Presented pursuant to the Government Resources and Accounts Act 2000 c20 s6(4)
and the Exchequer & Audit Departments Act 1921 c52 s2

HM Revenue & Customs 2007–08 Accounts

– Consolidated Resource Accounts
– Trust Statement
– Report by the Comptroller and Auditor General

LONDON: The Stationery Office
HC 674

14 July 2008
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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 & Customs (HMRC) 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 Managing Public Money.

1.2 As Acting Chairman of HMRC I am accountable to the Chancellor and to the Financial Secretary to the Treasury, to whom the Chancellor has delegated responsibility for the day to day oversight of the Department. The Financial Secretary 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 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. 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 HMRC for the year ended 31 March 2008 and up to the date of approval of the accounts, and accords with HM Treasury guidance.

3. Governance

3.1 A detailed description of HMRC's high-level governance, including its senior committee and business structure, can be found in the Corporate Governance Report, published as a separate section to the Accounts.

4. Risk Management

Capacity to handle risk

4.1 As head of the Department, I have a key role to play in promoting and supporting the risk management strategy. I am supported by Executive Committee members who are accountable for identifying, assessing and managing the risks within their portfolio. In turn, Directors are accountable to their Executive Committee members for risk management within their Directorates, and reporting on the actions they are taking to mitigate them.

4.2 Between April 2007 and January 2008 a Risk Committee operated as one of a number of sub-committees of the Executive Committee. It had responsibility for taking an overview of risks facing HMRC and ensuring effective risk management. The Committee:

- Reviewed the effectiveness of risk management and risk mitigation in HMRC, and identified improvements;
- Considered whether existing risks were being well managed;
- Identified new risks and allocated ownership.

In January 2008 oversight of risk moved to the lines of business led by individual Executive Committee members.

4.3 In carrying out this role, the Risk Committee received information from individual Directors and Executive Committee members, as well as from other sub-committees. The Committee updated the Executive Committee with their assessment of HMRC's exposure to risk. It also informed the Audit Committee of changes to the risk management arrangements in the Department, to assist the Audit Committee in assessing the effectiveness of those arrangements.

The risk and control framework

4.4 The current approach to risk management in HMRC involves the upward reporting of risks. The primary mechanism for this is the Directors' monthly and quarterly performance reports. These Director-level risks inform the strategic risk management process, which is focused around the Departmental Risk Register. Ownership of the risks in the Departmental Risk Register is assigned at Executive Committee level, and at the next level of management down – the Delivery Manager.

4.5 The Department's strategy for managing risk is outlined in the Risk Management Framework. The Risk Committee highlighted a number of areas where improvements could be made and work is being taken forward in the following areas:

- Professional risk management expertise will be brought in to provide leadership, technical expertise and to facilitate the transformation of risk management across the whole Department;
- Appropriate IT support will be implemented;
- Training and awareness raising will be carried out to embed Risk Management throughout the organisation;
- Further work on the definition of Risk Appetite at a strategic level.

The improvement activity will take place over the next twelve months alongside ongoing risk management.

4.6 One of the recommendations of the Capability Review (see paragraphs 5.7 to 5.9) was that HMRC "should augment one of its existing external reviews to include an immediate management risk review…" (p28 *Area for Action 3*). This work was taken forward by PricewaterhouseCoopers who reported at the end of June. Plans are being developed to roll out their recommendations to all of HMRC.

5. Control

5.1 Key developments during the year included:

United Kingdom Border Agency (UKBA)

5.2 In November 2007, following a Cabinet Office review, the Prime Minister announced the creation of the UK Border Agency, primarily focused on security. The UKBA was established in a shadow form on 1 April 2008, whilst full legal and machinery of government changes are worked through.

5.3 As the UKBA is the key delivery agent for HMRC at the border, aspects of HMRC's security activity in relation to the border have moved to the UKBA. However, the main Customs role and HMRC's wider border responsibilities in relation to fiscal, economic, international trade and customer service remain in HMRC. HMRC officers within the shadow agency continue to retain the same powers and delegated authority they did while in HMRC; key operational decisions continue to be made by HMRC managers; and overall accountability remains with the Executive Committee.

5.4 HMRC has put in place a governance structure and programme team, headed at Executive Committee level, to manage this change. The programme management team oversee and coordinate development of work in HMRC and liaise with the Home Office. A steering group, with representation from all business areas with a significant interest in border issues, has also been established. Its role is to have strategic oversight of the HMRC/HM Treasury contributions to the development of a UKBA and the organisation of the HMRC residual border activity. It is developing and managing delivery of the overall programme plan; risks and issues of the change process; a new business design; and a change programme for the development of the new UKBA and HMRC.

Transformation

5.5 The Departmental Transformation Programme (DTP) developed a Strategic Framework and a Target Operating Model, which will help determine the long-term look and feel of HMRC, as well as providing a cohesive change platform for the Department to work from.

5.6 Several programmes within DTP have already delivered key successes in 2007–08. These include reducing bureaucracy and improving compliance through the Construction Industry Scheme Programme; simplifying the existing Pensions processes into a single approach to make life easier for employers and savers; and the award winning International Trade Single Window in Customs. From 2008, PAYE records currently held on 12 regional databases will be transferred to a new single database, the 'PAYE Service'. One customer record will be created for each taxpayer containing all their tax and National Insurance details, moving the Department towards a whole customer view.

Capability Review

5.7 HMRC's Capability Review was published in December 2007. Following the review the HMRC Board agreed an Implementation Plan covering 6 areas:

- Clarify Accountabilities
- Set a clear direction
- Increase the pace of change
- Generate passion, pride and motivation in the workforce
- Use evidence and analysis to drive performance
- Focus on immediate priorities following the loss of Child Benefit data including tighter controls on data management (see paragraphs 6.5 to 6.9) and improved relations with customers and their agents.

5.8 Departmental activity to implement the plan is commissioned and assured by a Capability Review Implementation Board, comprising the key senior managers who are responsible for delivery of the individual actions contained in the plan and accountable to the Executive Committee. Key developments that have taken place so far include:

- A review to clarify personal accountabilities. Having focussed initially on members of the Executive Committee, it is now moving down through the organisation. There is ongoing work to articulate non-financial delegated authorities at all levels.
- Strengthening the senior external advice available to HMRC through the appointment of four new external advisors who work with the Executive Committee.

- New governance arrangements have been initiated to ensure that named leaders are held to account rather than committees.
- A Revised Operating Model has been put into place with four clear operational businesses. This is delivering sharper accountabilities, improved organisational clarity and greater customer focus; all of which contribute to improved performance.

5.9 I am ultimately accountable to the Cabinet Secretary for progress against the plan. Risks which could threaten the proper and timely implementation of the plan are reviewed by the Implementation Board at each of its meetings both to ensure careful monitoring of current risks and that all risks are captured as the plan moves forward.

Other Developments

5.10 The work performed by Directors during the year on governance, risk and control is also reflected in a number of notable developments including:

- The commissioning of an Olympics Steering Group (OSG) for directing and co-ordinating HMRC's contribution to the 2012 Olympic Games.
- The implementation of a litigation strategy which underlies our customer facing principles and ensures consistency in dealing with cases. This is supported by a set of best practice legal advisory principles.
- We have negotiated a major restructuring of our IT contract with Aspire. The restructured contract will deliver improvements in value for money, service and quality. The new contract will reduce IT running costs by around 10 per cent per year by 2011. In return for this commitment to reduce costs, the contract is being extended by three years to 2017.
- HMRC is following best practise within the law enforcement community in developing a Professional Standards policy and strategy. As part of this work, various Directorates have been involved in a successful pilot exercise to develop a Corruption and Internal Fraud Strategic Risk Assessment process for HMRC. This is being rolled out across the whole Department during 2008, aiming to provide both a strategic and tactical view of risk and control.
- The Risk and Intelligence Service has been restructured to ensure that all HMRC Enforcement and Compliance activities are directed and supported by the best possible risk and intelligence information.
- A new resource allocation tool will be used to allocate resources more effectively within Local Compliance for 2008-09, helping to ensure that resources are better targeted at risk, as opposed to using historic levels.
- Relevant Directors across HMRC engage with their counterparts in overseas tax administrations to ensure the UK's influence is both maintained and grown.
- A tax agents and advisors steering group, made up of representatives of the tax advisory profession and senior HMRC officials, promotes engagement between HMRC and tax advisors.

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 executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, by the work of the internal auditors and comments made by NAO in management letters and other reports.

6.2 I discuss significant control issues with my executive team as they arise at our regular Executive Committee meetings. These meetings are informed by an assessment of our current exposure to risks associated with our major programmes and projects. They are further informed by feedback from a series of performance reviews held each quarter between the relevant Executive Committee manager and Director. The focus of these reviews is the progress being made in each Director's area to deliver value and the key issues/risks that could prevent the achievement of key targets/objectives by the year end.

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

6.4 The Directors General 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 observations from the Director of Internal Audit and from NAO, I recognise that there are a number of material control weaknesses. Of those I have identified the most significant are detailed below. I am giving priority to the plans that we have put in place to address these weaknesses and to improve the overall control environment.

Data Security: Data Loss

6.5 In November 2007 HMRC reported that two Compact Discs containing personal details of 7.25 million families in receipt of Child Benefit had been lost. In response to this incident, the Independent Police Complaints Commission (IPCC) undertook an investigation into the series of events leading up to the loss and considered whether any criminal, conduct or disciplinary offences had been committed by HMRC staff. And Kieran Poynter, Chair of PricewaterhouseCoopers, was invited to undertake a full investigation of the circumstances surrounding the loss and of HMRC's wider data security arrangements.

6.6 HMRC took immediate steps to enhance data security following the incident including:

- Appointment of data guardians.
- A complete ban on the transfer of bulk data on removable media without adequate security protection such as encryption.
- Removing the ability of all staff to save data to portable media such as CDs and memory sticks and reintroducing this only where there is a compelling business case to do so.
- The provision of a Data Security Booklet to all staff.

6.7 In the interim report published by HM Treasury on 17 December 2007 Kieran Poynter noted "…… the first actions that I would have recommended had already been taken by HMRC before I began my review…."

6.8 A final report was published by HM Treasury on 25 June 2008 and the Chancellor made a further statement to Parliament on the same day. The Chancellor has accepted the report's detailed findings and recommendations in full and has endorsed in principle the direction of travel proposed by the review team. Significant progress has been made by HMRC on 39 out of the 45 recommendations, including 13 which have already been fully implemented.

6.9 The IPCC report was also published on 25 June 2008. The report found no evidence whatsover of misconduct or criminality by any member of HMRC. HMRC is committed to implementing all of its recommendations.

Data Security: Data Sharing with other Departments

6.10 HMRC shares customer information with several other government departments. We ensure that departments receiving HMRC information are aware of their statutory obligations under the provisions of the Data Protection Act including the need to comply with all of the principles of that Act such as the need to keep information safe and secure. These principles are set out in Memoranda of Understanding, Service Level or Partnership Agreements detailing the legal and administrative framework in which HMRC information may be used (including onward disclosure of HMRC information by the receiving department). However, we currently have no formal mechanism for those departments to report back to HMRC on how they comply with data security and what steps they have taken to prevent unlawful disclosures. In addition we have no method of gaining assurance from the receiving department that the data is being held securely and appropriately controlled. This presents a greater risk in the area of tax credits where Exchequer funds could be vulnerable to fraud (or inappropriately applied) as a result.

6.11 The Data Security Programme is overseeing a review of HMRC's approach to granting roles and access to IT systems. This will include a review of access rights granted to other government departments and the controls in place to ensure they are granted, used and closed appropriately.

6.12 Our Internal Auditors are also working on new initiatives to establish the necessary data feeds to support fraud investigation work where we are providing data to other departments, in particular in relation to Tax Credits.

6.13 We have also raised the issue with Cabinet Office in respect of Shared Services and cross-departmental business processes as we believe this will be a significant issue under the Transformational Agenda.

Data Security: Legacy IT Systems

6.14 Not all of our legacy IT systems have been fully assessed for security risks. As part of the measures being taken to strengthen data security governance, HMRC will ensure that the IT systems supporting our most time critical business processes are reviewed to establish a known risk position by December 2008. We will carry out a review of our remaining systems during 2009.

Tax Credits: Fraud and Claimant Compliance

6.15 We measure the levels of error and fraud (excluding organised fraud) each year via a Random Enquiry Programme. In 2007-08 we checked 4,250 finalised awards from 2005-06 and 4,030 finalised awards from 2006-07 to determine in each case if the customer's final entitlement was correct – i.e. was the award finalised on the customer's latest circumstances. Results were then extrapolated to determine the overall level of error and fraud across the whole tax credits population. We estimated 2005-06 tax credit error and fraud to be between £1.36 billion and £1.69 billion (8.5 to 10.6 per cent of the final value of awards) and 2006-07 error and fraud to be between £1.31 billion and £1.54 billion (7.2 to 8.4 per cent of the final value of awards). The Comptroller and Auditor General has again qualified his opinion on the regularity of the expenditure reported in the Trust Statement in respect of tax credits error and fraud.

6.16 In response to these findings we are proposing a target to reduce this figure to no more than 5 per cent of expenditure by March 2011. We have refreshed our Compliance strategy, and our future actions involve moving away from a numerical target to a broader set of responses which influence the behaviours of the many rather than just a few, and which maintains those behavioural changes.

Tax Credits: Re-finalisation of awards

6.17 The Tax Credits Act 2002 provides for awards to be adjusted after finalisation only in specific circumstances. The guidance generally being used by staff and the supporting IT system does not reflect this. In the period between June 2006 and June 2007 this shortcoming became apparent through the standard technical checks and it became evident that the correct procedures had not always been followed, in particular:

- Enquiries had been opened without informing the claimant.
- Overpayments on finalised awards caused by official error were being recovered.

6.18 Around 250,000 cases from earlier years appeared to be impacted by this problem. Letters were sent to customers in August 2007 advising them that their awards for earlier years would be reviewed. A three year programme of work is now underway. It is estimated that the cost of the exercise will be the equivalent of 150 staff for each of the 3 years. Current findings indicate that overpayments will have to be remitted in around 8 per cent of the cases reviewed (more for the very old cases). Early estimates of the cost to the Exchequer are around £20 million.

6.19 New processes have been introduced to re-organise the renewals process and amend the way in which changes of circumstances for earlier years are considered and captured. The IT system is also being changed so that it will no longer allow finalised awards to be re-opened except under prescribed circumstances. This will become effective in April 2009.

6.20 As part of the subsequent programme of remedial action we undertook a review of our guidance to see whether there were other potential problems with our processes or guidance. This uncovered a number of weaknesses. We are now embarking on a major programme of work which will urgently examine and rewrite tax credits guidance over the next 2 years to ensure that it is both user-friendly and legislatively correct.

PAYE: Open cases

6.21 Last year we reported that the balance of open cases, i.e. cases where the end of year check identifies that clerical action is needed to clear, was 13 million. Additional resources were deployed during 2007–08 to enable us to reduce the balance to 10.5 million by the end of March 2008. However, during the year a number of factors militated against this. We were required to divert a significant number of staff to deal with Tax Credit re-finalisation of awards cases (see paragraphs 6.17 to 6.20). Also new computer functionality introduced in April 2007 to better reconcile information from employers on employee earnings, while successful, also generated some additional cases which would previously have passed through the system unnoticed. As a result the balance of open cases at the end of March 2008 was 16.2 million.

6.22 The introduction of the new PAYE Service (see paragraph 5.6) in October 2008 will automate matching and processing of data sufficient to reduce the number of cases needing clerical intervention to less than 5 million each tax year, starting with the year 2007–08. Those cases should all be cleared during the same year in which they occur so backlogs should no longer accrue. We plan to treat the 16 million balance inherited from March 2008 as a discrete piece of work. We expect to clear 5 million in 2008-09 and the balance in 2009-10, though at the time of writing we are still exploring whether additional staff and IT investments might enable us to clear this balance more quickly.

Self Assessment (SA) Online Filing – 31 January 2008

6.23 The total number of returns filed online in 2008 increased to a record 3.8 million returns, up by nearly one million (30 per cent) on the previous year. On 31 January alone over 204,000 returns were successfully filed online as compared to 150,000 on 31 January 2007. Unfortunately we experienced significant technical problems on 31 January (the SA filing deadline) and 1 February with about 10-15,000 customers unable to use our SA online service. As a result, we decided to treat all returns filed on 1 February as filed on 31 January. There was no interruption to the service for filing using commercial software (used by the great majority of tax agents) which operated well throughout although agents did have difficulty accessing the SA portal to use other services (e.g. view their clients' liabilities and payments). We recognise that the experience of those customers who had difficulty accessing our service or experienced delays while attempting to file their returns fell short of the high standards expected. This is why we took the steps described above to ensure no one was disadvantaged or unfairly penalised. Valuable lessons have been learned from this experience and these will be taken forward to the January 2009 filing peak.

Missing Trader Intra-Community (MTIC) VAT fraud

6.24 The attempted MTIC fraud for 2006-07 was estimated to be between £2.25 billion and £3.25 billion, with an estimated negative impact on VAT receipts during the same year of between £1 billion and £2 billion. This is a significant improvement on the statistics reported in last year's SIC. There is no doubt that the current MTIC strategy has had a dramatic impact on the levels of MTIC carousel fraud activity and subsequent losses. Trade statistics also indicate that the reduction in attempted fraud was sustained in 2007.

6.25 The successful extended verification programme of suspect repayment claims has continued throughout 2007–08, with the rejection of fraudulent repayment claims occurring in appropriate circumstances. Several hundred additional compliance officers were redeployed to this work for most of the year.

6.26 With the agreement of EU member states, the reverse charge accounting measure for goods most commonly used in missing trader fraud was introduced in the UK on 1 June 2007 for two years. Evidence suggests that legitimate UK businesses are successfully complying with the obligations of the reverse charge system. Reverse charge prevents MTIC fraud in the specified goods concerned and is helping to keep fraud-related trading at very low levels. In the coming year, HMRC will make an application for the reverse charge derogation to be extended.

VAT Registration Performance

6.27 Extended delays in HMRC's handling of VAT registration applications in the early part of the year were caused by a combination of factors: the need to introduce more rigorous and appropriately targeted anti-fraud checks; short-term staffing issues; reliability of HMRC IT systems; and a spike in application numbers. Concerted action over the year on each of these aspects returned the turnaround times for handling VAT registration applications to target levels by December 2007. Achieving this has had some limited and short-term impact in other areas of work on maintaining the VAT Register (deregistration and variations) but these were fully resolved by June 2008.

Child Trust Fund

6.28 At birth, eligible children receive a government payment to their Child Trust Fund account of £250. Children from lower income families – defined as those that are entitled to a full Child Tax Credit award and with a household income below the Child Tax Credit threshold for that year (£15,575 for 2008-09) – are entitled also to an additional government payment of £250.

6.29 Some children eligible for an additional payment of £250 to their Child Trust Fund account have not yet received the payment. HMRC has identified an IT programming error, which means additional payments to the accounts of around 50,000 children born in 2006-07 have not yet been made. The payments will start to be made in June, and compensation will be paid for the late payment. HMRC is still investigating further administrative issues affecting some additional payments, and is working to identify affected accounts in order to make the payments. Parents will not have to do anything extra to claim the additional payment or any recompense. HMRC will ensure that both will be paid in full to the relevant account automatically.

Coventry International Hub

6.30 Lock ups are located at major ports, airports and other frontier locations where HMRC (UKBA) operate. They are secure facilities for holding high value and high risk goods such as seized drugs, cash, firearms, and cigarettes until they can be removed for destruction or to more suitable long-term storage. On 4 December 2007, as a result of a local management audit, a quantity of Class A drugs stored in the lock up at Coventry International Hub was found to be missing. Local searches failed to identify the missing packages and Security and Business Continuity, Internal Governance and the Independent Police Complaints Commission (IPCC) were immediately notified. Warwickshire police were called in by the IPCC to perform their own investigation.

6.31 The police investigation criticised the level of control over access to the facility. Measures to restrict access to the secure storage area have been instigated. Additional security has also been established by the immediate appointment of an independent experienced senior law enforcement manager.

Disaster Recovery

6.32 HMRC recognises that risks associated with our existing disaster recovery arrangements could seriously impact on the collection of revenue and the payment of benefits and credits. We have allocated additional funding (£7.1 million) to implement improved disaster recovery arrangements for some of the key IT systems that support our most critical business processes. This additional investment will help HMRC reduce its disaster recovery risk exposure.

Health & Safety

6.33 The management arrangements for control of Occupational Health & Safety continue to be more closely aligned with best practice in Government and with international standards. A step in this process has been to establish an H&S Senior Operating Committee. The committee is chaired by a Director General with particular responsibility for H&S. It has recognised a number of risks not yet under satisfactory control. These include the need to address management capability and capacity and the reliability of control exercised over third party providers who are contracted to help us meet our statutory duties in respect of our Estate. The committee has agreed the actions required to reduce these risks to acceptable levels and will check that the actions are properly carried out.

Enterprise Resource Planning (ERP)

6.34 ERP is an online system providing a single finance, HR and procurement function for HMRC. During 2007–08 a number of weaknesses in the system and operating difficulties involving on-line HR and payroll functions had a significant impact on the quality of service and timely handling of transactions.

6.35 On-line HR suffered from a combination of slow running of systems; an unexpected and sustained increase in the number of transactions generated by business units; and poor quality input. In response to these issues a series of productivity initiatives were introduced to improve transaction clearing times. Additional staff were also taken on to help with the backlog. By early March 2008 all work had been cleared to within the agreed SLA of processing within 10 days of receipt. For the longer term we will continue to make efficiencies to improve the productivity of processes within the service centres.

6.36 A number of control weaknesses within the payroll system were also identified involving the allocation of roles and the management of ex-HMCE overpayments. In response to these all key roles were reviewed to ensure they were allocated appropriately and extra resource was allocated to a pilot exercise to determine the best way to handle these old cases. The results of this will be available in summer 2008.

Repayments

6.37 Last year's SIC reported on evidence of organised criminal activity to obtain fraudulent repayments of SA. In response to this we are:

- Progressing an Action Plan to make process and other changes to reduce risks to direct tax repayments processes and develop specific actions to counter remaining risk.
- Directing all relevant investigation/prosecution activity and ensuring it is being appropriately managed and co-ordinated.
- Ensuring feedback from that activity is informing process improvement and 'business as usual'.

Pre-Appointment Checks

6.38 When HMRC externally recruit we perform a number of checks, including an applicant's nationality and immigration status, their criminal record, their health, that they possess any required educational qualifications and considering their employment references. Prior to April 2008, there were instances where employment references were not followed up by the HR Service Centre until after the new recruit had been appointed. This mainly involved the recruitment of people to administrative posts where the business areas concerned were keen to get people in post as quickly as possible. All checks were eventually completed with the exception of a small number of references which could not be obtained. As a result of these post-appointment checks around 50 cases with adverse references were referred back to the relevant business. This led to the dismissal of four people and the resignation of a further two.

6.39 The practice of making conditional appointments i.e. conditional on receipt of satisfactory references, all other checks having been completed prior to take up duty, was criticised in an Internal Audit report. We have responded promptly to their findings and, from April 2008, have revised our policy to ensure that all basic checks are completed prior to appointment.

Consultancy

6.40 The last two years' Statements on Internal Control reported problems with the procurement of consultancy services and the measures we were introducing to ensure tighter controls over consultancy spend across HMRC. The control over consultancy spend across HMRC has been further strengthened this year through:

- The implementation of a Specialist Consultancy Framework. Our focus in the year ahead will be to ensure compliance with this.
- A tightening of the authorisation process so that all requirements with a value over £30,000 have to be approved by a Portfolio Finance Director in addition to the Chairman's authorisation as set out in HM Treasury guidance.
- An enhanced education programme regarding employment of consultants.
- The establishment of cross-government processes and practices for consultancy management.

Dave Hartnett
Principal Accounting Officer
3 July 2008

Resource Accounts

Consolidated Resource Accounts for the year ended 31 March 2008

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The Annual Report

Introduction

1. These Resource Accounts have been prepared under a direction issued by the Treasury Officer of Accounts in accordance with the Government Resources and Accounts Act 2000. They present the operating costs and financial position of HM Revenue & Customs (HMRC) for the year ended 31 March 2008 and include the Core Department and the Valuation Office Agency (VOA). Figures for the VOA are also published separately in their agency accounts which can be viewed at www.voa.gov.uk.

2. HMRC is responsible for collecting taxes, duties and National Insurance Contributions, making payments of tax credits, Child Benefit and Child Trust Fund, collecting repayments of student loans, enforcing payment of the national minimum wage, providing the Government business link portal and enforcing Government requirements relating to the movement of goods across the UK national and EU common frontier. More information about the Department's aim and objectives can be found in the Management Commentary (see paragraphs 7 to 11).

3. HMRC has a close relationship with the Department for Work and Pensions (DWP) and its counterpart in Northern Ireland, the Department for Social Development (DSD), as they are responsible for the payment of benefits based on National Insurance Contributions. Administrative expenditure related to the collection of National Insurance Contributions and the associated income recovered from the National Insurance Funds is included in the Operating Cost Statement.

4. Receipts and payments of direct and indirect taxes, National Insurance Contributions and payments of tax credits are accounted for in the Trust Statement which is on pages 77-111 of this publication.

5. Pension benefits are provided through the Civil Service pension arrangement (see note 1.12 and the Remuneration Report).

Departmental reporting cycle

6. The Department produces regular reports on its performance which appear as part of the Departmental and Autumn Reports. The HMRC Departmental Report 2006-07 was published in May 2007 (Cm 7107) and the Autumn Performance Report was published in December 2007 (Cm 7251). The HMRC Departmental Report 2007–08 (Cm 7402) will be published in July 2008. These reports are available from The Stationery Office and the HMRC website (www.hmrc.gov.uk).

Management Commentary

Departmental aim and objectives

7. The aim of HM Revenue & Customs (HMRC) is to administer the tax and customs control systems 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.

8. The Department has the following objectives:

   - Objective 1. 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.

   - Objective 2. Improve customer experience, support business and reduce the compliance burden.

   - Objective 3. 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.

9. These objectives can be subdivided into five Requests for Resources as described in the 'Consolidated Statement of Operating Costs by Departmental Aim and Objectives' of these Resource Accounts (see page 42).

10. Details of the VOA objectives and performance can be found in its Annual Report and Accounts (HC 583), which is available from The Stationery Office and the VOA website (www.voa.gov.uk).

11. The UK Border Agency came into existence on 3 April 2008. The new agency brings together work of the Border and Immigration Agency, UKvisas, and HMRC Detection work at the border and forms part of the Government's strategic response to the growth in international trade and migration and the escalating terrorism related security threat facing the UK. The Agency is currently operating in interim form until legislation can be approved to formally transfer customs powers and responsibilities from HMRC, after which staff and assets will be transferred from HMRC to the new agency.

The Department's efficiency challenge

12. The 2004 Spending Review (SR04), covering the period 2005-06 to 2007–08, set us the following efficiency targets:

- A gross reduction of 16,000 full-time equivalent (FTE) posts, 12,500 net of redeployment of 3,500 to front line areas by 31 March 2008 (from a baseline of 1 April 2004);
- Annual efficiency gains of at least £507m from 1 April 2008; and
- To relocate 1,950 FTE posts out of London and the South East by 31 March 2008, with a further 2,300 posts to be relocated by 31 March 2010.

13. The performance of HMRC is assessed through its Public Service Agreement (PSA) targets, underpinning key indicators and other work targets set out by the Chancellor of the Exchequer in the Department's remit for 2007–08. Performance targets for 2007–08 are set out in the Spending Review 2004 for the period 2005-08.

14. Full details of performance against those targets are reported in the Departmental Report and the Autumn Performance Report.

Financial position and results for the year

Financial results

15. A 3-year settlement provided pay awards for 2005, 2006 and 2007. The Department implemented an assimilation exercise in 2006 to ensure that all staff from the former Departments who opted in to HMRC terms and conditions were brought into line with each other and received the appropriate salary. The Department is now considering the reward strategy for 2008 onwards. It will be consulting with businesses, HM Treasury and other key stakeholders (see note 9).

16. Child Benefit and Child Trust Fund are accounted for within programme costs (see note 11) and the Operating Cost Statement.

17. Details of the Department's significant provisions are reported in note 21.

18. The Department has three significant Private Finance Initiative (PFI) contracts, which are included within these Resource Accounts:

- Mapeley STEPS Contractor Ltd contract for private sector provision of serviced accommodation across the majority of the Departmental estate for 20 years. This is a joint contract with the former two Departments and Valuation Office Agency.
- Exchequer Partnerships contract for provision of serviced accommodation at 100 Parliament Street for 33 years.

- Newcastle Estates Partnership contract for provision of serviced accommodation at a number of sites in the Newcastle upon Tyne area, including the redevelopment of the Benton Park View site. This contract has two elements, one which will run for 20 years and the other for 22 years.

19. In addition, the Department has a significant IT contract (non PFI), which is included within these Resource Accounts. The Capgemini contract is to deliver high standards of IT infrastructure. Under the contract, Capgemini provides user services for desktop, business applications management, enhancements and development, projects, new projects integration services (including the testing of applications and infrastructure), as well as other IT services to HMRC and VOA.

20. The Department negotiated the settlement of a compensation claim against Electronic Data Systems Limited (EDS) in 2005-06. Part was settled immediately, leaving an amount outstanding, £26.5m, where payments were to be made from amounts becoming due to EDS under certain of their future contracts with customers. To date HMRC has received £0.8m.

Comparison Outturn against Estimate

21. Expenditure outturn for the year was £15,208.7m, £173.0m (1.1 per cent) below the Estimate. The variances which exceed 10 per cent are explained below as required by the *Government Financial Reporting Manual (FReM)*.

    Request for resources 1B (RfR 1B), e-filing incentive payments is underspent by £73.9m (37.0 per cent). There are three factors:

    - The Departmental Estimate was adjusted in line with the upward trend in on-line filing, but actual growth in e-filed returns was 10 per cent compared to an estimated 17 per cent.
    - Nil returns ceased to qualify for the incentive as a result of changes to the eligibility criteria implemented in 2007–08.
    - Over 200,000 employer returns remain outstanding at the end of 2007–08.

    Request for resources 1D (RfR 1D), Net revaluation loss is overspent by £14.2m, (568.0 per cent). The variance is primarily caused by the £12.9m impairment loss on tax credit software identified when all major systems were reviewed to verify asset lives and value during late 2007.

    Request for resources 4 (RfR 4), Payment of Local Authority Rates (POLAR) was underspent by £8.7m (22.7 per cent). Assumptions that formed the basis of this RfR did not materialise during the year, however, the Government funding processes did not permit a net reduction in the Departmental Estimate in year. Within the Comprehensive Spending Review 2007, this downward trend has been reflected in net costs for the next three years.

Balance sheet

22. The balance sheet of HM Revenue & Customs is dominated by its tangible fixed assets (note 14), which are valued at £1,393.7m (2006-07: £1,296.9m).

23. Other significant assets and liabilities include:

    - creditors (amounts falling due within one year) of £1,128.6m (note 20).
    - debtors of £488.6m (falling due within one year) of which £336.7m relates to penalties (note 18).
    - provisions of £297.0m mainly relating to early departure costs and Child Trust Fund liabilities (note 21).

Cash flow

24. The net cash outflow for the year of £15.7m is caused by the timing of the payover of Consolidated Fund Extra Receipts (CFER).

Reconciliation of resource expenditure between Estimates, Accounts and Budgets

	Estimate 2007–08 £m	Outturn 2006-07 £m
Net Resource Outturn (Estimates)	**15,381.7**	**15,029.4**
Adjustments to remove:		
Provision voted for earlier years	–	–
Adjustments to additionally include:		
Non-voted expenditure in the OCS	–	1.9
Consolidated Fund Extra Receipts in the OCS	–	(24.2)
Other adjustments	–	–
Net Operating Cost (Accounts)	**15,381.7**	**15,007.1**
Adjustments to remove:		
Gains/losses from sale of capital assets	–	2.6
Capital grants	(260.0)	(178.0)
European Union income and related adjustments	–	–
Voted expenditure outside the budget	–	–
Adjustments to additionally include:		
Other Consolidated Fund Extra Receipts	–	(0.2)
Resource consumption of non-departmental public bodies	–	–
Unallocated resource provision	24.9	–
Other adjustments[1]	15,312.9	14,504.1
Resource Budget Outturn (Budget)	**30,459.5**	**29,335.6**
of which		
Departmental Expenditure Limits (DEL)	4,537.3	4,577.3
Annually Managed Expenditure (AME)	25,922.2	24,758.3

[1] The figure of £15,312.9m (2006-07: £14,868.4m) relates to the estimated Annually Managed Expenditure that is classified as non-voted by HM Treasury and which is accounted for in the Trust Statement. Tax credits make up the majority of this adjustment £14,794.0m (2006-07: £14,109.0m).

