Presented pursuant to the Government Resources & Accounts Act 2000 c20 s6
and the Exchequer & Audit Departments Act 1921 c52 s2

Department of Inland Revenue 2004-05 Accounts

- Consolidated Resource Accounts
- Trust Statement
- Standard Report

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10 October 2005

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(For the year ended 31 March 2005)

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Department of Inland Revenue 2004-05 Accounts

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Statement on Internal Control

1. Scope of responsibility

1.1 As Principal Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of HM Revenue and Customs (HMRC), and previously Inland Revenue (IR), policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

1.2 I am the Executive Chairman of HMRC which was formed by Act of Parliament in April 2005, and prior to that I was Executive Chairman of IR. As Executive Chairman of HMRC, and before that of IR, I am accountable to the Chancellor, and to the Paymaster General, to whom the Chancellor has delegated responsibility for the day-to-day oversight of the Department. The Paymaster General is kept informed of progress and significant issues facing the Department in the course of regular bilateral meetings that she has with me and the other Board members.

1.3 As Principal Accounting Officer for HMRC, and previously for IR, I am supported by a number of Additional Accounting Officers. Each of these has clearly defined responsibilities outlined in their appointment letters. Their relationship with me is also clearly set out in separate Memoranda of Understanding.

1.4 The Valuation Office Agency (VOA) is an Executive Agency of HMRC and before that was an Executive Agency of IR. The Chief Executive of the VOA is an Additional Accounting Officer for the resources authorised by Parliament in relation to the VOA. The relationship between the VOA and HMRC is set out in the VOA's Framework Document, and in a separate Memorandum of Understanding between the VOA's Chief Executive and myself.

2. The purpose of the system of internal control

2.1 The system of internal control is designed to manage risk to a reasonable level rather than to eliminate all risk of failure to achieve policies, aims and objectives; it can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to: identify and prioritise the risks to the achievement of departmental policies, aims and objectives; to evaluate the likelihood of those risks being realised and the impact should they be realised; and to manage them efficiently, effectively and economically. The system of internal control has been in place in IR for the year ended 31 March 2005 and in HMRC up to the date of approval of the annual report and accounts, and accords with Treasury guidance.

2.2 In the period leading up to and following the creation of HMRC on 18 April 2005, we have been putting in place key elements of the governance, risk and control framework for the new Department. An overview of these elements is set out in the following sections. It will take time to fully embed the structural, managerial and behavioural changes that will be required to meet the challenges facing HMRC but, even at this early stage, we have made significant progress.

3. Governance

3.1 One of the earliest and most important challenges in the last year has been the establishment of a high-level governance structure, which will provide the leadership for the creation of a successful new department while at the same time ensuring that existing targets continue to be met. In my statements for the two former departments last year, I set out the initial steps towards this. I can now outline the major developments that have taken place since then.

3.2 The Commissioners of HMRC, created by the Act of Parliament, met in April 2005 and put in place a high level governance structure that includes:

- A Board that comprises the members of the Executive Committee, the Chief Executive of the Valuation Office Agency and the Non-Executive Directors. Its role is to set the Department's strategic direction and to provide advice to the Executive.
- An Executive Committee that is the primary decision making forum for the Department. Its members' portfolios span the whole of the organisation of the Department.
- An Operating Committee that supports the Executive Committee by providing an oversight of the Department's day-to-day performance.
- An Audit Committee that comprises non-executive board members and provides me with advice and support in my responsibilities for risk management, internal control, corporate governance and associated assurance.

3.3 In addition to these committees, a Social Responsibility Steering Group will meet from September to oversee the Department's corporate responsibility agenda and review progress against specific objectives; and a People Committee will support major HR policy initiatives. I have also established a General Counsel role to provide me with expertise and direct support on legal and governance issues.

3.4 Finally we are developing relationships with those external bodies that provide both scrutiny of and support for the work done by HMRC that is linked to the criminal justice system. Her Majesty's Inspectorate of Constabulary (HMIC) provide external inspection of our standards of compliance with criminal justice requirements and the Independent Police Complaints Commission (IPCC) are tasked with consideration of serious complaints against HMRC officials. The Revenue and Customs Prosecution Office (RCPO) is responsible for prosecuting all criminal cases involving drug smuggling, money laundering and tax fraud brought as a result of HMRC investigations.

4. Risk Management

4.1 The two former revenue departments had well understood (and externally well regarded) risk management frameworks, based on principles, standards and practices now common across central government. We are building on the progress that has been made in the two departments, but we are also taking the opportunity provided by the creation of HMRC to secure a step-change in the way that we manage risks to delivery. For instance the Executive Committee is taking a more direct and active role in the identification and management of risk. This has had an impact on the risk profile of the organisation as risks are escalated and discussed more openly. We are also integrating risk reporting with our new performance reporting process. We are keeping at the forefront of risk management developments in central government, and I sit on the Civil Service Management Board sub-group on risk.

Capacity to handle risk

4.2 Integration of the two departments presented significant risks both in terms of achieving the merger itself and maintaining delivery of business objectives. The decision was therefore taken to reduce the risks associated with the process as far as possible. As a result, the legislation addressed the specific issues necessary to get the new organisation in place, while integration was carefully managed to minimise the impact on delivery and to ensure there was no inappropriate spend on HMRC prior to successful passage of the Bill.

4.3 In balancing the need to manage the change against the need to manage the business, in November 2004 the joint Board agreed an approach to create a single strategic view of risks across the organisation. A workshop was held in February 2005 when the senior management team reached a consensus on the top risks to delivery. Progress in managing these top risks is part of the information that is available for the weekly meetings of the Executive Committee.

4.4 Staff in the two former departments continue to have access, through the intranet, to risk management guidance. We are in the process of drawing this guidance together into a single risk framework for HMRC.

The risk and control framework

4.5 The risk management frameworks developed in the two former departments, although different, were consistent with common risk management principles and practices. Each involved a process for identifying top risks, taking account of impact and probability, and the upward reporting of these. The new risk management framework we are putting in place for HMRC will retain these fundamental elements and will seek to embed them across the organisation. We are also putting in place arrangements to integrate risk and performance reporting. Risk management is also a key component of the Management Framework that has been developed for all HMRC managers.

5. Control

5.1 Another key aspect of our control framework is the development throughout 2004 of a new business design model, and the organisational structure that is emerging in 2005 to deliver this. The model, which is overseen by the Executive Committee, is based on four interrelated work groups:

- **Operations.** These include the 12 core businesses employing the majority of staff in the Department.
- **Corporate Functions.** These will deliver cost effective customer focused services to all staff.
- **Product and Process Groups.** These are the taxes, duties, credits and benefits that form the basis of the Department's business and the schemes by which products are delivered. Staff in these areas are responsible for design, specification and providing advice to departmental staff and Ministers.
- **Customer Units.** These will focus on identifying and understanding the requirements and behaviours of our customers, and the risks associated with them. The aim is to make it easier for customers to comply and to reduce compliance costs.

5.2 The aim is for this model to be the foundation for a transformation in performance by placing greater emphasis on the customer. We are aiming also for a balanced organisation that requires collaborative working across and between its different elements while also introducing clear accountabilities within each element.

5.3 A major challenge that faced senior managers in Inland Revenue and HM Customs and Excise was the integration of different control mechanisms that existed in those departments, while at the same time continuing to meet stretching targets. The statements I have received from my fellow Executive Committee members of their own reviews of internal controls reflect the vital work that has taken place in this area. Examples of this include:

- Integrated management structures and common policies and practices quickly established.
- Key managers undertaking thorough reviews of their new areas of responsibility to ensure that best practice is identified and promulgated.
- A specialist professional team established early in 2005 to identify risks to delivery and improve compliance in the Commerce and Estates areas.
- Integrated business planning and resource allocation procedures designed and implemented.
- Common systems of financial management and reporting introduced, including combined management accounts established in August 2004.
- An active approach to fraud prevention, detection and redress for our corporate systems, including full investigation of all incidents of suspected internal fraud.

- A data quality executive supported by a multi-discipline data quality task force established in January 2005. This aims to 'cleanse' over the next year the address and identity data held by HMRC by comparing it to third party databases held by employers and others. Clean data will ensure that we work more efficiently and also provide a better service to our customers.

6. Review of effectiveness

6.1 As Principal Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letters and other reports.

6.2 I discuss significant control issues with my executive team at our weekly Executive Committee meetings, and I meet Directors individually to discuss performance. These meetings are informed by an assessment of our current exposure to risks associated with our major programmes and projects. I also receive detailed, monthly Management Accounts, which highlight potential areas of concern.

6.3 To provide me with an assurance on the effectiveness of the system of internal control, the Director of Internal Audit now provides me with a summary of the findings from every internal audit review, and he also alerts me to significant control issues as they arise. The Chairman of the Audit Committee, who is also a non-Executive Board member, provides the Board with a written report after each Audit Committee meeting.

6.4 The Director Generals and other senior managers have drawn up statements that set out the governance, risk and control arrangements in their business areas. Taking these statements into account, and the views of the Director of Internal Audit and external auditors, I recognise that there are a number of significant control weaknesses. These are detailed below. I am giving priority to the plans that we have put in place to address these weaknesses.

Update on issues raised in 2003-04 Statement

PAYE

6.5 Last year, I reported that a well established housekeeping routine on our PAYE computer databases, which was designed to delete only redundant records, had deleted some records before the usual final review to check whether any tax remains overpaid or underpaid for the relevant year. We needed to carry out further work to establish the full impact, including the number of records affected. The exercise deleted about 1.5 million records per year over a period of 10 years, but most would already have had their final review. These were cases where the customer had left their last known employment some years earlier and were not shown anywhere else on our systems as having restarted. For those who left employment in 2001-02, and all subsequent years, the process was corrected so that cases not reviewed are no longer being deleted. For those who left in 2000-01, the deleted records have been recreated and are being worked in the normal way. For 1998-99 and 1999-2000, it was not possible to recreate the records. We looked very hard at all the options for contacting those affected but as the records had been deleted there were no simple solutions. All the suggested courses of action would have had a high cost with potentially a very low response rate. We therefore received Ministerial approval to take no further action. We estimate that for these two years 638 thousand records were deleted before the final review. For years before 1998-99, our legal advice was that we were time-barred from taking any action. However, before that time, we were clearing around 99 per cent of all cases before they were three years old, so it is likely that, in those earlier years, only a very small number of records would have been deleted without being finally cleared.

Tax Credits

6.6 There have been significant problems with claimant error and fraud in this area. This has seen the Comptroller and Auditor General give a qualified audit opinion on the Department's Trust Statement since 2002-03. Details of this can be found in note 3.5 of the Trust Statement.

6.7 We have recovered considerably from the initial IT systems problems that beset the introduction of new Child and Working Tax Credits and the number of problems caused by system errors is reduced. In addition, I have agreed to make further improvements under a 6-point plan with the Paymaster General. That said, there are some issues to deal with, including:

- Software errors, write-offs and provision for doubtful debts: The significant software errors that caused the early problems in 2003 have largely been resolved. Amounts remitted or written off to date are as disclosed in the Trust Statement (Note 3). Software errors continued to arise in 2004-05, albeit on a smaller scale. The total write-off of £123m also covers remissions resulting from official error, fraudulent encashment of cheques and duplicate payments. In addition, a provision for doubtful debts at 31 March 2005 of £961.4 million has been made (£480.7 million for each of 2003-04 and 2004-05).
- Reconciliation issues: Problems with the IT systems continued to prevent automatic daily reconciliation between payments made and payments authorised. However, all system-generated payment discrepancies arising from this source to 5 April 2005 were adjusted on claimant records by 15 May 2005. A programme is in place to ensure this continues regularly until November 2005 when we will have in place a system that provides for automatic adjustment, on a daily basis.
- Payment via Employer: Although systematic reconciliation from employers' end-of-year tax details to actual amounts authorised for payment to employees has not been achieved, the Department seeks to ensure that the amount paid is correct by selecting a statistically valid sample of employer records and manually reconciling the amounts paid. We have a robust process which is independently monitored by Internal Audit. Fully verified results from the last tax year will not be available until after the Trust Statement is published but assurance is being taken from the previous year's results (i.e. a reconciliation rate of 78.9%). The Department considers this to be reasonable given 2003-04 was the first year for the new Tax Credits for both employers and staff.

6.8 With regard to fraud and claimant compliance, the Department has put in place a variety of operational measures to detect and minimise non-compliance. There are stringent checks on identity to exclude fraudulent cases before payment although the Department is still vulnerable to the attentions of fraudsters who aquire 'stolen identities' to obtain financial gain through fraud. Other system checks based on risk, include the ability to cross check claims within the system and by comparing with Department for Work and Pensions data. We also carry out additional compliance action to intervene and terminate claims, where there is evidence of potential organised fraud. The Department believes that this direct intervention is proving to be a cost effective and appropriate action to protect the Exchequer. While the claimant does not lose any right of appeal against the decision such claims are terminated without prior contact with the claimant. In more than 8,000 cases, we have received only one appeal. By Spring 2006 we will have the results of our first statistically valid sample exercise to enable us to measure the overall level of error and non-compliance across the current tax credits population. The results will enable us to measure the proportion of claimants that are non-compliant, the financial consequences of that non-compliance, as well as the effectiveness of our automated risk process.

National Insurance Fund underpayment

6.9 Last year I reported on an accumulated underpayment to the Great Britain and Northern Ireland National Insurance Funds. During 2004-05 we implemented controls to prevent similar underpayments occurring in the future and in March 2005 we paid over £938 million to the funds to make good the underpayment. This was reported to the Permanent Secretary of HM Treasury.

New issues raised in 2004-05

PAYE

6.10 This year the Department has carried out a number of reviews of PAYE business to ascertain the amount of tax at risk as a result of errors. The reviews found that in 2003-04, over £500 million of underpaid tax is not being identified or collected and that almost £300 million may be due to be refunded to customers. These figures, although significant, do not reflect the full scale of the problem and other areas of PAYE are expected to show similar problems. Key weaknesses include:

- No single PAYE account for an individual and inadequate end of year reconciliation of a customer's PAYE account - this was the major weakness identified, accounting for some 85 per cent of the underpaid tax and more than 90 per cent of the tax estimated to have been over-deducted.
- Poor quality data throughout the system - which means that information from employers cannot be matched with the right tax records, affecting both our ability to collect tax and to provide a quality customer service. This is a major contributory cause of the inadequate reconciliations at the year-end referred to above.
- Self Assessment underpayments not accurately transferred to the PAYE system and therefore the correct amount not collected. Administrative and systems errors in this area accounted for over 10 per cent of the tax underpaid.
- Inability to move work to where operational capacity is best placed to deal with it - because the computer system which supports PAYE is old and inflexible and generates high volumes of paper lists.
- Inadequate information to support managers in making decisions about priorities.
- Failures to identify, educate and/or challenge employers who do not notify us when employments start or end and do not operate the tax code numbers which we send them.

6.11 While we are seeking to minimise further losses and reduce the instances of overpayments not refunded to taxpayers, this will take some time. We cannot address all the recommendations in the reviews at once, but have set up a Steering Group to prioritise them and ensure changes are implemented that improve performance. As I have already reported in paragraph 5.3, we have set up a Data Quality Executive to tackle directly the issue of poor quality data. In addition, we are working with our IT partners to scope improvements, but the computer changes needed to the systems which support PAYE are complex and costly, so the benefits are unlikely to be seen for some years.

Class 2 National Insurance 'debt' balances

6.12 Class 2 National Insurance (C2N) is a flat-rate contribution (currently £2.10 per week) paid by the self-employed. When we are notified that a person is self-employed, we assume that they continue to be liable for C2N until we are told otherwise. Inevitably, some of the debt balance on our system will be false - for example, where a contributor has ceased self-employment, but failed to notify us.

6.13 As a result of a combination of factors, the level of the C2N debt balance has continued to rise over a number of years, and £616 million of it was over six years old as at 6 April 2005 and therefore time-barred. A cross-departmental working group was set up in February 2005 to gain an understanding of the end-to-end C2N process - which included establishing what percentage of total balances represents true debt. In June 2005, the departmental Operating Committee agreed the following actions:

- Within the time-barred irrecoverable balance of £616 million, the level of true debt is estimated as £333 million, which has been formally written off. The remainder of the balance, which is not debt, has been written out of the accounts.
- We will pursue as a priority, subject to action being cost effective, those balances, estimated as £71million, which will become time-barred and irrecoverable after 6 April 2006.
- We will look at options for reviewing the C2N policy and processes.
- A director-level group will oversee all actions and report regularly to the Operating Committee.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Resource Accounts

Consolidated Resource Accounts for the year ended 31 March 2005

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Annual Report to the Resource Accounts

Scope

Following the Chancellor's announcement in his March 2004 budget speech, legislation received Royal Assent on 7 April 2005 bringing into existence a new department, HM Revenue and Customs. This became a legal entity on 18 April 2005, incorporating the Inland Revenue and HM Customs and Excise. These Resource Accounts report on the final financial year of the Inland Revenue and include expenditure and income relating to the core Department and the Valuation Office Agency (VOA).

The Inland Revenue has a close relationship with the Department for Work and Pensions (DWP) and its counterpart in Northern Ireland, the Department of Social Development (DSD), as they are responsible for the payment of benefits based on National Insurance Contributions. Administrative expenditure relating to the collection of National Insurance Contributions is included in the Operating Cost Statement while associated income recovered from the National Insurance Funds is included as Appropriations in Aid (A in A). Receipts and payments of direct taxes and National Insurance Contributions and payments of tax credits are accounted for in the Trust Statement which is on pages 58-92 of this publication.

RN Ltd, a Nominee Company registered in 1933, was set up to hold taxpayers' assets as security for outstanding taxes and liabilities. These assets do not belong to the Department and are not included in these Resource Accounts.

The Department produces regular reports on its performance. In addition to the Annual Report, performance updates are given in Spring and Autumn Performance Reports. A single Spring report covering HMRC was published on 16 June 2005 (Cm 6542). A single HMRC Annual Report, covering the 2004-05 performance for the two former departments, will be published in Autumn 2005. The departmental reports are available from The Stationery Office and the HMRC website (www.hmrc.gov.uk). Details of the Valuation Office Agency's objectives and performance can be found in its Annual Report and Accounts, which is available from The Stationery Office and the VOA website (www.voa.gov.uk).

Operating and Financial Review

The Department's Aim and Objective for 2004-05 was:

Aim

To administer the tax system fairly and efficiently and make it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credits and other entitlements.

Objective

To collect the right revenue and give the right entitlements, at the right time. This Objective can be subdivided into five activities as described in Schedule 5 of this account.

The Inland Revenue's performance is assessed through its Public Service Agreement (PSA), Service Delivery Agreement (SDA) and other work targets.

The Department's PSA for the period 2003-2006 (set out in the Spending Review (SR) 2002) contained five key targets. Full details of performance against those targets are reported in the Board's Annual Report.

Events in 2004-05

From 1 April 2003 the Inland Revenue started to pay New Tax Credits (the Child Tax Credit and Working Tax Credit) to families with children and individuals in work under certain circumstances. The administration costs have been accounted for in the Department's Resource Accounts. Payment of tax credits have been accounted for in the Trust Statement.

The Chancellor announced his intention to introduce the Child Trust Fund (CTF) in the April 2003 Budget. The CTF is a savings and investment account for children and was available from April 2005 for eligible children born on or after 1 September 2002. A child is eligible for a CTF account if Child Benefit has been awarded to them or they are in care, and they are living in the UK. A total liability at 31 March 2005 of £637m has been included in this Resource Account, to recognise payments that will become due, in respect of births between 1 September 2002 and 31 March 2005. This has been split as £406.7m as a creditor becoming due in less than one year and £230.7m as a provision for future related costs.

Following a review of Departmental capacity, plans for the Modernising PAYE Processes for Customers (MPPC) programme (including implementation of the recommendations in Patrick Carter's Review of Payroll Services) were deferred. The Carter proposals were implemented as part of new End of Year processes in April to June 2005. The remaining PAYE regime improvements to be delivered by MPPC are now expected to be delivered during 2007, which will improve Departmental efficiency.

The commercial competition to replace our IT contracts with EDS and Accenture resulted in selection, in December 2003, of Capgemini UK PLC, (trading as "Capgemini", formerly known as Cap Gemini Ernst & Young UK Ltd.), as the Department's new IT partner with effect from July 2004. The new contract aims to facilitate business change to deliver our strategic objectives, and to deliver high standards of IT infrastructure. Under the new contract, the Department will account for charges for computer hardware used by Capgemini as operating costs, whereas under the Department's former contract with EDS the computer hardware to which corresponding charges related were provided under a finance lease and accounted for as capital assets. The effect of this change will be to reduce capital expenditure during project development, with the costs of hardware being included within IT operating costs. The assets owned by the Department used to provide this service were transferred to Capgemini in accordance with the contract. The accounting treatment is explained in note 13.

The joint Private Finance Initiative (PFI) with HM Customs & Excise to relocate a substantial part of our Head Office function to 100 Parliament Street, London, was completed in October 2004. This is in addition to the existing PFI accommodation contracts. The accounting treatment is explained in note 13.

In line with a recommendation made in Gus O'Donnell's review report, tax policy functions were transferred to HM Treasury to improve the ability of the Government to respond to modern tax challenges and create a greater delivery focus in the new department. Comparative expenditure figures for 2003-04 have been restated as explained in note 2 to this account.

Total resources consumed for the year were £12,726.7m, £357.4m (2.7per cent) below the amount authorised by Parliament. This underspend was mainly split between the administration of the core Department (£65.0m) and Child Benefit and Child Trust Fund (£264.2m).

There is one main event affecting future accounting periods:

In March 2004, the Government accepted in full the recommendations of the review of the Revenue Departments, led by Permanent Secretary to the Treasury, Gus O'Donnell. The key recommendation of the review was the creation of a new Department, integrating HM Customs and Excise and the Inland Revenue, tasked with improving customer services, particularly reducing compliance costs, improving compliance with tax law, and increasing efficiency. David Varney was appointed chairman of this new department with Paul Gray as his deputy. Further information is given on page 9 of the Board's Annual Report for 2003-04.

The HM Revenue and Customs website (www.hmrc.gov.uk) includes the published Investment Strategy.

Management

During 2004-05, the Chairman of the Board of Inland Revenue was accountable to the Chancellor of the Exchequer for the administration of its affairs and the implementation and stewardship of tax policy. The Chancellor was supported by the Paymaster General, who was the Departmental Minister with day-to-day responsibility for the Inland Revenue.

During the year, the executive members comprising the Statutory Board of the Inland Revenue were:

		(Period if not full year)
David Varney	Chairman	from 1 September 2004
Paul Gray CB	Deputy Chairman	from 1 September 2004
Ann Chant CB	Acting Chairman Director General	from 1 April to 31 August 2004 from 1 September 2004
Dave Hartnett CB	Director General	
Helen Ghosh	Director General	
Steve Heminsley	Acting Director General	
Steve Lamey	Chief Information Officer	from 18 October 2004

The following non-executive Board members, together with the Statutory Board members, formed the Departmental Board.

David Park	Acting Chief Executive Valuation Office Agency	from 1 April to 6 June 2004
Andrew Hudson	Chief Executive Valuation Office Agency	from 7 June 2004
Pat Stafford	Non-executive Board member	
Rene Carayol	Non-executive Board member	to 2 July 2004
Kate Owen	Non-executive Board member	
Bill Griffiths	Non-executive Board member	from 17 November 2004

The Chairman of the Board of Inland Revenue and other members of the Board were appointed in accordance with the procedures in the Civil Service Management Code.

The remuneration of the executive members of the Statutory Board (see note 3.3 to these Resource Accounts) was determined in accordance with the report of the Senior Salaries Review Body.

Public interest and other

- Pensions

  Present and past employees are covered by the provisions of the Principal Civil Service Pensions Scheme (PCSPS), which is non-contributory and non-funded.

- Policy on employment of disabled persons

  The Department's policy on the employment of disabled persons is included in the Department's general approach to diversity. Diversity is an essential element of how we serve our customers, and recruit and retain our staff. We continue to embed diversity into our business processes by establishing diversity aims and objectives within the Departmental planning process, to demonstrate the links between our business processes and diversity actions.

- Policy on diversity and equal opportunities

  The Department's policy on diversity and equality is to:

  - ensure that we recruit and retain the very best people from the widest possible pool;
  - value our people as individuals and the differences between them;
  - harness those differences to improve our business performance to provide the best possible service for all our different customers; and
  - promote diversity and equality in a proactive way, consistent with our business performance standards.

- Policy on payment of suppliers

  Where there is no contractual provision or other understanding or accepted practice governing the timing of payment, the Department will pay within 30 days of receipt of goods or services or on the presentation of a valid invoice or similar demand for payment, whichever is the later. During 2004-05 98.86 per cent (2003-04: 99.07 per cent) of suppliers were paid within 30 days of inputting receipt on the purchasing system. Interest charges amounting to £3,168 for 20 invoices (2003-04: £2,516 for 30 invoices) were paid in respect of late payment of commercial debts.

- Auditors

  The Comptroller and Auditor General audits these Resource Accounts in accordance with section 6 of the Government Resources and Accounts Act 2000. The notional charge for these audit services as disclosed in these accounts is £0.3m (2003-04: £0.3m). In addition the Comptroller and Auditor General audits the Trust Statement and it has been agreed that it is also appropriate to reflect the cost of this audit in these Resource Accounts. For 2004-05 the cost of the audit of the Trust Statement amounted to £0.2m. As a result the total audit fee reported in these Resource Accounts is £0.5m.

- Provision of information to and consultation with employees

  The Department is committed to maintaining good relations with its staff. Consultation with trade unions provides an appropriate focus for this and ensures that staff interests are properly taken into account when decisions are taken.

The Department makes comprehensive use of an intranet system which can be accessed by all staff to provide information concerning all aspects of work and developments. In recent months the use of a Direct Dial message system has been made available to all staff so that they can hear recorded interviews from senior managers. This includes interviews from the new Chairman David Varney, his deputy Paul Gray and other Board members.

- Details of Company directorships and other significant interests held by members of the Board

  No directorships or other significant interests were held by members of the Board which may have conflicted with their management responsibilities.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, the Department is required to prepare Resource Accounts for each financial year, in conformity with a Treasury direction (see page 85 of this publication), detailing the resources acquired, held, or disposed of during the year and the use of resources by the Department during the year.

The Resource Accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Department, the net resource outturn, resources applied to objectives, recognised gains and losses and cashflows for the financial year.

HM Treasury has appointed the Permanent Head of Department as Principal Accounting Officer of the Department with overall responsibility for preparing the Department's accounts and for transmitting them to the Comptroller and Auditor General.

In preparing the accounts, the Principal Accounting Officer is required to comply with the *Resource Accounting Manual* prepared by HM Treasury, and in particular to:

- observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates on a reasonable basis;
- state whether applicable accounting standards, as set out in the *Resource Accounting Manual*, have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going concern basis.

In addition, HM Treasury has appointed Additional Accounting Officers to be accountable for those parts of the Department's accounts relating to specified requests for resources and the associated assets, liabilities and cashflows. These appointments do not detract from the Head of Department's overall responsibility as Accounting Officer for the Department's accounts.

The allocation of Accounting Officer responsibilities in the Department is as follows:

For the period 1 April 2004 to 31 August 2004 the Principal Accounting Officer was Ann Chant CB. She was supported by the following Additional Accounting Officers:

David Park (from 1 April 2004 to 6 June 2004) and Andrew Hudson (from 7 June 2004) in respect of
Request for Resources 2:
Administration costs incurred by the Valuation Office Agency, etc.
Request for Resources 4:
Payment of rates to local authorities in respect of premises occupied by foreign and Commonwealth government, etc.

On 1 September 2004 David Varney became Principal Accounting Officer, following his appointment as Executive Chairman of the Inland Revenue. At the same time, the following Additional Accounting Officers were appointed:

Paul Gray CB, in respect of
Request for Resources 1:
Administration costs incurred by the Inland Revenue in the management and collection of the direct taxes, tax credits, etc.
Request for Resources 5:
Payments of Child Benefit, Child Trust Fund endowments and associated non-cash items.

Dave Hartnett CB, in respect of
Request for Resources 3:
Expenditure by Inland Revenue on transitional payments to charities previously entitled to receive tax credits on dividends.

Andrew Hudson continues to have responsibility for
Request for Resources 2:
Administration costs incurred by the Valuation Office Agency, etc.
Request for Resources 4:
Payment of rates to local authorities in respect of premises occupied by foreign and Commonwealth government, etc.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which an Accounting Officer is answerable, for keeping proper records and for safeguarding the Department's assets, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in *Government Accounting*. Under the terms of the Accounting Officers' Memorandum, the relationship between the Department's Principal and Additional Accounting Officers, together with their respective responsibilities, is set out in writing.

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Resource Accounts and the Trust Statement, is shown on pages 1 to 7.

The Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the financial statements on pages 18 to 55 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention as modified by the revaluation of certain fixed assets and the accounting policies set out on pages 25 to 29.

Respective responsibilities of the Accounting Officer and Auditor

As described on pages 13 to 14, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the ethical guidance applicable to the auditing profession.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder, and whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report if, in my opinion, the Annual Report is not consistent with the financial statements, if the Department has not kept proper accounting records, or if I have not received all the information and explanations I require for my audit.

I read the other information contained in the Accounts, and consider whether it is consistent with the audited financial statements. I consider the implications for my certificate if I become aware of any apparent misstatements or material inconsistencies with the financial statements.

I review whether the statement on pages 1 to 7 reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of audit opinion

I conducted my audit in accordance with United Kingdom Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Department in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. In forming my opinion I have also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Inland Revenue at 31 March 2005 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by Treasury; and
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

JOHN BOURN
Comptroller and Auditor General
7 October 2005

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

The maintenance and integrity of the HM Revenue and Customs' website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Schedule 1 Summary of Resource Outturn 2004-05 (£millions)

		2004-05							2003-04
				Estimate			Outturn		
		Gross expenditure	A in A	NET TOTAL	Gross expenditure	A in A	NET TOTAL	Net total outturn compared with estimate: saving/ (excess)	Restated Prior year Outturn*
RfR 1:	Administration	3,248.5	(402.5)	2,846.0	3,183.5	(402.5)	2,781.0	65.0	2,558.2
RfR 2:	Valuation Office Agency	205.8	(205.8)	-	198.4	(198.4)	-	-	-
RfR 3:	Payments in lieu of Tax Relief	119.0	-	119.0	93.4	-	93.4	25.6	162.6
RfR 4:	Payments of Local Authority Rates	38.5	(4.2)	34.3	35.6	(3.9)	31.7	2.6	31.0
RfR 5:	Child Benefit and Child Trust Fund	10,084.8	-	10,084.8	9,820.6	-	9,820.6	264.2	9,836.4
Total Resources		**13,696.6**	**(612.5)**	**13,084.1**	**13,331.5**	**(604.8)**	**12,726.7**	**357.4**	**12,588.2**
Non Operating Cost A in A (see note 7)		**-**	**-**	**73.7**	**-**	**-**	**58.9**	**14.8**	**1.8**
Net Cash Requirement (Schedule 4)		**-**	**-**	**12,621.8**	**-**	**-**	**12,386.3**	**235.5**	**12,284.9**

Reconciliation of Resources to Cash Requirement (£millions)

	Note	Estimate	Outturn	Net total outturn compared with estimate: saving/ (excess)
Net total resources		**13,084.1**	**12,726.7**	**357.4**
Capital :				
Acquisition of fixed assets	12, 13, 14	388.1	314.4	73.7
Investments	15	-	-	-
Non operating A in A:				
Proceeds of fixed asset disposals	12	(73.7)	(58.9)	(14.8)
Accruals adjustments:				
Non cash items	4a, 5	(713.2)	(285.8)	(427.4)
Changes in working capital other than cash	16	(68.8)	(519.0)	450.2
Changes in creditors falling due after more than one year[1]	20	-	(97.8)	97.8
Use of provisions	21	5.3	306.7	(301.4)
Net Cash Requirement (Schedule 4)		**12,621.8**	**12,386.3**	**235.5**

[1] *The capital repayment of finance leased assets is represented by assets acquired under finance leases in the year.*

The movement in creditors over one year in Schedule 1 is represented by the net value of both the capital repayment of finance leased assets and changes in creditors.

* *Certain prior year figures have been restated as per note 2. The Net Cash Requirement of £12,284.9m in 2003-04 is shown net of the transfer of £5.8m to HM Treasury in respect of the transfer of policy function (see Schedule 4).*

The notes on pages 25 to 55 form part of these accounts.

