their taxes in full. It does not use the full range of sanctions at its disposal to pursue vigorously all unpaid tax, and its measure of the tax gap does not capture all the avoided tax that it should be collecting. HMRC massively over-estimated how much it would collect from UK holders of Swiss bank accounts, and in 2013-14 has so far collected only £440 million of the £3.12 billion predicted in the 2012 Autumn Statement. HMRC is not doing enough to collect tax credits debt or to tackle tax credit error and fraud.

When determining the tax regime for businesses, HMRC needs to strike the right balance between support and enforcement. It has not considered adequately the impact that measures designed to make the UK a more attractive place for large businesses to operate would have on the way companies structure their business, and how this would affect tax receipts from them. While HMRC has made good progress towards implementing Real Time Information (RTI), it must continue to support small and medium-sized enterprises (SMEs) with the transition to the new system.

## Conclusions and recommendations

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1. HMRC is responsible for collecting UK taxes and duties from businesses and individuals and providing financial support to taxpayers through tax credits. It aims to deliver three strategic priorities: to improve customer service; to reduce operating costs; and to reinvest money from its efficiency savings to generate increased tax revenue. In 2012-13, HMRC reported that it had brought in £475.6 billion of revenue, an increase of £1.4 billion or 0.3% in cash terms compared to 2011-12. Tax revenue therefore fell in real terms in 2012/13 as compared to 2011/12.
2. **The tax gap is a theoretical concept to assess tax revenues lost to the Exchequer.** It does not cover the full amount lost through tax avoidance. It sets out to measure the difference between the amount collected and the amount that should be collected. The stated tax gap underestimates the amount of money lost to the Exchequer. Despite the Department's increased efforts on reducing the tax gap, the latest figures for 2011-12 shows an increase of £1 billion to £35 billion compared to the previous year. Furthermore, HMRC has not attempted to gather intelligence about how much tax revenue is lost through aggressive tax avoidance schemes, so this is not included in its figures. HMRC is not explicit about this limitation to its current measure.

**Recommendation:** *HMRC should be explicit about the limitations of its current measure of the tax gap and gather intelligence about the value of tax lost through aggressive tax avoidance schemes. When there are firm plans to change international tax laws to tackle avoidance, HMRC should use this intelligence to assess how much additional tax revenue the changes would generate within the UK.*

3. **HMRC needs to demonstrate that it deals robustly with individuals and companies who deliberately mislead it.** While HMRC told us that it is committed to collecting the tax that the law provides for, the lack of prosecutions against multinational corporations seems at odds with HMRC's stance on pursuing tax debt from small and medium-sized businesses in the UK. HMRC has yet to test how existing tax law impacts on global internet-based companies. Despite assurances given to us by HMRC a year ago, it remains the case that only one of 16 cases subject to criminal investigations arising from the Lagarde list of Swiss bank account holders has resulted in a prosecution.

**Recommendation:** *HMRC should be more willing to pursue prosecutions against individuals and large businesses to test the boundaries of the law and to demonstrate firm action against those who have knowingly misled or withheld information.*

4. **HMRC massively over-estimated how much it could collect from UK holders of Swiss bank accounts and has not been sufficiently vigorous in pursuing outstanding liabilities.** The 2012 Autumn Statement estimated that in 2013-14 HMRC would recover £3.12 billion unpaid tax from the Swiss bank accounts of UK taxpayers and this figure was built into budget estimates. So far it has collected just

£440 million.<sup>1</sup> We were astonished that HMRC could not explain the reasons for such a huge shortfall, or what it was doing to gather the data it needs from the Swiss authorities to assess and collect the tax due, despite it having met with the Swiss authorities to discuss these issues.

**Recommendation:** *HMRC must continue to press the Swiss authorities to provide accurate and complete information about amounts held there by UK taxpayers, and pursue more vigorously the amounts owed in unpaid tax.*

5. **In seeking to make the UK more attractive to business, HMRC has not considered adequately the impact that changes to the tax regime will have on the behaviour of large businesses.** UK-based companies may reduce their tax liability by borrowing money in the UK to invest in an offshore subsidiary and then offsetting the borrowing cost against their UK profits. The UK's Controlled Foreign Companies rules have been weakened and incentivise UK companies to move finance operations offshore. Multinational companies are also using the Eurobond rules to lend money to their UK subsidiaries via low-tax jurisdictions and offset the interest payments against their UK profits, thereby reducing their corporation tax liability.

**Recommendation:** *HMRC needs to better understand how companies and their advisers will react to new tax rules and legislation, and prevent unintended consequences. If the department is creating new incentives that may also enable international corporations to avoid tax, then it should be open about any such consequences.*

6. **HMRC's implementation of its Real Time Information system has been encouraging overall, although some smaller businesses continue to struggle with the transition.** HMRC's gradual approach to implementing RTI has gone well so far, and has been characterised by a willingness to learn lessons and adapt as it goes along. It has extended its implementation deadline for smaller businesses, and increasing numbers of employers have signed up to it. HMRC has had responses from 24,000 businesses to its survey of RTI but it has yet to analyse these. We are concerned that, while HMRC is planning to introduce fines for non-compliance with RTI from April 2014, some small businesses face continuing challenges to adopt it.

**Recommendation:** *HMRC should analyse the information it has from its customers to help it understand the problems faced by smaller businesses struggling to adopt RTI, so that it can continue to provide them with effective support.*

7. **The lack of full disaster recovery arrangements in the RTI system means there is a risk that any system failure will delay or introduce errors in payments to Universal Credit claimants.** The successful implementation of Universal Credit depends on HMRC working effectively with the Department for Work & Pensions, both because Universal Credit uses information transferred to it from RTI to calculate payments to claimants and because it will eventually replace tax credits.

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<sup>1</sup> On 5 December 2013, the Autumn Statement also stated that "The UK's tax agreement with Liechtenstein, forecast to bring in a total of £630 million by 2013-14, has so far yielded over £800 million with over two and a half years left to run".

However, delays in receiving information from RTI, or any system failures, are likely to affect payments to individual claimants, and RTI currently lacks full disaster recovery arrangements.

**Recommendation:** *HMRC must undertake work necessary to improve the provision for disaster recovery within the RTI system to ensure that correct payments to claimants will continue in the event of a system failure.*

8. **Personal tax credit debt has increased since 2011-12, and HMRC has reduced markedly the amount it expects to recover.** Personal tax credit debt increased from £4 billion at the end of 2011-12 to £4.8 billion in 2012-13. HMRC estimates it could increase to £5.5 billion by 2014-15. It reduced its estimate of recoverable tax debt in 2012-13 from 43% to 31% and increased the provision in its accounts for “irrecoverable” debt by £985 million to £3.3 billion. While it is unlikely that these amounts will be fully recovered, HMRC has not actually written-off these debts.

**Recommendation:** *HMRC should undertake a thorough analysis to identify which tax credit debt is recoverable and write off that which is not, to provide a more accurate assessment of the position before tax credits are transferred to Universal Credit.*

9. **HMRC has not done enough to identify potential tax credit error and fraud, prosecute offenders and pursue overpayments.** HMRC has had some success in identifying losses from tax credit error and fraud through a pilot programme using a private sector provider to identify potential fraud cases. However, it could make far greater use of information from organisations, including banks, to help it identify potential fraud risks, for example to identify bank accounts which receive tax credits but from which withdrawals are consistently made outside the EU.

**Recommendation:** *HMRC must analyse the cost-effectiveness of the various measures it uses to counter tax credits error and fraud, to establish which provide the best return on its investment.*

# 1 Business tax and tax avoidance

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1. On the basis of a report from the Comptroller and Auditor General on HM Revenue & Customs' (HMRC) 2012-13 Annual Report and Accounts, we took evidence from HMRC on its progress in dealing with various personal tax, business tax and tax avoidance issues.<sup>2</sup> HMRC is responsible for collecting UK taxes and duties from businesses and individuals and providing financial support to taxpayers through tax credits. It has three strategic priorities: to improve customer service; to reduce operating costs; and to reinvest money from its efficiency savings to generate increased tax revenue.<sup>3</sup> In 2012-13, HMRC brought in £475.6 billion of revenue, an increase of £1.4 billion or 0.3% in cash terms compared to 2011-12.<sup>4</sup> There was a real terms reduction in revenue over the two years.

2. Each year HMRC publishes its estimate of the tax gap to set out the difference between the amount of tax it collects and the amount that should be collected according to its interpretation of the intention of Parliament in setting tax law (the theoretical liability).<sup>5</sup> HMRC's most recent estimate of the tax gap, for 2011-12, is £35 billion, a £1 billion increase on 2010-11, although the tax gap as a proportion of the theoretical tax liability decreased slightly from 7.1% to 7.0%.<sup>6</sup>

3. HMRC's calculation of the tax gap does not include an assessment of the amount of tax lost through tax avoidance, therefore it represents only a fraction of the amount that the public might expect to be payable.<sup>7</sup> The Prime Minister has called for measures to tackle tax avoidance and the Organisation for Economic Co-operation and Development (OECD) is also considering this issue. However, HMRC said it had not attempted to calculate how much more tax would be owed to the UK by multinationals were such anti-avoidance measures introduced. It considered that any calculation based on the OECD's initiatives to date would require a significant amount of work and be unreliable, as the OECD's work was still on-going. HMRC said that the OECD was uncertain about how much money would be involved globally, and how this should be allocated between different states.<sup>8</sup>

4. HMRC has not tested the limits of its power to address aggressive tax avoidance. It has not prosecuted any major internet company despite huge differences in the value of UK sales reported in the US and in the UK, and allegations that sales had been recorded as being made offshore in order to reduce tax liabilities, despite the sales actually being made

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2 HM Revenue & Customs 2012-13 Accounts, *Report by the Comptroller and Auditor General*, June 2013

3 C&AG's Report, paragraph. 7

4 C&AG's Report, paragraph 1.2

5 HM Revenue & Customs, *Measuring tax gaps 2013*, October 2013

6 Qq 222-223

7 Qq232-235, 258

8 Qq 252-256



in the UK. HMRC reported that it investigates all such claims and that it is pursuing prosecutions against a number of businesses.<sup>9</sup>

5. HMRC said that in the first half of 2013, it had secured £1 billion through prosecuting eight large businesses for their involvement in tax avoidance.<sup>10</sup> It also told us it was committed to taking action against individuals and firms which invent and sell targeted avoidance schemes in the UK that overstep the boundaries of what is acceptable. It reported that it had recently secured two convictions for fraud, and that Government is currently consulting on measures to identify high-risk promoters of tax avoidance schemes and to penalise those who do not disclose information about their activities.<sup>11</sup>

6. In October 2011 the UK and Swiss governments signed an agreement to tackle offshore tax evasion, under which the 2012 Autumn Statement forecast that HMRC would receive £3.12 billion in 2013-14. The forecast was based on joint analysis by HMRC and the Office for Budget Responsibility (OBR) of the information received from Swiss banks.<sup>12</sup> HMRC told us that it had received £440 million in the first seven months of 2013-14, just 14% of the total amount expected this year.<sup>13</sup> HMRC was unable to explain why the data it provided to the OBR resulted in such an inflated estimate. Although HMRC had met with the Swiss authorities to express concern about this shortfall, it could not elaborate on what had been discussed, or what explanation the Swiss government gave for the inadequacy of the information provided by Swiss banks.<sup>14</sup>

7. Most of the £440 million received came from amounts withheld by the Swiss banks to settle the liabilities of account holders from the UK who wish to remain anonymous. HMRC has the right to investigate individuals who waive their right to anonymity but it has made little progress in doing so. Of the 18,000 names provided by the Swiss government, HMRC has secured settlements with 200 people and brought in £2 million of revenue.<sup>15</sup> HMRC does not know how much of the estimated £40 billion held by UK citizens in Swiss bank accounts has been moved out of Switzerland since the agreement was made public.<sup>16</sup>

8. When we took evidence on HMRC's 2011-12 accounts in November 2012, HMRC had 15 criminal investigations underway into individuals on the so-called Lagarde list (of Swiss bank account holders with potential UK tax liabilities) and it had secured one prosecution. HMRC told us in October 2013 that there have been no further prosecutions since.<sup>17</sup> Six of the 15 cases are currently under civil investigation and the remaining nine have agreed to provide disclosures under the Liechtenstein Disclosure Facility.<sup>18</sup>

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9 Qq265-271

10 Q284

11 Qq 277-278

12 Q295; C&AG's Report, paragraph 1.9

13 Q 292

14 Qq 312-314

15 Q 309

16 Qq 322-323

17 Qq 333-334

18 Supplementary note on Q343 provided by HMRC to the Committee, 11<sup>th</sup> November 2013

9. HMRC told us it had struggled to devise rules that struck the right balance between taxing business profits in the UK and not driving business overseas. It claimed the desired policy outcomes of only taxing profits in the UK, preventing businesses moving overseas and preventing profits being shifted overseas was in effect impossible to reconcile, and that some degree of tax leakage was inevitable.<sup>19</sup>

10. Under existing rules UK tax-based companies may reduce their tax liability by borrowing money in the UK to invest in an offshore subsidiary and then offsetting the cost of borrowing against their UK profits.<sup>20</sup> HMRC told us that if it identified that such borrowing was for an unallowable purpose, such as solely to get a tax advantage, it would consider whether anti-avoidance rules could be deployed and seek to disallow the deduction.<sup>21</sup>

11. HMRC confirmed that recent changes to the Controlled Foreign Companies (CFC) rules had been designed to protect the UK tax base.<sup>22</sup> However, the new CFC rules had weakened the tax regime, in that they now allowed companies which move their finance operations offshore to reduce their tax liability.<sup>23</sup> Under the new CFC rules, HMRC considers any UK company that locates its finance operation in a low-tax jurisdiction to be liable for corporation tax on a quarter of its profits, which means that the total tax due amounts to 5% of all profits. In contrast, the corporation tax liability of a company located only in the UK amounts to 20% of its profits.<sup>24</sup>

12. HMRC told us that it no longer intended to implement proposals it had put out to consultation to address a tax loophole arising from the use of Eurobonds. The Eurobond exemption allows groups of companies to issue Eurobonds, listed on the stock market of territories such as the Channel Islands and Cayman Islands, and trade them between companies within the group without tax being deducted. While HMRC did carry out a public consultation, it explicitly sought comments from those who benefited from the loophole and who therefore opposed the change.<sup>25</sup>

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19 Q394

20 Qq 345-348,

21 Qq 380-381

22 Q345

23 Qq 382-387

24 Qq 354-357

25 [http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?\\_nfpb=true&\\_pageLabel=pageLibrary\\_ConsultationDocuments&propertyType=document&columns=1&id=HMCE\\_PROD1\\_031986](http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_031986)

## 2 Personal tax and tax credits

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13. Real Time Information (RTI) is a major change to the PAYE system which requires employers to provide HMRC with PAYE information when payments are made, rather than after the end of the tax year.<sup>26</sup> The introduction of RTI has gone well so far. During 2012-13 HMRC piloted the system successfully with over 60,000 employers, of which 73% had fewer than nine employees. It then used this pilot to learn lessons which assisted the full roll-out.<sup>27</sup> HMRC required all employers to adopt RTI during 2013-14, and it told us that 90% of employers were now using the system.<sup>28</sup>

14. HMRC recognised that the small and medium-sized enterprise (SME) sector is very varied and that some businesses—including pubs and those in the farming industry—continue to experience difficulties implementing RTI, such as with reporting on time or dealing with casual employees. HMRC told us it had sought to understand the issues that businesses faced and to provide support. During the summer of 2013 it had surveyed businesses to find out what burdens and difficulties they faced, and it was analysing the 24,000 responses it had received. HMRC said it supported SMEs through helplines and websites, and it had relaxed SMEs' reporting requirements, allowing them an additional six months to April 2014 to implement RTI fully. However, from April 2014 this relaxation will end, and at the same time HMRC plans to introduce fines for non-compliance with RTI.<sup>29</sup>

15. Effective working between HMRC and the Department for Work & Pensions (DWP) is critical for the successful roll-out of Universal Credit, both because Universal Credit uses information transferred to it from RTI to calculate payments and because it will eventually replace tax credits. HMRC is working closely with DWP to prepare for a gradual transition of tax credit recipients to Universal Credit. It recognises the need for both cultural and organisational change to minimise disruption to individual claimants.<sup>30</sup>

16. HMRC has linked its RTI system with DWP to provide it with the information needed to calculate payments to claimants, and data on the 2,197 people who already receive Universal Credit has been transferred.<sup>31</sup> However, HMRC chose to implement RTI with neither comprehensive disaster recovery arrangements (i.e. technical resilience) nor full financial accreditation in place.<sup>32</sup> Regarding technical resilience, HMRC told us that its discussions with other departments had not identified a need for the system to be available at all times. It considers that its current business continuity arrangements, which allow up to a week for major technical faults to be rectified, are sufficient to meet the needs of the PAYE system and other departments currently, and that further technical resilience to

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26 C&AG's Report, paragraph 2.15

27 Qq 3-4, 71; C&AG's Report, paragraph 14

28 Q 62

29 Qq 4-7, 65-66, 85

30 Qq 43, 56-57

31 Q 32

32 Financial accreditation provides HMRC with assurance that any systems introduced are acceptable for accounting and financial control purposes – C&AG's Report, paragraph 2.24

support Universal Credit can be added later if required. On financial accreditation, HMRC regards this to be the ‘gold standard’ for its financial systems, with no impact on what the customer sees or its ability to collect taxes.<sup>33</sup>

17. HMRC has committed to add financial accreditation to RTI and to keep the level of technical resilience under review. HMRC said it had not experienced long-term or on-going problems with RTI; however there had been specific problems which it has addressed through its continuity arrangements such as returning temporarily to the old PAYE system. HMRC told us that it has used the first year of RTI to test and develop its systems and, while it accepts that errors still impact on individuals, it can identify overpayments and underpayments sooner than under the old PAYE system.<sup>34</sup>

18. At the end of March 2013, HMRC recorded personal tax credits debt of £4.8 billion, £800 million higher than at the end of the previous tax year. It estimates this could increase to £5.5 billion by 2014-15. Work to track historic debt has led HMRC to increase its provision for irrecoverable debt by £985 million to £3.3 billion, some 69% of the current personal tax credits debt balance. It also reduced its estimate of recoverable tax debt from 43% to 31%. Although HMRC considers that it may recover more than this, the provision was based on HMRC’s past performance and actual recovery rates.<sup>35</sup>

19. HMRC’s latest central estimate is that in 2011, 12 7.3% of personal tax credits payments were incorrect due to error and fraud, down from 8.1% in 2010–11.<sup>36</sup> HMRC told us that it carried out over 100,000 interventions to target the risk of fraud through undeclared partners and prevented over £200 million of losses in 2012–13, and that it expects 2012-13 data to show an improvement in its performance in this area.<sup>37</sup>

20. HMRC told us it is in discussion with private sector organisations about how they can help increase HMRC’s capacity to reduce fraud and error. It ran a six-week trial between May and July 2013, costing £50,000, to test whether a private sector company specialising in data analytics could check child tax credits successfully. The company dealt with 5,000 cases and identified £20 million of fraud and error, a return on investment of £400 to £1. HMRC challenged the suggestion that it does not have the capacity to do the same work in-house, but reported it was considering whether a mixed economy, in which it does not have to do all such work, could be useful in allowing it to use its resources more flexibly in future.<sup>38</sup>

21. HMRC could not show us that it was making most effective use of other sources of information, such as from banks and statutory child maintenance services, to identify possible tax credits fraud. HMRC claimed that confidentiality issues restricted how transparent it could be when responding to reports of suspected fraud involving reports from the statutory child maintenance services, but it committed to liaise with them to

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33 Qq 17-18

34 Qq 13-15, 20, 28

35 Qq 88-89, 99-100, 103-104; C&AG’s Report, paragraphs 4.26 to 4.27.

36 Q113

37 Q 125

38 Qq 116, 118, 160-167

establish whether there were widespread or systemic problems.<sup>39</sup> HMRC told us that it had started to liaise more closely with banks and that the flow of information had improved, so it was now more likely to pick up, for example, instances of child tax credits payments being paid into a UK account but withdrawn outside the EU. However, there is no current requirement for banks to identify all such activity by making a Suspicious Activity Report to the National Crime Agency. Such a requirement could highlight routinely to HMRC a population of claimants which it should investigate.<sup>40</sup>

22. HMRC said that it was committed to prosecuting more cases of tax credits fraud and that the number of cases that it had referred for prosecution was growing fast compared to a relatively low base—it expects to refer between 600 and 700 cases for prosecution in 2013–14. However, HMRC confirmed that it does not prosecute all those who knowingly provide fraudulent information and told us that, with 4.8 million families in receipt of tax credits, it was not possible to do so due to the numbers involved. HMRC explained that it also uses a mixture of civil penalties, refusal of tax credits awards and other influencing techniques to deter fraud, and it pointed to evidence that telling claimants when it was suspicious that an over-claim had been made had been effective in changing people's behaviour.<sup>41</sup>

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39 Qq 113, 126-129

40 Qq 133, 142-144

41 Qq 116, 119, 121

# Formal Minutes

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**Wednesday 11 December 2013**

Members present:

Mrs Margaret Hodge, in the Chair

Mr Richard Bacon  
Stephen Barclay  
Jackie Doyle-Price  
Chris Heaton-Harris  
Meg Hillier

Mr Stewart Jackson  
Fiona Mactaggart  
Nick Smith  
Justin Tomlinson

Draft Report (*HMRC Tax Collection: Annual Report & Accounts 2012-13*), proposed by the Chair, brought up and read.

*Ordered*, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 22 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

*Resolved*, That the Report be the Thirty-fourth Report of the Committee to the House.

*Ordered*, That the Chair make the Report to the House.

*Ordered*, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Monday 16 December at 3.00 pm]

## Witnesses

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### Wednesday 16 October 2013

Page

**Lin Homer**, Permanent Secretary and Chief Executive, **Ruth Owen**, Director General Personal Tax, **Simon Bowles**, Chief Finance Officer, and **Nick Lodge**, Director General Benefits and Credits, HM Revenue & Customs

Ev 1

### Monday 28 October 2013

**Edward Troup**, Tax Assurance Commissioner, **Jim Harra**, Director-General, Business Tax, and **Jennie Granger**, Director-General, Enforcement & Compliance, HM Revenue & Customs

Ev 24

## List of printed written evidence

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| 2 | Further evidence from HM Revenue & Customs | Ev 52 |

# List of Reports from the Committee during the current Parliament

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The reference number of the Government's response to each Report is printed in brackets after the HC printing number.

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Third Report	Department for Communities and Local Government: Financial sustainability of local authorities	HC 134
Fourth Report	HM Revenue & Customs: tax credits error and fraud	HC 135
Fifth Report	Department for Work and Pensions: Responding to change in jobcentres	HC 136
Sixth Report	Cabinet Office: Improving government procurement and the impact of government's ICT savings initiative	HC 137
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Seventeenth Report	Administering the Equitable Life Payment Scheme	HC 111
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Twenty-third Report	HM Revenue & Customs: Progress in tackling tobacco smuggling	HC 297
Twenty-fourth Report	The rural broadband programme	HC 474
Twenty-fifth Report	The Duchy of Cornwall	HC 475
Twenty-sixth Report	Progress in delivering the Thameslink programme	HC 296
Twenty-seventh Report	Charges for customer telephone lines	HC 617
Twenty-eighth Report	The fight against Malaria	HC 618



Twenty-ninth Report	The New Homes Bonus	HC 114
Thirtieth Report	Universal Credit: early progress	HC 619
Thirty-first Report	The Border Force: securing the borders	HC 663
Thirty-second Report	Whole Government Accounts 2011-12	HC 667

# Oral evidence

## Taken before the Committee of Public Accounts

on Wednesday 16 October 2013

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon  
Stephen Barclay  
Jackie Doyle-Price  
Meg Hillier  
Mr Stewart Jackson

Fiona Mactaggart  
Austin Mitchell  
Nick Smith  
Ian Swales  
Justin Tomlinson

**Amyas Morse**, Comptroller and Auditor General, **Gabrielle Cohen**, Assistant Auditor General, **Paul Keane**, Director, National Audit Office, and **Marius Gallaher**, Alternate Treasury Officer of Accounts, were in attendance.

### REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

#### HM Revenue & Customs 2012–13 Accounts

##### Examination of Witnesses

*Witnesses:* **Lin Homer**, Permanent Secretary and Chief Executive, HM Revenue & Customs, **Ruth Owen**, Director General Personal Tax, HM Revenue & Customs, **Simon Bowles**, Chief Finance Officer, HM Revenue and Customs, and **Nick Lodge**, Director General Benefits and Credits, HM Revenue & Customs, gave evidence.

**Q1 Chair:** Welcome. You have had a bit of respite from us for a bit, and we will now see a lot of you. I will just say how we will handle the two hearings. We will talk today about real time information, tax credits, some general PAYE things, some customer service and perhaps a little bit on child benefit. So we will cover those sorts of issues today, and then we will come back on the 28th and do the whole lot around the tax gap, tax avoidance and the work that you are doing to get the money in. Is that all right?

**Lin Homer:** That's fine. Chair, I hope you got the message that for the next meeting I am away.

**Q2 Chair:** Yes.

**Lin Homer:** But we are expecting Edward and the team to come down, so I think you will be well served.

**Q3 Chair:** Okay. Good. Let us start with the real time information, if we can. Having just come out of a session on universal credit, this looks like a much better story. What lessons have you learned from the pilots you have done so far?

**Lin Homer:** I will hand over to Ruth, because I think she deserves the credit for where we have got to. We would just caution that it is too early to call it "done" yet. We think we are part-way through a significant introduction. We think it has gone well so far and we think we know some of the challenges we still face, but our view is that the whole of this first period needs to be seen as a learning period and a transition. I think it will be some while before we would see this as something that you mark as "done". With that, over to Ruth to talk about—as you say—the lessons learned and where we think we are.

**Ruth Owen:** We have taken a gradual approach to implementation, learning as we go. RTI was dreamt up in 2009 and we did a pilot, starting last year. Between those two times, we did a full public consultation, at which point we learned from and listened to what businesses said, and changed the design, the solution and the length of the pilot off the back of that immediate feedback, which is what those businesses recommended. Then we gradually built up from a handful of schemes coming in during April 2012 through to 60,000 schemes by the end of the period.

What we learned along the way is exactly how PAYE works out in the real world, so the assumption about how PAYE works changed from an end-of-year reconciliation process to what companies actually do every week, every month. There was the feedback we got from the pilots, about how that was actually operationalised, and the feedback we got from pilot employers about what they thought went well, the trouble that they had and therefore the things that we could put right during the pilot. So we were much more confident by the time we went national in April this year that we knew roughly how businesses were able to respond.

**Q4 Chair:** You knew how big businesses were going to respond. You have had much less experience of the small and medium-sized enterprise sector.

**Ruth Owen:** 73% of the pilot schemes were under nine employees, so we had a really good set.

**Lin Homer:** There were a lot of micros. You are absolutely right. That was the biggest transition. A lot of our pilot were small, but there were many more to be brought in. They are very varied.

**Q5 Chair:** You have given the SME sector much longer. You have given it until April 2014 to come on board nationally—am I reading that right?—so you have allowed another six months.

**Ruth Owen:** Yes. We mandated everybody to join this year, and almost everybody has now. The point about real time and what we mean by real-time reporting—the phrase “on or before the time at which you pay your employees”—was one of the pieces of feedback we had from the pilot; some small businesses were finding it tricky. We agreed that for this year they would have a relaxation. As a minimum they would have to report monthly, but not necessarily on the day of payment. As you say, that has been extended until the end of this operational tax year.

**Q6 Chair:** Do you think you are giving sufficient support to the SME sector to enable it to adjust and do its business with you in a different way?

**Ruth Owen:** I think generally we have given good support to businesses. The feedback generally has been good. The pilot employers said they felt well supported. Most businesses say, “I was quite worried about going in; I wasn’t really sure how this was going to work in practice.” Generally, once they get going, if they have got the right software, it becomes an integral part of how they run their pay-as-you-earn system and payroll system.

Of course, for some people it has been difficult. We are not ignoring the fact that some people have had difficulties. For some people it has meant some significant changes to the way they run their payroll system—small businesses in particular. We have constantly supported businesses through our helplines, websites and things like that. As soon as we pick out where issues arise we update our guidance to help them through that.

**Q7 Chair:** What about the zero-hour contracts? A growing number of people now have those contracts. They are going to change very often.

**Ruth Owen:** It is not the contracts themselves; it is when people get paid. One of the pieces of feedback is that many businesses have a high turnover of people who get irregular payment, such as people who come in on a Friday night to help in the pub but don’t have regular employment. We concentrated on those areas to try to understand what the impact of the changes will be for those businesses. Over the summer we put out a survey to ask businesses exactly what burdens and difficulties they face, and we have had 24,000 responses. I have not got the conclusions yet—it closed only at the end of last month—but we will certainly listen to what that survey tells us.

**Q8 Chair:** Is that a good response rate?

**Ruth Owen:** Yes, it is.

**Q9 Chair:** And is that because they are worried?

**Ruth Owen:** We pushed it out as much as we could because we genuinely want to hear which businesses are finding this difficult, how they are coping and what we can do as a consequence.

**Q10 Chair:** Let me ask about an issue about which there is a little bit more concern, which is the resilience that you have not built into the system because you felt you could not afford to do it within your financial constraints. If there is a breakdown you do not have the resilience there. Is that a wise decision?

**Lin Homer:** I think there are two forms of resilience here. I might ask Simon to talk about financial accreditation. We went live with partial accreditation, but that was still better than what it replaced, so it was a move forward. Simon can update you on our plans to bring that up to full. In addition, this is another new system and we have been making sure it has got the normal business continuity resilience built in. If one part of the system—as with all of our technology systems—goes down, how will that impact on employers, employees and the Department for Work and Pensions? We are confident that we are in a good place on that, but clearly as universal credit stands up we will have to keep testing that.

**Q11 Chair:** What does that mean: “in a good place”? I read somewhere that it broke down. Clearly, while piloting, it will break down. So it has broken down but I do not know how often.

**Ruth Owen:** Not a lot.

**Q12 Chair:** How many times since you have been running it as a pilot?

**Lin Homer:** It is not really one system.

**Q13 Chair:** What do you mean, it is not one system? My understanding was that people logged their information in and there have been times when that information has not been shoved through into your internal systems so you can then use it and make sure that the person pays the right amount of tax at that time.

**Lin Homer:** I do not think that we have had a situation where we have had a long-term or ongoing problem, but with all our systems we have moments, including recently with an enterprise release.

**Q14 Chair:** That is the point at which you need a back-up. You did not invest in one, though.

**Lin Homer:** We did. We have business continuity arrangements in place.

**Q15 Chair:** You go back to the old PAYE system, don’t you?

**Lin Homer:** It depends what the issue is. Sometimes we might just give a signal that says: “Do it again tomorrow”. Sometimes we might revert to the old system or to more traditional systems of updating. It depends a bit on what the problem is. We do not have a situation where if something goes wrong the whole system goes down. There are switches and resilience built into what we have done and so far that has proven to be—

**Q16 Chair:** Give me some examples if I log in and tell you what my employee has earned.

**Ruth Owen:** If we had a catastrophic failure and one of our data centres went down, for example, we can

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queue for up to a week employers sending us things. Generally that is plenty of time for our well-trialled business continuity, to bring it back up again and get the information flowing. So it is built to give us at least a week's recovery.