Personal data related incidents

25. The Cabinet Office's Interim Progress Report on Data Handling Procedures made a commitment that Departments will provide information on risk management of data handling within their Annual Report.

    Incidents, the disclosure of which would in itself create an unacceptable risk of harm, may be excluded in accordance with the exemptions contained in the Freedom of Information Act 2000 or may be subject to the limitations of other UK information legislation.

TABLE 1: SUMMARY OF PROTECTED PERSONAL DATA RELATED INCIDENTS FORMALLY REPORTED TO THE INFORMATION COMMISSIONER'S OFFICE IN 2007–08

Date of incident (month)	Nature of incident	Nature of data involved	Number of people potentially affected	Notification steps
April	Insecure disposal of paper documents.	Name and address.	4	Individuals notified by post via an intermediary.
April	Unauthorised disclosure.	Bank account name, sort code and account number.	11,000	Individuals notified by post.
September	Loss of inadequately protected laptop from outside secured Government premises.	Investor name, address and account number.	421	Individuals notified by post via an intermediary.
October	Loss of inadequately protected electronic storage devices from outside secured Government premises.	Surname, initials, National Insurance number, date of birth.	15,685	Individuals notified by post.
October	Loss of inadequately protected electronic storage devices from outside secured Government premises.	For customers, alternative claimants (usually partners) and children: name; address; Child Benefit number; National Insurance number; gender; date of birth; date of death; method of payment; bank account number, sort code and account type; details of other benefits; and weekly payment amount.	25,000,000	Individuals notified by post. Police notified. Statement to Parliament.
October	Loss of inadequately protected electronic storage device from outside secured Government premises.	Name, address, National Insurance number, date of birth, contributions, rebates, payments, fund values.	6,800	Individuals notified by post via an intermediary.
October	Loss of inadequately protected electronic storage device from outside secured Government premises.	Name, address, National Insurance number, date of birth, tax code, employment starting and leaving dates.	146	No notification at this time. Due to the incomplete and historic nature of the data it was considered inappropriate to contact the individuals concerned.
January	Unauthorised disclosure.	Name, address, tax reference, National Insurance number and tax code.	361	Individuals notified by post.
January	Loss of paper documents from outside secured Government premises.	Name, address and bank account numbers of companies plus the name, National Insurance number and date of birth of a Director.	41	Individuals notified by post.
Further action on information risk	The Department will continue to monitor and assess its information risks in the light of events noted above in order to identify and address any weaknesses and ensure continuous improvement of its systems. Further action will be formulated upon publication of the Poynter Report.			

TABLE 2: SUMMARY OF OTHER PROTECTED PERSONAL DATA RELATED INCIDENTS IN 2007–08

Incidents deemed by the Data Controller not to fall within the criteria for report to the Information Commissioner's Office but recorded centrally within the Department are set out in the table below. Small, localised incidents are not recorded centrally and are not cited in these figures.

Category	Nature of incident	Total
I	Loss of inadequately protected electronic equipment, devices or paper documents from secured Government premises.	52
II	Loss of inadequately protected electronic equipment, devices or paper documents from outside secured Government premises.	106
III	Insecure disposal of inadequately protected electronic equipment, devices or paper documents.	1
IV	Unauthorised disclosure.	52
V	Other.	0

TABLE 3: YEAR-ON-YEAR TOTAL NUMBERS OF PROTECTED PERSONAL DATA RELATED INCIDENTS PRIOR TO 2007–08

Total number of protected personal data related incidents formally reported to the Information Commissioner's Office, by category number.

	I	II	III	IV	V	Total
2006-07	1	–	–	–	–	1
2005-06	–	–	–	–	–	–
2004-05	–	–	–	–	–	–

No details have been provided of protected personal data related incidents not formally reported to the Information Commissioner's Office. Records held of protected personal data related incidents prior to 2007–08 do not permit a reliable and complete picture to be presented.

Management

Ministers and senior managers

26. The Remuneration Report (page 27) identifies those senior managers who are members of the Executive Committee (ExCom).

Register of interests

27. Senior managers within HMRC are required to complete a declaration of any interests. No significant company directorships or other interests were held by Board members which may have conflicted with their management responsibilities. Details of the related party interests of members of the Board, including non-executives, are shown in note 34 to the accounts.

Diversity and equality

28. Our goal is to become a flagship organisation for diversity. Our priorities are to provide the necessary services and support for our diverse staff and customer groups and to gain a complete picture of the diversity of our staff.

29. The promotion of key messages in our Gender, Race and Disability Equality Schemes are helping us to progress our diversity strategy and to create a culture of inclusion. Specific responsibilities have been assigned to Board members and Directors for both internal and external activities.

30. A Departmental wide audit of accessibility standards for disabled customers has highlighted areas where improvement is needed and contributed to our disability service delivery strategy. We make reasonable adjustments in the workplace for our employees with disabilities to enable them to carry out a broad range of duties.

Payment of suppliers

31. The Department is committed to the prompt payment of invoices. Payment is regarded as late if made outside the agreed terms, or, where no terms are agreed, beyond 30 days after receipt of goods and valid invoice. During 2007–08 the Department paid 96 per cent (2006-07: 90 per cent) of supplier invoices on time.

Communications

32. The Department has a long standing policy of actively informing and consulting its staff and their representatives through a number of well defined and established channels. A variety of channels are employed, including hotseat – an opportunity to send questions and feedback to the senior managers who run HMRC, staff telephone conferences with top managers, email alerts, intranet pages, team briefing, newsletters, staff surveys, staff magazine, and regular meetings and discussions with trade union representatives. New initiatives started this year are "Town Hall" events, where the Chairman and other ExCom members meet and talk with staff around the country and "Back to the Floor" days for all directors.

Sustainable development

33. HMRC is fully committed to ensuring that sustainable development objectives set out in the UK Sustainable Development Strategy – Securing the Future, published in March 2005, should underpin the way we meet our operational responsibilities and manage our estate.

- As the Department responsible for administering environmental taxes – Climate Change Levy, Aggregates Levy and Landfill Tax, HMRC has a direct role to play in combating climate change and protecting the environment. Our border control responsibilities also mean that we play a key role: prohibiting the importation of environmentally damaging material; protecting endangered species, and preventing crime through the prohibition of drugs, obscene material and other goods that flood the black market. Administering the tax systems fairly and making it as easy as possible for individuals and businesses to comply and receive their tax credit and other entitlements, also has important positive social and economic impacts.
- Our ability to conduct our business and manage our estate sustainably is measured against the targets for Sustainable Operations on the Government Estate. We developed and published a Sustainable Development Action Plan for 2007-2012, in line with Securing the Future commitments, to help us to improve performance in key areas and monitor our progress effectively.

We employed consultants towards the end of 2007 to conduct a diagnostic of carbon management within HMRC and to identify areas for improvement, particularly around reducing carbon emissions through IT and building management. As a result of this work we are now developing a programme of actions that should put us in a strong position to meet Government targets.

We have continued to work closely with our contractors to agree measures that will reduce energy and water consumption and improve the provision of recycling arrangements across the estate. Pioneer business areas are engaged in raising awareness programmes and have developed Corporate Responsibility Plans, which include a range of actions to promote environmental best practice.

- In terms of travel HMRC has already been successful in reducing our business mileage and carbon related emissions. During the five year period 2002-07, the Department reduced its road travel by over five million miles and in 2006-07 reduced the carbon emissions from road vehicles for business travel by 12 per cent compared to 2005-06. We have joined the Government's carbon offsetting scheme for air travel and are considering extending offsetting arrangements to all travel in 2008-09. More importantly, we are promoting sustainable travel policies by asking staff to consider if the journey is necessary in the first place and if, for example, telephone conferencing or video conferencing could be used instead. Since October 2006 we have actively discouraged domestic air travel and have supported this line by publishing the CO_2 emissions for equivalent journeys by rail and air.
- Commercial Directorate is developing the Department's Sustainable Procurement Strategy and will be ensuring that minimum environmental standards are complied with in all contracts. They will also be actively engaging with our suppliers to ensure that the environmental impacts of our contracts are managed as rigorously as possible.
- The Department's performance for 2006-07 is set out in the latest Sustainable Development in Government Report, which can be found at www.sd-commission.org.uk/sdig2007/, and we are currently gathering information on our performance in 2007–08.

Auditors

34. The Comptroller and Auditor General audits these Resource Accounts in accordance with the Government Resources and Accounts Act 2000. The notional charge for these audit services as disclosed in these accounts is £0.7m (2006-07: £0.7m). 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 2007–08 the cost of the audit of the Trust Statement amounted to £1.2m (2006-07: £1.2m). As a result the total audit fee reported in these Resource Accounts is £1.9m (2006-07: £1.9m). There was no non-audit work.

35. So far as I am aware, there is no relevant audit information of which the auditors are unaware. I have taken all the steps that I ought to have taken to make myself aware of any relevant audit information and to establish that the auditors are aware of that information.

Dave Hartnett
Principal Accounting Officer
2 July 2008

Corporate Governance Report

Period of Report

1. This report covers the period from 1 April 2007 to 31 March 2008.

Code of Good Practice on Corporate Governance in Central Government Departments

2. The governance arrangements set out in this report are compliant with the provisions of HM Treasury's Code of Good Practice on Corporate Governance in Central Government Departments. The interim arrangements have been drawn up in consultation with HM Treasury and Cabinet Office.

Ministerial arrangements

3. HM Revenue & Customs (HMRC) is a non-ministerial department established by the Commissioners for Revenue and Customs Act (CRCA) 2005. HMRC's status as a non-ministerial department aims to ensure that the administration of the tax system is fair and impartial. The Department is accountable to the Chancellor of the Exchequer for the discharge of all its functions.

4. The Chancellor is responsible for setting the strategic objectives for the Department and the UK tax system as a whole. He has delegated responsibility for oversight of the Department to the Financial Secretary to the Treasury as Departmental Minister for HMRC.

The Commissioners

5. The Commissioners are responsible under the CRCA for the collection and management of revenue, the enforcement of prohibitions and restrictions, as well as other financial functions e.g. payment of tax credits. They exercise these functions in the name of the Crown.

6. The Commissioners are directly accountable to HM Treasury Ministers and Parliament and are required by the CRCA to comply with any directions of a general nature given to them by HM Treasury. In 2007–08 these were principally the Public Service Agreement targets and Annual Remit.

7. Under the legislation all Commissioners have equal authority but one Commissioner is appointed as Chairman.

8. The Chairman is further appointed by the Prime Minister to be Permanent Head of the Department and by HM Treasury to be the Principal Accounting Officer (PAO).

9. A list of the HMRC Commissioners during the reporting period is shown below:

		(Period if not full year)
Dave Hartnett CB	Director General Acting Chairman and Permanent Head of HMRC	to 20 November 2007 from 21 November 2007
Paul Gray CB	Chairman and Permanent Head of HMRC	to 20 November 2007
Mike Eland CB	Director General Enforcement and Compliance	
Mike Hanson MBE	Director General Benefits and Credits	
Steve Lamey	Director General and Chief Operating Officer	

The Department's Key Committees

Executive Committee

10. The Commissioners, together with the following people, comprised the Executive Committee during this period:

		(Period if not full year)
Stuart Cruickshank	Director General and Chief Finance Officer Director General	to 31 January 2008 from 1 February 2008
Melanie Dawes	Acting Director General Business Tax	from 23 November 2007
David Hogg CB	General Counsel and Solicitor Director General Governance and Security	to 2 March 2008 from 3 March 2008
Chris Hopson	Director Change and Capability	to 31 December 2007
Anthony Inglese CB	General Counsel and Solicitor	from 3 March 2008
Bernadette Kenny	Director General Personal Tax	
Philip Moore	Director General Director General and Chief Finance Officer	from 23 January 2008 to 31 January 2008 from 1 February 2008
Robin Roberts	Director General and Chief People Officer	from 2 January 2008
Deepak Singh	Acting Director General and Chief Information Officer	from 15 October 2007

11. Executive Committee members have portfolios of responsibility that span each line of HMRC business and corporate service support. The Executive Committee provides the strategic management of HMRC. Its responsibilities include:

- Forming HMRC's vision and strategic direction.
- Setting high-level objectives and deciding priorities.
- Shaping the Department's underpinning behaviours, policies, processes and structures.
- Leading and promoting change to secure improved performance.
- Reviewing overall business planning and performance.
- Ownership and management of key strategic risks.

12. The Executive Committee meets regularly, usually twice a month, and summary minutes are published on the HMRC Internet site.

13. The Committee reviews its own effectiveness on a regular basis as part of the arrangements for each meeting and periodically by other means, for instance coaching, workshops, external scrutiny and formal review.

14. During this reporting period the Executive Committee was supported by a number of sub-committees, established on 15 June 2007, which had decision-making powers formally delegated to them by the Commissioners. Membership of each sub-committee was a combination of Executive Committee members, non-executive Board members, Directors and other key Departmental managers. The purpose of these committees was to:

- Increase the depth of discussion on key Departmental activities.
- Allow the Executive Committee to focus on strategic matters.

- Provide a broader framework for engagement between the Executive Committee, Directors and others.
- Provide a more structured and fuller engagement between the Executive Committee, Directors and the non-executive Board members.
- Improve the delivery of Public Service Agreements and Key Performance Indicators.

15. The Executive Committee Sub-Committees were as follows:
    - Capability Committee
    - Compliance Strategy Committee
    - Corporate Responsibility and Diversity Committee
    - Corporate Service Delivery Committee
    - Cross Cutting Performance Committee
    - Customer Strategy Committee
    - Departmental Transformation Programme (DTP) Stakeholder Forum
    - DTP Steering Group
    - Health and Safety Committee
    - Information Management Solutions (IMS) Service Delivery Committee
    - People Committee
    - Repayments Committee
    - Risk Committee
    - Security and Business Continuity Committee
    - Standards, Governance & Integrity Committee
    - Tax System Development Committee
    - Transformational Government Committee

The Departmental Board

16. The Board in 2007–08 comprised the Executive Committee and the non-executive Board members.
17. The objectives of the Board included to:
    - Contribute at an early stage to the development of strategic and operational proposals.
    - Provide advice on the achievement of performance objectives.
    - Assess the effectiveness of the management of risk, supported by the Audit Committee.
    - Encourage enterprise and innovation.
    - Oversee the Department’s governance arrangements.
18. The Board also provided oversight of HMRC’s executive agency, the Valuation Office Agency.
19. The Chairman leads an annual evaluation of the performance of the Board. Every two years, the Board considers its remit, constitution and operating procedures.
20. The Board met seven times during 2007–08. Minutes of these meetings are published on the HMRC Internet site.

Capability Review

21. During 2007–08 HMRC instigated a number of changes to its governance and accountability arrangements in response to the recommendations of the Capability Review. A number of these changes are reflected in the following paragraphs, including:

- Clarifying the role of the Executive Committee and simplifying its members' responsibilities;
- Revoking the powers of the existing 17 Executive Committee sub-committees with a view to replacing them with committees more closely reflecting the new Executive accountabilities;
- Ensuring that the Executive had the right level of external experience and expertise to guide, support and challenge them by the appointment of four interim external advisers. In the longer term the Department intends to strengthen the non-executive board member arrangements.

The Executive and Advisers Committee

22. In response to recommendations in the Capability Review HMRC strengthened its external challenge and advice. From 5 February 2008 four external advisers were appointed, initially for a period of six months, and together with the Executive and the non-executive Board members, they meet as the Executive and Advisers Committee (EAC). This is an interim arrangement during which time the Board has been temporarily paused awaiting the appointment of a permanent Chair and Chief Executive, who will have the full remit to review these governance arrangements. A list of the non-executive Board members and external advisers is shown at paragraphs 25 and 26.

23. The objectives of the EAC include the provision of advice:

- To ensure that the Capability Review action plan is stretching but achievable and focuses on the key recommendations of the Review;
- To ensure that plans to address the recommendations of the reviews of data security in HMRC focus on and deliver robust systems for handling customer data;
- In relation to the Department's strategic planning, its financial affairs, its people strategy; its Risk management and the work of the Chief Operating Officer in managing change.

24. The EAC met twice in 2007–08. Summary minutes of these meetings are published on the HMRC Internet site.

Non-Executive Board Members

25. The non-executive Board members during 2007–08 were as follows:

	(Period if not full year)
Kate Dunlop	to 6 March 2008
Bill Griffiths	
Mark Haysom	
Nick Macpherson	to 7 June 2007
Penny Melville-Brown	to 13 February 2008
Kate Owen	
John Spence OBE	

26. The external advisers on the EAC during 2007–08 were as follows:

	(Period if not full year)
Kate Barker CBE	from 5 February 2008
Phil Hodkinson	from 5 February 2008
Naquib Kheraj	from 5 February 2008
Rudy Markham	from 5 February 2008

27. All of the non-executive Board members and external advisers are considered to be independent of HMRC, being neither Commissioners nor officers of HM Revenue & Customs. Nick Macpherson had a clear and acknowledged relationship with HMRC as Permanent Secretary of HM Treasury. His role was to facilitate closer working with HM Treasury and, through his knowledge and experience, to aid better strategic decision-making by the Board. Arrangements are in place to safeguard taxpayer confidentiality by ensuring that the non-executive Board members and external advisers do not participate in decisions involving specific tax matters.

28. The non-executive Board members and advisers provided constructive challenge to decisions and processes, drawing on their knowledge and expertise. They did this primarily through their attendance at Board and sub-committee meetings but also through visits and meetings with staff.

29. The external advisers also provided specific advice to the Executive Committee on their response to the recommendations of the Capability Review, reviews of data handling and strategic plans to transform the Department.

30. The Chairman, as Permanent Head of HMRC, holds meetings periodically with the independent non-executive Board members and advisers, as a group and individually, without the executives present.

31. HMRC has a rigorous, fair and open process for the selection and appointment of non-executive Board members. On appointment they undertake a structured induction process. This process was reviewed during 2007–08 and a new process was implemented for the external advisers.

Audit Committee

32. The Audit Committee is a sub-committee of the Board/EAC. It provides the Chairman, as Principal Accounting Officer, and the Board/EAC with independent advice on the effectiveness of the Department’s governance, risk and control arrangements.

33. In fulfilling this role, the Audit Committee reviews significant issues identified by Internal Audit (IA) and the National Audit Office (NAO), acting on behalf of the Comptroller and Auditor General (C&AG) as the appointed independent external auditor, and invites executive managers to attend and provide an account of action being taken to address these issues.

34. Specific areas that come within the remit of the Audit Committee include:

- Strategic processes for governance, risk management and control.
- Departmental Accounts and the Annual Report.
- Statements on Internal Control (SICs).
- Planned IA and NAO activity and the results of their work.

35. During the reporting period membership of the Audit Committee was drawn exclusively from non-executive Board members. The members were:

- Bill Griffiths (Chairman)
- Kate Owen
- John Spence

36. A number of standing invitees also attend Audit Committee meetings. These include the Chief Finance Officer and other Executive Committee members, the Head of Corporate Governance, the Director Internal Audit and representatives from NAO.

37. The Audit Committee Chairman evaluates the performance of the committee in regular meetings with Audit Committee members and reports on performance to the HMRC Chairman.

38. The Audit Committee met nine times during 2007–08 and the Chair provided a written report to the Board/EAC after each meeting. Its terms of reference and minutes of meetings are published on the HMRC Internet site.

Structure of the Department

39. The organisational structure of HMRC during 2007–08 was based on four inter-related work groups:

- **Operations**. This covered the vast majority of staff and focused on delivering high quality, cost effective services. The core activities were delivering customer contact, processing and operational compliance, enforcement capabilities and debt management and banking.

- **Product and Process Groups**. Products can be defined as taxes, duties, credits and benefits. Processes are the schemes by which products are delivered. Staff in these six units were responsible for the design of our products and processes, providing advice and liaising with HM Treasury and Ministers.

- **Customer Units**. Two units focused on identifying and understanding the requirements and behaviours of our customers, and the risks associated with them so that HMRC could improve the customer experience and overall compliance.

- **Corporate Functions**. These guided and supported HMRC. Fourteen business units delivered customer focused services such as HR and Learning, Estates & Support Services, Finance, Communications and Marketing and Information Management Services.

40. In January 2008, as part of the HMRC response to the Capability Review, the structure was changed to sharpen accountabilities and provide a greater customer focus. The structure is now based around four operational groups, each led by a Director General. These are:

- **Personal Tax.** Responsible for helping some 60 million individual customers across the UK to fulfil their tax obligations.

- **Benefits and Credits.** Responsible for ensuring families receive the payments they are entitled to, that customers get it right first time and that losses from fraud and claimant error are reduced.

- **Business Tax.** Responsible for ensuring businesses pay the right amount of tax while improving our customers' experience and the overall UK business environment.

- **Enforcement and Compliance.** Responsible for ensuring that HMRC successfully collects the full and correct amount of money due from UK taxpayers. It is also responsible for investigating offences against the tax and duty system.

These are supported by:

- **Corporate Services.** These provide internal services such as HR and Learning, Finance, Estates & Support Services, Legal, Communications and Marketing and Information Management to HMRC.

- **Change and Performance.** These are responsible for improving HMRC's operational performance. This group includes the programme management office for HMRC's transformation and change projects and works to ensure projects align with the strategy to deliver the improvements needed.

Relationships with Arms Length Bodies

41. HMRC has identified one arms length body, the Environmental Trust Scheme Regulatory Body Limited (ENTRUST). ENTRUST are a not-for-profit private sector company who act as regulator of the Landfill Communities Fund (LCF). They are approved by the Commissioners, via a Terms of Approval document, to carry out the function. Governance arrangements are in place to ensure appropriate oversight by HMRC.

Remuneration Report

Remuneration Policy

The remuneration of senior civil servants is set by the Prime Minister following independent advice from the Review Body on Senior Salaries.

In reaching its recommendations, the Review Body has regard to the following considerations:

- the need to recruit, retain and motivate suitably able and qualified people to exercise their different responsibilities;
- regional/local variations in labour markets and their effects on the recruitment and retention of staff;
- Government policies for improving the public services including the requirement on departments to meet the output targets for the delivery of the departmental services;
- the funds available to departments as set out in the Government's departmental expenditure limits;
- the Government's inflation target.

The Review Body takes account of the evidence it receives about wider economic considerations and the affordability of its recommendations.

Further information about the work of the Review Body can be found at www.ome.uk.com.

Service Contracts

Civil Service appointments are made in accordance with the Civil Service Commissioners' Recruitment Code, which requires appointment to be on merit on the basis of fair and open competition but also includes the circumstances when appointments may otherwise be made. The Senior Appointments Board meets each month to consider appointments, succession planning and development issues relating to the Senior Civil Service.

Unless otherwise stated, the officials covered by this report hold appointments which are open-ended. Early termination, other than for misconduct, would result in the individual receiving compensation as set out in the Civil Service Compensation Scheme.

Non-executive Board members are appointed for a fixed term of usually three years.

Further information about the work of the Civil Service Commissioners can be found at www.civilservicecommissioners.gov.uk.

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

Remuneration

	2007–08 Salary £000	2007–08 Benefits in kind (to the nearest £100)	2006-07 Salary £000	2006-07 Benefits in kind (to the nearest £100)
Dave Hartnett CB	160–165	–	150–155	–
Paul Gray CB[1] (to 20 November 2007)	120–125 (180–185 full year equivalent)	300	165–170	33,900
Mike Eland CB	155–160	–	150–155	–
Mike Hanson MBE	140–145	–	135–140	–
Steve Lamey[2]	245–250	–	240–245	900
Stuart Cruickshank[3]	175–180	22,000	50–55 (175–180 full year equivalent)	–
Melanie Dawes (from 23 November 2007)	45–50 (115–120 full year equivalent)	–	–	–
David Hogg CB	150–155	–	150–155	–
Chris Hopson (to 31 December 2007)	120–125 (155–160 full year equivalent)	–	155–160	–
Anthony Inglese CB[4] (from 3 March 2008)	–	–	–	–
Bernadette Kenny	140–145	–	130–135	–
Philip Moore[5] (from 23 January 2008)	35–40 (195–200 full year equivalent)	–	–	–
Robin Roberts[6] (from 2 January 2008)	–	–	–	–
Deepak Singh[7] (from 15 October 2007)	85–90 (165–170 full year equivalent)	–	–	–

[1] Paul Gray stood down from the Board of HMRC on 20 November 2007 and left on 31 December 2007. Under the relevant Civil Service contractual terms he received a lump sum payment at date of leaving of £137,591 and monthly payments totalling £49,292 until attaining the age of 60 on 2 August 2008.

[2] Steve Lamey was appointed on a four-year contract commencing on 18 October 2004.

[3] Stuart Cruickshank was appointed on a three-year contract commencing on 18 December 2006. He left HMRC on 31 March 2008 and an amount of £88,125 is payable to him for loss of office.

[4] Anthony Inglese joined the Department on 3 March 2008 and was paid by his former employer, the Department for Business, Enterprise and Regulatory Reform, until 31 March 2008.

[5] Philip Moore was appointed on a six-month contract commencing on 21 January 2008. He joined the Board on 23 January 2008 and became the Chief Finance Officer on 1 February 2008.

[6] Robin Roberts joined on secondment for a period of 6 months from Egon Zehnder International on 2 January 2008. Egon Zehnder International were paid for his services as below.

[7] Deepak Singh was appointed on a three-year contract commencing 19 June 2006.

Salary

Salary covers both pensionable and non-pensionable amounts and 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. Bonus payments made in 2007–08 are in respect of performance in 2006-07. This presentation is based on payments made by the Department and thus recorded in these accounts.

Benefits in kind

The monetary value of benefits in kind covers any benefits provided by the employer and treated by HM Revenue & Customs as a taxable emolument. Paul Gray CB had the private use of an allocated car in the circumstances permitted by the Civil Service Management Code for the period 1 April 2007 to 3 April 2007. Certain legal and other fees were covered by the Department upon Stuart Cruickshank's departure on 31 March 2008.

Third party payments for services of a senior manager

In 2007–08 £59,925 was payable to Egon Zehnder International for the services of Robin Roberts who held the position of the Department's Chief People Officer.

Non-Executive Board Members

The Department's 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:

	2007–08 Fees £000	**2006-07** Fees £000
Kate Dunlop (to 6 March 2008)	10–15 (15–20 full year equivalent)	0–5 (15–20 full year equivalent)
Bill Griffiths	20–25	20–25
Mark Haysom	15–20	15–20
Nick Macpherson[1] (to 7 June 2007)	–	–
Penny Melville-Brown (to 13 February 2008)	10–15 (15–20 full year equivalent)	15–20
Kate Owen	20–25	20–25
John Spence OBE	20–25	20–25

[1] Nick Macpherson was paid by HM Treasury.

Pension Benefits

	Total accrued pension at age 60 at 31 March 2008 and related lump sum	Real increase in pension and related lump sum at age 60	CETV at 31 March 2008	CETV at 31 March 2007	Real increase in CETV	Employer contribution to partnership pension account
	£000	£000	(to the nearest £000)	(to the nearest £000)	(to the nearest £000)	(to the nearest £100)
Dave Hartnett CB[1]	60–65 (Plus 140–145 lump sum)	2.5–5.0 (Plus 2.5–5.0 lump sum)	1,382	1,158	74	–
Paul Gray CB[2] (to 20 November 2007)	95–100	5.0–7.5	2,021[6]	1,781*	141	–
Mike Eland CB[3]	55–60 (Plus 175–180 lump sum)	0–2.5 (Plus 2.5–5.0 lump sum)	1,300	1,120	21	–
Mike Hanson MBE[3]	50–55 (Plus 160–165 lump sum)	0–2.5 (Plus 5.0–7.5 lump sum)	1,332	1,136*	47	–
Steve Lamey[2]	5–10	0–2.5	138	89	18	–
Stuart Cruickshank[2]	0–5.0	0–2.5	47	11	30	–
Melanie Dawes[3] (from 23 November 2007)	20–25 (Plus 70–75 lump sum)	0–2.5 (Plus 5.0–7.5 lump sum)	350	288[7]	12	–
David Hogg CB[3]	70–75 (Plus 210–215 lump sum)	0–2.5 (Plus 2.5–5.0 lump sum)	1,785	1,644	38	–
Chris Hopson[2] (to 31 December 2007)	5–10	0–2.5	83[8]	55	17	–
Anthony Inglese CB[4] (from 3 March 2008)	–	–	–	–	–	–
Bernadette Kenny[3]	40–45 (Plus 125–130 lump sum)	2.5–5.0 (Plus 7.5–10.0 lump sum)	848	698*	48	–
Philip Moore[5] (from 23 January 2008)	–	–	–	–	–	–
Deepak Singh[2] (from 15 October 2007)	0–5.0	0–2.5	44	29[9]	7	–

[1] Member of the Classic Plus Scheme.
[2] Member of the Premium Scheme. Paul Gray is entitled to a pension from August 2008 including an Annual Compensation Payment of £2,658 per annum.
[3] Member of the Classic Scheme.
[4] Officers contributions were paid through his former employers until 31 March 2008. He joined the Department's payroll on 1 April 2008.
[5] Officer is not contributing towards Civil Service pension scheme.
[6] CETV at 20 November 2007, Paul Gray received an early retirement package under the terms of the Civil Service Compensation Scheme.
[7] CETV at 23 November 2007.
[8] CETV at 31 December 2007.
[9] CETV at 15 October 2007.
* Due to certain factors being incorrect in last years CETV calculator there may be a slight difference between the final period CETV for 2006-07 and the start of period CETV for 2007–08.

David Pickup left HMRC on 31 July 2007. Under the relevant Civil Service contractual terms he received immediate payment of his pension and associated lump sum, plus a compensation payment of £61,697.

Civil Service Pensions

Pension benefits are provided through the Civil Service pension arrangements. From 30 July 2007, civil servants may be in one of four defined benefit schemes; either a 'final salary' scheme (classic, premium or classic plus); or a 'whole career' scheme (nuvos). These statutory arrangements are unfunded with the cost of benefits met by monies voted by Parliament each year. Pensions payable under classic, premium, classic plus and nuvos are increased annually in line with changes in the Retail Prices Index (RPI). Members joining from October 2002 may opt for either the appropriate defined benefit arrangement or a good quality 'money purchase' stakeholder pension 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, classic plus and nuvos. Benefits in classic accrue at the rate of 1/80th of final pensionable earnings 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. Classic plus is essentially a hybrid with benefits in respect of service before 1 October 2002 calculated broadly as per classic and benefits for service from October 2002 calculated as in premium. In nuvos a member builds up a pension based on his pensionable earnings during their period of scheme membership. At the end of the scheme year (31 March) the member's earned pension account is credited with 2.3 per cent of their pensionable earnings in that scheme year and the accrued pension is uprated in line with the RPI. In all cases members may opt to give up (commute) pension for lump sum up to the limits set by the Finance Act 2004.

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 from a panel of three providers. 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).

The accrued pension quoted is the pension the member is entitled to receive when they reach pension age, or immediately on ceasing to be an active member of the scheme if they are already at or over pension age. Pension age is 60 for members of classic, premium and classic plus and 65 for members of nuvos.

Further details about the Civil Service pension 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 figures include the value of any pension benefit in another scheme or arrangement which the individual has transferred to the Civil Service pension arrangements. They also include any additional pension benefit accrued to the member as a result of their purchasing additional pension benefits at their own cost. CETVs are calculated within the guidelines and framework prescribed by the Institute and Faculty of Actuaries and do not take account of any actual or potential reduction to benefits resulting from Lifetime Allowance Tax which may be due when pension benefits are drawn.

Real Increase in CETV

This reflects the increase in CETV effectively funded by the employer. It does not include 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.

Elements of the Remuneration Report have been audited, as required by the *Government Financial Reporting Manual*.

Dave Hartnett
Principal Accounting Officer
2 July 2008

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, HM Treasury has directed HM Revenue & Customs to prepare, for each financial year, Resource Accounts detailing the resources acquired, held or disposed of during the year and the use of resources by the Department during the year. The accounts are prepared on an accruals basis and must give a true and fair view of the state of affairs of the Department and of its net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year.

In preparing the accounts, the Principal Accounting Officer is required to comply with the requirements of the *Government Financial Reporting Manual* and in particular to:

- observe the Accounts Direction issued by HM Treasury, including 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 *Government Financial Reporting Manual* have been followed, and disclose and explain any material departures in the accounts; and
- prepare the accounts on a going concern basis.