Summary of income payable to the Consolidated Fund (£millions)

In addition to Appropriations in Aid, the following income relates to the Department and is payable to the Consolidated Fund (cash receipts being shown in italics and figures in £millions)

		Forecast 2004-05		Outturn 2004-05	
		Income	Receipts	Income	Receipts
	Note				
Total	6	(60.0)	*(60.0)*	(113.9)	*(113.9)*

Explanation of the variation between Estimate and Outturn (net total resources):

Resource expenditure for the year was £357.4m below the amount authorised by Parliament, mostly relating to programme expenditure being lower than expected and also to underspends on central initiatives and projects.

Request for Resource (RfR) 3, Payments in lieu of Tax Relief, expenditure was £25.6m (21.5%) below the amount authorised. Stakeholder pension expenditure on this RfR is calculated by the Department using a statistical model, based upon information from the Family Resources Survey. This was reviewed and adjusted in late March 2005 reducing expenditure by £24.0m.

Explanation of the variation between Estimate net cash and requirement and Outturn (net cash requirement):

The net cash requirement was £235.5m less than estimated. Variances are explained as follows:

- Acquisition of fixed assets. The "cash purchase" and "finance lease" expenditure combined provides a net saving of £73.7m. This primarily arose due to a delay in work on major IT projects and the re-prioritisation of work leading to the new HMRC department.
- Proceeds of fixed asset disposals were £14.8m lower than estimate. It was necessary to adjust the estimate in the Spring Supplementary Estimate for the transfer of 100 Parliament Street from HM Treasury. The value of the land (£12.0m) was incorrectly included in the Department's estimate of proceeds from disposal instead of the HM Treasury estimate.
- Non-cash items. A variance of £427.4m is reported for this category. The 2004-05 estimate included an expected provision of £399.9m for a liability relating to the Child Trust Fund (CTF). It was appropriate that this provision was actually made when the 2003-04 account was being prepared, however the estimate cover remained in the 2004-05 estimate. As a result £399.9m of this underspend relates to the recognition of the CTF provision a year earlier than expected, when the 2004-05 estimate was prepared.
- Changes in working capital other than cash. A variance of £450.2m is reported for this category. £287.6m arose from the movement of the Child Trust Fund from a provision to a creditor balance, this movement had not been recognised in the estimate but had a net nil affect on the overall cash requirement. A further £97.8m is explained by the movement in creditors of more than one year which were not separately identified in the estimate but were included in this category.
- Changes in creditors falling due after more than one year. A variance of £97.8m is reported for this category as no separate estimate was requested (see changes in working capital above).
- Use of provisions. A variance of £301.4m is reported for this category. £287.6m was caused by the transfer of the Child Trust Fund provision to creditors of less than one year (see changes in working capital above).

Prior-period adjustments:

- There were no prior-period adjustments.

Schedule 2 Operating Cost Statement for the year ended 31 March 2005 (£millions)

	Note	2004-05		Restated* 2003-04	
Administration costs:					
Request for resources 1 & 2 -					
Staff costs	3	1,951.2		1,865.9	
Exceptional item - building revaluation[1]	13	61.5		-	
Non-staff administration costs	4	1,338.4		1,274.5	
Gross administration costs		**3,351.1**		**3,140.4**	
Operating income	7	(619.6)		(599.8)	
Net administration costs			**2,731.5**		**2,540.6**
Programme costs					
Request for resources 5 -					
Child Benefit and Child Trust Fund:					
Expenditure	5	9,822.2		9,838.2	
Less: Income		-		-	
		9,822.2		**9,838.2**	
Request for resources 3 -					
Payments in lieu of Tax Reliefs:					
Expenditure	5	93.4		162.6	
Less: Income	7	-		-	
		93.4		**162.6**	
Request for resources 4 -					
Payments of Local Authority Rates:					
Expenditure	5	35.6		34.0	
Less: Income	7	(3.9)		(3.0)	
		31.7		**31.0**	
Request for resources 1 -					
Efficiency Challenge Fund					
Staff costs	3, 5	5.3		-	
Non-staff administration costs	5	8.8		-	
Less: Income	7	-		-	
		14.1		-	
Net programme costs	5		**9,961.4**		**10,031.8**
Net operating cost	9		**12,692.9**		**12,572.4**
Net resource outturn	9		**12,726.7**		**12,588.2**

[1] This exceptional expense relates to the revaluation of the asset 100 Parliament Street, see note 13.
** Certain prior year figures have been restated as per note 2.*
All income and expenditure are derived from continuing operations.

Statement of Recognised Gains and Losses for the year ended 31 March 2005 (£millions)

	2004-05	2003-04
Net gain on revaluation of tangible fixed assets	39.1	34.9
Total recognised gains and losses for the financial year	**39.1**	**34.9**

The notes on pages 25 to 55 form part of these accounts.

Schedule 3 Balance Sheet as at 31 March 2005 (£millions)

	Note	31 March 2005		31 March 2004	
Fixed assets:					
Tangible assets	13	641.4		555.5	
Intangible assets	14	10.7		-	
			652.1		**555.5**
Debtors falling due after more than one year	18		**178.5**		**136.4**
Current assets:					
Stocks and work in progress	17	2.8		2.8	
Debtors	18	155.2		207.2	
Cash at bank and in hand	19	66.7		74.6	
		224.7		284.6	
Creditors (amounts falling due within one year)	20	(910.5)		(458.2)	
Net Current Liabilities			**(685.8)**		**(173.6)**
Total assets less current liabilities			**144.8**		**518.3**
Creditors (amounts falling due after more than one year)	20	(97.8)		-	
Provisions for liabilities and charges	21	(289.6)		(461.0)	
			(387.4)		**(461.0)**
			(242.6)		**57.3**
Taxpayers' equity:					
General fund	22		(322.2)		16.6
Revaluation reserve	23		79.6		40.7
			(242.6)		**57.3**

DAVID VARNEY
Principal Accounting Officer
5 October 2005

The notes on pages 25 to 55 form part of these accounts.

Schedule 4 Cash Flow Statement for the year ended 31 March 2005 (£millions)

	2004-05	Restated* 2003-04
Net cash outflow from operating activities (Note a)	(12,194.8)	(12,088.1)
Capital expenditure and financial investment (Note b)	(152.3)	(121.0)
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities	78.5	66.2
Payments of amounts due to the Consolidated Fund	(108.5)	(102.2)
Financing from the Consolidated Fund (Note c)	12,367.6	12,158.8
Financing from the National Insurance Fund (Note c)	1.6	1.8
Increase/(decrease) in cash in the period	(7.9)	(84.5)

Notes:

a See the table below giving a reconciliation of operating cost to operating cash flows.

b See the table below giving an analysis of capital expenditure and financial investment.

c See the table below giving an analysis of financing and reconciliation to the net cash requirement.

* Certain prior year figures have been restated as per note 2.

a) Reconciliation of operating cost to operating cash flows

	Note	2004-05	Restated* 2003-04
Net operating cost (Schedule 2)		12,692.9	12,572.4
Less interest on finance leased assets		-	-
Adjustments for non-cash transactions	4a	(285.8)	(566.1)
Adjustments for movements in working capital other than cash	16	(519.0)	65.8
Use of provisions	21	306.7	16.0
Net cash outflow from operating activities		**12,194.8**	**12,088.1**

b) Analysis of capital expenditure and financial investment

	2004-05	2003-04
Tangible fixed asset additions	300.4	176.8
Intangible fixed asset additions	14.0	-
Finance lease acquisitions	(103.2)	(54.0)
Proceeds of disposal of fixed assets	(58.9)	(1.8)
Interest element of finance lease	-	-
Net cash outflow from investing activities	**152.3**	**121.0**

Schedule 4 Cash Flow Statement for the year ended 31 March 2005 (£millions) (continued)

c) Analysis of financing and reconciliation to the net cash requirement

	2004-05	Restated* 2003-04
From the Consolidated Fund (Supply) - current year[1]	12,373.9	12,218.8
To the Consolidated Fund (Supply) - prior year	(0.9)	-
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts	(5.4)	(54.2)
Transfer to HM Treasury in respect of transferred function	-	(5.8)
	12,367.6	12,158.8
Financing from the National Insurance Fund	1.6	1.8
Net financing	**12,369.2**	**12,160.6**
Decrease in cash (see note 19)	**7.9**	**84.5**
Net cash flows other than financing	**12,377.1**	**12,245.1**
Adjustments for payments and receipts not related to Supply:		
Amounts due to the Consolidated Fund - received in a prior year and paid over	(24.4)	(42.8)
Amounts due to the Consolidated Fund - received and not paid over	29.8	24.4
Financing from the National Insurance Fund	(1.6)	(1.8)
Supply-financed repayments of financing		
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts	5.4	54.2
Transfer to HM Treasury from Inland Revenue in respect of transferred function	-	5.8
Net cash requirement (Schedule 1)	12,386.3	12,284.9

** Certain prior year figures have been restated as per note 2.*

Notes

[1] Amount of grant actually issued to support the net cash requirement = £12,373,930,168

Schedule 5 Resources by Departmental Aim and Objective for the year ended 31 March 2005 (£millions)

			2004-05			Restated* 2003-04
	Gross	**Income**	**Net**	**Gross**	**Income**	**Net**
Aim: To administer the tax system fairly and efficiently and make it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credit and other entitlements.						
Objective: To collect the right revenue and give the right entitlements, at the right time. We have subdivided this objective into the following:						
RfR 1 - Administration in the management and collection of the direct taxes, tax credits, National Insurance Contributions, Child Benefit and Child Trust Fund, Administration of the National Insurance Funds for Great Britain and Northern Ireland, for services provided to the Department's information technology and wider markets' partners, for other departments and public bodies, and for overseas tax administration.	3,122.0	(431.9)	2,690.1	2,970.8	(424.4)	2,546.4
	61.5	-	61.5[1]	-	-	-
RfR 2 - Administration in the provision of valuation and other services for government departments and other public bodies by the Valuation Office Agency.	198.4	(204.4)	(6.0)	187.0	(191.2)	(4.2)
RfR 3 - Transitional payments to charities, supplements on payroll giving, donations to charities and on personal and stakeholder pension schemes, life assurance premium relief, stamp duty relief and residual payments for mortgage interest relief, vocational training relief and private medical insurance.	93.4	-	93.4	162.6	-	162.6
RfR 4 - Rates paid by the Inland Revenue Department in respect of non-domestic property occupied by accredited representatives of Commonwealth and foreign countries and certain international organisations, contributions in lieu of rates in respect of properties occupied by the Crown in Gibraltar and other similar payments.	35.6	(3.9)	31.7	34.8	(3.6)	31.2
RfR 5 - Payments of Child Benefit, Child Trust Funds and the associated items.	9,822.2	-	9,822.2	9,836.4	-	9,836.4
Intra departmental consolidation adjustment	(16.7)	16.7	-	(16.4)	16.4	-
Net Operating Costs (Schedule 2)	**13,316.4**	**(623.5)**	**12,692.9**	**13,175.2**	**(602.8)**	**12,572.4**

[1] *This exceptional expense relates to the revaluation of the asset 100 Parliament Street, see note 13.*

* *The Department's sub-division of it's objective has been realigned with its Request for Resources (RfR), and therefore it has been necessary to amend prior year figures where relevant.*

In addition certain prior year figures have been restated as per note 2.
The intra departmental consolidation adjustment is in respect of transactions between the Department and the Valuation Office Agency.

See note 24 - Notes to Schedule 5.

The notes on pages 25 to 55 form part of these accounts.

Notes to the Departmental Resource Accounts

1. Statement of Accounting Policies

The financial statements have been prepared in accordance with the 2004-05 *Resource Accounting Manual (RAM)* issued by HM Treasury. The accounting policies contained in the *RAM* follow UK Generally Accepted Accounting Practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector. Where the *RAM* permits a choice of accounting policy, the accounting policy judged to be most appropriate to the particular circumstances of the Department for the purpose of giving a true and fair view has been selected. The Department's accounting policies have been applied consistently in dealing with items considered material in relation to the accounts.

1.1 Accounting Convention

These accounts have been prepared under the historical cost convention modified to account for the revaluation of fixed assets, and stocks where material, at their value to the business by reference to their current costs.

1.2 Basis of Consolidation

These accounts comprise a consolidation of the core Department and the Valuation Office Agency, which fall within the Departmental boundary as defined in the *Resource Accounting Manual (RAM)* (Section 1.5) issued by HM Treasury. Transactions between entities included in the consolidation are eliminated.

A list of all those entities within the Departmental boundary is given in note 34.

1.3 Tangible Fixed Assets

1.3.1 General

With the exceptions stated below concerning furniture utilised by the core Department, tangible fixed assets are stated at the lower of replacement cost and recoverable amount. Expenditure on tangible fixed assets of over £1,000 is capitalised. On initial recognition they are measured at cost including any costs such as installation directly attributable to bringing them into working condition. Appropriate indices are applied to each class of asset shown in note 1.4 for all assets, except intangible fixed assets, which have not been formally valued during the year.

1.3.2 Property Assets

Property assets were transferred from the Inland Revenue to Mapeley STEPS Ltd., in March 2001, under a twenty-year Private Finance Initiative (PFI) contract. Note 13 reports the property asset 100 Parliament Street and costs of refurbishing some properties not owned by the Department, that have been treated as capital expenditure.

1.3.3 Furniture

For the core Department, the value and depreciation of furniture are estimated on the basis of the average number of staff accommodated, the average current furniture costs for each employee and the useful economic life ascribed to furniture assets. Actual furniture costs each year are expensed. This methodology provides a reasonable approximation of the actual values and depreciation that would have been available had the Department maintained detailed records for the individual items of furniture, which individually are of relatively low value, but collectively are material to these accounts. Adopting this capitation estimating method avoids the Department having to incur significant costs in maintaining and validating detailed records.

1.3.4 Computer Software

National tax system computer software, including new Tax Credit software, that has been developed by the Department and its computer service partner, and for which the Department has ownership rights e.g. the corporate tax collecting software, has been capitalised. This capitalisation includes the cost of staff and mainframe resources used in the development of the programs. Upon abolition of a tax we will conduct an impairment review of the asset(s) and adjust the value accordingly.

1.4 Depreciation

Tangible fixed assets are depreciated at rates calculated to write them down to estimated residual values on a straight-line basis over their estimated useful lives. Asset lives are normally in the following ranges:

Fixed Asset Category		**Depreciation Period**
EDS held computer equipment	until 31 March 2003 from 1 April 2004*	5 years (desktop) and 7 years (mainframe) remaining period of lease
Freehold buildings		50 years
Building refurbishments		period of the lease
Office equipment and furniture		10 years
Desktop computer equipment		3 years
Other computer equipment		5 years
Vehicles		3 to 7 years
Computer software		Remaining economic life not greater than 10 years
Intangible assets (3rd party software licences)		Remaining period of the licence

* *Where a decision is taken to dispose of an asset prior to the end of its previously planned remaining useful economic life, and all other factors remain unchanged, the useful economic life has been revised to reflect the remaining period of service and the residual value adjusted to the expected disposal proceeds, less costs.*

1.5 Intangible Fixed Assets

Initial one-off purchased computer software licences are capitalised as intangible fixed assets where expenditure of £1,000 or more is incurred. Except where reliable evidence of current value cannot be readily ascertained, these are restated to current value each year. Software licences are amortised over the shorter of the term of the licence and the useful economic life. Ongoing software licence fees payable at regular intervals are treated as period rentals and charged to the Operating Cost Statement.

1.6 Stocks and Work in Progress

Stocks and work in progress are valued as follows:

Stock purchases are accounted for as administration expenditure.

Work in progress relates to the Valuation Office Agency only and is an accounting estimate determined by applying the lower of selling price or an outturn unit cost for each type of work to the number of outstanding cases at year-end.

1.7 Operating Income

Operating income is income which relates directly to the operating activities of the Department. It principally comprises fees and charges to other government departments, agencies and other non-departmental public bodies for services provided on a full-cost basis to external customers. It includes not only income appropriated in aid of the Estimate but also income to the Consolidated Fund, which in accordance with the *RAM* is treated as operating income. Operating income is stated net of VAT.

1.8 Administration and Programme Expenditure

The Operating Cost Statement is analysed between administration and programme costs. Administration costs reflect the costs of running the Department. These include both administrative costs and associated operating income. Income is analysed in the notes between that which, under the administrative cost-contol regime, is allowed to be offset against gross administrative costs in determining the outturn against the administration cost limit, and that operating income which is not. Programme costs reflect non-administration costs, including payments of grants and other disbursements by the Department, as well as certain staff costs where they relate directly to service delivery. The classification of expenditure and income as administrative or as programme follows the definition of administration costs set by HM Treasury.

1.9 Cash at bank and in hand

These are balances in respect of administering the Department only and exclude all tax and duty revenues collected. The latter are included in the Department's Trust Statement.

1.10 Capital Charge

A charge, reflecting the cost of capital utilised by the Department, is included in operating costs. The charge is calculated at the real rate set by HM Treasury (currently 3.5 per cent) on the average carrying amount of all assets less liabilities, except for cash balances with the Office of the Paymaster General and cash balances payable to the Consolidated Fund, where the charge is nil.

1.11 Foreign Exchange

Transactions which are denominated in a foreign currency are translated into sterling at the rate of exchange ruling on the date of each transaction. These translation differences are dealt with in the Operating Cost Statement.

1.12 Pensions

Past and present employees are covered by the provisions of the Principal Civil Service Pension Scheme (PCSPS) which are described in note 3. The defined benefit schemes are unfunded and are non-contributory except in respect of dependants' benefits. The Department recognises the expected cost of these elements on a systematic and rational basis over the period during which it benefits from employees' services by payment to the PCSPS of amounts calculated on an accruing basis. Liability for payment of future benefits is a charge on the PCSPS. In respect of the defined contribution schemes, the Department recognises the contributions payable for the year.

1.13 Leases

Where substantially all risks and rewards of ownership of a leased asset are borne by the Department, the asset is recorded as a tangible fixed asset and a debt is recorded to the lessor of the minimum lease payments discounted by the interest rate implicit in the lease. The interest element of the finance lease payment is charged to the Operating Cost Statement over the period of the lease at a constant rate in relation to the balance outstanding. Other leases are regarded as operating leases and the rentals are charged to the Operating Cost Statement on a straight-line basis over the term of the lease.

1.14 Private Finance Initiative (PFI) Transactions

PFI transactions have been accounted for in accordance with Technical Note No. 1 (Revised), entitled *How to Account for PFI Transactions* as required by the *RAM*. Where the balance of risks and rewards of ownership of the PFI property are borne by the PFI operator, the PFI payments are recorded as an operating cost. Where the Department has contributed assets, a prepayment for their fair value is recognised and amortised over the life of the PFI contract.

Where the balance of risks and rewards of ownership of the PFI property is borne by the Department, the property is recognised as a fixed asset and the liability to pay for it is accounted for as a finance lease. Contract payments are apportioned between an imputed finance lease charge and a service charge.

1.15 Provisions

The Department provides for legal or constructive obligations which are of uncertain timing or amount at the balance sheet date on the basis of the best estimate of the expenditure required to settle the obligation. Where the effect of the time value of money is significant, the estimated risk-adjusted cash flows are discounted using the real rate set by HM Treasury (currently 3.5 per cent).

1.16 Early Departure Costs

The Department is required to meet the additional cost of benefits beyond the normal PCSPS benefits in respect of employees who retire early. The Department provides in full for this cost when the early retirement programme has been announced and is binding on the Department. The Department has, in certain circumstances, settled some or all of its liability in advance by making a payment to the Paymaster General's account at the Bank of England for credit of the Civil Service Superannuation Vote.

1.17 Provision for Doubtful Debt

A general provision for doubtful debts has been made in respect of legal costs that have been awarded to the Department. These costs arise as a result of legal proceedings against taxpayers for the recovery of outstanding tax liabilities. A general provision is made in respect of penalty debtors (note 1.19) to allow for penalties which are expected to be remitted and in respect of Child Benefit debtors to allow for potentially uncollectable amounts. These provisions have been estimated having regard to the level of debts not recovered during 2004-05.

1.18 Valued Added Tax

Most of the activities of the Department are outside the scope of VAT and, in general output tax does not apply and input tax on purchases is not recoverable. Irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of fixed assets. Where output tax is charged or input VAT is recoverable, the amounts are stated net of VAT.

1.19 Penalty Debtors

HM Treasury has directed that income arising from the levying of tax penalties should be matched against the expenditure incurred in determining and collecting those debts. The penalties covered by HM Treasury directive exclude those where the Department and the taxpayer have agreed a tax settlement without recourse to the Commissioners and those arising from National Insurance Contributions. The income generated from penalties is classified either as Appropriations in Aid, where there is a significant administrative cost, or Consolidated Fund Extra Receipts (CFER), where the penalty is levied automatically, such as Self Assessment late filing.

1.20 Child Benefit

Responsibility for the payment of Child Benefit transferred from the Department for Work and Pensions to the Inland Revenue with effect from 1 April 2003.

Child Benefit is accounted for within the programme costs in the Operating Cost Statement and includes both Child and Lone Parent benefits. Payments to claimants are recorded as a creditor when the payment falls due. Appropriate accruals and prepayment adjustments are made to ensure that the expenditure arising from the entitlement period of each payment is recorded to the correct month. These adjustments are based on the number of days of the entitlement period falling within each calendar month.

Where an overpayment of benefit is established, a debt is created and programme expenditure in the Operating Cost Statement is reduced accordingly. Where possible, overpayment of debt is recovered from future benefit entitlement. Debt which is deemed irrecoverable is written-off in accordance with the Department's normal remission policy, and recorded as expenditure within the Operating Cost Statement (see also note 1.17).

1.21 Child Trust Fund

The Chancellor announced his intention to introduce the Child Trust Fund (CTF), in the April 2003 Budget. The liability for future payments, in respect of births between 1 September 2002 and the balance sheet date, for which no payment has been made, are appropriately recognised within creditors amounts falling due within one year and provisions.

2. Transfer of function from the Inland Revenue

With effect from April 2004 the function of providing advice to ministers concerning tax policy was transferred to HM Treasury. During the year, the staff previously working for the Inland Revenue were transferred and they moved into HM Treasury accommodation, no assets relating to delivering this service were transferred to HM Treasury.

The transfer has been accounted for as a business combination using merger accounting principles in accordance with HM Treasury resource accounting requirements. Accordingly, the results and cash flows relating to the transferred service have been brought to account from the start of the financial year. Prior year comparative figures have been restated.

The share of the operating cost for the year attributable to the transferred function was £5.8m.

Restatement of Operating Cost Statement at 31 March 2004

	Published accounts at 31 March 2004 £m	Function transferred to HMT £m	Restated at 31 March 2004 £m
Administrative costs			
Staff costs	1,871.0	5.1	1,865.9
Other administration costs	1,275.2	0.7	1,274.5
Gross administration costs	**3,146.2**	**5.8**	**3,140.4**

3. Staff numbers and related costs

3.1 Staff Costs

	2004-05			Restated* 2003-04
	Total[1] £m	Permanently employed staff £m	Others £m	Total £m
Wages and salaries	1,628.5	1,566.7	61.8	1,556.3
Social security costs	114.7	111.3	3.4	109.6
Other pension costs	213.3	206.6	6.7	200.0
Sub-total	**1,956.5**	**1,884.6**	**71.9**	**1,865.9**
Less recoveries in respect of outward secondments	(1.6)	(1.6)	-	(1.3)
Total net costs	**1,954.9**	**1,883.0**	**71.9**	**1,864.6**

[1] *Staff consist entirely of officials*

The Department does not pay the salary of the Minister, Dawn Primarolo MP, who has responsibility for the Inland Revenue. This is paid out of central funds and can be found in the resource accounts of HM Treasury.

The Principal Civil Service Pension Scheme (PCSPS) is an unfunded multi-employer defined benefit scheme but the Inland Revenue is unable to identify its share of the underlying assets and liabilities. A full actuarial valuation was carried out at 31 March 2003. Details can be found in the resource accounts of the **Cabinet Office**: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2004-05, employers' contributions of £212,853,234 were payable to the PCSPS (2003-04: £200,248,744) at one of four rates in the range 12.0 to 18.5 per cent of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. From 2005-06, the salary bands will be revised and the rates will be in a range between 16.2 per cent and 24.6 per cent. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

Employees joining after 1 October 2002 could opt to open a **partnership** pension account, a stakeholder pension with an employer contribution. Employers' contributions of £421,007 (2003-04: £245,722) were paid to one or more of a panel of four appointed **stakeholder** pension providers. Employer contributions are age-related and range from 3 to 12.5 per cent (2003-04: 3 to 12.5 per cent) of pensionable pay. Employers also match employee contributions up to 3 per cent of pensionable pay. In addition, employer contributions of £32,152, 0.8 per cent (2003-04: £19,423, 0.8 per cent) of pensionable pay, were payable to the PCSPS to cover the cost of the future provision of lump sum benefits on death in service and ill health retirement of these employees. Contributions due to the **partnership** pension providers at the balance sheet date were nil. Contributions prepaid at that date were nil.

171 persons (2003-04: 175 persons) retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £221,259 (2003-04: £233,605).

3.2 Average number of persons employed

The average number of whole-time equivalent persons employed during the year was as follows. These figures include those working in the Department as well as in agencies and other bodies included within the consolidated Departmental Resource Account.

		2004-05		Restated* 2003-04
			Number	Number
	Total	**Permanently employed staff**	**Others**	**Total**
Assessment & Collection of Taxes, National Insurance and Tax Credits	**73,863**	69,639	4,224	**71,282**
Child Benefit	**1,688**	1,568	120	**1,610**
Valuation	**4,949**	4,727	222	**4,434**
Payments in lieu of Tax Relief	**2**	2	0	**2**
Payments of Local Authority Rates	**3**	3	0	**2**
Total	**80,505**	**75,939**	**4,566**	**77,330**

** Certain prior year figures have been restated as per note 2.*

3.3 Salary and pension entitlements

The following sections provide details of the remuneration and pension interests of the most senior officials of the Department.

a) Remuneration:

	2004-05		2003-04	
	Salary £000	Benefits in kind (to the nearest £100)	Salary £000	Benefits in kind (to the nearest £100)
David Varney* (from 1 September 2004)	60-65 (150-155 full year equivalent)	8,900	-	-
Paul Gray CB* (from 1 September 2004)	55-60 (140-145 full year equivalent)	12,900	-	-
Ann Chant CB	140-145	-	130-135	-
Dave Hartnett CB	140-145	-	145-150	-
Helen Ghosh	110-115 (125-130 full year equivalent)	-	90-95 (110-115 full year equivalent)	-
Steve Heminsley	110-115	1,200	95-100	2,800
Steve Lamey* (from 18 October 2004)	65-70 (200-205 full year equivalent)	-	-	-

** The Inland Revenue accounted for 70% of the salary and any benefit in kind for David Varney, Paul Gray CB and Steve Lamey. HM Customs and Excise accounted for the remaining 30% in their Resource Accounts.*

The salary details of the following members of the Inland Revenue and HM Customs & Excise transitional board are shown in the HM Customs & Excise Resource Accounts: Mike Eland, Mike Hanson MBE, David Garlick OBE, David Hogg CB, Mike Norgrove.

Salary

"Salary" includes gross salary; performance pay or bonuses; overtime; reserved rights to London weighting or London allowances; recruitment and retention allowances; private office allowances and any other allowance to the extent that it is subject to UK taxation.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by the Inland Revenue as a taxable emolument. David Varney, Paul Gray CB and Steve Heminsley had the private use of allocated car in the circumstances permitted by the Civil Service Management Code.

The Department's Departmental Board comprises both senior operational management and external appointees. The remuneration of senior management is included above. External Board appointees' remuneration excluding pension contributions was in the following ranges:

	2004-05 Salary £000	**2003-04** Salary £000
Rene Carayol *(Non executive Board Member to 2 July 2004)*	5-10 (15-20 full year equivalent)	15-20
Kate Owen *(Non executive Board Member)*	15-20	15-20
Pat Stafford *(Non executive Board Member)*	20-25	20-25
Bill Griffiths *(Non executive Board Member from 17 November 2004)*	5-10 (20-25 full year equivalent)	-

(b) *Pension Benefits:*

	Accrued pension at age 60 at 31 March 2005 and related lump sum	Real increase in pension and related lump sum at age 60	CETV at 31 March 2004	CETV at 31 March 2005	Real increase in CETV	Employer contribution to partnership pension account
	£000	£000	(Rounded to the nearest £000)	(Rounded to the nearest £000)	(Rounded to the nearest £000)	(Rounded to the nearest £000)
David Varney*	0-5	0-2.5	-	14	12	-
Paul Gray CB*	70-75	5.0-7.5	852	982	82	-
Ann Chant CB**	65-70 Plus 195-200 lump sum	0-2.5 Plus 2.5-5.0 lump sum	1,145	1,221	24	-
Dave Hartnett CB***	45-50 Plus 125-130 lump sum	0-2.5 Plus 0-2.5 lump sum	711	782	34	-
Helen Ghosh**	30-35 Plus 95-100 lump sum	0-2.5 Plus 5.0-7.5 lump sum	438	497	28	-
Steve Heminsley**	40-45 Plus 125-130 lump sum	2.5-5.0 Plus 10.0-12.5 lump sum	606	711	66	-
Steve Lamey*	0-5	0-2.5	-	9	8	-

* *Member of the premium scheme, lump sum not applicable*
** *Member of the classic scheme*
*** *Member of the classic plus scheme*

The pension benefits for David Varney, Paul Gray CB and Steve Lamey are shown in full in both the Inland Revenue and HM Customs & Excise Resource Accounts although the employers benefits are funded at 70% by the Inland Revenue and 30% by HM Customs & Excise.

The pension details of the following members of the Inland Revenue and HM Customs & Excise transitional board are shown in the HM Customs & Excise Resource Accounts: Mike Eland, Mike Hanson MBE, David Garlick OBE, David Hogg CB, Mike Norgrove.

Civil Service pensions

Pension benefits are provided through the Civil Service Pension (CSP) arrangements. From 1 October 2002, civil servants may be in one of three statutory based 'final salary' defined benefit schemes (classic, premium and classic plus). The Schemes are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium and classic plus are increased annually in line with changes in the Retail Prices Index. New entrants after 1 October 2002 may choose between membership of premium or joining a good quality 'money purchase' stakeholder arrangement with a significant employer contribution (partnership pension account).

Employee contributions are set at the rate of 1.5 per cent of pensionable earnings for classic and 3.5 per cent for premium and classic plus. Benefits in classic accrue at the rate of 1/80th of pensionable salary for each year of service. In addition, a lump sum equivalent to three years' pension is payable on retirement. For premium, benefits accrue at the rate of 1/60th of final pensionable earnings for each year of service. Unlike classic, there is no automatic lump sum (but members may give up (commute) some of their pension to provide a lump sum). Classic plus is essentially a variation of premium, but with benefits in respect of service before 1 October 2002 calculated broadly as per classic.

The partnership pension account is a stakeholder pension arrangement. The employer makes a basic contribution of between 3 per cent and 12.5 per cent (depending on the age of the member) into a stakeholder pension product chosen by the employee. The employee does not have to contribute but where they do make contributions, the employer will match these up to a limit of 3 per cent of pensionable salary (in addition to the employer's basic contribution). Employers also contribute a further 0.8 per cent of pensionable salary to cover the cost of centrally-provided risk benefit cover (death in service and ill health retirement).

Further details about the CSP arrangements can be found at the website www.civilservice-pensions.gov.uk

Cash Equivalent Transfer Values

A Cash Equivalent Transfer Value (CETV) is the actuarially assessed capitalised value of the pension scheme benefits accrued by a member at a particular point in time. The benefits valued are the member's accrued benefits and any contingent spouse's pension payable from the scheme. A CETV is a payment made by a pension scheme or arrangement to secure pension benefits in another pension scheme or arrangement when the member leaves a scheme and chooses to transfer the benefits accrued in their former scheme. The pension figures shown relate to the benefits that the individual has accrued as a consequence of their total membership of the pension scheme, not just their service in a senior capacity to which disclosure applies. The CETV figures, and from 2003-04 the other pension details, include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the CSP arrangements and for which the CS Vote has received a transfer payment commensurate to the additional pension liabilities being assumed. They also include any additional pension benefit accrued to the member as a result of their purchasing additional years of pension service in the scheme at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries.