**Q17 Chair:** Have you the staff to handle that backlog?

**Ruth Owen:** It is automated. You do not need the staff. You just need to automatically open the doors again.

**Paul Keane:** The point that we raised in the report, in 2.26 and 2.27, is the choices that you made at the planning stage—

**Lin Homer:** About financial accreditation?

**Paul Keane:** Sorry, around technical resilience and that you did not have full technical resilience. What the report tries to pick out is that it is fine up to a point, but it is whether then you have a dependency with other Government Departments that might need the information urgently or may need it now, and whether you have that facility to service them. The answer that we are trying to pick out is an issue in the report in 2.26 and 2.27.

**Ruth Owen:** We chose not to have what I would call 24/7, 365-day availability, because pay-as-you-earn does not need that and the discussions we have had with other Departments have not identified that spending tens of millions of pounds on that is a good choice right now.

**Lin Homer:** That was my point about universal credit. As it develops, we are in constant debate with universal credit. They are going to have a chance to test their system with us incrementally. If we reached a point, then these systems are then capable of being changed and of adding extra resilience. So I do not think that this is a decision for all time.

**Q18 Chair:** Do you want to say a few words on financial accreditation?

**Simon Bowles:** May I start by reassuring the Committee that financial accreditation has no impact on what the customer sees or on our ability to collect taxes. Financial accreditation is essentially our internal gold standard, which looks at 15 different characteristics of a financial system. When we launched RTI we focused on what the customer sees and getting a good landing for customers. We are now following on with work to ensure that we move to resolve the issues which NAO identified. These are mainly about tracing through from the tax that is paid, through to this document, the published accounts. You will be aware that our accounts have not been qualified in respect of that, and I can assure the Committee that we have work in hand using the existing data feeds that will ensure that we can sign off the accounts. I believe NAO can approve them at the end of this financial year.

**Q19 Chair:** Having lived through the PAYE fiasco, and particularly because universal credit has now not become as time-demanding as it might have been originally—i.e. it is going to be jolly late—we think that you should be getting this right, both on the financial underpinning and on the resilience. You

should prioritise that, rather than speed of change. That does not mean that speed is not important. If you can get the new system in, I can see that it saves you right the way through the organisation. But given your history with PAYE there is just a question mark here as to whether you are moving a bit too fast and you have not got the resilience in. There are quotes around the place. The Student Loans Company has talked about losing the individual because of a change of circumstances. What is it called? There is a word for it, but I cannot remember. Duplicating.

**Lin Homer:** Duplicate records, yes.

**Q20 Chair:** So somebody reports to the Student Loans Company that they have lost their job when they haven't, it is just that the information has not been translated on the same pay and tax record. So it does impact on individuals. Basically, you are looking at the whole picture.

**Lin Homer:** Of course. Our whole system impacts on individuals, and I think your point is well made. The fact that we are standing up the system before full pressure is applied actually gives us as long as we need to check and develop. As I said earlier, we have used the whole of this first year to test and develop. We are planning to add financial accreditation, and we will keep the resilience point under review. You may not have picked up on it, but we have recently appointed a new CIO. One of the things we are doing with him is looking across the piece at our technological resilience, if I can put it like that. So I think it is very well made.

All I would say is that we should not think that our old system did not inconvenience individuals. Our experience of RTI so far is that, when people get used to it, it is working well and accurately. It is bringing a bit more tax in sooner than we used to see, and it is making people more aware of what they are doing as they are doing it, and not shunting problems to year end. We will keep considering impact. I think Ruth was being modest. The reason why we have had a good response to the consultation is that people have observed her to be listening to what they say. So we will absolutely keep tuning in, and if that requires us to add some more layers of resilience, of course that would be a high priority.

**Q21 Chair:** *The Sunday Times* said that you had issued incorrect tax codes to 40,000 people as a result of duplication. Is that right?

**Lin Homer:** Yes. I think we have identified a number of duplicate records at the start, but that was a feature of our old system, too.

**Q22 Chair:** Okay, but 40,000 is a lot.

**Lin Homer:** No. That is since we started.

**Q23 Chair:** Since you started nationally?

**Ruth Owen:** It is 40,000 schemes in which a duplicate record occurred, so something came in that didn't look quite like your normal PAYE record.

**Q24 Chair:** So you started a new record?

**Ruth Owen:** We did in some circumstances. What we have learned from the previous PAYE changes is that

things that change within our systems can very quickly generate incorrect output to customers. Our learning from that was that we tried to quarantine new changes coming into the system, so of those 40,000 duplicates that could have been created, only 10,000 incorrect tax codes actually reached customers, and we have now corrected 98%. We have tried to spot where information looks like it is coming in incorrectly and stop it generating a new code for a customer, and where a new code has been generated, because we did not spot it or because the matching was not quite tight enough, we have been able to spot and correct it.

**Lin Homer:** One of the main changes with this system, which, again, has been quite challenging for employers but has been really important, is that they have had to recognise that they have to have clean and accurate information about their employees. The old system, in a way, could allow them to ignore that for a very long time. We could end a year with an employment record of someone who might have been paid throughout the year on data that was basically just fill-in data—we would sometimes get “A.N. Other, born 1 January 1892.” This has required effort from the employer, but that up-front effort makes the whole system much more reliable. That is really good practice for universal credit, because if we get that right, the ability to change payments for the individual as their income fluctuates is based on much better and much more accurate information. These are cleansing but deeply important changes, and again, I think we are giving employers help and assistance to get through that.

**Q25 Chair:** I accept that this is not as many as 40,000 and that it has already been done nationally, but in the instances where it is wrong for the customer and there will be an underpayment—

**Lin Homer:** Under or over.

**Q26 Chair:** They are all underpayments?

**Lin Homer:** No, some can be over.

**Q27 Chair:** There is both; okay. What happens when there is an underpayment? Will the customer—like with tax credits, which we will come on to—be liable for the tax that they did not realise they would have to pay?

**Ruth Owen:** We think we spotted most of them. Where customers have identified an incorrect tax code having been received by them, they have contacted us and we have put them right straight away. So, again, it is not stacking up debt for the future. We believe that we are on top of this and where customers are identifying it, we are correcting it there and then on the call with them, so we can tell them, “Your tax code is now put back to x, and we have made sure that the duplicate is now removed.”

**Lin Homer:** Under the old system, they might not have noticed that until three months after the last tax year. That is the NPS experience, where we then go back quite a long time later and say, “Actually, three years ago you underpaid tax,” and they say, “I didn’t know that.” In this system, it is a much more rapid response that hopefully narrows the risk time when

they are under or over and gives us a chance to keep them much more straight.

**Q28 Chair:** Okay. So what you are really telling us is that you can identify overpayments and underpayments earlier—

**Ruth Owen:** Yes, more quickly.

**Q29 Chair:** But that the individual, if it is an underpayment—even though it is not their fault—will still be liable for that.

**Lin Homer:** The same rules apply as have always applied. There is a responsibility on any individual taxpayer to pay the right tax, but if there is clearly a mistake on the part of their employer or us, we have rules to deal with that.

**Q30 Chair:** What does that mean?

**Lin Homer:** You probably know this from your constituency postbags—

**Q31 Chair:** You sometimes write it off.

**Lin Homer:** Exactly. If we have clearly made a mistake, we have rules—we are quite rule-bound—that allow us to accept that. We also have some rules that allow us to pursue the employer. But if an individual knows that they have two employments and, for instance, they are getting their basic rate of tax relief on both, we will not necessarily accept that, because we will be saying, “You should have known that you don’t get your tax relief twice over.” But in this system, at least, we might be having that conversation after a few months, not a few years. That would be the difference.

**Q32 Ian Swales:** Just testing this a bit further, the essence of universal credit is very close connection between what you are doing and what DWP are doing. Can you say a bit more about the progress of that and whether the required system integration is going according to plan?

**Ruth Owen:** Yes, we completed the link over 12 months ago. It is working and we have got 2,197 universal credit claimants logged on our system and we have been feeding back information on them, with just over 5,000 payments so far. In the scale of the pathfinder so far, it is being tested. It clearly has not been scaled up yet, until we are ready to extend it.

**Q33 Ian Swales:** What is happening to people whose circumstances change frequently? One of the problems with the old systems was that people would not take a job that lasted for a few weeks because of the battle they would have in informing all the authorities that they had got work, followed by the huge battle in informing them that they no longer worked. Have you any experience of cases where people have gone in and out of various parts of the system through their circumstances? How effectively has it been working with that?

**Ruth Owen:** It is probably too early to say whether we have had lots of people going in and out, but we have certainly had people going into work and having—

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**Q34 Chair:** Will you repeat those figures on universal credit claimants, Ruth?

**Ruth Owen:** The number of claimants was 2,197.

**Q35 Chair:** Out of those, you had some other figures underneath that.

**Ruth Owen:** Just over 5,000 payments have been made as a result of the information that we provided to DWP.

**Q36 Chair:** 5,000 payments. Are those the old tax credit payments? What kind of payments are you talking about?

**Lin Homer:** No, those are benefit payments.

**Ruth Owen:** These are people moving into work.

**Q37 Chair:** 5,000 payments of tax?

**Ruth Owen:** No, payments of universal credit.<sup>1</sup>

**Lin Homer:** At the DWP end—

**Q38 Ian Swales:** At what speed are those 5,000 payments to the 2,000 people in the pilots taking place? Is it in real time?

**Ruth Owen:** Yes, it does live up to its name. It goes over daily to DWP. I do not have a lot of data on lots of people moving in and out of work, but I have got anecdotal evidence from people who work in the jobcentres that they are able to use it to say to people, “This will support your move into work. You will have confidence that universal credit will match up to your real-time earnings.”

**Q39 Ian Swales:** What about the management and the staff interface in this now? Universal credit, by definition, is one system but you have two Departments involved.

**Lin Homer** indicated assent.

**Q40 Ian Swales:** Are you satisfied that you have put the right procedures in place outside the system to make this work effectively? I ask that because one of the things anecdotally we hear about universal credit is that there is something of a turf war going on between the two Departments about who does what and where the responsibility lies. By definition universal credit is meant to be one system. How are you making it look and feel like one system as far as customers are concerned?

**Lin Homer:** I don’t think from the customer perspective that they should see any evidence of a turf war. So if you have picked that up, Robert and I would want to hear about it. In terms of the day-to-day working, both Ruth’s and Nick’s people are heavily engaged in the programme that is universal credit. The decisions we take at our end, both in RTI and tax credits that either have an impact or will in the future on universal credit, we sight DWP on. Robert and I have regular conversations. We have plans for the transfer of staff so it does not feel like a turf war. Indeed, when the Secretary of State went before the Employment Committee, Suzanne Newton, who is one of Ruth’s key people on RTI, went with him. So

it feels joined up to me but there is a lot of work still to do. I am sure we will have our moments.

**Q41 Ian Swales:** To clarify, it is more to do with the systems work behind the scenes rather than the point you were just making.

**Lin Homer:** That comes into it.

**Q42 Stephen Barclay:** On that point, the reason for the Committee having that sense was that in response to Q197 at our previous hearing, Sharon White of the Treasury said: “The relationships—certainly the ones across Whitehall—are not perfect but they are much more solid than they were previously”. I think she was alluding to the fact that there have been difficulties in the relationships.

**Lin Homer:** She may have been speaking for herself.

**Q43 Ian Swales:** Is it true to say that the expression “tax credit” should be disappearing from your lexicon and that you should no longer be talking about tax credits in future in the world of universal credit?

**Lin Homer:** Yes. In due course, tax credit ends and migrates. We have come up with an agreement. Nick can talk about this if you like. We have come up with an agreement which is for a transition over of tax credits in a way that is agreed with DWP. We are not doing this as a traditional machinery of government: one day they are mine, the next day they are all Robert’s. We are moving at a rate and in a way that suits universal credit as the dominant project but at some point tax credits will not exist any more.

**Q44 Ian Swales:** Are you talking about the people who are already in the system and you are still dividing the cake in two ways? Does the expression “tax credit” still apply to the 2,197 people in the pilot?

**Lin Homer:** Tax credits—

**Ruth Owen:** They are on universal credit.

**Lin Homer:** Tax credits are still being paid to people who are not on universal credit.

**Q45 Ian Swales:** Okay, I understand that. So it is joined up now for the people who are on universal credit? They only see one system facing them. Is that true?

**Lin Homer:** Yes

**Q46 Ian Swales:** And it is joined up behind the scenes?

**Lin Homer:** Yes.

**Q47 Chair:** May I just delve a little into that number: 2,197 is tiny. That 2,197 is from when?

**Ruth Owen:** The start of the pathfinder.

**Q48 Chair:** Which was when?

**Ruth Owen:** Fairly recently. April.

**Q49 Chair:** April? So these are people who are in work but they are applying for universal credit because they are low-paid and to make work pay? Is that right?

**Lin Homer:** No. Universal credit covers all benefits.

<sup>1</sup> Note by witness: These are payments made by employers to employees reported to DWP to feed into their Universal Credit calculation.

**Q50 Chair:** So it might be child benefit or it might be—

**Lin Homer:** No. Child benefit is with us. But housing benefit, jobseeker's allowance—

**Q51 Ian Swales:** Is it true to say that the 2,197 are the proverbial single man, no children or whatever? What is the range of people that you are now covering?

**Chair:** On JSA.

**Nick Lodge:** The pathfinder is currently testing the roll-out of universal credit in a quite a narrow range of potential claimants.

**Chair:** We know.

**Q52 Mr Bacon:** Define “quite narrow”, please, just for the record.

**Nick Lodge:** It tends to be the customer base that Mr Swales just mentioned, so it is the people who are perhaps coming into work. There is no connection with tax credits. They were not on tax credits.

**Q53 Chair:** Single and with no children?

**Nick Lodge:** Exactly. That is my understanding.

**Mr Bacon:** Living in Ashton-under-Lyne.

**Q54 Ian Swales:** Let us clarify this: the people going into the pilot were not the people in receipt of tax credits.

**Nick Lodge:** By and large, so far, that is absolutely the case.

**Lin Homer:** Not so far.

**Q55 Ian Swales:** So you have given us confidence that very simple cases are now operating smoothly.

**Chair:** Not really. It is only 2,000, Ian. It is hardly testing anything.

**Q56 Ian Swales:** Well, as I often say in this Committee, if you can make a system work for one person, you can make it work for a million. The problem is systems that do not work for even one person. In this case, what comfort can you give the Committee that you have processes in place to deal with people who are currently in receipt of tax credit and people with more complicated family situations? In other words, what is the pace at which you will be able to cover the population that you have to deal with?

**Lin Homer:** Those are decisions for the Secretary of State and the DWP. We plan to work with them as they come into the area that has traditionally been ours. We will be involved in the design and test of the system; we will be transferring staff who have experience in our system, and we have agreed to transfer the staff that DWP need. So this is my point about our very close partnership. I am not just saying, “Have ‘em all.” We are saying, “These are the folk you need.” We will agree the pace at which they go, and we are determined to try to share our experience with them and to have our business in as good a shape as possible so that, as they are transferred over, the customer impact is as good as it can be.

**Q57 Ian Swales:** Can you think of any example where it would actually be HMRC that would be on the critical path of that implementation, or are you saying that DWP will always be on the critical path of rolling this out? In other words, the moment they say, “OK, now it's man, woman and two children,” are you ready to respond as fast as they can move? Or are you on the critical path on any systems or organisational issues?

**Lin Homer:** RTI is a critical part of the system, as we discussed. Timewise, it might not be so critical now. We are key to their project at a number of points. With the planning that we have in place, we will always know the lead-in time. We are being very clear about that to DWP. They are understanding. We are docking all the way up, so we are in all their key programmes. We have got people working closely. Indeed, Robert and I sit down and discuss pinch points regularly, but your point is well made. From the customer perspective, they should not expect Departments to make life difficult for them because we cannot get on, so we are doing our best to culturally and organisationally make that a low risk.

**Q58 Chair:** May I ask one more question on RTI? You are introducing automatic filing penalties in April 2014.

**Lin Homer:** Yes.

**Q59 Chair:** So if an employer puts the data in and for some reason it does not go through, because your systems do not work properly—hence the question about resilience—how do you ensure that they do not face a penalty because of a fault at your end?

**Ruth Owen:** It is what we call reasonable excuse. If a penalty is applied to a business, for which they have a reasonable excuse and they could not use our system or the system failed—

**Q60 Chair:** They may not know. As I understand it, with some of these duplicates, you do not know that it has not gone through

**Ruth Owen:** No, we should, and they always get a confirmation. If you did not get a confirmation, you should check to make sure that we received it.

**Q61 Chair:** And they know that, do they?

**Ruth Owen:** That has been happening, so everyone should be getting used to it now. Every time you send us something, something pings back to say, “Got it”. That is standard electronic data exchange. If, in a major disaster, people were sending us things and nothing was coming back, they would have a record to say that they had been trying to send us something and nothing came back. If by chance we had not spotted that, which would be very unusual, they would be able to apply for any penalty to be discharged, but generally, we would have been able to see if we had had a major outage, and that would be the reason why the submissions had not come through.

**Lin Homer:** In addition, we are contacting people this year when we are not applying penalties and saying, “If you had done that when we were applying penalties, you would have left yourself exposed to a penalty.” So we are not penalising people, but we are

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using it to illustrate to them what they did not do or where they went wrong. Again, we are trying to use this first year as a chance to familiarise people with the system before it is for real. I think that that is proving helpful and should also help us to learn if there are circumstances we have not spotted where people can do something wrong without knowing.

**Q62 Stephen Barclay:** You said a little earlier that most employers do not have a problem if they have the right software. What proportion of employers do not have the right software?

**Ruth Owen:** I didn't quite say that. I said that most employers are in—we have 90% of employers in. The feedback that we have had from businesses so far is that they have found it quite straightforward and that it has been less of a difficulty than expected for most employers. The point about the software is that if you have it—including the software that we give away free—and run your payroll on it, generally that means that when you run your payroll the final task says, "Press the button to make sure that this gets reported to HMRC." People who have software like that have said, "That has been quite straightforward. I know what I have to do to run my payroll and that is one additional step."

**Q63 Stephen Barclay:** So you don't foresee any business cost to firms for software?

**Ruth Owen:** Well, there could be if people choose either to upgrade their software or change supplier. All the major payroll software suppliers and payroll bureaux have been working with us on redesigning for at least two years. Of course, they refresh every year according to tax rates and things like that. They have all been integrating it into their systems.

**Q64 Stephen Barclay:** So it is not that the free software that you are giving away will be fully fit for purpose? They might need something bespoke.

**Ruth Owen:** Ours is very basic. It is called the basic payroll tool for a reason, so if you need to do additional things such as pay pensions or make deductions for loans—things like that—you need something greater than that to run your payroll. Our software is specifically to help you to run PAYE.

**Q65 Stephen Barclay:** Are the businesses that are most likely to need a more bespoke system the pubs and some of those firms you have identified that had particular problems in the pilot and for whom you have de-scoped the requirements on an interim basis?

**Ruth Owen:** I don't think that that is a software issue but, again, I will look at the research and see whether that tells me anything. The people who I understand are having most problems are those who run their payroll monthly—using software or whatever records they keep—but pay their employees weekly and have always caught up at the end of the month. Our requirement is for them to tell us every time they make a payment. If they did that and were paying people weekly, that would multiply the number of times that they were running a payroll. I assume that in the pub at the time they were probably just keeping a record.

**Q66 Stephen Barclay:** Sure, but you are allowing it monthly at the moment. If you attach fines in April at the point where you remove the exemption, you are raising the bar on something that has already proven difficult, at the same point that you apply a fine.

**Ruth Owen:** *indicated assent.*

**Lin Homer:** Well, the requirement was always there. I think that RTI has shown up organisations and small businesses that may not have been doing it. I think we had this debate on one of the previous occasions when I was here. We would encourage owners of small businesses to think about how they are keeping good records if they are paying out weekly but—truthfully—reconciling monthly, because there is a risk that they are inadvertently making errors in that system.

It has always been a requirement of our system that you deduct tax and give it to us when you pay. We will look at the impact of the changes. I know that one of the consultation responses we have had is about whether we will run a penalty-free period for people who are coming in later. That is going to be one thing on Ruth's list, but I do not think that we have reached a conclusion about it.

**Q67 Stephen Barclay:** Thank you; that was very helpful. On the 2,190 so far, could you tell us what the next two interim milestones are?

**Lin Homer:** Sorry—are you going back to universal credit?

**Q68 Stephen Barclay:** Yes, I am asking about the join-up with universal credit. We know that universal credit is behind the pallet—from memory I think that it was 140,000 by April 2014, and I think they are on around 8,000, so I assume they are not going to deliver that. In terms of your feeding into them, what are your next two milestones?

**Lin Homer:** In terms of our positioning, we stand ready to move those numbers up as they come forward.

**Q69 Stephen Barclay:** So when will it be 100,000 then?

**Lin Homer:** I haven't come with those details. Those are for the Secretary of State and DWP to decide. Obviously, we think we can cope with transition either that is slow and steady or a bit steeper. We would encourage them to give us time to learn and adapt, but those are not figures that I have to hand.

**Q70 Stephen Barclay:** May I just ask about the increase in cost? I think the original cost was around £240 million, and it has gone up £115 million since then, which seems quite a significant increase.

**Lin Homer:** It is.

**Q71 Stephen Barclay:** Why were there so many unforeseen costs?

**Lin Homer:** I will get Ruth to give you the detail. I think we did not put all the elements of cost in to start with. So it is not a situation in which individual things we estimated turned out to be significantly wrong. In some areas we didn't recognise the additional costs in other parts of our system. For instance, this allows us



to keep an earlier and closer eye on debt. That will probably be good for us in the long term, but in the short term it can make collecting debt more expensive. I don't think we had anything in the original business case for that. Perhaps Ruth could add a bit more detail.

**Ruth Owen:** There were two main reasons. The first one was that having a year-long pilot gave us lots more things to identify that we wanted to build in as we learned through the pilot. The IT costs increased as we saw things that we could improve based on the feedback. The costs that increased more significantly were the business change costs, where quite frankly I think it was underestimation of the changes that we need to make within our own HMRC business at the beginning of the outline business case.

**Q72 Stephen Barclay:** So, why was that not covered in contingency costs allocated at the start of the programme?

**Lin Homer:** Because we are a big Department and we run a significant number of projects, we don't tend to drop contingency into every project. We deal with that in our business planning. I think we have made the point to you before that the increasing costs for RTI HMRC has absorbed, so we run our programmes as a portfolio.

The reason Simon's beard is grey is that he holds that space in the middle. Within year and year to year we adjust our programmes effectively to provide that contingency. That is a portfolio management approach as opposed to a project approach. That is an approach that has been thoroughly tested with MPA and is something that NAO has observed. We think that is a better way to get our capital spend quite close to the amount. You would rightly criticise us if we significantly underspent, but that is a bigger risk if you attach contingency to every project.

**Q73 Stephen Barclay:** You have given us very reassuring answers. Is the project still rated amber by the Major Projects Authority?

**Ruth Owen:** Yes.

**Q74 Stephen Barclay:** In light of the reassurance today, why is it still rated amber?

**Simon Bowles:** I think any large programme of this scale is going to be amber until we are pretty close to delivery. We started by saying that, although progress is good, we have still got a way to go.

**Q75 Chair:** But you've got no contingency left.

**Stephen Barclay:** There wasn't any to start with.

**Simon Bowles:** Chair, I think we have shown that we have managed to absorb those pressures successfully.

**Q76 Chair:** Are you expecting more pressures?

**Simon Bowles:** I think we have reached a high-water mark, and indeed recent iterations of the business case have shown costs coming down.

**Q77 Stephen Barclay:** As part of getting to where we are today, around £1 billion of tax was written off.

**Lin Homer:** Yes. Again, I think we have talked with you about that.

**Q78 Chair:** That was PAYE. We'll come to that at the end. We will come back to that as it is a very important point.

May I raise a final thing, and then I think we can move on out of RTI? I got hold of a survey done by HW Fisher and Co, an accountancy firm, of 2,000 SMEs. Have you seen that survey?

**Ruth Owen:** No.

**Q79 Chair:** It is less glowing than the report you have given us today, which is on the SME sector. Almost a quarter described RTI as frustrating. Less than a third said they had a positive view about it. Nearly half said they had encountered hitches. A third described the transition as difficult, and 39% felt it was a cost burden to their business.

**Lin Homer:** I hope we have not painted too rosy a glow. You started by saying that, at least relative to others, it had gone quite well. What both Ruth and I have tried to say is that we think this is work in progress. We would wholly accept that the transition has been challenging for some people, and I am not surprised at the use of the word "frustration". We would hope that once people have settled into this way of working, they will not continue to find it frustrating, and indeed that it will really help them run their business well. Part of the consultation is to pick up any messages we are missing, and we are trying to do a retrospective evaluation of business administrative burden to challenge our original assumptions.

**Q80 Chair:** Are you going to do your own customer service testing? That would be helpful.

**Lin Homer:** That is what our survey is.

**Q81 Chair:** So it will be a sort of customer service survey, will it? Your current thing is that you put out a consultation and 26,000 responded, which is good. If you got somebody to do a survey for you, you might get a slightly different picture—a truer picture—if it is done properly.

**Ruth Owen:** I will see what our original survey shows us. We continue to want to understand the voice of the customer, and to know which segments of the market are struggling and what we can do to support them.

**Q82 Stephen Barclay:** Your public statement on that original one seems at odds with that survey. The Department's position was that RTI was "easy" for most employers. The majority reported no problems with RTI. There was "no change in payroll running costs" for most. That is the experience of the majority. The longer-term expectation is that the majority anticipate that the burden will decrease.

**Ruth Owen:** Yes. That is from the pilot.

**Lin Homer:** Those words are from the pilot, and that was true.

**Q83 Stephen Barclay:** Do you think that that is consistent with that survey, though?

**Lin Homer:** I think we still believe that overall this will be a significant admin reduction for business. What we want to test is whether that is evenly

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distributed, or whether it is better for some—medium to big—and tougher for small. We are open-minded about how it falls, and that is part of the reason why we want to do a retrospective on the admin burdens. I think I have said before that businesses that were not running their administration particularly well are going to find this something of a challenge.

**Q84 Chair:** But that is a lot.

**Lin Homer:** We would be very interested in seeing that survey.

**Chair:** H.W. Fisher and Company, in September—2,000 SMEs.

**Lin Homer:** Yes. There are 4.6 million<sup>2</sup>, so what we need to do is check that we can hear their voices. We have got to keep testing.

**Q85 Fiona Mactaggart:** You have said that you think that companies that are not well run are struggling with this—fair enough. But I got the sense from what Ruth said that you think that some sectors of business are finding this harder than others. Can you tell us about that, please?

**Lin Homer:** That is why we put some easements in.

**Ruth Owen:** So it is sectors that have particular labour forces or payroll practices. I think pubs were the example, where you might have people who you have just hauled in on Friday night and you have not kept records, necessarily. In the farming industry, we have worked very closely with the National Farmers Union, because they have harvest casual workers and things like that where it is very hard to keep records and keep track of people who are—if you like, itinerant workers. You do not generally keep in-depth records of those people because they turn up for one shoot for a weekend and you never see them again. We have tried to work with the NFU to come up with compromises on how we can address some of those issues without being burdensome. We continue to work with them, because that is the key question of our surveys: which sectors are struggling and for what purpose, and what can we do about that?

**Q86 Fiona Mactaggart:** I am just struck by the fact that on the screen behind you is the title of the debate that is happening now in Parliament, which is about zero-hours contracts. In effect, what you are saying is that this modern contracting system could cause real problems for some businesses in doing this.

**Lin Homer:** To be clear, zero-hour contracts are often used by big employers, such as big retail. We expect them to be able to run systems as complex as their operating model. We would not necessarily expect to make as many easements for that sector as we would for some of the people that Ruth has described. In fact, RTI ought to help with that, because you can make different payments each week and our system should bring them all together. Zero-hours contracts are probably less of a challenge for us in an RTI world than they were before. I am not saying that they are only used by big employers, but they are used

significantly more by some of the very big employers with variable work loads than they are by others.

**Q87 Fiona Mactaggart:** I accept that the big employers are capable of doing this, but small employers are beginning to follow their big leaders.

**Lin Homer:** That is more like the agricultural worker and the pub worker. We were already looking at them.

**Q88 Chair:** I am going to move on to tax credits, because that is the other biggie. It is a less happy story. Paragraph 4.26 on page 47 of the Report tells us that you are going to write off nearly 70% of the tax credits debt. Isn't that really letting the taxpayer down?

**Lin Homer:** Do you mean Amyas's Report or the annual accounts?

**Chair:** The NAO Report. Paragraph 4.26 on page 47 states that, basically, 69% of tax credits debt is going to be written off.

**Lin Homer:** I am going to invite Nick to explain that to you.

**Chair:** It is not a very happy story and it is not very good for the taxpayer.

**Nick Lodge:** This is the impairment we have made to the tax credits debt balance, which was £4.8 billion as at the end of 2012–13. We ran an exercise to look at the collection rates. That came up with the figures that you mentioned. According to that exercise, the recoverability of tax credits debt was, I think, a shade over 30%—on average, 31%—implying that 70% would not be collected.

**Q89 Chair:** So 69% won't be collected. That is pretty shocking.

**Nick Lodge:** It is a large figure. As we have discussed in this Committee several times before, tax credits debt is very difficult to collect. If we look at the historical figures, going back to 2003, and look at the total amounts that have been created in terms of overpayments, which is about £16 billion, the total amounts collected and remitted, and the total amounts on the debt balance, actually, we have collected about £7 billion overall and remitted about £4 billion. So generally we do a bit better with regard to that.

**Q90 Chair:** I have to stop you there. I asked for a little bit of work on this. If you look at the value of the debt arising out of 2003–04, done on lower bound, central estimate and high bound, it came to £3.5 billion. That was the first year, when you were bedding down and expecting things to be going wrong—I accept it is a complex system, and all that. But then look at 2011–12: it has doubled, in the paper I have, to £6.25 billion. So, despite the fact that one would have thought that you are getting smarter at detecting and stopping problems over the years, the amount you have overpaid or people have overclaimed—whatever it is due to—is £6.25 billion. It has gone up. That is a really sorry story.

**Mr Bacon:** Can I just add something? You are adding a further £1.8 billion—this is in paragraph 4.27 on page 47 of the Report—of new personal tax credits debt in 2012–13. The Report says: "HMRC estimates that it is likely to produce £1.9 billion of new personal

<sup>2</sup> Note by witness: This number includes self-employed and partnerships. In the context of RTI, there are 1.6 million schemes with between 1 and 249 employees.

tax credits debt in 2013–14 and, based on current business processes, total debt could increase to £5.5 billion by 2014–15.” That is on top of what we have now, isn’t it? It is new extra debt.

**Lin Homer:** It is important to explain the general context of tax credits and our approach to them. After that I will get Nick to explain some of what he is doing. The nature of the system is that we make a payment based on what we are told at the time. At the end of a year we reassess that and we adjust that payment retrospectively: so if someone has ended up earning more than they expected to or they have told us, by the end of the year, that they owe us money, there are then very strict rules about—

**Q91 Chair:** Lin, I am going to stop you. I want you to withdraw a little bit there. When we had Ruth in looking at 0845 numbers, she told us that when people were ringing up on that last day of the year to discuss their change in circumstances on the tax credit hotline—

**Lin Homer:** They couldn’t get through.

**Q92 Chair:** If I remember correctly, only 16% got through. It is not all about people not telling you. If you have a system where people cannot even tell you or ask you about their change of circumstances, it is bound to be wrong and these are all poor people. I accept that it is a hideously complex system. We all understand that.