HM Treasury has appointed the Permanent Head of the Department as Principal Accounting Officer of the Department. 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 cash flows. 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 2007 to 20 November 2007 the Principal Accounting Officer was Paul Gray. He was supported by the following Additional Accounting Officers:

- Mike Eland, in respect of
  Request for resources 1:
  Administering the tax and customs control systems fairly and efficiently and making it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credits and other entitlements.
  Request for resources 5:
  Payments of Child Benefit, Child Trust Fund endowments and associated non-cash items.
- Dave Hartnett, in respect of
  Request for resources 3:
  Providing payments in lieu of tax relief on certain bodies i.e. 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.
- Andrew Hudson in respect of
  Request for resources 2:
  Administration costs incurred by the Valuation Office in administering the beneficial portion of rates and providing or securing valuation and other services.
  Request for resources 4:
  Payment of rates to Local Authorities in respect of premises occupied by foreign and Commonwealth governments for diplomatic purposes and premises occupied by certain international organisations.

With effect from 21 November 2007 Dave Hartnett was appointed Principal Accounting Officer following his appointment as Acting Chairman of HM Revenue & Customs.

He was supported by the following Additional Accounting Officers:

- Dave Hartnett continues to have responsibility for
  Request for resources 3:
  Providing payments in lieu of tax relief on certain bodies i.e. 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.
- Mike Eland continues to have responsibility for
  Request for resources 1:
  Administering the tax and customs control systems fairly and efficiently and making it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credits and other entitlements.
  Request for resources 5:
  Payments of Child Benefit, Child Trust Fund endowments and associated non-cash items.
- Andrew Hudson continues to have responsibility for
  Request for resources 2:
  Administration costs incurred by the Valuation Office in administering the beneficial portion of rates and providing or securing valuation and other services.
  Request for resources 4:
  Payments of rates to Local Authorities in respect of premises occupied by foreign and Commonwealth governments for diplomatic purposes and premises occupied by certain international organisations.

The responsibilities of an Accounting Officer, including responsibility for the propriety and regularity of the public finances for which the Accounting Officer is answerable, for keeping proper records and for safeguarding the Department's assets, are set out in chapter 3 of *Managing Public Money* published by HM Treasury.

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 10.

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

I certify that I have audited the financial statements of HM Revenue & Customs for the year ended 31 March 2008 under the Government Resources and Accounts Act 2000. These comprise the Statement of Parliamentary Supply, the Operating Cost Statement and Statement of Recognised Gains and Losses, the Balance Sheet, the Cashflow Statement and the Statement of Operating Costs by Departmental Aim and Objectives and the related notes. These financial statements have been prepared under the accounting policies set out within them. I have also audited the information in the Remuneration Report that is described in that report as having been audited.

Respective responsibilities of the Accounting Officer and auditor

The Accounting Officer is responsible for preparing the Annual Report, which includes the Remuneration Report, and the financial statements in accordance with the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Accounting Officer's Responsibilities.

My responsibility is to audit the financial statements and the part of the Remuneration Report to be audited in accordance with relevant legal and regulatory requirements, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000. I report to you whether, in my opinion, the information which comprises the Introduction, the Management Commentary (other than the Reconciliation of resource expenditure between Estimates, Accounts and Budgets), the Corporate Governance Report and the unaudited part of the Remuneration Report, included in the Annual Report, is consistent with the financial statements. I also report 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.

In addition, I report to you if the Department has not kept proper accounting records, if I have not received all the information and explanations I require for my audit, or if information specified by HM Treasury regarding remuneration and other transactions is not disclosed.

I review whether the Statement on Internal Control reflects the Department's compliance with HM Treasury's guidance, and I report if it does not. I am not required to consider whether this statement covers all risks and controls, or to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Annual Report 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. My responsibilities do not extend to any other information.

Basis of audit opinions

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the financial statements and the part of the Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgments made by the Accounting Officer in the preparation of the financial statements, and of whether the accounting policies are most 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 and the part of the Remuneration Report to be audited are free from material misstatement, whether caused by error or fraud, 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 also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Remuneration Report to be audited.

Opinions

In my opinion:

- the financial statements give a true and fair view, in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by HM Treasury, of the state of the Department's affairs as at 31 March 2008, and the net cash requirement, net resource outturn, net operating cost, operating costs applied to objectives, recognised gains and losses and cashflows for the year then ended;
- the financial statements and the part of the Remuneration Report to be audited have been properly prepared in accordance with HM Treasury directions issued under the Government Resources and Accounts Act 2000; and
- information which comprises the Introduction, the Management Commentary (other than the Reconciliation of resource expenditure between Estimates, Accounts and Budgets), the Corporate Governance Report and the unaudited part of the Remuneration Report, included in the Annual Report, is consistent with the financial statements.

Opinion on Regularity

In my opinion, 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.

Report

I have no observations to make on these financial statements.

T J Burr
Comptroller and Auditor General
10 July 2008

National Audit Office
151 Buckingham Palace Road
Victoria
London SW1W 9SS

Statement of Parliamentary Supply

Summary of Resource Outturn 2007–08

								2007–08 £m	2006–07 £m
		Estimate			Outturn				Outturn
Request for Resources	Note	Gross Expenditure	A in A	Net Total	Gross Expenditure	A in A	Net Total	Net Total outturn compared with Estimate: saving/ (excess)	Net Total
RfR 1: Administration	2	4,887.4	(520.1)	4,367.3	4,725.6	(506.9)	4,218.7	148.6	4,547.8
RfR 2: Valuation Office Agency	2	215.2	(215.2)	–	201.3	(201.3)	–	–	–
RfR 3: Payments in lieu of tax relief	2	86.0	–	86.0	83.7	–	83.7	2.3	80.5
RfR 4: Payments of Local Authority Rates	2	40.6	(2.2)	38.4	31.6	(1.9)	29.7	8.7	29.2
RfR 5: Child Benefit and Child Trust Fund	2	10,890.0	–	10,890.0	10,876.6	–	10,876.6	13.4	10,371.9
Total resources	3	**16,119.2**	**(737.5)**	**15,381.7**	**15,918.8**	**(710.1)**	**15,208.7**	**173.0**	**15,029.4**
Non-operating cost A in A				**4.0**			**0.7**	**3.3**	**3.8**

Net cash requirement 2007–08

				2007–08 £m	2006–07 £m
	Note	Estimate	Outturn	Net Total outturn compared with Estimate: saving/ (excess)	Outturn
Net cash requirement	4	**15,593.2**	**15,231.1**	**362.1**	**15,229.2**

Summary 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 (*cash receipts being shown in italics*).

		Forecast 2007–08 £m		Outturn 2007–08 £m	
	Note	Income	Receipts	Income	Receipts
Total	**5**	**(351.0)**	***(305.0)***	**(373.6)**	***(334.7)***

Explanations of variances between Estimate and outturn are given in note 2 and in the Management Commentary.

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The notes on pages 43 to 75 form part of these accounts

Operating Cost Statement
for the year ended 31 March 2008

		2007–08 £m							2006–07 £m
		Core Department			Consolidated			Core Department	Consolidated
	Note	Staff Costs	Other Costs	Income	Staff Costs	Other Costs	Income		
Administration Costs:									
Request for resources 1 & 2 –									
Staff costs	9	2,652.2			2,787.6			2,703.2	2,842.5
Other administration costs	10		1,785.8			1,835.1		1,866.4	1,913.2
Operating income	12			(468.5)			(661.6)	(408.2)	(599.6)
Programme Costs:									
Request for resources 1 & 2 –									
Staff costs	9	–			–			0.1	0.1
Programme costs	11		287.6			287.6		411.7	411.7
Income	12			(40.8)			(40.8)	(44.3)	(44.3)
Request for resources 3 – Payments in lieu of tax relief:									
Staff costs	9	–			–			–	–
Programme costs	11		83.7			83.7		80.5	80.5
Income	12			–			–	–	–
Request for resources 4 – Payments of Local Authority Rates:									
Staff costs	9	–			–			–	–
Programme costs	11		–			31.6		–	33.3
Income	12			–			(1.9)	–	(4.1)
Request for resources 5 – Child Benefit and Child Trust Fund:									
Staff costs	9	–			–			–	–
Programme costs	11		10,878.5			10,878.5		10,373.8	10,373.8
Income	12			–			–	–	–
Totals		**2,652.2**	**13,035.6**	**(509.3)**	**2,787.6**	**13,116.5**	**(704.3)**		
Net Operating Cost	3, 13			**15,178.5**			**15,199.8**	**14,983.2**	**15,007.1**

Statement of Recognised Gains and Losses
for the year ended 31 March 2008

	2007–08 £m		2006–07 £m	
	Core Department	Consolidated	Core Department	Consolidated
Net gain/(loss) on revaluation of tangible fixed assets	36.0	37.5	(20.3)	(19.7)
Recognised gains and losses for the financial year	36.0	37.5	(20.3)	(19.7)

The notes on pages 43 to 75 form part of these accounts

Balance Sheet
as at 31 March 2008

	Note	2008 £m Core Department		2008 £m Consolidated		2007 £m Core Department		2007 £m Consolidated	
Fixed assets:									
Tangible assets	14		1,355.7		1,393.7		1,263.6		1,296.9
Intangible assets	15		6.2		6.2		8.2		8.2
Debtors falling due after more than one year	18		165.2		167.0		177.5		179.6
Current assets:									
Stocks and work in progress	17	5.0		8.7		8.4		11.7	
Debtors	18	482.3		488.6		434.5		442.4	
Cash at bank and in hand	19	57.2		68.0		75.2		83.7	
		544.5		565.3		518.1		537.8	
Creditors (amounts falling due within one year)	20	(1,109.5)		(1,128.6)		(1,118.2)		(1,132.2)	
Net current liabilities			(565.0)		(563.3)		(600.1)		(594.4)
Total assets less current liabilities			962.1		1,003.6		849.2		890.3
Creditors (amounts falling due after more than one year)	20		(192.8)		(192.8)		(188.6)		(188.6)
Provisions for liabilities and charges	21		(278.8)		(297.0)		(238.7)		(257.9)
			490.5		**513.8**		**421.9**		**443.8**
Taxpayers' equity:									
General fund	22		430.9		450.2		270.4		289.8
Revaluation reserve	23		59.6		63.6		151.5		154.0
			490.5		**513.8**		**421.9**		**443.8**

Dave Hartnett
Principal Accounting Officer
2 July 2008

The notes on pages 43 to 75 form part of these accounts

Consolidated Cash Flow Statement

for the year ended 31 March 2008

	Note	2007–08 £m	2006–07 £m
Net cash outflow from operating activities	24a	(14,971.3)	(14,906.3)
Capital expenditure and financial investment	24b, 24c	(255.8)	(303.8)
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities		323.9	266.7
Payments of amounts due to the Consolidated Fund		(373.6)	(232.2)
Financing from the Consolidated Fund	24d	15,259.2	15,210.2
Financing from the National Insurance Fund	24d	1.9	1.9
Increase/(decrease) in cash in the period	24e	**(15.7)**	**36.5**

The notes on pages 43 to 75 form part of these accounts

Consolidated Statement of Operating Costs by Departmental Aim and Objectives

for the year ended 31 March 2008

	2007–08 £m			2006–07 £m		
	Gross	Income	Net	Gross	Income	Net
Aim: To administer the tax and customs control systems 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 1: 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.						
Objective 2: Improve customer experience, support business and reduce the compliance burden.						
Objective 3: 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.						
We have subdivided these objectives into the following: **RfR 1:** Administering the tax and customs control systems fairly and efficiently and making 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 1	3,657.6	(433.4)	3,224.2	3,876.2	(426.1)	3,450.1
Objective 2	787.0	(68.7)	718.3	643.0	(22.0)	621.0
Objective 3	281.0	(7.2)	273.8	462.2	(4.4)	457.8
RfR 2: Growing a contribution to the good management of property where the public interest is involved.	201.3	(209.7)	(8.4)	201.9	(207.2)	(5.3)
RfR 3: Providing payments in lieu of tax relief to certain bodies.	83.7	–	83.7	80.5	–	80.5
RfR 4: Making payments of rates to Local Authorities on behalf of certain bodies.	31.6	(1.9)	29.7	33.3	(4.1)	29.2
RfR 5: Payments of Child Benefit and Child Trust Fund endowments.	10,878.5	–	10,878.5	10,373.8	–	10,373.8
Intra departmental consolidation adjustment	(16.6)	16.6	–	(15.8)	15.8	–
Net Operating Costs	**15,904.1**	**(704.3)**	**15,199.8**	**15,655.1**	**(648.0)**	**15,007.1**

This analysis is an apportionment, because in practice many activities undertaken by the Department support more than one of the three objectives within RfR 1.

The intra departmental consolidation adjustment is in respect of transactions between the Department and the Valuation Office Agency.

See note 25.

Notes to the Departmental Resource Accounts

1. Statement of Accounting Policies

These financial statements have been prepared in accordance with the 2007–08 *Government Financial Reporting Manual (FReM)* issued by HM Treasury. The accounting policies contained in the *FReM* follow UK Generally Accepted Accounting Practice for companies (UK GAAP) to the extent that it is meaningful and appropriate to the public sector.

The Government intends that, from 2009-10, departments' financial statements should be prepared using International Financial Reporting Standards (IFRS), adapted as relevant for the public sector.

In addition to the primary statements prepared under UK GAAP, the *FReM* also requires the Department to prepare two additional primary statements. The *Statement of Parliamentary Supply* and supporting notes show outturn against Estimate in terms of the net resource requirement and the net cash requirement. The *Consolidated Statement of Operating Cost by Departmental Aim and Objectives* and supporting notes analyse the Department's income and expenditure by the objectives agreed with Ministers.

Where the *FReM* permits a choice of accounting policy, the accounting policy which has been 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.

1.2 Basis of consolidation

These accounts comprise a consolidation of the non-agency parts of the Department (the Core Department) and those entities which fall within the Departmental boundary as defined in the *FReM* (chapter 1.5). Transactions between entities included in the consolidation are eliminated.

A list of all those entities within the Departmental boundary is given at note 36.

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. A £5,000 capitalisation threshold applies to all tangible fixed assets except for furniture, vehicles and IT hardware, which are capitalised regardless. On initial recognition assets are measured at cost including any costs such as installation directly attributable to bringing them into working condition. Appropriate indices are applied to developed computer software, which have not been formally valued during the year. Assets under construction are recorded at historical cost. All other tangible assets (excluding property and furniture) are of low value with short lives where the historical cost is considered to be comparable to the modified historical cost had indices been applied.

1.3.2 Property assets

The majority of the property assets occupied by HMRC were acquired from the predecessor Departments by Mapeley STEPS Contractor Ltd in March 2001 under a twenty-year Private Finance Initiative (PFI) contract (see note 28.1).

Freehold Land and Buildings at note 14 reports the property asset at 100 Parliament Street. This asset has been stated at existing use value using professional valuation every five years, with interim professional review three years after each full valuation. Valuations in intermediate years are undertaken where a material change is likely.

Accommodation refurbishments at note 14 reports expenditure in respect of major capital refurbishments and improvements of properties occupied but not owned. HMRC policy from April 2005 is to capitalise refurbishments when the project costs exceed £150,000.

1.3.3 Furniture

For the Core Department, additions accurately reflect the cost of furniture purchases each year. The value and depreciation of furniture and fittings is 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. Individually these assets have a low value, but collectively are material to these accounts. This methodology provides a reliable estimation of the actual value and the depreciation that would have been charged had the Department maintained detailed records for individual items of furniture. The use of this method avoids the Department having to incur significant costs in maintaining and validating detailed records.

1.3.4 Developed computer software

Computer software, including 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 staff costs for developing, integrating and testing IT software in the development of the programs.

1.3.5 Assets under construction

Assets under construction are separately reported in note 14. Costs are accumulated until the asset is completed and brought into service when the asset is transferred to the relevant asset class and depreciation commences.

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:

Asset category	Estimated useful life
Freehold land	Not depreciated
Freehold buildings	50 years
Accommodation refurbishments	Period of the lease
Office equipment	5 to 10 years
Computer equipment	3 to 7 years
Vehicles	3 to 7 years
Furniture and fittings	15 years
Developed computer software	Remaining economic life not greater than 10 years
Vessels	10 to 20 years
Scientific aids	3 to 12 years

1.5 Intangible fixed assets

One-off purchased computer software licences are capitalised as intangible fixed assets where expenditure of £5,000 or more is incurred. 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 are valued at lower of cost and net realisable value. Stocks consist of stationery and purchased uniforms.

Work in progress is an accounting estimate mainly determined by applying the lower of selling price and outturn unit cost for each type of work to the number of outstanding cases or projects at year end. It mainly consists of International Assistance project work and Valuation Office Agency case work relating to land services.

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, other non-departmental public bodies and external customers for services provided on a full-cost basis. It includes not only income appropriated in aid of the Estimate but also any Consolidated Fund income which, in accordance with the *FReM,* 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 income and expenditure. The classification of expenditure and income as administration or as programme follows the definition of administration costs set out in the *FReM* by HM Treasury.

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 budget, is allowed to be offset against gross administrative costs in determining the outturn against the administration budget, and that operating income which is not.

Programme costs reflect non-administration costs, including Child Benefit and Child Trust Fund payments and other disbursements by the Department.

1.9 Cash at bank and in hand

These are balances in respect of administering the Department and programme expenditure including that relating to both Child Benefit and Child Trust Fund, but 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, where the charge is nil.

1.11 Foreign exchange

Balances held in a foreign currency, including Euro bank balances, are translated into Sterling using the Bank of England rate on the last working day of the month. Other transactions denominated in a foreign currency are translated into Sterling at the rate of exchange ruling on the date of each transaction. Any exchange differences are posted to an expenditure account and are therefore 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). 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) contracts

PFI transactions have been accounted for in accordance with FRS 5, Application Note F, supplemented by Technical Note No.1 (revised), entitled *How to account for PFI transactions* as required by the *FReM*. 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 an imputed 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 2.2 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 makes provision in full for this cost when the early retirement 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 provision for doubtful debt 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 further provision is made in respect of penalty debtors (note 1.19) to allow for the remission of uncollectable penalties and in respect of Child Benefit debtors to allow for potentially irrecoverable amounts. All these provisions have been estimated having regard to the level of debts not recovered during 2007–08 and earlier years.

1.18 Value Added Tax

Most of the activities of the Department are outside the scope of VAT. In general, output tax does not apply and input tax on purchases is not recoverable. Some input VAT on a restricted number of services is recovered under Section 41(3) of the VAT Act 1994 and in accordance with the HM Treasury 'Contracting-out Direction'. Section 41(3) is intended to remove any disincentive to government departments of contracting-out activities performed 'in-house' where there is a sound basis for doing so. Irrecoverable VAT is charged to the relevant expenditure category or included in the capitalised purchase cost of fixed assets. Income and expenditure is otherwise shown net of VAT.

1.19 Tax penalty income

Income arising from the levying of tax penalties is generally treated as Consolidated Fund Extra Receipts (CFER). However, HM Treasury has given authority for certain penalties relating to Income Tax, Corporation Tax and Capital Gains Tax, to be appropriated in aid by the Department, i.e. kept by the Department to fund the costs of collection.

Further, in accordance with HM Treasury guidance, where it is not possible to distinguish between tax receipts and penalty receipts collectable as part of investigation settlements, the whole amount is accounted for as a tax receipt in the Trust Statement.

Penalties relating to National Insurance Contributions do not appear in these Resource Accounts. They are accounted for as income in the Trust Statement and paid over to the National Insurance Fund.

1.20 Child Benefit

Child Benefit is accounted for within the programme costs in the Operating Cost Statement and includes both Child Benefit and Child Benefit (Lone Parent) Premium, although the latter ceased to be paid with effect from the week commencing 9 April 2007. 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 note 1.17).

1.21 Child Trust Fund

Child Trust Fund (CTF) provides endowments, in respect of eligible children, to assist with the funding of long term individual savings and investment accounts provided by approved financial institutions. Eligibility for an endowment arises when a claim for Child Benefit is approved. All eligible children born on or after 1 September 2002 are entitled to an initial endowment. This is normally satisfied by the issue of a voucher which is then used to open a CTF account with an approved financial institution. In addition to the initial endowment, children in families where the family income is below the income threshold for Child Tax Credit purposes in the year of birth will also qualify for a supplementary endowment. Payments due, where they remain unpaid, are recognised as either creditors (amounts falling due within one year) or as a provision.

1.22 Third-party assets

On behalf of the Department, the Bank of England holds Euro deposits in relation to the European Commission (EC) twinning projects. These assets are not held as part of the Department's activities and as such do not form part of these accounts.

The Department manages interest-bearing accounts containing seized money, and also holds non-monetary assets as physical evidence in connection with ongoing legal proceedings. These assets are held as part of the Department's law enforcement activities and as such do not form part of these accounts.

Details of these assets are reported in note 35.

1.23 Contingent liabilities

In addition to contingent liabilities disclosed in accordance with FRS 12, the Department discloses for parliamentary reporting and accountability purposes certain statutory and non-statutory contingent liabilities where the likelihood of a transfer of economic benefit is remote, but which have been reported to Parliament in accordance with the requirements of *Managing Public Money*.

Where the time value of money is material, contingent liabilities which are required to be disclosed under FRS 12 are stated at discounted amounts and the amount reported to Parliament separately noted. Contingent liabilities that are not required to be disclosed by FRS 12 are stated at the amounts reported to Parliament.

2. Analysis of net resource outturn by section

								2007–08 £m	2006–07 £m
						Outturn		Estimate	
	Admin	Other current	Grants	Gross resource expenditure	A in A	Net Total	Net Total	Net Total outturn compared with Estimate	Prior–year outturn
Request for resources 1:									
A. Administration	4,438.0	142.9	1.6	4,582.5	(506.6)	4,075.9	4,164.8	88.9	4,269.5
B. e-filing incentive payments	–	–	126.1	126.1	–	126.1	200.0	73.9	278.3
C. Operational local clearance procedures	–	0.3	–	0.3	(0.3)	–	–	–	–
D. Net revaluation loss	–	16.7	–	16.7	–	16.7	2.5	(14.2)	–
Total	4,438.0	159.9	127.7	4,725.6	(506.9)	4,218.7	4,367.3	148.6	4,547.8
Request for resources 2:									
A. VOA Administration	201.3	–	–	201.3	(201.3)	–	(0.3)	(0.3)	–
B. VOA Fixed Asset Revaluation	–	–	–	–	–	–	0.3	0.3	–
Total	201.3	–	–	201.3	(201.3)	–	–	–	–
Request for resources 3:									
A. Payments in lieu of tax relief	–	–	83.7	83.7	–	83.7	86.0	2.3	80.5
Request for resources 4:									
A. Payments of Local Authority Rates	–	31.6	–	31.6	(1.9)	29.7	38.4	8.7	29.2
Request for resources 5:									
A. Children’s benefits	–	(13.8)	10,650.4	10,636.6	–	10,636.6	10,630.0	(6.6)	10,131.3
B. Child Trust Fund endowments	–	(8.9)	248.9	240.0	–	240.0	260.0	20.0	240.6
Total	–	(22.7)	10,899.3	10,876.6	–	10,876.6	10,890.0	13.4	10,371.9
Resource Outturn	**4,639.3**	**168.8**	**11,110.7**	**15,918.8**	**(710.1)**	**15,208.7**	**15,381.7**	**173.0**	**15,029.4**

Explanation of the variances between Estimate and outturn for each Request for Resources

Request for resources 1B (RfR 1B), e-filing incentive payments is underspent by £73.9m (37.0 per cent). There are three factors:

- The Departmental Estimate was adjusted in line with the upward trend in on-line filing, but actual growth in e-filed returns was 10 per cent compared to an estimated 17 per cent.
- Nil returns ceased to qualify for the incentive as a result of changes to the eligibility criteria implemented in 2007–08.
- Over 200,000 employer returns remain outstanding at the end of 2007–08.

Request for resources 1D (RfR 1D), Net revaluation loss is overspent by £14.2m, (568.0 per cent). The variance is primarily caused by the £12.9m impairment loss on tax credit software identified when all major systems were reviewed to verify asset lives and value during late 2007.

Request for resources 4 (RfR 4), Payment of Local Authority Rates (POLAR) was underspent by £8.7m (22.7 per cent). Assumptions that formed the basis of this RfR did not materialise during the year, however, the Government funding processes did not permit a net reduction in the Departmental Estimate in year. Within the Comprehensive Spending Review 2007, this downward trend has been reflected in net costs for the next three years.

Detailed explanations of the variances are given in the Management Commentary.

3. Reconciliation of outturn to net operating cost and against Administration Budget

3(a) Reconciliation of net resource outturn to net operating cost

				2007–08 £m	2006–07 £m
	Note	Outturn	Supply Estimate	Outturn compared with Estimate	Outturn
Net Resource Outturn	2	15,208.7	15,381.7	173.0	15,029.4
Non-supply income (CFERs)	5	(10.8)	–	10.8	(24.2)
Non-supply expenditure	22	1.9	–	(1.9)	1.9
Net operating cost		**15,199.8**	**15,381.7**	**181.9**	**15,007.1**

3(b) Outturn against final Administration Budget

	2007–08 £m		2006–07 £m
	Budget	Outturn	Outturn
Gross Administration Budget	4,766.1	4,639.4	4,771.5
Income allowable against the Administration Budget	(349.4)	(329.1)	(274.8)
Net outturn against final Administration Budget	**4,416.7**	**4,310.3**	**4,496.7**

4. Reconciliation of resources to cash requirement

	Note	Estimate £m	Outturn £m	Net total outturn compared with Estimate: savings/ (excess) £m
Resource Outturn	2	15,381.7	15,208.7	173.0
Capital				
Acquisition of fixed assets		292.2	256.5	35.7
Non-operating A in A				
Proceeds of fixed asset disposals		(4.0)	(0.7)	(3.3)
Accruals adjustments				
Non-cash items	10, 11	(406.8)	(378.8)	(28.0)
Changes in working capital other than cash		244.5	32.6	211.9
Changes in creditors falling due after more than 1 year	20	–	(4.2)	4.2
Use of provisions	21	85.6	117.0	(31.4)
Excess cash receipts surrenderable to the Consolidated Fund	5	–	–	–
Net cash requirement		**15,593.2**	**15,231.1**	**362.1**

Explanation of the variances between Estimate and cash requirement

- The acquisition of fixed assets varied by £35.7m (12.2 per cent) from the Estimate. The outturn relating to software development was £35.0m lower than expected due to a reprioritisation of software development and a postponement of projects.
- Proceeds of fixed asset disposals varied by £3.3m (82.5 per cent) from the Estimate. This is due to a significant receipt for the sale of a property, Elmbridge Court being realised in 2006-07, but included in the 2007–08 Estimate.
- Changes in working capital other than cash varied by £211.9m (86.7 per cent) from the Estimate. The majority of this variance can be explained by accruals and deferred income being significantly lower than expected compared to the Estimate.
- Changes in creditors falling due after more than one year varied by £4.2m from the Estimate. No separate Estimate was made for this item, it was included within the working capital category.
- Use of provisions varied by £31.4m (36.7 per cent) from the Estimate. This primarily results from higher than expected consumption of provisions in respect of early departure costs for staff, in addition a significant amount was utilised to meet a Shipbuilders Relief liability.

5. 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 (*cash receipts being shown in italics*).

		Forecast 2007–08		Outturn 2007–08	
			£m		£m
	Note	Income	Receipts	Income	Receipts
Operating income and receipts – excess A in A		–	–	(8.4)	*(8.4)*
Other operating income and receipts not classified as A in A		(1.0)	*(1.0)*	(2.4)	*(2.4)*
		(1.0)	*(1.0)*	(10.8)	*(10.8)*
Non-operating income and receipts – excess A in A	7	–	–	–	–
Other non-operating income and receipts not classified as A in A	8	–	–	–	–
Other amounts collectable on behalf of the Consolidated Fund		(350.0)	*(304.0)*	(362.8)	*(323.9)*
Excess cash surrenderable to Consolidated Fund	4	–	–	–	–
Total income payable to the Consolidated Fund		**(351.0)**	***(305.0)***	**(373.6)**	***(334.7)***

6. Reconciliation of income recorded within the Operating Cost Statement to operating income payable to the Consolidated Fund

		2007–08	2006–07
	Note	£m	£m
Operating income	12	(704.3)	(648.0)
Adjustments for transactions between RfRs		(16.6)	(15.8)
Gross income		(720.9)	(663.8)
Income authorised to be appropriated in aid		(710.1)	(639.6)
Operating income payable to the Consolidated Fund	5	**(10.8)**	**(24.2)**

7. Non-operating income – Excess A in A

	2007–08	2006–07
	£m	£m
Principal repayments of voted loans	–	–
Proceeds on disposal of fixed assets	–	(2.3)
Other	–	–
Non-operating income – excess A in A	**–**	**(2.3)**

8. Non-operating income not classified as A in A

The Department has no non-operating income not classified as A in A.

9. Staff numbers and related costs

Staff costs comprise:

			2007–08	2006–07
			£m	£m
	Total[1]	Permanently employed staff	Others	Total
Wages and salaries	2,215.0	2,173.5	41.5	2,256.5
Social security costs	161.2	158.7	2.5	166.0
Other pension costs	412.6	406.3	6.3	420.1
Sub Total	**2,788.8**	**2,738.5**	**50.3**	**2,842.6**
Less recoveries in respect of outward secondments	(2.0)	(2.0)	–	(1.5)
Total net costs[2]	**2,786.8**	**2,736.5**	**50.3**	**2,841.1**
Of which:				
Core Department	**2,651.3**	**2,602.7**	**48.6**	**2,701.8**

[1] Staff consist entirely of officials.
[2] Of the total, £0.8m has been charged to capital.

The Department does not pay the salary of the Minister who has responsibility for HM Revenue & Customs (HMRC). 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 HMRC is unable to identify its share of the underlying assets and liabilities. The scheme actuary valued the scheme as at 31 March 2007. You can find details in the resource accounts of the Cabinet Office: Civil Superannuation (www.civilservice-pensions.gov.uk).

For 2007–08, employer's contributions of £412,001,850 were payable to the PCSPS (2006-07: £419,483,950) at one of four rates in the range 17.1 per cent to 25.5 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 2008-09, the salary bands will be revised but the rates will remain the same. (The rates will be changing with effect from April 2009). The contribution rates are set to meet the cost of the benefits accruing during 2007–08 to be paid when the member retires, and not the benefits paid during this period to existing pensioners.

Employees can opt to open a partnership pension account, a stakeholder pension with an employer contribution. Employer's contributions of £603,236 (2006-07: £601,154) were paid to one or more of a panel of three appointed stakeholder pension providers. Employer contributions are age-related and range from 3 per cent 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 £44,317, 0.8 per cent of pensionable pay (2006-07: £45,506, 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.

139 persons (2006-07: 186 persons) retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £196,491 (2006-07: £258,531).

Average number of persons employed

The average number of full-time equivalent persons employed during the year was as follows. These figures within the Consolidated Departmental Resource Accounts include those working in the Core Department and the Valuation Office Agency.

			2007–08	2006–07
			Number	Number
	Total	Permanently employed staff	Others	Total
RfR 1: Administration				
Objective 1	64,683	62,637	2,046	68,629
Objective 2	14,414	13,958	456	12,286
Objective 3	5,148	4,984	164	8,831
RfR 2: Valuation Office Agency	4,092	4,061	31	4,425
RfR 3: Payments in lieu of tax relief	2	2	0	2
RfR 4: Payments of Local Authority Rates	4	4	0	3
RfR 5: Child Benefit and Child Trust Fund	1,522	1,498	24	1,625
Total	**89,865**	**87,144**	**2,721**	**95,801**
Of which:				
Core Department	**85,769**	**83,079**	**2,690**	**91,373**

This analysis is an apportionment, because in practice many activities undertaken by the Department support more than one of the three Objectives within RfR 1.