Real Increase in CETV

This reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

4. Non-staff administration costs

	Note				Restated*
			2004-05		2003-04
	Note	£m	£m	£m	£m
Rentals under operating leases:					
Hire of plant and machinery		3.4		4.0	
Other operating leases		21.4		24.9	
			24.8		28.9
Interest charges:					
Finance leases		-		-	
On-balance sheet PFI contracts		1.7		-	
			1.7		-
PFI service charges:					
Off-balance sheet contracts		199.1		214.7	
Service element of on-balance sheet contracts		0.5		-	
Indexation of liability on PFI deals		1.6		-	
			201.2		214.7
Non-cash items (Note a):					
Depreciation and amortisation of fixed assets		116.4		129.7	
Barter deal prepayments		9.8		5.9	
Profit on disposal of fixed assets		(0.1)		(0.6)	
Loss on disposal of fixed assets		1.0		1.4	
Net (profit)/loss on revaluation		18.9		(28.5)	
Cost of capital charge		17.0		16.1	
Auditors remuneration and expenses[1]		0.5		0.3	
Amounts provided for liabilities and charges	21	(17.9)		20.2	
Amounts provided for early departure costs	21	33.0		8.1	
Unwinding of early departure costs discounting		0.5		0.7	
			179.1		153.3
Other expenditure:					
Travel, subsistence and hospitality		52.6		53.0	
Accommodation expenses		107.4		113.4	
Administrative staff related costs		3.9		7.7	
Printing, postage, stationery and office supplies		117.1		116.3	
Telephone expenses		26.1		27.3	
IT services and consumables		401.1		317.8	
Legal costs		29.3		27.3	
Consultancy		72.6		60.6	
Contracted out services		13.9		17.0	
Publicity		21.6		20.7	
Post Office services		38.1		65.0	
Bank charges		15.6		17.3	
Losses	31	7.0		5.2	
Special payments	31	5.1		4.5	
Other miscellaneous expenditure		20.2		24.5	
			931.6		877.6
			1338.4		**1274.5**

[1] These are notional amounts and there was no non-audit work.

** Certain prior year figures have been restated as per note 2.*

Note

a The total of non-cash transactions included in the Reconciliation of Resources to Net Cash Requirement in Schedule 1 and in the Reconciliation of Operating Costs to Operating Cashflows in Schedule 4 comprises:

	2004-05
	£m
Other administration costs - non-cash items (as above)	179.1
Other non-cash amounts charged to operating expenditure	165.1
Non-cash proceeds of fixed asset disposal	(58.4)
Total non-cash transactions	**285.8**

Land and building 100 Parliament Street, on the site formerly known as Government Offices on Great George Street (GOGGS).

The Inland Revenue is contracted to pay Exchequer Partnership (EP2) an annual unitary amount of £9.2m at 1999 prices for the 33-year term of the contract subject to deductions for non-availability and under-performance, starting in September 2004. The payment finances the cost of the refurbishment, maintenance, lifecycle replacement costs and ongoing services over the 33-year term.

The contract requires that the building be maintained in its condition at the beginning of the contract throughout the contract period at no additional cost to the Inland Revenue. During the contract period EP2 bears the risk of latent defects, building maintenance requirements and the cost of replacing capital items.

The difference of £61.5m between the existing use value of the building, excluding the land element, at the date of occupation, and the opening fair value of the creditor under the finance lease agreement has been taken to the Operating Cost Statement for 2004-05, (see Schedule 2).

This difference arises because the valuation reflects rental potential in a depressed property market. The refurbishment cost reflects a policy decision for the Inland Revenue and HM Customs & Excise to occupy the building and to modernise and maintain an important Grade II listed building with long-term heritage value whilst providing good quality, flexible and modern office space.

5. Net programme costs

	2004-05		2003-04	
	£m	£m	£m	£m
Child Benefit and Child Trust Fund:				
Child Benefit	9,575.1		9,379.3	
Child Benefit (Lone Parent) Premium	16.5		45.8	
Guardians Allowance (Funded from NIF)[1]	1.6		1.8	
Child Trust Fund Endowments	126.6		-	
Child Trust Fund Endowments (Provision)	118.5		399.9	
Interest on capital	(16.1)		11.4	
		9,822.2		9,838.2
Payments in Lieu of Tax Reliefs:				
Life assurance premium relief, mortgage interest relief, private medical insurance premium relief, and vocational training relief	13.0		18.1	
Remitted Stamp Duty	-		0.2	
Transitional payments to charities	11.7		51.4	
Supplement on payroll giving to charities	0.7		7.9	
Stakeholder pensions	68.0		85.0	
		93.4		162.6
Payments of Local Authority Rates:				
Payments of Local Authority Rates	34.4		32.5	
Payments of Local Authority Rates (Provision)	1.2		1.5	
Less: Programme Income (note 7)	(3.9)		(3.0)	
		31.7		31.0
Request for Resource 1				
Paybill	5.3		-	
Other running costs	8.8		-	
Less: Programme Income (note 7)	-		-	
		14.1		-
Total Programme Costs		**9,961.4**		**10,031.8**

[1] *Guardians Allowance is funded by the National Insurance Fund and therefore does not appear in net resource outturn in Schedule 2.*

6. Analysis of income payable to the Consolidated Fund

In addition to Appropriations in Aid, the following income relates to the Department and is payable to the Consolidated Fund.

		Forecast 2004-05		Outturn 2004-05	
		Income	Receipts	Income	Receipts
	Note	£m	£m	£m	£m
Operating income and receipts - excess A in A	7	-	-	(34.6)	*(34.6)*
Non-operating income and receipts - excess A in A	22	-	-	-	-
Subtotal		-	-	(34.6)	*(34.6)*
Other operating income and receipts not classified as A in A	7	-	-	(0.8)	*(0.8)*
Other non-operating income and receipts not classified as A in A	Schedule 4	(60.0)	*(60.0)*	(78.5)	*(78.5)*
Other amounts collectable on behalf of the Consolidated Fund	7	-	-	-	-
Excess cash surrenderable to the Consolidated Fund		-	-	-	-
Total		**(60.0)**	***(60.0)***	**(113.9)**	***(113.9)***

7. Income and Appropriations in Aid

7.1 Operating income

Operating income not Appropriated in Aid (i.e. surrenderable to the Consolidated Fund) is analysed for resource budget purposes between that which is included in public expenditure and that which is not (see note 8). In 2004-05, all operating income not classified as A in A was within public expenditure.

	2004-05			
	Resource Outturn	**Reconciliation to Operating Cost Statement**		**Operating Cost Statement**
	A in A	Payable to Consolidated Fund	Transactions between Requests for Resources	Income
	£m	£m	£m	£m
Administrative income:				
Transactions between Requests for Resources	(16.7)	-	16.7	-
Fees and charges to external customers	(182.3)	-	-	(182.3)
Fees and charges to other departments and the National Insurance Fund	(375.2)	(35.1)	-	(410.3)
Other income - bank interest	-	(0.3)	-	(0.3)
Operating leases external income	(0.6)	-	-	(0.6)
Operating leases OGD income	(26.1)	-	-	(26.1)
	(600.9)	**(35.4)**	**16.7**	**(619.6)**
Programme income:				
Payments of Local Authority Rates	(3.9)	-	-	(3.9)
Request for Resource 1 Efficiency Challenge Fund	-	-	-	-
Total	**(604.8)**	**(35.4)**	**16.7**	**(623.5)**

	2003-04			
	£m	£m	£m	£m
Administrative income:				
Transactions between Requests for Resources	(16.4)	-	16.4	-
Fees and charges to external customers	(175.6)	-	-	(175.6)
Fees and charges to other departments and the National Insurance Fund	(377.0)	(16.5)	-	(393.5)
Other income - bank interest	-	(1.1)	-	(1.1)
Operating leases external income	(2.1)	-	-	(2.1)
Operating leases OGD income	(27.5)	-	-	(27.5)
	(598.6)	**(17.6)**	**16.4**	**(599.8)**
Programme income:				
Payments of Local Authority Rates	(3.0)	-	-	(3.0)
Request for Resource 1 Efficiency Challenge Fund	-	-	-	-
Total	**(601.6)**	**(17.6)**	**16.4**	**(602.8)**

An analysis of income from services provided to external and public sector customers is as follows:

	2004-05			2003-04		
	Income	Full cost	Surplus/ deficit	Income	Full cost	Surplus/ deficit
	£m	£m	£m	£m	£m	£m
Services provided by the Inland Revenue	(398.1)	398.1	-	(390.7)	390.7	-
Services provided by the Valuation Office Agency	(191.1)	191.1	-	(178.4)	178.4	-
	(589.2)	**589.2**	**-**	**(569.1)**	**569.1**	**-**

7.2 Non-operating income not classified as Appropriations in Aid

	2004-05	2003-04
	£m	£m
Self Assessment & Corporation Tax Penalties	78.5	66.2

The Department received penalties for late receipt of Self Assessment and Corporation Tax returns. These penalties that are raised automatically are not regarded as income for the Department and are surrendered to the Consolidated Fund.

7.3 Non-operating Appropriations in Aid

	2004-05	2003-04
	£m	£m
Principal repayment of voted loans	-	-
Disposal of fixed assets	(58.9)	(1.8)
	(58.9)	**(1.8)**

8. Administration cost limits

The outturn within the administration costs control regime shown against individual administration cost limits is as follows:

	2004-05		Restated* 2003-04	
	Outturn	Limits	Outturn	Limits
	£m	£m	£m	£m
RfR 1 Administration	3,169.4	3,227.0	2,969.8	3,090.2
RfR 2 Valuation Office Agency	198.4	205.8	187.0	191.3
Total within administration cost control	**3,367.8**	**3,432.8**	**3,156.8**	**3,281.5**
Administration expenditure excluded from administration cost limit				
RfR 1 Administration income allowable within the administration cost limit	(85.3)	(56.7)	(68.5)	(56.7)
RfR 2 Administration income allowable within the administration cost limit	(204.4)	(205.8)	(191.2)	(191.3)
Total administration outturn	**3,078.1**	**3,170.3**	**2,897.1**	**3,033.5**

** Certain prior year figures have been restated as per note 2.*

9. Reconciliation of net operating cost and net resource outturn

	2004-05 £m	Restated* 2003-04 £m
Net operating cost[a]	12,692.9	12,572.4
Remove non-supply income scored as Consolidated Fund Extra Receipts (CFERs):		
Operating income not classified as A in A	35.4	17.6
A*djust* for Child Benefit Guardians Allowance	(1.6)	(1.8)
Net resource outturn[a]	**12,726.7**	**12,588.2**

** Certain prior year figures have been restated as per note 2.*

Note

[a] *Net operating cost is the total of expenditure and income appearing in the Operating Cost Statement (Schedule 2). Net resource outturn is the total of those elements of expenditure and income that are subject to parliamentary approval and included in the Department's Supply Estimate. The outturn against the Estimate is shown in the Summary of Resource Outturn (Schedule 1).*

10. Analysis of net operating cost by spending body

	2004-05 Budget £m	2004-05 Outturn £m	Restated* 2003-04 Budget £m	Restated* 2003-04 Outturn £m
Spending body:				
Core Department	13,049.8	12,667.2	12,826.2	12,545.6
Valuation Office Agency	34.3	25.7	31.2	26.8
	13,084.1	**12,692.9**	**12,857.4**	**12,572.4**

** Certain prior year figures have been restated as per note 2.*

11. Analysis of net resource outturn by Estimate subhead and reconciliation to Operating Cost Statement

	2004-05								2003-04
	Admin.	Other current	Grants	Gross resource expenditure	A in A	NET TOTAL	Estimate	Net total outturn compared with Estimate	Restated Prior year outturn*
	£m	£m	£m	£m	£m	£m	£m	£m	£m
Request for resources 1:									
IR Administration	3,169.4	14.1	-	3,183.5	(402.5)	2,781.0	2,846.0	65.0	2,558.2
Request for resources 2:									
VOA Administration	198.4	-	-	198.4	(198.4)	-	-	-	-
Request for resources 3:									
Payments in lieu of Tax Relief	-	-	93.4	93.4	-	93.4	119.0	25.6	162.6
Request for resources 4:									
Payments of Local Authority Rates	-	35.6	-	35.6	(3.9)	31.7	34.3	2.6	31.0
Request for resources 5:									
A. Children's Benefits	-	-	9,593.0	9,593.0	-	9,593.0	9,591.2	(1.8)	9,436.5
B. Child Trust Fund Endowments	-	-	227.6	227.6	-	227.6	493.6	266.0	399.9
Resource Outturn	**3,367.8**	**49.7**	**9,914.0**	**13,331.5**	**(604.8)**	**12,726.7**	**13,084.1**	**357.4**	**12,588.2**

** Certain prior year figures have been restated as per note 2.*

Reconciliation to Operating Cost Statement

	Gross resource expenditure	A in A	NET TOTAL
	£m	£m	£m
Non-Supply expenditure	1.6	-	1.6
Income payable to the Consolidated Fund	-	(35.4)	(35.4)
Transactions between Request for Resources netted off in Operating Cost Statement	(16.7)	16.7	-
Income netted off in gross sub-head grossed up in Operating Cost Statement	-	-	-
Transfer of estimate cover	-	-	-
Gross operating expenditure	**13,316.4**		
Operating income		**(623.5)**	
Net operating cost			**12,692.9**

12. Analysis of capital expenditure, financial investment and associated A in A

	2004-05			2003-04		
	Capital expenditure	A in A	Net Total	Capital expenditure	A in A	Net Total
	£m	£m	£m	£m	£m	£m
Administration	304.0	(56.9)	247.1	163.1	(1.6)	161.5
Valuation Office Agency	10.4	(2.0)	8.4	13.7	(0.2)	13.5
Total	**314.4**	**(58.9)**	**255.5**	**176.8**	**(1.8)**	**175.0**

13. Tangible fixed assets

Cost or valuation	Freehold Land & Buildings £m	Accommodation refurbishments £m	Office & Computer Equipment £m	Vehicles £m	Furniture & Fittings[1] £m	Developed Computer Software £m	Software being developed £m	EDS held computer equipment[2] £m	Total £m
At 1 April 2004	-	12.0	148.2	1.6	143.7	594.0	58.3	172.4	1,130.2
Additions	109.5	0.1	37.6	-	9.5	7.7	130.2	5.8	300.4
Assets completed	-	-	-	-	-	96.2	(96.2)	-	-
Disposals	-	-	(16.8)	(1.2)	(11.4)	-	-	(178.2)	(207.6)
Revaluation[3]	(61.5)	0.3	2.8	-	(48.4)	62.4	-	-	(44.4)
At 31 March 2005	**48.0**	**12.4**	**171.8**	**0.4**	**93.4**	**760.3**	**92.3**	**-**	**1,178.6**
Depreciation									
At 1 April 2004	-	(8.0)	(99.1)	(1.0)	(79.0)	(271.6)	-	(116.0)	(574.7)
Charged in year	(0.4)	(2.1)	(32.7)	(0.1)	(9.9)	(64.1)	-	(3.8)	(113.1)
Disposals	-	-	15.7	0.8	11.4	-	-	119.8	147.7
Revaluation[3]	-	(0.2)	3.8	-	27.8	(28.5)	-	-	2.9
At 31 March 2005	**(0.4)**	**(10.3)**	**(112.3)**	**(0.3)**	**(49.7)**	**(364.2)**	**-**	**-**	**(537.2)**
Net book value at 31 March 2005	**47.6**	**2.1**	**59.5**	**0.1**	**43.7**	**396.1**	**92.3**	**-**	**641.4**
Net book value at 31 March 2004	**-**	**4.0**	**49.1**	**0.6**	**64.7**	**322.4**	**58.3**	**56.4**	**555.5**
Asset financing:									
Owned	12.0	2.1	59.5	0.1	43.7	396.1	92.3	-	605.8
On-balance sheet PFI contracts	35.6	-	-	-	-	-	-	-	35.6
Net book value at 31 March 2005	**47.6**	**2.1**	**59.5**	**0.1**	**43.7**	**396.1**	**92.3**	**-**	**641.4**

[1] *See note 1.3.3 for accounting policy for furniture. A review of the model used to calculate the current value invested in furniture produced a significant reduction reported as a revaluation adjustment.*

[2] *Computer equipment used by our former computer services partner, Electronic Data Systems Ltd. (EDS), was subject to a finance lease. Ownership of these assets was transferred to our new computer services partner, Capgemini, on commencement of the ASPIRE contract on 1 July 2004 at a charge of £1. The assets had been valued at open market value at that date following a professional independent external valuation by ATIS REAL Weatheralls Ltd. The transfer of these assets was treated as a fixed asset disposal (at their open market value of £56.4m) with the value being transferred to debtors under HM Treasury's PFI barter deal arrangements (see note 18).*

[3] *Please refer to note 1.3 for the accounting policy regarding revaluation of fixed assets.*

Land and building 100 Parliament Street, on the site formerly known as Government Offices on Great George Street (GOGGS).

The accounting treatment adopted by the Inland Revenue in respect of its arrangement with HM Treasury for the land and building on the site, which was formerly known as Government Offices on Great George Street (GOGGS), is consistent with that adopted by HM Treasury and HM Customs & Excise.

The contract

The Inland Revenue and HM Customs & Excise entered into a joint 33-year finance lease agreement with Exchequer Partnership (EP2) in September 2002 in respect of 100 Parliament Street, part of the site formerly known as GOGGS.

This agreement provided for the refurbishment and provision of serviced office accommodation to the Inland Revenue and HM Customs & Excise from November 2004 to October 2037 in return for an annual unitary payment.

The building is subject to a 35-year Private Finance Initiative contract commencing in August 2002 between HM Treasury and EP2. It was in operational use by HM Treasury until vacated in August 2002.

Refurbishment work started in December 2002 and was completed in October 2004. The Inland Revenue and HM Customs & Excise commenced relocation to the building in November 2004.

The decision to refurbish GOGGS followed a review by HM Treasury of available alternative locations. EP2 agreed to undertake the risks of planning, construction, ongoing maintenance of the fabric and plant and machinery and the delivery of serviced accommodation to standards originally specified by HM Treasury in advance.

The Treasury sought to ensure that EP2's bid for refurbishment of the building represented good value for money by detailed evaluation of the technical and financial aspects, benchmarking against the Public Sector Comparator and market rentals at the time. HM Treasury tendered the external project funding to introduce a further element of competition.

Valuation

The land on which 100 Parliament Street is sited was reflected on HM Treasury's balance sheet on 31 March 2004 at a net book value of £15.1m. The building was reported as nil value as it required refurbishment. All values for the property transferred have been split between the Inland Revenue and HM Customs and Excise on the basis of staff occupancy numbers. The Inland Revenue's share of the land has been capitalised at the value of £12.0m and the value of the refurbishment building work at £97.5m. This is shown as an addition to tangible fixed assets above at £109.5m. On completion of the refurbishment by EP2 the Valuation Office Agency (VOA) valued the building and land in November 2004. The Inland Revenue's share was valued at £48m the reduction in value of £61.5m has been reported as an exceptional item of expenditure in the Operating Cost Statement, Schedule 2.

14. Intangible fixed assets

The Department's intangible fixed assets comprise purchased software licences.

	IT Software Licence
Cost or valuation	£m
At 1 April 2004	-
Additions [1]	14.0
Assets completed	-
Disposals	-
At 31 March 2005	**14.0**
Amortisation	
At 1 April 2004	-
Charged in year	(3.3)
Disposals	-
At 31 March 2005	**(3.3)**
Net Book Value:	
At 31 March 2005	**10.7**
At 1 April 2004	**-**

[1] *In April 2004, the Department purchased the licence from Accenture, to enable its computer services partner, Capgemini, to maintain the National Insurance Recording system.*

15. Investments

The Department has no financial investments.

16. Movements in working capital other than cash

The movements in working capital used in the Reconciliation of resources to cash requirement comprise:

	2004-05	2003-04
	£m	£m
Decrease in stocks and work in progress	-	(3.1)
(Decrease)/increase in debtors (excluding prepayments for PFI assets)	(58.7)	19.0
Decrease/(increase) in creditors falling due within one year	(452.4)	134.4
	(511.1)	**150.3**
Adjustment: movement in working capital not related to net operating costs		
Amounts due to the Consolidated Fund	(7.9)	(84.5)
Movement in working capital related to the acquisition/disposal of tangible fixed assets	-	-
Amounts receivable that will be due to the Consolidated Fund when received	-	-
Net (decrease)/increase in working capital other than cash	**(519.0)**	**65.8**

The movements in working capital other than cash used in the Cash Flow Statement comprise the entries in the table above.

17. Stocks and work in progress

	2004-05	2003-04
	£m	£m
Stocks	-	-
Work in progress	2.8	2.8
	2.8	**2.8**

18. Debtors

	2004-05	2003-04
	£m	£m
Amounts falling due within one year:		
Trade debtors	6.8	7.1
Deposits and advances	15.3	20.3
VAT	12.4	29.8
Other debtors excluding Child Benefit	23.6	24.3
Other debtors - Child Benefit	17.3	37.4
Prepayments and accrued income excluding Child Benefit	7.1	11.2
Prepayments and accrued income - Child Benefit	34.8	42.3
Barter deals	12.3	6.1
Tax penalty debtors (note 1.19)	25.6	28.7
Amounts due from the Consolidated Fund in respect of supply	-	-
	155.2	**207.2**
Amounts falling due after more than one year:		
Other debtors	1.3	1.6
Barter deals	177.2	134.8
	178.5	**136.4**
	333.7	**343.6**

Loans have been advanced to staff in accordance with rules established for Government Departments. At 31 March 2005 these totalled £3,468,032 (31 March 2004: £3,261,060) and were made to 5,461 (31 March 2004: 4,994) members of staff.

No cash payment was made following the transfer of Computer Equipment held under the Department's computer services contract to Capgemini on 1 July 2004. The value of the assets transferred has been accounted for as a barter prepayment with a remaining value of £52.9m, of which £5.2m is shown as falling due within one year and £47.7m is shown as falling due after more than one year.

19. Cash at bank and in hand

	2004-05 £m	2003-04 £m
Balance 1 April	74.6	159.1
Net change in cash balances:	(7.9)	(84.5)
Balance at 31 March	**66.7**	**74.6**
The following balances at 31 March are held at:		
Office of HM Paymaster General	13.3	43.2
Commercial banks and cash in hand	53.4	31.4
Balance at 31 March	**66.7**	**74.6**
The balance at 31 March comprises:		
Cash due to be paid to the Consolidated Fund	-	-
Amounts issued from the Consolidated Fund for supply but not spent at year end	36.9	50.2
Consolidated Fund extra receipts received and due to be paid to the Consolidated Fund	29.8	24.4
	66.7	**74.6**

20. Creditors

	2004-05 £m	2003-04 £m
Amounts falling due within one year:		
Other taxation and social security	(44.2)	(39.6)
Trade creditors	(12.6)	(28.7)
Other creditors excluding Child Benefit	(6.7)	(7.1)
Other creditors - Child Benefit and CTF	(480.7)	(66.1)
Accruals and deferred income excluding Child Benefit	(118.8)	(83.1)
Accruals and deferred income - Child Benefit	(179.8)	(159.0)
Finance leases	(1.0)	-
Amounts issued from the Consolidated Fund for supply but not spent at year end	(36.9)	(50.2)
Consolidated Fund extra receipts received and receivable and other due amounts to be paid to the Consolidated Fund	(29.8)	(24.4)
	(910.5)	**(458.2)**
Amounts falling due after more than one year:		
Finance leases	(97.8)	-
Total	**(1,008.3)**	**(458.2)**

Land and building 100 Parliament Street, on the site formerly known as Government Offices on Great George Street (GOGGS).

The Inland Revenue and HM Customs & Excise have recognised the apportioned cost of refurbishment as a finance lease creditor to be paid off during the period of the contract with EP2 on an annuity basis. The creditor balance has been indexed annually at the same rate as the unitary payment. The Inland Revenue share of the creditor as at 31 March 2005 was calculated as follows:

	2004-05	2003-04
	£m	£m
Fair value of the building	(97.5)	-
Uplift for inflation on future unitary payments (see note 3)	(1.6)	-
Principal repaid during 2004-05	0.3	-
	(98.8)	-
Creditor payable within 12 months	(1.0)	-
Creditor payable in more than 12 months	(97.8)	-
	(98.8)	-

21. Provisions for liabilities and charges

	Early Departure Costs	Child Trust Fund	Legal claims	Accommodation Costs	Other	Total
	£m	£m	£m	£m	£m	£m
Balance at 1 April 2004	(14.2)	(399.9)	(12.3)	(10.4)	(24.2)	(461.0)
Provided in the year	(33.0)	(118.8)	(6.3)	(3.9)	(3.2)	(165.2)
Provisions not required written back	-	0.4	5.6	8.3	16.1	30.4
Provisions utilised in the year	9.6	287.6	1.7	0.9	6.9	306.7
Unwinding of discount	(0.5)	-	-	-	-	(0.5)
Balance at 31 March 2005	**(38.1)**	**(230.7)**	**(11.3)**	**(5.1)**	**(4.4)**	**(289.6)**

21.1 Early Departure Costs

The Department meets the additional costs of benefits beyond the normal PCSPS benefits in respect of employees who retire early by paying the required amounts annually to the PCSPS over the period between early departure and normal retirement date. The Department provides for this in full when the early retirement programme becomes binding on the Department by establishing a provision for the estimated payments discounted by the Treasury discount rate of 3.5 per cent in real terms. In past years the Department paid in advance some of its liability for early retirement by making a payment to the Paymaster General's Account at the Bank of England for the credit of the Civil Service Superannuation Vote. The balance remaining is treated as a prepayment.

21.2 Child Trust Fund

The Child Trust Fund Act received Royal Assent in May 2004; it establishes tax-free savings and investment accounts for eligible children born on or after 1 September 2002. The Government will make payments into a Child Trust Fund account for each eligible child, enabling the accumulation of assets to be made available upon attaining the age of 18. Child Trust Fund accounts will be available to the public from April 2005. A provision of £230.7m has been made in respect of this in these Resource Accounts for amounts that will become due for payment in respect of the period from 1 September 2002 to 31 March 2005 in 2005-06. This provision comprises £47.8m in respect of initial endowments that have not yet been issued, £4.1m of endowments for children in Local Authority care and £178.8m of supplementary endowments due in respect of children in households where Child Tax Credit is in payment.

21.3 Legal Claim

A provision of £11.3m (2003-04: £12.3m) has been made for costs relating to various legal claims against the Department. The provision reflects all known claims where legal advice indicates that it is probable that the claim will be successful and the amount of the claim can be reliably estimated. Legal claims which may succeed but are less likely to do so or cannot be estimated reliably are disclosed as contingent liabilities in note 29.

21.4 Accommodation Costs

A provision of £5.1m has been made (2003-04: £10.4m) mainly for buildings-related claims giving rise to probable liabilities under tenancy agreements where the amount of the claims can be reliably estimated. Claims, which may succeed but are less likely to do so or cannot be estimated reliably, are disclosed as contingent liabilities in note 29.

21.5 Other

Overpaid Age Related Rebates (ARRs) - a provision for the estimated compensation payments of £8.8m to Pension Providers was brought forward. This was in respect of those who suffered financial loss when the Department delayed the recovery of overpaid ARR's. Of this, £6.7m has been paid in this period and the remaining provision of £2.1m not required has been written back.

Annual Leave Compensation - a provision of £14.0m was made in respect of possible future claims for statutory leave. A 21 April 2005 Court of Appeal ruling in our favour means the provision is no longer required. As an appeal to the House of Lords is possible, a contingent liability for £17.0m has been made. (See note 29).

National Insurance Contributions Office (NICO) - discussions are underway between the Inland Revenue and a Pension Provider concerning a compensation claim of £2.0m arising from loss of investment following the late processing of electronically submitted pension forms.

Payments of Local Authority Rates - a provision of £2.4m has been made in respect of 2004-05 invoices that are under discussion to agree liability. This programme expenditure is included in note 5 of this account.

22. Reconciliation of net operating cost to changes in General Fund

			2004-05		Restated* 2003-04
		£m	£m	£m	£m
Net operating cost for the year (Schedule 2)		(12,692.9)		(12,572.4)	
Income not appropriated in aid payable to Consolidated Fund		(35.4)		(17.6)	
Child Benefit Guardians Allowance		1.6		1.8	
Non A in A income from disposal of fixed assets		-		-	
			(12,726.7)		(12,588.2)
Parliamentary funding					
Drawn Down		12,373.9		12,218.7	
Transferred from Inland Revenue in respect of transferred tax policy function	Note 2	-		(5.8)	
Deemed Supply		49.3		116.3	
			12,423.2		12,329.2
Transferred to General Fund of realised element of revaluation reserve (see Note 23)			0.2		(0.6)
Consolidated Fund creditor for cash unspent			(36.9)		(50.2)
Non-cash charges:					
Cost of capital	Note 4 and 5	0.9		27.5	
Auditors' remuneration	Note 4	0.5		0.3	
			1.4		27.8
Prior-period adjustments			-		-
Net decrease in General Fund			**(338.8)**		**(282.0)**
General Fund at 1 April			**16.6**		**298.6**
General Fund at 31 March (Schedule 3)			**(322.2)**		**16.6**

** Certain prior year figures have been restated as per note 2.*

23. Reserves

	2004-05 Revaluation reserve	2003-04 Revaluation reserve
	£m	£m
Balance at 1 April	40.7	5.2
Arising on revaluation during the year (net)	39.1	34.9
Transferred to General Fund in respect of realised element of revaluation reserve	(0.2)	0.6
Balance at 31 March	**79.6**	**40.7**

The revaluation reserve reflects the unrealised elements of the cumulative balance of indexation and revaluation adjustments.

24. Notes to Schedule 5

Programme grants and other current expenditures have been allocated as follows:

	2004-05	2003-04
	£m	£m
RfR 1: Administration	8.8	-
RfR 2: Valuation Office Agency	-	-
RfR 3: Payments in lieu of Tax Relief	93.4	162.6
RfR 4: Payments of Local Authority Rates	31.7	31.0
RfR 5: Child Benefit and Child Trust Fund	9,822.2	9,838.2
	9,956.1	**10,031.8**

The capital employed by the Department is allocated by analysis of the underlying assets and liabilities attributable to each category.

Capital Employed by Departmental Aim and Objectives at 31 March 2005

	2004-05 Capital employed	2003-04 Capital employed
	£m	£m
Aim:		
RfR 1: Administration	576.4	590.2
RfR 2: Valuation Office Agency	18.0	16.7
RfR 3: Payments in lieu of Tax Relief	(0.5)	(3.9)
RfR 4: Payments of Local Authority Rates	(3.3)	(0.4)
RfR 5: Child Benefit and Child Trust Fund	(833.2)	(545.3)
	(242.6)	**57.3**

25. Capital commitments

	2004-05	2003-04
	£m	£m
Contracted capital commitments at 31 March for which no provision has been made	**154.3**	**21.3**

26. Commitments under leases

26.1 Operating leases

Commitments under operating leases to pay rentals during the year following the year of these accounts are given in the table below, analysed according to the period in which the lease expires.

	2004-05		2003-04	
	Land & buildings	Other	Land & buildings	Other
	£m	£m	£m	£m
Obligations under operating leases comprise:				
Expiry within 1 year	-	1.9	-	43.3
Expiry after 1 year but not more than 5 years	-	1.1	-	1.5
Expiry thereafter	200.2	347.0	193.2	359.7
	200.2	**350.0**	**193.2**	**404.5**

26.2 Finance leases

The Department's obligations under finance leases are as follows.

	2004-05	2003-04
	£m	£m
Obligations under finance leases comprise:		
Rentals due within 1 year	9.6	-
Rentals due after 1 year but within 5 years	41.2	-
Rentals due thereafter	449.7	-
	500.5	-
Less: interest element	(212.5)	-
	288.0	-

27. Commitments under PFI contracts

The Department has entered into the following PFI contracts.

27.1 Off-balance sheet

Description of Scheme	Estimated Capital Value £m	Contract Start Date	Contract End Date
Manchester New Office Structure - Serviced office accommodation for 1900 staff.	32	September 1998	September 2013
Edinburgh New Office Structure - Serviced office accommodation for 320 staff.	10	November 1998	November 2013
Glasgow New Office Structure - Serviced office accommodation for 290 staff.	10	December 1998	December 2013
Stockport New Office Structure - Serviced office accommodation for 400 staff.	6	May 1999	May 2014
Strategic Transfer Estate to Private Sector	271	April 2001	March 2021
St John's House Bootle - Financial Intermediaries & Claims Office (FICO) - office accommodation for 700 staff.	12	May 2000	May 2025
Newcastle Estate Development	88	October 1999	August 2027
Newcastle Estate Development with DWP (NEDFAR)	27	October 2004	October 2029
National Insurance Records System (NIRS2)	134	May 1995	December 2004

27.2 On-balance sheet

Description of Scheme	Estimated Capital Value £m	Contract Start Date	Contract End Date
100 Parliament Street - Serviced office accommodation for 845 staff	98	November 2004	October 2037

27.3 Charge to the Operating Cost Statement and future commitments

The total amount charged in the Operating Cost Statement in respect of off-balance PFI transactions and the service element of on-balance PFI transactions was £211.0m (2003-04: £220.6m) and the payments to which the Department is committed during 2005-06, analysed by the period during which the commitment expires, is as follows.