**Lin Homer:** That was my point. It was not the individuals—

**Chair:** We understand that, but no progress has been made. When there are simple things such as people not being able to get through on the phone—

**Lin Homer:** I am sure we will come to that. I know you have already had Ruth here earlier in the term. The point that I was trying to make was the system point. We then seek to collect any overpayments where we can from ongoing payments that we are making. That means we will hold a debt arrangement with an individual in tax credit much longer than you would hold a debt arrangement with a business or in a normal business environment. We might take 10 years to take the sum back. We will let the debt sit on our books for a long time while we try to get it back.

**Q93 Chair:** We are not talking about that; we are talking about writing off 69%.

**Lin Homer:** No. The figures you—

**Chair:** It’s writing off.

**Lin Homer:** The figures you were talking about when mentioning our debt growing are about us being prepared to wait longer to get—

**Chair:** I started on the write-off.

**Lin Homer:** You did, but you moved on to debt. I think our debt will go up because we wish to take as much opportunity as we can to allow the families in this very complex system—I will be completely frank with you. Were it not transiting to universal credit, it would be at the top of my priorities to change, because it is complex for us and for the country and difficult for the people who are in it to run, but we are in transition, so we are making the best of it. Debt is likely to go up a little bit as we actually pursue more

of the debt, rather than write it off, but pursue it over quite a slow payment process. During this year, we think we will have touched all the debt that we are owed, but in some of those circumstances that will be to enter into arrangements to take very small sums back over a very long period. That leaves the debt on your books and I think that is the right thing to do.

**Q94 Chair:** 69% is being written off. Perhaps Nick can answer that question.

**Lin Homer:** Only in a given year.

**Nick Lodge:** Well, 69% is the book figure. That is not necessarily the amount that will end up being written off, because, as Lin said, we will attempt to collect all of that debt. We will put it through a full collection cycle this year and will continue to recover it—

**Q95 Chair:** Can we read this paragraph again? “This led it to reduce estimated recovery rates by 12 per cent”. You have reduced your estimated recovery rates—I accept that you are going to do a little bit every week over a longer period of time—by 12% “from 43.3 per cent to 31.4 per cent”. You will collect 31.4%, which means that 68.6%, you don’t.

**Lin Homer:** That is of the historic debt. That does not count the amounts which, as overpayments, are turned into ongoing collection—

**Q96 Chair:** What is “historic”?

**Lin Homer:** Where there isn’t an ongoing payment—

**Q97 Chair:** What years?

**Lin Homer:** If there is not a continuing tax credit payment or an agreement to code it out, we will turn that into traditional debt and we will seek other ways to receive it. We are not suggesting that we only get back 30% of all overpayments in the tax credit system.

**Q98 Chair:** Define “historic debt” for me. What is it?

**Lin Homer:** That is debt that is accumulated over many years that might still be owing at a point, for instance, when a tax credit payment finishes.

**Chair:** It has only been in since 2002–03.

**Lin Homer:** Yes.

**Chair:** So it’s not that many years.

**Lin Homer:** Quite a lot—

**Chair:** Where is your cut-off point? What is your definition of historic?

**Lin Homer:** In terms of when we move debt over, it will be if we are in a position where we no longer have an arrangement that we can attach the debt to, an example of which is if someone has fallen out of tax credits. At the moment, we—

**Chair:** They will still be earning.

**Lin Homer:** Yes, but then we have to pursue it as a normal debt. We cannot offset, so then you—

**Q99 Chair:** This is writing off. I will read it again. This is a reduced estimated recovery rate to 31.4%.

**Lin Homer:** On debt.

**Nick Lodge:** That is applied to the tax credits debt balance for the accounts. Those figures are absolutely right and they were calculated with the NAO. It does not mean in practice that we necessarily will write off

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that amount. Historically, we have done better than that. We are making improvements to our debt collection to try to do better than that for the future.

**Q100 Chair:** Well, you haven't done better—sorry about that—because you have reduced it. Your performance was such that you reduced the estimated recovery rate by 12% from 43.3% to 31.4%. You can't say you were doing better so you assumed you would get less in. That doesn't make sense.

**Lin Homer:** That paragraph is referring to our judgment about how much we can recover.

**Q101 Chair:** I understand that. I understand that it's an estimate of recovery, and I understand that you might do a little better. I also understand that the amount you estimate you are going to get in has gone down, so you can't say your performance has got better. I also understand that there is a heck of a lot you estimate you won't get in. You might do a little better than that, but it is still a heck of a lot.

**Simon Bowles:** I think it is worth saying, Chair, that this is a provision in the accounting records. In fact, there is a lot of work under way that Nick probably wants to talk about to ultimately prove that that is a conservative view.

**Q102 Mr Bacon:** Can I just be clear about this? Are you saying we should be clear that this is a provision in the accounting records? You make it sound technical, and not merely boring but unimportant.

**Simon Bowles:** That is not my intention, Mr Bacon.

**Q103 Mr Bacon:** Good. I read again from the paragraph the Chair was reading from: "and increase the provision for irrecoverable debts by £985 million"—in other words, nearly £1 billion. Can I just be clear about one thing? This £985 million we are talking about is money that was paid out that should not have been paid out because it was an overpayment. That is correct, isn't it?<sup>3</sup>

**Simon Bowles:** That is correct.

**Q104 Mr Bacon:** You are now saying it is irrecoverable.

**Simon Bowles:** That is correct.

**Q105 Mr Bacon:** What is the purpose of making it clear that it is an accounting adjustment? We can see it is a change in the records. I am not with you.

**Lin Homer:** If you think about our approach to recovering overpayments, we don't turn all overpayments instantly into debt. Some of them never go beyond being an overpayment. So we say to you, "Last year, because your income changed in year"—there is no fault; as we discussed before, we think much of this is error, not badness—"next year we will take 10% or 25% of that debt off your payment." Many people, although it takes them a long time, repay that money and their overpayment never turns into debt.

**Q106 Chair:** But they shouldn't appear in this number.

**Lin Homer:** They don't. This is a provision for the debts we expect to become irrecoverable. It is a proportion. Nick was talking earlier about overpayments in the system since it started. We are arguing about smallish amounts, so perhaps it is important to talk to you about what we are going to do about it, rather than the differences. We think it is £7 billion collected to £4 billion written off, plus another £4 billion or £5 billion still being pursued.

**Mr Bacon:** The C&AG is dying to come in here.

**Amyas Morse:** Only if it would be helpful, just to bring it together.

**Lin Homer:** He always says that.

**Paul Keane:** I think it does cover it. This amount covers the amounts that you are going to receive from ongoing awards as well. The £4.8 billion includes the sums you are recovering directly through your own efforts or through debt collection agencies, plus the amounts you are recovering through ongoing awards, which may be, in some cases, paying back small amounts over a long period. The provision applies to the entire amount of the sums that are recoverable.

**Amyas Morse:** The provision is justified if it is proposed on the basis that it is a realistic estimate of what is recoverable. That must be true; otherwise, you wouldn't even be able to do it. It's true that the debts don't cease to be recoverable. If the point is that the debts don't cease to be recoverable then there's nothing preventing you from continuing to try to recover them. Just making a provision does not mean you are not trying to recover them.

**Lin Homer:** That's right. That is the point Simon just made.

**Amyas Morse:** I understand that point; that's true. None the less, what you provided must be justified on the basis that it was the most reasonable estimate of what was probably recoverable.

**Lin Homer:** But the link I'm trying to break is the link to overpayments. If you look at the sum that has been paid out as overpayments, it would not be true to say that we only recovered 30%. We have recovered more than half, and only a smaller proportion has solidified into write-offs, and that is the £4.8 billion.

**Q107 Mr Bacon:** I was talking about the £985 million.

**Lin Homer:** Overpayments has been closer to £16 billion.

**Q108 Mr Bacon:** Hang on. Irrecoverable debt only arises from payments that have been made, yes?

**Lin Homer:** Yes.

**Q109 Mr Bacon:** And, ultimately, payments have been made that should not have been made and therefore need to be recovered, but are deemed by you to be irrecoverable.

**Lin Homer:** Yes.

**Q110 Mr Bacon:** How can you break the link between that and overpayments? Aren't they intimately connected?

<sup>3</sup> Note by witness: A fundamental part of the policy intent is that payments are correctly made provisionally until reconciliation at the year end. At this stage, my mismatch would then become an over or under payment.

**Lin Homer:** They are connected, but it is not true to say that 60% of that £16 billion has been written off; it is £4.8 billion—

**Mr Bacon:** I didn't say it was.

**Chair:** Nobody is saying that.

**Q111 Stephen Barclay:** If I understand correctly, is there not a distinction between what you have written off and therefore will not claim—that is gone—and a further sum that you could reclaim, in theory, but in practice that is so unlikely that in the accounts you file that as a write-off? Legally, if one of those people wins the lottery, you could go after that money, but in practice you are not doing that.

**Lin Homer:** Yes.

**Q112 Stephen Barclay:** So, for the purposes of my constituents—to go back to Mr Bacon's point—the amount of money overpaid that the Exchequer is unlikely ever to see again is the figure covered by the £985 million. Would that be a fairer way of summarising that, in layman's language?

**Lin Homer:** Yes, I think so.

**Chair:** It is an even worse figure.

**Lin Homer:** No—

**Stephen Barclay:** So it is £985 million that the Government could have spent on other things, but which they will not be able to spend because they are very unlikely to see that again. As far as our constituency postbag is concerned, that would be termed as a Government cut, but in this instance it is a provision in the accounts for money we will not see again.

**Chair:** And that is only the recent addition to the £2.3 billion already written off.

**Stephen Barclay:** Indeed.

**Q113 Mr Jackson:** If you accept that the bulk of the losses is unrecovered overpayments that relate to changes in circumstances, let us put that aside and explore deliberate fraud. To use the Home Office expression “fraud prevention upstream”—I know you had success recently with child tax credits with the extended Czech family in Nottingham that had defrauded the public purse of many millions of pounds.

Let me tell a little anecdote. A constituent, who was a landlord, came to my surgery. He had tenants who were masquerading as Portuguese when they were in fact Brazilian. They were claiming working tax credits. He is, fortunately, receiving their bank statements and helpfully observing that they are taking out large cash payments, clearly having a good time in Rio, where they are now domiciled, despite his telling the DWP and HMRC four times that the working tax credit and child tax credit payments should be stopped. They are still taking money out, care of our constituents.

My question is: at the time of forms being filled in and the administrative work being done to set up these claims, particularly for child tax credits in relation to EEA citizens—mindful of the Romanian and Bulgarian free movement from January—what specific concrete steps are being taken to deal with fraud at its commencement?

**Lin Homer:** I will ask Nick to do that.

**Nick Lodge:** We do carry out a number of checks at that point. We have an automated screening process through which we screen all claims to try to weed out those that are fraudulent or contain errors before they get into the system, and we have some success with that. We carry out particular checks on documentation for certain types of claimant, and we screen our systems to try to find the kinds of awards that you are describing by understanding the characteristics that apply to them. I will have to sound very disappointed if we have been told about this and have not yet taken any action.

**Mr Jackson:** I have written to Ms Homer, so she will have my letter.

**Nick Lodge:** And we carry out a large number of interventions each and every year—about 1.5 million—to try to address different risks in the tax credit system to reduce the amount of error and fraud in the system, which we have done in the latest figures, which have been reduced to 7.3% from 8.1%. That is still too high, but it is a significant move in the right direction, at least.

**Q114 Mr Jackson:** And the existence of children who are at the centre of the child tax credit claim—are you able to verify that and how do you do it? Is it through birth certificates in the respective countries?

**Nick Lodge:** Yes. When we have a claim along the lines of the one you describe, our process normally would be to look at the original documentation—a birth certificate and probably one other piece of original documentation as well—and check it to make sure that the child exists, for example. Clearly, sometimes we see forged documents and we have to look out for those, but we do check the documentation.

**Q115 Mr Jackson:** How were you able to apprehend or successfully prosecute in this case? It has now been expedited and I assume you can talk about it; it was quite a wide-scale extended family fraud involving working tax credits, in the Nottingham area. Was it forensic documentation that you looked at, or was it a tip-off? How did you do it?

**Nick Lodge:** We liaised closely with other agencies, both here and abroad. I don't know the absolute details of that case, but I do know that we worked with other agencies on it. These cases take quite a long time to come to fruition because of the evidence gathering and so on; but yes, we would have scanned our systems and drawn together all the information and, as you say, we managed to bring these people to court.

**Q116 Mr Jackson:** Finally, do you think you have the resource capacity to deal with deliberate fraud—the forensic examination and investigation that is necessary in these cases—going forward over the next two or three years?

**Nick Lodge:** The number of cases that we refer for prosecution is growing quite fast from a relatively low base. We are doing more and more of that. So far this year, we expect to refer 600 or 700 cases, whereas a few years ago it would have been only a few tens of

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cases, so it is rapidly growing. We work closely with DWP and are looking at capacity generally in the tax credits system for addressing error and fraud. Only this week we had opened discussions with the market, through issuing a prior information notice, so that we can talk to private sector organisations about how they can help us to reduce error and fraud in the system. This follows a small trial that we ran in the summer. We expect to do quite a lot more in that direction in the coming few months.

**Lin Homer:** We are also exploring how our Connect system can be used—our data analytics, which you have heard us talk about before. So if you think about that case, which has received quite a lot of publicity, we should increasingly be able to have our data analytics tell us if one set of bank accounts, one address or one agent pops up in too many places. So there will be more use of Connect. The final bit—which is for the future rather than now—is our investment in digital. We received £200 million in the autumn statement, and we will be rolling it out over the next couple of years. Clearly, this will be key particularly to customer service, but we think it will be really useful to us in compliance and fraud as well. Despite the short nature of the future of tax credits with us, we still think it will be worth checking what online work we can do.

So if we have had someone who has made a lot of errors in change of circumstance, let us say, we might require more regular confirmation of circumstance from them than our current system requires. We want to keep playing with this, because we think that observing patterns and behaviours will be one of the ways to get in earlier. It was a big catch to get that whole criminal gang—that is definitely serious organised crime—but at the moment that takes an awful lot of resource to stop. Jenny Granger will tell you that she believes she can take compliance more upstream and do more of that within our data analytics, which gives us more chance.

**Q117 Ian Swales:** I would like to follow on from what Stewart talked about. The report says that the estimate of error and fraud equates to about £2 billion. Lin, you have heard me ask this question in another context many times. Have you presented a business case to the Treasury to say, “If you give me this amount of money, I will reduce that by x?” It seems to be another example of, if there is £2 billion of fruit on the tree, it is worth paying some money to get at it.

**Lin Homer:** Yes. Our position is that we will present business cases to our Ministers, broadly, on a six-monthly basis: Budgets and autumn statements. I think that HMRC has probably had some investment at most of those occasions over the past four or five years.

**Q118 Ian Swales:** Have you done one specifically on this topic?

**Lin Homer:** We have already done some investment in this area. The notice that Nick alluded to is one of our current projects, so that would be the use of the private sector to increase our capacity in fraud and error.

**Q119 Ian Swales:** May I build on a question that has just been answered around the question of prosecutions? I can well understand the large resource required for a serious organised crime situation, but you often walk into a shop and see a sign, “We always prosecute shoplifters.” Do you always prosecute people who knowingly submit fraudulent documents to you?

**Lin Homer:** No, I don’t think I could tell you that we do that. We seek to take action whenever we see a situation, but we will use civil approaches and behavioural nudges as well, just because of the numbers. We have 4.8 million families. For instance, in the compliance field, not in tax credits but in tax, we have recently used a “nudge” technique, where we believe there has been over-claiming of some reliefs. Where we would not have had the investigative power to look at all of those, we have asserted a belief that there is an over-claim in tens of thousands of cases, and had something like a 94% response rate to that of people conceding. So, that is not a prosecution but that is action.

**Q120 Ian Swales:** I understand that, but there is another form of nudge. If you are in a community where people are doing this sort of thing and getting away with it, they tell their friends. If they are prosecuted, they also tell their friends.

**Lin Homer:** And we tell their friends when we prosecute.

**Q121 Ian Swales:** Exactly. As I said, I can understand the high resource required where you have a complicated case, but where you have a simple case, where it is clear that somebody has attempted to defraud HMRC, I would have thought the resource required to prosecute was quite low and therefore you should be doing a lot of it. How do you respond to that?

**Lin Homer:** I think we committed to prosecuting more. That was one of my early commitments to the Chair. When you have the next team here I am sure they will happily give you more information about our prosecutions overall. We agree with you; we think we should prosecute more. You asked me a direct question whether I prosecute everyone; I told you truthfully that the answer is no. There would just be too many, and even a simple prosecution is quite resource-hungry.

Our experience is that of a mixture of civil penalties and refusal of award. You are absolutely right that if a scam does not work, people stop doing it. If we see a scam working, we will do a mixture of things in that space to signal that we are watching. Some of that includes simple advertising. I hope you noticed over the past year quite a lot of our eyes looking out at you. There is some good statistical evidence that adverts like that deter people from this kind of behaviour. We have to use the whole scheme.

**Q122 Ian Swales:** I will move on. I will leave the thought on record that once again I think the resource required to prosecute should be there, because the payback would be there.

**Lin Homer:** I might disagree with you on that one, but I hear your comment.

**Q123 Ian Swales:** Okay. May I move on to figure 11? We have talked about the reduction in fraud and error in certain categories. It is quite stark in figure 11 that the two categories where it appears to have reduced dramatically are both to do with children. I wonder whether there are any messages about what you have done there. Is it a coincidence?

**Lin Homer:** No, it is hard work.

**Q124 Ian Swales:** Have you done something specific? Is there any learning for the other categories here?

**Nick Lodge:** Yes, we have done some specific things. We break down fraud and error into these different risk categories and we plan around each one of them. When Lin and I were before the Committee in March talking about tax credits, we did not have this latest set of figures with us and were looking at the previous year, when the risk, for example, around children had grown quite substantially. We were saying at that time that we were going to do more data matching between tax credits and child benefit, which are two separate systems. Child benefit is a very old system so did not lend itself to much manipulation, but we have done more data matching. We have therefore found more cases where, typically, a young person aged 16 to 19 is no longer in further education and so qualifying for tax credits, and we have been told that—we have picked up those kind of cases. That has enabled us to reduce the amount attaching to children. With child care we have made a specific series of interventions talking directly to child care providers to check what is actually going on.

**Q125 Ian Swales:** That is helpful. The same chart also shows that the estimate for undeclared partners remains stubbornly high, having gone up in the past two years. Is there any learning you can apply from what you have been doing on children?

**Nick Lodge:** Yes, I think that there is. The undeclared partner risk and the amount associated with it has gone up roughly in line with entitlement. As you say, it has remained stubbornly high. We devised and began to implement a new series of interventions towards the end of the year to which the figures relate—in about December 2011, and the figures relate to the year 2011–12. We used financial information and information from credit reference agencies to tell us when a couple might be tied together financially but telling us that they are lone claimants. We began to do that and saw some effect, but not a marked effect in that particular year because we started late in the year. The following year, we carried out well over 100,000 interventions and prevented well over £200 million of losses. We would expect that to come through in next year's figures.

**Q126 Mr Bacon:** I would like to follow up Mr Lodge's point about children who are being claimed for because it is claimed that they are in education from the age of 16 onwards. The most recent communication I have from HMRC about this issue

relates to a constituency case. I was told by the HMRC person who wrote to me that, "Unfortunately it is not a quick or easy process, and in the circumstances I ask for your patience in this matter." That was dated 23 September 2013. This is a matter that I have been drawing to the attention of HMRC and the CSA since June 2012, so there have been 15 months during which something hasn't happened. Am I not right that, where a child benefit claim is being made on the basis that the children are still in education, the CSA is obliged to make a maintenance assessment for the ex-spouse to pay maintenance?

**Lin Homer:** I think that was a letter from me, Mr Bacon.

**Q127 Mr Bacon:** My constituent seems to be under that impression, because in this particular case the children are not in education, but the claimant, the other parent, has asserted that they are in order to claim child benefit—the allegation is that the claim is fraudulent. We are now at the point where the CSA is telling HMRC, "We have checked—these individuals are not in education," but there is nobody at the other end. It is like knocking on a vacuum.

The point that the CSA made to us is that this is rife. I am only raising it here because it is a systemic problem. There is a particular problem relating to my constituent—I am happy to get my office to draw it to your attention afterwards, Mr Lodge—but the CSA tells us that it is often facing this problem. HMRC tell me that unfortunately it is not a quick or easy process, but with the powers of Government, finding out whether or not someone is in full-time education is not actually a particularly difficult thing to do. My constituent has managed to find it out and the CSA has managed to find it out and verify it, but answers come there none from HMRC, over a period of well over a year.

**Lin Homer:** I think I have just signed a reply to you on this case, Mr Bacon. It might be a different one, but it sticks in my mind. First, I must say that if there is a systemic issue from CSA's perspective, we should talk to them about it, and I will take that away.

**Q128 Mr Bacon:** That is what they told us—that they often have this experience of drawing things to your attention and nothing happens.

**Lin Homer:** That is helpful. That is not a comment they have made to me, and we of course should look at that. On the individual cases we see there are a couple of things. I am not an absolute expert and I don't have my letter in front of me but one of the issues for us is that the definition of "in education" includes work where ongoing training is being provided in work. So one of our challenges is that one partner may not know as much about a case as he or she thinks. The second—many of you know this from the letters we write to you—is that we are not always at liberty to tell you if your constituent is one half of a partnership.

**Q129 Mr Bacon:** I understand that, but when it is asserted that someone is registered at a particular institution and there turns out to be documentary evidence that this is not the case and they are not

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registered and never have been, it is fair slam dunk. It is not that difficult.

**Lin Homer:** Well, I may still be in a position where because you are writing on behalf of one constituent and the tax issues relate to another, I am not able to tell you as much as I know. I do believe that in the letter I have just written to you I give you some general information about this. So my apologies if that letter has not got to you. That was much more recent than September. I will certainly take away the CSA issue and I will make sure that we talk to them.

**Mr Bacon:** I will certainly make sure that Mr Lodge sees the relevant correspondence.

**Q130 Ian Swales:** On the remaining point, having listened to this discussion, I feel that what we need is confidence that the processes you are operating and spending money on will be leveraged in the new universal credit world. If you are spending £200 million on this, then from a taxpayer, value-for-money point of view, it is self-evident that you should be closely tied to DWP. Either it is spending the same money—

**Lin Homer:** No. Absolutely.

**Q131 Ian Swales:** Or it is a joint project.

**Lin Homer:** Well, first we are spending £200 million over our whole system. This is not £200 million being invested in tax credits. We anticipate we will get a very good rate of return on that in a sense regardless of any benefit in the tax credits area. The universal credit system is innately better than the tax credit system at preventing fraud and error. It is a real-time system. It does not allow claimants to tell us something by error or intention, and require us to wait a long time before we can challenge that. I think the design will design out some fraud and error. RTI will allow that to be much more up to date. But we are determined to try to share fully our experiences of this system with DWP so that the learning is not done twice and so that the investment is not done twice.

**Q132 Ian Swales:** So no redundancy of cost and work now?

**Lin Homer:** Absolutely.

**Chair:** Let's try and get Steve in on this issue and then we must come back to PAYE.

**Nick Lodge:** Chair, may I quickly clarify one point? The £200 million was not investment. It was £200 million that we had identified and addressed in error and in fraud. So that is not an investment in a system or anything like that. That is the amount from those interventions that we identified.

**Q133 Stephen Barclay:** Mr Lodge, may I go back to Mr Jackson's point, which as I understood it was about benefits being paid into a UK account but withdrawn overseas outside the EU? Would your controls pick up such payments?

**Nick Lodge:** Increasingly they would, because we are now beginning to liaise much more closely with the banks so that we get a flow of information about such cases that we can then pick up. Historically that would not necessarily have been the case, but we are now doing that.

**Q134 Stephen Barclay:** But the banks would be aware of that, wouldn't they? Payments had come in the form of a benefit and been paid out overseas.

**Nick Lodge:** They are able to identify that, yes.

**Q135 Stephen Barclay:** Might banks report that as a suspicious activity report to SOCA?

**Nick Lodge:** I am not sure whether they would, because my understanding of the particular arrangements for that is not good enough. They might do under some money laundering—

**Q136 Stephen Barclay:** My understanding is several years out of date, but is it the case that there were not industry requirements to report but that some banks would report such transactions as suspicious activity reports?

**Lin Homer:** I think the money laundering requirements have substantially changed over recent years. We put a lot of obligation on people who handle money to report.

**Q137 Stephen Barclay:** What I am driving at is, in a case like that identified by Mr Jackson—he has told me which bank it was—might it have filed a SAR with SOCA?

**Lin Homer:** As we said earlier, we will have involvement with the law enforcement agencies in those big cases.

**Q138 Stephen Barclay:** Sure. Perhaps you could let us have a note. In the case identified by Mr Jackson, I am interested in whether the information concerning that, as a suspicious activity report, was already sitting with SOCA. Could we have a note on that? And perhaps we could have a note on why that which is clearly preventable—in agreement with the banks, because the banks have that information—is not being addressed.

**Lin Homer:** We will seek to give you a note. I am not sure, and I might need to talk to Mr Jackson. The case we were talking about predominantly has come to fruition and led to a prosecution.

**Q139 Stephen Barclay:** Of course it is resource-intensive, and usually it is only triggered by other information such as in the Nottingham case and that leads to an investigation, but the point is that banks are perfectly able, at very low cost, to identify coded payments that come into an account from Government agencies in the form of benefits, and, as a matter of routine fraud controls, know the minute people are withdrawing from accounts overseas. Many constituents will know that if they go overseas and do not notify their bank, sometimes they cannot use their card. These are routine controls. Some—not all—banks, I suspect, report some of those things to SOCA, and yet another part of Government is not speaking to SOCA.

**Lin Homer:** That is not true. On the National Crime Agency, as it is now—Jennie Granger is heavily involved in the development of SOCA—the NCA. She sits on the programme boards with Keith Bristow. We are looking at ways to develop greater use by us of their data, but increasingly they are using ours.



**Q140 Stephen Barclay:** You have just confirmed to me that you cannot say there is a process whereby the banks are reporting information that they know about, which would be a standard fraud risk control. If the banks are looking at it with their own data and these payments are taken overseas, straight away that is a fraud alert. What Mr Jackson was alerted to—

**Lin Homer:** Not necessarily.

**Q141 Stephen Barclay:** Well, it is not if a customer is notified in advance, but what I am driving at is, if benefits are going into an account and the withdrawals are constantly overseas, I would expect that to be a finite population, which you would want to investigate.

**Lin Homer:** Yes. And some of the experiments that we are going into involve a greater use of what we would call third party data.

**Q142 Stephen Barclay:** But these are experiments you are going into. I am saying that this has been known for years. The sums at issue are very large. I cannot understand why we do not have today a process for the information that the banks have—we have confirmed that the banks have this information—on these accounts. It may already be sitting with SOCA in some instances; it may not for others. It would be an easy requirement to ask the British Bankers Association to make that an industry standard. That information is then simply an issue of data matching between who you are paying accounts to and who is withdrawing from the accounts overseas. That creates a population for you to investigate. It baffles me why that control is still not in place.

**Q143 Mr Bacon:** Particularly since I drew exactly this problem to the attention of the NAO and Customs and Excise many years ago.

**Lin Homer:** I understand your frustration. I think we are in this space. I do not think it is quite as easy as it sounds, because the threshold for referrals needs to be right so that you are not overwhelmed. There will be many instances of people who are entirely entitled to withdraw money, who may choose to do that overseas on occasion. I mentioned earlier that we think we are now reaching a space where we can do much more data analytics than we could before.

**Q144 Stephen Barclay:** With respect, you say “on occasion”. I am talking about repeated withdrawals overseas. You could set a risk profile of countries that are a higher risk—an obvious one would be Brazil into Portugal—but you are saying that we do not have that.

**Lin Homer:** No. I am saying that we are now in that space. Traditionally, we were not. We did not have the data analytic capability before to watch those trends and do that matching. We do now and we are beginning to get benefits from doing it. We totally agree with you, but I do not think that Customs and Excise would have had the data analytics capacity to do it.

**Chair:** We will stop now because we have a vote, but we are coming back.

*Sitting suspended.*

*On resuming—*

**Chair:** We are moving off tax credits. Is everybody happy? Okay.

**Q145 Austin Mitchell:** Why was there a fall in the amount of overdue tax collected in 2012–13? I think it fell by £3.4 billion.

**Lin Homer:** In overdue tax collected? Generally or specifically, Mr Mitchell?

**Q146 Austin Mitchell:** The amount of overdue tax collected in 2012–13 was down £3.4 billion. See paragraph 1.5 of the Report.

**Lin Homer:** So this is back to debt?

**Paul Keane:** Yes. Tax debt rather than tax.

**Lin Homer:** The position we have been in on debt generally is that we have been separating out more clearly stock debt from flow debt and we have been trying to make progress on both at once; in a sense, to clear up the past while improving the future. I think it would be fair to say that it has taken a bit of adjustment to work out how much resource to put on each side of that equation. From my perspective, we have made some adjustments during the year to ensure we were pursuing enough of the flow debt as well as the old debt. It may be that that has led to the change that you are talking about. The difficulty is that I can't see the figure you refer to in paragraph 1.5.

**Paul Keane:** It is in the paragraph with the £37.9 billion.

**Lin Homer:** I follow. Sorry, I just misheard. I was looking for a different figure.

**Chair:** The amount you have decided “not to pursue for reasons such as hardship or value for money...has increased from £5.17 billion last year to £5.31 billion this year”.

**Q147 Austin Mitchell:** That could be due to more insolvencies.

**Lin Homer:** That is a different point.

**Austin Mitchell:** Why was there a drop in the amount of overdue tax collection?

**Q148 Chair:** Is that not what you meant?

**Lin Homer:** You are talking about different points, but that's fine.

**Chair:** Oh sugar, sorry.

**Lin Homer:** Don't worry. Overall debt fell during that period, but that is the amount we collected. That is because we were placing a greater emphasis on the old debt during that period. This links back a little bit to our conversation around tax credit. We have been trying to move into a position whereby we are active on all our debt, as opposed to just chasing the newest debt. In doing that, for a while, you might not be absolutely maximising your return. I think Mr Swales made the point about prosecution. We are trying to send a signal that we will pursue debt, whether it is small, big, old or new. We have altered where our resources go, but overall our proportion of debt collected has gone up and remains very high—Simon might have the figure to hand. We think that the approach of being active in relation to all our debt will allow us to send the message through the system

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that there is not a sort of line beyond which we will not go—if your debt is this old or this small, don't worry, they won't chase you. We are trying to change people's perception.

**Q149 Austin Mitchell:** That's a hope for the future, isn't it? I mean, £3.4 billion is a big drop.

**Lin Homer:** Not in relation to—

**Austin Mitchell:** In relation to a falling take.

**Simon Bowles:** If we see it in the context that overall tax debt fell from £16 billion to £15.3 billion, there has actually been a reduction overall in the level of debt.