10. Other Administration Costs

		2007–08 £m				2006–07 £m			
	Note	**Core Department**		**Consolidated**		**Core Department**		**Consolidated**	
Rentals under operating leases:									
Hire of plant and machinery		3.0		3.0		3.9		3.9	
Other operating leases		21.5		21.8		26.2		26.7	
			24.5		24.8		30.1		30.6
Interest charges:									
On-balance sheet PFI contracts		13.8		13.8		13.4		13.4	
			13.8		13.8		13.4		13.4
PFI service charges:									
Off-balance sheet contracts		263.1		278.5		245.3		259.8	
Service element of on-balance sheet contracts		4.1		4.1		4.0		4.0	
Indexation of liability on PFI deals		6.9		6.9		4.9		4.9	
			274.1		289.5		254.2		268.7
Non-cash items:									
Depreciation		158.9		164.6		166.9		172.4	
Amortisation		3.6		3.6		5.4		5.4	
Barter deal prepayments		13.7		14.1		14.1		14.3	
Profit on disposal of fixed assets		(0.7)		(0.7)		(4.2)		(4.2)	
Loss on disposal of fixed assets		4.5		5.3		1.7		1.7	
Net revaluation loss		–		0.1		–		–	
Cost of capital charges		30.2		30.8		26.9		27.6	
Auditor's remuneration and expenses[1]		1.9		1.9		1.9		1.9	
Amounts provided for liabilities and charges	21	4.1		3.7		0.9		1.8	
Amounts provided for early departure costs	21	56.2		61.2		67.6		71.4	
Unwinding of discount on provisions	21	1.9		2.0		1.9		2.1	
			274.3		286.6		283.1		294.4
Other expenditure:									
Travel, subsistence and hospitality		89.0		94.4		91.4		96.3	
Accommodation expenses		108.5		113.3		138.1		147.1	
Administrative staff related costs		1.7		1.7		3.3		3.3	
Printing, postage, stationery and office supplies		109.3		111.0		113.2		115.0	
Telephone expenses		48.1		49.7		59.5		60.8	
IT services and consumables		582.9		592.8		645.4		653.8	
Legal costs		–		0.2		–		–	
Consultancy[2]		56.8		57.0		80.5		81.0	
Contracted out services		21.1		20.6		22.9		22.9	
Publicity		15.2		16.5		17.6		17.6	
Post Office services		24.4		24.4		22.5		22.5	
Bank charges		18.5		18.5		18.9		18.9	
Other miscellaneous expenditure		123.6		120.3		72.3		66.9	
			1,199.1		1,220.4		1,285.6		1,306.1
Total			**1,785.8**		**1,835.1**		**1,866.4**		**1,913.2**

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

[2] Consultancy costs amounting to £2.1m (2006-07: £8.4m) have been capitalised as part of the cost of developing fixed assets. The total amount of consultancy expenditure for 2007–08 was £59.1m (2006-07: £89.4m).

11. Programme Costs

		2007–08 £m				2006–07 £m			
	Note	Core Department		Consolidated		Core Department		Consolidated	
Child Benefit and Child Trust Fund									
Child Benefit		10,650.3		10,650.3		10,144.3		10,144.3	
Child Benefit (Lone Parent) Premium		0.1		0.1		1.9		1.9	
Guardians Allowance (Funded from NIF)		1.9		1.9		1.9		1.9	
Child Trust Fund Endowments		168.2		168.2		176.4		176.4	
			10,820.5		10,820.5		10,324.5		10,324.5
Payments in lieu of tax relief									
Life Assurance Premium Relief, MIRAS		8.6		8.6		10.3		10.3	
Transitional payments to charities		0.1		0.1		0.2		0.2	
Stakeholder pensions		75.0		75.0		70.0		70.0	
			83.7		83.7		80.5		80.5
Payments of Local Authority Rates									
Payments of Local Authority Rates (POLAR)		–		31.2		–		32.9	
Less programme income		–		(1.9)		–		(4.1)	
			–		29.3		–		28.8
Other Programme Costs									
Incentive Payments		126.1		126.1		278.3		278.3	
Legal and Investigation		55.0		55.0		67.2		67.2	
Enforcement Costs		39.8		39.8		34.3		34.3	
Business Link Payments		24.1		24.1		–		–	
Bank charges via OPG		6.9		6.9		6.7		6.7	
Other programme expenditure		1.9		1.9		9.5		9.5	
Less programme income		(40.8)		(40.8)		(44.3)		(44.3)	
			213.0		213.0		351.7		351.7
Non-cash items									
Depreciation		9.0		9.0		8.5		8.5	
Net revaluation loss		16.7		16.7		–		–	
Cost of capital charges		(22.7)		(22.7)		(23.4)		(23.4)	
(Profit)/Loss on disposal of fixed assets		–		–		(0.1)		(0.1)	
Amounts provided for liabilities and charges	21								
Child Trust Fund		80.7		80.7		72.7		72.7	
POLAR		–		0.4		–		0.4	
Other programme provisions		8.1		8.1		7.3		7.3	
			91.8		92.2		65.0		65.4
Total			**11,209.0**		**11,238.7**		**10,821.7**		**10,850.9**

12. Income

Core Department	RfR 1	RfR 2	RfR 3	RfR 4	RfR 5	2007–08 £m Total	2006–07 £m Total
Income from external customers	(122.3)	–	–	–	–	(122.3)	(77.7)
Income from other departments	(46.3)	–	–	–	–	(46.3)	(35.5)
Income from the National Insurance Fund	(338.3)	–	–	–	–	(338.3)	(338.7)
Other income	(2.4)	–	–	–	–	(2.4)	(0.6)
	(509.3)	**–**	**–**	**–**	**–**	**(509.3)**	**(452.5)**

Consolidated	RfR 1	RfR 2	RfR 3	RfR 4	RfR 5	Total	Total
Income from external customers	(122.3)	(18.1)	–	–	–	(140.4)	(93.8)
Income from other departments	(41.4)	(179.9)	–	–	–	(221.3)	(210.8)
Income from the National Insurance Fund	(338.3)	–	–	–	–	(338.3)	(338.7)
Other income	(2.4)	–	–	(1.9)	–	(4.3)	(4.7)
	(504.4)	**(198.0)**	**–**	**(1.9)**	**–**	**(704.3)**	**(648.0)**

Of total operating income received, the following relates to services provided to external and public sector customers where full cost exceeds £1.0m. In each case the financial objective is to recover the full costs of the service. This information is provided for fees and charges purposes, not to comply with SSAP 25.

	2007–08 £m Income	Full Cost	Surplus/ (deficit)	2006–07 £m Income	Full Cost	Surplus/ (deficit)
Fees & Charges raised by the Valuation Office Agency (VOA)						
Rating & Council Tax	(180.1)	171.7	8.4	(176.6)	170.7	5.9
Other valuation work	(18.1)	16.8	1.3	(19.2)	19.8	(0.6)
Work on behalf of HMRC	(11.5)	12.8	(1.3)	(11.5)	11.5	–
Fees & Charges raised by the Core Department						
International Assistance	(1.8)	1.5	0.3	(2.5)	2.9	(0.4)
Money Laundering Regime	(3.4)	3.6	(0.2)	(2.2)	3.2	(1.0)
Bank charges via OPG	(6.9)	7.2	(0.3)	(6.5)	6.7	(0.2)
National Minimum Wage	(6.5)	6.5	–	(5.7)	5.5	0.2
Collection of Student Loans	(6.0)	6.0	–	(4.4)	4.3	0.1
DWP Welfare Reform Agenda	(2.8)	2.8	–	(2.9)	3.3	(0.4)
DWP Office Services and Accounting[1]	–	–	–	(4.1)	4.1	–
DWP Disclosure of Tax Credits data to Local Authorities	(1.1)	1.3	(0.2)	–	–	–
DWP Employment Support Allowance IT	(1.0)	1.2	(0.2)	–	–	–
DWP Pensions Reform Delivery Programme	(1.5)	1.3	0.2	–	–	–
IT services provided to RCPO[1]	–	–	–	(1.6)	1.6	–
Services provided to the Valuation Office Agency	(4.1)	3.3	0.8	(4.0)	4.1	(0.1)
Charges to the National Insurance Fund	(338.3)	374.0	(35.7)	(338.7)	304.3	34.4
Total	**(583.1)**	**610.0**	**(26.9)**	**(579.9)**	**542.0**	**37.9**

[1] For 2007–08 the full cost figures were below £1.0m.

13. Analysis of net operating cost by spending body

		2007–08	2006–07
		£m	£m
Spending body:	**Estimate**	**Outturn**	**Outturn**
Core Department	15,343.3	15,178.5	14,983.2
Valuation Office Agency	38.4	21.3	23.9
Net Operating Cost	**15,381.7**	**15,199.8**	**15,007.1**

14. Tangible fixed assets

	Freehold Land & Buildings[1]	Accommodation refurbishments[1]	Office & Computer Equipment	Vehicles	Furniture & Fittings[2]	Developed Computer Software	Assets under construction	Vessels	Scientific Aids	Total
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Cost or valuation										
At 1 April 2007	92.6	155.2	236.9	28.5	118.0	1,328.8	225.0	29.9	58.8	2,273.7
Additions	–	0.7	12.7	2.8	2.9	2.3	232.4	–	1.0	254.8
Donations	–	–	–	–	–	–	–	–	–	–
Disposals	–	(9.5)	(41.6)	(4.2)	(13.1)	(9.9)	(0.8)	–	(3.5)	(82.6)
Reclassifications	–	1.3	–	–	–	243.8	(245.9)	0.1	0.7	–
Revaluations[3]	14.8	0.6	6.4	0.2	(23.6)	(22.8)	–	–	0.7	(23.7)
At 31 March 2008	**107.4**	**148.3**	**214.4**	**27.3**	**84.2**	**1,542.2**	**210.7**	**30.0**	**57.7**	**2,422.2**
Depreciation										
At 1 April 2007	(1.9)	(73.1)	(160.5)	(19.4)	(61.9)	(611.6)	–	(10.9)	(37.5)	(976.8)
Charged in year	(1.5)	(9.8)	(35.7)	(3.5)	(5.5)	(108.6)	–	(1.5)	(7.5)	(173.6)
Disposals	–	6.9	40.7	3.2	12.7	9.8	–	–	4.2	77.5
Reclassifications	–	–	–	–	–	–	–	–	–	–
Revaluations[3]	2.9	(0.4)	0.3	(0.1)	6.4	35.4	–	–	(0.1)	44.4
At 31 March 2008	(0.5)	(76.4)	(155.2)	(19.8)	(48.3)	(675.0)	–	(12.4)	(40.9)	(1,028.5)
Net book value at 31 March 2008	**106.9**	**71.9**	**59.2**	**7.5**	**35.9**	**867.2**	**210.7**	**17.6**	**16.8**	**1,393.7**
Net book value at 31 March 2007	**90.7**	**82.1**	**76.4**	**9.1**	**56.1**	**717.2**	**225.0**	**19.0**	**21.3**	**1,296.9**
Asset financing:										
Owned	26.8	71.9	59.2	7.5	35.9	867.2	210.7	17.6	16.8	1,313.6
Finance leased	–	–	–	–	–	–	–	–	–	–
On-balance sheet PFI contracts	80.1	–	–	–	–	–	–	–	–	80.1
PFI residual interests	–	–	–	–	–	–	–	–	–	–
Net book value at 31 March 2008	**106.9**	**71.9**	**59.2**	**7.5**	**35.9**	**867.2**	**210.7**	**17.6**	**16.8**	**1,393.7**
Analysis of tangible fixed assets										
The net book value of tangible fixed assets comprises:										
Core Department at 31 March 2008	106.9	70.7	57.5	7.5	34.8	836.7	207.2	17.6	16.8	1,355.7
Valuation Office Agency at 31 March 2008	–	1.2	1.7	–	1.1	30.5	3.5	–	–	38.0
Core Department at 31 March 2007	90.7	81.3	75.8	9.1	54.4	693.1	218.9	19.0	21.3	1,263.6
Valuation Office Agency at 31 March 2007	–	0.8	0.6	–	1.7	24.1	6.1	–	–	33.3

[1] See note 1.3.2 for the accounting policy for property assets.
[2] See note 1.3.3 for the accounting policy for furniture.
[3] See notes 1.1 and 1.3 for the accounting policy regarding revaluation of fixed assets.

Freehold Land and building 100 Parliament Street

The accounting treatment adopted by HM Revenue & Customs is consistent with that of HM Treasury in respect of our joint arrangement for the land and building on the site. An interim valuation, undertaken in January 2008 on the basis of existing use, established the value as being £107.4m, with the last full valuation having been in November 2004. Both valuations were performed by Valuation Office Agency, an executive agency of HMRC, whose services include providing valuation and estate surveying services to government departments.

15. Intangible fixed assets

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

	Total £m
Cost or valuation	
At 1 April 2007	27.5
Additions	1.7
Donations	–
Disposals	(7.1)
Reclassifications	–
Revaluation[1]	0.1
At 31 March 2008	**22.2**
Amortisation	
At 1 April 2007	(19.3)
Charged in year	(3.6)
Disposals	6.9
Reclassifications	–
Revaluation[1]	–
At 31 March 2008	**(16.0)**
Net book value at 31 March 2008	**6.2**
Net book value at 31 March 2007	**8.2**

Analysis of intangible fixed assets	
The net book value of intangible fixed assets comprises:	
Core Department at 31 March 2008	6.2
Valuation Office Agency at 31 March 2008	–
Core Department at 31 March 2007	8.2
Valuation Office Agency at 31 March 2007	–

[1] See notes 1.1 and 1.5 for the accounting policy regarding intangible fixed assets.

16. Investments

The Department has no financial investments.

17. Stocks and work in progress

	2007–08 £m		2006-07 £m	
	Core Department	**Consolidated**	**Core Department**	**Consolidated**
Stocks	4.6	4.6	8.1	8.1
Work in progress	0.4	4.1	0.3	3.6
	5.0	**8.7**	**8.4**	**11.7**

18. Debtors

18(a) Analysis by type

	2007–08 £m		2006-07 £m	
	Core Department	Consolidated	Core Department	Consolidated
Amounts falling due within one year:				
Trade debtors	–	9.0	–	6.6
Deposits and advances	28.6	24.8	19.3	17.5
Value added tax	16.3	16.3	43.6	43.6
Other debtors – excluding Child Benefit and CTF	20.8	20.6	28.3	29.9
Other debtors – Child Benefit and CTF	12.0	12.0	20.1	20.1
Prepayments and accrued income – excluding Child Benefit and CTF	20.7	21.8	28.5	29.8
Prepayments and accrued income – Child Benefit and CTF	34.3	34.3	12.5	12.5
Current part of PFI prepayment	9.2	9.2	9.0	9.0
Current part of non-PFI prepayment	3.7	3.9	5.5	5.7
Penalties	336.7	336.7	267.7	267.7
Amounts due from the Consolidated Fund in respect of supply	–	–	–	–
	482.3	**488.6**	**434.5**	**442.4**
Amounts falling due after more than one year:				
Trade debtors	–	–	–	–
Deposits and advances	–	–	–	–
Other debtors	0.5	0.5	0.5	0.5
Prepayments and accrued income	–	–	–	0.1
Barter deals	164.7	166.5	177.0	179.0
	165.2	**167.0**	**177.5**	**179.6**

18(b) Intra-Government Balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	2007–08	2006-07 £m	2007–08	2006-07 £m
Balances with other central government bodies	33.5	63.7	–	–
Balances with local authorities	2.2	1.8	–	–
Balances with NHS Trusts	2.1	1.5	–	–
Balances with public corporations and trading funds	–	0.1	–	–
Subtotal: intra-government balances	37.8	67.1	–	–
Balances with bodies external to government	450.8	375.3	167.0	179.6
Total debtors at 31 March	**488.6**	**442.4**	**167.0**	**179.6**

CFER penalties not yet collected from taxpayers are reported as a debtor in the balance sheet, matched by a corresponding creditor to the Consolidated Fund (see note 20). Within this note they are included in the balance related to 'Penalties'.

19. Cash at bank and in hand

	2007–08 £m		2006-07 £m	
	Core Department	**Consolidated**	**Core Department**	**Consolidated**
Balance 1 April	75.2	83.7	35.3	47.2
Net change in cash balances	(18.0)	(15.7)	39.9	36.5
Balance at 31 March	**57.2**	**68.0**	**75.2**	**83.7**
The following balances at 31 March were held at:				
Office of HM Paymaster General	35.4	46.2	15.1	23.6
Commercial banks and cash in hand	21.8	21.8	60.1	60.1
Balance at 31 March	**57.2**	**68.0**	**75.2**	**83.7**

20. Creditors

20(a) Analysis by type

	2007–08 £m		2006-07 £m	
	Core Department	**Consolidated**	**Core Department**	**Consolidated**
Amounts falling due within one year:				
Taxation and social security	(54.5)	(54.5)	(51.5)	(51.5)
Trade creditors	(147.9)	(149.6)	(153.6)	(152.5)
Other creditors – excluding Child Benefit and CTF	(2.0)	(2.2)	(6.0)	(7.0)
Other creditors – Child Benefit and CTF	(143.5)	(143.5)	(169.3)	(169.3)
Accruals and deferred income – excluding Child Benefit and CTF	(214.4)	(220.8)	(217.9)	(223.5)
Accruals and deferred income – Child Benefit and CTF	(195.6)	(195.6)	(189.8)	(189.8)
Current part of finance leases	–	–	–	–
Current part of imputed finance lease element of on-balance sheet PFI contracts	(2.6)	(2.6)	(1.9)	(1.9)
Amounts issued from the Consolidated Fund for supply but not spent at year end	(38.0)	(40.0)	(17.9)	(16.9)
Consolidated Fund Extra Receipts due to be paid to the Consolidated Fund				
received	(19.2)	(28.0)	(57.3)	(66.8)
receivable	(291.8)	(291.8)	(253.0)	(253.0)
	(1,109.5)	**(1,128.6)**	**(1,118.2)**	**(1,132.2)**
Amounts falling due after more than one year:				
Finance leases	–	–	–	–
Imputed finance lease element of on-balance sheet PFI contracts	(192.8)	(192.8)	(188.6)	(188.6)
	(192.8)	**(192.8)**	**(188.6)**	**(188.6)**

20(b) Intra-Government Balances

	Amounts falling due within one year		Amounts falling due after more than one year	
	2007–08	2006-07 £m	2007–08	2006-07 £m
Balances with other central government bodies	(448.9)	(417.4)	–	–
Balances with local authorities	(0.5)	(1.1)	–	–
Balances with NHS Trusts	(0.1)	–	–	–
Balances with public corporations and trading funds	–	–	–	–
Subtotal: intra-government balances	(449.5)	(418.5)	–	–
Balances with bodies external to government	(679.1)	(713.7)	(192.8)	(188.6)
Total creditors at 31 March	**(1,128.6)**	**(1,132.2)**	**(192.8)**	**(188.6)**

CFER penalties not yet collected from taxpayers are reported as a debtor in the balance sheet (see note 18), matched by a corresponding creditor. Within this note they are included in the balance 'Consolidated Fund Extra Receipts due to be paid to the Consolidated Fund: receiveable'.

21. Provisions for liabilities and charges

	Early departure costs	Child Trust Fund	Legal claims	Accommodation costs	Other	Total
Core Department	**£m**	**£m**	**£m**	**£m**	**£m**	**£m**
Balance at 1 April 2007	(118.1)	(86.3)	(13.4)	(1.9)	(19.0)	(238.7)
Provided in the year	(56.2)	(85.7)	(11.1)	(0.2)	(4.5)	(157.7)
Provisions not required written back	–	5.0	2.3	0.8	0.5	8.6
Provisions utilised in the year	47.6	44.1	2.6	0.1	16.5	110.9
Unwinding of discount	(1.9)	–	–	–	–	(1.9)
Balance at 31 March 2008	**(128.6)**	**(122.9)**	**(19.6)**	**(1.2)**	**(6.5)**	**(278.8)**
Consolidated						
Balance at 1 April 2007	(131.2)	(86.3)	(19.0)	(1.9)	(19.5)	(257.9)
Provided in the year	(61.5)	(85.7)	(13.5)	(0.2)	(4.9)	(165.8)
Provisions not required written back	0.3	5.0	5.1	0.8	0.5	11.7
Provisions utilised in the year	53.0	44.1	2.8	0.1	17.0	117.0
Unwinding of discount	(2.0)	–	–	–	–	(2.0)
Balance at 31 March 2008	**(141.4)**	**(122.9)**	**(24.6)**	**(1.2)**	**(6.9)**	**(297.0)**

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 by establishing a provision for the estimated payments discounted by HM Treasury discount rate of 2.2 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 (2004) established tax-free savings and investment accounts for eligible children born on or after 1 September 2002. The Government makes 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. A provision of £122.9m has been included in the 2007–08 Resource Accounts as at 31 March 2008 for amounts that will become payable in respect of children born up to 31 March 2008 (2006-07: £86.3m). This provision includes £108.7m (2006-07: £69.0m) for supplementary endowments expected to be payable in respect of children in families where the family income is below the income threshold for Child Tax Credit purposes.

21.3 Legal claims

A provision of £24.6m (2006-07: £19.0m) 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 31.

21.4 Accommodation costs

A provision of £1.2m has been made (2006-07: £1.9m) 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 31.

21.5 Other

Provisions relating to various other claims against the Department amount to £6.9m (2006-07: £2.5m). The £17.0m provision in respect of Shipbuilders Relief at the end of 2006-07 has been utilised in 2007–08 and the remaining balance not required written back.

22. General Fund

The General Fund represents the total assets less liabilities of each of the entities within the accounting boundary, to the extent that the total is not represented by other reserves and financing items.

		2007–08 £m		2006-07 £m
	Core Department	Consolidated	Core Department	Consolidated
Balance at 1 April	270.4	289.8	72.6	81.7
Prior period adjustment	–	–	4.6	4.6
Adjusted opening balance	270.4	289.8	77.2	86.3
Net Parliamentary Funding				
Drawn down	15,222.3	15,254.3	15,177.0	15,207.0
Deemed	17.9	16.9	31.2	39.0
Net financing from the Contingencies Fund	–	–	–	–
National Insurance Fund	1.9	1.9	1.9	1.9
Year end adjustment				
Supply creditor – current year	(38.0)	(40.0)	(17.9)	(16.9)
Excess vote – prior year	–	–	–	–
Net transfer from operating activities				
Net operating cost	(15,178.5)	(15,199.8)	(14,983.2)	(15,007.1)
CFERs repayable to Consolidated Fund	(2.4)	(10.8)	(21.2)	(26.5)
Non-cash charges				
Cost of capital	7.5	8.1	3.5	4.2
Auditor's remuneration	1.9	1.9	1.9	1.9
Transfer from revaluation reserve	127.9	127.9	–	–
Balance at 31 March	**430.9**	**450.2**	**270.4**	**289.8**

23. Reserves

Revaluation Reserve

The revaluation reserve reflects the unrealised element of the cumulative balance of indexation and revaluation adjustments (excluding donated assets).

		2007–08 £m		2006-07 £m
	Core Department	Consolidated	Core Department	Consolidated
Balance at 1 April	151.5	154.0	171.8	173.7
Arising on revaluation during the year (net)	36.0	37.5	(20.3)	(19.7)
Transferred to General Fund in respect of realised element of revaluation reserve	(127.9)	(127.9)	–	–
Balance at 31 March	**59.6**	**63.6**	**151.5**	**154.0**

24. Notes to the Consolidated Cash Flow Statement

24(a) Reconciliation of operating cost to operating cash flows

	Note	2007–08 £m	2006-07 £m
Net operating cost	13	15,199.8	15,007.1
Adjustments for non-cash transactions	10, 11	(378.8)	(359.8)
Increase/(Decrease) in Stock and work in progress	17	(3.0)	7.6
Increase/(Decrease) in Debtors	18	33.6	30.6
less movements in debtors relating to items not passing through the OCS		(24.8)	(24.4)
(Increase)/Decrease in Creditors	20	(0.6)	24.8
less movements in creditors relating to items not passing through the OCS		28.1	78.5
Use of provisions	21	117.0	141.9
Net cash outflow from operating activities		**14,971.3**	**14,906.3**

24(b) Analysis of capital expenditure and financial investment

	Note	2007–08 £m	2006-07 £m
Tangible fixed asset additions	14	254.8	305.0
Intangible fixed asset additions	15	1.7	2.6
Proceeds of disposal of fixed assets		(0.7)	(3.8)
Net cash outflow from investing activities		**255.8**	**303.8**

24(c) Analysis of capital expenditure and financial investment by Request for Resources

	Cash expenditure £m	Loans etc. £m	A in A £m	Net total £m
RfR 1: Administration	246.7	–	(0.7)	246.0
RfR 2: Valuation Office Agency	9.8	–	–	9.8
RfR 3: Payments in lieu of tax relief	–	–	–	–
RfR 4: Payments of Local Authority Rates	–	–	–	–
RfR 5: Child Benefit and Child Trust Fund	–	–	–	–
Total 2007–08	**256.5**	**–**	**(0.7)**	**255.8**
Total 2006-07	**307.6**	**–**	**(3.8)**	**303.8**

24(d) Analysis of financing

	Note	2007–08 £m	2006-07 £m
From the Consolidated Fund (Supply) – current year	22	15,254.3	15,207.0
From the Consolidated Fund (Supply) – prior year		–	–
From the National Insurance Fund	22	1.9	1.9
Payments to the National Insurance Fund		–	–
Advances from the Contingencies Fund		–	–
Repayments to the Contingencies Fund		–	–
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts		4.9	3.2
Net financing		**15,261.1**	**15,212.1**

24(e) Reconciliation of Net Cash Requirement to increase/(decrease) in cash

	Note	2007–08 £m	2006-07 £m
Net cash requirement		(15,231.1)	(15,229.2)
From the Consolidated Fund (Supply) – current year	24(d)	15,254.3	15,207.0
From the Consolidated Fund (Supply) – prior year	24(d)	–	–
Amounts due to the Consolidated Fund received in a prior year and paid over		(66.9)	(4.1)
Amounts due to the Consolidated Fund received and not paid over		28.0	62.8
Increase/(Decrease) in cash		**(15.7)**	**36.5**

25. Notes to the Consolidated Statement of Operating Costs by Departmental Aim and Objectives

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

	2007–08	2006-07
	£m	£m
RfR 1: Administration		
Objective 1	218.2	347.6
Objective 2	21.1	11.5
Objective 3	7.5	8.3
RfR 2: Valuation Office Agency	–	–
RfR 3: Payments in lieu of tax relief	83.7	80.5
RfR 4: Payments of Local Authority Rates	29.7	29.2
RfR 5: Child Benefit and Child Trust Fund	10,878.5	10,373.8
Total	**11,238.7**	**10,850.9**

The capital employed by the Department is allocated by analysis of the underlying assets and liabilities attributable to each Request for Resources (RfR). A framework of operational and support activities is used to apportion the objectives within RfR 1.

Capital Employed by Departmental Aim and Objectives at 31 March 2008

	2007–08	2006-07
	£m	£m
RfR 1: Administration		
Objective 1	695.7	638.4
Objective 2	155.1	114.3
Objective 3	55.4	82.1
RfR 2: Valuation Office Agency	23.8	22.6
RfR 3: Payments in lieu of tax relief	–	–
RfR 4: Payments of Local Authority Rates	(0.4)	(0.7)
RfR 5: Child Benefit and Child Trust Fund	(415.8)	(412.9)
Total	**513.8**	**443.8**

This analysis is an apportionment, because in practice many activities undertaken by the Department support more than one of the three objectives within RfR 1.

26. Capital commitments

		2007–08		2006-07
		£m		£m
	Core Department	Consolidated	Core Department	Consolidated
Contracted capital commitments at 31 March 2008 for which no provision has been made	77.2	77.3	31.6	32.8

27. Commitments under leases

27.1 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.

		2007–08		2006-07
		£m		£m
	Core Department	**Consolidated**	**Core Department**	**Consolidated**
Obligations under operating leases comprise:				
Land and buildings:				
Expiry within 1 year	14.8	16.5	15.0	15.2
Expiry after 1 year but not more than 5 years	–	1.9	–	2.8
Expiry thereafter[1]	249.9	267.6	250.0	267.8
	264.7	**286.0**	**265.0**	**285.8**
Other:				
Expiry within 1 year	0.1	0.3	0.8	0.9
Expiry after 1 year but not more than 5 years	20.2	20.3	4.3	4.5
Expiry thereafter	438.6	447.6	480.9	490.9
	458.9	**468.2**	**486.0**	**496.3**

[1] Certain prior year figures have been revised following a review of the basis of calculation.

27.2 Finance leases

The Department has no finance leases.

28. Commitments under PFI contracts

28.1 Off-balance sheet

The following assets are not the property of the Department.

Description of Scheme	Estimated Capital Value[1] £m	Contract Start Date	Contract End Date
Trinity Bridge House, Manchester – Serviced office accommodation	32	September 1998	September 2013
Elgin House, Edinburgh – Serviced office accommodation	10	November 1998	November 2013
Cotton House, Glasgow – Serviced office accommodation	10	December 1998	December 2013
Archer House, Stockport – Serviced office accommodation	6	May 1999	May 2014
Strategic Transfer Estate to Private Sector – Serviced office accommodation	370	April 2001	March 2021
St John's House, Bootle – Serviced office accommodation	12	May 2000	May 2025
Newcastle Estate Development – Serviced office accommodation[2]	164	October 1999	August 2027
Newcastle Estate Development with DWP (NEDFAR) – Serviced office accommodation[2]	54	October 2004	October 2029

28.2 On-balance sheet

The following asset is treated as an asset of the Department under FRS 5. The asset is the provision of serviced accommodation at 100 Parliament Street (see note 14). The substance of the contract is that payments comprise two elements – imputed finance lease charges and service charges. Details of the imputed finance lease charges are in the following table.

		2007–08 £m		2006-07 £m
	Core Department	Consolidated	Core Department	Consolidated
Imputed finance lease obligations under on-balance sheet PFI contracts comprise:				
Rentals due within 1 year	16.2	16.2	15.7	15.7
Rentals due within 2 to 5 years	68.0	68.0	67.1	67.1
Rentals due thereafter	624.7	624.7	657.4	657.4
	708.9	708.9	740.2	740.2
Less interest element	(513.5)	(513.5)	(549.7)	(549.7)
	195.4	**195.4**	**190.5**	**190.5**

28.3 Charge to the Operating Cost Statement and future commitments

The total amount charged in the Operating Cost Statement in respect of off-balance sheet PFI transactions and the service element of on-balance sheet PFI transactions was £291.7m (2006-07: £290.1m)[2]; and the payments to which the Department is committed during 2008-09, analysed by the period during which the commitment expires, are as follows.

		2007–08 £m		2006-07 £m
	Core Department	**Consolidated**	**Core Department**	**Consolidated**
Expiry within 1 year	–	–	–	–
Expiry within 2 to 5 years	–	–	–	–
Expiry within 6 to 10 years	12.7	12.7	11.6	11.6
Expiry within 11 to 15 years	200.0	216.6	203.3	219.9
Expiry within 16 to 20 years	30.4	30.4	2.6	2.6
Expiry within 21 to 25 years[2]	6.8	6.8	32.5	32.5
Expiry within 26 to 30 years	4.1	4.1	–	–
Expiry within 31 to 35 years	–	–	4.0	4.0

[1] The estimated capital value is as at commencement of the schemes.
[2] Certain prior year figures have been revised following a review of the basis of calculation.

29. Other financial commitments

The Department has entered into non-cancellable contracts (which are not leases or PFI contracts) for various services. The payments to which the Department is committed during 2008-09, analysed by the period which the commitment expires are as follows.

		2007–08 £m		2006-07 £m
	Core Department	**Consolidated**	**Core Department**	**Consolidated**
Expiry within 1 year	–	–	2.0	2.0
Expiry within 2 to 5 years	0.5	0.5	30.3	30.3
Expiry thereafter	–	–	–	–
	0.5	**0.5**	**32.3**	**32.3**

30. Financial instruments

The Department has very limited powers to borrow or invest surplus funds and except for 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. 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.

31. Contingent liabilities disclosed under FRS 12

At 31 March 2008 contingent liabilities existed in respect of:

- Shipbuilders Relief – a contingent liability of £95.0m (2006-07: £101.6m) exists for various claims against the Department.
- Legal Claims – a contingent liability of £10.3m (2006-07: £27.8m) exists for costs that may be awarded should various legal cases in which HMRC is involved be determined against the Department. The contingent liability covers all such cases where the outcome is unknown or cannot be estimated reliably.
- Property Dilapidation – the Department has a small number of contingent liabilities relating to lease termination.
- The Department has a further number of contingent liabilities amounting to £5.0m (2006-07: £4.5m).

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

32.1 Quantifiable

The Department has entered into quantifiable contingent liabilities by offering 125 (2006-07: 79) indemnities to the value of £2.0m (2006-07: £2.0m). None of these is a contingent liability within the meaning of FRS 12 since the likelihood of a transfer of economic benefit in settlement is too remote. The Department has not entered into any guarantees or letters of comfort.