	2004-05	2003-04
	£m	£m
Expiry within 1 year	-	43.3
Expiry within 2 to 5 years	-	-
Expiry within 6 to 10 years	11.4	10.6
Expiry within 11 to 15 years	-	1.1
Expiry within 16 to 20 years	159.9	178.6
Expiry within 21 to 25 years	19.0	2.8
Expiry within 26 to 30 years	-	-
Expiry within 31 to 35 years	9.9	-
	200.2	**236.4**

28. Other financial commitments

The Department has no other financial commitments.

29. Contingent liabilities disclosed under FRS 12

At 31 March 2005 contingent liabilities existed in respect of:

The Department has a small number of property dilapidation contingent liabilities relating to lease termination.

A contingent liability of £10.5m - (2003-04: £2.2m) has been made for costs relating to various legal claims against the Department. The contingent liability reflects all known claims where legal advice indicates that it may succeed but less likely to do so or cannot be estimated reliably.

Action where appointed liquidators have been guaranteed costs with a view to recovery of outstanding tax liabilities £0.7m - 188 cases (2003-04: £1.2m - 179 cases).

Back Service Costs - because we have been making unsocial hours working payments pensionable for some time a liability of £260,000 has been identified but we are currently awaiting the outcome of an attendance allowance review.

Annual Leave Compensation - a 21 April 2005 Court of Appeal ruling in our favour means a provision is no longer required. As an appeal to the House of Lords is possible, a contingent liability for £17.0m has been made (see note 21.5).

The Valuation Office Agency has contingent liabilities as at 31 March 2005 relating to 18 appeals. The legal opinion obtained by the Valuation Office Agency is that these appeals can be successfully resisted.

30. Contingent liabilities not required to be disclosed under FRS 12 but included for parliamentary reporting and accountability

30.1 Quantifiable

The Department has not entered into any quantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort.

30.2 Unquantifiable

The Department has not entered into any unquantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort.

31. Losses and special payments

Losses Statement	£m
Losses are made up of:	
Child Benefit irrecoverable overpayments (57,469 cases)*	6.6
Law costs remissions (70,000 cases)	5.6
Payment made for obsolete forms (7 cases)	0.1
Others (7,145 cases)	1.3
Total [134,621 cases]	**13.6**

** The Child Benefit losses are excluded from note 4, being within Programme expenditure.*

Details of cases over £100,000:
There were no cases over £100,000.

Special Payments	£m
Payments and Accruals	5.2
New Provisions	2.0
Write back of Provisions	(2.1)
Total [53,755 cases]	**5.1**

Details of cases over £100,000:

£115,000 - Compensation payment for ill health retirement in respect of occupational stress;

£585,000 - Extra-statutory payment for the delayed recovery of overpaid Age Related Rebates;

£285,000 - Compensation payment for discrimination and unfair dismissal;

£1,967,000 - Extra-statutory payment provided for in respect of Age Related Rebate payments arising from the late processing of electronically submitted pension forms.

Other Notes

Special Payments: write back of extra statutory payment provision

Overpaid Age Related Rebates (ARRs) - a provision for the estimated compensation payments of £15.3m to pension providers was made in the 2002-03 accounts and reported within the losses statement for that year. This was in respect of those who suffered financial loss when the Department delayed the recovery of overpaid ARR's.

Of this provision £8.8m was carried forward at the end of 2003-04. The liability has been settled at a cost of £6.7m and the remaining provision of £2.1m has been written back. See also note 21.

32. Related-party transactions

The Inland Revenue is the parent of the Valuation Office Agency. This body is regarded as a related party with which the Inland Revenue has had various material transactions during the year.

The Valuation Office Agency has had a significant number of material transactions with other government departments. Most of these transactions have been with the Office of the Deputy Prime Minister and the Welsh Assembly Government.

Ms Gwenda Sippings was the Director of Information Resources for the Inland Revenue until September 2004, her step-brother-in-law was a director at Capgemini. Capgemini was successful in a contract tender to provide Information Technology services to the Inland Revenue, with effect from July 2004. Gwenda Sippings had no involvement with the review of tenders; negotiations; or any other aspect to establish this contract. The Department's commitment under this contract is reported at note 26 to this account.

None of the Board members, other key managerial staff or other related parties has undertaken any material transactions with the Inland Revenue during the year.

33. Financial instruments

FRS 13, *Derivatives and Other Financial Instruments*, requires disclosure of the role which financial instruments have had during the period in creating or changing the risks an entity faces in undertaking its activities. Due to the largely non-trading nature of its activities and the way in which Government departments are financed, the Department is not exposed to the degree of financial risk faced by business entities. Moreover, financial instruments play a much more limited role in creating or changing risk than would be typical of the listed companies to which FRS 13 mainly applies.

The Department has very limited powers to borrow or invest surplus funds and except for relatively insignificant forward purchases of foreign currency, financial assets and liabilities are generated by day-to-day operational activities and are not held to change the risks facing the Department in undertaking its activities.

33.1 Liquidity risk

The Department's net revenue resource requirements, including capital expenditure, are financed by resources voted annually by Parliament. The Department is not, therefore, exposed to significant liquidity risks.

33.2 Interest rate risk

All of the Department's financial assets and liabilities carry nil or fixed rates of interest. The Department is therefore not exposed to significant interest rate risk. The interest profile of the Department's financial liabilities and assets has not been shown/disclosed separately.

33.3 Foreign currency risk

The Department's exposure to foreign currency risk is not significant. Foreign currency income and expenditure are negligible.

33.4 Fair values

The book values of the Department's financial assets and liabilities at 31 March 2005 are not significantly different from their fair values. They have accordingly not been shown separately.

34. Entities within the departmental boundary

The entities within the boundary during 2004-05 were as follows:

- **Supply-financed agencies:** Valuation Office Agency
- **Non-executive NDPBs:** None
- **Other entities:** None

The Annual Report and Accounts of the Valuation Office Agency are published separately.

35. Intra-government balances

	Debtors: amounts falling due within one year £m	Debtors: amounts falling due after more than one year £m	Creditors: amounts falling due within one year £m	Creditors: amounts falling due after more than one year £m
Balances with other central government bodies	32.8	-	(121.6)	-
Balances with local authorities	2.2	-	0.2	-
Balances with NHS Trusts	1.5	-	-	-
Balances with public corporations and trading funds	0.1	-	-	-
Balances with bodies external to government	118.6	178.5	(789.1)	(97.8)
At 31 March 2005	**155.2**	**178.5**	**(910.5)**	**(97.8)**
Balances with other central government bodies	52.6	-	(132.8)	-
Balances with local authorities	1.7	-	(0.3)	-
Balances with NHS Trusts	1.3	-	-	-
Balances with public corporations and trading funds	0.2	-	-	-
Balances with bodies external to government	151.4	136.4	(325.1)	-
At 31 March 2004	**207.2**	**136.4**	**(458.2)**	**-**

ACCOUNTS DIRECTION GIVEN BY THE TREASURY IN ACCORDANCE WITH SECTION 5 (2) OF THE GOVERNMENT RESOURCES AND ACCOUNTS ACT 2000

The accounts direction given by The Treasury in accordance with section 5 (2) of the Government Resources and Accounts Act 2000, covering both the Resource Accounts and the Trust Statement is shown on pages 85 to 86.

Trust Statement

Trust Statement for the year ended 31 March 2005

Contents

Principal Accounting Officer's Foreword to the Trust Statement

Scope

Following the Chancellor's announcement in his March 2004 budget speech, legislation received Royal Assent on 7 April bringing into existence a new department, HM Revenue and Customs. This became a legal entity on 18 April 2005, incorporating the Inland Revenue and HM Customs and Excise. This Trust Statement reports the revenue and expenditure of direct taxes, Student Loan recoveries, National Insurance Contributions (NIC) and tax credits for the final financial year to 31 March 2005. The Balance Sheet shows accruals of tax revenues and expenditure, and other balances, appropriate to 2004-05.

The costs of running the Department are included in the Departmental Resource Accounts.

The Department collects National Insurance Contributions (NICs) on behalf of the National Insurance Funds (NIFs). These contributions are transferred to the NIFs to fund the payment of contribution based benefits. These payments are accounted for in the National Insurance Fund White Paper Accounts, published separately.

Operating and Financial Review

The Department's Aim and Objective for 2004-05 were:

Aim

To administer the tax system fairly and efficiently and make it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credit and other entitlements.

Objective

To collect the right revenue and give the right entitlements, at the right time. This Objective is subdivided into five activities as described in Schedule 5 of the Resource Account (see page 24).

The Inland Revenue's performance is assessed through its Public Service Agreement (PSA), Service Delivery Agreement (SDA) and other work targets. The Department's PSA for the period 2003-2006 (set out in the Spending Review (SR) 2002) contained five key targets. Full details of performance against those targets are reported in the Department's Annual Report and its Spring and Autumn Performance Reports.

New Basis for the production of the Trust Statement

The HM Treasury Accounts Direction issued under Section 2 of the Exchequer and Audit Departments Act 1921 requires the Department to produce the Trust Statement.

This year we are moving from a cash to an accruals basis which will change the emphasis of the Trust Statement from reporting the cash actually received and paid in a given year to the revenue earned and expended in respect of that year. One of the effects of this change is that we will publish a Trust Statement Balance Sheet for the first time and will identify new figures in the accounts including:

- Revenue

  The figures in the Statement of Revenue and Expenditure represent the amounts expected to become payable as a result of the earning of taxable income, profits or gains or the occurrence of other taxable transactions. They are therefore essentially a forward-looking measure of our tax receipts whereas the previous cash based statements were a backward-looking measure of that same flow of receipts. No attempt is made to incorporate any estimate of the 'tax gap' within the Revenue figures which, owing to evasion or avoidance, is never paid.

- Revenue Remissions and Write-offs

  Some of the taxes and duties we seek to collect will, for a variety of reasons, never be paid over. The Statement of Revenue and Expenditure therefore discloses amounts we have either written off (where the debt is irrecoverable) or remitted (where it would not be appropriate to pursue the debt). The treatment is explained further in Accounting Policy note 1.3.5.

- Debtors and Accrued Revenue Receivable

  The Trust Statement now includes a Balance Sheet disclosing debtors (money owed to the Department at the year end) and accrued revenue receivable (amounts included within revenue but either not yet due for payment or not yet received from taxpayers and not included in debtors).

- Doubtful Debt Provisions

  Under UK Generally Accepted Accounting Practice (GAAP), and in line with commercial practice, we do not only report debts that have been remitted or written off, but we also provide for debts that are likely to become uncollectable in the future. The Revenue figure in the Statement of Revenue and Expenditure is stated net of changes in the doubtful debt provision. Our Balance Sheet figures for Debtors and Accrued Revenue Receivable are also quoted net of provisions. Details of the provisions and changes to them for the year are disclosed in note 5.1 to the account.

Contingent Liabilities

These are less certain possible cash outflows due to outstanding legal actions and certain other matters concerning the finalisation of tax assessments. Each case is reviewed and assessed based on its merits and technical advice from our solicitors. In accordance with UK GAAP, these amounts are not shown in the Statement of Revenue and Expenditure or the Balance Sheet.

Selection of appropriate Accounting Policies for the Trust Statement and use of judgements and estimates

As Principal Accounting Officer, it is my responsibility to apply suitable accounting policies in the preparation of the Trust Statement. With the move to the accruals basis the Department has fully reviewed its accounting policies. The underlying approach to accruals measurement is that revenues from taxation and National Insurance Contributions are deemed to accrue evenly over the (tax return) period for which they are due. Revenues are recognised in the period in which the event that generates the revenue occurs, for example, the earning of assessable income or profit. Given the nature of tax legislation and our associated systems some of the accrued revenue receivable figures and some other items are subject to statistical estimation or forecasts. Where this is the case reference is made in the relevant accounting policies.

We have used estimates for a number of taxation streams because the majority of tax returns reporting taxpayer liabilities are not required to be sent to us until several months after the year end, that is after the Department's accounts have been finalised.

In preparing our estimates we have to take account of areas of uncertainty around those factors which determine future revenue flows. We therefore have to make complex judgements concerning some of these factors and we have procedures in place to do this.

We use statistical models to derive the estimates. These are based on a combination of projections based on the most recent revenue flows and forecasts of economic variables on which future revenue flows depend. We have based these forecasts on what we believe to be the relevant inputs. However, because of the areas of uncertainty involved there will inevitably be differences between our forecasts and future outturns. These differences arise because of the need to make judgements on areas of uncertainty and are not indicative of deficiencies in our models. We believe that the levels of variation are acceptable with a maximum likely overall uncertainty expected to be some £2.5 billion, which does not significantly affect the reported position. This figure is equivalent to about:

- less than 1 per cent of total Revenue reported in the Statement of Revenue and Expenditure, or
- less than 5 per cent of total Debtors and Accrued Revenue Receivable reported in the Balance Sheet.

This maximum likely overall uncertainty is based on a combination of evidence from the performance of the models over three years and the judgement of professional Departmental economists and statisticians having substantial experience of forecasting in the area of direct taxes.

Accrued Revenue Receivable is separately estimated for each revenue stream and sub-component of income tax. The main economic assumptions which have been used are based on those which were, in part, set out in Parts B and C of the Chancellor of the Exchequer's March 2005 Financial Statement and Budget Report. The most important assumption in this context is that income from self-employment is assumed to rise by 6.9 per cent in 2004-05.

The 2005-06 Trust Statement will disclose actual figures and comment on the accuracy of the 2004-05 estimates in the light of more accurate information. However, it will not be our policy to restate the 2004-05 figures.

The Cash Flow Statement to the Trust Statement provides an analysis of the cash position, which can be compared with the Net Revenue.

As this is the first year of preparing the Trust Statement on an accruals basis it is not possible to report comparative revenue and expenditure figures relating to the financial year 2003-04. However, comparatives are disclosed in the Balance Sheet and the associated supporting notes.

Revenue and Expenditure in the Trust Statement

Total taxes and duties, as shown in the Statement of Revenue and Expenditure were £175.9 billion in 2004-05. This was about £4 billion (2 per cent) higher than the net cash equivalent. The inclusion of remissions in the net revenue due accounted for nearly £1 billion of the difference. The main component of the difference was Income Tax where accrued revenue was £3.5 billion higher than the cash equivalent. This was largely due to higher accrued revenue receivable for tax on employment and self-employed incomes on the Balance Sheet as at 31 March 2005 compared with one year earlier.

Net revenue due for National Insurance Contributions (NICs) was £80.2 billion - very close to the net cash equivalent. However the split between net revenue due for NICs and Income Tax is partly dependent on assumptions about the likely level of re-allocation between PAYE Income Tax and NICs following receipt of the employer end of year returns for 2004-05 and that re-allocation process is still ongoing. (The total net revenue due for Income Tax and NICs combined is not affected by these re-allocations.) Net expenditure on Child & Working Tax Credits was £13.8 billion compared with actual payments made of £15.8 billion. This was mainly due to an increase in debtors as a result of the 2003-04 finalisation exercise.

Net cash receipts of tax and duties were £172 billion in 2004-05. This represented an increase of £16 billion or over 10 per cent compared with the previous year. The main components of this increase were Income Tax and Corporation Tax. Income Tax receipts were £9 billion (8 per cent) higher mainly due to the growth in both employment and self-employed incomes. Corporation Tax receipts were over £5 billion (20 per cent) higher due to growth in business profits and higher oil and gas prices. In addition there was an increase of over £1 billion in receipts of stamp taxes due to higher volumes of house sales and higher prices.

Net cash receipts of NICs were £80 billion in 2004-05 representing an annual increase of £5 billion or over 6 per cent. The main reason was the growth in employment incomes. Cash payments of Child & Working Tax Credits increased by over £2 billion to £15.8 billion.

Events in 2004-05

Following a review of Departmental capacity, the Modernising PAYE Processes for Customers (MPPC) programme (including implementation of the recommendations in Patrick Carter's Review of Payroll Services) was deferred. The Carter proposals were implemented as part of new End of Year processes in April to June 2005. The remaining PAYE regime improvements to be delivered by MPPC are now planned to be delivered during 2007. This will improve Departmental efficiency but will not impact on the level of tax receipts.

In March 2004, the Government accepted in full the recommendations of the review of the Revenue Departments, led by the then Permanent Secretary to the Treasury, Gus O'Donnell. The key recommendation of the review was the creation of a new Department, integrating HM Customs and Excise and the Inland Revenue, tasked with improving customer experience, improving compliance with tax law, and increasing efficiency. David Varney was appointed chairman of this new department with Paul Gray as deputy chairman.

Transfer of tax policy functions and 150 staff to the Treasury was completed, to improve the ability of the Government to respond to modern tax challenges and create a greater delivery focus in the new Department. This transfer is reported in the Department's Resource Account.

Following the new legislation the Inland Revenue and HM Customs and Excise have now been integrated into one new department and so for the 2005-06 financial year one Trust Statement for HM Revenue and Customs will be published reporting the combined activities of the two former departments.

Management

During 2004-05, the Chairman of the Board of Inland Revenue was accountable to the Chancellor of the Exchequer for the administration of its affairs and the implementation and stewardship of tax policy. The Chancellor was supported by the Paymaster General, who was the Departmental Minister with day-to-day responsibility for the Inland Revenue.

During the year, the executive members comprising the Statutory Board of the Inland Revenue were:

		(period if not full year)
David Varney	Chairman	from 1 September 2004
Paul Gray CB	Deputy Chairman	from 1 September 2004
Ann Chant CB	Acting Chairman	from 1 April to 31 August 2004
	Director General	from 1 September 2004
Dave Hartnett CB	Director General	
Helen Ghosh	Director General	
Steve Heminsley	Acting Director General	
Steve Lamey	Chief Information Officer	from 18 October 2004

The following non-executive Board members, together with the Statutory Board members, formed the Departmental Board.

David Park	Acting Chief Executive Valuation Office Agency	from 1 April to 6 June 2004
Andrew Hudson	Chief Executive Valuation Office Agency	from 7 June 2004
Pat Stafford	Non-executive Board member	
Rene Carayol	Non-executive Board member	to 2 July 2004
Kate Owen*	Non-executive Board member	
Bill Griffiths*	Non-executive Board member	from 17 November 2004

** Audit Committee members.*

The Chairman of the Board of Inland Revenue and other members of the Board were appointed in accordance with the procedures in the Civil Service Management Code.

The remuneration of the executive members of the Statutory Board (see note 3.3 to the Resource Accounts) was determined in accordance with the report of the Senior Salaries Review Body.

The Trust Statement is audited by the Comptroller and Auditor General under Section 2 of the Exchequer and Audit Departments Act 1921. The auditor's notional remuneration for this is included in the Resource Accounts. There was no non-audit work.

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Statement of Principal Accounting Officer's Responsibilities in respect of these accounts

HM Treasury has appointed the Permanent Head of Department as Principal Accounting Officer of the Department with overall responsibility for preparing the Department's accounts and for transmitting them to the Comptroller and Auditor General.

The Principal Accounting Officer for the Inland Revenue is responsible for ensuring that there is a high standard of financial management of the Department's resources, including a sound system of internal control; that financial systems and procedures promote the efficient and economical conduct of business and safeguard financial propriety and regularity; that financial considerations are fully taken into account in decisions on policy proposals; and risk is considered in relation to assessing value for money.

The Principal Accounting Officer is responsible for the fair and efficient administration of the tax system, including the assessment, collection and proper allocation of revenue, and payment of tax credits and other entitlements.

Under section 2(3) of the Exchequer and Audit Departments Act 1921 the Principal Accounting Officer is responsible for the preparation and submission to the Comptroller and Auditor General of a Trust Statement for the Inland Revenue for the financial year 2004-05. In conforming with Treasury direction (see page 85 of this Trust Statement), it details the revenue and expenditure in respect of taxation, National Insurance Contributions, tax credits and Student Loan recoveries during the year together with the net amounts surrendered to the Consolidated Fund.

The Trust Statement is prepared on an accruals basis and must give a true and fair view of the state of affairs of the Department, including a Statement of Revenue and Expenditure, a Balance Sheet, and a Cash Flow Statement. Whilst the Department is concerned with compliance the Trust Statement does not show estimates of taxes foregone as a result of avoidance and non-compliance with taxpayers' obligations.

The Trust Statement should include a Statement on Internal Control (SIC) which sets out the governance risk and control arrangements for the Department. The SIC process is firmly and clearly linked to the risk management process in the Inland Revenue.

In preparing the Trust Statement accounts, the Principal Accounting Officer is required to:

- observe the relevant accounting and disclosure requirements, and apply suitable accounting policies on a consistent basis;
- make judgements and estimates and forecast tax receipts on a reasonable basis;
- state whether applicable accounting standards have been followed and disclose and explain any material departures in the accounts;
- make provisions for taxes assessed and likely not to be received, on a reasonable basis.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which an Accounting Officer is answerable, for keeping proper records and for safeguarding the Department's assets, are set out in the Accounting Officers' Memorandum issued by HM Treasury and published in Government Accounting. Under the terms of the Accounting Officers' Memorandum, the relationship between the Department's Principal and Additional Accounting Officers, together with their respective responsibilities, is set out in writing.

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Trust Statement and the Resource Accounts, is shown on pages 1 to 7.

The Certificate and Report of the Comptroller and Auditor General to the House of Commons

I certify that I have audited the Trust Statement on pages 68 to 84 under Section 2 of the Exchequer and Audit Departments Act 1921. These financial statements have been prepared under an accruals basis and the accounting policies set out on pages 71 to 76.

Respective Responsibilities of the Board of the Department, Accounting Officer and Auditor

As described on page 64, the Board of Her Majesty's Revenue and Customs is responsible for the preparation of the Inland Revenue Trust Statement in accordance with the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder. The Chairman of the Board of Inland Revenue (until 17 April 2005) and of Her Majesty's Revenue and Customs (from 18 April 2005) is responsible for ensuring the propriety and regularity of public finances and for keeping proper records. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with section 2(3) of the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder; and whether in all material respects the revenue and expenditure have been applied to the purposes intended by Parliament and conform to the authorities which govern them. I also report if, in my opinion, the Foreword is not consistent with the financial statements, proper accounting records have not been kept, or if I have not received all the information and explanations I require for my audit.

I review whether the statement on pages 1 to 7 reflects the Department's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of opinion

I conducted my audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Department's circumstances, consistently applied and adequately disclosed.

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity and that, in all material respects, the revenue and expenditure have been applied to the purposes intended by Parliament and conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Fundamental uncertainty relating to certain elements of Tax Accruals

In forming my opinion, I have considered the adequacy of the Department's disclosure in the Trust Statement of the following matter.

As a result of the change from cash based to accrual accounting the Department had to estimate tax due as at 31 March 2004 and 31 March 2005 but not paid or payable in the years then ended. For some taxes the Department had a reasonably firm basis for the estimate but for two significant tax streams the taxpayer returns were not due until after the Trust Statement was finalised.

The Department forecast that the amounts due at 31 March 2005 were £15.4 billion for Income Tax Self Assessment (including a National Insurance element) and £12.1 billion for Corporation Tax. These amounts are included within Accrued Revenue Receivable shown in note 6 to the accounts. The Department based these forecasts on patterns of receipts of revenue and tax returns in previous years, assumptions about the rate of growth in the economy overall and profitability in the sectors most affected by Income Tax Self Assessment.

As described in note 6 and the Foreword, the Department considered that it could not determine precisely the uncertainty in these forecasts but that the combined accrual of £27.5 billion at 31 March 2005 should be regarded as subject to uncertainty of up to £2.5 billion in either direction, equivalent to 5 per cent of the total Accrued Revenue Receivable. The Department does not expect the extent of uncertainty to change in future years.

This matter represents a fundamental uncertainty. It is adequately disclosed in the Trust Statement and my opinion is not qualified in respect of this matter.

Qualified opinion arising because the financial statements include Tax Credit payments that have not been applied to the purposes intended by Parliament

Part 2 of my report[1] on the Inland Revenue's financial statements considers various tax credit matters including the following.

A Departmental exercise in 2000-01 indicated that it had overpaid some 10 to 14 per cent by value of the former tax credits because of claimant error or fraud, and I therefore qualified my audit opinion in respect of the 2002-03 Trust Statement. Whilst the design of the New Tax Credits and supporting systems from 2003-04 should have reduced the risk of error and fraud, the Department had no evidence that error rates had in fact fallen and I therefore qualified my audit opinion for 2003-04.

From early 2005 the Department examined a sample of 2003-04 tax credit awards and in July 2005 produced interim findings which indicated overpayment of £460 million (around 3.4 per cent by value) because of claimant error and fraud in 2003-04. The Department believes that these interim results are subject to a wide margin of error because they are based on work that had been completed by May 2005 and it is likely that these cases were more compliant. The final results due in spring 2006 are likely to show an increase in the proportion of cases involving claimant error and fraud. Whilst the interim work suggests that the level of error is lower than with the previous tax credits, it remains in my view unacceptably high in both the amount and percentage terms. There is no evidence to suggest that the level of error would have fallen significantly from 2003-04 to 2004-05. Consequently, I have qualified my audit opinion on the 2004-05 Trust Statement in respect of tax credits.

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Board of Inland Revenue in respect of taxes, duties, National Insurance Contributions, tax credits and certain other items for the year ended 31 March 2005 and the revenue and expenditure and cash flows for the year then ended and have been properly prepared in accordance with section 2(3) of the Exchequer and Audit Departments Act 1921 and directions made thereunder by Treasury; and
- except for the probable level of error leading to significant amounts of overpayments of tax credits referred to above, in all material respects revenue and expenditure have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

JOHN BOURN
Comptroller and Auditor General
7 October 2005

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

[1] *Comptroller and Auditor General's Standard Report on the Accounts of the Inland Revenue 2004-05 (HC 446 2005-06 - pages R1 to R30).*

The maintenance and integrity of the HM Revenue and Customs' website is the responsibility of the Accounting Officer; the work carried out by the auditors does not involve consideration of these matters and accordingly the auditors accept no responsibility for any changes that may have occurred to the financial statements since they were initially presented on the website.

Statement of Revenue and Expenditure for the year ended 31 March 2005 (£billions)

	Notes	2004-05
Revenue:		
Taxes and duties		
Income Tax		130.9
Corporation Tax	2.1	33.0
Stamp Taxes		9.0
Other Taxes and Duties	2.2	6.7
Tax Credits treated as Negative Taxation	3.1	(3.7)
Total Taxes and Duties		**175.9**
Other Revenue		
National Insurance Contributions	4.1	80.2
Certificates of Tax Deposit	4.2	0.3
Student Loan Recoveries	4.3	0.2
Total Other Revenue		**80.7**
Total Revenue		**256.6**
Less Expenditure and Disbursements		
Tax Credits treated as Payments of Entitlement	3.1	10.1
National Insurance Contributions due to the National Insurance Funds and National Health Services	4.1	79.8
Certificates of Tax Deposit	4.2	0.3
Student Loan Recoveries due to the Department for Education and Skills	4.3	0.2
Revenue Remissions and Write-offs	5.2	2.0
Total Expenditure and Disbursements		**92.4**
Net Revenue for the Consolidated Fund		**164.2**

The notes at pages 71 to 84 form part of this Statement.

There were no recognised gains and losses accounted for outside the above Statement of Revenue and Expenditure.

Balance Sheet as at 31 March 2005 (£billions)

	Notes	31 March 2005	1 April 2004
Debtors falling due after more than one year	6	**1.9**	**0.5**
Current Assets			
Debtors	6	9.6	10.2
Accrued Revenue Receivable	6	47.4	43.8
Cash at Bank and in Hand		0.1	(0.4)
		57.1	53.6
Current Liabilities			
Creditors	7	9.9	9.8
Accrued Revenue Liabilities	7	11.7	12.2
Deferred Revenue	7	0.3	0.2
		21.9	22.2
Total Current Assets less Current Liabilities		**35.2**	**31.4**
Total Net Assets		**37.1**	**31.9**
Represented by:			
Balance on Consolidated Fund Account	8	**37.1**	**31.9**

The notes at pages 71 to 84 form part of this Statement.

The Balance Sheet was approved by the Principal Accounting Officer

DAVID VARNEY
Principal Accounting Officer
5 October 2005

Cash Flow Statement for the year ended 31 March 2005 (£billions)

	Notes	2004-05
Net Cash Flow from Revenue Activities	A	159.5
Cash paid to Consolidated Fund		159.0
Increase/(Decrease) in Cash in this period	B	**0.5**

Notes to the Cash Flow Statement

A: Reconciliation of Net Cash Flow to movement in Net Funds

	2004-05
Net revenue for the Consolidated Fund	164.2
(Increase)/Decrease in Non-cash assets	(4.4)
Increase/(Decrease) in Liabilities	(0.3)
Net Cash flow from Revenue Activities	**159.5**

B: Analysis Of Changes In Net Funds

	2004-05
Increase/(Decrease) in Cash in this period	0.5
Net Funds as at 1 April (Opening Cash at Bank)	(0.4)
Net Funds as at 31 March (Closing Cash at Bank)	**0.1**

The notes at pages 71 to 84 form part of this Statement.

Notes to the Trust Statement

1 Statement of Accounting Policies

1.1 **Basis of Accounting**

The Trust Statement is prepared in accordance with the Accounts Direction (see page 85) issued by HM Treasury under the Exchequer and Audit Departments Act 1921. The Statement is produced in accordance with UK Generally Accepted Accounting Practice (GAAP) to the extent that this is meaningful and appropriate. The accounting policies detailed below have been applied consistently in the Trust Statement.

1.2 **Accounting Convention**

These accounts have been prepared on an accruals basis and in accordance with the historical cost convention. It has not been practical to produce accruals in all cases, therefore, the cash basis has been used in the following cases: Corporation Tax for small companies*, Capital Gains Tax, Stamp Duty on non-registered shares, some minor elements of Income Tax, and National Insurance Classes 1A, 1B, and 3.

*More information on "small companies" is set out in 1.4.3 below.

As this is the first year that the accounts have been produced on an accruals basis, there is a difference between the closing balance on the Consolidated Fund Account shown in last year's published accounts, produced on a cash basis, and the opening balance on these accounts. Notes 8 and 9 provide more information.

1.3 **General Accounting Policies**

1.3.1 Net Accounting

Revenues are stated net of repayments and refunds. Repayments and refunds arise when tax liabilities have been overpaid and where tax relief is given, for example, when income from which tax has been deducted at source is received by a body enjoying an exemption from tax.

1.3.2 Interest

Interest is charged to taxpayers when tax liabilities have not been paid by the due date. Interest is paid to taxpayers when tax liabilities have been overpaid. Revenues include interest received less interest paid.

1.3.3 Fines and Penalties

Income generated from fines and penalties (except that relating to National Insurance) is recorded in the Department's Resource Accounts as either Appropriations in Aid or as payable to the Consolidated Fund.

1.3.4 Debtors

In certain circumstances tax legislation allows tax liabilities that have been established as due for payment to be paid over a period of more than one year. The most common examples relate to Inheritance Tax debt and to recovery of tax credit overpayments and these are disclosed separately in Note 6.

1.3.5 Remissions and Write-offs

Remissions are debts capable of recovery but the Department has decided not to pursue the liability, for example, due to hardship or official error. Write-offs are debts that are irrecoverable because there is no practical means for pursuing the liability.

Remissions and write-offs are recognised in the year they are authorised. Where the Department recovers an amount of money that has been written-off or remitted or the original assessment is found to be incorrect, such recoveries or amendments reduce the amount of the remissions and write-offs in the year of that recovery.

1.3.6 Provision for Doubtful Debt

In order to present revenue fairly, it is necessary to make an allowance for those amounts of taxes and National Insurance Contributions which we believe will be remitted or written-off in the future. This provision has been estimated using analysis of historic trends in debt recovery, remissions and write-offs supported by management judgement.

The figure in the Balance Sheet for debtors is shown net of the relevant provision for doubtful debts (note 5.1).

1.3.7 Unallocated Receipts

At 31 March each year there are receipts which cannot be allocated to a tax stream for various reasons, but which will normally be allocated to the appropriate tax stream during the following months. These sums have been apportioned across Income Tax, Capital Gains Tax and Corporation Tax using the information available at 31 March.