**Q150 Chair:** We are playing around with different figures. Can we all have the same figures? I am looking at paragraph 1.5.

**Lin Homer:** You are looking at the end of it.

**Chair:** In paragraph 1.5—overdue tax, that was the first figure; I went on to the second—in 2011–12, you collected £37.9 billion.

**Lin Homer:** It was £34.5 compared to £37.9.

**Q151 Chair:** So that is where Austin gets his £3.4 billion. You have collected less overdue tax.

**Q152 Ian Swales:** That is partly because you were chasing more old debt in the previous year. Is that what you are saying? That is what we would expect.

**Lin Homer:** Yes, and because we collect 99% of the taxes due, we are getting a smaller amount overdue. That is a sign of us getting more active in relation to debt.

**Q153 Chair:** How much was the overdue figure, of which you then collected £37.9 billion in 2011–12, compared with the overdue figure in 2012–13? What was it in the two years: the year where you collected more and the year where—

**Lin Homer:** It will be in one of the tables. I am sorry, I do not know if I can find it quickly.

**Q154 Chair:** Can somebody help us, otherwise it is pointless?

**Lin Homer:** Do you want me to give you a note on that?

**Chair:** Okay, it moves us on a bit.

**Q155 Austin Mitchell:** You are saying that it has nothing to do with staff shortages?

**Lin Homer:** No. We are putting a lot more into debt than we were. Our collection rates are good. As I say, we are moving out our sphere of influence, if you like, and chasing more debt. The question about how far back historically we can go, which is where we were on tax credit, is one issue, but our overall collection rate for debt in relation to tax is extremely good.

**Q156 Austin Mitchell:** Do you do any calculations about the increase in tax claimed or generated that is produced by employing an extra tax inspector?

**Lin Homer:** This is not done by tax inspectors. It is done by debt collectors.

**Q157 Austin Mitchell:** They produce claims about the amount of abuse discovered by DWP inspectors, and I am sure that the return from tax inspectors must be much better than hounding beneficiaries.

**Lin Homer:** Our return on each member of staff is very good. It depends how you want to calculate it. We collected £476 billion.

**Q158 Austin Mitchell:** It would be a useful weapon to urge against the Treasury when asking for more money.

**Lin Homer:** I think the Treasury thinks we are a good investment bet. I said earlier that I do not think we have had an autumn statement or a Budget in recent years without some investment. The Chair herself has quoted the return on investment in a number of our schemes, so you are absolutely right. But to be very clear on debt, we are deploying more resources than we used to and pursuing more of our debt. There is some that historically has not been value for money to collect, and one of the reasons why we have been testing the use of the private sector is to get a return on money that is poor value for money to collect, but you still get some return. One has to be practical. You may get 5p in the pound on some of that debt, but it would still be better than nothing. We would allocate our resources to the best return, so we are looking for models that would allow us to allocate more resourcing, even for the low return. That has been some of our practical work, both in fraud and error and in debt, in using the private sector.

**Austin Mitchell:** Okay. I want to ask about the Swiss-British agreement—

**Q159 Chair:** We will come back to that next week. On your private people—this goes a little back to tax credits fraud and error—you signed this contract with Transactis. What did it cost you? What did you get back?

**Nick Lodge:** We ran a very short proof of concept trial for about five or six weeks in the summer, just to see—

**Q160 Chair:** It says three months.

**Nick Lodge:** I think it started right at the end of May and concluded in July, so it spanned three months but it did not actually run for three months. I cannot remember the precise cost, but it was around £50,000—I can correct that if I have got the estimate wrong.<sup>4</sup> The purpose of doing that was to check the proposition that a private sector company could carry out the kind of checks that we do to counter tax credits error and fraud: the checks that I described earlier on child care or children. It did show that they could do that successfully, so we are now talking to private sector suppliers—

**Q161 Chair:** They did not get extra money in.

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<sup>4</sup> Note by witness: The value of the contract was in fact £240,180. This figure was already in the public domain and is available at: <https://online.contractsfinder.businesslink.gov.uk/Common/View%20Notice.aspx?site=1000&lang=en&noticeid=1036233&fs=true>

**Nick Lodge:** They worked, to a conclusion, on over 5,000 cases and identified about £20 million-worth of fraud and error.

**Q162 Chair:** So they identified £20 million of fraud and error.

**Nick Lodge:** They did.

**Q163 Chair:** For the £50,000 you paid them.

**Nick Lodge:** Yes. As I said, I will correct that figure if I have remembered it incorrectly. That has shown us enough to want to talk to the potential private sector suppliers in a much more open way about whether we can extend those arrangements and bring them in at scale to improve tax credits capacity.

**Chair:** We will hear from Amyas first.

**Amyas Morse:** Following that, have you got a benchmark of what it is costing you to do that in-house so that you know—

**Lin Homer:** Yes.

**Amyas Morse:** Have you got the right costing information to do that?

**Nick Lodge:** We understand how many staff do this work and we understand the return they get from it in terms of losses prevented, so we have a calculation that we can do for that rate of return.

**Lin Homer:** For both debt and fraud and error, we can match the internal and external performance.

**Amyas Morse:** As I said, to make good decisions—

**Q164 Chair:** What is the advantage of the external?

**Lin Homer:** Potentially two. One is wider reach, and the second is that they may be better at it than us. Either is worth having, so even if they are not better than us, we could give them lower-value work and they could reach to a space that we cannot. We are looking at the sustainability of these models and ways to fund them sustainably, which may include payment by results.

**Q165 Ian Swales:** That is pretty spectacular: a 400-fold return on the money you spent, if I heard the figures correctly. Did you say £50,000 for £20 million?

**Nick Lodge:** I will need to check the figures and, clearly, I will correct them if I have—

**Q166 Ian Swales:** It almost beggars belief. Without necessarily going into all the details, what kind of work were they doing? Was this more sophisticated data matching than you do, or was it boots on the streets going round? Because you do not get that much for £50,000.

**Nick Lodge:** Transactis are a specialist data company, so they did some data analytics to select cases, and we saw some benefit from their expertise in that in selecting and homing in on the right cases to pick up. Then they were phoning up and writing to claimants to check the circumstances for those cases, to correct them if they were incorrect and pass that information back to us. So it was a combination of data analytics and some—but not very many—boots on the ground. It was quite a small trial; it was not very large numbers.

**Q167 Ian Swales:** This comes back to something that I keep talking about: investment in order to get out. These amounts of money—these billions—that we see in these sorts of reports buy you an awful lot in terms of people or third-party effort or systems and so on. Is that not a perfect example of how perhaps we should not be as quick either to write things off or to say, “There is this percentage of fraud and error” when that kind of expertise is out there? If they can do that, that suggests to me that, even though we think our systems are good in Government and in the Department, what sounds like a relatively small company has far better systems. What is that telling us?

**Lin Homer:** We talked earlier today about what we have achieved ourselves. To put that in context, the 1% improvement over the last year that Nick referred to earlier has been achieved internally with relatively small resources, and that also adds up to a pretty big sum. My maths is not very quick, but Nick will probably calculate what proportion of the £1.9 billion less error and fraud that means there is in the system. I would therefore slightly challenge the view that we do not have the capacity to do these things ourselves. The question for us is whether we can create mechanisms whereby we don’t think we have to do it all ourselves—we can use a mixed economy. One thing you can do is deploy your resources more flexibly. We are trying that in contact centre work. Our view is that, in a number of these areas, having a mixture of resources to deploy is useful. Very often, ours will be the most skilled, but we can share and deploy and use other people. We think this is a rich field and we are very interested. We are looking at it within customer service debt and fraud and error, and we think it is a big opportunity for the future.

**Q168 Ian Swales:** Can I pick up another couple of points? Figure 5 of the NAO Report summarises the work with which the Committee is familiar—the catch-up work you have been doing. It says that the tax forgone over the eight or so years concerned is £953 million. The first item shows that you temporarily changed the threshold for cases that you looked at—have you now changed that back?

**Lin Homer:** Yes. This linked to the introduction of NPS. I know that you have spent a lot of time looking at this. For the debts that had occurred in the period from 2008–09 through to 2011–12, when we retrospectively tried to pursue them, we changed the threshold from 50 to 300.

**Q169 Chair:** How much did that mean in terms of estimated loss of revenue?

**Lin Homer:** That is the £266 million. We have changed that back. If I am honest—you alluded to this earlier—I think that that was a practical response to the impact on the taxpayer and us, but we now believe that we can and should maintain that lower level of tolerance. As we were discussing earlier, with people having greater understanding about their position, it is hopefully less easy for taxpayers to get into debt without realising and we can therefore pursue more confidently because there has not been confusion on their part—it has been more deliberate.

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**Q170 Chair:** May I come in on that issue? It is a lot of money, in the end. Congratulations on having sorted it out—in the end—but £1 billion of revenue was lost because of the bad way in which it was handled. Has anybody ever been held responsible and accountable for that?

**Lin Homer:** I am afraid I think it is a systemic issue. I do not think that anybody sat there and said, “Write off £953 million.” I suspect that the question about the open cases—how many there would be and how long they would run—was not well anticipated. We have to learn the lesson of anticipating that better, but a fairly big chunk of that ended up being time served—we just ran out of time to pursue them. We have tightened up our systems and you would rightly be able to hold me to account if in four years’ time I was back telling you—

**Chair:** You’ll be off then.

**Lin Homer:** You hope.

**Q171 Ian Swales:** It is a hidden cost of the systems and reorganisation overload.

**Lin Homer:** To some extent, our old PAYE system was not as accurate as we or others thought for many years. In a way, the good news is that it is more accurate now, but in the years we were making it more accurate, we had an opportunity to pursue those greater accuracies in a sense that was greater than we managed to grasp. I would accept that.

**Q172 Ian Swales:** A final point from me. We have been looking at paragraph 1.5. The last bit, which we have not yet mentioned, says that the amount you “decided not to pursue for reasons such as hardship or value for money...has increased from £5.17 billion last year to £5.31 billion this year.” Again, that is an enormous amount of money. That could cover a wide range of circumstances from too small to chase, to bankrupt companies or whatever. Can you tell us a bit more about what is behind those figures because, as I say, they are enormous?

**Simon Bowles:** Yes, I can tell the Committee that over 90% of that related to insolvency.

**Q173 Chair:** Over 90%?

**Simon Bowles:** That’s right.<sup>5</sup>

**Q174 Ian Swales:** So that would be tax assessed but the company had gone away or gone bust. I guess this is partly a policy point, but do you do any work to look at where a company closes down and the directors—I forget what the term is—

**Chair:** Phoenix.

**Ian Swales:** That’s it. Often HMRC is one of the big losers in situations like that. Do you do any work to pursue directors who may have engaged in that kind of activity?

<sup>5</sup> Note by witness: The figure of £5.3 billion is made up of £929 million remissions and £4,378 million write offs. Remissions are debts which are technically capable of being recovered, but where HMRC has decided not to pursue the liability. Reasons for this could include hardship or value for money. Write-offs are debts that are considered to be irrecoverable because there are no practical or legal means for pursuing the liability. Over 90% of write offs are due to insolvency.

**Simon Bowles:** We are doing quite a lot of work on that. I would not want the Committee to think that we just accept that over 90% being insolvent is the end of it. We are trying to improve risk assessment and have better trained and earlier interventions. We are also doing some more work to look at how we might better secure HMRC as a creditor.

**Q175 Chair:** What about the phoenix company?

**Lin Homer:** We try through our criminal investigation and our tax investigations base to tag and watch people with a history.

**Q176 Chair:** Any success on that?

**Lin Homer:** Yes. We do have some success but our systems allow companies to go down and come up. One of the spaces you will sometimes perceive us in, and you may indeed pressurise us to be kinder, is in time to pay. We will not always exercise our discretion to offer time to pay if we believe the company is at risk of insolvency, whether deliberately, or just that they are no longer sustainable. If giving them longer to pay leaves them falling off, we are then standing in line with creditors. In areas where we think we can envisage known characters appearing again, we will exercise more observation and closer scrutiny of those companies.

**Q177 Ian Swales:** Being more specific, what powers do you have with phoenix companies? I know enough about corporate law to know that a company is like a person. If they die you cannot resurrect them. Do you have any powers to deal with people who do that kind of thing?

**Lin Homer:** I haven’t come with this as my specialist subject today. I think it would be a fair question to put to the team on 28 October. I know that we exercise scrutiny of those companies. I am afraid I am not good enough on the company law side of this to be able to say whether we can exercise discretion. What we can do is use our criminal powers to investigate where we perceive a pattern of behaviour. So, for instance, in some of the MTIC fraud, where we have been very successful, we saw people appearing more than once. At the end of the day, if the legal entity is properly stood up and put down, there are limits to what we can do. We have discussed some of this around charities, haven’t we, as well? So we exercise what powers we can but I am afraid that I could not off the top of my head tell you our position in relation to phoenix.

**Q178 Ian Swales:** Last question: of the £5 billion-ish written off, in what categories of tax does that mainly fall?

**Paul Keane:** That is in note 7.2 to the accounts. Income tax in total was £1.3 billion; VAT £2 billion and so on.

**Ian Swales:** You caught me out. I know the rest of it. I had just forgotten that bit.

**Simon Bowles:** It is a gripping read.

**Q179 Mr Bacon:** I should like to ask about the construction industry scheme, which as far as I can see rates one mention in the Report on page 169 about a bulk remission. It concerns £206 million of penalties

relating to 1.2 million cases that were considered irrecoverable or where there was a low likelihood of recovery. Do you think that the construction industry scheme is now an expensive anachronism?

**Lin Homer:** The construction industry scheme is quite complex. We have gained some experience of penalties in a number of elements. Two things are going on here. The first is the scheme itself, which the construction industry would probably say is very necessary and important. The other is the way we tie penalties to schemes to encourage them to be well managed.

**Q180 Mr Bacon:** I was alluding to the penalties because they were the only reference I could find in the report. My question was not about penalties, but about whether you think it is now an expensive anachronism.

**Lin Homer:** That is a policy question at its heart, so I am not going to answer that. From the letters I get, it remains strongly supported by the industry itself.

**Q181 Mr Bacon:** When you say that, it's interesting to me. Which bits of the industry write to you supporting it?

**Lin Homer:** We get a lot of pressure when payments due under it are either challenged or slow.

**Q182 Mr Bacon:** Do you mean payments by you back—

**Lin Homer:** Back.

**Q183 Mr Bacon:** That is not quite the same as supporting it. "Dear HMRC, I had some deductions taken from me by my main contractor as I, a sub-contractor, have to be a member of this scheme, and I am not given gross payment status. The contractor has duly paid over this money, but you haven't paid it back to me yet. I have therefore given you a free loan for 15 months. Please pay." Frankly, that does not sound to me like support for the scheme; it sounds like me wanting my money back. Are you seriously praying in aid that type of letter as support for the scheme?

**Lin Homer:** No, but I am saying I get—

**Q184 Mr Bacon:** I think you will agree that it is not evident that that is support for the scheme.

**Lin Homer:** My point is that the people using the scheme do get in contact with us about it.

**Q185 Mr Bacon:** I didn't expect to have to belabour this point, but that is not support for the scheme. They are entrapped in it, and they want to make it work, because they want their money back.

**Lin Homer:** Your view.

**Mr Bacon:** You mean they don't want their money back?

**Lin Homer:** If they are due it, they will get it back. On the broader issue, you know that we put into effect the policies we are given.

**Q186 Mr Bacon:** I understand that. I am interested in the effectiveness of the scheme—whether it achieves its aim. If someone who is necessarily

enmeshed in the scheme wants it to work for them, that is not the same as saying that they support the scheme.

**Lin Homer:** No. I am happy to take back the word "support".

**Q187 Mr Bacon:** Who writes to you saying that they support the scheme? You said, "From the letters I get from industry, the scheme is well supported."

**Lin Homer:** I am happy to withdraw the word "support". What I am saying is that I get a lot of letters indicating that people are dependent on the scheme. I am not going to enter into a debate with you about the policy. I have not had anything like the amount of conversation about the effectiveness of the scheme as I have about some other areas, so I have not been lobbied that it is ineffective or administratively burdensome.

**Q188 Mr Bacon:** What does the scheme cost to administer?

**Lin Homer:** I don't know that off the top of my head.

**Q189 Mr Bacon:** The three numbers that I have from Government—these are all Government figures—are, a first estimate of £52 million, which went down to £30 million, and which later was admitted to be much higher than that—possibly £100 million.

**Lin Homer:** I am happy to give you a note. It is not something I know off the top of my head.

**Q190 Mr Bacon:** It sounds to me like there isn't a clear handle on how much it costs. I do not know if work is now being done on establishing what it costs—

**Lin Homer:** That is not true, Mr Bacon. I just don't come with every fact about all our systems in my head. I am very happy to give you a note, and I am confident that we have a handle on it. It was not a question that I anticipated. As you say, it was not a big feature of the annual report.

**Q191 Mr Bacon:** No, indeed.

When the scheme was set up—I think, 40 years ago, in the early 1970s—there was a structure in the construction industry whereby a great deal of cash was paid. People would turn up with security vans with literally lorry-loads of wage packets; they were called wage packets. They were counted out and put into envelopes, and then handed to people in cash. It was to combat potential tax evasion in those circumstances that the scheme was originally introduced in 1972, wasn't it?

**Lin Homer:** I wasn't there.

**Mr Bacon:** Neither, I hasten to add, was I.

**Lin Homer:** I think we were probably both at school in East Anglia at the time.

**Q192 Mr Bacon:** Well, yes.

Given that that is not quite the picture now, do you happen to know what proportion of workers in this sector are paid in cash?

**Lin Homer:** No. I think we have a briefing coming up with you on VAT. I am sure we could come along with a note on the construction industry scheme.

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**Q193 Mr Bacon:** You spent taxpayers' money on asking Ipsos MORI to ask this question. If you ask subcontractors how contractors pay them for subcontracting work, cash is 4%. It is a tiny amount.

**Lin Homer:** I would hope so.

**Q194 Mr Bacon:** Indeed. Not only because it is more secure, cheaper, quicker and more traceable to do it by direct payments; a lot of it happens now by direct payments, and the industry is not anything like what it was. Even for those that are not deemed large enough businesses to qualify for gross payment status, a significant proportion of the others will be small to medium-sized businesses that derive their own money from larger audited businesses, where it can be easily traced, and even the really small self-employed ones are getting their money mostly as direct payments, not through cash, are they not?

**Lin Homer:** I am not an expert on this scheme. I am happy to enter into a conversation with you about it, but I am not going to give you good value this afternoon. You clearly do not think it is a good scheme.

**Q195 Mr Bacon:** It has been put to me by people, including the Institute of Chartered Accountants in England and Wales, that now—

**Lin Homer:** They have not put that to me, interestingly enough, and I see them quite regularly.

**Q196 Mr Bacon:** They may be knocking on your door.

**Lin Homer:** I would be very happy to talk to them.

**Q197 Mr Bacon:** Given the structural changes that we have seen in the industry, there are now questions that might not have been there at the beginning about the scheme's effectiveness and efficiency, and indeed its economy, because of the cost of running it.

**Lin Homer:** Well, I would be very happy to talk to them.

**Q198 Austin Mitchell:** The agreement between Britain and Switzerland over unpaid tax—

**Chair:** Austin, we are going to deal with Switzerland and all the tax avoidance stuff next week—the whole lot together. We all have lots of questions to ask on that, so save it until next week.

**Q199 Austin Mitchell:** You will not raise an estimated £4.4 billion over the next three years, particularly since part of that will be raised directly from individuals who will suddenly break down and confess, "I've got a Swiss bank account" and hand over the money. That was my thought. I was going to give you that thought.

**Q200 Chair:** Okay. Give it to them next week. I have two final questions. One concerns customer performance. We talked earlier about your failure to answer calls on the child tax credit. If you look at appendix B of the Report that we got from the NAO, you will see that performance appears to have deteriorated in the first quarter of 2013–14.

**Paul Keane:** It is appendix B to the brief we have given the Committee, but it is from HMRC's Business Plan Indicators—Quarterly Performance: Quarter 1—April to June 2013.

**Q201 Chair:** Okay. If I just take that. Post received and dealt with within 15 days was 85% in the fourth quarter of 2012–13, and in the first quarter of 2013–14 that was down to 70.3%. The percentage of calls "attempt handled"—I don't know what means; I assume it means answered—

**Ruth Owen:** Answered, yes.

**Q202 Chair:** "Percentage of calls" answered "by our Contact Centres within 5 minutes"—which is dire—is now at 57.7%, and those seem pretty grim statistics. Apologies if you have not got them, but Ruth will be familiar with them.

**Lin Homer:** Before Ruth gives you the update, we do not think customer service is good enough yet, so do not for a moment think we are yet content. We are making some underlying improvements. Again, I would credit Ruth and her team with working very hard in this space. The best comparators are quarter to quarter, because our business is very different in its seasons.

**Q203 Chair:** Let me take you from quarter to quarter. Quarter 1 of last year, on the answering of the letters, was 77.4%; it is down to 70.3% this year. On the other one—calls handled—you obviously were not collating the stats last year.

**Lin Homer:** I think we were, but Ruth can give you the detail.

**Austin Mitchell:** How do we tie in the policy, which is mentioned in paragraph 7, of getting more tax by co-operation and by encouraging businesses and individuals to comply with their obligations—the job of an accountant or whatever—with the fall in responses that we have just had?

**Lin Homer:** Quarter 1 of this year.

**Ruth Owen:** So on calls answered, in quarter 1 of this year, we answered 78% of calls compared with the same period the previous year, which was 67%. The same quarter the previous year was 56%. None of those is where we want to be, but there is an underlying trend, even in what is a busy quarter for us, of us actually understanding how to manage supply and demand.

**Q204 Chair:** The first quarter, of course, is when most people ring you up, isn't it?

**Ruth Owen:** It is a busy quarter. I gave you some figures the last time I was here to talk about 0845 numbers. At the year to date, we are at 73% over the whole year, so just over halfway.

**Q205 Chair:** You are at what?

**Ruth Owen:** 73% of calls answered.

**Q206 Chair:** Calls answered within five minutes?

**Ruth Owen:** No, calls answered.

**Q207 Chair:** Calls answered full stop? This is where Fiona hangs on for 20 minutes before she gets an answer.

**Ruth Owen:** Hopefully less now. Compare that with last year when it was 66%. Year on year, we are trying to get better. We know the first half of the year is always difficult. In the second half of last year, we were consistently at 90% and I expect to do the same this year, which is why when I last spoke to you—I wrote to you afterwards—solving how we manage the summer and the peak of that tax credit activity is the key to getting this customer service right.

**Q208 Chair:** You have also closed your—people cannot walk in any more.

**Ruth Owen:** We have not closed any offices, no.

**Lin Homer:** We have a pilot going in the north-east, which is providing telephony as an alternative, and we will be looking at that. I have sat in on some of those calls, and I must say that they are providing an extraordinarily high level of service to vulnerable customers.

**Q209 Chair:** When they get through.

**Lin Homer:** No, no, these are calls that are being answered quite quickly. They are also being consistently answered by the same person, who is giving as long as it takes. This is not our normal contact centre. We have not closed an inquiry centre and they are just joining the normal queue. We are directing the vulnerable customers to our most specialised telephonists. I think it will be worth talking it through with you because it is going to be an improvement in service. Ruth has faced up to the bits that she is still not happy with, but on the last occasion that I was here with her, she was committing to changing to 0300 numbers, and we completed that by the end of September. That has gone faster and was easier than we expected.

**Q210 Chair:** It is faster, is it?

**Ruth Owen:** It was faster to deliver it—that is what we mean, not faster to get through. It is cheaper to get through.

**Lin Homer:** That has moved some of those costs, which you rightly challenged us on, off the customer. We do continue to be very alive to our need to improve customer service.

**Q211 Chair:** Okay. We will keep coming back to it.

**Lin Homer:** Of course you will.

**Chair:** The other thing is to talk about the child benefit changes. You were quite robust last week. You said that 165,000 people should get off their backsides and register with HMRC. First, 165,000 is what percentage of the cohort where at least one earner earns more than £50,000?

**Lin Homer:** So 1.1 million families were affected by the change in high income.

**Chair:** So it is about 16%.

**Lin Homer:** Some 325,000 opted out by 7 January. Another 65,000 or so have opted out since, and 425,000 were in self-assessment anyway. We also needed to get in another 325,000. At the point where I used the “backside” word, which may not have been

wise but did get some attention, our anxiety was that those people were facing penalties if they continued to take no action between now and the end of the year. About 165,000 have registered and about 165,000 have not. I actually gave out an overly optimistic figure about a week ago, because immediately after the weekend, we thought that that had dropped to 110,000, but we got over-excited and double counted some people in that weekend. We still have 165,000 people that we need to get to do something; otherwise they will still owe us the child benefit that they have had, which for 7 January to March for one child is about £263, but the worst-case scenario is that they could then owe us as much again. So from now until the end of the year, we will continue to try—by direct letter, by media and by any means we can—to get the rest of those people to take action before the due date.

**Q212 Fiona Mactaggart:** How much is it costing you to do that?

**Lin Homer:** Much less than we anticipated, because so many people have been compliant. Over 90% of people are now compliant in the system. The vast majority of those did it online. We had far fewer calls than we expected. I have reduced the amount we expected to spend on this from the early 20s to about £13 million; that is not bad for a 1.7 billion response. But I am keen, in this first year, that we put all the effort in that we need to, because these people are losing a benefit. That, in a sense, is what the Government wanted to happen, but we do not want them to face a penalty as well. So you will see us continue to try and chase down that 165,000. It is actually about 145,000 now.

**Q213 Chair:** These are all households where one person earns—

**Lin Homer:** Or the other.

**Q214 Chair:** So they are not how we would define vulnerable citizens.

**Lin Homer:** No.

**Q215 Chair:** Yet getting them to change their behaviour is proving extremely difficult.

**Lin Homer:** Well, getting around 90% compliant within the first six months of introduction is pleasing. There is an element of human nature—we see it in tax credit renewal and in self-assessment—where people leave it really close to the end date before they do anything, so—

**Q216 Chair:** I was going to observe that if it is that difficult—I accept that 90% do, but 10% is quite a lot of people.

**Lin Homer:** It will be less than that by the end of the year. I am confident of that.

**Q217 Chair:** What does that tell you about how you implement these changes? I am thinking about universal credit, on the other side of the spectrum, where you will be dealing with vulnerable citizens and you are expecting behaviour change.

**Lin Homer:** Well, throughout the tax system in this country, we consistently see about 90% compliance.

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It tells us that we are a great deal better than many other countries. The natural level of voluntary compliance, I believe, is high, but people have a right to expect the system to help them keep their affairs in order by being simple and understandable.

**Q218 Mr Bacon:** May I clarify, for the avoidance of doubt, that those 425,000 who are in self-assessment anyway would not be subject to penalties, but would just be expected, when the self-assessment comes, to make a declaration?

**Lin Homer:** The self-assessment has a very clear box in it which says, “Have you or your partner received child benefit?” We can tell them, effectively, how much they have received. If they do their self-assessment by 30 December, we can code that sum out so they do not even have to pay it back in a lump sum. If they leave it to the last minute and do it on 31 January, they are more likely to have to pay us back in a lump sum, but it is built into the SA system. So yes, it is there for them.

**Q219 Mr Bacon:** Okay. That is the first part. The second part is: in terms of claiming child benefit, if

you are a person who comes into this category—I should know this—are you then able to continue claiming child benefit *ad infinitum* but it is then completely taxed away?

**Lin Homer:** Yes.

**Q220 Mr Bacon:** There is not a sword of Damocles that comes down and prevents you from claiming it.

**Lin Homer:** No, because the Government’s view was that child benefit has been universal and they wanted it to remain like that. So if you choose to keep having it here, and have it coded out there, that is one choice. For people with between £50,000 and £60,000 of income, that is the right thing to do, because they will be partial beneficiaries. So it is very important that people make—

**Q221 Mr Bacon:** It is when you earn over £60,000 that you are not a beneficiary at all.

**Lin Homer:** Over £60,000, you would pay back what you get, but it is income, not earnings. That is why we put the calculator on the site, so people could work out if it applied to them.

**Chair:** Thank you very much indeed.

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Monday 28 October 2013

Members present:

Margaret Hodge (Chair)

Mr Richard Bacon  
Guto Bebb  
Meg Hillier  
Fiona Mactaggart

Austin Mitchell  
Ian Swales  
Justin Tomlinson

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**Amyas Morse**, Comptroller and Auditor General, **Paul Keane**, Director, National Audit Office, **Ashley McDougall**, Director, National Audit Office, and **Madeleine Smith**, Alternate Treasury Officer of Accounts, were in attendance.

## REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

### HM Revenue and Customs 2012–13 Accounts

#### Examination of Witnesses

*Witnesses:* **Edward Troup**, Tax Assurance Commissioner, HM Revenue & Customs, **Jim Harra**, Director-General, Business Tax, HM Revenue & Customs, and **Jennie Granger**, Director-General, Enforcement & Compliance, HM Revenue & Customs, gave evidence.

**Q222 Chair:** We have a new person looking after us from the Treasury. Welcome.

Welcome to you all. We are thin on the ground because people have not been able to get to Westminster today, but I am sure the quality of our questioning will make this a very worthwhile occasion for you all.

I don't know whether this is for you, Mr Troup, but when you responded to the recommendations in our previous inquiry on tax, you said that, although the tax gap is quite a theoretical concept—we will come back to that—it is a health check on your performance. The tax gap has now gone up. Does that mean that HMRC is chronically and institutionally incapable of collecting tax in the way it should?

**Edward Troup:** First, I am sorry that Lin Homer is not here. I think she has already sent her apologies to you, but I am standing in.

Yes, I am the right person to answer on the tax gap, and we did say that it is a health check. It has gone up from £34 billion on an adjusted basis last year to £35 billion in cash, but it has come down in percentage terms from 7.1% to 7.0%, which we think is a better measure, because if Parliament puts up the rate of tax, as it did in that year for VAT, the tax gap tends to go up.

**Q223 Chair:** Yes, but corporation tax came down. Various taxes have gone up and down, and you have never previously used that as an argument for justifying an increase in the tax gap.

**Edward Troup:** No, but we have always looked at the tax gap as a percentage measure. Since 2005–06 it has come down from 8.3% to 7.0%. If the tax gap was still 8.3% now, we would be losing £7 billion more tax through the tax gap than we currently are. In that sense, I think it is a health check. If we had not brought the tax gap down from 8.3% to 7.0% over that period, we would be losing that £7 billion, which is roughly the amount of improved compliance that we have had over the period.

**Q224 Chair:** Am I right that in 2011–12, which is the year we are looking at, you therefore collected an extra £1 billion in tax? That is 0.2% extra tax from what we collected in 2010–11: £475.6 billion.

**Edward Troup:** The compliance yield for that year was actually—

**Q225 Chair:** Is that right? Can you just answer yes or no? Is it up by £1 billion?

**Edward Troup:** Tax receipts were £1 billion up.

**Q226 Chair:** So that is 0.2% more in 2011–12 than you collected in 2010–11.

**Edward Troup:** I don't think we can take credit or take the blame for changes in the overall economy or for policy decisions made by the Government to cut or increase tax rates, but those are all reflected in tax receipts.

**Q227 Chair:** Don't tell us that. The problem with that whole argument is that you say you are doing better and better, but if you actually look at the money in—there may be all sorts of reasons for it—it is not better; it is 0.2%. I assume that we are talking about a cash sum, not a real terms sum.