32.2 Unquantifiable

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

33. Losses and special payments

33(a) Losses Statement

	2007–08		2006-07	
	cases	**£m**	**cases**	**£m**
Losses are made up of:				
Child Benefit irrecoverable overpayments	*42,213*	11.3	*58,776*	16.8
Law costs remissions	*71,063*	11.1	*71,716*	8.0
Tax penalty remissions	*27,336*	14.0	*28,386*	12.1
Others	*3,447*	0.9	*1,029*	1.2
Total	***144,059***	**37.3**	***159,907***	**38.1**

Details of cases over £250,000

£0.6m – During the period April 1997 to March 2006 overpayments of salary were made amounting to £0.6m (412 cases) in relation to which it has been decided not to invest in recovery on value for money grounds. This amount is not included in the figures shown above as these costs have been reported as expenditure in the previous related financial years

33(b) Special Payments

	2007–08		2006-07	
	cases	**£m**	**cases**	**£m**
Payments and accruals	*20,177*	5.7	*21,517*	7.7
New provisions[1]	*100,003*	4.7	*6*	0.5
Increase in existing provisions		0.5		–
Write back of provisions		(0.5)		(0.6)
Total	***120,180***	**10.4**	***21,523***	**7.6**

Details of cases over £250,000

£0.6m – Ex-gratia payments in respect of delayed payments of Age Related Rebates arising from the late processing of electronically submitted pension forms.

HMRC receives two types of penalty income: Appropriations in Aid (A in A) penalties that can be applied to fund operational activities and Consolidated Fund Extra Receipts (CFER) penalties that the Department must surrender direct to the Exchequer. A in A penalties are recorded within the Operating Cost Statement (OCS) and any related remissions appear within the losses note above. CFER penalties are recorded within note 5 to the accounts. They are not related to operating activities so are not proper to the OCS and the related losses do not appear within the body of this note. The Department wrote-off £162.9m of CFER fines and penalties in 2007–08 (2006-07: £107.9m), the majority as a result of trader/taxpayer insolvency and Missing Trader Intra Community (MTIC) fraud. Debt cleansing exercises and a rise in MTIC fraud cases account for the majority of the increase over 2006-07.

[1] As a result of delays in making payments to certain Child Trust Fund recipients, a provision of £3.0m has been created for compensation payments to an estimated 100,000 families.

34. Related-party transactions

The Department is the parent of the Valuation Office Agency. This body is regarded as a related-party with which the Department 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 Communities and Local Government and the Welsh Assembly Government.

In addition, the Department has had a small number of transactions with other government departments and other central government bodies.

No Board member, key manager or other related parties has undertaken any material transactions with the Department during the year.

35. Third-party assets

35.1 EU Funds

The Department holds Euro deposits in relation to European Commission (EC) Twinning Projects. For such projects it is common for the lead body to hold Euro funds on behalf of the EC. The funds are payable to other European Union (EU) member states as reimbursement for work undertaken in assisting EU candidate states in preparing for membership of the EU. The Department holds these funds as an agent of the EC. Neither the Department nor the Government generally have any beneficial interest in these funds, which are separately held at the Bank of England.

35.2 Seized monies and other assets

The Department manages Sterling and US dollar interest-bearing accounts at the Bank of England containing seized monies. The Department also holds cash and other significant assets retained as physical evidence in connection with ongoing legal proceedings. These are not Departmental assets but are held as part of the Department's law enforcement activities and as such do not form part of these accounts. Once legal proceedings have been completed any seized cash is either forfeited to the Home Office, confiscated by the court or, if the defendant is found not guilty, returned.

Where seized assets are forfeited to HMRC without legal proceedings, proceeds from the sale are paid to the Exchequer as CFER within 'Other amounts collectable on behalf of the Consolidated Fund' (note 5).

These are not Departmental assets and are not included in the accounts. The assets held at the balance sheet date to which it was practical to ascribe monetary values comprised monetary assets such as bank balance and monies on deposit. They are set out in the table immediately below.

		31 March 2007	Gross inflows	Gross outflows	31 March 2008
Monies on deposit at the Bank of England					
Euro deposits	**€**	0.5m	1.2m	1.1m	0.6m
Sterling deposits	**£**	15.6m	15.6m	15.2m	16.0m
US Dollar deposits	**$**	1.0m	–	–	1.0m

Other significant assets held at the balance sheet date to which it was not practical to ascribe monetary value comprised:

	31 March 2007 Number	31 March 2008 Number
Motor vehicles	1,493	1,070
Vessels	4	3

36. Entities within the departmental boundary

The entities within the boundary during 2007–08 were as follows:

- Supply-financed agencies – Valuation Office Agency
- Non-departmental public bodies – None
- Others – None

The Annual Report and Accounts of the Valuation Office Agency are published separately and can be viewed at www.voa.gov.uk.

37. Post balance sheet events

There are no reportable post balance sheet events. The financial statements were authorised for issue by the Principal Accounting Officer on 10 July 2008.

Accounts Direction given by HM Treasury in accordance with Section 5 (2) of the Government Resources and Accounts Act 2000

The accounts direction given by HM 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 110 to 111.

Trust Statement

Contents

Principal Accounting Officer's Foreword to the Trust Statement

Scope

HM Revenue & Customs (HMRC) is a non-Ministerial Government Department. It is responsible for collecting direct and indirect taxes, making payments of tax credits and child benefit, collecting repayments of student loans, enforcing payment of the national minimum wage and enforcing Government requirements relating to the movement of goods across the UK national and the EU common frontier. The Trust Statement reports the revenues and expenditures and assets and liabilities related to the taxes and duties for the financial year 2007–08 and reports the full year's activity of HMRC. The costs of running HMRC, and payments of Child Benefit and Child Trust Fund, are reported in the Departmental Resource Accounts.

The taxes and duties for which HMRC has accounted for in this Trust Statement are:

- Income, Corporation, Capital Gains, Inheritance, Insurance Premium, Stamp and Petroleum Revenue taxes
- Value Added Tax (VAT)
- Excise duties
- Customs duties
- Environmental taxes: climate change levy, aggregates levy and landfill tax
- National Insurance Contributions (NICs)
- Tax Credits and
- Recovery of Student Loan repayments

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 within the Trust Statement.

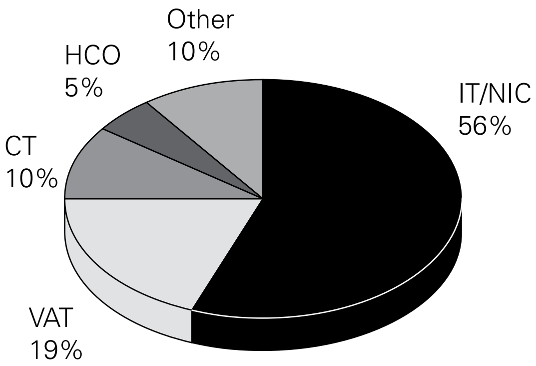
The general direction and priorities for HMRC were set out in the remit letter issued to the Chairman by the Chancellor of the Exchequer on 7 April 2005. HMRC's aim and objectives are stated in the Annual Report to the Resource Accounts, which also provide details of its Management, and includes a Management Commentary.

Financial Review of 2007–08 Trust Statement

1. Total Revenue

The total Revenue accruing to the Department is £457.4 billion, an increase of £20.5 billion (4.7 per cent) on last year. This is mainly due to Income Tax and NICs and to a lesser extent Corporation Tax and Hydrocarbon Oils.

Taxes and duties as a percentage of total revenue



Any differences in percentage calculations are due to roundings

Total revenue accruing to the Department is shown before deduction of bad and doubtful debt. In order to analyse taxes and duty after bad and doubtful debt the Statement of Revenue and Expenditure should be viewed in conjunction with note 8.

	2007–08 £ billion
Total Revenue	457.4
Bad and Doubtful Debt (note 8)	(7.2)
Total Revenue less Bad and Doubtful Debt	**450.2**

2. Comparison by Tax Type

2.1 Income Tax & NICs

Income Tax and NICs accounted for 55.4 per cent of the total revenue. Receipts were £13.0 billion (5.4 per cent) higher than in 2006-07. Accrued receipts reflected a reduction in the estimates of Self Assessment (SA) 'accured revenue receivable' resulting from a change in the basis on which this was estimated; this change was made to bring the estimation methods in line with improved HMRC models for forecasting SA receipts.

Cash receipts rose by £17 billion. Within this total PAYE IT/NIC1 receipts increased by £14.6 billion (7 per cent), primarily due to increases in wages and salaries. Self Assessment (SA) receipts grew by £2.1 billion (11 per cent), mainly due to large increases in the amounts of self employment and dividend income declared for tax.

2.2 VAT

In year VAT receipts are monitored on a cash basis and increased by £4 billion compared to 2006–07. This is partially due to a reduction in the level of Missing Trader Intra Community Fraud (MTIC)*, which along with robust growth in consumer expenditure in 2007–08, increased cash revenues.

The year-end accounts are produced on an accruals basis therefore the reduction in repayments referred to above would not have increased accrued revenue to the same extent, as much of the MTIC loss reduction would have fallen into financial year 2005–06. On an accruals basis VAT accounted for 18.6 per cent of the total revenue. Receipts were £0.6 billion (0.7 per cent) lower than in 2006–07.

**MTIC in its simplest form is a type of VAT fraud, which involves a business obtaining a VAT registration number in the UK for the purposes of purchasing goods free from VAT in another EU member state. The business then sells the goods at a VAT inclusive purchase price in the UK and then goes missing or defaults without paying the output tax due to HMRC.*

2.3 Corporation Tax

Corporation Tax accounted for 10.2 per cent of the total revenue. Receipts were £3.5 billion (8.1per cent) higher than in 2006–07. There were total higher receipts from non-North Sea oil companies due mainly to changes in the economy, particularly an increase in profits, an increase in receipts resulting from new incorporations, and policy measures the largest of which was the reform of the taxation of Real Estate Investment Trusts.

These increases were partially offset by lower receipts from North Sea oil companies (those companies engaged in oil and gas extraction activities in the UK or on the UK continental shelf). The shortfall in North Sea oil receipts was mainly due to lower gas prices and output.

2.4 Hydrocarbon Oils Duties

Hydrocarbon Oils duties accounted for 5.4 per cent of the total revenue, £1.3 billion (5.5 per cent) higher than 2006–07. Average daily clearances of diesel have increased by 5.9 per cent whilst petrol clearances have decreased by 1.8 per cent. By clearances, we mean that amount of fuel released for consumption and at which point the duty becomes payable.

2.5 Stamp Taxes

Stamp Taxes accounted for 3.0 per cent of the total revenue, £0.1 billion (0.7 per cent) lower than in 2006–07.

In year, stamp tax receipts are monitored on a cash basis and increased by £0.7 billion compared to 2006–07. Receipts were higher from both share transactions and land and property, reflecting higher equity and residential property prices and higher volumes of equity and commercial property transactions.

However, year-end accounts are produced on an accruals basis and these decreased by £0.8 billion. This was mainly due to an over estimate used for the 2006–07 accrued revenue receivables figure and also declining receipts in the latter part of the year which lowered the 2007–08 accrued revenue receivable estimate.

2.6 Other Taxes

The remaining taxes accounted for 7.4 per cent of the total revenue and increased by £3.4 billion (11.2 per cent) on 2006–07.

3. Movement in Accrual Adjustments

3.1 Debtors and Accrued Revenue Receivable (Note 6)

The total of debtors and accrued revenue receivable before provision for doubtful debt increased by £0.4 billion (0.4 per cent) between 31 March 2007 and 31 March 2008.

3.2 Debtor & Debtor Days:

	2007–08 £ billion	2006–07 £ billion
Total Revenue	457.4	436.9
Debtors	25.0	24.6
Debtor Days	**19.9 days**	**20.5 days**

Note: Debtor Days = Debtors/Total Revenue x 365 days

Debtors increased before provision for doubtful debt by £0.4 billion (1.6 per cent).

Due to the structure of tax collection it is not possible to directly benchmark debtor days with the private sector. However, it still remains a good year-on-year comparator.

3.3 Provision for Doubtful Debt (Note 8.4)

	2007–08 £ billion	2006–07 £ billion
Debtors	25.0	24.6
Provision	7.9	6.5
Provision as a percentage of Debtors	**31.6 per cent**	**26.4 per cent**

Provision for doubtful debt increased by £1.4 billion (22 per cent). This increase was almost entirely due to a change in the way the provision for direct taxes is calculated. During the year HMRC has worked to improve the quality and accuracy of Debt Collection Management Information, thus resulting in a more accurate provision calculation. Using the revised approach, the 2006–07 provision would have been approximately £8.2 billion and 33 per cent as a percentage of debtors. The reduction from £8.2 billion to £7.9 billion was caused mainly by a decrease in the amount of Missing Trader Intra Community Fraud (MTIC) debt. The provision for doubtful debt as a percentage of Debtors increased by 5.2 per cent.

3.4 Creditors, Accrued Revenue liabilities & Deferred Revenue (Note 7)

The total of creditors, accrued revenue liabilities and deferred revenue increased by £1.1 billion (2.7 per cent).

3.5 Revenue Losses (Note 8.2)

Revenue losses increased by £1.0 billion (20.8 per cent) from £4.8 billion in 2006–07 to £5.8 billion in 2007–08. VAT represented the largest increase of £598 million mainly due to proactive insolvency action related to fraudulent companies. Alcohol duties increased by £196 million due to a clearance of aged debts related to fraud. Other large increases across a number of taxes are due to changes in departmental insolvency procedures. These increases were partly off-set by a reduction in Tax Credit losses following the inclusion of a large loss in the 2006–07 accounts.

4. Comparison of Growth over the last 4 years

	2007–08 £ billion	2006–07 £ billion	2005–06 £ billion	2004–05 £ billion
Total revenue	457.4	436.9	405.2	379.2
Increase to prior year	20.5	31.7	26.0	–
Increase to prior year (per cent)	4.7 per cent	7.8 per cent	6.9 per cent	–
Money GDP growth (per cent)	6.1 per cent	6.1 per cent	4.5 per cent	–

Slower growth in 2007–08 is mainly due to a slow-down in the growth of VAT revenue (see section 2.2 'VAT') and changes to the methodology used to estimate self assessment income tax revenue accruing (see section 2.1 Income Tax & NICs).

In 2005–06 and 2006–07 revenues increased faster than money GDP resulting in HMRC tax receipts increasing as a percentage of GDP from 31.7 per cent in 2004–05 to 33.0 per cent in 2006–07. The slower growth of revenues in 2007–08 (as above) and continued strong money GDP growth saw revenues as a percentage of GDP decline to 32.5 per cent.

5. Tax Credits

Tax Credits payments when compared to last year were £1.6 billion (9.0 per cent) higher of which £0.9 billion was due to higher entitlements for in work families, £0.5 billion due to higher entitlements for out of work families, and £0.2 billion the result of lower net overpayments.

Basis for the Preparation of the Trust Statement

The HM Treasury accounts direction, issued under Section 2 of the Exchequer and Audit Departments Act 1921, requires HMRC to prepare the Trust Statement to give a true and fair view of the state of affairs relating to the collection and allocations of taxes and duties and the revenue income and expenditure and cash flows for the financial year. Regard shall be given to all relevant accounting and disclosure requirements given in *Managing Public Money* and other guidance issued by HM Treasury and the principles underlying UK Generally Accepted Accounting Practice (UK GAAP).

HMRC has worked closely with HM Treasury to ensure that the accounting policies that underpin these accounts are comprehensive, appropriate, and supported to a sufficient level of detail by reports from Departmental business systems.

Owing to the diverse nature of the taxes and duties administered by HMRC, a variety of methods are used to produce the relevant accruals information.

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. The underlying approach to accruals measurement is that revenues from taxation 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.

In respect of the direct taxes, 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. 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 Trust Statement has been published.

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 £4 billion, which does not significantly affect the reported position. This figure is equivalent to less than 1 per cent of total revenue reported in the Statement of Revenue and Expenditure.

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

The accuracy of the estimates included in the 2006–07 Trust Statement has been reviewed as more recent data has become available, and I can confirm that they were within the levels of overall uncertainty quoted there.

Accrued revenue receivable is separately estimated for each revenue stream and 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 2008 Financial Statement and Budget Report. The most important assumption in this context is that profits from self-employment are assumed to rise by 6.3 per cent in 2007–08.

Accrued revenue receivable and accrued revenue liabilities are estimated for VAT, as the amounts involved are material. Estimation techniques are not required for other indirect taxes and duties where actual data is available.

No tax collection system can ensure that all those who have a tax liability comply with their obligations. Whilst the Department is concerned with compliance, the Trust Statement does not include estimates of taxes foregone as a result of avoidance and non-compliance with taxpayers' obligations.

Auditors

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 HMRC's Resource Accounts.

No non-audit work was carried out by the auditors for HMRC.

Dave Hartnett
Principal Accounting Officer
2 July 2008

Statement of the Principal Accounting Officer's Responsibilities in Respect of the Trust Statement

HM Treasury has appointed the Permanent Head of Department as Principal Accounting Officer of HMRC with overall responsibility for preparing the Trust Statement and for transmitting it to the Comptroller and Auditor General.

The Principal Accounting Officer for HMRC is responsible for ensuring that there is a high standard of financial management, 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 that 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 HMRC for the financial year 2007–08. In conforming with HM Treasury direction (see page 110 of this Trust Statement), the Trust Statement reports the revenue collected and expenditure in respect of taxes, duties, National Insurance Contributions, tax credits and Student Loan recoveries administered by HMRC during the year, together with the net amounts surrendered to the Consolidated Fund.

The Trust Statement is prepared on an accruals basis, except for Corporation Tax for small companies, Stamp Duty and National Insurance Classes 1A, 1B and 3, which are accounted for on a cash basis. The Trust Statement must give a true and fair view of the state of affairs of HMRC, including a Statement of Revenue and Expenditure, a Balance Sheet, and a Cash Flow Statement.

The Trust Statement includes a Statement on Internal Control (SIC), which sets out the governance, risk and control arrangements for HMRC. The SIC process is firmly and clearly linked to the risk management process in HMRC.

In preparing the Trust Statement, 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 on a reasonable basis;
- state whether applicable accounting standards have been followed and disclose and explain any material departures in the account.

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 *Managing Public Money*.

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 10.

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

I certify that I have audited HM Revenue & Customs' (the Department's) Trust Statement for the year ended 31 March 2008 under the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000. The Trust Statement comprises the Statement of Revenue and Expenditure, the Balance Sheet, the Cash Flow Statement and the related notes. The Trust Statement has been prepared under the accounting policies set out within the notes to the Statement.

Respective responsibilities of the Principal Accounting Officer and auditor

The Principal Accounting Officer is responsible for preparing the Trust Statement in accordance with Section 2(3) of the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000 and HM Treasury directions made thereunder, and for ensuring the regularity of financial transactions. These responsibilities are set out in the Statement of Principal Accounting Officer's Responsibilities.

My responsibility is to audit the Trust Statement in accordance with relevant legal and regulatory requirements, including Section 2 of the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000, and with International Standards on Auditing (UK and Ireland).

I report to you my opinion as to whether the Trust Statement gives a true and fair view and has been properly prepared in accordance with HM Treasury directions issued under the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000. I also report whether in all material respects the revenue and expenditure have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

In addition, I also report to you 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 review whether the Statement on Internal Control, on pages 1 to 10, reflects the Department's compliance with HM Treasury's guidance, and I report if it does not. In forming an audit opinion on the Trust Statement, I am not required to consider whether the Principal Accounting Officer's Statement on Internal Control covers all risks and controls, or to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

I read the other information contained in the Principal Accounting Officer's Foreword to the Trust Statement and consider whether it is consistent with the audited financial statements. I consider the implications for my opinion if I become aware of any apparent misstatements or material inconsistencies with the Trust Statement. My responsibilities do not extend to any other information.

Basis of audit opinions

I conducted my audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. My audit includes examination, on a test basis, of evidence relevant to the amounts, disclosures and regularity of financial transactions included in the Trust Statement. It also includes an assessment of the significant estimates and judgements made by the Principal Accounting Officer in the preparation of the Trust Statement, and of whether the accounting policies are most 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 Trust Statement is free from material misstatement, whether caused by fraud or error, and that in all material respects the revenue and expenditure 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 also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinions

In my opinion:

- the HM Revenue & Customs Trust Statement gives a true and fair view of the state of affairs as at 31 March 2008 relating to the collection and allocation of taxes, duties, national insurance contributions, tax credits and student loan recoveries and related expenditures administered by the Department, and the revenue income and expenditure and cash flows for the year then ended;

- the Trust Statement has been properly prepared in accordance with HM Treasury directions issued under the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000.

Emphasis of Matter: significant uncertainty in the estimates of accrued revenue receivable and accrued revenue liabilities

In forming my opinion on the truth and fairness of the Trust Statement, which is not qualified, I have considered the adequacy of the disclosures made in Notes 6 and 7 on the estimates of accrued tax revenue receivable of £80.6 billion and accrued revenue liabilities of £22.2 billion at 31 March 2008. As described in Note 6.1.4, the Department considers that the combined accrued revenue receivable and accrued revenue liabilities at 31 March 2008 are subject to maximum likely uncertainty of £4 billion in either direction, equivalent to less than one per cent of total revenue reported in the Statement of Revenue and Expenditure. The significant uncertainty is adequately disclosed in the Trust Statement.

Qualified opinion on regularity: tax credits error and fraud

The Trust Statement records £19.5 billion of tax credits in 2007-08. As shown in Note 3.3 to the Trust Statement, the Department's latest estimate is that in 2006-07 error and fraud resulted in overpayments of between 7.2 per cent to 8.4 per cent of the final award by value to claimants to which they were not entitled. This expenditure had not therefore been applied to the purposes intended by Parliament.

Note 3.3 also shows that the Department estimates that error led to underpayments of between 1.3 per cent to 2.1 per cent of the final award by value in 2006-07. Tax credit transactions resulting in under and overpayments because of error and fraud are not in conformity with the Tax Credit Act 2002 and the regulations made thereunder.

The Department currently has no estimate of the total level of error and fraud in the tax credit awards made in 2007-08 and therefore no evidence to demonstrate a lower estimate for overpayments attributable to error and fraud in 2007-08. I have therefore qualified my opinion on the regularity of tax credits in the Department's Trust Statement for 2007-08.

In my opinion, except for the probable level of error and fraud in tax credits, in all material respects the revenue and expenditure have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

Report

Please see my Report at pages 89 to 92 on these matters.

TJ Burr
Comptroller and Auditor General
10 July 2008

National Audit Office
151 Buckingham Palace Road
Victoria
London SW1W 9SS

HM Revenue & Customs 2007-08 Trust Statement

Report by the Comptroller and Auditor General

Introduction

1. The HM Revenue & Customs' (the Department's) Trust Statement records the total taxes and duties collected and receivable as a result of earning taxable income, profits or gains from other taxable transactions. It also records certain disbursements and expenditure, notably the national insurance contributions collected by the Department on behalf of the National Insurance Funds and National Health Services, and expenditure on tax credits.

2. In 2007-08, some £358.6 billion (2006-07: £344.9 billion) was collectable by the Department in tax revenues, against total expenditure of £23.3 billion (2006-07: £21.9 billion). Other revenue of £98.8 billion (2006-07: £92.0 billion), principally £98.2 billion of national insurance contributions was also collectable. Disbursements totalling £98.2 billion primarily comprised £97.6 billion of national insurance contributions payable to the National Insurance Funds and the National Health Services.

3. As recorded in Note 3.1 to the Trust Statement, the Department incurred £19.5 billion (2006-07: £17.9 billion) of expenditure on tax credits awards in 2007-08. In accordance with Organisation for Economic Co-operation and Development's classification rules, tax credit expenditure is presented in the Trust Statement as negative taxation to the extent that the tax credits are less than or equal to the recipient family's income tax liability and as payments of entitlement where tax credits exceed the recipient family's income tax liability. In 2007-08 tax credit expenditure comprised £4.2 billion classified as negative taxation and £15.3 billion classified as payments of entitlement.

Audit opinion on the truth and fairness of the Trust Statement

4. I am required, under International Standards on Auditing, to obtain sufficient appropriate evidence to satisfy myself that the Department's Trust Statement gives a true and fair view and has been properly prepared in accordance with Treasury Directions issued under the Exchequer and Audit Departments Act 1921 as amended by the Government Resources and Accounts Act 2000. In forming my opinion, I examine, on a test basis, evidence supporting the amounts, disclosures and regularity of financial transactions included in the financial statements and assess the significant estimates and judgements made in preparing them.

Qualified opinion on regularity: tax credit error and fraud

My responsibilities with regard to regularity

5. I am required, under the Exchequer and Audit Departments Act 1921, as amended by the Government Resources and Accounts Act 2000, to form an opinion on 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.

The legal framework

6. The Tax Credits Act 2002 and statutory instruments made thereunder form the regulatory framework for tax credits. This framework prescribes the entitlement of individuals to claim Child Tax Credit and Working Tax Credit and the determination of the awards in accordance with the individual's circumstances. Tax credit payments may be made in error where claimants incorrectly or fraudulently disclose their circumstances in their application.

Error and fraud

7. As stated in Note 3.3, the Department establishes its overall measure of the level of error and fraud by investigating a random sample of tax credit awards. Regulations and procedure established under Section 19 of the Tax Credits Act 2002 only allow the Department to begin its enquiries into randomly selected awards after the awards have been finalised; that is, after claimants have confirmed their income and circumstances for the year of the award. The Department's most recent estimate of the total level of error and fraud in tax credits awards relates to 2006-07. Awards for 2007-08 are due to be finalised by the end of July 2008, and some claimants such as those taxpayers included within Self Assessment, may not finalise their awards for 2007-08 until January 2009. The Department will not therefore be able to start its investigation on some finalised awards for 2007-08 until February 2009.

8. The Department's latest estimate, based on the examination of a random sample of some 4,000 awards from 2006-07, is that error and fraud resulted in claimants receiving between £1.31 billion and £1.54 billion (7.2 per cent to 8.4 per cent of the final award by value) to which they were not entitled. Expenditure arising from these overpayments has not been applied to the purposes intended by Parliament, and is material in relation to the £19.5 billion expenditure on tax credits. Whilst the Department has made changes to its compliance procedures since 2006-07, there is currently no evidence to demonstrate a lower estimate of error and fraud in the tax credit awards for 2007-08.

9. Overpayments are moreover inconsistent with the Tax Credits Act 2002 and the regulations made thereunder. Based on its examination of 2006-07 awards, the Department also estimates that error led to underpayments of between £0.24 billion and £0.39 billion (1.3 per cent to 2.1 per cent of the final award by value), where claimants have not been paid their full entitlement. To a material extent, these payments too do not fully accord with the requirements of the Tax Credits Act 2002. Accordingly I have concluded that both the over and underpayments constitute material transactions not in conformity with the authorities that govern them.

Emphasis of matter: Significant uncertainty in the estimates of accrued revenue receivable and accrued revenue liabilities

10. As stated in Note 6.1 to the Trust Statement, the Department has provided estimates to support the accrued revenue receivable balances and accrued revenue liability balances where tax returns reporting taxpayer liabilities are not filed until after the Trust Statement has been published.

11. The Trust Statement records accrued tax revenue receivable of £80.6 billion at 31 March 2008, as shown in Note 6. This figure 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. It comprises separate estimates of accrued revenue receivable balances for income tax collected under PAYE, self assessment, company income tax and tax deducted from savings income, corporation tax, value added tax, petroleum revenue tax, stamp duty land tax and stamp duty reserve tax, and national insurance contributions. The Department estimates these figures using statistical models for each component tax stream.

12. The Trust Statement also records some £22.2 billion in respect of accrued revenue liabilities at 31 March 2008, as shown in Note 7. This includes value added tax liabilities and amounts due to National Insurance Funds and National Health Services in respect of national insurance contributions. The Department also estimates these figures using statistical models.

13. Note 6 to the Trust Statement describes the estimation techniques and details of the underlying assumptions used by the Department in arriving at the estimate of accrued revenue receivable for corporation tax, self assessment income tax and Class 4 national insurance contributions, and value added tax. Similar descriptions have not been provided for those tax streams where the estimated monetary amounts are either relatively small or not deemed to be particularly sensitive to changes in the underlying assumptions.

14. As described in Note 6.1.4, the Department considers, because of the areas of uncertainty involved, there will inevitably be differences between the 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 the models. The Department believes that the levels of variation are acceptable with a maximum likely overall uncertainty expected to be some £4 billion. This figure is equivalent to less than one per cent of total Revenue reported in the Statement of Revenue and Expenditure.

15. My audit of the estimates for accrued revenue receivable and accrued revenue liabilities involved: gaining an understanding of each of the models used to support the estimates; assessing the appropriateness and validity of the inputs used for each model; testing the calculations involved in the estimate, including the calculation of the overall uncertainty of the estimates; reviewing subsequent events to confirm the reasonableness of the estimates; and assessing management's review and approval procedures. In forming my opinion, I have considered the adequacy of the disclosures made in Notes 6 and 7 to the Trust Statement of the estimates of accrued tax revenue receivable and accrued revenue liabilities at 31 March 2008.

16. I am satisfied that the significant uncertainty in the estimates of accrued revenue receivable and accrued revenue liabilities is adequately disclosed in the Trust Statement and my opinion is not qualified in respect of this matter.

Conclusion

17. Except for the tax credit payments affected by error and fraud, I am satisfied that, in all material respects, the revenue and expenditure recorded in the Trust Statement has been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I am also satisfied that the Trust Statement gives a true and fair view of the Department's affairs as at 31 March 2008 in respect of the collection and allocation of taxes, duties, national insurance contributions, tax credits and student loan recoveries and related expenditures administered by the Department, and the revenue income and expenditure and cash flows for the year then ended.

T J Burr
Comptroller and Auditor General
10 July 2008

National Audit Office
151 Buckingham Palace Road
Victoria
London SW1W 9SS

Statement of Revenue and Expenditure for the year ended 31 March 2008

	Notes	2007–08 £ billion	2006-07 £ billion
Taxes and Duties			
Income Tax		155.1	148.8
Value Added Tax	2.1	84.9	85.5
Corporation Tax	2.2	46.8	43.3
Hydrocarbon Oils Duties		24.9	23.6
Stamp Taxes	2.3	13.7	13.8
Alcohol Duties		8.3	8.0
Tobacco Duties		8.0	7.6
Other Taxes and Duties	2.4	21.1	18.7
Tax Credits treated as Negative Taxation	3.1	(4.2)	(4.4)
Total Taxes and Duties		**358.6**	344.9
Other Revenue			
National Insurance Contributions	4.1	98.2	91.5
Student Loan Recoveries	4.3	0.6	0.5
Total Other Revenue		**98.8**	92.0
Total Revenue		**457.4**	436.9
Less Expenditure			
Tax Credits treated as Payments of Entitlement	3.1	(15.3)	(13.5)
Bad and Doubtful Debts	8.1	(7.2)	(6.2)
Provision for Liabilities	9	(0.8)	(2.2)
Total Expenditure		**(23.3)**	(21.9)
Less Disbursements			
National Insurance Contributions due to the National Insurance Funds and National Health Services	4.1	(97.6)	(91.1)
Student Loan Recoveries due to the Department for Innovation, Universities and Skills	4.3	(0.6)	(0.5)
Taxation Revenue due to the Isle of Man	5	–	(0.2)
Total Disbursements		**(98.2)**	(91.8)
Total Expenditure and Disbursements		**(121.5)**	(113.7)
Net Revenue for the Consolidated Fund		**335.9**	323.2

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

The notes at pages 95 to 109 form part of this Statement.

Balance Sheet as at 31 March 2008

	Notes	31 March 2008 £ billion	31 March 2007 £ billion
Debtors falling due after more than one year	6	**2.8**	2.8
Current Assets			
Debtors	6	14.3	15.3
Accrued Revenue Receivable	6	80.6	80.6
Cash at Bank and in Hand		0.8	
		95.7	95.9
Current Liabilities			
Creditors	7	19.0	15.1
Accrued Revenue Liabilities	7	22.2	25.0
Deferred Revenue	7	0.6	0.6
Other Payables		1.0	0.5
		42.8	41.2
Net Current Assets		**52.9**	54.7
Total Assets less Current Liabilities		**55.7**	57.5
Provision for Liabilities	9	**2.2**	2.2
Total Net Assets		**53.5**	55.3
Represented by:			
Balance on Consolidated Fund Account	10	**53.5**	55.3

The notes at pages 95 to 109 form part of this Statement.