1.3.8 Contingent Liabilities

The Department is involved in revenue related legal actions. The courts may decide these cases for or against the Department. Where a case is still to be heard at court, or is subject to appeal, there is a large degree of uncertainty as to whether the Department has a contingent liability and the amounts involved.

Where the amounts involved are material and there is a possible chance that the Department will have to repay amounts of revenue, we will disclose these amounts as contingent liabilities in note 10. Some test cases may set a precedent that may result in further claims for repayment of revenue previously paid. Where appropriate, these amounts have also been included in the note.

Where a decision has been made that there is likely to be a repayment of revenue, which the Department can reliably estimate, we recognise this as a provision in the accounts. Where the outcome of court cases has gone against the Department and the case is uncontested, legal and administrative costs have either been provided for or charged through the Department's Resource Accounts.

1.3.9 Revenue Recognition

Taxation and duty revenues are recognised in the period in which the event that generates the revenues occurs, for example, the earning of assessable income or profit. Revenues are deemed to accrue evenly over the period for which they are due.

Repayments are accounted for on a cash basis and are recognised in the year the repayment is made.

Accounting for taxation revenue is not fully covered by UK GAAP, therefore revenue recognition is determined by guidance from HM Treasury which is reviewed by the Financial Reporting Advisory Board (FRAB)[1]. FRAB acts as an independent review in the process of setting accounting standards for government.

Where the revenue from taxes and duties derives from taxpayers' self-assessments of liability, the self-assessments may be subject to examination resulting in adjustment of receipts or repayments in future years. Any such adjustments are accounted for on a cash basis in the year of receipt or repayment.

Determinations (assessments) are raised if the taxpayer has not submitted a return or if the Inspector of Taxes believes the amount submitted to be incorrect. The taxpayer has the legal right to apply for the postponement of the determination, in which case there is a court hearing. Pending the court decision the tax is not legally due and cannot be collected, therefore we do not recognise this as revenue.

[1] *More information about FRAB can be obtained from the HM Treasury website (www.hm-treasury.gov.uk)*

1.4 **Significant Accounting and Estimation Policies**

Significant accounting policies, estimates and departures from UK GAAP are detailed below.

1.4.1 Income Tax

Pay as You Earn (PAYE)

Where payments have been received, but the end of year returns from employers have not yet been received, statistical estimates have been used to split the payments between Income Tax, National Insurance Contributions (NIC), Student Loan recoveries and tax credits paid.

The amount of debtors is obtained from the PAYE tax administration system. Where actual information is not available the debtor figure has been split between Income Tax and NIC Class 1 using estimates.

The estimate of accrued revenue receivable is defined as amounts either not yet due or received from taxpayers relating to the financial year where these have not been included in debtors. In general, payments of Income Tax and NIC Class 1 via PAYE exhibit a lag of one month - i.e. amounts deducted from wages and salaries by employers are paid to the Inland Revenue in the following month. The major component of accrued revenue receivable is therefore the April payment in respect of March liabilities which is known at the time the Accounts are prepared. The remainder comprises two separate elements. The first represents late payments not included in the debtor figure which are estimated on the basis of historical payment patterns. The other is re-allocations of PAYE between Income Tax and NIC Class 1. These are considered together because of the degree of re-allocation between the two following receipt of the end of year returns.

Self-Assessment (SA)

Under Self-Assessment, taxpayers have separate liabilities to Income Tax, National Insurance Contributions (NIC) Class 4, Student Loan repayments (see note 1.4.8 below) and Capital Gains Tax. Capital Gains Tax is accounted for on a cash basis.

The Department's tax administration systems record taxpayers' total liability, or total owing in refund cases, but do not provide the actual split of Income Tax, Capital Gains Tax, NIC Class 4 and Student Loan repayments. The total for Self-Assessment (SA) receipts is, therefore, allocated to these categories using estimates.

The estimate of accrued revenue receivable for SA Income Tax is defined as amounts not yet due from taxpayers relating to the financial year. It is estimated using a model that forecasts SA Income Tax liabilities and receipts. This model takes historical receipts and liabilities and projects them forwards using economic assumptions underlying the Budget 2005 forecast. The main economic determinant is the total amount of income from self-employment. The effect of changes in other more minor relevant variables such as interest rates is also incorporated.

A similar approach is used to produce accrued revenue receivable estimates for NIC Class 4 by the Government Actuary's Department.

The combination of SA Income Tax and NICs are considered together because statistical estimates are used to breakdown total receipts into the two categories. The maximum likely uncertainty is expected to be 14 per cent of the combined SA accrued revenue receivable.

The amount of debtors is obtained from the SA tax administration system. The debtor figure has been split between Income Tax and NIC 4 using the same allocation as for the cash receipts.

1.4.2 National Insurance Contributions (NIC)

NIC Class 1

Class 1 contributions relate to employers and employees.

The majority of Class 1 contributions are collected through the PAYE scheme (see above under Income Tax) with the same accounting policy and estimates.

Some PAYE receipts are received from employers as a combined payment of Class 1 contributions (NIC 1) and Income Tax (IT) receipts with no notification of the actual split. These receipts are split using an algorithm based on PAYE payments received during the year and the employer's record will initially reflect this preliminary split. The estimated NIC 1 receipt is paid over to one of the National Insurance Funds (NIFs). When the employer's year-end return is received and processed, after the financial year-end, the employer record will be updated to reflect the correct split. This may result in an adjustment from IT to NIC 1 or vice-versa, which will be reflected in both the receipt figures, and the amounts paid to the NIFs in the accounting period in which the adjustment is made.

This Trust Statement is net of amounts deducted by employers in respect of Statutory Sick Pay, Statutory Maternity Pay, Statutory Paternity Pay, Statutory Adoption Pay and is before deduction of payments for Personal Pension related rebates and incentives, which are accounted for in the National Insurance Fund Accounts.

NIC Class 1A, 1B and 3

Classes 1A and 1B relate to employee benefits and Class 3 are voluntary contributions.

These contributions are accounted for on a cash basis, being recognised in the financial year of receipt.

NIC Class 2 and 4

Classes 2 and 4 relate to the self-employed.

Class 4 contributions are collected with self-assessed Income Tax and a statistical estimation is provided as set out in note 1.4.1 above. Class 2 are flat rate contributions charged monthly or quarterly.

1.4.3 Corporation Tax (CT)

There are two Corporation Tax accounting policies to reflect the different tax regimes for large and small companies. Large companies are those with profits for an accounting period which exceed the Upper Relevant Maximum Amount (URMA) in force at the end of that period, and they therefore pay their tax at the main rate. URMA is currently £1.5m, and the main rate of corporation tax is 30 per cent from 1 April 1999. Small companies are those which do not fall within the definition of large companies.

Large Companies

CT for large companies is paid by four quarterly instalment payments (QIPs). The first payment is due 6 months and 13 days after the start of the company's accounting period, and the fourth payment is due 3 months and 14 days after the end of the accounting period.

Accrued revenue receivable for large companies CT is estimated using a model based on the QIPs. The model estimates full liabilities for these companies using QIPs actually received, with forecasts of QIPs not yet received. The QIPs actually received at the year-end are then deducted from the estimated full liabilities to arrive at the accrued revenue receivable. The key assumptions relate to the use of historical data to forecast the average profile for the four instalment payments made by companies and the volume of late payments (i.e. payments made after the due date for the fourth QIP).

Approximately 45 per cent of the accrued revenue receivable figure relates to company accounting periods where all four QIPs had been paid by the time the Accounts were finalised. The balance of the figure is based either on QIPs received plus a projection for further QIPs for the accounting period or, where no payments have been received, on the economic assumptions underlying the Budget 2005 forecast for Corporation Tax receipts.

Small Companies

CT for small companies is accounted for on a cash basis, recognised when the cash has been received.

Corporation Tax for small companies is due 9 months and 1 day after the end of the company's accounting period, therefore there is no reliable method of obtaining an estimate of the accrued revenue receivable. However, underpayments of CT arising from companies tax returns are included in the CT debtors.

1.4.4 Tax Credits

Tax credits have been recognised in the year in which they were authorised. Authorisation is the point at which the obligation to pay the tax credit arises.

Amounts authorised and due for payment by 5 April, but unpaid at this date, have been shown as a creditor.

Working Tax Credits (WTC) and Child Tax Credits (CTC) are treated as: negative tax to the extent that the Tax Credits are less than or equal to the income tax liability of the family unit; as public expenditure (referred to as "Payments of Entitlement" in the Statement) to the extent that credits exceed the liability. This definition is consistent with Organisation for Economic Cooperation and Development (OECD) classification rules and international best practice for the calculation of net taxes and social security contributions.

Payments of tax credits are provisional until entitlement is finalised after the financial year-end by the Department's renewals process. Any resultant underpayments identified are paid as lump sums and accounted for on a cash basis in the year of payment.

Overpayments identified are normally recovered from future tax credit awards over one or more years (subject to annual limits intended to minimise hardship to claimants) or by other recovery processes.

The amount of underpayments and overpayments identified when the Award has been finalised can only be quantified in the following accounting year and consequent payments, recoveries and any amounts written off are reported in that year's accounts.

The amounts of overpayments recoverable at 5 April have been shown as a debtor. Provision for unrecoverable overpayments is included in doubtful debts. An estimate has been provided for debts due more than one year after the Balance Sheet date.

In-year under or overpayments are calculated as and when changes of circumstances are notified to the Department and these are shown as debtors or creditors at 31 March.

1.4.5 Stamp Taxes

Accrued revenue receivable for Stamp Duty Land Tax and Stamp Duty on Registered Share Transactions has been estimated for transactions that were completed by 31 March, but the tax had not yet been received.

The minor stream of tax due on non-registered share transactions has been accounted for on a cash basis.

1.4.6 Inheritance Tax (IHT)

Assets in Lieu

The Department may, with the agreement of the relevant Secretary of State, accept qualifying assets on behalf of the Department for Culture, Media and Sport, in settlement of Inheritance Tax liabilities. The value of assets accepted in lieu of Inheritance Tax liabilities are accounted for in the Trust Statement and recognised as revenue and disbursements in the year of acceptance. These assets are not carried on the Balance Sheet.

1.4.7 Petroleum Revenue Tax (PRT)

A statistical estimate of the amount due at 31 March has been provided from a forecast of company assessments and actual payments made on account.

1.4.8 Student Loans

The Department recovers Student Loans through the taxes system, on behalf of the Department for Education and Skills (DfES), from those former students eligible to make repayments. On receipt of the funds from the Inland Revenue, DfES will arrange a transfer of a proportion to the Scottish Executive and the Department for Education and Learning Northern Ireland based on the percentages of student loan borrowers between England and Wales, Scotland and Northern Ireland.

Student Loan recoveries are estimated on the basis of the end of year employer returns processed before the Trust Statement is finalised. The actual value of Student Loan recoveries is established later in the year and the difference between the estimate and the actual receipt is paid to the DfES and disclosed in the Trust Statement for the following year.

Delays in the implementation of the new system for dealing with electronic employer returns for 2004-05 mean that there is a greater level of forecasting in this Trust Statement than in previous years. Any adjustment will be reflected in next year's Trust Statement.

1.4.9 Certificates of Tax Deposit

Under the Certificate of Tax Deposits (CTD) scheme the Department will accept deposits from people liable to UK taxes and other liabilities that are listed in the current Prospectus[2], which sets out the terms and interest payable. HM Treasury will notify depositors of changes to the terms of this Prospectus by issuing a Treasury Press Notice to Reuters.

These deposits are paid to the National Loans Fund (NLF) and HM Treasury issues receipts under section 12 of the National Loans Act 1968. Both the deposit and its interest will be held as a charge on the NLF, which is supported by the Consolidated Fund of the UK. The CTD can be used, in full or in part, to pay any liability listed in the Schedule that is current on the day the CTD is purchased. The CTD can be repaid in cash, together with accrued interest, at any time.

The Department administers this scheme on behalf of HM Treasury and the accounts of the NLF will include the principal and accrued interest for all issued CTDs at 31 March.

Processing lags between the issue and redemption of CTDs and the transfer of funds to and from the NLF can result in balances at the year end, which are included within debtors or creditors on the Trust Statement Balance Sheet. See note 4.2 for further breakdown.

2 Taxes and Duties Due

2.1 **Corporation Tax**

The Corporation Tax revenue is net of Research and Development, and Contaminated Land Tax Credits. The estimated figures for the payable elements of these credits are £5 million for Contaminated Land and £225 million for Research and Development.

2.2 **Other Taxes and Duties**

	Net Revenue Due 2004-05 £ billion
Inheritance Tax *	3.0
Capital Gains Tax	2.3
Petroleum Revenue Tax	1.4
Total Other Taxes and Duties	**6.7**

** Inheritance Tax revenue includes an amount of £6.7 million for assets accepted in lieu of Inheritance Tax liabilities for the year. This amount is treated as a disbursement to the Department for Culture, Media and Sport.*

[2] Prospectus (Series 7) details can be found at www.hmrc.gov.uk

2.3 **Unallocated Receipts**

At 31 March each year there are receipts which cannot be allocated to a tax stream for various reasons, but which will normally be allocated to the appropriate tax stream during the following months. These include amounts paid in advance, overpayments and unidentified items. These sums have been apportioned across Income Tax, Capital Gains Tax and Corporation Tax, using information available at 31 March.

The total of such items was £2,054 million at 31 March 2005 (£1,665 million at 31 March 2004).

3 Tax Credits

3.1 **The estimated breakdown is:**

	Net Expenditure 2004-05 £ billion
Child Tax Credits	10.0
Working Tax Credits	3.8
Total Tax Credits	**13.8**
Of which:	
Negative Tax	3.7
Payments of Entitlement	10.1
	13.8

In 2004-05 £1,648 million (£1,449 million in 2003-04) was paid via employers to recipients of Working Tax Credits. Of this an estimated £111 million (£146 million in 2003-04) was paid in March 2005 from receipts due to be paid to the Department in April 2005.

The division of amounts between Child and Working Tax Credits is based on estimates. Note 1.4.4 explains what are Negative Tax and Payments of Entitlement.

3.2 **Reconciliation between payments of Tax Credits and Net Expenditure:**

	Note	Net Expenditure 2004-05 £ billion
Payments made		15.8
Movement in Debtors	6	(1.7)
Movement in Creditors	7	(0.1)
Remissions and Write-offs	5.2	(0.1)
Direct Recoveries		(0.1)
Tax Credits Net Expenditure		**13.8**

Tax credit overpayments identified through in-year change of claimant circumstances or through the year-end finalisation exercise may be recovered in two ways: offset against future tax credit payments; or through repayments made by claimants, known as direct recoveries. Payments made in 2004-05 are net of £0.5 billion of offset recoveries, with £0.3 billion relating to 2003-04 overpayments.

3.3 Tax Credit Debtors

	Note	Total £ billion
Debtors as at 1 April 2004	6	0.9
2003-04 Finalisation Overpayments		1.3
Overpayments identified from Change of Circumstances in 2004-05		1.1
Recoveries made		(0.6)
Remissions and Write-offs	5.2	(0.1)
Debtors as at 31 March 2005	6	**2.6**
Provision for doubtful debts	5.1	(1.0)
Net		**1.6**

Debtors at 1 April 2004 represent overpayments of tax credits identified from changes of circumstances reported by claimants during 2003-04. Further overpayments relating to tax credits paid in 2003-04 totalling £1.3 billion were identified as a result of the finalisation exercise undertaken in 2004-05. These have been accounted for in 2004-05.

In accordance with the accounting policy for tax credits (Note 1.4.4), amounts under or over paid in 2004-05 that are identified during the finalisation exercise undertaken in 2005-06 are not included in the above figures. The values of under and overpayments arising from the 2004-05 finalisation exercise are estimated to be in the same order as those from the 2003-04 exercise.

3.4 The cost of managing and paying tax credits

The cost of managing and paying Working Tax Credit was £133 million (£139 million in 2003-04) and Child Tax Credit £342 million (£264 million in 2003-04). The total cost of £475 million has been charged to the Resource Accounts.

3.5 Tax credit error and fraud

The Department is using the results of enquiries into a random sample of finalised tax credit awards to establish an accurate measure of the level of claimant error and fraud in 2003-04. As some claimants did not finalise their 2003-04 incomes and circumstances until the deadline date of 31 January 2005, enquiries into the sample cases could not begin until well into 2005. Furthermore, enquires in more complex cases can take several months to complete. Because of these factors, a final estimate of claimant error and fraud for tax credits for 2003-04 will not be available until spring 2006.

The Department has nonetheless produced some interim results. These interim results, prepared in July 2005, suggest that a provisional estimate is that 13.1 per cent of awards contain an element of claimant error and fraud. The associated financial consequence of this is £460 million, which represents 3.4 per cent of the total value. However, these estimates were based on only 30 per cent of the random enquiries, the proportion that had been settled by the point at which data was extracted for analysis. As a result, they derive from cases that are less likely to be deliberately non-compliant, and are therefore subject to a wide margin of error. The final results are likely to show an increase in the proportion of cases involving claimant error and fraud.

4 Other Revenue

4.1 National Insurance Contributions

	Note	Net Revenue 2004-05 £ billion
Revenue		**80.2**
Remissions and Write-offs	5.2	**(0.4)**
Net Revenue due to the National Insurance Funds and National Health Services for the year		**79.8**

National Insurance Contributions: Allocations and Transfers

	Net Revenue 2004-05 £ billion	Transfers 2004-05 £ billion	Net Movement 2004-05 £ billion
National Insurance Fund - Great Britain	60.8	62.0	**(1.2)**
National Insurance Fund - Northern Ireland	1.2	1.3	**(0.1)**
National Health Services	17.8	17.9	**(0.1)**
Totals	**79.8**	**81.2**	**(1.4)**

National Insurance Contributions are paid over to the National Insurance Funds and National Health Services when received and not when accrued.

In March 2005 £938 million was paid over to the National Insurance Funds in settlement of the underpayment that had accumulated over the past ten years.

Some monthly PAYE receipts are received by the Department from employers as a combined payment of Income Tax and National Insurance Class 1 contributions with no notification of the actual split. A broad estimate based on one month's payments suggests that this amounted to about a fifth of receipts by value in deduction year 2003-04. The Department has to use an algorithm to achieve this split and to determine how much to pay over daily to the National Insurance Funds. The actual split is known only when end-of-year returns are received from employers and this is checked against the amounts allocated during the year. This process necessitated an adjustment of an estimated £1.4 billion for payments made during 2003-04, which was paid over to the Funds in 2004-05 and is included in the above transferred amounts.

4.2 National Loans Fund (NLF) - Certificates of Tax Deposit (CTD)

The Department administers this scheme on behalf of HM Treasury and these amounts are accounted for in the accounts of the National Loans Fund. See note 1.4.9 under accounting policies for further information.

	NLF-Issues 2004-05 £ million	NLF-Redemptions 2004-05 £ million	NLF-Total 2004-05 £ million
Receipts	113	180	**293**
Payments	(114)	(183)	**(297)**
	(1)	(3)	**(4)**
Balance brought forward			-
Balance carried forward (Included in debtors)			**(4)**

4.3 **Student Loan Recoveries**

	2004-05
	£ million
Receipts	209
Payments	(253)
Balance	(44)
Balance brought forward	30
Balance carried forward (Included in debtors)	**(14)**

Latest estimates, in respect of the 2003-04 tax year, indicate that Student Loan recoveries were lower than expected and the final amount is forecast to be £104.6 million. This results in a net overpayment of £14 million to the DfES at 31 March 2005, which with HM Treasury authorisation, will be recovered by reducing payments made to DfES during 2005-06.

5 Revenue Remissions and Write-Offs

5.1 **Provision for doubtful debts for the year ended 31 March 2005**

	Balance at 1 April 2004	**Movement in Provision**	**Balance at 31 March 2005**
	£ million	£ million	£ million
Income Tax	576	(165)	**411**
Corporation Tax	274	(138)	**136**
National Insurance Contributions	451	(150)	**301**
Tax Credits	-	961	**961**
Other Remissions and Write-offs	-	1	**1**
Total	**1,301**	**509**	**1,810**

No doubtful debt provision has been provided against the opening tax credit debtor as this was the first year of operation and the effects of finalisation for 2003-04 have not been included in this figure.

5.2 **Amounts remitted or written-off for the year ended 31 March 2005.**

	Note	**2004-05** £ million
Income Tax		576
Corporation Tax		322
National Insurance Contributions		452
Tax Credits		123
Other Remissions and Write-offs		2
Remissions and Write-offs		1,475
Movement in Provision for Doubtful Debts	5.1	509
Total remissions, write-offs and movement in provision		**1,984**

National Insurance Contribution write-offs include £67 million Class 2 contributions no longer collectable as they became time barred in year. The opening balance of NIC debt at 1 April 2004 is net of £266 million, which became time barred prior to this date.

5.3 **Amounts remitted or written-off for the year ended 31 October 2004 (Board's Remission List)**

	Income Tax £ million	Corporation Tax £ million	National Insurance £ million	Other £ million	Total £ million
Remissions - Hardship and Equity	12	-	1	1	14
Remissions - Other	28	3	5	4	40
Irrecoverable - Insolvency	452	299	271	4	1,026
Irrecoverable - Other	24	-	3	-	27
Total remissions and write-offs	**516**	**302**	**280**	**9**	**1,107**

The most recent analysis showing the grounds on which tax is remitted or written-off was prepared for the year ended 31 October 2004 and is summarised above. Work is in hand to align this process with a 31 March year-end, and to ensure consistency of reporting. The future of the Board's Remission List is being looked at as part of this review.

Remissions and write-offs for NIC Class 2 and Working and Child Tax Credits overpayments are not included in the above table.

6 Debtors and Accrued Revenue Receivable

Debtors due within one year and Accrued Revenue Receivable	**Debtors at 31 March 2005** £ billion	**Accrued Revenue Receivable at 31 March 2005** £ billion	**Total at 31 March 2005** £ billion	**Total at 1 April 2004** £ billion
Income Tax	5.7	25.0	**30.7**	27.8
Corporation Tax	1.7	12.1	**13.8**	13.3
Stamp Taxes	-	0.7	**0.7**	0.6
Inheritance Tax	0.3	-	**0.3**	0.2
Petroleum Revenue Tax	-	0.3	**0.3**	0.3
Tax Credit Overpayments	0.8	-	**0.8**	0.9
National Insurance Contributions	2.4	9.3	**11.7**	12.2
	10.9	47.4	**58.3**	55.3
Less Provision	(1.3)	-	**(1.3)**	(1.3)
	9.6	47.4	**57.0**	54.0
Debtors due after more than one year				
Inheritance Tax	0.6	-	**0.6**	0.5
Tax Credit Overpayments	1.8	-	**1.8**	-
	2.4	-	**2.4**	0.5
Less Provision	(0.5)	-	**(0.5)**	-
	1.9	-	**1.9**	0.5
Totals before Provision	13.3	47.4	**60.7**	55.8
Less Provision (Note 5)	(1.8)	-	**(1.8)**	(1.3)
Total	11.5	47.4	**58.9**	54.5

Debtors represent amounts due from taxpayers in respect of established liabilities for which, at the Balance Sheet date, payments had not been received. Of the £13.3 billion recorded in the Department's tax administration systems, we have provided £1.8 billion for debts we consider will not be recovered, see note 5.

Accrued Revenue Receivable represents amounts not yet due or received from taxpayers, but relating to the financial year (or for certain Corporation Tax liabilities to an earlier financial year) where these have not been included in debtors. These amounts have been estimated using statistical models based on projections of the most recent revenue flows and forecasts of economic variables on which future revenue flows depend.

As described below and outlined in the Foreword, we believe that within the estimates there is a maximum likely overall uncertainty amounting to some £2.5 billion, but that this does not significantly affect the reported position overall. This figure is equivalent to about:

- 1 per cent of total accrued revenue reported in the Statement of Revenue and Expenditure, and
- 5 per cent of total debtors and accrued revenue receivable reported in the Balance Sheet.

The maximum likely overall uncertainty is based on a combination of evidence from the performance of the estimating and forecasting models over three years and the judgement of professional Departmental economists and statisticians who have substantial experience of forecasting in the area of direct taxes.

PAYE and Class 1 National Insurance Contributions (NIC)

The estimate of PAYE and NIC Class 1 debtors and accrued revenue receivable represents amounts owed to the Department at the year end and amounts included within revenue but not yet due for payment in respect of the financial year. In general, Income Tax and NIC Class 1 collected via PAYE are deducted from wages and salaries by employers and paid to the Department in the following month. A major component of debtors and accrued revenue receivable is, therefore, the April payment in respect of March liabilities, and this is known at the time the Accounts are prepared. The remainder comprises:

a) late payments (estimated on the basis of historical payment patterns), and

b) re-allocations between PAYE Income Tax and NIC Class 1. See also note 1.4.1 PAYE

Self-Assessment (SA) Income Tax and Class 4 National Insurance Contributions (NIC)

The estimate of debtor and accrued revenue receivable for SA Income Tax represents amounts owed to the Department at the year end and amounts included within revenue but not yet due for payment in respect of the financial year. The accrued revenue receivable is estimated using a model that forecasts SA Income Tax liabilities and receipts using economic assumptions underlying the Budget 2005 forecast. The main economic determinant is the total amount of income from self-employment. The effects of changes in other more minor relevant variables, such as interest rates, are also incorporated.

A similar approach is used to produce accrued revenue receivable estimates for NIC Class 4 by the Government Actuary's Department.

Corporation Tax (CT)

Corporation Tax for large companies is paid by four quarterly instalment payments (QIPs) and accrued revenue receivable is estimated using a model based on the QIPs. The model estimates full liabilities for these companies using QIPs actually received, with forecasts of QIPs not yet received. The key assumptions relate to the use of historical data to forecast the average profile for the QIPs and the volume of late payments. For accounting periods where no QIPs have been received when the Accounts were finalised, the amounts are based on the economic assumptions underlying the Budget 2005 forecast for Corporation Tax receipts.
See also note 1.4.3.

7 Creditors, Accrued Revenue Liabilities and Deferred Revenue

A breakdown of Creditors, Accrued Revenue Liabilities and Deferred Revenue, which fall due within one year is included below.

	Creditors at 31 March 2005 £ billion	Accrued Revenue Liabilities at 31 March 2005 £ billion	Deferred Revenue at 31 March 2005 £ billion	Total at 31 March 2005 £ billion	Total at 1 April 2004 £ billion
Corporation Tax	9.5	-	-	9.5	8.4
Inheritance Tax	-	-	0.3	0.3	0.2
Tax Credits	0.1	-	-	0.1	0.2
National Insurance Funds and the National Health Services	0.3	11.7	-	12.0	13.4
Total	**9.9**	**11.7**	**0.3**	**21.9**	**22.2**

Creditors are amounts established as due at the Balance Sheet date but payment has not been made in full.

Accrued Revenue Liabilities includes amounts of Accrued Revenue Receivable due to a third party when received e.g. National Insurance Contributions due to the National Insurance Funds and National Health Services.

Deferred Revenue includes taxes and duties received in the current year that relate to future liabilities.

There are no creditors falling due after one year.

8 Balance on Consolidated Fund Account

	Note	£ billion
Balance as at 1 April 2004 (as disclosed in 2003-04 published Trust Statement)		**(0.4)**
Adjustments for changes in Accounting Policy	9	**32.3**
Adjusted balance as at 1 April 2004		**31.9**
Net Revenue for the Consolidated Fund		**164.2**
Less amount paid to the Consolidated Fund		**(159.0)**
Balance on Consolidated Fund Account as at 31 March 2005		**37.1**

9 Change in Accounting Policy

The basis of preparation of these accounts has been changed from cash to accruals as required by HM Treasury. Tax and duty revenues are now reported in the year in which the income or transaction giving rise to the taxes was earned or occurred rather than at the time of the cash receipts. Tax and duty amounts receivable and payable are now recorded as assets and liabilities on the Balance Sheet.

The adjustment for changes in accounting policy is made up of the balances at 1 April 2004, as follows:

	£ billion
Debtors	**10.7**
Accrued Revenue Receivable	**43.8**
Accrued Revenue Payable	**(12.2)**
Creditors	**(9.8)**
Deferred Revenue	**(0.2)**
Opening Adjustment	**32.3**

10 Contingent Liabilities

10.1 **Legal cases**

The Department is engaged in litigation with taxpayers across a range of cases. In the event of adverse decisions in some or all of these cases, there may be reductions in revenue and/or repayments of tax. The issues raised in litigation vary and for some cases it is not practicable to estimate the financial effect.

In certain circumstances where tax is assessed, the taxpayer has the legal right to apply for the postponement of payment in the case of a dispute. Pending the tribunal decision the tax is not legally due and cannot be collected. Consequently we neither recognise revenue nor disclose any contingent liabilities in respect of these cases.

Taking this into account, the Department regards the level of any contingent liability in respect of legal cases as not material.

10.2 **Consequences of oil field decommissioning on Petroleum Revenue Tax (PRT)**

The 1975 Oil Taxation Act as subsequently amended allows for PRT losses arising from the decommissioning of infrastructure associated with oil and gas fields subject to PRT to be carried back indefinitely. Estimates of the cost of decommissioning vary widely, ranging from £10 billion to £20 billion at today's prices in respect both of fields subject to PRT and those not. In so far as part of this expenditure generates PRT losses that are carried back then the PRT liabilities for the periods to which the losses get carried back may be less than originally measured. So any accrued revenue receivable for those periods will be less than originally thought. The cost of decommissioning remains uncertain since it will be determined by the domestic and international obligations that prevail when abandonment takes place. The majority of the expenditure is likely to be spread over the next 20 years or so but this depends on the extent to which North Sea output can be sustained, so the timing is uncertain. However, for certain fields decommissioning has already taken place.

11 Related Party Transactions

Due to the nature of the Department's business, we have a large number of transactions, relating to taxation income, with other Government Departments, other Central Government bodies, managerial staff and taxpayers. During the year none of the Board members or other related parties have undertaken material transactions with the Department.

Accounts Direction given by HM Treasury

BOARD OF INLAND REVENUE

ACCOUNTS DIRECTION GIVEN BY THE TREASURY IN ACCORDANCE WITH SECTION 5(2) OF THE GOVERNMENT RESOURCES AND ACCOUNTS ACT 2000 AND WITH SECTION 2(3) OF THE EXCHEQUER AND AUDIT DEPARTMENTS ACT 1921.

1. Her Majesty's Revenue and Customs shall prepare Resource Accounts in respect of Inland Revenue for the year ended 31 March 2005 in compliance with the accounting principles and disclosure requirements of the edition of the Resource Accounting Manual issued by HM Treasury (The Resource Accounting Manual) which is in force for that financial year.

2. Inland Revenue's Resource Accounts shall be prepared so as to give a true and fair view of the state of affairs at 31 March 2005 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year then ended. The Resource Accounts shall also be prepared so as to provide disclosure of any material expenditure or income that has not been applied to the purposes intended by Parliament or material transactions that have not conformed to the authorities which govern them.

3. Compliance with the requirements of the Resource Accounting Manual will, in all but exceptional circumstances, be necessary for the Resource Accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the Resource Accounting Manual is inconsistent with the requirement to give a true and fair view, the requirements of the Resource Accounting Manual should be departed from only to the extent necessary to give a true and fair view. In such cases, informed and unbiased judgement should be used to devise an appropriate alternative treatment, which should be consistent with both the economic characteristics of the circumstances concerned and the spirit of the Resource Accounting Manual. Any material departure from the Resource Accounting Manual should be discussed in the first instance with the Treasury.

4. Her Majesty's Revenue and Customs shall prepare a Trust Statement in respect of Inland Revenue for the financial year ended 31 March 2005, which shall give a true and fair view of the state of affairs relating to the collection and allocation of taxes, duties, National Insurance Contributions, Tax Credits and Student Loan recoveries administered by the Department and the revenue income and expenditure and cash flows for the financial year then ended. When preparing this Statement, Her Majesty's Revenue and Customs shall have regard to the format of the accounts as shown in the appendix to this Direction and shall also agree the format of the Operating and Financial Review and supporting notes (including the accounting policies, particularly with regard to income recognition), with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in "Government Accounting" and other guidance as issued by the Treasury, the principles underlying UK Generally Accepted Accounting Practice and, for Tax Credits, guidance issued by the Organisation for Economic Co-operation and Development.

5. The Resource Account shall be transmitted to the Comptroller and Auditor General together with the Trust Statement, by a date agreed with the Comptroller and Auditor General and the Treasury, but in any event no later than 30 November 2005, for the purpose of his audit examination and report.