**Edward Troup:** That is cash.

**Q228 Chair:** Yes, it is a cash sum, so in real terms we got less in tax in 2011–12 than we did in 2010–11, in effect—in real terms.

**Edward Troup:** Total cash receipts went up by £1 billion, as you say. Our compliance yield went up over that by—I do not have the figures in front of me for the actual compliance intervention receipts; one of my colleagues may—

**Q229 Chair:** That is definitional. Overall, for us—people who pay their taxes—the extra money that you guys manage to collect on our behalf should have gone up quite a lot. As you said, the VAT rate went up, although as I said, corporation tax came down, but

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let us give or take a bit there: more comes in on VAT than comes out on the other one. All that being true, in real terms, you actually collected less in 2011–12 than you did in 2010–11.

**Edward Troup:** Tax receipts overall were, in cash terms, £1 billion up. I have not got the calculation as to what that means in real terms.

**Q230 Chair:** Well, it must be £2 billion or £3 billion down. May I ask about that gap? I understand that it is a theoretical construct. The Prime Minister said in his speech in Switzerland, when he talked about tax avoidance, that the behaviour of multinationals in “setting up ever-more complex tax arrangements abroad to squeeze their tax bill right down” has crossed the boundary into aggressive tax avoidance, and they should—in his famous little quote—“wake up and smell the coffee”. Am I right in suggesting to you—he was alluding to what came out in our session with Starbucks, Amazon and Google—that none of that is included in your calculation of the tax gap?

**Edward Troup:** The impact on tax receipts of international rules is effectively reflected in the measurement of theoretical tax receipts that we could get. If the international tax rules were different, then the theoretical tax receipts would be different as well, and that would impact on the tax gap. The tax gap—

**Q231 Chair:** Am I right in saying that the sort of issues that we were discussing in relation to Starbucks, Amazon and Google—I completely understand that you cannot talk about individuals, but that is what the Prime Minister was referring to—and the tax that could have been payable from those companies is not included, because it is not seen to be within the rules?

**Edward Troup:** The tax gap that we measure is a compliance tax gap.

**Q232 Chair:** It does not include that. I am asking whether it includes the Starbucks scenario, the Amazon scenario or the Google scenario.

**Edward Troup:** It does not include the amounts of tax that some of the commentators have said these companies should pay. That is correct.

**Q233 Chair:** Thank you. There is research that I saw in an article in the *Daily Mail* based on American filings of the five big internet companies—covering Apple, Amazon, Google, eBay and Facebook, but not Microsoft, Yahoo! and others—that suggested that, in 2011–12, those five companies avoided paying £685 million, based on the American filings. Am I right in assuming that your figure on the tax gap does not recognise that these companies did anything wrong?

**Edward Troup:** Well, off or on the tax gap, our responsibility is to make sure that we collect all of the tax that is due under the law. If someone is claiming that those companies ought to pay more tax under the law or that the law ought to be changed for them to pay more tax, that is absolutely not included in our measure of the tax gap.

**Q234 Chair:** It is not included in your measure.

**Edward Troup:** It is not a measure that is included in our measure.

**Q235 Chair:** What I am getting at with all this is that, while I understand that the tax gap is a theoretical figure, even as a theoretical figure it does not include a lot of what ordinary punters in the street think we should be collecting, particularly from the large corporations.

May I ask you something else? In 2009, which is the last year for which I have figures, 30% of companies on the register—838,370 companies, to be precise—were not asked for a tax return; they did not provide a tax return to HMRC. How many did not provide a tax return to HMRC in 2011–12?

**Edward Troup:** Active companies or all companies on the register, because there are obviously quite a lot of dormant companies on the register?

**Q236 Chair:** All companies. I accept that there are dormant companies. It is just that 30% is a heck of large figure. Dormant companies might—you tell me—be about 8% or 10%, if we are lucky.

**Edward Troup:** I do not have those figures.

**Q237 Chair:** Do you know, Mr Harra?

**Jim Harra:** I don't have the figure for that next year. I suspect that, in percentage terms, it is not materially different from the previous year.

**Q238 Chair:** Why was that?

**Jim Harra:** The main reason why we do not seek tax returns from all companies is because a significant number of them are either dormant, or registered in the UK but are not within the UK charge to corporation tax, because they are in fact operating outside the UK.

**Q239 Chair:** What is your system of checks?

**Jim Harra:** First, we have a risk-based check. We send out a form called CT41G to every company, asking them for information about whether they are active. For those that say that they are not active, we then have a rolling programme of checks over a period on their dormancy.

**Q240 Chair:** I know that this is a 2009 figure. Can you give me the 2011–12 figure?

**Jim Harra:** I cannot offhand, I am afraid.

**Chair:** Can any of you? You are here talking about the 2011–12 accounts.

**Jim Harra:** I am afraid I cannot give you that figure. It will not be materially different, but I can certainly write to you afterwards with that figure.

**Q241 Chair:** Let us assume that there are about 800,000 to 900,000 companies. They are not all dormant, are they? Do you check all those 900,000?

**Jim Harra:** Over five years, on a rolling basis, we review the dormancy of companies.

**Q242 Chair:** Every company?

**Jim Harra:** Every company that we register as dormant, we review periodically over a period of time.

**Q243 Chair:** But dormant isn't the lot?

**Jim Harra:** The two main categories are either because they are dormant—company registration agencies set up shelf companies and keep them on the shelf, ready to sell to clients—or, increasingly, because the charges to register a company in the UK are low. We find that, for example, a lot of German businesses register on the UK register, but they operate only in Germany, so they are not within the charge to UK tax. Those would be the two main reasons.

**Q244 Chair:** And you can tell this Committee that of those 838,370 companies in 2009—a similar figure possibly today—all of those would have been checked? Or do you do a risk-based assessment, meaning that you will check a sample?

**Jim Harra:** Our process is to review dormancy on a periodic basis. Our experience is that the risk in that population is low.

**Q245 Ian Swales:** Can I ask for clarification on something that Jim has just said? Why would a German company take the time to register in this country? Just because it is low-cost would not make me go and register a company in a country I was not interested in.

**Jim Harra:** It has been our experience. I mentioned Germany in particular because it has been our experience that German businesses will register in the UK, because the charges for doing so are much lower than in Germany. Under EU law, they are entitled to establish wherever they wish.

**Chair:** What's the purpose?

**Q246 Ian Swales:** Why would they do that? Is that to avoid tax in Germany?

**Jim Harra:** No. It is to save them the registration cost.

**Q247 Mr Bacon:** So you mean that they trade in Germany, and their customer base is German—or perhaps they export and their customer base is overseas—but they do so as a UK-registered company?

**Jim Harra:** They will be on the UK register of companies.

**Q248 Mr Bacon:** But so long as none of the activity takes place in the UK, they don't attract any liability for tax in the UK.

**Jim Harra:** That's correct.

**Q249 Justin Tomlinson:** What is the difference in the fees?

**Jim Harra:** I do not know offhand. This is one of the things that we looked into. The number of companies that were not active in the UK was growing, and one of the reasons was because we were seeing an increasing number of companies from elsewhere in the EU choosing to use the UK register.

**Q250 Ian Swales:** A final question. The cost of registering a company in different countries might vary, but it is not a huge cost of running a business. It is probably beyond the scope of today, but you seem

to be suggesting that the UK has some regime—not just the cost of registration, but some other advantage—that would make companies register here. I cannot believe that it is simply to pay £200 rather than £800 or something. What else is going on?

**Jim Harra:** You are slightly talking to the wrong person, because it is not about tax, but about company registration and the behaviour. We have looked into it to get an understanding of why we were seeing the registration behaviour that we were. I can certainly pick up afterwards with you and write to you and explain that.

**Ian Swales:** The only relevance is that one of the Committee's concerns is this sort of tourism around the EU that seems to be going on, where you set up companies, invoicing points and so on, and one way or another you are extracting advantage from that. That just might be another example of that.

**Q251 Chair:** I want to ask one more question on the tax gap, and then I am going to go to Austin. What I was trying to demonstrate by my question is that the tax gap is the tip of the iceberg of the money that is owed between the money that you collect and the money that would be owed if everybody paid their fair share according to either their individual wealth or the profits they make from their economic activity. Have you any idea how big the tax gap would be if you had regard to, for example, tax being paid by Starbucks, Amazon, Google, Apple, eBay and Facebook, or if you had a less optimistic view about the amount of illegal trading that goes on? How big could it be?

**Edward Troup:** I cannot answer that question, because you are effectively asking whether I can think of an alternative view of how we levy corporation tax that could give us more corporation tax in the UK.

**Q252 Chair:** The Prime Minister said he thinks the behaviour of multinationals that set up ever more complex tax arrangements has crossed the boundary. He said, "Wake up and smell the coffee." He thinks we should be getting money from these people; you say we can't. If you added all that in, how much bigger would the tax gap be?

**Edward Troup:** That is a policy judgment; it is not for me to—

**Q253 Chair:** No, it is not. I am asking for the quantity. I cannot believe that you haven't calculated the amount that would be outstanding if the changes that the Prime Minister wants and is pursuing through the G8 and G20 were introduced. You must have a figure for that.

**Edward Troup:** No, we don't.

**Q254 Chair:** Why not?

**Edward Troup:** Because if we are going to make some changes, first we need to know what they are. As you know, an action plan has been published by the OECD with 15 different areas that we want to take forward. Some of them are complex things about what constitutes a permanent establishment. We have not put through our systems, for all the companies that could be affected, what that could produce.

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**Q255 Chair:** Why not?**Edward Troup:** We also have to take into account the fact that if the OECD makes that change UK companies that do not currently have permanent establishments overseas would pay tax there, so we would lose some revenue from them. Our job is to collect the tax from the law as it stands. It would require an awful lot of work to do that calculation.**Q256 Chair:** With the greatest respect, you make estimates all the way across the piece. You make estimates about the tax gap, you make estimates about how much extra you are going to get from the extra resources you get. I cannot believe that you have engaged in negotiations at G8 and G20 level and that you haven't responded to the views of the Prime Minister of this country and made a guesstimate of the amount we are losing out on.**Edward Troup:** Jim is going to contribute something on this.**Jim Harra:** As you are aware, Chair, at the behest of the G20 the OECD is carrying out a base erosion and profit shifting project. It made its first report in February this year. One of the things it was charged with doing in that report was to estimate how much tax is at stake in base erosion and profit shifting. It concluded that it was unable to do so on the basis of the current information it holds for two reasons: in play is both how much tax is taxable and how that tax should be allocated between the different states in which a multinational operates. It is doing more work, but it concluded in February that it could not put a number on how much is at stake globally. It is clearly in the billions.**Q257 Chair:** Okay. Globally is an even bigger ask. I am asking why you have not done, as you do for lots of things, a back-of-the-envelope estimate of what we are talking about.**Jim Harra:** We don't have that figure.**Q258 Chair:** At the moment, therefore, your tax gap is purely the tip of an iceberg.**Jim Harra:** Our tax gap is a complete measure of non-compliance with current tax law. It does not include a measure of how much additional tax might be collected if you changed the policy.**Q259 Fiona Mactaggart:** The Chief Secretary keeps referring to the general anti-avoidance rule that has been in force since July this year. It occurs to me that that is very relevant, in terms of the tax gap. I want to know whether you have used those powers in any of the double taxation treaty cases.**Edward Troup:** The general anti-avoidance rule has indeed been enacted.**Q260 Fiona Mactaggart:** Have you used it?**Edward Troup:** No, we haven't.**Q261 Fiona Mactaggart:** Have you used it in any case since it was enacted this summer?**Edward Troup:** No, because it has not yet fully come into force. There is an advisory panel that has to be set up, which has now been set up, to look at the

guidance. It is an anti-abuse rule; it is not an anti-avoidance rule.

**Q262 Fiona Mactaggart:** Absolutely. I am reading the guidance that is on the internet, which says that "where there are abusive arrangements which try to exploit particular provisions in a double tax treaty, or the way in which such provisions interact with other provisions of UK tax law, then the GAAR can be applied to counteract the abusive arrangements." The regulations exist; why haven't you used them?**Edward Troup:** They can and will be used. Jim may correct me, but they will not be in force until 31 March next year, as I recall.<sup>1</sup>**Jim Harra:** In my experience, the general anti-abuse rule is already having an impact, in that businesses, wealthy people and their advisers are adjusting their behaviours in response to it, and some of them in anticipation of it; a number of major accountancy firms, for example, announced the closure of some of their activities in advance of it. In terms of then actually applying it to people who are still persisting in abusing, it is too early in the day for us to have invoked it.

I believe that the detailed guidance that we have published on how it is going to apply makes it clear that, where a multinational business sets up its affairs in ways that comply with the tax law, it will not have an impact on that company. I believe that in evidence to another Committee I have already explained that I do not believe that the GAAR will have a direct application on the kinds of structures that this Committee has reviewed.

**Q263 Fiona Mactaggart:** So why will it have an impact on the tax gap at all?**Jim Harra:** Because it will counteract abusive avoidance schemes, on top of the targeted anti-avoidance rules that we have. It is a general application, so it gives us another string to our bow in challenging those schemes.**Q264 Austin Mitchell:** I doubt that. It is a very feeble measure. Let's go back to the scale of the tax gap. I am interested: you said you were minimising it, so why is our estimate of the tax gap so much smaller than the EU's estimate? Its estimate is that the tax gap for the total EU is €1 trillion, which would be about 850 billion quid. We are a major economy in the EU, so our share of that 850 billion quid must be quite substantial, and certainly far bigger than £35 billion. So why is our estimate so much lower than the EU's estimate of the tax gap?**Edward Troup:** Can I deal with that? First of all, there are very few countries in the world that actually publish a comprehensive tax gap as we do. The EU has published a VAT gap, which broadly agrees with our assessment, but gives a slightly higher figure: it gives 13%, whereas we give 10.4%. That compares very well to other countries. I would also say that not

<sup>1</sup> Note by witness: The GAAR came into force for tax when the 2013 Finance Act received Royal Assent on 17 July 2013, and applies to abusive arrangements entered into on or after that date. The NIC Bill that is currently going through Parliament extends the GAAR to NIC, and is expected to come into effect by the end of March 2014.

only are we one of the very small number of countries that does publish a comprehensive tax gap—Mexico, the US and Sweden are the only three others, I think—but we have recently had an IMF study, which was published on their website last week, affirming the robustness of our methodology. We are quite happy that our methodology and our tax gap as a measure are as good as possible given the difficulties of assessing any comprehensive tax gap.

As I say, on the EU's methodology, which is only for the VAT gap, we do very well. We do slightly worse than Germany on their measure, but considerably better than France and Italy.

**Q265 Austin Mitchell:** This is all very self-congratulatory. Surely you would want to play it down, because you appear to be more effective that way.

You said you couldn't include in the tax gap the estimates of any loss through the avoidance measures taken by the big firms that we interviewed, such as Amazon and Google. As you said you couldn't estimate those, let me provide you with the help of the material that was given last week: Google's own accounts as presented to the SEC in the States show that they had £3.25 billion revenue from people with addresses in the UK. They reported to you that they had only £506 million in the UK in the same year. That is a lot less than they were telling the Americans they were making out of this country. On that £506 million, they had a profit of £36.2 million and paid £11.2 million in tax. There is a huge gap there between the transactions and the profit they are making in the facts and figures reported to the SEC and what they are reporting to you.

**Edward Troup:** I am not quite sure what the question is.

**Q266 Austin Mitchell:** Okay, let me formulate the question again. We had evidence from whistleblowers about how this was done. There is an article that you have probably seen in the International Monetary Fund's *Fiscal Monitor* 2013 about something called the double Irish Dutch sandwich, which you may have heard of. It is an interesting technique. The essence of the technique—Google was applying it, as was Facebook—was that sales made in this country were reported as sales made in Ireland, so that the companies paid less tax. We heard evidence from a whistleblower that it was a fiction—that the sales had actually been made in this country, and therefore should be accountable in this country. Did you investigate that evidence, which was sent to HMRC as well as to us, to see where the sales were actually made and where the tax was due?

**Edward Troup:** As you have heard before, we cannot talk about individual taxpayers. As tax assurance commissioner, I am not, as the Committee knows—

**Q267 Austin Mitchell:** Was it investigated?

**Edward Troup:** Sorry, can I just finish? I will try to answer the question as far as I can. Jim and his people are responsible for investigating it. My job is to make sure that all the tax due under the law is collected, as far as possible. If Jim and his people were not

following up on that sort of information, I would be very unhappy. It is my responsibility to sign off on all the large settlements, both accepting and denying them. Jim is not going to say what he did in relation to a particular taxpayer, but I can tell you generally that I would be unhappy. In a sense, I am giving you an indirect assurance that in such cases, we follow up and make sure that the information is—

**Q268 Chair:** Let me ask you a question. I hate these general things. To be honest, Jim, we passed you our whistleblower.

**Jim Harra:** Yes.

**Chair:** And, I think, to anybody who met him and heard him, he was an incredibly credible whistleblower. What leaves me astounded in cases like that is why on earth you don't just test the law. Why not litigate? My understanding of the OECD model tax convention, which governs all the tax treaties in the UK, is that it allows the HMRC to deem a sale to have taken place in Britain if the sale is effectively concluded here, even if the legal authority to conclude the contract is held by a rubber-stamp operation elsewhere. It looks to me that under the OECD model, you should be litigating. If he was telling us 90% of the truth, you should be litigating, and yet we see absolutely nothing. Why have you not chosen to litigate and test your powers?

**Jim Harra:** Chair, first of all, I acknowledge that you referred the whistleblower to us. I believe that he has confirmed to the press that we met him, took evidence from him and paid a great deal of interest to what he had to tell us. That is what we do with anyone who provides evidence. We take it very seriously, and we always act on it if it indicates non-compliance by a taxpayer.

In those kinds of commissionaire structures, set up in particular by US internet giants, we have to look for evidence that the offshore organisation does nothing more than rubber-stamp: that it does not, for example, over-rule local people. We gather extensive evidence in major cases to determine that. I cannot say what we have done or may be doing in any particular case, but I can say that both in the particular case of this whistleblower and more generally, we always act on the evidence that we are given, and we are very grateful to the Committee for referring him to us.

**Q269 Chair:** I hear that you act, but bluntly, we do not see it. You have not litigated; you have not tested. We look at all the rules under which you operate. We are not daft here. Applying a tiny bit of common sense, we think there is room for you to at least test your powers and litigate. When do you decide to litigate? Why have you not litigated with one single internet company?

**Jim Harra:** We have a published litigation and settlement strategy that sets out when we do and do not litigate.

**Q270 Chair:** Why aren't you, in these instances? Explain to the Committee.

**Jim Harra:** I cannot talk about that particular company, but in general terms—

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**Chair:** You haven't litigated with one internet company. That is the point.

**Q271 Austin Mitchell:** You are hounding people on tax debt—small and medium-sized companies particularly—and yet here you are, taking this supine attitude and not even investigating evidence we dredged up, which has been given to you, about how taxes have been avoided. Why hasn't it been investigated and action taken?

**Edward Troup:** I think Mr Harra has come as close as he can to giving you some reassurance that it has been investigated. That is not quite what he said, but I hope you have taken that reassurance from his comments. And, in response to the question of why we have not litigated, that is because we have to collect the tax that the law provides for. If the law provides the tax, we will make sure it is collected. And actually, we persuade large businesses that the tax is due and we do not need to litigate. But we are still litigating a number of cases—not necessarily in the internet field—where businesses disagree with us on the application of the law.

**Jim Harra:** I would say that the BEPS project is there because a number of tax jurisdictions are all in the same position; it is not just the UK. We are all subject to that OECD convention, which constrains what we can do in these commissionaire structures. We liaise very closely with tax authorities right across the world who are grappling with the same businesses as us. I am comfortable that we are doing as well as any tax authority in the existing rules.

**Q272 Austin Mitchell:** Will you take action against the double Irish Dutch sandwich?

**Jim Harra:** If I can gather evidence that demonstrates a good chance of winning—

**Austin Mitchell:** You've seen that evidence.

**Jim Harra:**—and the company does not concede, I will definitely litigate.

**Q273 Austin Mitchell:** I suggested last week that having all that revenue going to Ireland rather than being taxed here was some way of making amends for the Black and Tans. Why, in this country, can't we tax profits made in this country?

**Jim Harra:** I think that is the aim of the OECD convention, but one of the problems is that it is quite old and it has not kept up with modern businesses and, in particular, internet businesses.

**Q274 Austin Mitchell:** But we can impose flight taxes and energy taxes—John Major wants to impose energy taxes. We can impose all sorts of taxes, so why cannot we impose tax on this?

**Edward Troup:** That is what the OECD is seeking to do.

**Chair:** I think there is a slightly different thing going on. In my view, you are not testing the limits of the UK. Can I bring in Fiona, who has been waiting and listening?

**Q275 Austin Mitchell:** I have two more questions. A lot of tax evasion comes through trusts. Do you

have a register of trusts, what they are doing and what is their beneficial ownership?

**Edward Troup:** Jennie, do you want to come in on that?

**Jennie Granger:** We have a register of taxpayers and, of course—

**Austin Mitchell:** Taxpayers, yes. But trusts?

**Jennie Granger:** And some of them will be trusts, but not a register of trusts per se, Mr Mitchell. In relation to that, and offshore trusts in particular, one of our challenges, as you would know, is to be able to identify who are ultimate beneficiaries of those trusts. But let me assure you that in relation to companies, which we have already talked about, and trusts and individuals, one of the big breakthroughs for us is that, through Connect, we run all the data we receive against taxpayers we have.

**Q276 Austin Mitchell:** So you have a central register of trusts.

**Edward Troup:** No.

**Austin Mitchell:** No, you do not?

**Jennie Granger:** We have a register of taxpayers.

**Q277 Austin Mitchell:** Okay. In a number of cases, tribunals and courts have struck down tax avoidance schemes used by firms, with action taken and money recovered, as it should be. What action has been taken in any cases against the firms—the big four in particular—who are prolific in inventing and selling tax avoidance schemes: the people who organise the theft?

**Jim Harra:** First, if they overstep the boundaries of what is acceptable, we will take action against them. For example—

**Q278 Austin Mitchell:** Have you taken action?

**Jim Harra:** Yes. For example, two directors of the Vantis tax group, which purported to sell a charity tax avoidance scheme, were imprisoned because our investigation showed that it was not an avoidance scheme; they were relying on fraud to make it work. So, where we can identify fraud, we take that kind of action.

Over the course of the summer, the Government has been consulting on a tougher set of rules to apply to promoters of avoidance schemes that would identify what we regard as high-risk promoters: these are the promoters at the very edge of this industry who are not transparent about what they do, do not co-operate with us and, frankly, are often not transparent with their clients, either. Included in that consultation, for example, is a proposal for a penalty for those high-risk promoters if they do not comply with a higher standard of information disclosure.

**Austin Mitchell:** Well, the public image, in my conclusion, is that instead of dealing with them and prosecuting, you are actually in cahoots and they are brought in to advise on anything you do, so that they can shape the whole system appropriate to their ends.

**Chair:** We will come back to that when we deal with CFCs.

**Q279 Fiona Mactaggart:** Mr Troup, you said that you were the person responsible for signing off deals

that you use instead of litigation. You will be aware that we were uneasy about some of the deals that your predecessor had signed off. Could you tell the Committee how many times you have agreed a deal and how many times you have rejected a deal since you have been in post?

**Edward Troup:** I commend to the Committee my first annual report, which was published this summer. That describes exactly what I did during my first year—in fact less than a complete year.

First, I would say that we do not do deals. There is a published litigation and settlement strategy, which Jim has referred to.

**Edward Troup:** The principle of that is that we will only settle on the tax that we think is due, 100%. The governance procedure, which is all set out in here, means that the largest deals and the most sensitive ones come to me and two other commissioners. Once they have been put together as a proposal for settlement we are not engaging with the taxpayer. We are saying yes or no. Of the 22—this is all in the report, and I do commend it.

**Q280 Fiona Mactaggart:** There has been some time since that report. Could we have up-to-date figures?

**Edward Troup:** I do not have up-to-date figures but they will be in next year's report. I would be happy—

**Q281 Fiona Mactaggart:** Could you provide the Committee with a note? Thank you.

**Edward Troup:** I could provide the Committee with a note for the first half year of how many proposals we have had.

**Q282 Mr Bacon:** Could you just finish your previous answer?

**Edward Troup:** Yes. Of the 22, 11 times we approved the settlement proposal that had been put forward by the team—sorry, by the taxpayer.

**Q283 Chair:** By the taxpayer, not the team?

**Edward Troup:** The taxpayer's proposal for settlement. We are effectively seeking 100%. Six times we approved the proposed settlement but with conditions, and five times the taxpayer's proposal for settlement was rejected as not being compliant with the litigation and settlement strategy.

**Q284 Chair:** Can I just ask two questions? Then I want to move on to another issue. When did you last litigate a company that you deal with in the large business service on any corporation tax issue? When did you last litigate?

**Jim Harra:** We published a press release in July this year identifying eight litigation successes in the first half of this year against large business avoidance, which brought in over £1 billion. Some of that was corporation tax and some was other taxes. We do actively litigate against large businesses all the time.

**Chair:** So you have done eight cases this year.

**Jim Harra:** That was eight avoidance cases involving large business. There are other non-avoidance cases as well. We currently have—

**Q285 Chair:** Is the avoidance corporation tax avoidance or VAT?

**Jim Harra:** It will have been a mixture. It was certainly not very much VAT.

**Q286 Chair:** When was the last case of litigation around an allegation of corporation tax avoidance against one of your large businesses? One of the businesses that you deal with in the large business service. When was the last one?

**Jim Harra:** If we go to the press release, it contains an appendix for a full list of all our avoidance litigation decisions and also lists those from large businesses.

**Q287 Chair:** Okay. Maybe you can tell me which one is about corporation tax and one of the companies that come under your purview.

**Jim Harra:** I believe the most recent one was in July this year, when we won against a company called Vocalspruce, which was a subsidiary of a FTSE company, where we secured £88 million.

**Q288 Chair:** In corporation tax?

**Jim Harra:** Yes, I believe that is correct. I will need to look.

**Q289 Chair:** All right. Can we move on to talk about Swiss bank accounts? Can you tell me how much you have got so far in 2013–14 from money owed in those bank accounts? In this year, how much have you got in?

**Edward Troup:** We had an initial payment of £342 million. This is converted from Swiss francs in some cases. That was in January this year, and since then we have had subsequent payments. So that is not in the 2013–14 year. With the other payments that we had so far, we have £782 million. That, of course, is money that we would just not have got otherwise.

**Q290 Chair:** Can you tell me how much in the first six months of this year?

**Edward Troup:** For the financial year it will be £258 million plus £181 million. So it is the £782 million, excluding £342 million, which I think makes £440 million.

**Chair:** This year.

**Edward Troup:** Yes, so far this financial year.

**Q291 Chair:** In his autumn statement last autumn the Chancellor estimated the income from the agreement in the year 2013–14 to be £3.12 billion. That was then incorporated into the Government's borrowing figures. Correct?

**Edward Troup:** Yes, that is the number.

**Chair:** You so far have got £440 million—

**Edward Troup:** I think the £342 million may be treated for national accounts purposes as being in this year, so we have got £782 million.

**Q292 Chair:** Why would it be treated as in this year, if you got it last year? It will not be. So, out of the £3.12 billion that the Chancellor put into the estimated income, which was then obviously relevant to public expenditure figures on debt and deficit and on borrowing, you so far have collected £440 million.

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**Edward Troup:** We have received from the Swiss that amount, and it is significantly less than the amount that we expected this year—

**Q293 Chair:** Why is it less?

**Edward Troup:** The whole principle of the deal is that we get money in two ways: the cash withholdings in this year; and disclosures of names of individuals who, rather than being subject to withholding and preserving their anonymity, are happy for their names to go forward for investigation. So far we have had more than 18,000 individual names given to us; we have sent out 9,000 letters in total to them. It was always expected that total receipts would be what we get this year plus, over a number of years, what we get through investigation.

**Q294 Chair:** I am sorry, but it wasn't. What the Chancellor put into his autumn statement, which was then fed into his borrowing figures and into what he said about the deficit and the debt, was £3.12 billion. You have so far collected £440 million. I do not believe that there is any accounting device that takes last year into this year, but even if that were the case you are still, halfway through the year, miles behind your estimate. Why?

**Edward Troup:** Because at the moment it looks as though we are going to get less in this year, so I agree that—

**Chair:** Why?

**Edward Troup:** We are pursuing this with the Swiss—we have an agreement with the Swiss that requires all sorts of audit arrangements and disclosure arrangements in relation to the withholding tax and the names. I have been to meet my Swiss counterpart, and I have reassured myself on the audit arrangements that they have put in place. During the first half of next year, we will start to get the results of that audit and we will find out to what extent the cash that we do not get this year is going to be offset by receipts that we get in future years, so that we can estimate the total amount that we get.

**Q295 Chair:** Did you agree the £3.12 billion?

**Edward Troup:** It was a forecast agreed—

**Chair:** Did you agree it?

**Edward Troup:** It was a forecast made by the Office for Budget Responsibility, working with our analysts on the best information that we had—

**Q296 Chair:** Did you agree it? I am asking a very simple question.

**Edward Troup:** No, I did not agree it. It is not my responsibility—

**Chair:** You are responsible for delivering it.

**Edward Troup:** No—sorry, may I be clear about the agreement? The agreement puts obligations on the Swiss to pay some amounts to us. Having signed the agreement, which is getting in money that—

**Q297 Chair:** No, the agreement puts obligations on you to trace those people who had those accounts in Switzerland—we will come back to how many there are—to get the tax due. That is the agreement.

**Edward Troup:** No, that is a misunderstanding. We did not have any means of tracing them.

**Chair:** They gave you the names.

**Edward Troup:** The Swiss agreement was groundbreaking in that the Swiss entered into an agreement to do certain things and to give us certain amounts of money. What we were concerned with was that they were performing their duties—

**Q298 Chair:** They gave you the names.

**Edward Troup:** They have given us 18,000 names. For the money that we have had so far, they do not give us the names—that is the principle of the agreement, that we get the withholding for this year and then the names, which we deal with in the future. That is an obligation on the Swiss.

**Q299 Chair:** With great apologies, Mr Troup, £3.12 billion was written down and fed into the public expenditure account—I cannot believe that that was done without your agreement. Maybe that was done with your disagreement.

**Edward Troup:** It was done on the basis of the best information that we had about how much were the funds of the people whose names we do not have in Switzerland, and how much we expected to get from them by way of withholding this year.

**Q300 Ian Swales:** Is that because they can move the money? That is what we all thought would happen as soon as this announcement was made—that the very people whom we were after would take their money out of Switzerland and move it to some other shady place. Is that what has happened?

**Edward Troup:** It is certainly a question that we would want to ask.

**Q301 Ian Swales:** Have you not asked it already?

**Edward Troup:** We have asked the Swiss; they are doing the audit; and we expect to get better information as a result of that audit and of other investigations.

**Q302 Chair:** Mr Troup, it appears now that the figure of £3.12 billion was completely unrealistic—right?

**Edward Troup:** It is certainly more than it looks as though we are going to get this year, yes.

**Chair:** More! At the moment, you are more than £2.5 billion light. At best, you will get a quarter of what you said—at best, on current trends. Who is being held to account for that failure? Time and time again, we sit here and have these discussions. That is a lot of money—more than £2 billion—being fed into the public expenditure figures. Who is being held to account for that? You?