Dave Hartnett
Principal Accounting Officer
2 July 2008

Cash Flow Statement for the year ended 31 March 2008

	Notes	2007–08 £ billion	2006–07 £ billion
Net Cash Flow from Revenue Activities	A	338.0	320.9
Cash paid to Consolidated Fund		(337.7)	(321.4)
Increase/(Decrease) in Cash in this period	B	**0.3**	(0.5)

Notes to the Cash Flow Statement

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

	2007–08 £ billion	2006–07 £ billion
Net revenue for the Consolidated Fund	335.9	323.2
Increase in Non-cash Assets	1.0	(6.0)
Increase in Liabilities	1.1	1.5
Increase in Provision for Liabilities	–	2.2
Net Cash Flow from Revenue Activities	**338.0**	320.9

B: Analysis Of Changes in Net Funds

	2007–08 £ billion	2006–07 £ billion
Increase/(Decrease) in Cash in this period	0.3	(0.5)
Net Funds as at 1 April (Opening Cash at Bank)	(0.5)	–
Net Funds as at 31 March (Closing Cash at Bank)	**(0.2)**	(0.5)

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 issued by HM Treasury under the Exchequer and Audit Departments Act 1921. The Trust Statement is prepared in accordance with the accounting policies detailed below. These have been developed by HM Revenue & Customs (HMRC) in consultation with HM Treasury, and with reference to UK GAAP and other relevant guidance. The accounting policies have been applied consistently in dealing with items considered material in relation to the accounts.

The financial information presented in the primary statements is rounded to the nearest £0.1 billion. The financial information presented in the notes to the financial statements is rounded to the nearest £0.1 billion except for Certificates of Tax Deposit, Student Loan Recoveries, tax revenue due to the Isle of Man and revenue losses which are rounded to the nearest £ million, and provision for liabilities which is rounded to the nearest £10 million.

1.2 Accounting Convention

The Trust Statement has been prepared in accordance with the historical cost convention. Taxes and duties are accounted for on an accruals basis, except for Corporation Tax for small companies, Stamp Duty and National Insurance Classes 1A, 1B and 3, which are accounted for on a cash basis.

1.3 Revenue Recognition

Taxes and Duties Recognised on an Accruals Basis

Taxes and duties are measured at the fair value of the consideration received or receivable net of repayments. Revenue is recognised when: a taxable event has occurred, the revenue can be measured reliably and it is probable that the economic benefits from the taxable event will flow to HMRC. Note 6 provides an explanation of Accrued Revenue Receivable.

Taxable events for the material tax streams are as follows:

- Income Tax – earning of assessable income during the taxation period by the taxpayer
- Value Added Tax – undertaking of taxable activity during the taxation period by the taxpayer
- Corporation Tax – earning of assessable profit during the taxation period by the taxpayer
- Excise duties – movement of goods out of a duty suspended warehouse
- Hydrocarbon Oils Duty – production of taxable goods
- Stamp Taxes – purchase of property or shares
- Inheritance Tax – the date of agreement of assessment, after death or other chargeable transfer of value
- Capital Gains Tax – disposal of a chargeable asset leading to a taxable gain

Revenues are deemed to accrue evenly over the period for which they are due. No revenue is recognised if there are significant uncertainties regarding recovery of the taxes and duties due.

Repayments of indirect taxes, for example VAT and Hydrocarbon Oils, are accounted for on an accruals basis.

Taxes Recognised on a Cash Basis

Taxes are recognised in the accounting period in which the tax receipt is received and are measured at the cash amount received.

Repayments of direct taxes, such as Income Tax and Corporation Tax, are recognised in the year the repayment is made.

Tax Credits

Tax credits are recognised in the year in which they are assessed and authorised by HMRC. Authorisation is the point at which the obligation to pay the tax credit arises.

Tax credits are presented as Negative Taxation to the extent that the tax credits are less than or equal to the recipient family's income tax liability and as Payments of Entitlement where tax credits exceed the recipient family's income tax liability. This is consistent with the Organisation for Economic Co-operation and Development's classification rules and international 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. Under-payments are accounted for on a cash basis in the year of payment. Over-payments are recovered from future tax credit awards or through repayments by claimants.

National Insurance Contributions

National Insurance Contributions are collected by HMRC on behalf of the National Insurance Funds of Great Britain and Northern Ireland, and the Health Services for England, Wales, Scotland and Northern Ireland. They are payable to the Funds and the Health Services when received. Payments are based on estimates of NIC receipts received by HMRC. Differences between estimated receipts paid over and actual receipts are corrected in the following month and at the balance sheet date are recognised as a creditor or debtor as appropriate. Amounts due from taxpayers to HMRC but not received at the balance sheet date are included as accrued revenue liability in respect of the Funds and Health Services.

Student Loan Recoveries

HMRC collects Student Loans that are recovered through the taxes system on behalf of the Department for Innovation, Universities and Skills (DIUS). Student Loan recoveries are accounted for on a cash basis. Amounts due at the year end are estimated on the basis of the end of year employer returns. Differences between estimated and actual recoveries are adjusted and accounted for in the following year.

1.4 Debtors

Debtors are shown net of a provision for doubtful debts.

1.5 Provisions and Contingent Liabilities

Provisions for legal claims are recognised when HMRC has a present legal or constructive obligation as a result of a past event, it is probable that HMRC will be required to settle that obligation and an amount has been reliably estimated.

Amounts are disclosed as contingent liabilities where it is probable that HMRC will be required to settle the obligation and is unable to reliably estimate the amount, or where it is possible that HMRC will be required to settle the obligation.

2 Taxes and Duties Due

2.1 Value Added Tax

	2007–08	2006-07
	£ billion	**£ billion**
Gross VAT receipts	146.5	144.5
Less: Repayments	(61.6)	(59.0)
Net VAT receipts	**84.9**	85.5

VAT is structured in such a manner that companies are also entitled to claim repayments; hence a breakdown of gross receipts and repayments is disclosed.

2.2 Corporation Tax

The Corporation Tax revenue of £46.8 billion (2006-07: £43.3 billion) is net of Land Remediation Relief, and Research and Development Tax Credits and Film Tax Relief. The estimated figures for the payable elements of these credits are £1 million (2006-07: £10 million) for Land Remediation Relief and £147 million (2006-07: £170 million) for Research and Development and £117.2 million for Film Tax Relief (2006-07: £0.2 million).

2.3 Stamp Taxes

	2007–08	2006-07
	£ billion	**£ billion**
Stamp Duty Land Tax	9.5	10.0
Stamp Duty Reserve Tax	3.6	3.2
Stamp Duty	0.6	0.6
	13.7	13.8

2.4 Other Taxes and Duties

		2007–08	2006–07
	Note	**£ billion**	**£ billion**
Capital Gains Tax		5.5	3.9
Inheritance Tax		3.9	3.7
Insurance Premium Tax		2.3	2.4
Customs Duties		2.1	1.9
Air Passenger Duty		1.9	1.1
Petroleum Revenue Tax		1.6	2.1
Betting And Gaming Duties		1.5	1.4
Landfill Tax	2.5	0.9	0.8
Climate Change Levy		0.7	0.7
Agricultural Duties		0.4	0.4
Aggregates Levy		0.3	0.3
Total Revenue Due		**21.1**	18.7

2.5 Landfill Tax

The Landfill Tax revenue of £878 million (2006–07: £828 million) is net of £59.8 million (2006–07: £52.5 million) for contributions made to environmental bodies by landfill operators, under the Landfill Tax Credit Scheme.

3 Tax Credits

3.1 Analysis of Tax Credit Expenditure:

	Child Tax Credits 2007–08	Working Tax Credits 2007–08	Total Tax Credits 2007–08	Child Tax Credits 2006–07	Working Tax Credits 2006–07	Total Tax Credits 2006–07
	£ billion	**£ billion**	**£ billion**	**£ billion**	**£ billion**	**£ billion**
Tax Credits treated as Negative Taxation	3.0	1.2	4.2	2.8	1.6	4.4
Tax Credits treated as Payments of Entitlement	10.7	4.6	15.3	8.9	4.6	13.5
Total Tax Credits	**13.7**	**5.8**	**19.5**	11.7	6.2	17.9

The division of amounts between Child and Working Tax Credits is based on estimates. Note 1.3 provides an explanation of Negative Tax and Payments of Entitlement.

3.2 Tax Credit Debtors

	Note	2007–08	2006-07
		£ billion	**£ billion**
Debtors as at 1 April	6	3.9	3.6
Finalisation Overpayments		0.7	0.8
Overpayments identified from change of circumstances in year		0.7	0.6
Organised fraud		-	0.1
Recoveries made		(0.8)	(0.8)
Remissions/Write-offs	8.2	(0.2)	(0.4)
Debtors as at 31 March	6	**4.3**	3.9
Provision for doubtful debts		(1.8)	(1.6)
Net		**2.5**	2.3

During 2007–08 further overpayments relating to: tax credits paid in 2003-04, 2004-05 and 2005-06, totalling £280 million; and tax credits paid in 2006-07 totalling £433 million, were identified as a result of the finalisation exercise undertaken in 2007–08. These have been accounted for in 2007–08.

In accordance with the accounting policy for tax credits (Note 1.3), amounts under or over paid in 2007–08 and identified during the finalisation exercise being undertaken in 2008-09 are not included in the above figures. It is estimated that the values of under and over payments arising from the 2007–08 finalisation exercise will be in the same order as those from the 2006-07 exercise.

Remissions and write-offs in 2007–08 include £20 million written off in respect of organised fraud identified during the year

3.3 Tax Credits Error and Fraud

HMRC measures the overall level of error and fraud by investigating a random sample of finalised awards, although the design of the tax credits scheme affects the speed with which it can complete this work. Some claimants, such as those taxpayers included with Self Assessment, may not finalise their awards for the preceding year until 31 January.

In June 2008, HMRC completed its testing of 2005-06 awards, based on a sample of some 4,250 random enquiries. As a result of this, HMRC estimates that error and fraud resulted in £1.36 billion to £1.69 billion (8.5 to 10.6 per cent by value) being paid to claimants to which they were not entitled. It also estimates that error resulted in £0.23 billion to £0.39 billion (1.4 to 2.4 per cent by value) not being paid to claimants to which they were entitled.

HMRC also completed its testing of 2006-07 awards in June 2008, based on a sample of some 4,027 random enquiries. As a result of this, HMRC estimates that error and fraud resulted in £1.31 billion to £1.54 billion (7.2 to 8.4 per cent by value) being paid to claimants to which they were not entitled. It also estimates that error resulted in £0.24 billion to £0.39 billion (1.3 to 2.1 per cent by value) not being paid to claimants to which they were entitled.

3.4 The Cost of Managing and Paying Tax Credits

As required by Section 2(5) of the Tax Credits Act 2002, the total cost of managing and paying tax credits was £581 million (2006-07: £587 million) and is accounted for in the Resource Accounts. This total cost was apportioned between Working Tax Credits (£173 million) and Child Tax Credits (£408 million).

4 Other Revenue

4.1 National Insurance Contributions

	Note	**Net Revenue 2007–08 £ billion**	**Net Revenue 2006-07 £ billion**
Revenue		98.2	91.5
Remissions and Write-offs	8.2	(0.6)	(0.4)
Net Revenue due to the National Insurance Funds and National Health Services for the year		**97.6**	91.1

	Net Revenue 2007–08 £ billion	**Cash Paid to NIFs/ NHS 2007–08 £ billion**
National Insurance Fund – Great Britain	(75.6)	76.6
National Insurance Fund – Northern Ireland	(1.6)	1.7
National Health Services (NHS)	(20.4)	20.5
Totals	**(97.6)**	**98.8**

Balances owing to/(due from) the National Insurance Funds (NIF) and NHS as at 31 March 2008 were:

- NIF Great Britain: £1.8 billion (opening balance at 1 April 2007: (£0.2 billion))
- NIF Northern Ireland: (£0.2 billion) (opening balance at 1 April 2007: (£0.2 billion))
- NHS: £0.8 billion (no opening balance at 1 April 2007)

The combined balance of £2.4 billion is included within creditors (Note 7).

National Insurance Contributions are paid over to the National Insurance Funds and National Health Services when received and not when accrued. The balances owing to/(due from) the National Insurance Funds (NIF) and the NHS represent the difference between cash receipts and cash transferred to the NIF and NHS.

About three quarters of Pay-As-You-Earn (PAYE) payments by value are made as combined payments of income tax and Class 1 National Insurance Contributions without any notification at the time of the breakdown between the two. In previous years these payments have been allocated between income tax and National Insurance based on an algorithm within the Department's PAYE accounting system, which required a re-allocation between income tax and National Insurance in the following year when the actual split was available from employers' end of year returns.

In recent years this algorithm has been less effective in predicting the actual split in revenues and the corrective re-allocations have been significant.

In 2007-08 the allocation between income tax and National Insurance has been made by means of an apportionment reflecting the best estimate of the respective amounts of income tax and National Insurance expected to be reported in end of year employer returns. Following this change in approach National Insurance Contributions net revenue for 2007-08 includes £2.9 billion which previously would have been included in income tax and adjusted through the re-allocation process in the following year.

Cash payments to the National Insurance Funds during the course of 2007-08 were still based on the algorithm. The process for paying revenues over to the Funds will be brought into line with the new allocation method during 2008-09.

4.2 Certificates of Tax Deposit

Under the Certificate of Tax Deposits (CTD) scheme, HMRC accepts deposits from people liable to UK taxes and other liabilities that are listed in the current Prospectus (details can be found at www.hmrc.gov.uk). HMRC administers this scheme on behalf of HM Treasury, and the accounts of the National Loans Fund include the principal and accrued interest for all issued CTDs as at 31 March.

Delays in processing between the issue and redemption of CTDs and the transfer of funds to and from the National Loans Fund can result in balances at the year end; these balances are included within debtors or creditors on the Trust Statement Balance Sheet.

	CTD Issues 2007–08	**CTD Redemptions 2007–08**	**CTD Total 2007–08**	**CTD Total 2006-07**
	£ million	**£ million**	**£ million**	**£ million**
Receipts	181	88	269	157
Payments	(164)	(100)	(264)	(161)
			5	(4)
Balance at 1 April			(3)	1
Balance at 31 March – Included in creditors/(debtors)			**2**	(3)

4.3 Student Loan Recoveries

	2007–08	**2006–07**
	£ million	**£ million**
Receipts	581	461
Payments	(600)	(450)
Balance	(19)	11
Balance at 1 April	8	(3)
Balance at 31 March – Included in (debtors)/creditors	**(11)**	8

The Department recovers Student Loans through the taxes system on behalf of the Department for Innovation, Universities and Skills (DIUS), from those former students eligible to make repayments. Student Loan recoveries are estimated on the basis of the end of year employer returns processed before the Trust Statement is certified. The actual value of Student Loan recoveries is established later in the year, and the difference between the estimate and the actual receipts is adjusted for the DIUS and disclosed in the Trust Statement for the following year.

There is a net overpayment of £11 million to the DIUS at 31st March 2008 which, with HM Treasury authorisation, will be rectified by decreasing payments to DIUS during 2008–09. Any adjustments to the annual figures will be reflected in next year's Trust Statement.

5 Taxation Revenue due to the Isle of Man

	2007–08 £ million	2006–07* £ million
Opening creditor (amount due to IoM in respect of prior year)	41	18
IoM Share of Revenue receipts	391	490
Less: Payments made to IoM during the year	(396)	(185)
Less: Revenue collected and retained in IoM	(453)	(282)
Balance at 31 March included in (debtors)/creditors	**(417)**	41

* 2006–07 figures re-stated following finalisation and audit of 2006–07 Isle of Man Account.

Under the Isle of Man Act 1979, a revenue sharing agreement exists between the UK and the Isle of Man (IoM) Governments whereby VAT and certain Excise duties are pooled and shared on an agreed basis. On 1 April 2007 a revised revenue sharing arrangement came into force with advance monthly payments being made to the IoM based on their forecast receipts. At the end of the year the IoM's estimated share of revenue is adjusted by: the monthly payments made; the amounts collected and retained in the IoM; and any final adjustments in respect of previous years to arrive at the net amount due to/from IoM. For 2007–08 the result is a net amount of £417 million repayable to the UK, principally because VAT receipts in the IoM were higher than forecast but also as under the new agreement monthly payments to IoM were not adjusted to reflect the amounts collected and retained in the IoM. The IoM authorities have agreed to repay this sum and the revenue sharing agreement has been modified to allow for in month netting.

6 Debtors and Accrued Revenue Receivable

	Debtors as at 31 March 2008	Accrued Revenue Receivable as at 31 March 2008	Total as at 31 March 2008	Total as at 31 March 2007
	£ billion	**£ billion**	**£ billion**	**£ billion**
Debtors and Accrued Revenue Receivable due within one year:				
Income Tax	5.6	27.5	33.1	30.5
Value Added Tax	7.1	22.8	29.9	29.4
Corporation Tax	2.2	14.9	17.1	15.5
Hydrocarbon Oils Duties	0.1	1.2	1.3	1.3
Alcohol Duties	0.2	0.5	0.7	1.0
Stamp Taxes	0.2	0.7	0.9	1.3
Tobacco Duties	–	1.0	1.0	1.2
Other Taxes and Duties	1.3	1.6	2.9	2.8
Tax Credit Overpayments	1.0	–	1.0	0.8
National Insurance Contributions	2.8	10.4	13.2	17.1
National Insurance Funds and NHS	–	–	–	0.4
Isle of Man	0.4	–	0.4	–
Prepayments	–	–	–	0.1
Totals before Provision	20.9	80.6	101.5	101.4
Less Provision	(6.6)	–	(6.6)	(5.5)
	14.3	**80.6**	**94.9**	95.9
Debtors due after more than one year:				
Inheritance Tax	0.8	–	0.8	0.7
Tax Credit Overpayments	3.3	–	3.3	3.1
Totals before Provision	4.1	–	4.1	3.8
Less Provision	(1.3)	–	(1.3)	(1.0)
	2.8	**–**	**2.8**	2.8
Totals before Provision	**25.0**	**80.6**	**105.6**	105.2
Less Provision (Note 8.4)	(7.9)	–	(7.9)	(6.5)
Total	**17.1**	**80.6**	**97.7**	98.7

Debtors represent amounts due from taxpayers or traders in respect of established liabilities for which, at the Balance Sheet date, payments had not been received.

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. The majority of 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.

6.1 Accounting Estimates

Estimates have been provided to support the accrued revenue receivable balances and accrued revenue liability balances where tax returns reporting taxpayer liabilities are not filed until after the Trust Statement has been published.

Estimates have been provided to support the accrued revenue receivable balances for Income Tax collected under PAYE, self assessment, Company Income Tax and Tax Deducted from Savings

Income; Corporation Tax, Value Added Tax, Petroleum Revenue Tax, Stamp Duty Land Tax, Stamp Duty Reserve Tax and National Insurance Contributions (Class 1 collected through PAYE and Class 4 collected through self assessment). Accounting estimates have also been provided to support the Value Added Tax and National Insurance Contributions accrued revenue liability balances.

Descriptions of the estimation techniques and details of the underlying assumptions have not been provided for Income Tax collected under PAYE, Petroleum Revenue Tax, Stamp Taxes, Company Income Tax and Tax Deducted from Savings Income as the estimated monetary amounts are either relatively small or not deemed to be particularly sensitive to changes in the underlying assumptions.

6.1.1 Corporation Tax

Corporation Tax for large onshore companies is paid by four quarterly instalment payments (QIPs). North Sea companies, who previously paid QIPs, have from 2006–07 moved to paying their Corporation Tax liabilities in three instalment payments (TIPs). Separate accrued revenue receivable estimates have been calculated for onshore and North Sea companies.

Onshore companies

Accrued revenue receivable has been estimated where between one and four QIPs for onshore companies have been received using a model that forecasts companies' Corporation Tax liabilities based on the number and value of QIPs received.

Corporation Tax is assumed to accrue evenly throughout the companies' accounting periods. Assumptions for the proportions of companies' Corporation Tax liabilities that are remitted with each QIP and adjustments for overpayments and late payments of Corporation Tax liabilities are based on historical trends of Corporation Tax liabilities and receipts. The principal assumptions are shown below:

	2007–08 (per cent)	**2006–07 (per cent)**
Proportion of Corporation Tax liability remitted with first QIP	27.2	26.6
Proportion of Corporation Tax liability remitted with second QIP	23.1	23.8
Proportion of Corporation Tax liability remitted with third QIP	27.3	26.2
Adjustment for overpayment of Corporation Tax liabilities	(10.0)	(10.0)
Adjustment for late payment of Corporation Tax liabilities	6.0	6.0

The proportions of Corporation Tax liability remitted with the first, second and third QIPs are now being separately calculated for each relevant accounting period. The proportions shown above are the overall weighted averages.

For accounting periods where no QIPs have been received, accrued revenue receivable has been estimated based on prior year outturn liabilities at a sectoral level adjusted for forecast growth in Corporation Tax liabilities. The annual growth rates applied are based on the economic assumptions that are provided by HM Treasury and used to forecast Corporation Tax revenues for the March 2008 Financial Statement and Budget Report, and are shown below:

Annual Growth in Corporation Tax liabilities	**2007–08**[1] **(per cent)**	**2006–07**[2] **(per cent)**
Onshore companies	3.2	7.5

[1] This is the growth rate used in the 2007–08 Trust Statement and relates to the growth in 2008 liabilities.
[2] This is the growth rate used in the 2006–07 Trust Statement and relates to the growth in 2007 liabilities.

North Sea companies

The accrued revenue receivable for 2007–08 is almost entirely attributable to companies with accounting periods ending December 2008. These are accounting periods for which no TIPs have been received and so the estimate is primarily based on prior year outturn liabilities adjusted for forecast growth in North Sea companies' Corporation Tax liabilities. The growth rate used for 2007–08 is shown below:

Annual growth in Corporation Tax liabilities	**2007–08[1] (per cent)**	**2006–07[2] (per cent)**
North Sea companies	35.7	10.1

[1] This is the growth rate used in the 2007–08 Trust Statement and relates to the growth in 2008 liabilities.
[2] This is the growth rate used in the 2006–07 Trust Statement and relates to the growth in 2007 liabilities.

6.1.2 Self Assessment Income Tax and National Insurance Contributions Class 4

Accrued revenue receivable represents accrued tax liabilities for 2007–08 where payment is not yet due at 31 March 2008. The estimation process has three stages:

(i) estimation of accrued tax liabilities for 2007–08. The estimates used are those prepared for Budget 2008 on the basis of the economic assumptions provided by HM Treasury modified in the light of the estimate of 2006–07 liabilities subsequently available from the head of duty analysis (see (ii) below). The most important of these assumptions is that self-employment profit rose by 6.3 per cent in 2007–08;

(ii) deduction from the 2007–08 accrued tax liabilities of relevant payments by 31 March 2008. An estimate of these payments is provided by the 'head of duty analysis', a statistical apportionment of total self assessment receipts of income tax, NICs, capital gains tax and student loan repayments between these four components. The breakdown is estimated from separate information on self assessment liabilities;

(iii) a further deduction for payments due by 31 March but not made by that date (these are included in the debtor balances). The amounts relate to payments on account due on 31 January. The breakdown of the total between income tax and NICs is made by statistical estimation.

6.1.3 Value Added Tax

VAT registered businesses in the UK are required to submit VAT returns either monthly, quarterly or annually one month in arrears of the end of the relevant accounting period. Consequently, some, but not all, information relating to VAT accrued revenue receivable and liable was available at the time of publication of these accounts.

To facilitate the creation of estimates for the remaining elements, historical time-series have been created to show the accrued revenue by month. Established statistical forecasting techniques have then been applied to construct estimates for the more recent periods based on the resulting trends. These have been combined with actual return data and adjusted to account for any payments or repayments relating to these returns that were made prior to the financial year end. This provides an estimate of accrued revenue receivable and liable via the regular return process. The statistical models selected on the basis of historical data provide a reliable indication of future accrued revenue receivable and liable.

To construct final estimates of accrued revenue receivable and repayable, a number of further adjustments have been made to reflect VAT that is accounted for outside the process described above. The principal adjustments relate to import VAT, repayments made to government departments and Officers' Assessments of errors in submitted VAT returns. These are based largely on actual return information although some forecast element remains.

6.1.4 Uncertainty Around the Estimates

Statistical models are used 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. The forecasts are based on what is believed to be the relevant inputs. However, because of the areas of uncertainty involved, there will inevitably be differences between the 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 the models. It is believed that the levels of variation are acceptable with a maximum likely overall uncertainty expected to be some £4 billion, which does not significantly affect the reported position. This figure is equivalent to less than 1 per cent of total revenue reported in the Statement of Revenue and Expenditure.

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

7 Creditors, Accrued Revenue Liabilities and Deferred Revenue

A breakdown of Creditors, Accrued Revenue Liabilities and Deferred Revenue falling due within one year is as follows:

	Creditors as at 31 March 2008	Accrued Revenue Liabilities as at 31 March 2008	Deferred Revenue as at 31 March 2008	Total as at 31 March 2008	Total as at 31 March 2007
	£ billion	£ billion	£ billion	£ billion	£ billion
Value Added Tax	2.1	9.0	–	11.1	10.2
Corporation Tax	14.0	–	0.2	14.2	12.9
National Insurance Funds and the NHS	2.4	13.2	–	15.6	17.1
Other Revenue Creditors	0.4	–	0.4	0.8	0.4
Sundry Creditors	0.1	–	–	0.1	0.1
Total	**19.0**	**22.2**	**0.6**	**41.8**	40.7

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

There are two distinct types of Accrued Revenue Liabilities. These comprise, first, amounts due to VAT traders that have an established revenue liability relating to the financial year, but the date the claim is received is after the balance sheet date; secondly amounts of debtors and accrued revenue receivable that will when received be passed to a third-party, e.g. National Insurance Contributions due to the National Insurance Funds and National Health Services.

Deferred Revenue includes duties and taxes paid in the current year that relate to future accounting periods.

There are no creditors which fall due after one year.

8 Bad and Doubtful Debts

8.1 Breakdown of Bad and Doubtful Debts

	Notes	2007–08 £ billion	2006–07 £ billion
Revenue Losses	8.2	5.8	4.8
Increase in Provision for Doubtful Debts	8.4	1.4	1.4
Total Bad and Doubtful Debts		**7.2**	6.2

Bad and Doubtful Debts are made up of revenue losses and the movement in the provision for doubtful debts. The analysis of revenue losses is shown below:

8.2 Revenue Losses

	Remissions 2007–08 £ million	Write-offs 2007–08 £ million	Total 2007–08 £ million	Remissions 2006–07 £ million	Write-offs 2006–07 £ million	Total 2006–07 £ million
Income Tax	59	677	736	52	600	652
Value Added Tax	38	3,516	3,554	75	2,881	2,956
Corporation Tax	3	374	377	3	214	217
Alcohol Duties	1	230	231	–	35	35
Tobacco Duties	–	48	48	–	23	23
Capital Gains Tax	4	54	58	14	27	41
National Insurance Contributions	41	544	585	10	436	446
Tax Credits	240	7	247	315	54	369
Other Remissions and Write-offs	9	12	21	1	15	16
Total Revenue Losses	**395**	**5,462**	**5,857**	470	4,285	4,755

Remissions are debts capable of recovery but HMRC has decided not to pursue the liability, for example, on the grounds of value for money or official error. Write-offs are debts that are considered to be irrecoverable because there is no practical means for pursuing the liability.

For certain taxes only a partial split between remissions and write-offs is known. Where information is unavailable the percentage split of the known element is applied to the remainder to calculate a total estimated remission and write-off split.

The Department has completed a review to align revenue loss policies along with accounting and reporting requirements across HMRC. Some initial changes have been introduced to align authorisation levels and losses terminology. Further work is being progressed to improve the management information available.

National Insurance Contribution write-offs include £35 million (2006–07: £16 million) of Class 2 contributions no longer collectable as they became time barred in year.

8.3 Revenue Losses – Cases over £10 million

There were 85 cases (70 cases in 2006–07) where the loss exceeded £10 million, totalling £2,385 million. Specific case details are shown below:

There was a write-off of £46 million tobacco excise duty in respect of a large scale cigarette smuggling operation. A number of individuals involved in the operation were arrested and received custodial sentences. The debt was considered irrecoverable and write-off appropriate.

There were 5 write-offs relating to excise duty diversion frauds over £10 million each, totalling £231 million in alcohol excise duty and VAT. In each case the debt was deemed irrecoverable and write-off appropriate.

There were 73 write-offs of VAT and interest relating to Missing Trader Intra-Community Fraud (MTIC) over £10 million each, totalling £2,022 million. All MTIC cases are assessed to establish if there is potential to recover revenue and, where appropriate, proactive insolvency action is initiated.

There were 6 write-offs relating to insolvency over £10 million each. They were for VAT, Corporation Tax and interest totalling £86 million.

8.4 Provision for Doubtful Debts

	2007–08	2006–07
	£ billion	£ billion
Balance as at 1 April	6.5	5.1
Increase in Provision for Doubtful Debts	1.4	1.4
Balance as at 31 March	**7.9**	6.5

Debtors in the Balance Sheet are reported after the deduction of the provision for doubtful debts. This provision has been estimated using debt analysis, trend analysis (including use of the revenue loss figures from the previous year) and internal expert opinion.

9 Provision for Liabilities

	Legal Claims 2007–08	Legal Claims 2006–07
	£ million	£ million
Balance at 1 April	2,200	34
Provided in the year	820	2,200
Provision not required written back	–	–
Provision utilised in the year	(800)	(34)
Balance at 31 March	**2,220**	2,200

Provision has been made for legal claims brought by taxpayers against HMRC. The information usually required by FRS 12 is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the legal claims against the Department. Legal claims, where it is probable that HMRC will be required to settle the claim and is unable to reliably estimate the amount, or where it is possible that the Department will be required to settle the claim, are disclosed as contingent liabilities in note 11.

10 Balance on Consolidated Fund Account

	2007–08	2006–07
	£ billion	£ billion
Balance on Consolidated Fund Account as at 1 April	55.3	53.5
Net Revenue for the Consolidated Fund	335.9	323.2
Less amount paid to Consolidated Fund	(337.7)	(321.4)
Balance on Consolidated Fund Account as at 31 March	**53.5**	55.3

11 Contingent Liabilities

11.1 Taxes subject to legal challenge

HMRC is engaged in legal proceedings with taxpayers across a range of cases, which include some in which reference to the European Court of Justice may be required, as well as cases wholly within the jurisdiction of United Kingdom courts. Depending on the judgement of the relevant court, in some or all of these cases, there may be reductions in revenue and/or repayments of tax. The issues raised in litigation vary. For cases where it is probable that HMRC will be required to settle the legal claim, it has not been practicable to estimate the financial effect. In other cases HMRC considers it possible that it will be required to settle the claims.

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 HMRC neither recognise revenue nor disclose any contingent liabilities in respect of these cases.

The information usually required by FRS 12 is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the legal claims against the Department.

11.2 Consequences of oil field decommissioning on Petroleum Revenue Tax

The 1975 Oil Taxation Act, as subsequently amended, allows for Petroleum Revenue Tax (PRT) losses arising from the decommissioning of infrastructure associated with oil and gas fields subject to PRT to be carried back indefinitely. As a result, there is always the possibility the field decommissioning costs will be set-off against the assessable profit arising for any chargeable period during the life of the field. The set-off must be made first against the assessable profit arising in the latest possible chargeable period with, thereafter, any balance of the loss offset against the profit of previous periods, working backwards until it is exhausted. As a result, the PRT liabilities for the period to which the losses get carried back may be less than originally measured and 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 expenditure is likely to be spread over the next 25–30 years or so but this depends on the extent to which the North Sea output can be sustained, so the timing is uncertain. Estimates of cost vary; in June 2007 BERR estimated the cost to be between £15 billion and £19 billion at todays prices (Decommissioning Offshore Energy Installations – A Consultation Document) in respect both of fields subject to PRT and those not, with just over half of all decommissioning costs estimated to fall on fields subject to PRT.

12 Related-Party Transactions

Due to the nature of HMRC's business, we have a large number of transactions, relating to taxation income, with other government departments and other central government bodies. No Board member, key manager or other related parties have undertaken material transactions with the Department during the year.

13 Post Balance Sheet Events

There are no reportable post balance sheet events. The financial statements were authorised for issue by the Principal Accounting Officer on 10 July 2008.

Accounts Direction Given by HM Treasury

ACCOUNTS DIRECTION GIVEN BY HM 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 (HMRC) shall prepare a **Resource Account** for the year ended 31 March 2008 in compliance with the accounting principles and disclosure requirements of the edition of the Government Financial Reporting Manual issued by HM Treasury ("FReM") which is in force for that financial year.

2. The Resource Account shall be prepared so as to give a true and fair view of the state of affairs as at 31 March 2008 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended. The Resource Account 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 FReM will, in all but exceptional circumstances, be necessary for the accounts to give a true and fair view. If, in these exceptional circumstances, compliance with the requirements of the FReM is inconsistent with the requirement to give a true and fair view, the requirements of the FReM 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 FReM. Any material departure from the FReM should be discussed in the first instance with HM Treasury.

4. HMRC shall prepare a **Trust Statement** for the financial year ended 31 March 2008 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 and any other revenues and related expenditures administered by the Department and the revenue income and expenditure and cash flows for the financial year then ended.