6. The Inland Revenue's Resource Accounts and the Trust Statement, together with this Accounts Direction, but with the exception of any appendices, shall be laid before Parliament in one volume containing both financial statements, the Report and the Report produced by the Comptroller and Auditor General under Section 2(2) of the Exchequer and Audit Departments Act 1921.

7. This Direction supersedes the Resource Accounts and Trust Statement Directions for the Board of the Inland Revenue dated 13 May 2004.

DAVID A CRUDEN FCA Date 25 July 2005
Head of the Central Accountancy Team
HM Treasury

Annex to the 2004-05 Trust Statement

This Annex does not form part of the accounts

This summary is only to provide further information on the taxes, National Insurance Contributions and tax credits for which the Department has responsibility for the reader of the Trust Statement. The relevant Tax and National Insurance Acts provide the detailed requirements.

Revenue Recognition

The Department's accounts are now reported on an accruals basis, which means that revenue is recognised in the year in which the income or transaction giving rise to the taxes and National Insurance Contributions is earned or occurred rather than at the time the cash is received. Tax credits are recognised when the award is authorised instead of when the payment is made. This method of reporting requires us to have revenue recognition points for the taxes and NICs for which the Department has responsibility. Revenue becomes established at the recognition points and is due to be reported in the accounts, if those points fall within the accounting year to 31 March.

Where revenue is received for accounting periods that cover more than one accounting year, the revenue is apportioned so that only the amount appropriate to the reporting year is included in the accounts.

All revenue is accounted for on an accruals basis and recognised in the year to which it relates unless otherwise stated. Each of the taxes and NICs has its own accounting policy and revenue recognition point reflecting in part the different tax structures and business cycles.

1. Income Tax

1.1 Pay as You Earn (PAYE)

Employers make monthly, quarterly and annual payments to the Department for the total PAYE, National Insurance Contributions, Student Loans recovered, and tax credits funded less tax credits paid for the period. End of year returns giving the split of the payments are not due until 19 May following the end of the tax year.

Where payments have been received, but the end of year returns from employers' have not yet been received, statistical estimates have been used to split the payments between tax, National Insurance Contributions, Student Loan recoveries and tax credits paid.

The amount of debtors is obtained from the PAYE tax administration system. Where actual information is not available the debtor figure has been split between tax and NIC Class 1 using estimates.

The estimate of accrued revenue receivable is defined as amounts either not yet due or received from taxpayers relating to the financial year where these have not been included in debtors. In general, payments of Income Tax and NIC Class 1 via PAYE exhibit a lag of one month - i.e. amounts deducted from wages and salaries by employers are paid to the Inland Revenue in the following month. The major component of accrued revenue receivable is therefore the April payment in respect of March liabilities which is known at the time the Accounts are prepared. The remainder comprises two separate elements. The first represents late payments not included in the debtor figure which are estimated on the basis of historical payment patterns. The other is re-allocations of PAYE between Income Tax and NIC Class 1. These are considered together because of the degree of re-allocation between the two following receipt of the end of year returns.

1.2 Self-Assessment (SA)

Under Self-Assessment, taxpayers have separate liabilities to Income Tax, National Insurance Class 4, Student Loan repayments and Capital Gains Tax.

Self-employed taxpayers pay two payments on account (due 31 January within the tax year and 31 July following it) based on their self-assessed liability for the previous year. A final balancing charge is then made on 31 January in the following tax year based on the current year's results.

The Department's SA tax administration systems record taxpayers' total liability, or total owing in refund cases, but do not provide the actual split of Income Tax, Capital Gains Tax, National Insurance Contributions Class 4 and Student Loan repayments. The total for Self-Assessment receipts is, therefore, allocated to these categories using estimates.

The estimate of accrued revenue receivable for SA Income Tax is defined as amounts not yet due from taxpayers relating to the financial year. It is estimated using a model that forecasts SA Income Tax liabilities and receipts. This model takes historical receipts and liabilities and projects them forwards using economic assumptions underlying the Budget 2005 forecast. The main economic determinant is the total amount of income from self-employment. The effect of changes in other more minor relevant variables such as interest rates is also incorporated.

A similar approach is used to produce accrued revenue receivable estimates for NIC Class 4 by the Government Actuary's Department.

The combination of SA Income Tax and NICs are considered together because statistical estimates are used to breakdown total receipts into the two categories. The maximum likely uncertainty is expected to be 14 per cent of the combined SA accrued revenue receivable.

The amount of debtors is obtained from the SA tax administration system. The debtor figure has been split between Income Tax and NIC 4 using the same allocation as for the cash receipts.

1.3 Company Income Tax

Company Income Tax is deducted by companies and other paying agents on distributions other than dividends. The tax is due on the 15th day of the month following the end of the calendar quarter. Amounts due for the quarter ending March, but not yet received have been shown as accrued revenue receivable.

1.4 Tax Deducted from Savings Income

Income Tax is deducted from savings income quarterly by banks and building societies in respect of interest credited to depositors' accounts in the previous quarter. The tax is due on the 15th day of the month following the end of the quarter. Amounts due for the quarter ended 31 March, but not yet received, have been shown as accrued revenue receivable.

1.5 Other Income Tax

Other minor streams of Income Tax are accounted for on a cash basis and recognised when the cash has been received.

2. Corporation Tax (CT)

There are two Corporation Tax accounting policies to reflect the different tax regimes for large and small companies. Large companies are those with profits for an accounting period which exceed the Upper Relevant Maximum Amount (URMA) in force at the end of that period, and they therefore pay their tax at the main rate. URMA is currently £1.5m, and the main rate of corporation tax is 30 per cent from 1 April 1999. Small companies are those which do not fall within the definition of large companies.

In addition to the policies described below, small and large company debt, which is identified when returns have been processed and the due/payable date has passed, is recognised with an appropriate provision. Tax returns are due for filing 12 months after the end of the accounting period.

2.1 Large Companies

CT for large companies is paid by four quarterly instalment payments (QIPs). The first payment is due 6 months and 13 days after the start of the company's accounting period, and the fourth payment is due 3 months and 14 days after the end of the accounting period.

Accrued revenue receivable for large companies CT is estimated using a model based on the QIPs. The model estimates full liabilities for these companies using QIPs actually received, with forecasts of QIPs not yet received. The QIPs actually received at the year-end are then deducted from the estimated full liabilities to arrive at the accrued revenue receivable. The key assumptions relate to the use of historical data to forecast the average profile for the four instalment payments made by companies and the volume of late payments (i.e. payments made after the due date for the fourth QIP).

Approximately 45 per cent of the accrued revenue receivable figure relates to company accounting periods where all four QIPs had been paid by the time the Accounts were finalised. The balance of the figure is based either on QIPs received plus a projection for further QIPs for the accounting period or, where no payment has been received, on the economic assumptions underlying the Budget 2005 forecast for Corporation Tax receipts.

2.2 Small Companies

Corporation Tax for small companies is accounted for on a cash basis and recognised when the cash has been received. However, underpayments arising from companies tax returns are included in debtors.

Corporation Tax for small companies is due 9 months and 1 day after the end of the company's accounting period, therefore there is no reliable method of obtaining an estimate of the accrued revenue receivable.

3 Capital Gains Tax (CGT)

Capital Gains Tax is accounted for on a cash basis and recognised when the cash has been received.

The majority of Capital Gains Tax receipts are paid at the same time as the final Income Tax payment under self assessment, i.e. ten months after the end of the financial year in which the accounting period ends. Therefore there is no reliable method of obtaining an estimate of the Capital Gains Tax due.

4 Inheritance Tax (IHT)

Inheritance Tax has been recognised in the year the initial assessment has been raised.

Inheritance Tax is due six months after the month in which the death occurs. Reliable estimates of the amount due can only be made after the initial assessment has been raised. Amendments to the initial assessment will be included in the year the amendment is issued.

4.1 Assets in Lieu

The Department may, with the agreement of the relevant Secretary of State, accept qualifying assets on behalf of the Department for Culture, Media and Sport, in settlement of Inheritance Tax liabilities. The value of assets accepted in lieu of Inheritance Tax liabilities are accounted for in the Trust Statement and recognised as revenue and disbursements in the year of acceptance.

5 Stamp Taxes

5.1 Stamp Duty Land Tax (SDLT)

SDLT was introduced in the Finance Act 2003 to replace tax charged on property transfer documents and became effective on 1 December 2003. An accrual has been provided for transactions that were completed by 31 March, where the tax had not yet been received.

5.2 Stamp Duty on Registered Share Transactions

Stamp Duty Reserve Tax (SDRT) on registered share transactions will be measured by reference to the Stock Exchange's CREST system. Payment is received twenty-one days after the settlement on a weekly basis. An accrual has been provided for transactions that were completed by 31 March, but the tax had not yet been received.

5.3 Stamp Duty on Non-Registered Share Transactions

SDRT on non-registered share transactions have been accounted for on a cash basis, in view of the reducing amount of duty, and recognised when the cash has been received.

6 Petroleum Revenue Tax (PRT)

Petroleum Revenue Tax is payable, in addition to Corporation Tax, by companies who extract oil and gas under licence from fields approved for development before 15 March 1993. The tax is paid by six monthly instalments followed by a balancing payment. A statistical estimate of the amounts due at 31 March have been provided based on company assessments and payments on account.

6.1 PRT Decommissioning Costs

The Petroleum Act 1998 came into force on 15 February 1999. Allowable decommissioning relief will not necessarily just be incurred at the end of a field's life, but probably the majority of it will be. Where on cessation of production the cost of decommissioning produces a loss, to the extent that the loss does not need to be carried forward against any tariff and disposal receipts, it will be carried back. If there are insufficient assessable profits in earlier periods to absorb the loss, it may be possible to claim it as an unrelievable field loss in another field.

Under the present rules companies can carry back losses computed for PRT purposes indefinitely, and claim relief at the rate of PRT pertaining in the period to which the losses are carried back, together with capped interest.

7 National Insurance Contributions

National Insurance Contributions (NIC) are collected by the Inland Revenue and paid over to the National Insurance Funds of Great Britain and Northern Ireland and to the National Health Services. Accounts for the National Insurance Funds are published separately as House of Commons Papers.

7.1 Class 1

Class 1 NIC relates to employers and employees and the majority is collected with PAYE income tax and reported on end of year returns due 19 May following the end of the tax year. The accounting policy and estimations are the same as reported in note 1.1 above.

7.2 Class 1A

Class 1A NIC is paid by employers on certain benefits received by employees. The end of year return is due 19 June following the end of the tax year and payment is due 19 July. As there is no in-year charge or payment there is no information available to provide accrued income for the year, therefore they have been accounted for on a cash basis.

7.3 Class 1B

Class 1B NIC is paid on small and irregular benefits that are not allocated to individual employees and therefore are not subject to Class 1A NIC. The charge is raised by a PAYE Settlement Agreement due by 6 July following the end of the tax year and payable by 19 October.

Class 1B National Insurance Contributions are accounted for on a cash basis and have been recognised in the year of receipt.

7.4 Class 2

Class 2 NIC is a flat rate contribution paid by self-employed taxpayers by monthly direct debit or charges are rendered quarterly in arrears. Debtors have been provided for contributions due, including the quarter to 31 March which is billed on 1 April, but payment has not yet been received.

7.5 Class 3

Class 3 NIC is a flat rate contribution paid voluntarily by people who have insufficient earned income. The main payment methods are monthly direct debit or quarterly billing.

Class 3 National Insurance Contributions are accounted for on a cash basis and have been recognised in the year of receipt.

7.6 Class 4

Class 4 Contributions are paid by the self-employed on their profits and included with self assessed Income Tax. A statistical estimation is provided as set out in self-assessed Income Tax in 1.2 above.

8 Tax Credits

Tax credit payments under the Tax Credits Act 2002 have been accounted for on an accruals basis for the tax year, which is deemed to equate to a 31 March year end.

Tax credits have been recognised in the year in which they were authorised. Authorisation is the point at which the obligation to pay the tax credit arises.

Payments are provisional until entitlement is finalised after the financial year-end by the Department's renewals process. Any resultant underpayments identified are paid as lump sums.

Overpayments identified are normally recovered from future tax credit awards over one or more years (subject to annual limits intended to minimise hardship to claimants) or by other recovery processes.

The amount of underpayments and overpayments identified when the Award has been finalised can only be quantified in the following accounting year and consequent payments, recoveries and any amounts written off are reported in that year's accounts.

Annual entitlements to Child Tax Credit and Working Tax Credit are amended in-year when changes of circumstances are notified to the Department. Payments for the remainder of the year are adjusted accordingly, but any under or overpayments still outstanding at the end of the year are shown as debtors or creditors at 31March.

Amounts authorised and due for payment by 5 April, but unpaid at this date, have been shown as a creditor. The amounts of overpayments recoverable at 5 April have been shown as a debtor. Provision for unrecoverable overpayments is included in doubtful debts. An estimate has been provided for debts due more than one year after the Balance Sheet date.

9 Audit and Enquiry Work

Revenue from audit and enquiry work has been accounted for on an adjusted cash basis. Debtors and creditors have not been recognised until the enquiry has been settled and an assessment raised.

Comptroller and Auditor General's Standard Report on the Accounts of the Inland Revenue 2004-05

Issued under Section 2 of the Exchequer and Audit Departments Act 1921
as amended by the Government Resources and Accounts Act 2000

John Bourn
Comptroller and Auditor General
7 October 2005

EXECUTIVE SUMMARY

1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of the Inland Revenue on behalf of the House of Commons to ascertain that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out. I am also required by that Act to examine the correctness of the sums brought to account and to report the results to the House of Commons. My audit certificate and report on the Trust Statement account and this report together satisfy that requirement.

2 Whilst recognising that no tax collection system can ensure that all those who have a tax liability comply with their obligations, the National Audit Office's work in 2004-05 provided overall assurance that the Inland Revenue's regulations and procedure continued to provide an effective check on the assessment, collection and proper allocation of revenue, and that they were being carried out. That overall assurance is subject to reservations about Tax Credits and other matters recorded later. The report also describes observations about management of Corporation Tax by the Large Business Office.

3 The Inland Revenue prepared a Resource Account and a Trust Statement account of taxes and Tax Credits for 2004-05 on an accruals basis, including estimates and forecasts of taxes collectible in respect of 2004-05, as well as amounts collected.

4 I qualified my audit opinion on the Department's Trust Statement for 2002-03 and 2003-04 because of the likely level of claimant error and fraud in respect of Tax Credits. In July 2005 the Department examined a sample of 2003-04 awards and estimated that 3.4% by value of Tax Credits (some £460 million) were overpaid because of applicant error or fraud. This is lower than with previous Tax Credits schemes, in both percentage and absolute terms, but in my view remains unacceptably high. There is no evidence to suggest that the level of error would have fallen significantly from 2003-04 to 2004-05. Consequently I have qualified my audit opinion on the Trust Statement in respect of Tax Credits. I gave an unqualified audit opinion on the Resource Account.

5 I present to Parliament Value for Money reports on the economy, efficiency and effectiveness with which the Department has used its resources. During the past year I have reported on Inheritance Tax (HC 17: 2004-05) and Filing of Income Tax Self Assessment Returns (HC 74: 2005-06).

Accrual accounts and debt management

6 The accounts show income from taxes of some £260.3 billion (net of repayments and from which £13.8 billion of Child and Working Tax Credits were paid) reported on an accrual basis. The balance sheet includes some £57.0 billion of taxes due at 31 March 2005 which consists of enforceable debts of £9.6 billion and £47.4 billion of estimates and forecasts of taxes in respect of 2004-05 that will become enforceable liabilities in due course. This is explained in more detail in my certificate and report on the account at (see pages 66-67).

7 The legally enforceable tax debt of £9.6 billion included some £4.8 billion of PAYE and National Insurance contributions, £2.6 billion of self assessment income tax and £1.7 billion of Corporation Tax. In the year to end

March 2005, the Department wrote off or remitted income tax and corporation tax debts of £818 million and National Insurance contributions of £280 million, mainly resulting from business failure or insolvency.

8 The Department has made good progress on several aspects of debt management in recent years and has important work still to do, including creating a new debt management and banking organisation from the former Inland Revenue and HM Customs & Excise debt arrangements. The new Department would benefit from setting more specific and comprehensive performance indicators for debt management and debt reduction.

PAYE

9 The Department's Internal Audit Office highlighted significant and widespread errors in PAYE. They estimated for the first time that these problems had resulted in around £575 million per annum of tax due not being pursued by the Department; and that taxpayers were not being advised of around £295 million per annum potentially repayable to them. The main cause was the Department's failure to finalise and calculate correctly tax liabilities where people had more than one source of employment income. In the summer of 2005, the Department prepared an action plan to correct these weaknesses over a number of years.

Repayments

10 In 2004-05 the Department issued tax repayments amounting to £13.1 billion, of which £8.7 billion related to Income Tax and £4.0 billion to Corporation Tax. In May 2004, the Department's Repayments Risk Review Group reported serious risks of duplicate repayments, and made recommendations to address the problem. In June 2005 the Department prepared an action plan to implement all the recommendations.

11 The Department recognised that pressure to meet repayment targets might undermine the quality of work and checks undertaken to ensure accuracy and avoidance of error. Deficiencies in management information and lack of formalised, specific accountabilities have made it difficult for the Department to ensure the proper control of repayments and prevent or detect error and irregularities. In response to the NAO's recommendations, the Department made a senior officer accountable for making improvements.

Tax Credits

12 The Department paid £15.8 billion under the new Tax Credits schemes. These schemes represented a major challenge for the Department. Claimants encountered problems as the system went live in April 2003 which continued to have ramifications throughout 2004-05. Tax Credits are a substantial part of the income of the poorest families who receive them. The Department recalculates the value of awards annually, in a process called "renewal", the first of which in 2004-05 identified that one third of recipients of 2003-04 awards had been overpaid a total of some £1.9 billion in 2003-04. Subsequent backdated payments in respect of 2003-04 awards brought the total overpayments for that year to £2.2 billion. This was mainly because family income had increased by more than £2,500 compared with the income declared at the time of the original application for Tax Credits. Half of the total overpayments related to some 283,000 families who had been overpaid by £2,000 or more. Overpayments are recovered where possible from future payments of Tax Credits. The Trust Statement account has provided for £961 million of doubtful debts as at 31 March 2005 in respect of tax credit overpayments. The annual basis of the Tax Credit award means that recipients need to be able to anticipate and plan for the consequences of changes in their income. This is clearly a problem for many families until they become used to the implications of the annual calculation of their entitlement. In May 2005, the Paymaster General announced plans to improve significantly the Tax Credit system.

13 In my last report, I noted that software errors were expected to lead to further write-offs, in addition to the £37 million the Department had calculated and written-off in 2003-04. In 2004-05, the Department calculated that they should write off some £2 million of Tax Credits caused by major software errors in 2003-04 and 2004-05 that together resulted in overpayments of £174 million. The Department also wrote off £33 million in respect of some manual payments made in 2003. By 30 June 2005 the Department had calculated and written off a further £95 million when official error relief had been granted to claimants who disputed the recovery of their overpayment. The Department expect to have further write-offs during 2005-06 in respect of continuing work on 2003-04 and 2004-05 cases.

14 The Department's measures to ensure that Tax Credit applicants complied with their obligations involved routine pre-payment checks on all claims; risk based investigations; verification of childcare expenditure; and investigations of suggestions that organised crime was targeting Tax Credits. The Department will need to maintain compliance work to ensure that confidence in the fairness of the schemes is not undermined by unacceptable levels of unjustified claims.

Large Business Office management of Corporation Tax

15 The Large Business Office (LBO) handled the tax affairs of some 800 large entities and employers which generated some £18.4 billion of tax in 2004-05. The main objectives were to safeguard the flow of revenue from large businesses and employers; enable customers to meet their obligations without unnecessary cost, whilst effectively tackling and deterring non-compliance. The complexity and sophistication of tax management in the large business sectors, including EU and other international dimensions, pose some of the most difficult and potentially costly challenges for the Department, both in terms of administration cost and loss of revenue.

16 The LBO generated an additional tax yield of some £2.1 billion in respect of 2004-05 – primarily from the examination of specific tax issues. Good quality and prompt tax risk assessments are essential to achieving the best deployment of the Department's resources and the most effective compliance effort. For some years the LBO had been developing sector specialist knowledge and structures to improve tax risk identification. The Department recognised that there was significant development work to do before sector based approaches to risk assessment became fully effective. The compilation of data and calculation of financial ratios used in tax risk assessments were largely manual, time consuming and resource intensive, and not eased by the data being supplied by corporate taxpayers mainly in hard copy format rather than electronically.

17 In 2004, the Department launched a project called "Better Data for Corporation Tax". This was intended to achieve a step change in the effectiveness of compliance work through better use of management information to improve the targeting and effectiveness of enquiry work in the LBO. There were also important initiatives in internal quality assurance of Corporation Tax case work, management and structural reorganisations, employment of specialists, and new compliance processes with some customers. These initiatives are continuing within the integration plans for the new Department.

18 The LBO was integrated with the Customs and Excise equivalent in April 2005 to form the Large Business Service of HM Revenue and Customs, with a mission to "make a substantial contribution to financing the UK's future by closing the tax gap". The management by large businesses of their tax affairs will continue to pose a challenge and the Department must continue to modernise its work on Corporation Tax within the large business sectors. The Department must ensure that its various initiatives enable it to match the sophistication of large businesses with equivalent Departmental expertise and methods.

Integration to form the new Department

19 HM Revenue and Customs (HMRC) brought together most of the functions of the Inland Revenue and HM Customs and Excise from 18 April 2005. Integration offers the opportunity for the new Department to adopt a more effective approach to taxpayer compliance across all tax streams. The Department reviewed the effect of the integration on its compliance strategy and sought to develop a better understanding of the tax gap and other measures to help taxpayers comply with their obligations.

20 There are also risks involved in the integration of two large departments, including risks that existing work priorities could be disrupted. The new Department is responsible for a number of the Government's nominated "mission critical" projects and it needs to remain focused on them. These projects are:

- Tax Credits;
- Modernising Stamp Duty;
- Pensions Simplification;
- Modernising PAYE Processes for Customers;
- Mandatory Electronic Payments by certain taxpayers;
- The e-Services Programme;
- Information Centre Programme (including the mission critical project, Better Data for Corporation Tax (see paragraph 3.31 below));
- Reform of the Construction Industry Scheme.

21 The 2004 Spending Review required annual efficiency savings of £507 million by 2007-08, including staff reductions. The combined Department had 98,370 Full time Equivalent staff in post at 1 April 2004 and planned to reduce this by a net 12,500 by 1 April 2008. By July 2005, the Department had identified how the forecast savings would be achieved.

22 It is important that the staff reductions do not adversely affect service provision and the Department's capacity to deliver the new IT systems underpinning intended efficiency gains. The Department has established an Efficiency Programme Board which was tasked with managing these risks and ensuring delivery against targets.

PART ONE

Scope of the audit and significant developments

Audit scope and approach

1.1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of the Inland Revenue on behalf of the House of Commons to ascertain that adequate regulations and procedure have been framed to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out. I am also required by that Act to examine the correctness of the sums brought to account; and to report the results to the House of Commons. My audit certificate and report on the Trust Statement account and this report together satisfy that requirement.

1.2 This report describes a number of significant developments on Tax Credits and the management of Corporation Tax by the Large Business Office. The results of my work not detailed in this report and suggestions of further improvements in controls have been notified to the Department in management letters.

1.3 The National Audit Office review periodically existing and new systems and significant changes to them, and undertake test examinations of individual transactions and balances as necessary. The audit approach emphasises aspects of the Department's management control over business and tax streams, including accountability; corporate governance procedures; management information; quality assurance procedures; risk analysis; and the Department's identification of obstacles to the assessment and collection of taxes. The National Audit Office also review Departmental progress in response to recommendations arising from my reports and those of the Committee of Public Accounts.

Accrual Accounts and Qualified Audit Opinion

1.4 For 2004-05, the Inland Revenue have presented a Trust Statement account on an accruals basis showing how much had been collected from or paid to individuals, corporate taxpayers and other Government Departments. This account includes estimates and forecasts of taxes collectible in respect of 2004-05, as well as amounts collected.

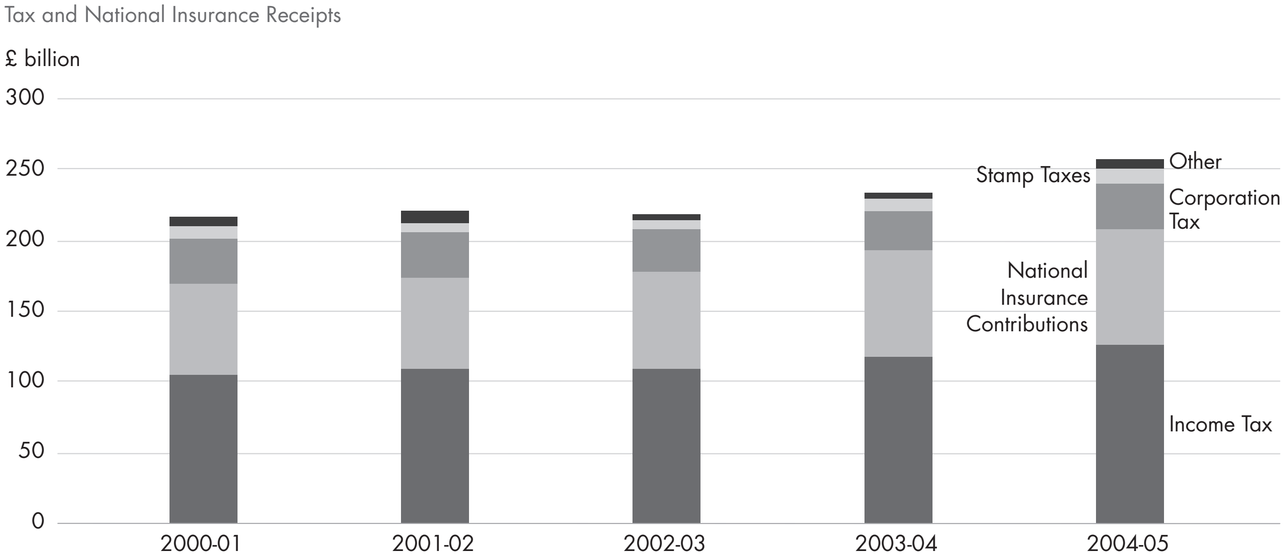
1.5 I qualified my audit opinion on the Trust Statement accounts for 2002-03 and 2003-04 in respect of non-compliance by Tax Credit claimants. I have also qualified my audit opinion in respect of Tax Credits this year, as is discussed in Part 2 of this report.

Taxes and National Insurance collectible and Tax Credits payable

1.6 In 2004-05 the Department collected some £256.9 billion, some 9.6 percent up on the previous year. The main increases were Income Tax and National Insurance (up by £14.4 billion) and Corporation Tax (up by £5.5 billion). **Figures 1 and 2 overleaf** show the trends in collections of recent years.

1.7 Receipts increased across all tax streams in 2004-05. The Department consider that the recent trend of declining corporation tax receipts was reversed largely as a result of better company profitability across most sectors of the economy. Corporation Tax is discussed in more detail in part three of this report.

1 Inland Revenue main Tax and National Insurance Receipts



Source: Inland Revenue accounts 2004-05

2 Tax and National Insurance receipts (net of repayments) and Tax Credit payments

	2001-02 £bn Cash	2002-03 £bn Cash	2003-04 £bn Cash	2004-05 £bn Cash	Net accrual adjustments[1] 2004-05 £bn	2004-05 £bn Accrual[2]
Income Tax (Gross of Tax Credits)	108.7	110.3	118.0	127.3	+3.6	130.9
National Insurance Contributions	65.3	67.4	75.2	80.3	-0.1	80.2
Corporation Tax	32.0	29.1	27.9	33.4	-0.4	33.0
Stamp Taxes	7.0	7.5	7.5	8.9	+0.1	9.0
Inheritance Tax	2.4	2.4	2.5	2.9	+0.1	3.0
Capital Gains Tax	3.0	1.6	2.2	2.3	-	2.3
Petroleum Revenue Tax	1.3	1.0	1.2	1.3	+0.1	1.4
Other	-	-	-	0.5	-	0.5
Total receipts	219.7	219.3	234.5	256.9	+3.4	260.3
Child and Working Tax Credit payments (gross)			-13.5	-15.8	+2.0	13.8

Source: Inland Revenue accounts 2004-05

NOTE

1 Net accrual adjustment is the difference between the accruals at the start and end of the year. The net accrual adjustment is added to the receipt or payment in the year to arrive at the tax or payments due on an accruals basis.

2 Figures as shown in the accruals based trust statement.

1.8 Accruals in the year-end balances mean that revenue of £260.3 billion recognised for 2004-05 is some £3.4 billion higher than would have been the case if net revenue had been recognised on the non accruals accounting basis used in previous years. Note 1 to the Trust Statement account explains the detailed accounting policies applied to the main revenue streams.

Debt and Debt Management

1.9 The amount of tax owed to the Department at the end of 2004-05 was some £9.6 billion including £4.8 billion of PAYE and National Insurance contributions, £2.6 billion self assessed income tax and £1.7 billion Corporation Tax. Around 40 per cent of the total was aged 0-3 months; 20 per cent 4 – 12 months and 40 per cent over 12 months. These figures are not directly comparable with those in the Trust Statement balance sheet as the definition of accruals for that account differs from that for debt management purposes. The Trust Statement is not intended to be used as a measure of debt management. Furthermore, both sets of figures exclude some £20 billion of "standovers". These are estimated liabilities where collection cannot be enforced as they are under appeal by the taxpayer. Much of this amount is likely to be cancelled as not due once relevant enquiries are complete. Any debts that do arise once an appeal has been settled are then enforced. The Department wrote-off tax debts of £818 million (year to March 2005) and £280 million of National Insurance contributions.

1.10 In April 2001 the Department formed the Receivables Management Service to be responsible for collecting debts, receiving and accounting for payments and following up the main areas of outstanding tax returns (PAYE and Self-Assessment). Its objective is to collect tax promptly and to keep debts to a minimum. The Department had different debt management targets to HM Customs and Excise (HMCE). For example HMCE had a target for outstanding debt, whereas the Department measured payment and filing on time and after 12 months. The Department achieved the majority of its published targets for receiving payments and for filing of returns from the different classes of taxpayer in 2004-05. The target for the percentage of self assessment taxpayers who paid by the due date was narrowly missed because the Department's Receivables Telephone Centre was unable to carry out as many telephone reminders as planned because of other business priorities. The Department expects to meet the target for 2005-06.

1.11 The Department uses an automated Integrated Debt Management System to manage the collection and enforcement of debts for Pay As You Earn and Corporation Tax. The system was introduced in November 1999 in response to the 1994 Fundamental Expenditure Review which compared the Department's debt management process with best practice in the private sector. Its objectives are to improve efficiency, reduce costs and tax arrears and to increase tax flow. The Department planned to extend the system to include Income Tax Self Assessment in 2005.

1.12 The Department had concerns about some aspects of the National Insurance contributions registered as due within the National Insurance recording system, which was historically separate from the Department. The National Insurance debt arrangements are not fully integrated into the Department's systems. The debt recorded stood at £1.24 billion at the end of 2004-05 including £616 million over 6 years old which the Department could no longer collect. However the Department had doubts about the reliability of these records. Following investigation of a sample of records, the Department concluded that it was appropriate to remove £283 million of National Insurance contributions erroneously recorded as due and wrote off the balance of £333 million as time-barred debt. The Department has set up a working group to improve the future management of National Insurance debt.

1.13 The Department has taken a number of steps to improve debt management in recent years, including developing management information about the debts. The Department monitors collectible debt balances, age profiles of debts, statistics on total debt and debt for each tax stream, performance against targets, risks and challenges for the future. Where possible debt management is automated to help ensure efficient and consistent treatment. However, the Department is aware of the need for more robust analysis of debt by customer, business area and type, and the need to improve its ability to identify high risk taxpayers and behaviours so as to target resources and attention most effectively.

1.14 In 2003, the Department started work on a Debt Analysis Matrix that it saw as a major information tool to improve business performance and help reduce debt. It is intended to enable management to address bottlenecks or delays in internal processes, to inform policy decisions about the effect of tax regimes on levels of debt and to contribute to the information needed for tax accrual and debtor accounts. The Department expect to develop the Matrix further.

HM Revenue and Customs

1.15 In July 2003, the Chancellor of the Exchequer announced a major review of the organisations dealing with tax policy and administration. The review led by Gus O'Donnell reported in March 2004 and recommended that a new Department should be created. HM Revenue and Customs (HMRC) was established in April 2005 by the Commissioners for Revenue and Customs Act which brought together most of the functions of the Inland Revenue and HM Customs and Excise.