**Edward Troup:** First, it is money that we would not have got through any other means. Secondly, it was the best estimate. I am happy to stand behind it as the best estimate at the time of the money we expected to get this year. That was the best estimate. We are getting money that we would not have got by any other means. We obviously want to pursue through the Swiss agreement and through any other sources of information to understand why the amount we get this year is falling short of what we expected to get.



**Q303 Chair:** Who is being held to account for the failure to reach anywhere—you are getting to about 20% or 25% of the figure that was fed into the public expenditure for 2013–14? Who is answerable for the failure of someone in the system to get the income in that was predicted you would get in?

**Edward Troup:** Sorry, it was a forecast—

**Q304 Chair:** It's an Alice in Wonderland figure, isn't it?

**Edward Troup:** There are two elements to this: the performance of the Swiss and the question of our forecasting. It looks as though our forecasting is not going to be accurate. No forecasting ever is completely accurate. What we need to challenge now is whether the Swiss are performing under the agreement. Mr Swales asked whether there was money that has gone elsewhere. That is where we should focus our attention and we are.

**Q305 Austin Mitchell:** Who made the estimate of £4.4 billion worth of revenue from it over the next three years? Was that you or the OBR?

**Edward Troup:** We had the usual discussion with the OBR. We produced the basis of our estimates. The OBR challenged those. They were naturally, as they are, sceptical and challenged us hard on the estimates. It is their forecast. It is an OBR forecast but it is based on information and estimates that we have provided.

**Q306 Austin Mitchell:** Isn't that a bit too high? Well, far too high, actually. It includes the assumption that as well as the money being paid by the Swiss banks, rather grudgingly, I suppose, lots of people would cough and say, "Oh yea, my god, I should have paid this tax. Here it is." Is that a likely assumption?

**Edward Troup:** No, that is not quite right. Every Swiss bank is required to look at all its—

**Q307 Austin Mitchell:** It does include the assumption that people will voluntarily—

**Edward Troup:** No. There was no assumption that they would cough voluntarily. The assumption is that they would either retain anonymity and then a deduction would be made from their accounts and paid to us, or their names would be put forward by the Swiss, under the disclosure arrangements to us, whether they liked it or not. So one way or another one of those two things had to happen. Either there was withholding or there was a disclosure.

**Q308 Austin Mitchell:** Is that likely? People are going to disguise it. That is why they went to Switzerland in the first place. Rather than putting the money into a bank account they are going to buy Swiss bonds or something. Then you don't know at all.

**Jennie Granger:** If I could come in with some information there. In terms of people coming forward voluntarily, 600 have come forward—

**Q309 Austin Mitchell:** Is this from the Lagarde list?

**Jennie Granger:** No, this is from the Swiss agreement. Six hundred have come forward of whom 200 have already settled £2 million in revenue

attached to that. As Mr Troup said, 18,000 bank accounts have been sent to us. We have already started writing to people about those. That is people who have chosen, rather than to keep anonymity, to have their bank account disclosed.

**Q310 Ian Swales:** Why have the US chosen to prosecute some people while we have not? What is the reason for that? Clearly one of the main things that is going on here is tax evasion, isn't it? People are essentially breaking the law in many cases by moving their money out of your reach. Why haven't we had any prosecutions?

**Jennie Granger:** We have had four prosecutions in relation to offshore.

**Q311 Ian Swales:** In relation to Switzerland specifically?

**Chair:** We've had one.

**Jennie Granger:** Yes.

**Q312 Chair:** Let's come back to that. I want to come back to the issue of prosecutions. I want to get the figures out. Amyas did you want to come in on that?

**Amyas Morse:** I have a sort of human question. When you went to see them to say, "I am a bit disappointed by the shortfall in the money," I know we are talking about Switzerland, but they must have said something to you besides, "We'll carry out an audit." They must have given you some indication of what had happened, surely?

**Edward Troup:** You've got to remember that my contacts are with the Swiss Government. The obligations effectively fall on the Swiss banks. They are certainly in no doubt as to our concern that we were not getting the flow of money which we expected, anticipating exactly this sort of challenge, which seems to me entirely right. They have taken that away.

**Amyas Morse:** Come on, if you were sitting having a coffee with these people, and you said, "What the heck went on?" they cannot have not given you any answer at all. Even informally, they must have given you an indication of what had actually gone on. It is surely not unfair to ask that. You might even have said, "Just give us a clue as to what might have happened." It is surely not unreasonable to ask that.

**Edward Troup:** Did I come away completely reassured that we were going to get the full amount of the £3 billion? No, I did not.

**Q313 Chair:** The full amount of what?

**Edward Troup:** The £3 billion that you referred to this year.

**Q314 Chair:** Actually, they said £5.3 billion was the deal over six years.

**Edward Troup:** Did I make it clear that Her Majesty's Government were not at all happy with this? Yes, I did. I am not going to say what actions might flow from this, because that is a matter of agreement—

**Amyas Morse:** Forgive me, I am really not asking that question. I am just asking a common-sense question, which is, when you had the discussions, there must

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have been somebody who was prepared to speak to you like a human being. When you said, "What can possibly have happened that these are so different?" somebody must have given you some indication of what had actually happened on the ground. Were they just not prepared to unbend at all?

**Edward Troup:** We are certainly concerned about the sort of questions that Mr Swales has raised—

**Amyas Morse:** I am just asking you for an actual straightforward answer.

**Q315 Ian Swales:** There is a basic question here that you must have an idea on. Is the base against which you are wanting to take this tax from radically different to what you thought it was, or are the Swiss banks doing what they do so well, which is playing things extremely tight, and they are not going to give you the proportion of that base that you originally thought? It can only be one of those two things, and did they not say which it was?

**Edward Troup:** I will come back to the start of all of this. We had no hard information about the names; that is why we entered into this agreement because it was an opportunity to get money which we would not otherwise have got. We have made a huge amount of progress in getting £782 million which would not otherwise have been obtained by the Exchequer. We still do not have sufficient information; we still would like more information, and this is an agreement that has had to take account of Swiss banking secrecy. I think that we are all agreed, and the world is moving on to a position where actually retaining banking secrecy in relation to tax affairs is not the way the world is going. We still have to work with the Swiss within the framework of their banking secrecy approach. We do not have the information that we would like.

**Q316 Ian Swales:** But with respect, if I was a Swiss banker, I would find it much more attractive to argue strongly to keep money in my customers' accounts than to give it to the UK Government. It just seems to me that we ought to have a clear answer as to whether they are doing what they said they would do in terms of the proportion of those accounts they would pay over, or have the accounts now been siphoned out, which is what I suspect and what Parliament thought would happen when the Chancellor made his announcement? We gave them plenty of warning to move it.

**Q317 Chair:** Can I be a bit more specific on the same thing? In the autumn statement documents, it said that £40 billion was the amount of funds held by UK residents in Switzerland. That was the figure in the documents, so that must have come from somebody. You then had a cut-off date of March of this year for declaring the assets held in Switzerland by UK residents, is that right?

**Edward Troup:** That is correct.

**Q318 Chair:** And has that £40 billion gone down?

**Edward Troup:** We do not know. This is the information we need.

**Q319 Chair:** Well, where did you get the £40 billion from?

**Edward Troup:** The £40 billion was extrapolated from the investigations and from some of the information we had had previously. We extrapolated across the whole UK population to try to estimate from the people that we did know about, and knowing how many other people there were of those characteristics in the UK, how much in total might be held in Switzerland. This is the problem with banking secrecy. We do not know. It was an estimate. It was a forecast. It was the figure on the basis of which the £3 billion was made.

**Q320 Chair:** So what have you learned? The cut-off date was May 2013, so we have had six months since the cut-off date when presumably somebody has got a list with a figure on it of the amount of funds now held by UK residents in Switzerland.

**Edward Troup:** No, we do not have that list.

**Q321 Chair:** The Swiss do?

**Edward Troup:** Well, in aggregate they do, but I do not think that they are held in one place. The individual banks have obligations under the agreement to pay us cash by way of withholding or to supply names by way of disclosure. Not all of the banks have yet completed that exercise. We have not had disclosures from all of the banks yet, because they have the whole of this fiscal year in which to do it, but we are collecting. We have 18,000 names and, as Jennie has said, we have acted on 9,000 of those already. Six hundred people have come forward voluntarily simply as a result of hearing this agreement had been entered into, and we have received £782 million.

**Q322 Chair:** You keep repeating the same thing; I am trying to move us on. Is the figure below the £40 billion figure in the supporting documents for the 2012 autumn statement?

**Edward Troup:** We do not know.

**Q323 Chair:** You have no idea how much money has gone, has seeped out in the way that Ian Swales has suggested.

**Edward Troup:** No, we do not.

**Q324 Ian Swales:** I wonder what on earth the conversation that you had with the Swiss banks contained. Was it anything beyond seeing how your kids were and where you were going on holiday? I am trying to imagine what was actually said, given the answers you have given the Committee today.

**Edward Troup:** I think I indicated in my previous answer that we conveyed our concern about the amounts that we were receiving, and of course we asked questions about what information and what action would be taken. As I say, I am not going to go any further into that. I—

**Q325 Chair:** Just out of interest, why can't you? I think it was Dave Hartnett who originally said that most of this money is probably money due in tax. Probably originally, the £40 billion ought to have all

come to the UK in tax. It isn't just cash that they held—

**Edward Troup:** No, the £40 billion—

**Chair:** Well, that was his line.

**Edward Troup:** The £40 billion was the accounts.

**Q326 Chair:** It was tax avoidance that got it there. I can't see any reason for this being confidential. You have no idea of the amount of money that the Swiss banks now collectively think is held by UK residents in Switzerland that they haven't actually—

**Edward Troup:** We have no information to update the £40 billion. We very much hope that we will get information to update the £40 billion, and indeed—

**Q327 Chair:** By the time of the next autumn statement, in a couple of weeks' time?

**Edward Troup:** No, I don't think so. I think we will revise the forecast for receipts at the next autumn statement, simply because of the reasons you give, in terms of the receipts so far, but building a picture of what is in Switzerland is intrinsically extremely difficult. There are a number of routes whereby we are doing it, and the agreement was effectively seeking to get at money where we could not find or get hold of the individuals by any other means.

**Q328 Chair:** I think we find that pretty incredible. Let me just take you back to what you said last year, which I have no doubt you recall. We talked about this. I said: "You have got one" prosecution "at the moment." You said: "We have had one so far. We have got another dozen criminal ones in train." I ask you: "Another dozen?" You reply: "Another dozen criminal ones in train"; and then you go on about the ones that have appeared. Why is it that none of those "in train" has ever reached the courts?

**Edward Troup:** I'm going to ask Jennie to come in in a minute, but can I just remind the Committee first of all that we are not a prosecuting authority; we do criminal investigations, and the prosecutions—

**Q329 Chair:** Please don't go off the subject. You said to us last year that you had another dozen criminal ones in train. My understanding is that none of those has reached the courts. The CPS knows nothing about them. Where are they? Just those dozen—I'm not asking you about others. You told this Committee you had another dozen criminal—

**Edward Troup:** In fact, we had 15 criminal investigations which were under way. Some of those went across to the CPS—

**Q330 Chair:** No, they didn't. It knows nothing about them.

**Edward Troup:** Yes, some of them went across to the CPS, but they did not meet, in all the cases which went across to the CPS apart from the one which we have successfully prosecuted, the standards of evidence or other conditions which the CPS will put before they prosecute. For others of them, the individuals went through the Liechtenstein disclosure facility. We collected the tax; we collected the interest; we collected penalties. That comes back to the point that while criminal prosecutions are very good as a

deterrent and very good publicity, they are expensive and not the most effective way of collecting—

**Q331 Chair:** Let me just say to you, Mr Troup, you have done one. You misled the Committee last time, because you said there were another dozen—you now tell me 15—criminal ones in train. None has ever reached the courts, and my understanding from the CPS is that it does not know of any of them. You tell us that you've only got £440 million in this year, against a provision that you put in of £3.2 billion, and you're not doing any other prosecutions. This is just laughable.

**Edward Troup:** First of all, the prosecutions you referred to were to do with the HSBC Swiss disc and were not to do with the Swiss agreement; it is a separate matter. Under that, we have had, as you know, 3,500—

**Q332 Chair:** I am frightfully sorry, but your answer to me last year was completely on the Lagarde list of Swiss banks.

**Edward Troup:** Yes, sorry, the Lagarde list; that's not the Swiss agreement. The HSBC Swiss list, which you have referred to as the Lagarde list, is not the Swiss agreement. The Swiss agreement is a separate matter from that list and that disc. My answer last year was on the prosecutions and investigations that we were following up.

**Q333 Chair:** Have those 12 gone in? You have only had one prosecution.

**Edward Troup:** We have had one prosecution out of the 15 which has actually gone through to criminal prosecution.

**Q334 Chair:** Which we knew about last year, because you told us about it last year.

**Edward Troup:** Yes, indeed. That is correct.

**Q335 Chair:** But you have had none in the ensuing year.

**Edward Troup:** No, because Parliament has given us two ways of pursuing tax fraud. It has given us civil investigation powers, which are extremely effective and allow us to maximise the amount of tax interest and penalties, and it has given us criminal prosecution powers, which are actually not an effective way for us to maximise the amount of tax interest and penalties, which is what Parliament wants us to do. Parliament has given us a choice as to how we pursue particular elements—

**Chair:** I understand all that. You do not have to tell us—we are not stupid. But you are being so ineffective in pursuing this particular debt, in that you have only managed to get £440 million. I cannot understand why you cannot, in those circumstances, employ one little weapon in your armoury—just make a few cases show cases. It is so bloody obvious.

**Q336 Ian Swales:** I think what bothers members of the public is the vigour with which the authorities pursue people who defraud a few thousand in benefit compared with the vigour with which we pursue people who evade thousands and thousands in tax.

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That is what the public do not like. I think that they expect to see some equity, because we are talking about the public pound in both cases. That is why we keep asking this question.

**Jennie Granger:** May I just come in on that? There have been four convictions in the—

**Chair:** Sorry. You will have to speak up.

**Jennie Granger:** I am sorry. There have been four convictions in the last year. Not all of them are to do with Swiss HSBC, you are correct. There was only one in relation to that.

**Q337 Chair:** That had already occurred before the hearing last year.

**Jennie Granger:** In three of the four cases, custodial sentences have been imposed. The way that we have used prosecution in relation to this has mainly been focused on those who lie to us during the process of disclosure. To answer your main question, we actually use the same process with small businesses as well. We encourage all taxpayers to come forward, come clean and to pay all tax and penalties.

To give you an example of the advantage that has been in this neck of the woods, 56,000 taxpayers have settled up since 2007, in relation to their offshore affairs. That is £1.3 billion that has come in from that. That is a cost-to-yield rate of 1:130. Similarly, if I take this year's figures for what we do in the small business personal tax area, we conduct about 800,000 inquiries. We certainly do some prosecutions in relation to that. There were 770 charging decisions this year. All those decisions, however, are in relation to deliberately forging documents, deliberately faking businesses, or indeed, organised crime. It is not trivial; it is quite serious. We do not make the final decisions on this, of course; the CPS does.

**Q338 Ian Swales:** I guess the point is that if you knowingly move money offshore to avoid tax, is it avoidance or is it actually evasion, which should lead to criminal prosecution in more cases? Where people claim benefits for those who do not exist or whatever, they are in the courts very quickly. That is what the public feel—that we do not go after people who fail to pay over public pounds with the same vigour.

**Jennie Granger:** In relation to evasion, most cases are dealt with civilly, and that is true whether it is small businesses or whether it is in this area. As I have said, what we try to do is certainly to use prosecution as a deterrent, but it is not the main part of the toolkit. The main part of the toolkit is how we get people back on track and, as fast as possible, get that money back to the Revenue with penalties and interest.

**Edward Troup:** And that is set out in our published criminal and investigation policy, which says that it is our policy “to deal with fraud by use of the cost effective Civil Investigation of Fraud...procedures, wherever appropriate.”

**Q339 Mr Bacon:** Before we move off that, you mentioned the CPS making the decisions. When does the CPS make the decision as opposed to it being made by the Revenue and Customs Prosecution Office?

**Jennie Granger:** We don't ever make the decision to charge in these cases. We investigate and then refer things to the CPS. If it is clear in the process of investigating that there is no case to answer, obviously we do not refer in those cases, but that is because the investigation has either seen more information come to light showing full compliance, or shown clear reasons why it is not in the public interest to prosecute.

**Edward Troup:** We are not a prosecuting authority.

**Q340 Mr Bacon:** I know you are not. You hived off your prosecutions division to a separate body called the Revenue and Customs Prosecution Office, which had a director called David Green last time I checked. We took evidence on their accounts, which I remember clearly because the first act of the chief operating officer whom David Green QC appointed to run the business was to award £100,000-worth of HR consultancy to his wife. What I am really asking is when does the CPS do it and when does the Revenue and Customs Prosecution Office do it? I am not asking when you do it—I know that you do not do it because you are not a prosecutions authority.

**Edward Troup:** I'm sorry, I am displaying my ignorance here but I thought that the Revenue and Customs Prosecution Office was part of the CPS. Perhaps I have misunderstood.

**Paul Keane:** It is again now—it was previously a separate entity.

**Q341 Mr Bacon:** Has it now merged? It was a separate body with its own accounting officer.

**Paul Keane:** It was, certainly when the Committee has had hearings in the past when it was the Revenue and Customs Prosecution Office, but it has now gone back into the CPS.

**Q342 Mr Bacon:** It has now just been merged with the CPS?

**Paul Keane:** Yes.

**Mr Bacon:** Okay.

**Q343 Chair:** I have one more question on this, then I want to move on. Of the 15 HSBC cases, how many resulted in settlements that incorporated both penalties and interest charge?

**Edward Troup:** If they were settled, they would have all settled with interest and penalties.

**Chair:** How many?

**Edward Troup:** I do not have that number for those 15 but I can certainly let you have it.

**Q344 Chair:** And how many were abandoned?

**Edward Troup:** I can let you have that as well. If they were abandoned, that will have been because we were satisfied that no liability was actually due or that there was no prospect of recovery of any amount.

**Q345 Chair:** I would be grateful for a note on that. We now move on to controlled foreign companies. The Government introduced changes to the controlled foreign company legislation. Is it right that the intention was to protect the UK tax base?

**Jim Harra:** Yes, that is correct.

**Q346 Chair:** All right. So is it possible for a UK tax-based company to borrow money and charge interest on that money against profits to offset its tax liability?

**Jim Harra:** Yes. If a UK company borrows money for the purposes of its business and pays interest, that will generally be tax deductible.

**Q347 Chair:** Is there nothing in the rules to stop that UK-based company putting the money it has borrowed into a lower tax jurisdiction or elsewhere in return for share capital? If it borrows money in the UK and gives it to a company based in a tax haven in return for share capital, is there anything in the rules that stops that?

**Jim Harra:** There are a variety of anti-avoidance rules, including an unallowable purpose rule, that act as constraints on when interest is deductible, but there is no rule prohibiting a UK company from investing in an offshore subsidiary company, no.

**Q348 Chair:** With money that it has borrowed and on which it gets tax relief here in the UK.

**Jim Harra:** That is possible, yes.

**Q349 Chair:** Okay. Is it then possible for the money that has found its way to the tax haven or a low-tax jurisdiction to be invested by another arm of the company in another jurisdiction? Let us take Germany as an example. The company in Germany borrows for investment in Germany the money that the UK company earning tax relief has placed into a tax haven. Is that possible?

**Jim Harra:** I am not an expert in German tax law. It would be a matter for the German tax authorities to determine whether a German company can have a deduction for such interest.

**Q350 Chair:** My understanding is that you know that they will be able to offset the interest they pay for the money they borrow from the tax haven, which is money that was originally borrowed in the UK. They will be able to offset interest against their tax liabilities, won't they? It is common sense. I accept that you are not an expert in German tax, but you know a heck of a lot about tax law so you must know from a common-sense perspective whether that is right or not.

**Jim Harra:** I would say that it is entirely possible.

**Q351 Chair:** Okay. So is it right that by using that structure one multinational company enjoys double tax relief when it is borrowing the money only once?

**Jim Harra:** If you follow the chain of borrowings, obviously you start off with a UK company borrowing money from someone, so they have a taxable receipt of the interest they receive, and right through the chain that you described there is only one set of tax relief, end-to-end, for the interest—

**Q352 Chair:** No, there are two sets of tax relief. There is a set of tax relief here in the UK and there is a set of tax relief in my example of Germany—I could have used France or anywhere.

**Jim Harra:** Then theoretically there are two tax charges that balance those out: one on the initial

company from which the UK business borrowed, and one on the offshore company through which the—

**Chair:** Say that again. Explain that to me.

**Jim Harra:** Well, you start off with a UK company borrowing from someone to invest in an offshore subsidiary. That someone it borrowed from will be liable to tax on the interest it receives, so right through that chain, in theory, each one cancels the other out, but inevitably, because one of the companies in the chain is in a tax haven, the risk is that profits will be shifted into that tax haven.

**Q353 Chair:** I want to stick to this one multinational, not take it back up the chain. I want to look at the multinational, which can enjoy two lots of tax relief. To add another ingredient, the whole purpose of our giving tax relief for that sort of borrowing is to encourage economic activity here in the UK. No such economic growth or investment took place here in the UK.

**Jim Harra:** There are two possibilities. One is that if the UK company had an unallowable purpose for its borrowing in the first place, an anti-avoidance rule would be triggered and it would not get a reduction. The more likely scenario is that there will be a UK CFC charge on 25% of the profits of the tax haven company.

**Chair:** There will be what?

**Jim Harra:** Sorry, a controlled foreign company charge, so when you have a controlled foreign company in a tax haven—

**Q354 Chair:** No, there won't be in this instance. That's the whole point, because you won't trace it.

**Jim Harra:** There is a general rule in the new CFC rules which applies a charge to corporation tax in the UK on 25% of the profits of the controlled foreign company if it is a finance company in the group.

**Q355 Chair:** There isn't a profit. The company in the UK has borrowed money. It gets tax relief on the borrowing. It gives that borrowed money to a tax haven where there is no tax of course, so there is no tax being charged there. The tax haven then lends the money to another arm of the company in Germany. That company in Germany, borrowing from the tax haven, is charged interest, probably excessive interest, and can therefore claim tax relief in Germany. So there are two lots of tax relief and the only one to make a profit would be the tax haven company, and as it is in a tax haven, it does not pay tax.

**Jim Harra:** Well, if the company in the tax haven made a profit in the circumstances you describe, it would be a controlled foreign finance company and it would be subject to a charge to UK corporation tax on 25% of its profits.

**Q356 Ian Swales:** Let's clarify the maths. You are not saying 25% tax; you are saying that 25% of the profits would be subject to tax.

**Jim Harra:** Yes, that's correct, based on the CT rate.

**Q357 Ian Swales:** So 5% would be the tax charge: 20% of 25%.

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**Q358 Chair:** Let me quote Mr Edwards of KPMG who said, that while the policy won't strictly say it, borrowing in the UK to equity fund your finance company for it to on-lend, is fine. "Significant UK tax saving, potentially yes. There's that opportunity there."

**Jim Harra:** Yes, the CFC rules are designed to protect the UK—

**Q359 Chair:** Is Mr Edwards wrong or right? He designed them.

**Jim Harra:** If I can go back to the CFC rules, they are there to protect the UK from profit-shifting to subsidiaries in low-tax jurisdictions. Because we have a territorial corporation tax system, they are focused on the shifting of UK profits, so the shifting of German profits is a matter for the German tax—

**Q360 Chair:** We are not talking about UK profits, we are talking about the UK company borrowing money if it exported its profits. It is doing it in a much more devious way, Mr Harra, which Mr Edwards knew about and he devised this scheme with Mr Troup. What I want to know is when you knew about it. This is a blatant or flagrant misuse—I am getting my words wrong.

**Mr Bacon:** "Blatant" is fine.

**Q361 Chair:** It is a blatant misuse of the rules to avoid paying corporation tax here and to get profits abroad. It is so obvious.

**Q362 Ian Swales:** As the same article says, you can easily end up with a net tax rate of minus 15%—in other words, you are getting money in—particularly if the first leg that you referred to is also borrowed offshore. You are assuming that the UK taxman will get their hands on the first leg of the transaction, but the chances are that they will not, because either the initial borrowing will be offshore or the UK entity lending the money will ensure that the tax charge disappears. It is a perfect chain, and it is leading to the massive incentive to own British business offshore. If you look, it is virtually every utility, every retail chain, every water company and every telephone company. Any company that makes high profits in the UK is in play the minute it declares them, because it is so attractive. The financing arrangements that the Chair is talking about mean that you are pretty crazy if you keep all this onshore, because it is so attractive to finance from offshore.

**Jim Harra:** First, you are right that in the chain, the initial borrower may or may not come from the UK. Theoretically, you are looking at where taxation falls globally. Capital can flow very freely across borders and we are not in a position to restrict where that capital flows. The aim of the CFC rules is to protect the UK Exchequer against the shifting of profits to offshore subsidiaries in low-tax jurisdictions, while at the same time keeping the UK competitive. For example, under the old CFC rules, we were starting to see a small but significant number of global companies migrating away from the UK, because the UK CFC rules were seen as an impediment.

**Q363 Chair:** I am going to bring in Guto, but, Mr Harra, I cannot bear what you said. You said that the aim was to protect profits made here so that they could be properly taxed. We will come to Mr Troup in a minute, but you have devised a mechanism that is well known by all the four big accountants, which are all flogging it all around the system, that gets the profits offshore and that fails to ensure that the profits made in the UK are taxed here. When did you discover that? Everyone else knows it. *Private Eye* is chock full of it, "Panorama" did a programme on it and *The Independent* has it. Everyone has it. You must have known about it. When?

**Austin Mitchell:** You should have got your boots on. **Chair:** When did you know?

**Jim Harra:** We have devised a set of CFC rules that are designed to protect the UK Exchequer.

**Q364 Chair:** You cannot tell us that, because the rules are not doing that.

**Jim Harra:** There are, of course, balances to be struck within that, and how those balances are struck is a political decision. It is a matter of policy for the Government.

**Q365 Chair:** So did you know when you devised the rules that this loophole was available? Is that what you are telling me? When they were first implemented, did you know that the loophole could emerge? Yes or no? Did you know at that time, because you wanted to protect capital coming into the UK?

**Edward Troup:** Can I come in on this? My name is being taken in vain a little on this.

**Chair:** No, I will question you in a minute. I am interested in Mr Harra, who is responsible for the implementation. Did you know, when they were devised?

**Jim Harra:** Yes.

**Chair:** Did you know?

**Jim Harra:** We had a very good understanding of how we expected the CFC rules to work. They have only recently come into force. Where we see them being used in ways that we do not anticipate, we will, of course—

**Q366 Chair:** Did you anticipate and know this?

**Jim Harra:** I do not actually agree with the analysis of what is happening in this example.

**Q367 Ian Swales:** Before we move on, just a quick question of clarification. Do you keep records? Do you know how much allowance you have given for foreign interest payments against corporation tax in the past year, for example?

**Jim Harra:** We carry out an annual monitoring exercise on the interest flows intra-group to overseas. We do that by tracking the main debtor companies, which are non-financial companies. We exclude from that businesses such as banks, where finance is on their trading account. That survey, which I believe was run from 2009 to 2011, is the most recent information that we have and looks at the largest debtors, who account for about 60% of non-financial debt. The net annual outflow from the UK from that exercise is about £4 billion. That is made up of about

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£10.5 billion gross outflow, less about £6.5 billion inflow.

**Q368 Ian Swales:** Up till 2011, you said?

**Jim Harra:** I believe it is 2011.

**Q369 Ian Swales:** Because it has only started happening on an industrial scale since then—this whole issue of wholesale foreign ownership and foreign capital. Almost all our newspapers—except *The Independent*, which is why it is the one doing these articles—are doing it now. Any company that is not, like Boots, Cadbury, Betfair or whoever, finds somebody knocking on their door who will do it for them.

That is the system we have now set up. It has already happened to most of our big, regular profit-making companies. They are now in a situation where there are huge amounts of foreign interest in the way they are structured. Also, you qualified your statement with “intra-group”. I would imagine it is fairly easy, either genuinely because you are using a foreign bank, or more subtly because the name of the organisation that you are dealing with does not look like an intra-group company. I would imagine the figure is far bigger than that.

**Jim Harra:** I think we have good information about which entities are and are not within the international group. You are right that if they borrow independently from a foreign bank, it is not included in that figure, because we are trying to track the movement of money within international groups going across the UK border in both directions.

**Chair:** KPMG’s Edwards, who had been on the inside because he was seconded to the Treasury to devise these laws as they were framed, confirmed that the scheme had been envisaged. Mr Harra, you appear to be the only one who didn’t understand it was happening.

**Q370 Guto Bebb:** When the Chair outlined the structure, the response we had from you was that that would be subject to CFC rules, which would then look at that as something that could be taxed in the UK. How often have you attacked that type of structure in order to try to recover tax?

**Jim Harra:** The new CFC rules have not been in place for very long—we do not even have the first set of accounts for most businesses that have been using them—but we do have good intelligence about how they are being used. Where we have concerns about how they are being used, we will either take action under existing legislation if we can or advise Ministers if we believe they need to be reported.

**Q371 Guto Bebb:** In other words, the structure as described could currently be used for tax avoidance purposes.

**Jim Harra:** It is potentially being used out there. Whether we think it is going to be successful in reducing tax or whether we think we can impose the CFC charge all remains to be determined.

**Q372 Austin Mitchell:** As I understand it, the Germans and the Canadians have rules on thin

capitalisation, so that tax relief can be limited to the amount of business a company transacts.

**Jim Harra:** A number of countries have restrictions on the deductibility of—

**Q373 Austin Mitchell:** But why don’t we have them nationally?

**Jim Harra:** Again, that is a matter of policy, not a matter of administration for me. You mentioned thin capitalisation specifically. We do have thin cap rules in the UK, and a number of other anti-avoidance rules, to prevent abuse, but those are manning the border posts of a very generous UK policy on deduction of interest, which is part—

**Q374 Austin Mitchell:** But it is generous to other people. An equity fund can buy, say Boots, pay it down with debt and then use the debt overseas.

**Jim Harra:** The Government’s approach is that they want to have a competitive corporate tax system. Having a generous regime for interest deductibility is part and parcel of that, but there is protection for the UK Exchequer right around the edges of that in terms of anti-avoidance rules such as CFCs, thin capitalisation rules and—

**Q375 Austin Mitchell:** But does any other country have a tax system which is so generous to other countries?

**Jim Harra:** Some other countries have equally generous interest deductibility rules, yes, and some others restrict interest deductibility.

**Austin Mitchell:** We should stop charitable giving and just carry on with this.

**Q376 Chair:** I have one more quote. Kashif Javed, another KPMG person—God!—said, “What the Revenue has explained to us is that they wouldn’t look to try and challenge the benefits of their regime, you know, to aggressively challenge the residence of finance companies.” You must have seen that article. Go on. You have had loads of time to prepare an answer to it.

**Jim Harra:** I have seen the article that you are referring to. In terms of challenging the residency of some of these companies, I suspect there is not a great deal in it for us. One of the challenges of taxing these interest flows is that it is relatively easy to set up, for example, finance companies and companies that own IP in these countries with the infrastructure they need to establish residency. What we have is the finance company CFC charge, where we accept that it is resident in the tax haven, but 25% of its profits are chargeable to UK tax. That is a rule of thumb.