5. When preparing this Statement, HMRC shall have regard to the guidance given in the attached Appendix to this Direction. HMRC shall also agree the format of the Principal Accounting Officer's Foreword to the Trust Statement and the supporting notes (including the accounting policies particularly with regard to revenue recognition) with HM Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in *Managing Public Money* and other guidance as issued by HM Treasury, the principles underlying UK Generally Accepted Accounting Practice and, for tax credits, guidance issued by the Organisation for Economic Co-operation and Development.

6. The Resource Account, together with the Trust Statement, shall be transmitted to the Comptroller and Auditor General for the purpose of his audit examination and report by a date agreed with the Comptroller and Auditor General and HM Treasury to ensure compliance with the administrative deadline for laying the audited accounts before Parliament before the Summer Recess.

7. The Resource Account and Trust Statement, together with this direction, (but with the exception of the appendix), shall be laid before Parliament in one volume containing both financial statements and the Report produced by the Comptroller and Auditor General under section 2(2) of the Exchequer and Audit Departments Act 1921 as amended by the Government Resources and Accounts Act 2000.

8. This Direction supersedes the Direction dated 14 December 2006.

DAVID WATKINS
Head of the Financial Reporting Policy Team, Government Reporting, HM Treasury
11 October 2007

National Audit Office

HM REVENUE & CUSTOMS 2007-08 ACCOUNTS

Report by the Comptroller and Auditor General

Issued under Section 2 of the Exchequer and Audit Departments Act 1921

This Report is published alongside the 2007-08 Accounts of HM Revenue & Customs

T J Burr
Comptroller and Auditor General
10 July 2008

SUMMARY

Introduction

1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of HM Revenue & Customs (the Department) 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 2007-08 provided assurance that HM Revenue & Customs has framed adequate regulations and procedure to secure an effective check on the assessment, collection and proper allocation of revenue, and that they were being duly carried out. That assurance is subject to reservations about the level of error and fraud in the award of tax credits (see Part 2 of this report). The report also considers the collection of income tax through PAYE and Self Assessment, the administration of Value Added Tax registrations, and Excise Duties – The Alcohol Strategy.

Tax Credits

3 During 2007-08, the Department paid a net £20.0 billion in tax credits and an average of 5.7 million families received awards. The Department estimated that year end adjustments to awards meant it overpaid £1.0 billion in 2006-07, compared with £1.7 billion in 2005-06. This fall is mainly because of the increase from £2,500 to £25,000 in income rises which are disregarded when finalising awards. Other measures announced in the 2005 Pre-Budget Report together with operational improvements by the Department have also contributed to the fall.

4 In the first four years since the scheme was introduced, the Department calculates that year end adjustments, and other small changes to entitlement after the finalisation of awards, have led to a debt of £7.3 billion. It has also identified £700 million from in year adjustments to 2007-08 awards and will identify further overpayments for this year once awards are finalised. By the end of March 2008 the Department had collected £2.7 billion of this debt and written off £1.0 billion. £4.3 billion remains to be collected of which £1.8 billion is in doubt. Some £0.9 billion of debt was not subject to active recovery, for example where recovery is temporarily halted due to a disputed overpayment or the debt was in the process of being transferred to direct recovery.

5 The tax credits scheme relies on claimants telling the Department when their circumstances change so that it can update their awards. Claimants have not always understood their obligations under the scheme or received the support they needed from the Department. As a consequence over and underpayments have occurred because the Department has made payments based on out of date information. As part of its Tax Credits Transformation Programme the Department is evaluating service improvement pilots that are designed to assist claimants who need extra support in making a claim and reporting changes in circumstances. It anticipates that most of these will be implemented by April 2009.

6 Since the tax credits scheme was introduced in April 2003 it has suffered from high levels of error and fraud. The Department's latest estimate is that in 2006-07 error and fraud resulted in between £1.31 billion and £1.54 billion (7.2 to 8.4 per cent of the final value of awards) being paid to claimants to which they were not entitled. I have qualified my opinion on the regularity of the expenditure reported in the Trust Statement in respect of tax credits error and fraud. The Department's estimate's of error and fraud from 2005-06 are based on a more robust approach to evaluating the results of its random enquiry of finalised awards. The estimate, however, excludes error and fraud on terminated awards included within the £148 million of incorrect payments identified during 2006-07 through the Department's compliance activity.

7 The Department has set a target to reduce the current level of claimant error and fraud to not more than 5 per cent by 2011. It is also strengthening its response to those claimants who represent the highest risk of error and fraud as well as considering other measures which it will pilot through 2008-09. The Department is aware of the need to carefully evaluate these pilots and use the results to direct its compliance activity to areas that have the greatest effect in reducing error and fraud.

8 The 2002 Tax Credits Act gave the Department certain powers to adjust awards after finalisation. The Department made adjustments to some finalised awards which were outside the circumstances provided for in legislation. The Department's specification for the computer system did not reflect the requirements of the Act and the day to day guidance used by staff was incorrect. The Department is reviewing 250,000 awards to determine whether repayments are due and it estimates this work will take three years to complete. Of these cases, it estimates it owes around 20,000 claimants an average repayment of between £800 – £1,000.

Follow up on the collection of Income Tax

9 In 2007-08 the Department collected £155.1 billion in income tax and £98.2 billion in National Insurance Contributions. Our 2006-07 Report considered a number of issues relating to the collection of income tax through Pay As You Earn (PAYE) and Self Assessment. During 2007-08 we have followed up on the progress made by the Department on some of the key aspects of its administration of income tax.

The collection of income tax through PAYE

10 Following the introduction of online filing in 2005, the Department continues to improve its processing of employer end of year returns. By 31 October 2007 it had processed 92.5 per cent of 2006-07 returns received, and 98.6 per cent of returns received from employers met the Department's quality standards. It still needs to develop better management information to support its governance of the end of year filing process. Following the automation in May 2007 of changes to tax codes for benefits in kind it has updated 72 per cent without manual intervention.

11 In 2008 the Department is planning to transfer its processing of PAYE for individuals on to the National Insurance Recording System and so allow it to bring all information on individuals' employment and pensions income together. The Department has deferred this change from April 2008 to October 2008 to allow more time to assure supporting systems.

12 At the end of the tax year, the Department's computer system may identify discrepancies in taxpayer records or be unable to match a return to a record and so it will establish an 'open case' for manual checking. Delays in clearing 'open cases' can mean that taxpayers are not notified on a timely basis of additional tax payable or refunds due. At the end of March 2008 the Department had 16.2 million open cases, which exceeded its target of 12.5 million, because computer system developments did not deliver the reduction in cases expected, staff were released to other work and there was lower than anticipated overtime. The Department plans to reach a steady state position by 2010 where open cases for each tax year are cleared within a year and there are no backlogs for 2006-07 and earlier years. The number of cases that will require manual intervention following the implementation of the computer changes cannot be predicted with absolute certainty, so the Department needs to consider the processing resources necessary to clear the backlog of 'open cases', should this exceed its current estimate.

13 Since 1983 the Department has not collected all the tax due from some pensioners because of a failure to apply the PAYE regulations properly. It estimates that this error could affect some 420,000 pensions with a tax loss of some £135 million per annum. It has taken steps to correct the tax treatment, but because of the deferral of the transfer of processing to the National Insurance Recording System, the Department will not now be in a position to correct tax codes until 2009-10. The Department has exercised its management discretion to waive the tax due for 2007-08 because it could not now give the taxpayers concerned reasonable notice of the tax payable. It will therefore not collect the estimated £135 million of tax due for 2007-08 as it originally planned. It will start to tax these pensions from 2008-09.

The collection of income tax through Self Assessment

14 The Department is introducing a number of important changes to the Self Assessment process in 2008. It has introduced a shorter, simplified return for the 2007-08 tax year and will bring forward the deadline for those who file paper returns from 31 January to 31 October. The Department did not achieve its previous target for the submission of returns by the 31 January deadline, although this target was always a challenge following the removal from Self Assessment of certain taxpayers with a better compliance record. The Department has planned publicity campaigns to remind taxpayers of the new deadline.

15 The Department has made good progress in the number of returns filed online. In 2007-08, 46 per cent of returns (3.8 million) were filed online and on time significantly exceeding its target of 35 per cent. A record number of 204,000 taxpayers submitted online returns on 31 January, but between 10,000 and 15,000 taxpayers could not on that day because of a hardware problem in the computer systems supporting the service. The Department and its supplier have updated the Self Assessment online system and reviewed the testing of online services to ensure peak demands are met in the future. It is also reviewing the wider lessons learned to enhance the speed with which it responds to such events.

16 The Department's latest estimates based on the 2002-03 tax year indicate that 34 per cent of filed returns were inaccurate putting between £2.9 billion to £3.7 billion tax at risk. This estimate is based on registered Self Assessment taxpayers and does not cover under-declared income from people working in the informal economy.

17 Self Assessment taxpayers can appeal against assessments, penalties, surcharges or amendments. These items are "stood over" as not collectible and not forwarded for collection until the appeal is cleared. The Department's latest estimate of the value of these amounts is £1.1 billion. The Department's Internal Audit found that "stoodover" items were given little attention and substantial backlogs of uncleared items had built up. The Department reviewed the process for handling standovers to identify areas for improvement and is now starting to address these issues.

Value Added Tax

18 In 2007-08 the Department collected net Value Added Tax receipts of £81.2 billion, and processed around eight million VAT returns. Traders are required to register for VAT if their taxable business turnover exceeds a defined threshold. The Department receives some 280,000 VAT registration applications a year. The Department faces two key challenges on VAT registrations. Firstly, to facilitate trade by ensuring that registration applications are processed as quickly as possible. Secondly, to ensure that potential fraudsters are prevented from entering the system. Since 2004-05, the Department has faced a sustained attack from fraudsters and has strengthened, among other things, its registration controls to prevent fraudsters from obtaining a VAT registration number.

19 In 2006 the Department introduced long term measures to increase registration performance which were initially successful. However, its registration performance deteriorated significantly in the early part of 2007 when the level of registration applications on hand increased from around 29,000 in January 2007 to a peak of 58,000 in June 2007, and the average number of days taken to process an application rose from 29 days in March 2007 to around 42 days in August 2007.

20 A combination of factors contributed to the deterioration of VAT registration performance.

- Increased checks to counter the threat from fraudulent traders, together with other measures, helped the Department to tackle missing trader fraud, reducing the estimated VAT losses by £1 billion. But some risk parameters were poorly targeted, resulting in more legitimate applications being subjected to delays whilst being checked than might otherwise have been necessary.
- These additional checks coincided with the reorganisation of the Registration Units which did not happen as planned and resulted in significant staff shortages. The Department released experienced casual staff before it had redeployed permanent staff from other parts of the Department. This situation was exacerbated by an increase in general staff turnover. Staff also took longer to process applications against a background of increased computer problems, and a significant increase in applications from traders seeking to circumvent legislative changes.
- The restructured risk team initially took longer to process the registration applications owing to the inexperience of the new team and the lack of access to the appropriate computer systems.
- The VAT registration computer systems could not provide reliable information on the level of work on hand as the data was not robust. Also, staff shortages meant that some applications were not entered promptly on to the registration computer systems. The Department was not fully aware of the increase in work on hand until it undertook a manual exercise in August 2007, which assessed the level at 48,000 applications.

21 In July 2007, the Department prepared an action plan to improve the registration performance by January 2008. The long lead time reflected the need to tackle the existing backlogs and to allow time for new staff to be fully trained. As at January 2008 the Department had made significant improvements in processing registration applications, achieving its target of processing 70 per cent of applications within 14 days. By March this figure had risen to 83 per cent. But the focus of resources on improving this part of the registration service has not been without detriment to the timeliness of the de-registration process, where performance has dropped.

22 The Department has now prepared an action plan to address the de-registration backlogs and is continuing to monitor the registration staffing position. It has also prepared a contingency plan which will be implemented should the registration problems re-emerge. In the longer term the Department aims to use the computer systems to monitor work on hand and is currently performing data cleansing exercises to ensure that they record reliable information.

Excise Duties: The Alcohol Strategy

23 In 2007-08, the Department collected excise duties of £8.3 billion on alcohol, comprising: spirits £2.4 billion, wine £2.6 billion and beer and cider £3.3 billion. Excise duty is liable at the time the alcohol is either produced or imported, although under duty suspension arrangements authorised traders are allowed to defer payment nearer to the time when they release their goods for consumption. Excise diversion fraud occurs where goods intended for export or delivery to another excise warehouse under duty suspension are diverted for consumption in the UK without the UK duty being paid.

24 The Department launched its Alcohol Strategy in 2005 in response to the estimated £250 million in lost excise duty due to spirits fraud. It has made good progress in embedding the measures underlying the Strategy, which is underpinned by a robust governance system. The Department has a Public Service Agreement Target to reduce the illicit spirits market to three per cent by March 2008. The latest data available shows the illicit market share mid-point at five per cent in 2005-06, a decrease of three per cent since 2003-04.

25 The Department has addressed the recommendations made by the Committee of Public Accounts in 2004 to strengthen its response to alcohol fraud. In particular, the Department has:

- Revised its methodology for estimating the illicit spirits market. The United Kingdom is one of the few countries to try to make such estimates, which are inherently difficult. The Department has not yet found an acceptable method for measuring potential tax gaps for other alcohol products, such as beer and wine, which in total comprise around 60 per cent of the duties collected. The Department recognises that it needs to do more and is working with the industry to establish a robust methodology to estimate the extent of the illicit market for all alcohol products.
- Established Memoranda of Understanding (MoUs) with the alcohol industry to provide a framework for cooperation in tackling alcohol fraud. The Department intends to agree memoranda with the British Beer and Pub Association and Transporters, which would extend the MoUs to other sectors involved with the acquisition, distribution and sales of alcohol.
- Developed an internal coordinated response to tackle suspected high risk traders. The Alcohol Strategy Delivery Group (ASDG), comprising representatives of all the internal operational groups involved in tackling alcohol fraud, coordinates the Strategy and ensures that all teams work together either through national or collaborative projects. The Department has developed a delivery agreement with the newly established UK Border Agency for 2008-09, which sets performance targets and ensures that this new body will continue to play a full role in the development and implementation of the Alcohol Strategy.
- Introduced tax stamps in October 2006 to make it easier to identify illicit bottles of spirits. Measures have been introduced to mitigate the associated compliance costs. The Department has delayed the full enforcement of the legislation in the retail sector to allow legitimate unstamped spirits to be sold making it easier to identify illicit bottles, but it plans shortly to implement an assurance programme to detect and deter fraudsters.

26 The Department is also working with the European Union to tackle alcohol fraud. The Department's response to requests from other EU Member States has been reasonable, but there is still room for improvement. In 2007-08, the Department responded to 74 per cent of requests within the statutory deadline but recognises that it should aim to provide replies to 95 per cent of requests within the deadline. The Department is working with the European Union to improve the performance of other Member States in responding to requests from the United Kingdom, with on average, only 53 per cent of outgoing requests receiving replies within the statutory three month period.

Summary of Recommendations

Tax Credits

27 During 2008-09, the Department will be introducing a range of service improvements to assist claimants as part of its Tax Credits Transformation Programme. The Department has taken steps to assess the pilots of the individual modules prior to their implementation. It needs to maintain a rigorous approach to the evaluation of the service improvement modules so it can continue to assess their effects following implementation.

28 The Department should continue its work to provide a more reliable estimate of the level of error and fraud in tax credits. In particular, it should build on its decision to use a dedicated team to carry out the random enquiries into finalised awards by enhancing its guidance to staff on the steps to be followed in examining cases and documenting judgements made to ensure that the quality of the testing is of a consistently high standard.

29 When reporting the overall estimate of the level of error and fraud, the Department should combine the results from its random enquiry of finalised awards with its estimate error and fraud on awards terminated during the year as a consequence of its compliance activity.

30 In implementing the strategy for reducing error and fraud, the Department also needs to develop its monitoring to support a more timely assessment of how the measures are contributing to the achievement of its target.

31 The Department is seeking to collect £4.3 billion of tax credit debt, of which £1.8 billion is in doubt. In the light of its recent work to introduce service improvements and refresh its compliance strategy, it may wish to consider extending this review of its processes to cover its debt collection procedures.

32 The Department found that aspects of its day to day guidance to staff on tax credits were incorrect and it is taking action to address this. It needs to set a clear timetable for completing this work.

Income Tax

33 The Department's is currently testing its arrangements in the run-up for the transfer of processing to the National Insurance Recording system. In the past its implementation of computer system changes to modernise PAYE processing have met with initial difficulties leading to increased workloads. The Department needs to:

- draw on its most recent experience with its computer systems changes to ensure the risk of disruption from unforeseen increases in workloads is minimised; and
- recognising that the number of cases requiring manual intervention following the transfer cannot be predicted with absolute certainty, it should establish appropriate contingency arrangements to clear processing backlogs.

34 The Department's computerisation of benefits in kind processing has allowed it to clear 72 per cent of all cases automatically. It needs to ensure that it maintains sufficient processing capacity to clear promptly the 28 per cent of cases which require manual intervention.

35 The Department should consider extending its estimate of tax at risk from Self Assessment taxpayers to cover under-declared income from people working in the informal economy. It should also consider how it could produce its estimates of tax at risk more quickly so that it can better assess the effectiveness of its compliance activities. The Department should also develop a strategy for increasing the levels of accuracy in filed returns.

Value Added Tax

36 The Department should continue to monitor VAT registration performance and ensure that:

- it strikes the right balance between stopping criminals from entering the VAT system and ensuring that legitimate traders receive their VAT registrations without undue delay; and
- it responds quickly to any management information indicators which show that VAT registration performance is deteriorating.

37 The Department should prepare and implement a phased action plan to further improve the speed of registration application processing beyond the current performance level of 83 per cent within 14 days.

38 The work on hand figure is a key indicator of performance and, as such, it is important that the information is robust and prepared regularly, at least once a month. This information is currently being generated by manual counts. The Department should prepare an action plan to address the VAT registration computer problems. This will enable it to use computer generated information and avoid the need for resource-intensive manual counts.

Excise Duties – The Alcohol Strategy

39 Both beer and wine excise duties account for around 60 per cent of the alcohol tax receipts collected by the Department. It should continue to work with the alcohol industry to establish a robust methodology for estimating the beer and wine illicit markets.

40 The Department should prepare an action plan to increase its current response rate to requests for administrative assistance from EU Member States, from currently 74 per cent to 95 per cent.

41 The delivery agreement signed by the Department and UK Border Agency should be reviewed frequently to ensure that the arrangements are delivering the planned outcomes. Additionally, discussions regarding future arrangements should be agreed as soon as possible.

42 A comprehensive compliance assurance programme should be prepared and implemented as soon as possible to identify non duty stamped bottles on retail shelves. Moreover, successful operations should be communicated to the alcohol industry as evidence that duty stamps are effective and to deter potential fraudsters.

PART ONE

Introduction

Background

1.1 Section 2 of the Exchequer and Audit Departments Act 1921 requires me to examine the accounts of HM Revenue & Customs (the Department) 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 part of my report explains the scope of my audit, the audit approach applied and the audit conclusion from my examination of the revenue accounts.

Scope of the audit

1.3 We have undertaken a programme of revenue audits across the Department's activities and tax streams. The findings from of our revenue audit are further informed by other work that has contributed to our overall view of the Department's management of the tax systems, including:

- the findings emerging from our value for money studies on revenue issues conducted under the National Audit Act 1983; and
- our consideration of the Department's Statement on Internal Control (paragraphs 1.8 to 1.10).

Audit of Revenue

1.4 We conduct specific work on the principal tax streams to gather sufficient and appropriate evidence on the adequacy of the systems and procedures the Department has developed to secure an effective check on tax revenues and to assess their application. This embraces:

- the overall control framework for the assessment, collection and proper allocation of revenue for each tax, including the arrangements for:
  - the effective governance of individual tax streams and the management of key risks to revenue collection;
  - framing of regulations and procedures for the collection of the tax or duty;
  - the information and key indicators used by the Department to monitor and assess its performance in the collection of revenues; and
  - the strategies and other plans the Department has established to help ensure taxpayer compliance, including its response to the risk of fraud and error.
- the systems and processes in support of the tax stream covering registration, filing, assessment, collection, allocation, debt management, repayments and accounting. This includes the periodic examination of the computer systems which support the key stages in the tax process; and
- changes to the regulations and procedure, including changes in the tax process and underlying computer systems.

1.5 As part of this work we have also conducted examinations into specific aspects of the Department's operation of the tax system and tax credits systems. Our 2007-08 Report covers four such examinations which deal with the Department's:

- administration of Tax Credits (Part 2);
- collection of income tax through Pay As You Earn (PAYE) and Self Assessment, a follow up of the issues raised in our 2006-07 Report (Part 3);
- administration of Value Added Tax registration (Part 4); and
- progress in tackling fraud on Alcohol Duty (Part 5).

1.6 In addition to this work we have also taken into account the results of our audit of tax revenues collected and reported in the Department's Trust Statement. The results of this work are set out in the separate Report appended to the Comptroller and Auditor General's audit certificate on the 2007-08 Trust Statement (pages 86 to 92).

Value for Money Audit

1.7 In 2007-08 we carried out four value for money studies under the National Audit Act 1983 that have contributed to my overall view of the Department's management of the tax systems, including reports on its:

- management of large business Corporation Tax (HC 614, Parliamentary Session 2006-07);
- approach to tackling the hidden economy (HC 341, Parliamentary Session 2007-08);
- transformation programme (to be published shortly); and
- the control and facilitation of imports (to be published shortly).

Statement on Internal Control

1.8 The Accounting Officer's Statement on Internal Control (pages 1 to 10 of the 2007-08 Accounts) covers the Department's Resource Account and the Trust Statement. The Statement serves two purposes:

- to provide Parliament with assurance that the Accounting Officer has put in place the necessary control framework to manage risk (paragraphs 2.1 to 5.10 of the Statement); and
- to highlight the areas of concern identified by his review of the effectiveness of internal control (paragraphs 6.1 to 6.40 of the Statement).

1.9 We consider whether the Accounting Officer's statement reflects the Department's compliance with HM Treasury's disclosure guidance and whether the Statement properly reflects all material control weaknesses that have come to attention in our audit. We also consider the Statement on Internal Control in reaching a conclusion about the adequacy of the systems for the assessment, collection and proper allocation of revenues brought to account by the Department.

1.10 The Statement on Internal Control for 2007-08 acknowledges a number of significant control weaknesses which affect its administration of tax and tax credits. Our report considers some of these issues, namely Tax Credits (Part 2), Pay as You Earn and Self Assessment (Part 3) and Value Added Tax (Part 4).

Conclusion

1.11 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 2007-08 provided assurance that HM Revenue and Customs has framed adequate regulations and procedure to secure an effective check on the assessment, collection and proper allocation of revenue, and that they were being duly carried out. That assurance is subject to reservations about the level of error and fraud in the award of tax credits (see Part 2 of this report).

PART TWO

Tax Credits

Introduction

2.1 The current tax credits system forms part of the personal tax system administered by the Department and uses tax definitions of income. Tax credits are not voted by Parliament under the Supply process but defrayed out of tax collected before the payment of the net revenues into the Consolidated Fund. The Department accounts for its expenditure on tax credits in its Trust Statement for taxes, duties and other revenues and related expenditure. We have therefore examined the Department's administration of tax credits as part of the Comptroller and Auditor General's overall responsibilities for the audit of revenue under Section 2 of the Exchequer and Audit Department Act 1921.

2.2 Child and Working Tax Credits (tax credits) were introduced in April 2003 as part of the Government's reforms of the tax and benefits system aimed at relieving child and in-work poverty. They provide additional financial support to families with children and to working people on low incomes. They replaced the Working Families' and the Disabled Person's Tax Credits which were introduced in 1999, and the Children's Tax Credit, introduced in 2001.

2.3 During 2007-08, the Department paid a net £20.0 billion in tax credits and an average of 5.7 million families received awards. The cost of administering the scheme was £581 million. **Figure 1** gives an overview of the tax credits scheme since its introduction in April 2003.

2.4 Our previous Reports have covered a number of important issues in the administration of tax credits, including overpayments and recoveries, levels of error and fraud and the steps taken by the Department to improve the service provided to claimants. As part of my work in 2007-08 I have examined the progress the Department has made in dealing with these issues and my report covers:

- the Tax Credits Scheme;
- the Tax Credits Transformation Programme;

1 Tax Credits: Scheme Overview

	2003-04	2004-05	2005-06	2006-07	2007-08 provisional[2]
Families benefiting[1]	4.6m	5.0m	5.3m	5.5m	5.7m
Net cash paid to claimants in year	£13.5bn	£15.8bn	£17.3bn	£18.7bn	£20.0bn
Final value of awards[3]	£12.0bn	£14.3bn	£16.0bn	£18.2bn	Not yet known
Administrative cost	£406m	£475m	£467m	£587m	£581m
Staff employed by the Department	7,300	8,200	8,750	10,120	9,200

Source: HM Revenue & Customs

NOTES

1 Figures represent the average number of families benefiting in the years up to and including 2006-07 in finalised awards and for 2007-08 in provisional awards.

2 Actual information for 2007-08 will be available in May 2009, after awards have been finalised.

3 The Department makes a final assessment of awards after the end of the year when the claimant's actual income and circumstances are known.

- the Department's approach to reducing claimant error and fraud;
- its management of overpayments caused by adjustments to awards; and
- inappropriate adjustments to finalised awards.

The Tax Credits Scheme

2.5 Child Tax Credit is designed to address the specific needs of families with children, and provides financial support based on the number of children and any disabilities they may have. It is available to those aged 16 or over, whether working or not, who are responsible for at least one child. Working Tax Credit is intended to support working people, both employed and self employed, by topping-up earnings; the amount depends on factors such as age and/or the number of hours worked. Additional support is available for eligible childcare costs or where a member of the household is disabled.

2.6 Tax credits are paid on the basis of an annual entitlement, which depends on a claimant's income and family circumstances. The Department initially calculates a provisional award based on the claimant's income for the previous year and their current family circumstances. Awards can be adjusted if claimants tell the Department of a change in their circumstances during the year. After the end of the year, the Department asks claimants to confirm by 31 July 2008 their actual circumstances and income. The Department uses this information to assess the final award and where appropriate establish a provisional award for the new year. The timetable for the calculation and payment of 2007-08 awards is in **Figure 2**.

The Tax Credits Transformation Programme

2.7 Claimants have not always understood their role and obligations in the tax credits system or received the support they needed from the Department. In November 2006 the Department established the Tax Credits Transformation Programme to assess and identify the root causes of these problems and define an action plan to address them. This work included developing a future operating model to guide the transformation of tax credits. The Department's aim was to allow claimants to complete transactions in one contact and for queries to be resolved immediately with a clear outcome. The model and the process of transformation towards it is summarised in **Figure 3**.

2 Timetable for the calculation and payment of 2007-08 awards

	Stages in the Tax Credits cycle	Payment/ recoveries
	New Claim/Renewal of 2006-07 Award for 2007-08	
2007-08	A claimant's prior year income is used as the initial basis for the 2007-08 provisional award.	Provisional payments made for 2007-08 awards.
	Changes in circumstances	
	Claimants may notify HMRC of changes in circumstances. HMRC then calculates a revised award.	Payments amended to reflect the latest information.
	Finalisation of 2007-08 Award and Renewal for 2008-09	
2008-09 April - July	The claimant informs HMRC of actual circumstances and income for 2007-08 to enable HMRC to finalise the award and processes renewal for 2008-09.	HMRC seeks recovery of overpayments and pays underpayments as lump sum.

Source: National Audit Office

3 HMRC's business change objectives for the Tax Credits Transformation Programme

i Delivering a customer service tailored to individual needs informed by better data to support a segmented approach.

ii Aligning the delivery of tax credits and child benefit, so claimants need to contact the Department only once to apply for and report changes of circumstances for both schemes.

iii More efficient and secure delivery systems, including improved authentication procedures to give claimants greater assurance that the tax credits system is secure.

iv Clearer communication with claimants to ensure more helpful interactions, more easily understandable outputs, and improved claimants' trust.

Source: National Audit Office adapted from HMRC's Tax Credits Transformation Programme and Benefits Realisation Management Plan

2.8 The Department's immediate focus for the Transformation Programme is to improve the service provided to claimants and its communications with them. However, the Department's scope for making service improvements is constrained by the current computer system, which makes it difficult for the Department to tell claimants with certainty, at the time they report a change of circumstance, how it will affect their entitlement. By May 2008 the Department had developed and piloted eight service improvement modules under the Programme. It is evaluating these and plans further pilots over the coming year. **Figure 4** opposite summarises the planned service improvements. The household breakdown telephone claims service was the first module to be implemented in November 2007. The Department expects most of the other improvements to be implemented by April 2009.

2.9 The Department is also trialling a new range of simple and clear communication products to help improve claimants' understanding of tax credits. It plans to launch these communication products in 2008-09. They will cover the overall tax credits process, and each stage in that process, from claiming, checking award notices, reporting changes in circumstances, and renewing awards.

Reducing claimant error and fraud

Overall levels of claimant error and fraud

2.10 The current tax credits scheme has suffered from high levels of error and fraud since it was introduced in April 2003. The Department's latest estimate, based on the examination of a random sample of 4,250 awards, is that error and fraud resulted in between £1.31 billion and £1.54 billion (7.2 to 8.4 per cent of the final value of awards) being paid to claimants to which they were not entitled. A summary of the Department's estimated ranges of error and fraud in each of the first four years of the scheme is given in **Figure 5 on page R14**. The C&AG has qualified his opinion on the regularity of the expenditure reported in the Trust Statement in respect of tax credits error and fraud.

2.11 The Department improved its methodology in 2005-06 to provide a more robust estimate of the overall levels of error and fraud in tax credits. In the past, the Department's source of data for selecting the sample was based on a snap-shot of the status of an award at finalisation. It was concerned that this method and the comparatively simple approach applied to the stratification of the population would lead to an increasingly inaccurate estimate of error and fraud. The Department's new approach is based on an analysis of information directly from the tax credits computer system, which provides more information about the nature of awards throughout the year, and supports a more detailed stratification of the population. It estimates that had it continued to sample from its original data source in previous years the estimate of error and fraud would have been overstated by as much as £240 million. The Department has not applied its revised methodology to updating its estimates of error and fraud for 2003-04 and 2004-05 because it does not consider this would be an effective use of its resources.

2.12 The Department reorganised and accelerated the testing process for awards made for 2006-07 to allow it to produce an of error and fraud in June 2008, almost a year in advance of the timetable for producing estimates in previous years.

2.13 The Department took steps to enhance the quality of its random enquiry of 2005-06 awards to provide a more reliable estimate of levels of error and fraud in individual cases. These included concentrating its review of random enquiries in four compliance offices to promote more consistent and higher quality case work. The Department also extended its random enquiry testing from 2005-06 to measure the extent of official error. It estimates that in 2006-07 official error led to £30 million being paid to claimants to which they were not entitled and £50 million not being paid to claimants to which they were entitled.

4 The Tax Credits Transformation Programme: Service Improvements

Stages in the tax credits cycle	Service Improvement Modules
Claims	**Household Breakdown Telephone Claims Service:** Claimants who suffer a household breakdown could have experienced a significant period of time without tax credits as their joint award ends and new single paper claim are processed into payment. The Household Breakdown Telephone Claims Service is now putting some 90 per cent of claimants back into payment within five days ensuring no break in payment.
	Assisted Claims: This module aims to understand the needs of claimants and match them with the right level of support to ensure they can get into payment as quickly, accurately and painlessly as possible.
Changes of circumstances	**Tax Credits/Child Benefit alignment:** at present, claimants using the telephone have to report the same piece of information separately for Child Benefit and Tax Credits. The Department has piloted a service to handle both regimes in the single contact.
	Find, Check and Amend: Where the Department has good quality data from a reliable source that shows a claimant has not reported a change of circumstance, it will either amend their award and notify the claimant of the change or proactively contact them to seek confirmation of the change.
	Health Check: The Department is contacting claimants who have not notified them of any change of circumstances for several years. During the pilot some claimants reported significant changes in circumstances which resulted in changes to their awards and in some cases generated overpayments.
	Proactive Questioning: Many claimants do not understand what changes of circumstances they need to report and the consequences of not reporting them. A pilot project in March 2007 found that 34 per cent of all claimants' calling with a change of circumstance, when prompted, had at least one further material change to report.
	The Department has run a further pilot to test its ability to better target callers at times when changes may have occurred that would impact their award i.e. when a child reaches 16 and leaves full time education.
	After Care: This project will focus on claimants who have received support through the Assisted Claims module. The Department will proactively contact these claimants and offer assistance to make sure they understand what they need to do and to provide advice on any problems encountered.
	Outreach Through Children's Centres: The Department will work with Children's centres to pilot different ways and different locations for providing advice and services to families with children under five.
	Avoiding Overpayments: Claimants will be offered a series of services designed to help them avoid overpayments.
Renewal	**Reach Out Renewal:** Around 250,000 claimants fail to renew their tax credits claims and many of those have ongoing entitlement. These claimants face losing their entitlement and having to reclaim and will also have to repay all the provisional payments they have received between April and July.
	In August 2007, the Department ran Phase 1 of its Reach Out Renewal service targeting those who had not renewed in time and who potentially face the biggest potential overpayment. It will be implementing this exercise on a larger scale in August 2008 and in subsequent years.
	In addition, the Department will contact claimants with large entitlements to Tax Credits during the renewal period to attempt to get them to renew earlier than they might otherwise, thus reducing the size of any overpayment which may have arisen due to unreported changes in circumstances.
	Assisted Renewals: Selected claimants will receive extra assistance when they call to enquire about renewals or to renew their award.