1.16 Good governance is vital for any organisation, particularly one as complex and wide ranging as HMRC. A group of Commissioners has statutory responsibility and authority for running the new organisation. They have created a departmental Board, including several non-Executive Directors, responsible for strategic oversight and providing advice. They are also supported by a number of Committees, of which the Executive Committee, chaired by the Chairman of HMRC, is responsible for strategy and driving performance across the business. Other top-level groups include an Operating Committee and an Audit Committee comprised of and chaired by Non-Executives. Core management processes include an annual planning and performance management cycle, with an important feature being a quarterly Chairman's review of each of HMRC's 36 business units.

1.17 Efficient and effective Information Technology (IT) is essential to the administration of taxes. In October 2004, the Department made a new Board-level post of Chief Information Officer (CIO). The departmental integration offered the opportunity of improving the service IT provided. The CIO's unit has taken a more active role in identifying and pursuing business opportunities, with a more customer-focused approach. In bringing the IT together, the Department is undertaking an on-going programme of health checks of the IT systems and the NAO will monitor the resulting changes.

1.18 Integration offers the new Department the opportunity to adopt a more effective approach to taxpayer compliance across all tax streams. The Department reviewed the implications of the integration for its compliance strategy and the tax gap.

1.19 There are also risks involved in the integration of two large departments. The Department set up a Change Management Centre to oversee the changes, provide information and make recommendations on risks posed by the Department's capacity to deal with the number of planned changes. There were risks that existing priorities could be disrupted. The new Department is responsible for a number of the Government's nominated "mission critical" projects and it needs to remain focused on them. The projects are:

- Tax Credits
- Modernising Stamp Duty
- Pensions Simplification
- Modernising PAYE Processes for Customers
- Mandatory Electronic Payments by certain taxpayers
- The e-Services Programme
- Information Centre Programme (which includes the mission critical project, Better Data for Corporation Tax)
- Reform of the Construction Industry Scheme.

Corporate Social Responsibility

1.20 Corporate Social Responsibility (CSR) involves doing business in a responsible way to improve the positive impact on society and the environment. The most widely used and recognised benchmarking tool for CSR is Business in the Community's Corporate Responsibility Index (CRI). The CRI rigorously and independently assesses how effective a business has been in translating its CSR agenda into responsible business practice.
In November 2004 the Inland Revenue became the first government department to complete BitC's Corporate Responsibility Index (CRI). They also achieved the 'Big Tick' standard for each of their entries into the 2004 Awards for Excellence.

1.21 CSR will also be an important part of how HMRC does business. Building on the work of the Inland Revenue and HM Customs and Excise, HMRC will give high level leadership for CSR via a CSR Steering Group chaired at Board level, through to senior managers with key CSR responsibilities. With measurable targets and clear accountability at senior level, HMRC will ensure that CSR activities remain focused on supporting the new Department's objectives. Examples of this include:

- working with schools and homelessness agencies to help people become employable and employed, through mentoring, interview coaching and CV assistance;
- working with drug rehabilitation organisations to help educate against drug use, to protect future vulnerable members of society and contribute to the improvement of frontiers work; and
- enabling HMRC staff to undertake volunteering or personal development community activities amongst socially excluded community groups so staff better understand customers' needs, resulting in improved customer service, improved customer perception of the Department and ensuring HMRC is seen as an employer of choice amongst those groups.

Sustainable Development

1.22 As part of its response to the Government's Sustainable Development objectives, the Department developed a strategy, a policy statement and various initiatives. It published on the Department's web site *(www.hmrc.gov.uk/about/sd-report-2002-2004.pdf)* its Sustainable Development Report for 2002 to 2004 recording achievements and performance against objectives and targets. The Department emphasised the significance of its policy initiatives that affect tax payers, such as enhanced tax allowances for water-efficient technologies. The report highlighted the need to work closely with the PFI partners who operate the Department's estate, as many of the objectives such as energy efficiency and water consumption relate to the Department's use of office space. The report also highlighted that detailed data on utilities consumed needs to be improved to facilitate targeted action to improve performance. The Department is working closely on integrating arrangements across the new combined Department, and aims to publish its next report on performance in the spring of 2006.

Efficiency Savings

1.23 The 2004 Spending Review required HMRC to achieve staff reductions and annual efficiency savings of £507 million by 2007-08, out of an annual budget of about £4.6 billion. The Department had 98,370 Full time Equivalent (FTE) staff in post at 1 April 2004 and planned to reduce this by a net 12,500 FTE posts by 1 April 2008.

1.24 By July 2005, the Department had identified how the forecast savings would be achieved through:

- Investment in Information and Communication Technology;
- Reform of back office functions;
- Savings in procurement of goods and services; and
- Improvements in productive time.

1.25 A significant challenge for the Department was to establish effective governance and monitoring arrangements to ensure the savings do not adversely affect service provision or the new IT systems underpinning intended efficiency gains. The Department established an Efficiency Programme Board to manage these risks and meet targets. The Office of Government Commerce concluded that achieving the Department's efficiency savings posed a very high but achievable challenge.

Public Service Agreements

1.26 Public Service Agreements (PSAs) and associated performance targets, are at the centre of the Government's and the Department's performance management systems. PSAs include three year targets, negotiated every two years with the Treasury during the spending review process. The objectives set by the Spending Review 2004 were:

- Improve the extent to which individuals and businesses pay the amount of tax due and receive the credits and payments to which they are entitled;
- Improve customer experience, support business and reduce the compliance burden;
- Strengthen frontier protection against threats to the security, social and economic integrity and environment of the United Kingdom in a way that balances the need to maintain the UK as a competitive location in which to do business.

1.27 Good quality data are crucial for effective targets and performance measures and accountability. An NAO review in 2004-05 of the Inland Revenue's relevant data systems found that risk management tends to focus on risks to business delivery rather than risks to the quality of the underlying data. The Department acknowledged the need to improve its approach to data system risks and subsequently focused on this through the Performance and Management Information programme, which with its Customs' counterpart, is now the HMRC Information Centre programme. This introduced a clear framework for accountability and the use of data to plan, manage and improve performance through the PSA and Cost and Resource Information project.

1.28 The Department targets and reviews systematically the quality of processes within its Tax Enquiry programme. The Department failed to meet the target for the percentage of cases reaching a satisfactory standard in 2004-05. The main reason was delays in dealing timeously with correspondence from taxpayers and failure to effectively address delays by taxpayers in producing required information. Over recent years the Department has introduced a quality improvement process and assurance programme to better understand and deal with the issues. In 2004-05 it instigated a training programme to focus on quality improvement. The Department considered that the results of these initiatives should result in quality improvements over the next few years.

Reform of the Construction Industry Scheme

1.29 In 1972 the Department established a special tax deduction scheme to deal with the practice, endemic in the construction industry, of engaging workers on a "cash in hand" basis, coupled with a poor record of complying with tax obligations. The current Construction Industry Scheme was introduced in 1999. Contractors must deduct an amount from payments to sub-contractors, unless the sub-contractor has met certain criteria which allow payment to be made gross. The amounts deducted are set against tax and National Insurance contributions, or in the case of companies, against their payment obligations as contractors or employers. The Scheme is intended to benefit businesses and sub-contractors since it encourages tax compliance across the industry and reduces the likelihood of tax evasion.

1.30 This Scheme has suffered from problems since its introduction and businesses are concerned about the costs to them of operating it. In 2000-01, the Department began preparations for introducing a new Scheme designed to:

- Reduce the regulatory burden of the Scheme on construction businesses;
- Improve the level of compliance by construction businesses with their tax obligations;
- Help construction businesses to get the employment status of their workers right.

1.31 In my report on the Inland Revenue accounts last year, I noted that the Scheme was to be introduced in April 2006, a year later than originally planned. There is a tight timetable for the introduction of the IT systems needed to support the new Scheme and the Department have tried to take on board the lessons of Tax Credits in managing this risk.

Pay As You Earn

1.32 A major programme of work by the Department's Internal Audit Office on the operation of the current PAYE businesses highlighted significant and widespread error. The Department knew of many of the underlying symptoms but for the first time the financial implications were quantified. Internal Audit estimated that around £575 million per annum of tax due had not been pursued by the Department; and that taxpayers were not being advised of around £295 million per annum potentially repayable. Internal Audit have calculated that this could mean that 3.8 million taxpayers have paid too much or too little tax. They considered it highly likely that there was additional tax at risk that had not been identified.

1.33 The main cause of the under - and over -payments was the Department's failure to finalise and calculate correctly tax liabilities where people had more than one source of employment income. There is no single PAYE account for individual taxpayers who have more than one job and inadequate end of year reconciliations. Different systems in place and a lack of communication between those systems means that the Department did not have a whole customer view. Other weaknesses identified included:

i Lack of flexibility to move work to where operational capacity is best placed to take action.

ii Inadequate Management Information Systems to help managers risk-assess operations and control PAYE business to best effect.

iii Poor quality data throughout the system, inadequate controls, and inconsistent approaches.

iv High volumes of paperwork, which have led to difficulties in managing and monitoring work volumes, backlogs of work, progress made and impacts of work done and work not completed.

v Department not pursuing some PAYE revenue due from an individual whilst pursuing Tax Credits recoveries.

vi The possibility that some Tax Credit recipients are asked to refund overpayments at the same time as the Department retained PAYE refunds due.

vii Failures to effectively address employers' non compliance with their obligations.

1.34 The Department undertook to carry out "Health Checks" across PAYE, leading to a full risk assessment and completion in the summer of 2005 of an Action Plan for recovery. The Department recognised that remedial action requiring major structural change can only be delivered over the longer term.

Modernising PAYE Processes for Customers

1.35 In April 2002, the Government announced that it would implement the recommendations of Patrick Carter's Review of Payroll Services. Regulations, laid in 2003, came into force in April 2005 to mandate online filing of large and medium employers' end of year returns and to encourage voluntary on line filing by small employers. The Department established in early 2003 a Modernising PAYE Processes for Customers (MPPC) Programme to deliver the new business processes, IT infrastructure and support for employers to give effect to those regulations.

1.36 Over the period to 2007-08, the Department also plans to modernise other elements of the PAYE processes and introduce a more flexible computer platform for PAYE. The intention is to achieve significant efficiency savings, improve customer service in PAYE for both employers and employees, simplify compliance for small business and encourage use of online services. One important element is a planned single customer view for all sources of employment income. The Department expects this to help address many of the issues identified in paragraph 1.33. The scope of the project was reduced in the summer of 2005, thus limiting one of the major benefits originally expected – a major increase in the extent of automatic reconciliation and clearance of customer records after the end of the tax year.

Spend to Save

1.37 The Finance Act 1998 provides for me to examine and report on conventions and assumptions underlying the fiscal projections that are submitted to me by the Treasury for examination. As a result of measures announced in the 2003 and 2004 Budgets, the Inland Revenue introduced two new Spend to Save packages: (i) designed to promote taxpayer compliance; and (ii) to counter tax avoidance and fraud.

1.38 In my report on the 2003 package of measures (HC 627, Session 2002-2003), I noted the importance of detailed arrangements being put in place to monitor and evaluate the measures. During 2004-05, the NAO noted that there had been earlier delays in introducing comprehensive central monitoring procedures over this package of measures. The Department made improvements towards the end of 2004, which helped to identify areas where remedial action was needed.

Tax Repayments

1.39 In 2004-05 the Department repaid £13.1 billion of tax, including £8.7 billion Income Tax and £4.0 billion Corporation Tax. Repayments are generated and authorised by seven systems that assess and record the tax affairs of individuals and companies. Claims are dealt with on a "process now, check later" basis and payment instructions sent to a centralised system that makes the payment to taxpayers. No individual in the Department had overall responsibility for repayments and no individual was specifically responsible for repayments under each tax stream. The Department has two Public Service Agreement (PSA) targets for Repayments: 97 per cent dealt with within 15 working days; and 97 per cent calculated correctly by specialist repayment offices. In 2004-05 the Department achieved 99.5 per cent on the former and 98.1 per cent on the latter.

1.40 In May 2004 the Department's Repayments Risk Review Group reported serious risks including duplicate repayments and it commented on the paucity of reliable management information about repayments. It made a number of fundamental recommendations, some of which it took forward. Following the NAO review, the Department prepared an action plan in the summer of 2005 covering all of the recommendations.

1.41 The Department's centralised repayments system is old and has certain problems which the Department planned to address by replacing the system. The planned replacement, the Payments Made Framework (PMF), was used for Tax Credits. As at 30 June 2005 the Department had no plans to move repayments to PMF and no timetable had been set for replacement of the old system.

1.42 In 2004-05, the Department undertook a review of the effectiveness of the routine anti-fraud checks on repayments and considered centralising the work to improve the quality of those checks. The Department planned to undertake in the Autumn of 2005 a feasibility study of enhanced risk profiling of repayment fraud using data from different HMRC systems.

1.43 The Department recognises the danger that pressure to meet repayment targets might undermine the quality of work and checks to ensure accuracy and avoid error. The deficiencies in management information and lack of formalised, specific accountabilities made it difficult for the Department to ensure the proper control of repayments and to prevent or detect error and irregularities. In response to the NAO's audit recommendations, the Department made a senior officer accountable for making improvements.

Conclusion

1.44 The accounts show income from taxes of some £260.3 billion (net of repayments and from which £13.8 billion of child and working Tax Credits were paid) reported on an accrual basis. The balance sheet includes some £57 billion of taxes and National Insurance contributions due at 31 March 2005. This figure is a combination of estimates and forecasts of taxes that will become enforceable liabilities in due course in respect of 2004-05 and so it does not represent the legally enforceable debt as at 31 March 2005 . This is explained in more detail in my certificate and report on the account (see pages 66-67).

1.45 Legally enforceable tax debt at the end of 2004-05 was some £9.6 billion, including some £4.8 billion of PAYE and National Insurance contributions, £2.6 billion of self assessment income tax and £1.7 billion of Corporation Tax. The Department wrote off or remitted income tax and corporation tax debts of £818 million and £280 million of National Insurance contributions in the year to end March 2005, mainly resulting from business failure or insolvency.

1.46 The Department has made good progress on several aspects of debt management in recent years and has important work still to do, including creating a new debt management and banking organisation from the former Inland Revenue and HM Customs & Excise debt arrangements. The new Department would benefit from setting specific and comprehensive performance indicators for debt management and debt reduction.

1.47 The Department's Internal Audit Office highlighted significant and widespread errors in PAYE. They estimated for the first time that these problems had resulted in around £575 million per annum of tax due not being pursued by the Department; and that taxpayers were not being advised of around £295 million per annum potentially repayable to them. The main cause was the Department's failure to finalise and calculate tax liabilities correctly where people had more than one source of employment income. In the summer of 2005, the Department defined an action plan to correct these weaknesses over a number of years.

1.48 In 2004-05 the Department issued tax repayments amounting to £13.1 billion, of which £8.7 billion related to Income Tax and £4.0 billion to Corporation Tax. In May 2004, the Department's Repayments Risk Review Group reported serious risks of duplicate repayments, and made recommendations to address the problem. In the summer of 2005 the Department prepared an action plan to implement all the recommendations over a number of years.

1.49 The Department recognised that pressure to meet repayment targets might undermine the quality of work and checks undertaken to ensure accuracy and avoidance of error. Deficiencies in management information and lack of formalised, specific accountabilities have made it difficult for the Department to ensure the proper control of repayments and prevent or detect error and irregularities. In response to the NAO's recommendations, the Department made a senior officer accountable for making improvements.

PART TWO
Child and Working Tax Credits

Introduction

2.1 In April 2003 the Government replaced Working Families Tax Credit and Disabled Person's Tax Credit with Child Tax Credit and Working Tax Credit (Tax Credits). These changes were part of the reforms of the tax and benefit systems aimed at relieving child and in-work poverty. My Standard Reports for 2002-03 and 2003-04 recorded serious problems during the introduction of the new Tax Credits. These included delays in making awards to claimants, overpayments, software errors and the failure of essential controls. This part of my report examines the Department's progress in recovering from these problems and completion of the Department's first annual renewal of Tax Credit claims in 2004.

2.2 At the time of my reports for 2002-03 and 2003-04 it had not been possible for the Department to determine a robust estimate of the level of claimant error and fraud for the new Tax Credits. A Departmental exercise in 2000-01 indicated that they had overpaid some 10 to 14 per cent by value of the former tax credits because of claimant error or fraud. Whilst the design of the new Tax Credits and supporting systems are very different from the former Tax Credits and should have reduced the risk of error and fraud, the Department had no evidence that error rates had in fact fallen. I therefore qualified my audit opinion on the Trust Statement accounts for 2002-03 and 2003-04.

2.3 In my report for 2003-04, I noted that the Department planned to undertake work to provide more information on the level of fraud and error. This examination involves a full check of 4,700 randomly selected claimants. This exercise is not due to be completed until Spring 2006. In July 2005 the Department produced interim findings which indicated that it had overpaid £460 million (around 3.4 per cent by value) because of claimant error and fraud in 2003-04. The Department believes that these interim results are subject to a wide margin of error because they are based on work that had been completed by May 2005 and it is likely that these cases were more compliant. The final results are likely to show an increase in the proportion of cases involving claimant fraud and error. Whilst this work suggests that the level of error is lower than with the previous Tax Credits, it remained in my view unacceptably high in both the amount and percentage terms. There is no evidence to suggest that the level of error would have fallen significantly from 2003-04 to 2004-05. Consequently, I have qualified my audit opinion on the 2004-05 Trust Statement account in respect of Tax Credits.

2.4 This part of my report provides an overview of the main features of child and working tax credit and discusses the overpayments that have arisen from the nature of the schemes.

2.5 The main features of the Child and Working Tax Credit are set out in **Figures 3 and 4**.

2.6 The Department paid £15.8 billion in Tax Credits to 5 million families during 2004-05. **Figure 5** provides further details on the cost of Tax Credits and the number of families benefiting from Tax Credits.

3 Main Features of Child Tax Credit

Child Tax Credit

Available to those aged 16 or over, ordinarily resident and present in the UK whether working or not, and who are responsible for at least one child. Normally paid directly into the bank account of the main carer.

Elements	2004-2005 Annual Rates	2005-2006 Annual Rates
Family Element (one per family)	£545	£545
Higher Family Element (in first year of child's life)	£545	£545
Child Element (for each child)	£1,625	£1,690
Disability Element (for each disabled child)	£2,215	£2,285
Severe Disability Element (for each severely disabled child)	£890	£920

Source: National Audit Office

NOTE

The Family Element is reduced by 6.67p for every £1 of income over £50,000, in most cases. For families entitled to Child Tax Credit but not Working Tax Credit, the Child Element is reduced by 37p for every £1 of income over a limit of £13,480 (£13,910 for 2005-06). For families entitled to both Child Tax Credit and Working Tax Credit, the child element is reduced in the same way after Working Tax Credit, including any childcare element, has been fully withdrawn.

4 Main Features of Working Tax Credit

Working Tax Credit

Available to people aged 16 or over, working at least 16 hours per week, with dependent children or a disability or, for those without children or a disability, aged 25 years or over and working at least 30 hours per week.

Elements	2004-2005 Annual Rates	2005-2006 Annual Rates
Basic Element	£1,570	£1,620
Second adult and Lone Parent Element	£1,545	£1,595
30 Hour Element	£640	£660
Disabled Worker Element	£2,100	£2,165
Severe Disability Element	£890	£920
Element for claimants aged 50 and above, working 16-29 Hours	£1,075	£1,110
Element for claimants aged 50 and above, working 30+ Hours	£1,610	£1,660
Childcare Element - childcare costs cannot exceed £135 per week for one child and £200 per week for two or more children	70 % of costs	70 % of costs

Source: National Audit Office

NOTE

An award is reduced by 37p for every £1 of annual income over a limit of £5,060 (£5,220 2005-06).

5 Scheme Overview

Child and Working Tax Credits paid by the Inland Revenue

		2003-2004	2004-2005 (provisional)
Families benefiting[1]:		4.6 million	5.0 million
Of which	Child Tax Credit[2]	4.4 million	4.8 million
	Working Tax Credit	1.6 million	1.8 million
Amount paid by Inland Revenue		£13.5 billion	£15.8 billion
Administrative cost to Inland Revenue		£406 million	£422 million
Staff employed by Inland Revenue		7,300	8,200

Source: HMRC

NOTES

1 Figures represent the average number of families benefiting in the year. Some families benefit from both Child and Working Tax Credits

2 From April 2004, families claiming Income Support and Job Seeker's Allowance for the first time began to receive Child Tax Credit instead of receiving the child premia in their benefits.

2.7 Child Tax Credit and the childcare element of Working Tax Credit are generally paid directly into claimants' bank accounts. Where the claimant was an employee, the elements of Working Tax Credit apart from childcare were paid via the employer. Payment via employer will be phased out between November 2005 and April 2006 and replaced by direct payment by the Department.

2.8 Tax Credit awards were initially based on the claimant's income for the preceding tax year. Claimants were encouraged, but not formally required, to advise the Department of income changes during the year. The Department considered the need to revise awards during the year, if claimants reported changes in their income or circumstances. Awards were revised where claimants' incomes increased by over £2,500 and the Department sought recovery of the resulting overpayments.

Award renewal, overpayment and recovery

2.9 In the six months after the end of the tax year, in a process termed "Renewal", the Department asked claimants to confirm their circumstances, including their actual income for that year ended, and where there had been changes the Department recalculated the award. Underpayments were paid as a lump sum, and overpayments recovered, where possible, from future payments of Tax Credits over the rest of the year or longer periods, or otherwise directly from claimants.

2.10 The Department published statistics on finalised 2003-04 awards on its website on 1 June 2005 which showed that 5.67 million awards had been made in the year. The renewals process during 2004-05 resulted in no further changes to entitlement for some 3.08 million families. This was mainly where annual incomes had increased by less than £2,500 (increases below this amount are disregarded) or because claimants had reported changes in time for the Department to fully adjust payments in year. The Department estimated that the final entitlement to Tax Credits in 2003-04 would have been about £800 million lower without the £2,500 'disregard'. In 2003-04 some 1.88 million families had been overpaid a total of £1.93 billion (average just over £1,000), and 0.71 million families had been underpaid by £464 million (average £650). Half of the total amount overpaid represented cases overpaid £2,000 or more, affecting some 283,000 families. **Figure 6** shows the distribution of these underpayments and overpayments.

2.11 Tax Credit payments can be backdated and some 2003-04 awards were paid in 2004-05 creating further overpayments. The Department estimated that the total overpayment of 2003-04 awards was therefore £2.2 billion. Some £391 million was recovered in 2004-05 either directly from claimants or through adjustments to Tax Credit payments in the later part of the year. The Department also wrote off some £95 million of overpayments. It further considered that some £481 million to be irrecoverable because claimants successfully contended that they could not repay because

6 Finalised 2003-04 awards underpaid or overpaid (Excluding awards with underpayments or overpayments under £10)

Band of underpayment or overpayment	Underpaid awards (thousands)	Underpayment at 5 April 2004 (£ millions)	Overpaid awards (thousands)	Overpayment at 5 April 2004 (£ million)
Up to £50	82	2	134	4
£50 to £100	81	6	121	9
£100 to £200	111	16	193	28
£200 to £500	170	56	414	141
£500 to £1,000	124	88	388	280
£1,000 to £2,000	92	129	347	493
£2,000 to £5,000	47	136	243	725
Over £5,000	5	29	40	252
Total	**713**	**464**	**1,879**	**1,931**

Source: HMRC (Figures may not sum due to rounding.)

of hardship, or because the Department had difficulty in tracing claimants no longer entitled to receive Tax Credits. To prevent hardship to claimants, recovery of amounts overpaid can take place over several years. Full recovery of the remaining 2003-04 overpayments is expected to take at least 5 years as shown in **Figure 7**.

7 Expected year of recovery of 2003-04 award overpayments outstanding at April 2005

	£ billion
Total overpayment for recovery	**1.3**
Expected recovery:	
2005-06	0.5
2006-07	0.4
2007-08	0.1
2008-09	0.1
Later	0.2

Source: HMRC

2.12 The Department expects the amounts needing to be recovered to grow over the next few years, as a result of overpayments for further cycles. The Department does not ask claimants to pay off overpayments in a lump sum if they are continuing to receive Tax Credit payments.

2.13 The Department estimated in July 2005 that overpayments for 2004-05 awards were likely to be similar to those for 2003-04 and the Trust Statement account includes a provision of £480 million in respect of 2004-05 awards. The number of households overpaid was much higher than the government's estimates when the schemes were designed. The Department considered that this was because the original assumptions overestimated the number of claimants who would report income changes during the year and also underestimated the growth in claimant incomes.

The operation of Tax Credits

2.14 This section of my report looks at:

- Tax Credit targets;
- controls over payments;
- errors due to software problems and writes-off;
- complaints; and
- improving claimants compliance and customer service.

Tax Credit targets

2.15 The Department checks the accuracy of the processing of claims including changes in circumstances and renewals. Its Public Service Agreement includes a target accuracy of 90% for processing. **Figure 8** shows that the accuracy of processing improved in 2004-05 and the 90% target was exceeded. The significant improvement over 2003-04 reflects continuing efforts by the Department to identify reasons for inaccuracy and to introduce new procedures to prevent error.

8 Accuracy of processing and calculating awards

	2001-02 %	2002-03 %	2003-04 %	2004-05 %
Target Accuracy	92.0	93.0	90.0	90.0
Tax Credits	Scheme not in existence		78.6	96.5
Working Families Tax Credit	87.1	85.2	Scheme not in existence	
Disabled Persons Tax Credit	95.0	90.9	Scheme not in existence	

Source: HMRC

2.16 The Department's research indicated that inaccuracy was mainly due to:

- inputting of income from wrong financial year;
- inputting of incorrect income; and/or
- omission of a partner's income, when claimant notified a change in their own income.

2.17 The Department's Internal Audit Office reported in February 2005 that Tax Credit system controls were not sufficient to give assurance that data were being accurately amended and that all changes were legitimate. The Department accepted all the recommendations in the report and implemented an improvement plan in March 2005, including improved controls, additional supervisory checks and additional training.

Controls over payments

2.18 In my last report, I noted that the Department had not been able to perform the planned daily reconciliation of payments authorised with payments made. Delays in completing these reconciliations meant that some incorrect payments to claimants were not promptly detected. The delays could also have contributed to poor customer service as departmental staff may not have had a complete record of all payments made when dealing with some queries. Checking of payments authorised against payments made in respect of 2003-04 was completed in January 2005 and resulted in adjustments to some claimant records. Work on 2004-05 payments was completed in May 2005. The Department adjusts the record of payments authorised so as to match the details provided on bank statements. The Department plans to introduce a fully automated daily check of payments authorised against payments made in the second half of 2005-06. This will eliminate the need for significant work in retrospective checks.

2.19 The Department also had difficulty in reconciling its own record of payments issued with those cleared through the banks. This reconciliation is complicated by the need to take into account some 400,000 payments in respect of both 2003-04 and 2004-05 which had not been allocated to claimants' accounts at the end of 2004-05.

2.20 The amount of Tax Credit expenditure paid via employers shown in the Trust Statement Account is based on awards made by the Department. It could only know that these amounts were actually paid to claimants by checking against the instructions issued by the Department to employers. The Department sought to obtain assurance by reconciling a sample of amounts reported as paid by employers to the Departmental record of awards.

2.21 The 2003-04 reconciliation exercise was completed in February 2005 and the reconciliation rate was 78.9 per cent; the Department was unable to reconcile the remaining 21.1 per cent. The Department required employers to correct awards where errors were found. The exercise indicated that, of the total £2 billion paid out by employers, there was a likely net overpayment of £20 million (within an estimated net range of £11 million underpaid to £51 million overpaid). Given that this was the first reconciliation exercise for the new Tax Credits and that this was the first year employers had operated the new scheme, the Department believed the result of the exercise to be reasonable. The 2004-05 reconciliations were in progress at the time of this report.

Errors and writes-off

2.22 The 2004-05 Trust Statement account shows that the Department wrote off £123 million and made provision of £ 961 million for future writes-off. Further writes-off may be recorded in the accounts for 2005-06.

2.23 In my 2003-04 report I noted that certain software errors had resulted in overpayments calculated as £94 million in 2003-04 of which the Department had written-off overpayments of less than £300 totaling some £37million. I also noted that the Department expected further write-offs in respect of the balance of £57 million. In addition, the Department calculated and wrote off other overpayments of some £2 million that it considered had been caused by software errors.

2.24 The Department calculated that the software errors referred to in the previous paragraph resulted in further incorrect payments in 2004-05 of £7.9 million. Various other incorrect payments have also resulted from other system miscalculations. The Department aims to recover as many of these incorrect payments as it can in accordance with its usual policies. The Department continued in 2004-05 to investigate the reasons for these incorrect payments with a view to correcting any software errors.

2.25 Further software and other errors, mainly omitting the income of one partner from joint claims led to overpayments of around £80m during 2003-04 and 2004-05 and affected 88,000 households. The largest individual overpayment was over £20,000. The Department is attempting to recover all of these overpayments.

2.26 The unexpected problems at the time of the introduction of Tax Credits in 2003 caused the Department to issue 500,000 manual cheque payments totalling £170 million, with the supporting documentation being inadequately completed in some cases. In 2004-05, the Department wrote-off £33 million because the records were not good enough to cost-effectively match them to claimants.

2.27 There was some particular disruption due to software failings that meant the Department could not access and set up awards or make automated payments. This resulted in temporary manual payments until the claimants' records were reinstated. This time-consuming process affected approximately 35,000 records. The Department has made system changes to reduce this problem.

Complaints

2.28 The Department's Tax Credit Office received complaints in around 51,000 cases in 2004-05 and had difficulties managing this workload. This had a detrimental effect on its aim to deal with 80 per cent of correspondence within 15 working days of receipt, which it was unable to meet. The level of complaints was far higher than in any other area of the Department's work. This required increased staffing from around 200 in April 2004 to a peak of around 400 staff in April 2005.

2.29 The Department recorded conversations between claimants and Call Centre advisers. Those recordings can be used to assist in the resolution of subsequent complaints. However, in some cases, the Department could not retrieve the recording due to limits in retrieval capacity and difficulty in tracing the call on the tapes. The Department decided to purchase a new digital recording system to facilitate faster call retrieval in greater volumes and it planned to enhance storage capacity.

2.30 The Department's policy is that the claimant should not have to repay back all or part of an overpayment due to a mistake by the Department and if it was reasonable for the claimant to think the award was right. This is termed "Official Error Relief". In 2004-05 the Department received around 217,000 disputes against the recovery of overpayments. The Department faced severe difficulties in managing this level of work and introduced streamlined procedures from April 2005 for dealing with Official Error Relief. These procedures were likely to be more generous to claimants in many situations and at that time the Department estimated that the new procedures were likely to result in a net loss of £46.5 million. This was a departure from the criterion the Department previously applied that procedures resulting in a loss to the Exchequer can only be justified if there is a greater saving in administrative cost. But the Department could see no other way to manage the problem within the resources available.

2.31 **Figure 9** shows the number of cases in which complaints were received in 2004-05 and the amount of compensation paid. The Department paid compensation to complainants in accordance with its published Code of Practice 1, *Putting things right*, for the costs they incurred as a direct result of the Department's mistakes or delays and for the worry or distress caused. Payments for worry and distress are not intended to put a value on the upset caused but acknowledge that the Department was responsible.

9 Complaints and compensation

	Year to March 2005
Cases in which complaints received	51,000
Dealt with on first contact from claimant	92%
Number of compensation payments made	20,000
Compensation paid	£1.24 million
Average compensation	£62

Source: HMRC

2.32 Under the Department's Code of Practice, compensation payments for worry and distress usually range from £25 to £500, but are usually below £100. The Department trained its complaint handlers to make decisions on compensation in accordance with its policy. All compensation recommendations were reviewed by a more senior person to ensure consistency. Around 5 per cent of customers compensated have complained about the level of compensation, which the Department considered to be reasonable.

2.33 The Department's decisions on complaints and compensation decisions are final, although if claimants are unhappy with the decision they could ask the Department to review their case again. There is no right of appeal to an independent body specifically dealing with Tax Credits, but if claimants are unhappy with the way the Department handle their complaint or request for compensation, they can ask the Adjudicator to review their case or contact their MP. Claimants can also refer their case to the Parliamentary and Health Service Ombudsman (the Ombudsman).