**Q377 Chair:** Did Ministers know about this scheme when they implemented the CFC rule changes? Did they realise it was a potential loophole? Did they understand that?

**Jim Harra:** Ministers and HMRC were not fully aware of how people would try to exploit the regime, which is why we monitor it very closely after it is taken up.

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**Q378 Chair:** But Mr Edwards from KPMG, who was helping you devise it, was completely aware. He went out and sold it.

**Jim Harra:** Over the course of two Governments, there was extensive consultation done on the CFC regime, which means that we have a good understanding of how it is used and where the risks are.

**Chair:** And how it can be exploited.

**Q379 Ian Swales:** May I come back to the question of thin capitalisation? Your website includes a lot of detail on that subject, and I would like to explore how it works. For example, one of the comments is that an interest rate is charged at an arm's length rate. *The Independent* last week was full of examples of inter-company loans being charged at 16%. Do you believe that is a good arm's length rate for an inter-company loan?

**Jim Harra:** We would look at the facts of each case to determine what we think an arm's length rate should be. Obviously it will vary, depending on the risk profile and the terms and conditions of borrowing. If I can go back to the basic protection that we have, there are two ways that we can tackle excessive borrowing or excessive interest. If we think a company is too highly geared—in other words, if it has been funded with an equity and credit balance that would not happen in the market—we will challenge whether any interest should be deducted from the borrowing on the grounds that it should have been put in as equity. That is the thin capitalisation argument. In addition, even if the company passes the thin capitalisation tests, we will only allow a deduction for an amount of interest, which would be the amount that would be paid on an arm's length basis. We have access to economists, for example, who go through all that, and it is done on a case-by-case basis.

I believe that the articles that were published this week acknowledged that, in a number of cases, we have indeed restricted the interest deduction. But it won't always be apparent, I am afraid, from looking at a company's accounts whether we have done that.

**Q380 Ian Swales:** What do you do if a UK company suddenly buys shares in an offshore country—let's say Luxembourg—lends the money back to the UK, and miraculously the amount of interest they pay is roughly the same amount as the UK profits, as quite a number of companies have done? What do you do about that?

**Jim Harra:** What we would do is look at whether any of our anti-avoidance rules can be deployed either to restrict or deny the deduction or if it complies with the rules. Obviously, this country does a lot of offshore investment. It is part of our economy.

**Ian Swales:** What if it doesn't? I know you are not going to talk about individual cases, but the group that owns the *Daily Express*, for example, did exactly that about two years ago.

**Chair:** All of them—BHS, Maplin, Pets at Home, Ask, Zizzi, Pizza Express, half of the health companies that get money from the taxpayer. It goes on and on.

**Q381 Ian Swales:** My real point is that now you just have to do it. You have to move your money offshore and charge it back in interest to get rid of your profits, or somebody will come and do it for you—a venture capital company in London/Luxembourg will buy your company and do it. That is their main edge, as Betfair found with their aggressive takeover, which I think was repulsed recently. This was a large profit-making UK company. The vulture capitalists come in straight away. Their main edge is the ability to move their profits offshore. How come, in those cases, where you have profit-making UK businesses, they are able to do this? Why do you allow that to happen?

**Jim Harra:** If the borrowings are used for the purposes of their business, they will almost invariably qualify for a deduction of an arm's length amount of interest. If, on the other hand, the borrowing is for an unallowable purpose, for example merely to get a tax advantage, we will seek to disallow the deduction.

**Q382 Ian Swales:** Where is the dividing line? If a company either borrows or moves its own cash to an offshore legal entity, and then loans the money back, of course the loan is in the business, but how do you get to the fact that it is being done for tax avoidance purposes?

**Jim Harra:** There is clearly an incentive for international groups to locate their group finance company in a low-tax jurisdiction. In the case of the UK, if it is a UK-parented group, where our CFC rules came in, a choice was made in creating the new CFC rules that, rather than trying to police each case, case by case, we would have a rule of thumb that assumes that 25% of the profits of the CFC finance company were diverted UK profits, and that gets taxed. That is the rule that Parliament passed.

**Q383 Ian Swales:** There is an underlying rule in all this, which is that people should be carrying out only transactions that make sense for their business. Are you saying that fancy footwork on finance is a legitimate path of any business, and that therefore you would not judge a move such as that which I have just described to be outside the realms of running a newspaper or a pizza shop? You would say that that is a normal part of running the business?

**Jim Harra:** It depends on the circumstances of the case, but international groups that have presences in many countries often have a group finance company, and they will often locate that in a country that is low tax.

**Q384 Chair:** A final question for you, Mr Harra, and then I want to ask some questions of Mr Troup.

Pascal Saint-Amans, head of tax for OECD, told a US congressional committee in June that most countries, but specifically not the UK, strengthened their CFC legislation to make sure that you fight the delocalisation of profit in low-tax jurisdictions. The UK has lowered its corporate income tax, but it has also changed its CFC legislation in a way that is not about strengthening it. Is the head of tax at OECD wrong in his assessment of the Government's approach to CFCs?



**Jim Harra:** The UK's previous CFC regime, when you looked specifically at the legislation, may well have been tougher.

**Chair:** Is he wrong? Do you disagree with him?

**Jim Harra:** In my view, the old CFC rules were extremely difficult to enforce, because they were under constant legal challenge. In addition, groups were effectively leaving the UK.

**Q385 Chair:** Is he wrong? Mr Hara, you are avoiding answering the question. He has asserted that we, unlike all the other countries in the OECD, weakened our CFC rules in the legislation that we passed. Is he right? Is he wrong?

**Jim Harra:** In my view, our new CFC rules are workable.

**Q386 Chair:** Are they weakened or strengthened?

**Jim Harra:** I am not going to make a comment on whether they were weakened or strengthened. They are workable. They were devised after a lot of consultation and were ultimately passed by Parliament.

**Q387 Chair:** I take it that they have been weakened. Thank you for that.

Mr Troup, you were in charge of tax policy in the Treasury when the decision was taken to adopt this more territorial approach.

**Edward Troup:** The Chancellor is in charge of tax policy. I was leading the teams that were giving advice to Ministers on tax policy. That is quite an important distinction.

**Q388 Chair:** But you were there giving advice to Ministers when they decided to adopt a more territorial approach to CFCs?

**Edward Troup:** Under both Governments, as Jim has said—

**Q389 Chair:** I am not making a party political point. I am asking you about your role.

**Edward Troup:** I was there from 2004 onwards.

My point is Jim's point, which is that whether you describe the previous rules as strong or not, there were two effects. First, they were just not working from an enforcement perspective, because it was becoming increasingly difficult—

**Q390 Chair:** I do hate this avoiding. Were you there? That was the only question I asked.

**Edward Troup:** I was there.

**Q391 Chair:** You were there, and you were giving advice when the decision was taken to adopt a more territorial approach.

**Edward Troup:** I cannot remember when the decision was taken. Although the previous Government did take that decision, and I was there, I think—

**Q392 Chair:** You were there under this Government, because I remember coming to see you about the previous head of tax.

**Edward Troup:** I do not know when the decision was taken. I was certainly in the building.

**Q393 Chair:** You were there, and you were head of tax. Richard, Ian and I came and talked to you about various issues at HMRC. I remember that.

**Edward Troup:** I would have been there because it would have been 2011.

**Q394 Chair:** Yes, you were there. So did you know when those rules were devised, on which you gave advice, that they could be used by multinational companies to wipe out their UK profits?

**Edward Troup:** I am going to risk going back over what Jim has talked about. We have a major challenge collecting corporation tax in the 21st century, in an open economy with capital flows. We need to try to tax, as this Committee has challenged, the profits that are earned in the UK. If we simply take a UK company and try to tax its worldwide profits, as we found during the 1980s and 1990s, the tax system would not work. The tighter we made the rules, the more businesses moved their headquarters overseas.

A balance has to be struck between finding a way of taxing profits in the UK and not driving business overseas. Ministers had taken the decision that they wanted generous interest rules, but they also wanted a degree of protection, under the CFC rules, that was compliant with EU law, that did not drive businesses overseas, and that provided an adequate deterrent to profits being shifted outside the UK. That was a completely unsquareable circle. A set of rules was put together with a great deal of consultation; throughout this process we consulted with a range of stakeholders, with Ministers involved throughout. It was absolutely recognised that, because it was an unsquareable circle, it was inevitable that there would be some degree of leakage, and it would not be possible to achieve exactly the effect we wanted, which was only to tax profits in the UK, prevent businesses moving overseas, and prevent profits being shifted overseas.

The set of rules is much more workable and effective. It is clearly understood. There is no sense of somebody devising them and then not knowing what had happened. Jim has said that we did not know exactly what people would do, because we cannot know exactly what businesses would do, but they are achieving the effect. Businesses are not leaving the UK. To that extent, it is a success.

**Q395 Ian Swales:** There were three impacts of all this. Were they discussed? The first is the incentive for UK business to be owned offshore. Secondly, there is the incentive for UK businesses to manufacture offshore, because that would no longer be treated as part of their tax base. Thirdly, there is the effect on UK competition of these companies of multinationals being able to have an inside track in the way that they finance their organisations. Those three economic effects are absolutely stark now in our economy. Were they discussed at the time?

**Edward Troup:** I think that on all three of those we are in a better, or certainly no worse, position than we were under the old rules. The incentive for overseas ownership is a feature, as you describe it, of our generous interest deductibility, and although, through the worldwide debt cap and some other measures, we

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have tightened up on that—Ministers have adopted a generous interest deductibility set of rules—I do not think we are any worse off under that. I do not really understand the point about manufacturing overseas. If you manufacture overseas, you pay tax there at the local tax rates. If you manufacture in the UK, you pay tax here at the local tax rate.

**Q396 Ian Swales:** It is the CFC issue.

**Edward Troup:** But the CFC rules do not apply if you manufacture overseas, because manufacture is excluded.

**Q397 Chair:** I have two or three questions on this, and then I will bring you back, Ian. One is: why did other countries strengthen their CFC rules, and why haven't we? They want to be as competitive as we do. Why have they done that?

**Edward Troup:** After we abolished exchange control in 1979, there was a significant outward flow of money, which required us to introduce the CFC rules in 1984. Because we were one of the first countries to abolish exchange control in this part of the world, we were one of the first countries to have CFC rules. They were very tough; they were too tough. Actually, other countries—

**Q398 Chair:** So you disagree with the OECD as well.

**Edward Troup:** I disagree if you take a point version, but have we ended up with CFC rules that are somehow weaker than other countries' CFC rules? No, I do not think we have.

**Q399 Chair:** Well, the OECD does think that. Is it true that you said at some time that "Taxation is legalised extortion"?

**Edward Troup:** I am very glad that Mr Murphy and others go back and read the articles I wrote in the *FT* in the 1990s.

**Q400 Chair:** Did you say that?

**Edward Troup:** I wrote a whole series of articles.

**Q401 Chair:** People go back the whole time to stuff I did in the 1990s and 1980s, I can tell you. You never get away from your past.

**Edward Troup:** The article was making the point—indeed, it is relevant to a lot of what we discussed today about tax being a matter of law—

**Q402 Chair:** Did you say "Taxation is legalised extortion"?

**Edward Troup:** In the context of that article, which you read, I was making the point that it should not be left to the discretion of tax administrators to decide how much was due; it had to be left to the rule of law, and that is quite an important principle.

**Q403 Chair:** Did you say "Taxation is legalised extortion"?

**Edward Troup:** In the context of that article, those words appeared. If you read on—

**Chair:** You said it—thank you.

**Edward Troup:** Would you like me to read it?

**Chair:** No. I was interested; I would never dream of putting those four words together. Can I talk about the GAAR amendment?

**Q404 Mr Bacon:** You know that George Orwell said never to use the passive if you can use the active. You said, "those words appeared." How did they appear—by magic?

**Edward Troup:** No. It is late on a Monday afternoon. I do have to admit that I did write those words.

**Mr Bacon:** You did; thank you. I was just checking.

**Edward Troup:** But I would like you to read the whole article. It is a rather good article, I have to say.

**Mr Bacon:** Please send it to the Committee, and we will definitely read it.

**Edward Troup:** Well, Mr Murphy put most of it up on his blog today.

**Q405 Chair:** Did you also say, of the GAAR, that "The taxpayer would be laid at the mercy of the bureaucrat"—that is you, Mr Harra?

**Edward Troup:** I am a bureaucrat these days, too.

**Q406 Chair:** You are not; he is the one who does it. We will come to you, Mr Harra, but did you say "The taxpayer would be laid at the mercy of the bureaucrat"?

**Edward Troup:** A proposal for the GAAR was put forward by the previous Government in 1998. That—

**Q407 Chair:** Did you say that?

**Edward Troup:** I said it of the GAAR that was put forward by the previous Government in 1998.

**Chair:** I know; now we have a toothless one, and it is okay.

**Edward Troup:** And having no protection for the taxpayer whatsoever.

**Q408 Chair:** Given those views, are you really the best person to lead the people's fight against tax avoidance?

**Edward Troup:** It is very kind of you to say that I am leading the fight. Actually, Jennie and Jim and the 30,000 people—

**Q409 Chair:** You are their boss. You are the top person here—although you are not accountable for Switzerland; I hear that.

**Edward Troup:** I am a tax professional, but as the papers have written today, Jim is our most senior tax inspector, so he ultimately is leading the fight, with Jennie and her people.

**Chair:** Right. We want to talk about Eurobonds. It seems to me that they are working for big businesses, not the taxpayer, really.

**Q410 Ian Swales:** The question of eurobonds has been well-reported in the media in the last week; this is another version of what we have been talking about. HMRC said in its consultation that "in recent years a number of groups have issued Eurobonds between companies in the same group, and listed them on stock exchanges in territories such as the Channel Islands and Cayman Islands, where they are not actually

traded. In effect, the conversion of existing inter-company debt into quoted Eurobonds enables a company to make gross payments of interest out of the UK to a fellow group company, where otherwise deduction of tax would be required.” That is a special case of what we were just talking about. Quite rightly, you thought that that was out of order and put it out for a consultation. According to the reports, the usual suspects told you that it would be a bad idea to do anything about that, so you will not be doing anything. Can you talk us through the process by which you went from deciding that you wanted to do something to not doing anything?

**Jim Harra:** The Government has not said that it will not do anything about it, but it has decided that it would not be right to implement the proposal put forward in that consultation, because it is clear that that would not have had the desired effect, which was to yield the £200 million we had anticipated. The eurobond exemption has existed since 1984. It is a means by which UK businesses can access international finance, because it allows that finance to flow without the deduction of withholding tax. We monitor how it is used, and we were concerned that intra-group finance, in the circumstances you described, was not how we originally envisaged the exemption working, although we are clear that that is the effect of the rules unless and until some reform is made.

We put forward the proposal in the belief that that would hopefully yield about £200 million. We are satisfied, from the responses we received and further analysis we did, that that would not have been the result of the measure we proposed. Therefore, the Government decided that it would not proceed with that.

**Q411 Ian Swales:** Why is that?

**Jim Harra:** For a number of reasons. First, it was demonstrated to us that not all intra-group lending in these circumstances originates within the group: some of it is external borrowings moved through a group finance company, at which point they use the eurobond exemption. Arguably, that is within the original policy intent. Secondly, because there is a wide array of other ways whereby withholding tax does not apply, what the measure would have done is just put some administrative obstacles in the way, which people could have got around. The issue is still under review and, in particular, the whole question of withholding taxes and how they can be used to prevent profit shifting is being looked at in the context of the BEPS project.

**Q412 Chair:** In the context of what project?

**Jim Harra:** Sorry, the BEPS—base erosion and profit shifting—project, which the OECD is leading on behalf of the G20.

**Q413 Ian Swales:** Would you agree that, as a top tax director of a very large company said to me, this whole issue of moving capital and interest around is the No. 1 method of tax avoidance used by large companies?

**Jim Harra:** It depends on your definition of tax avoidance. There is no doubt that, as I described, there are large amounts of capital and interest flowing across borders. The UK does have a generous regime for giving deduction for interest, and therefore that is something that we have to monitor all the time, and that we have to use the anti-avoidance rules to police all the time.

**Q414 Guto Bebb:** Obviously, HMRC did a consultation. When the consultation was announced, it was said that eurobond exemption was used to circumvent the need to deduct tax at source. We have seen a number of newspaper stories highlighting the potential savings for companies engaged in this process. I know that you cannot speak about individual companies involved in your investigations, but to what extent has your research identified a figure for the losses incurred by the Exchequer as a result of these activities?

**Jim Harra:** Our best estimate at the time when we put the proposal out for consultation was that there was about £200 million of additional tax that we might have been able to recover from this measure. As it happens, we now believe that it would not yield anything approaching that, but that was our best estimate and remains our best estimate of the target that you might be able to achieve if you could devise a protection that would work in these circumstances.

**Q415 Guto Bebb:** HMRC therefore obviously disputes the figures that were announced today by *The Independent*, which claimed the figure was £72 million for one company.

**Jim Harra:** I have obviously read *The Independent* articles this week, and they conflate two different things. They conflate the withholding tax, which you would obviously get if eurobond exemption did not apply, with excessive deduction of interest, for which there are other separate measures.

In terms of the withholding tax, some of the articles have failed to take account of the fact that there will be a behavioural change, and that financing will operate in a different way where there is still not withholding tax; the UK gives up its right to withholding tax in a large number of double taxation agreements, or reduces it, in return for some reciprocal concession by the other country. In one of the examples used in *The Independent* this week, it assumed that there would have been a 20% withholding tax, but in fact there would have been a 10% withholding tax under the relevant double taxation agreement—the sum there is zero. In addition, finance can be structured in such a way that the return is not in the form of interest, and therefore there would be no withholding tax.

We concluded that what was going to happen if we implemented that measure would have been a number of behavioural changes, which would have significantly reduced the yield, and increased the admin burden, effectively, for companies and for HMRC. Ministers concluded then that it would not be wise to implement that measure, but we will keep it under review and try to find a way of doing that.

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**Q416 Guto Bebb:** To be fair, it sounds as if what you are saying is that your original comments when the consultation was announced have been contradicted by the work that you are doing.

**Jim Harra:** What has happened is that the original proposal we consulted on, which we only consulted on because we believed we could implement it and make it work, we have had to conclude we were wrong about.

**Q417 Chair:** I have a couple of general questions. Dave Hartnett has been around again, and he is quoted in *The Times*, which I picked up, as saying that tax relief on films, as applied by my friend Patrick McKenna, is nothing more than “scams for scumbags”. Do you agree?

**Edward Troup:** There was a decision of the High Court last week, to which I think you are referring, on some comments that Dave Hartnett made last year. I do not think that we would have used such colourful language, but as you know, film schemes—

**Chair:** I envied it, actually; I thought it was a good description.

**Edward Troup:** I am sure you would have used such colourful language, but we might not have. As you know, we have seen and are vigorously challenging a very large number of cases in which film tax relief, which we recognise is a perfectly legitimate tax relief with a legitimate objective, has been used in a way absolutely contrary to Parliament’s intention, and we will continue to challenge such cases.

**Q418 Chair:** Can you talk a bit about the composition of the board? I am particularly interested in how many people have grown from inside HMRC. How many people have come up through the ranks, been promoted and trained through HMRC? How many have you brought in from the private sector?

**Edward Troup:** The board, not including non-executives? You mean the executive committee of the department—

**Q419 Chair:** The non-executives would sit on the board, wouldn’t they?

**Edward Troup:** Yes, but they do not take part in the executive decisions relating to any taxpayer; they are simply a challenge.

**Q420 Chair:** No, but they are on your board.

**Edward Troup:** I am sorry, but I do not have an answer.

**Q421 Chair:** Let’s do the executives, and then we will do the non-execs.

**Edward Troup:** None of the non-executives have come through the department. They are, by definition, externals with external experience. Jim has been around HMRC for the longest, so he will correct me if I am wrong. Lin Homer, as you know, is a career civil servant who has not come up through the department. I have been in the Treasury for the past 10 years and in the department for the past year. Jim has been in the department for—

**Jim Harra:** Over 29 years.

**Edward Troup:** Nick Lodge, who has recently been confirmed as director general of benefits and credits, has been there for—

**Jim Harra:** More than 20 years.

**Edward Troup:** Jennie, as you know, has been here for a year, but she is very much a career tax person.

**Jennie Granger:** I have spent 30 years in the Australian Taxation Office.

**Edward Troup:** Ruth Owen, who is director of personal tax, has come from DWP, where I think she spent most of her career, which has been extremely pertinent to the challenges of her responsibility for personal tax. And then we have HR, IT and finance directors, none of whom, I think, are career HMRC people, but that is very much the model of the civil service today—you get experts into those fields.

**Jennie Granger:** Simon Bowles might want to challenge us about how old you have to be at HMRC before you are regarded as a local.

**Edward Troup:** Yes, he has been here for quite a long time.

**Jim Harra:** Five years, I think.

**Q422 Chair:** The other thing I am worried about is that I read somewhere—it was probably in the same *Private Eye* article—about the appointment relating to the GAAR. This Mr David Heaton was appointed to the committee that judged whether a proposed tax scheme was abusive or unreasonable, yet he is the guy who, it is said, wants to keep money “out of the chancellor’s grubby mitts”. He was doing a particularly awful scheme in which he exploited the statutory right to maternity pay to get more money out of the Revenue by upping the pay just in those weeks used to assess entitlement to paternity pay.

**Edward Troup:** I may have given the wrong date to Ms Mactaggart about the commencement of the GAAR. I will write to correct that.

The GAAR advisory panel is headed by Mr Patrick Mears, who was appointed following a proper competition. It is an advisory panel. It is not making decisions; it is giving advice, as provided for in legislation enacted by Parliament. In consultation with us, Patrick Mears appointed a panel, and Mr David Heaton, to whom you referred, resigned very shortly after that particular fact came to light.

**Q423 Chair:** Why on earth did you appoint him if you knew? Do you go to all those “101 ideas on how to stop paying tax, either corporate or personal” things, Mr Harra? Do you send your spies along?

**Jim Harra:** I do send my spies along.

**Q424 Chair:** Mr Heaton seems to be particularly grubby, in that he talked about keeping money “out of the chancellor’s grubby mitts”. Then there is the really awful scheme that he proposed at the conference for exploiting an important benefit, statutory maternity pay, for a wrong purpose.

**Edward Troup:** I understand that the interviews for the members of the panel were chaired by Patrick Mears. Each of the candidates was expressly asked “Is there anything in your closet? Is there anything you have said?”

**Q425 Mr Bacon:** “Have you written any articles?”.

**Edward Troup:** I am not sure whether that was asked. That particular interview was not in the public domain at the time and, as I said, Mr Heaton resigned fairly briskly after it came to light.

**Q426 Chair:** You must have known. It is not that big a world. It is a small world, as I am coming to realise. Tax avoidance advisers are all there.

**Q427 Austin Mitchell:** Certainly the people who recorded the speech.

**Q428 Ian Swales:** I have two quick ones to raise. I know we are going to have a separate hearing about reliefs at some point. The NAO is doing some work on that. I would like to ask one quick one, which is that we had a hearing about charitable tax relief. How do you determine offshore charities? If people say they have paid money to an offshore charity, what sort of checks can you make and do you make about the legitimacy of the charity? It sounds to me as if it is absolutely wide open.

**Edward Troup:** I am not sure whether we have anyone here who can answer that. We have not got anyone here from personal tax.

**Q429 Ian Swales:** Wrong person, we will perhaps pick that up when we do the reliefs. It feels as if it must be wide open in terms of how that works.

**Amyas Morse:** We do have a report coming out.

**Q430 Ian Swales:** My final point is congratulations really for getting after the accountancy partners who were involved in the scam of moving their remuneration from their partnerships into companies, which was recently reported. It completely blows the cover, if you like, on their stance on these issues. I am just wondering whether you would describe that activity as avoidance or evasion?

**Jim Harra:** I take it that you are referring to the measure that the Government have put forward on partnerships. It is doing two things. One is that it is changing the rules for limited liability partnerships to make sure that those people who are properly employees are taxed as employees. It is also changing the rules to prevent the profits of any partnership from being allocated to a corporate member, which would then pay tax at a reduced rate and not in proportion to its input to the partnership.

**Q431 Ian Swales:** Are you saying that it was perfectly acceptable before the Government said anything that accountancy partners would allocate their remuneration effectively to a corporate vehicle? Are you saying that that was okay?

**Jim Harra:** I think the fact that the Government are proposing to bring forward quite significant changes in this area is because it does require a change in the law to enable us to tackle that behaviour. Whether or not you call that behaviour avoidance is every person's opinion. What I think the Government are clear about is that it is not how they want to see the partnership rules being used, which is why they have brought forward these measures.

**Q432 Ian Swales:** Let us press this a bit further. Why would you have allowed that even under the old rules? Would that not have been equivalent to the scam of paying money to the Channel Islands to avoid national insurance? Is it not of the same order? It would be great to have your salary paid to a corporate vehicle to avoid higher rate tax.

**Edward Troup:** I have a slight feeling that we are being damned if we do and damned if we don't. Having identified this as something where there was a loss of tax, in discussions with the Treasury, the rules have been changed, which is what you are asking us to do elsewhere.

**Q433 Ian Swales:** Sorry. To be fair, I did start my remarks with congratulations. I am just curious—I am not being critical—to know how that was even allowable in the first place.

**Jim Harra:** I think the type of arrangement that the new legislation is directed at is not what I would characterise as evasion. It has been about people setting up partnerships with corporate members and exploiting the ability to allocate losses and profits within the partnership to reduce tax. It is a form of avoidance, but we need to change the rules to be able effectively to tackle that.

**Q434 Ian Swales:** A final point on limited liability partnerships, I am guessing that it is not just accountants who are doing it. There is this whole issue of the very large number of LLPs that have now come into being since they were made a legitimate vehicle some years ago. How does HMRC tackle those organisations when the normal company approach does not apply because they are not companies, and often their ownership is quite opaque.

**Jim Harra:** There is specific legislation which provides that, for tax purposes, they are partnerships and that is the way that we then tax them. That is the piece of legislation that creates a weakness which has allowed some people to disguise what is in reality an employment relationship, as self-employment in a partnership, which is why the LLP tax rules are being changed to counteract that.

**Q435 Ian Swales:** Is it fair to say that the partners of many LLPs are either opaque or offshore organisations?

**Jim Harra:** There is a whole variety of people who use LLPs. One of the trends that we have seen in recent years exploiting the tax rules is for some relatively low-paid people, like catering and cleaning staff, to be purported to be partners in a limited liability partnership, often, we feel, without them even being aware, in order to sidestep employment taxes. It ranges over some very wealthy and sophisticated professional people, but increasingly in recent years it has been used to exploit low-paid workers as well.

**Q436 Ian Swales:** So, as you have rightly done in the case that I started with, you are bringing that forward now as a potential policy requirement to change it?

**Jim Harra:** Yes.

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**Chair:** Right, Guto, Austin and then I've got one final area I want to cover.

**Q437 Guto Bebb:** I have two broad questions, one of which touches on the tax gap. I was so happily listening to the Chair that I did not get in at that point.

**Chair:** Sorry, apologies.

**Guto Bebb:** No problem at all. The first question is about the total tax take. It appears that the money coming in from personal taxation fell in 2011–12. That is primarily blamed on a fall in self-assessment or the tax collected through self-assessments. Is the number of people registered for self-assessment higher or lower during that year? Obviously the employment figures, which have been very strong, have been driven primarily by an increase in self-employment. I am curious as to whether the Revenue has seen more people registered for self-assessment even though the total tax take has fallen.

**Edward Troup:** We will probably have to write to you on that. I don't have self-assessment numbers in front of me.

**Q438 Guto Bebb:** Okay. Secondly, we have been talking about large companies avoiding tax. Certainly a key concern that I have from my constituents on a regular basis is the issue surrounding VAT and registration. When VAT accounts for a significant portion of the tax gap, what sort of work do you do to try to identify those businesses that should be registered for VAT but are not, because it is obviously a source of frustration for many businesses that play by the rules that they seem to be undercut by those businesses that do not?

**Jennie Granger:** This is a particularly hidden economy. It can be lack of registration, certainly, or it can be not fully disclosing income. We have been making a lot of inroads with that, with both our campaigns and taskforces. For example, last year nearly £7 billion of the yield that we brought in was from VAT. Some of it is in this area. One of our best weapons is the amount of data matching we can now do through our Connect system that starts to flush out where we start to see income or other indicators—wealth indicators—that suggest that a business is not disclosing all that it can. Of course, we also, which the NAO has commented on, have a particular focus on VAT repayment and, in particular, at its most virulent, the MTIC scheme. So there is a range of things that we do in that. I think you are asking more about how we find the hidden economy part of this. As you said, data matching in particular has helped us a lot with that in recent years.

**Q439 Guto Bebb:** A final question: from a policy perspective has any work been undertaken on the way in which the cliff-edge impact of the VAT threshold contributes to the creation of this black economy around the margins of where people register their VAT? Has there been any analysis of the way in which policy could be changed in order to reduce that cliff-edge effect on small businesses?

**Jim Harra:** I believe analysis has been done over time. The UK's threshold is set at a turnover of £79,000 which is quite high and means that there are

not as many businesses around that cliff-edge; if you had set it at £25,000 to £30,000 far more businesses would be affected. No matter where you put the registration threshold, you are bound to have that cliff-edge effect for whatever number of businesses are clustered around it. We are conscious that thresholds such as that one and others can sometimes create an incentive for taxpayers to keep or purport to keep their turnovers below that level. Obviously Jennie's people police that.

**Q440 Meg Hillier:** We have been talking a lot about big businesses, but day-to-day in my constituency small business owners raise many issues with me. While you are here, I just wanted to touch briefly on real-time information and how that is going. You have already extended the deadlines for smaller businesses, which has been welcomed locally, but are you confident that you are going to meet the target of delivery by April of next year?

**Edward Troup:** I am sorry, but this is the second go that you have had on the accounts and Ruth Owen, who is responsible for RTI, came to the first one. I do not think that any of us have come equipped with RTI facts. I am sorry, but we can certainly take questions and come back to you on that.

**Q441 Austin Mitchell:** Why do you place so much reliance on bringing in people from the big four accountancy houses and law firms? After all, they are selling advice on how to avoid taxes for a steady fee income and have an interest in making schemes as easy to evade and avoid as possible. However—the Chair mentioned the example of the man who wants to keep money out of the Chancellor's pockets—accountancy house people were advising on the general anti-avoidance measures and on the patent box and were even brought directly into the Department. It is incredible. These people do not have Chinese walls in their own heads; they are there to pursue the interests of their big accountancy houses, themselves and their clients. Why should we bring them in to the process of formulating policy? I do not suggest that Grimsby police should bring in the local burglars to the crime prevention committee for advice on what crime prevention measures should be taken. Why is it permissible with this measure when they are robbing the country and not in burglary prevention?

**Jim Harra:** I suspect that the big four companies may not agree with that analogy, but I will leave that to them. First of all, I will say that we do not place a big reliance on them at all.

**Q442 Austin Mitchell:** Does HMRC lack the necessary expertise?

**Jim Harra:** I do not believe that we do. As I said, we do not place a big reliance on them. If I can take my area, for example, there are some 3,000 staff in business tax in HMRC and I currently have two secondees from the big four, which is a very small number in that context. So we certainly do not lack expertise. However—

**Q443 Chair:** Where are they in your organisation?

**Jim Harra:** I believe that they are working on policy initiatives.

**Chair:** Quite. That is the problem.

**Q444 Mr Bacon:** Do the secondees tend to be quite senior?

**Jim Harra:** They can vary in size, but—

**Mr Bacon:** I did not ask about size.

**Jim Harra:** Sorry. They can vary in seniority. We go for the particular expertise in the area that we want.

**Q445 Chair:** So they write the policy and then go out and flog it.

**Jim Harra:** That is not what they do.

**Chair:** Mr Edwards does on the CFCs.

**Jim Harra:** We do find that they have made a very useful contribution, because they are very highly skilled tax professionals, but, from working with their clients, they have insights that are helpful. Also, they are people who are going to have to operate whatever we design, so they can give us practical assistance on what the operational impacts will be of different designs. Clearly, however, we keep a grip on what the policy objective is, we assess their input and we advise Ministers. They have an input in that, but they in no way lead or control it.

**Edward Troup:** I do think that there is some misunderstanding that there are some secrets that are part of the policy world that they can somehow take out. We are completely transparent about our policy. Mr Swales has been looking up our guidance on thin capitalisation while we have been sitting here. There is nothing about our policy or our policy guidance that is not transparent once the policy is announced.

**Austin Mitchell:** Except the policies are too soft.

**Q446 Chair:** Hang on. The secrets are twofold. The first is that they all too often advise companies, which, because of commercial confidentiality, you cannot share with us. They will advise company A and get a deal for them out of you—you make shake your head, but that is the way that the world works—and then use that intelligence to inform their negotiations with company B. That is the first thing. The second thing is that, like the other KPMG character, Mr Edwards—I keep talking about this Mr Edwards, but I have now lost my little piece of paper—went in and did the technical writing of the rules, which no parliamentarian can do and which only technical people can. They write those technical rules in such a way that they can then identify the loopholes that they can exploit when they go back to their companies.

**Edward Troup:** I do not think there is a shred of evidence that that is true, and I personally would very much like to see—

**Chair:** I will find the quotes from Mr Edwards. Where is my bit of paper?

**Mr Bacon:** Was it in the bit about patent box?

**Q447 Chair:** This was not patent box. This was the guy who did the CFCs. When I was a Minister, I talked to my stakeholders. What I did not do was to select one set of stakeholders at the expense of others. When we look at how you consulted on the eurobonds, who devised your CFC rules and who

devised the patent box, you only talked to one group of stakeholders. It always seems as though you are on the side of big business, not on the side of the ordinary, hard-working, completely law-abiding taxpayer. That really is what gets everybody's goat.

**Jim Harra:** I cannot agree with that characterisation.

**Chair:** Of course you can't, but it is true.

**Jim Harra:** There are two stages to policy making. First of all, there is consultation about what the policy should be. In that, we have public consultation and anyone can put forward their views. The next stage is the technical design of what is, unfortunately, quite complex and technical legislation, where we do find that it can be useful to have experts from the big four in our teams, because they have expertise and because they know how their clients operate and what the operational impact will be. But it is very much a design phase.

**Q448 Chair:** Why don't you bring Richard Brooks and Richard Murphy in?

**Jim Harra:** If they wish to apply on secondment—

**Q449 Chair:** No, why don't you consult some of the charities that are trying to protect developing countries?

**Jim Harra:** When it comes to consultation, we very much do.

**Q450 Chair:** There are a whole lot of other people. I think you are right to consult the accountants; nobody is against that. What I find offensive is that you seem to consult one bunch of interested parties at the expense of the rest of us. That is offensive.

**Jim Harra:** We certainly do consult with the NGOs on the policy, for example. It is more usual when we are in that final design phase that we are engaging tax professionals to assist us with that.

**Q451 Ian Swales:** As I understand it, the PFI Green Book, which was heavily designed by outside experts, still includes the assumption that 6% of the PFI income comes back in tax. We know from hearings and so on that virtually none of that income comes back in corporation tax, because all the PFI deals end up being structured with offshore arrangements. Even secondary schools are now owned in the Channel Islands. Have you made any input to the Treasury saying that that assumption needs changing because we are not seeing the tax coming back?

**Edward Troup:** That is a procurement issue for the Treasury. I do not know the answer to that, and I do not think any of us has that. There is a process, obviously, on all these things.

**Q452 Mr Bacon:** Are your buildings still owned by Mapeley Estates in Bermuda?

**Edward Troup:** We do have a contract with Mapeley, which covers a significant proportion of our estates.

**Q453 Mr Bacon:** Is it extant? I remember at the time you did this deal with them and they promptly moved offshore, so you became one of the country's leading tax avoiders. I am just trying to find out whether it is extant. Is it ongoing?

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**Edward Troup:** There is a Mapeley contract. I do not know the location of the company with which—

**Mr Bacon:** Bermuda, unless it has moved back again.

**Chair:** I doubt it.

**Edward Troup:** Mapeley is now owned by another outfit, so I am not sure exactly.

**Q454 Mr Bacon:** It has not come back to the UK, has it?

**Edward Troup:** Amyas has looked at all this, and he may know who ultimately owns Mapeley now. No, it is not in the UK, I don't think.

**Q455 Mr Bacon:** On the subject of tax allowances, how many different allowances are there in total?

**Edward Troup:** We have got a lot of notice of that question.

**Jim Harra:** Yes, we have been sharing different numbers with the National Audit Office.

**Amyas Morse:** This is in our forthcoming Report, which you are going to have a hearing on.

**Q456 Chair:** My understanding, Richard, according to the Office of Tax Simplification, is that there are 1,078 different tax reliefs.

**Jim Harra:** That, I believe, is the number that has been published.

**Q457 Mr Bacon:** I know that we will come to this later, but do you know the total value of those in terms of the extent to which they are taken advantage of in the economy?

**Chair:** That is what Amyas is going to give us.

**Amyas Morse:** We are going to be having hearings on this.

**Q458 Austin Mitchell:** Returning to the advice of the big four accountancy houses, they are enormous in power, scale and brutal brainpower, and HMRC is comparatively puny against the power they can bring to bear. I missed the part in the Bible when David goes up to Goliath to ask for advice on what stones he should use in his slingshot. Goliath says, "Here's a ping-pong ball. It will be wonderful in your slingshot. It is specially flight tested." I missed that part of the Bible, but I have a final question, which is irrelevant to that.

The National Audit Office told us last year that 41,000 tax avoidance schemes are under scrutiny. Can you please tell us what has happened and what progress has been made with those investigations?

**Edward Troup:** We are coming back with that in December. If you want us to go into it now, we are happy to do so, but I know there is a commitment to come back in December.

**Chair:** Let's do it then. Austin, is that okay? You can have another right old bash at it then.

**Austin Mitchell:** Okay.

**Mr Bacon:** And you can give us a different biblical quote then.

**Q459 Chair:** I want finally to do VAT and the NHS. Who is that?

**Jim Harra:** That would be me.

**Q460 Chair:** I have had a series of representations about this. I know it is complex, but it has been attracting attention. There are three separate issues. One is whether it is an employment agency or a temp staffing agency. An NHS trust recruits a doctor. If it recruits them from a staffing agency, VAT is due on the whole of the locum doctor's salary and everything. If it is just an introduction and the trust recruits them through an employment agency, you pay VAT only on the recruitment fee. I am right about that, aren't I?

**Jim Harra:** That is correct.

**Q461 Chair:** That anomaly between the two regimes has led to PwC in particular devising schemes to exploit the difference. PwC now does business with getting on for 100 trusts. What are you doing about this?

**Jim Harra:** I wrote in some detail to the National Audit Office about this a couple of weeks ago. We certainly have concerns about how this is operating in practice. There is no doubt that where they do this properly and legitimately that is the way the VAT rules work, but of course it then means that the locum becomes an employee of the NHS and it has to take on the responsibilities of employer.

**Q462 Chair:** But they could be sacked within a week.

**Jim Harra:** But what we have seen is some very short-term appointments being structured in that way which is not how the scheme was originally described to us and is not the basis on which we originally gave our view about its VAT treatment. We have a review under way on that, and just this month we have met the Recruitment and Employment Confederation, which has its own concerns about it, to get its assistance with our review. We expect that by the end of this financial year we will have tackled cases that we believe are not operating VAT correctly. It is a cause for concern.

**Q463 Mr Bacon:** How short-term?

**Jim Harra:** Some that we have been told about may be a day—

**Q464 Mr Bacon:** An employment contract for a day.

**Jim Harra:** Yes, which is clearly not how the scheme was described to us, so we reserve our right to challenge that, but we have to investigate it, obviously.

**Q465 Chair:** Okay. Another wheeze in the NHS is when a trust buys goods. If it buys them in a managed service contract it avoids VAT, and if it buys goods directly they are VAT-chargeable. The issue has been raised concerning pathology services. Is this a VAT-avoidance device and, if so, why do you tolerate it? I have three questions.

Secondly, there is an overall loss to the public purse because it is not just that the NHS, which is publicly funded, then does not pay the VAT. It is not circular, because 8% or thereabouts goes to the managed service contractor, so there is a seeping out of 8% and the Government loses that. Do you agree?



Thirdly, the concern has been raised with me that it is all right for the bigger companies that provide pathology services to set up a managed services contract, but that SMEs, which the Government are anxious to encourage, just cannot do that so they lose out entirely in this area of business from the NHS.

**Jim Harra:** On managed laboratory services, NHS hospitals obviously have a choice either to operate their own in-house laboratory or outsource that service. It has been successive Governments' policy to ensure that the VAT system does not distort those outsourcing choices. Therefore, they have put in place a VAT refund scheme, which means that if an NHS hospital decides to outsource and suffers VAT, it can reclaim it. The aim is to remove VAT from the equation of the outsourcing decision. What I would say about NHS funding generally is that its irrecoverable VAT is taken into account in its funding by the Treasury. To the extent that NHS bodies find ways to recover VAT, that will impact on the funding they get from the Treasury.

**Q466 Chair:** I hear that, and it is welcome. Would you accept two things? One, you lose the money on the managed services contract. Because that is NHS money, it is taxpayers' money.

**Jim Harra:** As I said, the aim is to take VAT out of the equation. If an NHS hospital finds that it can make savings by outsourcing its laboratory services—

**Q467 Chair:** It will save 12%. VAT is 20%, so it will save 12%, but we the taxpayers lose 8%, because you get yourself into a managed services contract, and they will charge.

**Jim Harra:** I think it is for the NHS hospital to determine whether it is getting good value for money for the public purse.

**Q468 Chair:** No, it is for us to determine whether using that as a device to avoid VAT serves the taxpayer's interest well. What I am saying to you is that I do not think it does, because you will end up having to pay the managed services contract management fee.

**Jim Harra:** It is not so much about avoiding VAT. What the scheme does is ensure that the Government give a refund to the NHS body on the VAT that it suffers when it outsources, so that it is in the same position—

**Q469 Chair:** I don't think you understand me. I understand that a company sets up a managed services contract to provide pathology services to a hospital. By doing that, it then avoids VAT, but the managed services contractor asks a fee for the work he is doing, and that fee is a loss to the public purse. It is not the VAT loss; it is the loss of that fee to the NHS, which is funded by the taxpayer.

**Jim Harra:** On the VAT analysis, I do not recognise the avoidance, but certainly the fee is an outgoing from the public purse. If that is not made up by a better saving, presumably the NHS body should not be doing it.

**Q470 Chair:** The final thing I wanted to ask was about pharmacies. There is a further loophole which disadvantages hospital pharmacies. Drugs to in-house pharmacies are not considered business supplies for VAT purposes, because they are bought to fulfil a statutory purpose. Therefore, they have to pay VAT, but if it is outsourced—say, to Boots, who were in the papers a couple of weeks ago for not paying any UK tax and relocating offshore—Boots can claim back the VAT. Boots gets a financial advantage on price over the in-house hospital pharmacy.

**Jim Harra:** There certainly is a net VAT advantage to an NHS body from outsourcing its pharmacy services to outpatients, compared with doing them in-house.

**Q471 Chair:** Is that good, especially when it is Boots and they outsource their profits?

**Jim Harra:** However, that advantage is the kind of thing that the Treasury then takes into account in the funding of the NHS generally.

**Q472 Mr Bacon:** Hang on a minute. If you were a hospital, you might have, in effect, an incentive to cut a deal with Boots or some other pharmacist and say, "You can recover VAT and we can't. How about a private arrangement whereby we split the difference?" Are you aware of any such arrangements like that?

**Jim Harra:** No, I am not aware of any, and I would expect that others might well take a dim view of them. All I can say is that we have no evidence of any VAT avoidance through these structures, but we are aware—

**Q473 Chair:** Was it the policy intent to close down in-house hospital pharmacies?

**Jim Harra:** This is the way that the European VAT system works.

**Q474 Chair:** But was that our policy intent?

**Jim Harra:** I am not aware that it is the policy intent, and I am not aware that, when combined with the funding mechanisms that the Treasury use, it is actually the effect. Although a particular NHS body can gain a tax advantage from outsourcing out-patient pharmacy, the Treasury is then aware that the irrecoverable VAT to the NHS has reduced and will therefore take that into account in its funding.

**Q475 Ian Swales:** But they won't look at it hospital by hospital.

**Jim Harra:** They will not do it body by body, I assume, but they will do it for the NHS.

**Q476 Ian Swales:** Well, I am sure that the management of a particular hospital is just going to look at it on the basis of pound notes. They will not take account of the hope that the—

**Edward Troup:** This is how the VAT system works.

**Q477 Chair:** I know how it works but you can actually have a go at it and see. In both these instances, whether it is in the buying of goods and services, where we lose the management fee and damage SMEs, or in the pharmacies, where you are

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basically killing off in-house pharmacies, that is the policy intent. Be explicit about it.

**Jim Harra:** We certainly do police it. For example—

**Q478 Chair:** I know that you police it. It is not a question of policing. The actual policy has this impact. If that is not the policy intent, you should look at it.

**Jim Harra:** Certainly in relation to pharmacies policy the EU VAT does have that effect. The main mechanism for counteracting that is through the Treasury's funding of the NHS.

**Q479 Chair:** Finally, we asked about your executive but failed to ask you about the non-executive. Can you describe to me the non-execs at HMRC?

**Edward Troup:** If there is a list in the back of the accounts, we will go to those. Otherwise I would rather just drop you a note.

**Q480 Chair:** Is any of them from an NGO?

**Paul Keane:** There is a list on page 29.

**Edward Troup:** I think their biographies are also in here, but I might be wrong.

**Q481 Chair:** Who are they? Ian Barlow—what was he, ex-KPMG?

**Mr Bacon:** He is chairman of the Racecourse Association.

**Chair:** Yes, but he is ex-KPMG. John Whiting was previously at PricewaterhouseCoopers. Edwina Dunn—where is she at?

**Edward Troup:** She formed a company called Dunnhumby that worked for Tesco in developing its clubcard. Janet Williams is a former deputy assistant commissioner of the Metropolitan Police.

**Q482 Chair:** Did she work for any—she worked for a private company. She is “a Non-Executive for a private company”.

**Edward Troup:** She is president of a UK charity. Norman Pickavance comes from Morrisons. Volker Beckers is from RWE npower. Leslie Ferrar has a number of non-executive positions and has a life of public service.

**Q483 Chair:** What is her background? She is ex-KPMG.

**Edward Troup:** Sorry, I am reading things out that you can read for yourselves.

**Q484 Chair:** Yes, she was a tax partner at KPMG.

**Edward Troup:** Philippa Hird was in HR at ITV. Colin Cobain has retail experience and Paul Smith is no longer with us.<sup>2</sup>

**Q485 Ian Swales:** Have you ever considered having what you might call grit in the oyster? You could have a campaigner on behalf of taxpayers on your board.

**Edward Troup:** This is something you have discussed with Lin before.

**Q486 Chair:** I don't think we have actually, but we are now discussing it with you in her absence.

**Edward Troup:** Perhaps you haven't. I am going to defer to Lin.

**Chair:** Maybe she can write to us, because we want an HMRC that is on the side of the people, not on the side of big business. Thank you.

<sup>2</sup> Note by witness: Paul Smith is currently a Non Executive Director. Colin Cobain stood down as a Non Executive Director at the end of September, 2013.

**Written evidence from HM Revenue & Customs****Q138: Stephen Barclay: Suspicious Activity Reports (SARs)**

Stephen Barclay asked about a specific case identified by Stewart Jackson and whether there had been a suspicious activity report on the case.

It is not always appropriate to divulge operational matters in relation to criminal investigations, however given it is a matter of court record, HMRC can confirm that it received two SARs in relation to the case from SOCA during the course of this investigation.

HMRC accesses and reviews SARs that are submitted by the reporting industry that are of interest to HMRC using various techniques, including matching SARs Intelligence to the HMRC CONNECT system. This enables the department to profile a greater number of SARs, allowing early identification of threats and better targeted interventions. The department provides feedback concerning the success of the use of SARs across HMRC business to the NCA in anonymised cases, and this is shared twice a year with the reporting industry.

**Q153: Chair: Overdue Tax Collected**

The chair of the Committee asked about the overdue tax and duties (debt) figure against which HMRC collected £37.9 billion in 2011–12 and £34.5 billion in 2012–13. The fall in this measure should be seen in the context of a fall over the two years in the total overdue debt due for collection.

There was less overdue tax flowing into the debt system in 2012–13: £42.5 billion versus £47.9 billion: part of a continuing trend.

Of the debt which was available for collection (including £13.3 billion uncollected debt carried forward from the previous year) 70% was collected in cash compared with 67% in 2011–12.

Cash collected per capita fell by 6% to £6.34 million in 2012–13 as we took the opportunity of reduced debt flow to focus “spare” resource on collecting older, smaller value debts.

(Cash collected per capita is cumulative receipts per annual average FTE in Debt Management.)

<i>£bn</i>	<i>2011–12</i>	<i>2012–13</i>
Total net revenue collected	474.2	475.6
<i>£bn</i>	<i>2011–12</i>	<i>2012–13</i>
Opening debt balance	15.0	13.3
New debt during the year	47.9	42.5
<b>Overdue debt for collection</b>	<b>62.9</b>	<b>55.8</b>
<i>less discharges</i>	<i>6.3</i>	<i>6.5</i>
<b>REAL overdue debt for collection</b>	<b>56.6</b>	<b>49.3</b>
<i>of which debt collected</i>	<i>37.9</i>	<i>34.5</i>
<i>of which written off</i>	<i>4.2</i>	<i>4.4</i>
<i>of which remitted</i>	<i>1.0</i>	<i>0.9</i>
<b>Cash collected as % of real overdue debt</b>	<b>67%</b>	<b>70%</b>

#### Q188: Mr Bacon: Costs of the Construction Industry Scheme (CIS)

CIS is an HMRC-administered tax compliance scheme for businesses in the construction industry. This is an industry that traditionally attracts a large itinerant workforce and often involves a “cash-in-hand” approach, resulting in a potentially significant loss to the Exchequer of payments of tax and NICs. As a result, since 1972 there has been a dedicated compliance scheme in place, in one form or another, to monitor payments made between “contractors” and “subcontractors”.

The current scheme, introduced in 2007, brought a number of changes to improve tax compliance and to relieve some of the administrative burdens on the industry that had been associated with the previous schemes. The new scheme removed the former requirement on contractors to complete payment vouchers and for subcontractors to have to present personalised CIS identity cards before payment could be made. It also introduced a single monthly return for contractors to replace the previous voucher system and, for the first time, introduced various non-mandatory e-filing facilities. These included on-line verification of subcontractors’ tax payment status and on-line completion of CIS contractor returns.

An estimate of the basic running costs of administering the scheme for the current year (2013–14) is £12,500,000. This figure includes IT, print and postage and staff costs.

A Regulatory Impact Assessment of the Scheme in March 2004 estimated the costs to HMRC of around £32 million per annum by 2009–10. This estimate will have reduced substantially due to the following improvements since its introduction:

- CIS has been centralised since 2009. Originally, it was managed in many small units around the country but is now concentrated in Newry with a much smaller unit in Hull.
- In 2010, a project to rationalise the use of IT across HMRC was undertaken. It looked at CIS and a number of subsidiary services were trimmed from the IT running costs, most notably the pre-2007 CIS computer system which was still running alongside the new one (for compliance purposes).
- The contractors’ pack, which HMRC issues to about 22,000 new contractors each year, has been rationalised significantly to save costs and is now much reduced in size, thus saving on output and postage costs. In addition, the number of contractors using the paper filing method has reduced by 50% since 2007, with a consequent reduction in processing costs at our Liverpool processing centre. The CIS includes about 160,000 contractors and about 849,000 subcontractors at any one time. Some contractors are also subcontractors.

HMRC plans further improvements in its administration of the CIS scheme within its SR10 efficiency plans, mostly in terms of process re-engineering.

At the PAC hearing on 16 October 2013, Mr Bacon mentioned figures of £32 million, £50 million and £100 million as potential costs of administering the scheme.

Our enquiry into the origin of these figures concludes that they originate from the Regulatory Impact Assessment for the current scheme in March 2004 which shows an estimated annual cost **to the industry** of the pre-2007 scheme of £52 million and concludes that the current scheme will save industry £22 million, costing £30 million per annum. These figures are **the cost to the industry and not the HMRC costs of administering the scheme**.

We believe that £100 million industry costs quoted by Mr Bacon originate from the July 2009 HMT/HMRC Consultation Document “False self-employment in construction: taxation of workers” which quotes “Using the Standard Cost Model the ongoing **administrative burden [to the industry]** of CIS is estimated at around £100 million per annum (2005 prices)”. At the hearing, Mr Bacon also quoted an IPSOS/MORI poll which was commissioned by HMRC in October 2010. Chapter 4 from the report concludes:

#### 4. OVERALL IMPRESSIONS OF NEW CIS

##### 4.1 Chapter overview and summary

In this section, we describe the overall view that the research audience holds about CIS, including why they think such a system operates and their general perceptions of tax compliance issues:

##### Headline figures—compliance

- 36% of respondents spontaneously say that CIS exists to *ensure income tax gets paid*.
- 81% of respondents think that CIS is *effective in ensuring that construction businesses pay income tax*.
- 79% of respondents feel that CIS helps them feel *confident that construction businesses are complying with their tax obligations*,

##### Headline figures—administrative burden

- Around half of contractors and dual-role businesses (52% and 49% respectively) *agree* that CIS is a burden, compared to slightly over a third (35%) of subcontractors. However, slightly more subcontractors (49%) disagree than agree that CIS administration is a burden on their business.

##### Headline figures—trust

- (53%) feel the industry is honest and disagree with the notion that *construction businesses will always find a way to avoid paying tax*.
- (51%) think that the existence of CIS shows that *HMRC does not trust the construction industry*.
- (57%) think that it is *uncommon* for businesses to deliberately avoid taxes.

As indicated in the headline figures box, CIS is mostly successful in meeting one of its policy aims: **improving compliance with tax obligations**. It has also demonstrated a degree of success in **reducing the regulatory burden**, as shown within the *changing face of CIS* section (p.50), although CIS is still a burden for some (41%), the changes have reduced the administrative burden for many businesses: nearly two-thirds (65%) of those who used the old scheme think that the new system is *simpler* and 57% say it *takes less time to administer*.

CIS is particularly successful in relation to compliance—four in five respondents agree that the scheme is *effective in ensuring construction businesses pay income tax* and that it makes them feel *confident the construction businesses are complying with their tax obligations*.

#### **Q209: Chair: Additional information for the Committee concerning customers who need additional support.**

HMRC has been piloting a new service for customers who need extra help getting their tax or entitlements right. The pilot is currently taking place in the north east of England and as part of that pilot HMRC has closed its 13 Enquiry Centres in that region.

The new service currently being piloted provides specialist help for these customers, either by phone or by a mobile team of face-to-face advisers.

Customers initially make contact with HMRC through our Contact Centre service. Customers identified as needing extra help by our Contact Centre advisers will be quickly transferred to a team of Extra Support Telephone Advisers who will spend more time with the customer on the call, will take ownership of the case, and will see it through to completion. If the case cannot be dealt with over the telephone they will hand the customer over to an Extra Support Mobile Adviser team to arrange a face to face appointment at a public venue convenient for the customer, or at the customer’s home. This approach would replace the current network of Enquiry Centres.

In addition, customers may also be referred directly to our Extra Support Telephone Advisors by one of our Voluntary and Community Sector (VCS) partners. An Extra Support Telephone Advisor will also be able to decide that a customer query is best dealt with by a VCS organisation and will give the customer the information they need to decide on the most appropriate organisation to approach.

A decision on whether to roll out this new service across the United Kingdom will be taken in January 2014.

*Lin Homer*

Chief Executive & Permanent Secretary

29 November 2013

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#### **Further written evidence from HM Revenue & Customs**

##### **Q239 Chair: Companies that are not within the charge to Corporation Tax**

For 2011–12, HMRC issued notices to file a company tax return to 1.9 million companies. This is equivalent to 70% of the 2.6 million active companies on the UK Companies House register at 1 April 2012.

HMRC requires all companies within the charge to corporation tax to file a company tax return. All new incorporations are automatically notified to HMRC by Companies House and a record created on the HMRC database.

The department issues a form CT41G to all newly registered companies (around 460,000 in 2011–12) to enable them to notify us if they are within the charge to tax, although companies do not have to use this form. They can notify us of chargeability by a variety of means, including online, by letter or by filing a company tax return. Companies do not have to notify HMRC if they are not within the charge to tax (because, for example, they do not have a source of taxable income). Tax law imposes a financial penalty if companies fail to notify HMRC that they are within the charge to tax.

HMRC's research shows that around 40% of newly incorporated companies do not become active in their first year. Many (about half) of these never become active; the rest take some months before commencing in business. This makes direct comparison of the Companies House register and the HMRC database of active companies difficult.

The department does not require dormant companies, or companies that are otherwise outside the charge to tax (for example, charities), to file a company tax return because this would give rise to wasteful costs for companies and HMRC. We do, however, deploy an increasingly sophisticated range of risk assessment tools, including IT systems such as HMRC's Connect, with real time information from banks and credit card companies, to manage the risk that a company is active and has failed to notify chargeability. The tax status of all companies that have not been asked to file a company tax return is reviewed at least every five years. HMRC may issue a notice to file a company tax return to any company at any time if we feel there is a risk that they may have failed to notify us that they are within the charge to tax.

Included on the Companies House register and the HMRC database are a significant number of essentially foreign companies. Some of these trade in the UK, are within the charge to UK corporation tax, and so are subject to the same processes as UK companies. Others do not carry on any taxable activity in the UK and are not within the charge to UK tax under the terms of the appropriate double tax treaty (such as the one with Germany). Such companies are incorporated in the UK because of lower incorporation costs and capital requirements.

Independent research shows the UK as having the simplest incorporation procedures and lowest costs for both formation and minimum capital requirements as well as being a highly respected jurisdiction. Registration agents have further reduced the significance of territorial jurisdiction, some charging less than £40 plus UK VAT to incorporate a foreign company in the UK.

For these companies, as for any other UK incorporation, a record is automatically created and returns issued until we establish their status under a double tax treaty. All such cases are dealt with by a specialist HMRC unit which liaises with the tax authorities of the country of residence. The issue of returns is stopped only when we have agreed with the other fiscal authority that they are properly taxed.

A small proportion of companies file returns late. Late filing penalties were charged on around 240,000 companies for periods ending in 2011–12. The total value of those penalties was £164 million. Where failure to file a return continues after the imposition of penalties, HMRC estimates the tax due, using a variety of information sources, and makes a determination of tax liability.

HMRC recognises non-filing as a serious potential compliance risk, encompassing those companies which trade for a short period and the particular phenomenon of "phoenixism" (the practice where directors carry on the same business successively through a series of two or more companies). Each of the companies in turn becomes insolvent, involving non-compliant behaviour including debts and other attempts to evade obligations. We take robust counter action against these risks.

Failure by companies to file returns affects other duties as well as corporation tax. For example, in 2012 we protected £650 million through the use of up-front VAT and PAYE security action. Where companies fail to change non-compliant behaviour, we will prosecute. In the 12 months to 31 March 2013, 41 cases were prosecuted with a 100% conviction rate. In addition to prosecutions, we are increasingly deploying our own specialist insolvency teams to use the full range of civil recovery tools and work closely with the Insolvency Service to drive out abuse.

**Q280–281 Fiona Mactaggart: The number of referrals to the Tax Commissioner between 1 April and 30 September 2013**

The Committee requested updated figures for decisions made by three HMRC Commissioners in respect of the largest and most sensitive tax disputes. Figures for the period 1 April–30 September 2013 are in the table below: these figures will be included in the Tax Assurance Commissioner's annual report next year.

PERIOD 1 APRIL 2013 TO 30 SEPTEMBER 2013

20 cases referred to the Commissioners

Taxpayer's position agreed as an acceptable basis for settling the dispute	11
Taxpayer's position accepted with conditions	1
Taxpayer's position rejected	6
Commissioners remitted the case for further work and re-consideration	2

**Total cases referred in the period** **20**

**Q343 Chair: Of the 15 HSBC cases, how many resulted in settlements that incorporated both penalties and interest charged?**

At the time of the PAC hearing in 2012 HMRC had 15 live individual criminal investigation cases. Of those, six are now currently under civil investigation and where irregularities are identified tax, interest and penalties will be charged.

The other nine have entered the Liechtenstein Disclosure Facility (LDF). Three have already made disclosure reports, two contending that they have no outstanding UK liabilities and one admitting tax irregularities and making a payment on account. These disclosures are currently being looked at to ensure they are correct and complete.

The other six have registered with the LDF and their reports are due to be sent to HMRC by 21 November 2013. These will then be risk assessed in the same way.

**Q437 Guto Bebb: .... The first question is about the total tax take. It appears that the money coming in from personal taxation fell in 2011–12. That is primarily blamed on a fall in self-assessment or the tax collected through self-assessments. Is the number of people registered for self-assessment higher or lower during that year? Obviously the employment figures, which have been very strong, have been driven primarily by an increase in self-employment. I am curious as to whether the Revenue has seen more people registered for self-assessment even though the total tax take has fallen.**

The table below details the number of Self Assessment Tax Returns (all types) issued for the tax return years 2009–10 to 2012–13 with a filing deadline of 31 January following the end of the tax year.

<i>Filing Deadline</i>	<i>31 Jan 2011</i>	<i>31 Jan 2012</i>	<i>31 Jan 2013</i>	<i>31 Jan 2014</i>
Tax Return Year	2009–10	2010–11	2011–12	2012–13
Issued	10m	10.5m	10.34m	11m

(Note—a number who no longer needed to be in SA were taken out after 31 January 2012)

Although the number of Self Assessment tax returns issued has risen, tax paid under SA during 2011–12 would not fully reflect people who newly registered for self assessment during the period 6 April 2011—5 April 2012. This is because most people new to self assessment during this period would not be required to complete their SA tax return and pay any corresponding amount due until 31 January 2013.

The Committee may like to be aware a publication was issued by HMRC on 31 July 2013 entitled “Income Tax Receipts” which provided some insight into why the income tax receipts fell between the tax years 2010–11 and 2011–12. Further information is available on page 13 of the document linked at: <http://www.hmrc.gov.uk/statistics/income-tax-receipts/latest-stats.pdf>