2.34 The Adjudicator is an independent body which considers routinely whether or not HMRC has applied its discretion appropriately when investigating cases of complaints and redress. The Adjudicator has found in the claimants favour in 86 per cent of the Tax Credit investigations completed. Many of these complaints concerned the Department's handling of overpayments arising from an Inland Revenue mistake. In June 2005, the Adjudicator reported that common themes in these investigations included:

- Conflicting information on award notices, which makes it virtually impossible for claimants to understand what they are due;
- Difficulties faced in contacting the Tax Credit Helpline and instances where incorrect advice was given;
- Failure by the Department to update claimants' records;
- Delays in claimants receiving their correct entitlement;
- Payments made to the wrong bank account.

2.35 Citizens Advice Bureaux (CAB) dealt with 144,000 Tax Credit enquiries in 2003-04 and 151,000 in 2004-05, the two most frequent issues reported being poor administration by the Inland Revenue and the recovery of overpayments. In June 2005, the CAB comprehensively reported many cases where claimants had faced problems with Tax Credits. The CAB commented that the complexity of Tax Credits made it difficult for claimants to understand and that substantial levels of error have diminished confidence in Tax Credits. The Department has a dedicated helpline for intermediaries such as CAB which provides priority access to advice and case information. The introduction of a system with a provisional annual award was a culture change for many claimants who were used to budgeting and receiving benefits on a weekly basis. The system does not guarantee a weekly income and in some of the CAB cases in 2004-05 claimants saw their payments cut with no advanced warning as they were found to have been overpaid for earlier months.

2.36 Members of Parliament too received a large volume of complaints from constituents and the Department has a dedicated telephone helpline to answer their questions on behalf of constituents.

2.37 The Ombudsman received many complaints from Members of Parliament on behalf of claimants and upheld 79 per cent of these. In June 2005, the Ombudsman issued a special report on the administration of Tax Credits. This report commented that the introduction of Tax Credits had been broadly successful, but concluded that the delivery of Tax Credits does not take proper account of the needs of some of the poorest customers. It noted that Tax Credits had brought the Department a new customer group which has created fresh challenges which it has yet to meet. Disputes about the recovery of overpayments after the year end and excess payments in-year were a dominant issue in the cases referred to the Ombudsman. Several of the report's recommendations related to how the Inland Revenue sought to recover such overpayments and notified families of the process by which they could challenge recovery. The Ombudsman also highlighted several other problems with the way in which the Tax Credits system was delivered, including:

- Poor information on - and multiple versions of - award notices, which make it difficult if not impossible for claimants to work out their entitlement;
- poor communication with claimants;
- continuing problems faced by claimants in contacting the Department, including the Tax Credits Helpline; and
- delays in dealing with appeals and complaints.

2.38 On 22 June 2005 the Prime Minister told Parliament that the Government apologised for the hardship and distress that have been caused to some families and noted that action was being taken to address the criticisms of the system (see paragraph 2.46).

Improving claimant compliance and customer service

2.39 The Department's examination of a sample of awards (see paragraph 2.3) provided a new insight into claimant error and fraud and where attention on compliance could best be focussed. The Department also has carried out compliance checks throughout the claims process. These have included pre-payment verification checks, reviews on the basis of certain risk factors and, where relevant, investigation. Claims have also been subject to post payment risk assessment and investigation with recovery of amounts identified as overpaid.

2.40 In 2004-05, the Department started around 107,500 risk based investigations, of which 17,000 were pre-award and 90,500 post-award. The total was in line with the Department's internal targets and reflected the 1,225 staff years available for this work. In the 85,600 cases settled by July 2005 the payment of £130 million Tax Credits due to claimant error or fraud, relating to some 55,000 cases was prevented. Work was continuing on the remaining cases under investigation as at the end of July 2005.

2.41 Pre-award work was designed to be carried out within five days of a claim being received, with the intention of preventing incorrect awards. Information on some risks was not available at that stage and the majority of risk based investigations were therefore carried out post-award with the resulting need to recover any overpayments. In order to prevent incorrect payments the Department put greater emphasis on pre-award work in 2005-06 and has extended the time for enquiries from five days to ten days.

2.42 The Department performed a separate review of 2003-04 claims for childcare costs, by attempting to verify with childcare providers the childcare expenditure claimed in every Tax Credits award. The exercise relied on the goodwill of childcare providers who responded in 68 per cent of the claims. The Department investigated higher risk examples where, for example, childcare charges were significantly different from those claimed and found errors in 26,400 cases (21%) resulting in £18 million adjustments to reduce Tax Credit awards. As at 30 June 2005 the Department was continuing its investigations in 4,450 cases and was looking at the most effective way of following up those where childcare providers did not respond.

2.43 The 2003-04 childcare cost exercise had limited IT support due to competing IT priorities. This hindered full analysis of results, made the exercise labour intensive, and placed considerable demands on providers of information. The Department repeated the exercise in respect of 2004-05 awards but with improved IT support, which should reduce the burden on childcare providers.

2.44 The Department have evidence that Tax Credits have been targeted by organised criminals, particularly where they can make claims over the internet without proving identity. The Department's Internal Audit Office concluded that there was a lack of comprehensive information to allow a robust analysis of the problem. The Department established a group in 2004-05 to seek solutions to these issues, for example, by implementing new types of interventions to tackle organised fraud and prevent unjustified Tax Credits payments. The Department's Special Compliance Office planned to investigate all fraudulent claims over £1,500 but there were too many such cases for them to deal with. Some were therefore passed to local compliance teams to follow up. The Department intends, in 2005-06, to re-evaluate the level of activity directed at dealing with serious fraud. The Special Compliance Office works closely with banks and other financial institutions to curtail frauds involving money laundering from false Tax Credits claims.

2.45 The Department has acknowledged that more rigorous checks could have been carried out where claimants notified 'changes of circumstances' which affected their awards. The Department is considering revising procedures, including:

- Increased claimant identification requirements;
- Call centre staff to request more details about changes from claimants;
- Follow up enquiries by telephone if awards significantly increased;
- Enhanced fraud awareness programme for staff.

2.46 On 26 May 2005, the Paymaster General announced steps to improve the Tax Credits system. The Department has prepared a plan to:

- Review the effectiveness of information provided to claimants, and to reduce the number of cases where people receive unnecessary duplication of award notices;
- Test new methods of reminding claimants of the importance of providing up to date in year information on changes in income and circumstances;
- Develop options to improve the quality of the helpline service;
- Identify IT system problems and processing errors more quickly;
- Work more closely with the voluntary sector to target more active support for vulnerable families;
- Review the operation of the Code of Practice on overpayments, so that recovery can be suspended in cases of genuine hardship, while a disputed overpayment is resolved.

Compensation from EDS

2.47 During the introduction of Tax Credits, there were very serious problems which affected the stability, speed and availability of the computer system, which both delayed the processing of claims and led to incorrect payments being made. The Department and EDS (the Department's former IT supplier) have for some time been discussing these issues in an effort to agree fault, consequent loss and any compensation payable. At the time this report was finalised, those discussions continued.

Effect on the Department's other work

2.48 Problems with the introduction of Tax Credits in 2003 adversely affected tax administration. By the end of 2003-04, recovery was well underway and, in 2004-05, the Department began to absorb Tax Credits into its normal business operations with increased resources deployed to deal with the number of complaints about Tax Credits. Resources required for Tax Credits work, however, meant that some Departmental operational targets were not met in 2004-05. In particular, work on PAYE open case clearance (the Department's final check after the tax year-end that the pay and tax details for people on the PAYE system are correct) was affected as telephone calls were diverted from Contact Centres to back offices. Several hundred staff were used in this way. Although overtime was used later in the year to try to catch with up that work, it meant that the open case targets could not be achieved.

Conclusions

2.49 The Department paid £15.8 billion under the new Tax Credits schemes. These schemes represented a major challenge for the Department. Claimants encountered problems as the system went live in April 2003 which continued to have ramifications throughout 2004-05. Tax Credits are a substantial part of the income of the poorest families who receive them. The Department recalculates the value of awards annually, in a process called "renewal", the first of which in 2004-05 identified that one third of recipients of 2003-04 awards had been overpaid a total of some £1.9 billion in 2003-04. Subsequent backdated payments in respect of 2003-04 awards brought the total overpayments for that year to £2.2 billion. This was mainly because family income had increased by more than £2,500 compared with the income declared at the time of the original application for Tax Credits. Half of the total overpayments related to some 283,000 families who had been overpaid by £2,000 or more. Overpayments are recovered where possible from future payments of Tax Credits. The Trust Statement account has provided for £961 million of doubtful debts as at 31 March 2005 in respect of tax credit overpayments. The annual basis of the Tax Credit award means that recipients need to be able to anticipate and plan for the consequences of changes in their income. This is clearly a problem for many families until they become used to the implications of the annual calculation of their entitlement. In May 2005, the Paymaster General announced plans to improve significantly the Tax Credit system.

2.50 In my last report, I noted that software errors were expected to lead to further write-offs, in addition to the £37 million the Department had calculated and written-off in 2003-04. In 2004-05, the Department calculated that they should write off some £2 million of Tax Credits caused by major software errors in 2003-04 and 2004-05 that together resulted in overpayments of £174 million. The Department also wrote off £33 million in respect of some manual payments made in 2003. By 30 June 2005 the Department had calculated and written off a further £95 million when official error relief had been granted to claimants who disputed the recovery of their overpayment. The Department expect to have further write-offs during 2005-06 in respect of continuing work on 2003-04 and 2004-05 cases.

2.51 The Department's measures to ensure that Tax Credit applicants complied with their obligations involved routine pre-payment checks on all claims; risk based investigations; verification of childcare expenditure; and investigations of suggestions that organised crime was targeting Tax Credits. The Department will need to maintain compliance work to ensure that confidence in the fairness of the schemes is not undermined by unacceptable levels of unjustified claims.

PART THREE

Large Business Office management of Corporation Tax

Introduction

3.1 The aims of Corporation Tax are to ensure that business makes a fair contribution to the funding of public services whilst enabling an environment in which business can thrive. In 2004-05, the Department received net Corporation Tax of £33.4 billion. The tax was managed by two parts of the Department, the Large Business Office (LBO) and the network offices. This part of my report looks at some of the developments in the management of Corporation Tax within the LBO.

3.2 The LBO was created in 1997 to facilitate centralised leadership, ensure greater consistency of approach and increase industry awareness and specialisation. In 2004-05, the Large Business Office (the LBO) handled the tax affairs of some 800 large entities which provided about two thirds of Corporation Tax.

3.3 When the two revenue Departments merged in 2005, the LBO and HM Customs and Excise equivalent were brought together to form the Large Business Service (LBS). Its mission is to "make a substantial contribution to financing the UK's future by closing the tax gap".

3.4 Integration will be phased, with the intention that it will be substantially completed by March 2007. The Department expected to have defined the customer population of the LBS and the division of responsibilities within the LBS by the end of the Autumn 2005. A Client Relationship Manager role will be the single point of contact with each customer for all taxes and duties. The Department was looking to develop a single assessment of risk across all the taxes in order to deploy resources to best effect.

3.5 The Department has faced increasing numbers of legal challenges to the UK direct tax system including landmark cases relating to EU tax law. The Department closely monitor major litigation and the potential risks to Corporation Tax, to help identify and rectify weaknesses in the UK tax system and has introduced changes to legislation, for example the extension of the rules on transfer pricing. Corporate taxpayers' advisers and lawyers have continued to represent exceptional challenges to the Department and litigation has consumed considerable Departmental resources, notably high quality experts over extended periods.

Corporation Tax targets

3.6 The Department did not set targets for overall corporation tax to be collected in 2004-05. For 2005 to 2008 it has set a PSA target for the reduction of underpayment of direct tax and national insurance contributions due by at least £3 billion a year. Targets set for Corporation tax were achieved, with the exception of the target for the percentage of returns filed within 12 months of the due date. The Department did not achieve e-filing targets for 2004-05 and considers it highly unlikely that they will be met in 2005-06. In the summer of 2005, the Paymaster General invited Patrick Carter to provide advice on measures to increase take up of its online services. This work is due to be reported in the autumn of 2005.

3.7 The Department found unexpected difficulties in extracting from existing computer systems reliable data for 2003-04 to measure achievements against the Service Delivery Targets. These systems had been designed before the targets were set and either did not hold the information required or held it in a way that made it difficult to extract. Information to report progress on e-filing by large, medium and small companies was not available until mid-way through 2004-05 when the Department put in place arrangements for measuring e-filing.

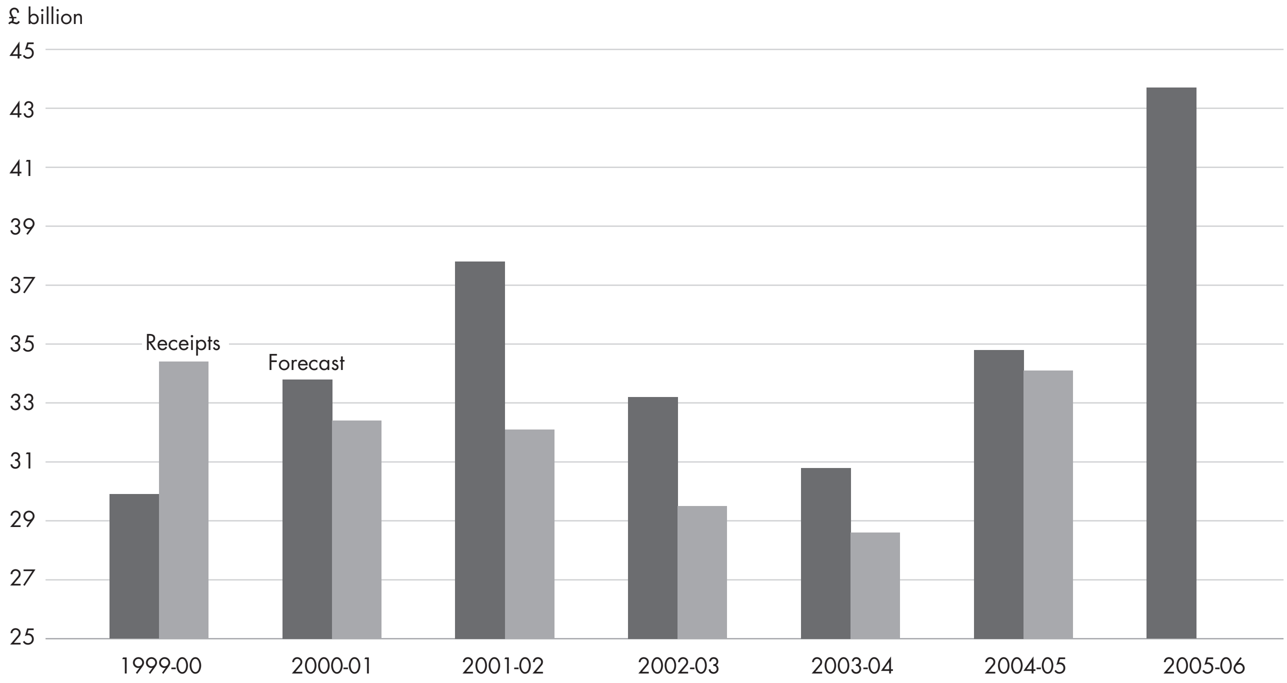
Corporation Tax Receipts

3.8 **Figure 10** shows that Corporation Tax receipts were generally below government forecasts as set out in the Budget for the five years from 2000-01 but that the shortfall was reduced in 2004-05. A significant proportion of receipts come from a small number of companies and one large adjustment can therefore have a significant impact. The Department considered that legislative changes also affect company behaviour and complicate forecasting.

3.9 In 2003 the Department commissioned an academic review which identified a number of weaknesses in the Department's forecasting model and developed a potential alternative approach. The two methods are now being used in parallel in order to test their relative accuracy and the Department will choose the most appropriate method in due course. Neither method, however, takes explicit account of the tax gap and they assume that historical trends of non-compliance will continue in the future. The Department will clearly need to review the forecasting methodology as its work on the tax gap progresses.

3.10 Receipts declined from 1999-2000 to 2003-04. The Department's research showed that a major reason for the decline was the phased introduction of Quarterly Instalment Payments (QIPs) and the abolition of Advanced Corporation Tax. These changes led to increased receipts in 1999-2000 because some companies paid more than one year's worth of tax liabilities. This was particularly pronounced in the financial sector where almost all companies pay QIPs. This effect diminished year on year until 2003-04 when payments stabilised. Departmental analysis also shows that major falls in financial company profits in 2001 and 2002 further reduced receipts and the subsequent recovery in profits has been relatively weak. The forecasts did not fully anticipate the continuing weaknesses in financial company profits.

10 Corporation Tax receipts



Source: HM Treasury Budget Reports

3.11 The Department's research suggests that the decline in receipts was not caused by significant changes in avoidance. The Department has, however, been unable to provide a robust estimate of the tax gap, in common with other fiscal authorities. But it is developing a model of the tax gap for the main customer groups. In December 1999, the Department began a programme of work for small and medium sized companies, in line with its developing Compliance Strategy, which provides data on the tax gap. The first analysis of the results started in 2005. There are difficulties in estimating the tax gap for large companies where there are unique and complex issues. This work therefore involves judgement, based on well informed risk assessments and enquiries of a small number of entities. The Department considered that new Departmental performance and management information systems should help to improve the analysis of the tax gap.

LBO targets and management information systems

3.12 The main objectives of the LBO were to safeguard the flow of revenue from large businesses and employers and enable customers to meet their obligations without unnecessary cost, whilst tackling and deterring non-compliance. The work of the LBO was planned and managed within the context of the Public Service Agreements. The LBO also measured its performance against other key targets **(shown in figure 11)**, although these did not contribute directly towards the Department's Service Delivery Agreement targets.

11 Large Business Office Targets

Large Business Office – Corporation Tax Key Targets	**2004-05 Target %**	**2004-05 Progress %**
Per cent Large Business Office correspondence replied to within 4 months	99	99.67
Per cent of issues worked to the required high standard or better	80	91.3
Per cent of entities worked to the required high standard or better	80	98.5
Process CTSA returns within 14 days	95	99.8
Process CTSA returns within 28 days	99.5	99.9
Process ITSA returns received by 30 September 2004 and processed by 31 December 2004	99	100
Process ITSA returns received by 31 January 2005 and processed by 31 March 2005	98	100
Handling of claims for tax repayments within 14 days	95	98.92
Handling of claims for tax repayments within 28 days	98	99.67
Where a group files all returns promptly, enquiries raised within 12 months of the date of filing	99.5	99.5
To work co-operatively[1]		

Source: HMRC

NOTE

1 The team's decisions, communications and actions align with the Inland Revenue Core Purpose, Core Traits and the departmental Business Direction. The team will demonstrate an acceptance of higher priorities adopting a co-operative approach by willingly sharing resources, knowledge, ideas and skills in a transparent way to achieve goals

3.13 In 2004, the LBO became concerned about the accuracy of the data used to measure the results for some of its targets. It was therefore unable to validate several important aspects of their performance for 2003-04. Senior managers also had concerns that staff did not fully understand their roles and responsibilities in relation to key targets. It set up a Performance Validation Project team in July 2004 to review processes for recording, reporting and validating performance and local LBO office governance arrangements. In August 2004, the Department's Internal Audit Office commented that that the team's proposals should provide more robust procedures. Following these developments the LBO generally outperformed its targets in 2004-05.

3.14 The LBO did not set a target for the additional Corporation Tax its work on corporation tax assessments would generate, although senior management regularly monitor the results. This was valued in the Department's annual report at £2.1 billion in 2004-05. The Department's Internal Audit Office undertake an annual review of LBO yield before it is reported and for 2003-04 identified errors in the recording of 11% of all adjustments. Some errors were relatively small, but in total the result was an adjustment of £47.7 million over-recorded in respect of 2003-04. The LBO's own annual review of specific large cases had already led to a correction of £13 million over-recorded. Errors were due to the complex relationship between the effects of different adjustments, a lack of staff understanding and human error. Internal Audit however highlighted the concerted efforts being made to address the quality and completeness of management data.

The Basic Data system

3.15 In April 2004 the LBO introduced a new system – "Basic Data" - to support and monitor casework. This was designed to address concerns with the old LBO IT system, including the need to improve reporting of tax at risk and yield information. It was also intended to improve information sharing and the monitoring of workloads.

3.16 The Department experienced problems during the changeover to the Basic Data system.

- Due to system limitations no major data cleansing exercise was possible before transferring data to the new system; this required subsequent work to remove and correct data;
- Some important data on completed enquiries were removed in error during the decommissioning of the old IT system and had to be restored;
- Tax at risk information was needed to manage ongoing work and had to be entered onto the new system. This was achieved, despite problems of access in some offices and the volume of work involved.

3.17 The National Audit Office found varying use of the Basic Data system. Some of the Department's staff lacked understanding of how to use the system, despite initial training and failed to record information appropriately, which undermined the usefulness of management information. The Department planned to improve the system later in 2005 and to issue further guidelines.

LBO working methods and quality assurance procedures

3.18 The National Audit Office reviewed procedures at three LBO offices.

Risk assessment

3.19 The LBO generates additional Corporation Tax through changes to self assessments, which arises primarily from the examination of specific issues. Effective risk assessment is important in targeting this work. Risk assessment involves the preparation of a background description of the corporates' activities, combined with an annual scrutiny of taxpayer accounts and computations to identify areas where tax law has not been applied consistently. The preparatory work is labour intensive and the department had no standardised way of undertaking it. Manual risk assessment is relatively slow and inefficient and reduces the time available for examining specific cases. There is also a time lag for initially spotting tax avoidance and other new high risk areas; annual risk assessments have to wait on receipt of the accounts and so are typically completed some 15-21 months after the tax year end.

3.20 The National Audit Office found risk assessment guidance being followed in general, but with a range of interpretations of what the process involved, and what information should be included. The LBO explained that this was to provide for some flexibility. But it does not ensure that all major risks are identified and tackled. Effective case work requires the prioritisation of identified risks, but the NAO found that evidence of this varied from very clear to ambiguous.

"Business" Sectorisation

3.21 The LBO's work in 2004-05 was influenced by the Department's 2001 "Review of Links with Business" which looked at how the Department could be more supportive to large businesses. One initiative involved creating sector groups of entities operating within a similar business, for example the pharmaceutical industry, which display common behaviours and tax risks. This could help to improve tax risk identification and achieve more consistent working of tax issues through the development of specialist knowledge. Sectors were initially seen as supporting more informed risk assessment and better understanding and working of tax issues, rather than being the main driver for managing work.

3.22 The LBO operated through 13 offices. Financial sectors casework was concentrated in 5 offices with a high degree of specialisation and non-financial work in the other 8 offices. Where work was organised by sectors the LBO had undertaken a process of consolidating work into fewer locations, typically 2 or 3. At the end of 2004-05 70% of taxpayer entities were assigned to formal sectors as shown in **Figure 12**. Some of these were more developed than others, in particular the financial sector. Each sector had a lead officer responsible for ensuring the consistency of approach and developing tax risk assessments. The Department recognised that there was significant development work to do before sectors became the primary driver for their work. It intends to change to a fully sector based management structure for the Large Business Service.

12 Sectoral analysis of LBO business

Sector	Number of taxpayer entities	Additional tax from LBO work in 2004-05 £m	Corporation Tax Receipts in 2004-05 £m
Financial	300	790	6,594
Pharmaceuticals	22	310	887
Major utilities	45	160	722
Property	13	7	167
Major retail	44	49	1,841
Air Transport/Shipping/Rail	42	28	318
Motor	20	39	136
Media	32	42	694
Telecommunications	20	22	462
Tobacco and Alcohol	13	9	253
Construction	29	24	538
General	244	623	5,831
Total	**824**	**2,103**	**18,443**

Source: HMRC

Resource allocation

3.23 The Department established a resources working group in 2001 to consider the most effective way of allocating LBO resources between offices. In 2004 the Department accepted a core recommendation of the working group and adopted a new risk based model. A new computerised caseworker diary system was introduced in 2004 to assist in allocating and recording resources, but the system failed to perform as intended. At the end of 2004-05, the Department was working with the IT provider to rectify these problems.

3.24 The Department had planned to introduce a new LBO-wide IT system to monitor the use of resources. Since the announcement to create the Large Business Service of the merged Department, however, IT plans were subsumed into developing a new process for risk management and allocating resources. This was expected to be completed in October 2005.

3.25 Resource allocation was performed on an office rather than a sector basis. Each office was required as a minimum to have an auditable system for allocating resources to taxpayer entities and risks. Entity risk scores and data on resource usage were used as a starting point in allocating resources. The mechanisms in place, and the information used to inform this process varied from office to office. Some offices were piloting the use of less senior case directors on lower risk cases, to allow more experienced staff to focus on more complex issues.

Quality assurance procedures

3.26 As part of the Continuous Improvement Programme, the LBO considered that the existing approach to quality assurance, which involved self-assessment and peer review, was not sufficiently robust and could be improved upon. In 2003 the LBO commissioned two working groups to review quality assurance and produced guidance on professional standards and quality control. These analysed the risks and the processes and standards in place to manage them within nine high level risks identified by senior management.

3.27 In March 2004 the LBO created a new Quality Standards team with the objective of evaluating the performance of the LBO as a whole. The team developed a programme of LBO reviews to tackle quality assurance, control and improvement.

3.28 The original plans for 2004-05 involved reviews of the LBO headquarters and all LBO offices, some reviewed in more depth. In June 2004, the Quality Standards team completed a pilot audit of the Peterborough Office that dealt with the retail and construction sectors, which led to refinements in the methodology used. It also highlighted the resource and time pressures, and the range of specialist knowledge which would be required in the Quality Standards team to perform in-depth reviews of all significant issues. Subsequent audits therefore involved a less comprehensive review, concentrating on pre-selected issues, ensuring risk assessment processes were in place and that minimum standards were complied with. Some planned audit work for 2005-06 was put on hold due to creation of the Large Business Service. The Quality Standards team proposed to move to a more risk-based, real-time approach, in order to achieve coverage of the largest cases over a period of years.

3.29 The Quality Standards teams work for 2004-05 found inconsistent standards of risk assessment across the offices. This was attributed to the LBO minimum standards not being sufficiently prescriptive and robust. The Department planned to review the standards as part of the creation of the Large Business Service. The team found varying approaches to resource allocation across the LBO and a lack of review of resources used and the results they achieved. They also found delays in dealing with some issues due to staffing problems, and delays in gaining input from technical specialists. The Quality Standards team itself had no powers to follow-up progress on its recommendations but reported them to the LBO senior management team who accepted them for implementation in 2005-06.

3.30 The LBO also seeks to validate its performance by commissioning customer surveys. The last survey was undertaken in August 2004 and involved over 400 telephone interviews. This reported that 85% of customers believed that the LBO was very or fairly effective at identifying tax risks, and that 78% believed that it was very or fairly effective at resolving these once identified. Only 3% thought that the LBO should concentrate on more material issues. There was, however, some criticism over the turnover in case teams, and the extent to which the LBO kept customers informed about tax issues. These findings have helped to inform the role of the Client Relationship Manager.

Major initiatives aimed at improving the LBO's effectiveness

Better Data for Corporation Tax

3.31 The effectiveness of the LBO's compliance work was hindered by limitations in its management information systems. The Department commenced work on a new direct tax compliance package in 2004, with a key element being "Better Data for Corporation Tax." This aimed to improve compliance through better use of management information to improve both the targeting and effectiveness of Corporation Tax and other enquiry work in the LBO. The Department intended this project to achieve a step change in the effectiveness of the LBO's compliance work by:

- Improved compliance and risk profiling, by introducing a more comprehensive and efficient approach to risk assessments and allowing LBO management to identify areas of increasing tax risk early;
- Better forecasting of Corporation Tax, via improved forecasting tools and business data;
- Better reporting against Public Service Agreement targets, through a suite of information for setting, reporting and evaluating targets;
- Increased tax yield, through better targeting of resources and enhanced productivity of teams from improved data and analysis tools.

3.32 Phase one of the project was completed at the end of January 2005 and offered some initial improvements to available management information. Phase one also provided limited external data on companies and limited capacity to analyse company data sources. It also provided the capability to capture electronically paper based company accounts; a number of pilot cases were captured in 2004-05 (albeit less than originally planned) and more will be added during 2005-06. Additional functions were planned in phases, with full completion scheduled for April 2006. The Department emphasised that the system's effectiveness would be considerably enhanced if company accounts and data were received electronically, which is currently not a requirement.

Specialisation

3.33 The LBO recognised the importance of building up commercial awareness. Employing tax experts specialising in particular industries and issues, for example on avoidance and transfer pricing, could yield more tax. In 2004-05 the LBO employed more specialists and tax technicians with the aim of adding value to compliance work. These were intended to improve targeting of risks, saving time on misdirected enquiries and quicker dropping of issues on which the Department was unlikely to win. The Department expected these specialists to generate additional tax of over £100 million a year by 2006-07 and considered that it would be a very cost effective initiative.

Reorganisation of the financial sector of the LBO

3.34 The financial sector was the LBO's largest and most complex sector. A high proportion (some 20% in 2004-05) of Corporation Tax came from this sector. But the Department considered that significant amounts of tax were lost through avoidance in this sector. A higher proportion of time was spent on management at the expense of specific casework than in other sectors, as the work was spread over several management units. Compliance results were also relatively poor in comparison with the non-financial sectors. The tax yield: cost ratio in the financial sector offices was 38:1 and 68:1 in the other offices, despite the financial offices dealing with businesses where tax was thought to be most at risk.

3.35 In 2005, the LBO integrated the four London financial sector offices onto one site to share a common management structure. The reorganisation offered the opportunity for significant change, improved performance and better and more flexible team working. The LBO expected the reorganisation to enable a more effective industry-wide approach and that the increased flexibility to move resources when needed was expected to produce extra yield. Further, the integration should reduce the time spent on management and release resources to improve the identification of tax risks. The Department considered that action being taken to ensure more effective resource allocation should improve the yield:cost ratios.

New compliance process

3.36 The Department piloted a new compliance process in 2002-03, involving 17 LBO customers on a voluntary basis. This aimed to improve working relationships with customers in order to identify and resolve tax issues earlier. The customers agreed to disclose significant tax risks before returns were filed and the Department agreed to focus on those risks. The Department saw the main advantages as being that the case team could focus on key risks, so that speculative enquiries should be unnecessary, and that businesses would have greater certainty of its tax charge much sooner. The customers and teams involved in the pilot judged it to be a success, and the Department was extending the process on a voluntary basis; with approximately 80 entities signed up by the end of 2004-05.

3.37 The new approach required a significant change in the approach to managing the risks of non-compliance. Rigorous analysis and evaluation is needed to ensure that the new approach effectively tackles non-compliance. In April 2005, the Large Business Service started a review of this matter.

Conclusions

3.38 The Large Business Office (LBO) handled the tax affairs of some 800 large entities and employers which generated some £18.4 billion of tax in 2004-05. The primary objective was to safeguard the flow of revenue from large businesses and employers, enabling customers to meet their obligations without unnecessary cost, whilst effectively tackling and deterring non-compliance. The complexity and sophistication of tax management in the large business sectors, including EU and other international dimensions, pose some of the most difficult and potentially costly challenges for the Department, both in terms of administration cost and loss of revenue.

3.39 The LBO generated an additional tax yield of some £2.1 billion in respect of 2004-05 – primarily from the examination of specific tax issues. Good quality and prompt tax risk assessments are essential to achieving the best deployment of the Department's resources and the most effective compliance effort. For some years the LBO had been developing sector specialist knowledge and structures to improve tax risk identification. The Department recognised that there was significant development work to do before sector based approaches to risk assessment became fully effective. The compilation of data and calculation of financial ratios used in tax risk assessments were largely manual, time consuming and resource intensive, and not eased by the data being supplied by corporate taxpayers mainly in hard copy format rather than electronically.

3.40 In 2004, the Department launched a project called "Better Data for Corporation Tax". This was intended to achieve a step change in the effectiveness of compliance work through better use of management information to improve the targeting and effectiveness of enquiry work in the LBO. There were also important initiatives in internal quality assurance of Corporation Tax case work, management and structural reorganisations, employment of specialists, and new compliance processes with some customers. These initiatives are continuing within the integration plans for the new Department.

3.41 The LBO was integrated with the Customs and Excise equivalent in April 2005 to form the Large Business Service of HM Revenue and Customs, with a mission to "make a substantial contribution to financing the UK's future by closing the tax gap". The management by large businesses of their tax affairs will continue to pose a challenge and the Department must continue to modernise its work on Corporation Tax within the large business sectors. The Department must ensure that its various initiatives enable it to match the sophistication of large businesses with equivalent Departmental expertise and methods.

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