Source: HM Revenue & Customs

5 HMRC's estimates of claimant error and fraud on finalised awards[1]

Year	2003-04	2004-05	2005-06	2006-07
Value of finalised awards				
£ billion	£12.0bn	£14.3bn	£16.0bn	£18.2bn
Error and fraud favouring the claimant				
Estimated range (per cent)	8.8 – 10.6%	7.3 – 9.1%	8.5 – 10.6%	7.2 – 8.4%
Estimated value (£ billion)	£1.06bn – £1.28bn	£1.04bn – £1.30bn	£1.36bn – £1.69bn	£1.31bn – £1.54bn
Error favouring HMRC				
Estimated range (per cent)	1.6% – 2.3%	1.4% – 2.4%	1.4 – 2.4%	1.3 – 2.1%
Estimated value (£ billion)	£0.19bn – £0.28bn	£0.20bn – £0.35bn	£0.23bn – £0.39bn	£0.24bn – £0.39bn

Source: HM Revenue & Customs

NOTE

1 The Department estimates levels of error and fraud based on the examination of a random sample of finalised awards.

2.14 Our examination of the Department's estimate of error and fraud and the underlying random enquiries has raised two issues.

- Establishing a dedicated team to carry out the work has helped to accelerate the testing programme. But the Department needs to enhance its guidance to staff on the steps that should be undertaken when examining cases and the documentation of judgements made to ensure that the quality of the testing is of a consistently high standard.
- The estimates of claimant error and fraud are based on finalised awards at the end of the year. The estimate excludes error and fraud already identified during the period through the Department's compliance activity. These amounts are shown within the figures in **Figure 6 opposite** and should be taken into account when reporting the overall level of error and fraud.

The current compliance regime

2.15 The Department tries to maintain a balance between ensuring the accessibility of the scheme to claimants and maintaining safeguards against the risk of error and fraud. It uses a risk-based approach to identify the highest risk claims that might need a compliance investigation and on the most significant cases looks to do so before any payment is made.

2.16 In 2007-08, the Department's compliance teams carried out over 157,000 pre and post payment checks, which identified incorrect payments of £187 million and prevented incorrect payments of £150 million. Since April 2005, the Department has increased the number of checks undertaken before awards are paid, so that the highest risk claims are checked at an early stage and to reduce the risk of incorrect payments. During 2007-08 it performed 43 per cent of its compliance checks on claims before they were paid. The Department also uses profiling techniques to identify awards in payment which contain certain risks for further examination. An analysis of the number of compliance checks performed and their estimated yield over the past four years is given in Figure 6.

2.17 Where a compliance investigation identifies an error affecting a claim in payment, the Department corrects the award and adjusts future payments to take account of any amounts wrongly paid. In some cases these errors may also affect claims for previous years. Where a claim is no longer in payment the Department seeks recovery of these overpayments.

2.18 The Department considers imposing a financial penalty where it concludes there has been a deliberate attempt to over-claim or where the claimant has been negligent and provided the wrong information. The Department is introducing a new approach to penalties in 2008-09, where the size of the penalty will be related to the level of non-compliance and the claimant's behaviour. It expects this approach will better target and deter those who seek to overclaim because of carelessness or deliberate intent. The Department can also pursue criminal prosecution, but it limits this to the more serious cases of tax credits fraud and those involving organised attacks on the system. An analysis of penalties imposed and cases selected for criminal prosecution is given in **Figure 7 opposite**.

6 HMRC's compliance checks on tax credit awards

	2004-05	2005-06	2006-07	2007-08
Number of Checks				
Target	101,500	110,000	130,000	150,000
Actual checks	107, 789	146,376	137,930	157,468
Pre payment: post payment ratio	16%:84%	45%:55%	41%:59%	43%:57%
Estimated Yield				
Yield comprising:	£130m	£528m	£286m	£337m
Incorrect payments prevented[1]	Not available	£307m	£138m	£150m
Incorrect payments found[2]	Not available	£221m	£148m	£187m
Checks resulting in change to award:				
Pre award	93%	93%	68%	65%
Post award	65%	85%	81%	78%

Source: HM Revenue & Customs

NOTES

1 The estimate of incorrect payments prevented is the additional amounts that would have been paid during the year had payment not been stopped.

2 The estimate of incorrect payments found is the value of payments made before HMRC took action.

7 Tax Credits Sanctions

	2004-05	2005-06	2006-07	2007-08
Cases where a penalty was charged	1,114	2,241	1,365	1,040
Total value of penalties charged	£445,645	£887,585	£610,000	£750, 000
Cases selected for criminal prosecutions	211	289	183	165

Source: HM Revenue & Customs

Tackling the threat of organised fraud

2.19 The tax credits system has experienced attacks from organised criminals. As previously reported, in 2005 there was a serious attack on the system by organised criminals submitting false claims using stolen identities via the internet. The Department closed the tax credits e-portal on 2 December 2005 as a consequence of these attacks. The Department is developing a framework for validating the identity of individuals for both telephone and internet channels. It will only re-open the internet system once this work is complete and it is assured of its effectiveness.

2.20 In addition to the closure of the e-portal, the Department has responded to the risk that fraudsters target the system by paper claims or by notifying false changes of circumstances to tax credit call centres. The Department's Organised Criminal Attacks Strategy embraces a range of activities which cover its understanding of the risk of fraud, enhancing its intelligence and the response to fraud threats. In accordance with the strategy it has implemented a range of measures designed to restrict the opportunity for fraudsters to abuse the system, including tighter control on the issue of claim forms, fraud awareness training for staff, and deploying compliance officers in tax credit call centres. The Department has also introduced a number of checks designed to identify and prevent payments to fraudsters. These measures, combined with the closure of the e-portal, have significantly reduced the level of identified losses due to organised fraud from the levels in 2005-06.

2.21 The examinations by the Department's Organised Fraud Team and other procedures, such as inspecting claim forms prior to processing for evidence of organised fraud, have prevented some £66 million of incorrect payments, comprising £41 million from checks on claims before they were paid and £25 million from checks on awards in payment. The Department's checks of awards in payment also found it had made incorrect payments of some £20 million relating to suspected organised fraud.

2.22 The Department has to address the risk that its staff or Department for Work and Pensions (DWP) Jobcentre Plus staff, who also have access to the tax credits system, may abuse their access rights to provide information which could be used by organised fraudsters to make false claims. The Department's Anti Fraud Assurance Team (AFAT) has identified six cases of suspicious access to tax credits data by DWP staff since October 2006. In response, the DWP has worked closely with the Department throughout the year to investigate these cases of suspicious access, ensuring that appropriate measures are taken with staff and to address any identified control weaknesses. The Department is analysing the potential loss as part of its preparation for criminal prosecution. It is also considering placing tax credits data on the DWP's Customer Information System (CIS) to facilitate better local authority access. As part of its security controls under the proposed arrangements, AFAT will review local authority staff access to tax credit claimant records.

The Department's future strategy for reducing error and fraud

2.23 Tax credits are vulnerable to fraud where applicants provide false information, for example by understating or failing to declare income, or by misrepresenting their circumstances, for example by failing to declare the existence of a partner or overstating the hours worked. Claimants may also make genuine errors in their applications which result in incorrect awards, for example misunderstanding what should be reported as income or incorrectly calculating childcare costs.

2.24 The Department's compliance strategy has a range of measures which are designed to address the underlying causes of error and fraud. These include risk-based investigation of certain awards, comparison with the information held elsewhere in the Department and by third parties and providing guidance and assistance to claimants.

2.25 During 2007 the Department undertook a review to better understand the exposure to losses from particular risks, the breakdown between error and fraud for each risk, and the various responses available to tackle each risk. The losses attributable to the most significant causes of error and fraud for 2006-07, in terms of value and the proportion of cases affected, are shown in **Figure 8 opposite**.

2.26 In the light of its work to understand the underlying causes of error and fraud, the Department has developed a plan to reduce the level of clamant error and fraud to not more than 5 per cent of the value of finalised awards by 2011. It aims to increasingly tailor its approach to address the root causes of error and fraud in different claimant groups and ensure it has robust measures to identify and tackle deliberate non-compliance. Its responses are designed to supplement and enhance existing measures for deterrence and prevention and involve:

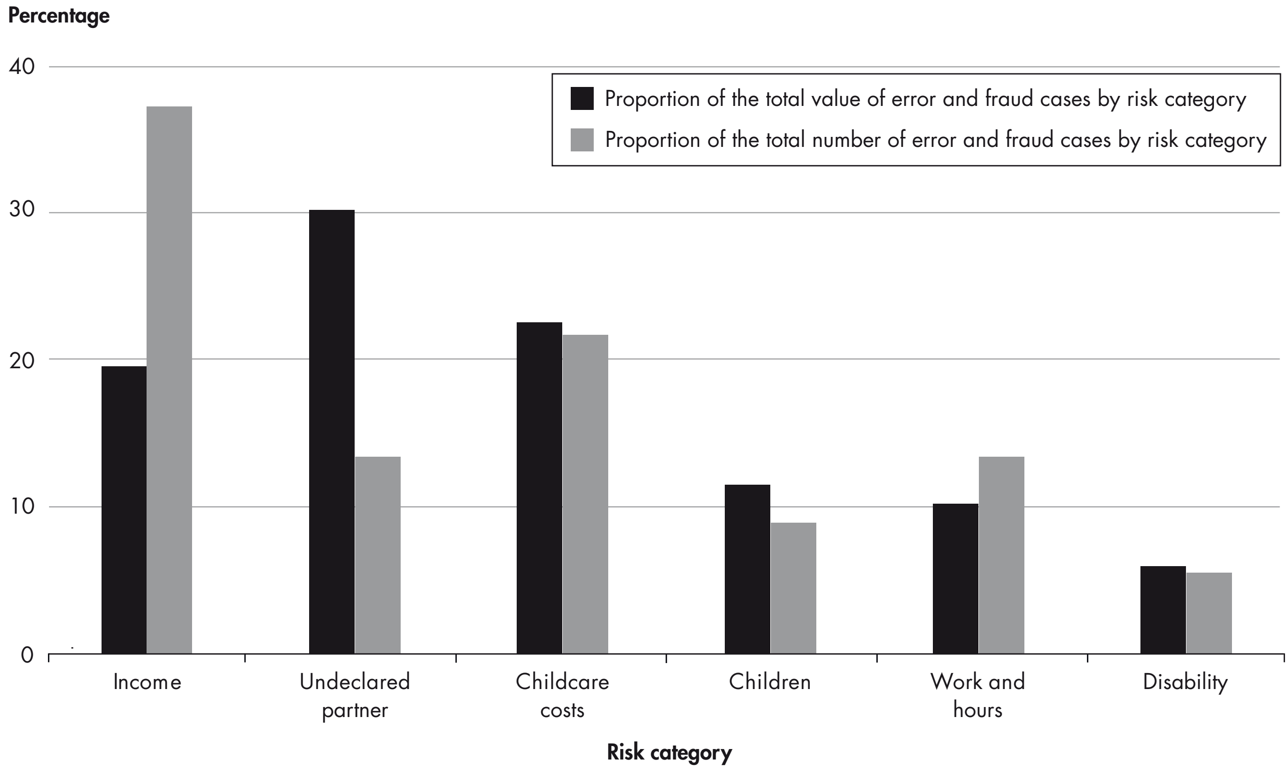
- introducing more sophisticated risk profiling of claims to assist in the identification and targeting of high risk cases and claimant groups;
- adopting a more structured approach to the deployment of compliance resources to ensure the systematic examination of high risk cases, including the use of specialist teams to tackle different types of error and fraud; and
- making more use of internal data and that held by other government departments to corroborate information provided to the Department across a larger proportion of the claimant population than that currently examined through compliance enquiries.

2.27 Through its compliance work and the Transformation Programme, the Department aims to enhance the education and support provided to those claimants who want to get it right by allowing them to better understand their obligations. The improvements to communication products and the future compliance strategy should also help to support claimants who may not be receiving their full entitlement.

Managing overpayments caused by adjustments to awards

2.28 As described in paragraph 2.6, the Department initially calculates a provisional award based on the information it holds on the claimant's income and family circumstances. It will adjust the award when changes in the claimants circumstances and income are reported. This adjustment can occur either during the year or as part of the end of year finalisation process. Where the provisional award resulted in an overpayment, the Department will seek to recover the overpayment from future awards or, if there is no ongoing entitlement, directly from the claimant. The Department pays the claimant the balance if the provisional award was lower than the final award.

8 Tax credits error and fraud in 2006-07 by risk category



Source: HM Revenue & Customs

NOTE

This figure shows the breakdown of error and fraud by risk category as a proportion of the total value of estimated losses and the estimated number of cases involved. Thus, for example, the mis-declaration of income accounted for 37.1 per cent of all cases involving error and fraud but only 19.7 per cent of the estimated value of losses.

2.29 In 2006-07 overpayments were £1.0 billion, significantly lower than the first three years of the scheme, as shown in **Figure 9 overleaf**. In accordance with the Department's normal approach, this figure excludes remissions and recoveries of overpayments made before the end of the year. Tax credit awards for 2007-08 are not all due to be finalised until the end of January 2009. The Department will publish overpayment statistics on these awards in May 2009.

2.30 To limit the need for adjustments to provisional awards, rises in the claimant's income during the previous year are disregarded up to a set level when awards are finalised. This level was initially set at £2,500, but as part of the 2005 Pre-Budget Report, the Government increased it to £25,000. This change, as well as other administrative changes to the scheme announced in the 2005 Pre-Budget Report, came into effect in 2006-07. The Department anticipated that the 2005 Pre-Budget package as a whole would reduce the value of overpayments by a third from the level they would have been had the package not been implemented. It estimated the increase in the disregard would contribute between £400 million and £600 million to this reduction and the indications from the finalisation of 2006-07 awards are broadly consistent with this estimate.

2.31 The Department also implemented administrative improvements in its processing of tax credits changes in circumstances which are also likely to have contributed to the fall in overpayments. But the respective contribution of the policy and operational changes cannot be quantified.

2.32 In addition to the fall in the overall level of overpayments the value of overpayments as a proportion of the value of finalised awards is now 5.5 per cent compared with 19.2 per cent in the first year of the scheme, as **Figure 10 overleaf**. The number of families affected by overpayments and the average value of overpayments are also lower in 2006-07 than in previous years.

9 Tax Credits Overpayments and Underpayments to 31 March 2007

	2003-04	2004-05	2005-06	2006-07
Families benefiting	4.6m	5.0m	5.3m	5.5m
Families affected by overpayments	1.9m	2.0m	1.9m	1.3m
Families affected by underpayments	0.7m	0.9m	0.9m	0.8m
Net cash paid to claimants in year	£13.5bn	£15.8bn	£17.3bn	£18.7bn
Overpayments	£2.2bn	£1.8bn	£1.7bn	£1.0bn
Subsequent changes to entitlement[1]	£0.1bn	£0.3bn	£0.2bn	–
Total to be recovered	£2.3bn	£2.1bn	£1.9bn	£1.0bn
Underpayments	£464m	£556m	£ 549m	£525m

Source: HM Revenue & Customs

NOTE

1 This is mainly individual error and fraud subsequently identified in finalised awards through the Department's compliance activity.

Figures may not sum due to rounding.

10 Tax Credits Overpayments

	2003-04	2004-05	2005-06	2006-07
Final value of awards	£12bn	£14.3bn	£16.0bn	£18.2bn
Total to be recovered[1]	£2.3bn	£2.1bn	£1.9bn	£1.0bn
Overpayments as a percentage of final value of awards	19.2%	14.7%	11.9%	5.5%
Average overpayment	£1,211	£1,050	£1,000	£769
Families affected by overpayments	1.9m	2.0m	1.9m	1.3m

Source: HM Revenue & Customs

NOTES

1 Comprising total overpayments plus subsequent changes in entitlement, see Figure 9.

Recovering tax credit debt

2.33 Overpayments arise where the Department has paid the claimant more money than they are entitled to. Where there is on-going entitlement, the Department recovers overpayments from future tax credit payments. But it restricts recoveries made against the payment of future awards to prevent hardship. It seeks direct recovery of overpayments where the claim is no longer in payment. The Department expects that in some cases complete recovery of overpayments may take several years.

2.34 At the end of March 2008, £4.3 billion was owed to the Department in respect of overpayments. Of this debt, £1.6 billion was being recovered from ongoing awards and £1.8 billion directly from claimants. In addition, some £0.9 billion of debt was not subject to active recovery action, for example where recovery action is temporarily halted when the claimant has disputed the recovery of an overpayment, or where the debt is sufficiently new that the Department has not or has only recently issued a notice to pay. It is now taking action to enhance its monitoring of this debt.

2.35 Over the first five years of the scheme the Department has recovered £2.1 billion of overpayments from ongoing tax credit awards. It is seeking to collect a further £1.6 billion against future payments. By the end of 2007-08, it had collected £0.6 billion directly from claimants and £1.8 billion was outstanding.

2.36 The Department has to form a view on the tax credit debt that may not be recovered and may eventually be written off. In the first four years of the scheme, it has written off £1.0 billion of the £7.3 billion overpayments shown in **Figure 11**. It has also written off £0.2 billion in respect of amounts paid and written off in the same year, before awards were finalised, for example where it has identified organised fraud. In addition, a total provision of £1.8 billion has been made in the Trust Statement for overpayments expected to be written off.

Disputed Overpayments

2.37 The Department has established procedures for resolving disputes about overpayments and their recovery. **Figure 12** provides details of the number of overpayments that have been disputed since the Department began to recover overpayments in 2004-05. The Department aims to deal with disputed overpayments within four weeks. At the end of 2007-08 it had 69,000 disputed overpayment cases on hand.

2.38 The Department's policy for the recovery of overpayments is set out in its Code of Practice 26, 'What happens if we have paid you too much tax credit." Until December 2007 the Department did not seek to recover overpayments where it had made a mistake and the claimant could reasonably have thought the payment was right. In January 2008, it introduced a new approach which moves away from reliance on judgments of what claimants could be expected to know and sets out the responsibilities the Department and claimants need to fulfil. Under the new approach, the Department will accept responsibility for processing information received from a claimant within 30 days.

11 Recovery and write-offs of overpayments from 2003-04 – 2006-07

	2003-04	2004-05	2005-06	2006-07	Total
Total to be recovered[2]	£2.3bn	£2.1bn	£1.9bn	£1.0bn	£7.3bn
Amounts written off by 5 April 2008	(£0.4bn)	(£0.3bn)	(£0.2bn)	(£0.1bn)	(£1.0bn)
Amounts recovered by 5 April 2008	(£1.3bn)	(£0.8bn)	(£0.6bn)	(£0.1bn)	(£2.7bn)
Debt to be recovered at 5 April 2008	£0.7bn	£1.0bn	£1.1bn	£0.8bn	£3.6bn

Source: HM Revenue & Customs

NOTES

1 This table excludes amounts for 2007-08 awards. The overall level of overpayments for these awards will not be known until they have been finalised.

2 Comprising total overpayments plus subsequent changes in entitlement, see Figure 9.

3 Figures may not sum due to rounding.

12 Disputed Overpayments

	2004-05	2005-06	2006-07	2007-08
Disputes received	216,679	364,380	371,282	240,786
Number of overpayments written off following the dispute	10,300	160,702	9,912	6,816

Source: HM Revenue & Customs

Inappropriate adjustments to finalised awards

2.39 The 2002 Tax Credits Act gives the Department certain powers to adjust awards after finalisation. In 2007 the Department found that it had made adjustments to some finalised awards beyond the circumstances provided for in legislation. Although these adjustments brought the revised award into line with the claimant's actual circumstances, the Department did not always follow the correct process, in particular:

- The 2002 Act requires it to write to the claimant if it makes enquiries into a finalised award, but there have been cases where it effectively opened enquiries without informing the claimant.
- In other cases it has made adjustments to awards that were beyond its powers. Under Section 21 of the Tax Credits Act, the Department can adjust finalised awards in the claimants favour in cases of official error. But the Department has also recovered overpayments on finalised awards caused by official error. It therefore needs to repay these amounts.

2.40 The Department has written to claimants whose awards it considers might have been affected, but it needs to examine each of these in detail to determine if it made incorrect adjustments. It is now reviewing 250,000 awards to regularise its enquiries by informing the claimant and making repayments where these are due. The Department estimates this work will take three years to complete. Of these cases, it estimates it owes around 20,000 claimants an average repayment of between £800 – £1,000.

2.41 The Department has taken action to correct its procedures. It is developing computer changes to ensure staff are warned when there is a danger of incorrectly adjusting a finalised award, which it plans to implement in April 2009. In the interim period, it has introduced revised manual procedures to prevent incorrect adjustments.

2.42 The Department's review of why its procedures failed to comply with legislation concluded that the provisions of the Tax Credits Act were not fully reflected in the computer system specification. In particular, the system does not prevent or warn staff from reopening a finalised award. The Department also found that certain aspects of the day to day guidance used by staff were incorrect. The Tax Credits Technical Manual, as the highest level of guidance, should have formed the basis for more detailed desk guidance but this was not in place for the launch of tax credits in 2003. Instead the Department prepared desk guidance based on the computer system specification, which did not fully reflect the legislation. The Department did not re-examine its desk guidance to assess its consistency with the Technical Manual once it was in place in 2004. The Department is now taking action to ensure that all tax credits guidance provided to staff is correct. It has also undertaken a wider programme of work to provide assurance over the full tax credits process.

Conclusions

2.43 The tax credits scheme relies on claimants telling the Department when their circumstances change so that it can update their awards. Claimants have not always understood their obligations under the scheme or received the support they needed from the Department. As a consequence over and underpayments have occurred because the Department has made payments based on out of date information.

2.44 In November 2006 the Department established the Tax Credits Transformation Programme to identify and deliver improvements. It is currently evaluating some service improvement pilots designed to assist claimants who need extra support in making a claim and reporting changes in circumstances. It anticipates that most of these will be implemented by April 2009. To date its work on tax credits transformation has been limited to changes that can be made within the framework of the existing computer system.

2.45 Since the tax credits scheme was introduced in April 2003 it has suffered from high levels of error and fraud. The Department's latest estimate is that in 2006-07 error and fraud resulted in between £1.31 billion and £1.54 billion (7.2 to 8.4 per cent of the final value of awards) being paid to claimants to which they were not entitled. I have qualified my opinion on the regularity of the expenditure reported in the Trust Statement in respect of tax credits error and fraud. The Department's estimate's of error and fraud from 2005-06 are based on a more robust approach to evaluating the results of its random enquiry of finalised awards. The estimate, however, excludes error and fraud on terminated awards included within the £148 million of incorrect payments identified during 2006-07 through the Department's compliance activity.

2.46 The Department has set a target to reduce the current level of claimant error and fraud to not more than 5 per cent by 2011. It is also strengthening its response to those claimants who represent the highest risk of error and fraud as well as considering other measures which it will pilot through 2008-09. The Department is aware of the need to carefully evaluate these pilots and use the results to direct its compliance activity to areas that have the greatest effect in reducing error and fraud.

2.47 The Department estimated that year end adjustments to awards meant it overpaid £1.0 billion in 2006-07, compared with £1.7 billion in 2005-06. This fall in overpayments is mainly because of the increase from £2,500 to £25,000 in income rises which are disregarded when finalising awards. Other measures announced in the 2005 Pre-Budget Report together with operational improvements by the Department have also contributed to the fall.

2.48 In the first four years since the scheme was introduced, the Department calculates that year end adjustments, and other small changes to entitlement after the finalisation of awards, have led to a debt of £7.3 billion. It has also identified £700 million from in year adjustments to 2007-08 awards and will identify further overpayments for this year once awards are finalised. By the end of March 2008 the Department had collected £2.7 billion of this debt and written off £1.0 billion. £4.3 billion remains to be collected of which £1.8 billion is in doubt. Some £0.9 billion of debt was not subject to active recovery, for example where recovery is temporarily halted due to a disputed overpayment or the debt was in the process of being transferred to direct recovery.

2.49 The 2002 Tax Credits Act gave the Department certain powers to adjust awards after finalisation. The Department made adjustments to some finalised awards which were outside the circumstances provided for in legislation. The Department's specification for the computer system did not reflect the requirements of the Act and the day to day guidance used by staff was incorrect. The Department is reviewing 250,000 awards to determine whether repayments are due and it estimates this work will take three years to complete. Of these cases, it estimates it owes around 20,000 claimants an average repayment of between £800 – £1,000.

PART THREE

Follow up on the collection of Income Tax

Developments in the administration of PAYE

Introduction

3.1 Pay As You Earn (PAYE) collects income tax at source from employment and pensions. In 2007-08 the Department collected £127 billion in income tax and £98 billion in National Insurance Contributions through PAYE. Our recent reports on the Department's accounts have commented on the increasing complexity of the employment market which the Department's PAYE computer systems are not well suited to administer and the inconsistent working practices because staff are not aware of or are failing to follow Departmental procedures. In 2008 we have examined the Department's progress in dealing with these issues.

The PAYE System

3.2 Employers and pension schemes usually make a single monthly payment to the Department for all income tax and National Insurance deducted from employees' earnings and pensions. But these payments are not accompanied by information about the individual employees or pensioners to whom they relate. The Department cannot allocate payments to individuals until the year end when employers and pensions schemes submit their annual returns reconciling the totals paid with deductions made from each employee or pensioner. These returns show total earnings, tax deducted, National Insurance Contributions and statutory payments under each PAYE scheme (form P35) and information on individual employees (form P14). The Department reconciles amounts received from employers to this information and records income received and tax and national insurance paid by individual taxpayers.

Filing of Employer Returns

3.3 In April 2002, the Chancellor of the Exchequer announced that the Government would implement the recommendations of Lord Carter of Coles' Review of Payroll Services to mandate online filing of employers' end of year returns. The Department has made consistent improvements in the filing and processing of employer end of year returns following the introduction of online filing in 2005. Whereas only 50,000 employers were mandated to file online in 2006-07, 1.4 million returns were received this way, as shown by **Figure 1 opposite**. The Department also exceeded its targets to process 98 per cent of employers' annual returns by 31 December and 99 per cent by 31 March. However, the Department still lacks management information to allow it to track processing of P14s through the key stages in the end of year filing process. This can make it difficult for the Department to monitor the precice status of the returns within the end of year process prior to the updating of the relevant PAYE and National Insurance systems.

3.4 A further review of the Department's online services by Lord Carter, published in March 2006, recommended that employers should be required to file in year returns (forms P45 and P46 which record changes in employments) electronically, starting with large and medium sized employers from April 2008. Following the consultation process, mandatory online filing was deferred until April 2009 to provide employers with additional time to prepare for the change. In 2007-08 the Department received 4.6 million in-year forms over the internet.

Benefits in Kind

3.5 Employers inform the Department of expenses and benefits in kind provided to employees in the year, such as a company car or private health care, using forms P11D. The processing of this information involves computer checks of the tax paid against the liability. Where there are differences, clerical action is required to make repayments

1 Filing and processing of employer end of year PAYE returns

Tax Year	2004-05	2005-06	2006-07	2007-08[1]
Processing of P14s by end of October	57%	86%	92.5%	89.2%
Percentage of returns that failed to meet HMRC's quality standards	13%	5%	1.4%	0.9%
Returns received online by end of May	1.1 million	1.2 million	1.4 million	1.4 million

Source: HM Revenue & Customs

NOTES

1 The figures for 2007-08 record the position as at 3 June 2008.

or collect underpayments and to change tax codes for the future so that taxpayers pay the correct amount. Our 2006-07 Report noted that the clerical action was not always being undertaken and computer printouts were not being worked accurately or in a timely manner because of competing work priorities. In May 2007 the Department introduced an automated process for managing changes to tax codes for benefits in kind. The Department estimates that this process has resulted in 72 per cent of tax codes being automatically updated following the receipt of P11Ds. Tax codes for 2.0 million taxpayers have therefore been updated much earlier than had been possible when they were handled manually. The automated process also means that there are fewer exceptions that need to be reviewed clerically. But there is a risk that competing work priorities will continue to affect the Department's ability to work exceptions in a timely manner, and these exceptions are not a current priority.

Employees with Multiple Sources of Income

3.6 The PAYE system was introduced when it was usual for employees to have a single stable, full-time employment. Changes in work patterns, with much more fluid employment patterns being typical, have made it more difficult for the Department to ensure the right amount of tax is collected during the year and that all the necessary information is brought together at the end of the year to check the accuracy of deductions. The Department's PAYE computer systems structure records around employers rather than individual taxpayers and records are held in 12 regional databases. As a result, it can have difficulty identifying all relevant sources of income when calculating tax that should be paid.

3.7 In April 2007 the Department implemented an interim solution to this problem by automatically bringing together P14 returns for all the employments of a taxpayer before making its year-end checks. The aim was to make it easier to identify cases where too much or too little tax has been paid. This change increased by 2.6 million the number of cases where the Department matched information received to a taxpayer's record automatically. But the new process identified an additional 2.3 million cases that did not automatically reconcile and required manual checking to ensure the right amount of tax was paid.

3.8 The Department recognises that significant improvement in the operation of PAYE can only be achieved through fundamental changes in its computer systems. It therefore plans to transfer the computer support for PAYE on to the National Insurance Recording system which will progressively become the main system which processes PAYE information. This system will allow all information on individuals to be brought alongside their national insurance record and provide the Department with a more complete view of a taxpayer's employment income. The Department originally planned to introduce this change in April 2008, but deferred implementation until October 2008 to allow more time to assure itself that there were adequate supporting systems.

Open cases

3.9 At the year end the Department's computer system checks whether the tax an employee should have paid in the year is consistent with year-end pay and tax information received from employers. The computer identifies approximately 30 per cent of cases that have to be checked clerically (open cases). These might be where there are doubts that the right amount of tax has been paid or there are difficulties matching information to a taxpayer's record. The Department has an annual programme to check cases manually, but it gives priority to individuals who contact them if they think their tax affairs are incorrect. Delays in clearing these records can mean that taxpayers are not notified on a timely basis if additional tax is payable or refunds are due. Based on analysis from previous years, the Department estimates that around 70 per cent of open cases contain no material under or overpayments of tax. But the nature of open cases for 2007-08 may be affected by the computer changes explained in paragraph 3.7.

3.10 At 31 March 2007 there were 13 million open cases. The Department took measures designed to reduce these numbers, including redeploying staff to work on open cases, using staff in other areas to help with the easier cases and offering more overtime for its more experienced staff to deal with the more difficult cases. It expected these measures, along with the new automatic process for bringing together P14s and a greater management focus on clearance, to reduce the number of open cases to 10.5 million by March 2008. The Department subsequently increased this estimate to 12.5 million, following the redeployment of staff onto tax credits work and its efforts to reduce levels of outstanding taxpayer post.

3.11 At the end of March 2008 the actual level of open cases was 16.2 million. The Department considers that the following factors are responsible for the increase:

- as outlined in paragraph 3.7 above, automatically bringing together information on all the jobs of a taxpayer identified an additional 2.3 million cases which required manual checking;
- competing work pressures from other areas led to staff planned to be used on open case work being diverted to other work;
- economic growth and changing demographics and working patterns have led to a 30 per cent increase in the number of records held on the Department's PAYE computer systems since April 2000; and
- lower than anticipated take-up of overtime and using overtime to deal with other work pressures.

3.12 The Department now aims to have eliminated the backlog of 2006-07 and earlier open cases by 2010. It plans to achieve this through the computer changes described above which will transfer its PAYE employee records on to the National Insurance Recording System. The Department anticipates its improved ability to match information received to a taxpayer's record and the automatic reconciliation of end of year information will reduce the volume of cases generated for checking for 2008-09 and subsequent tax years. This reduction will also allow the Department to redeploy some of the staff savings to clear open cases for earlier years. The Department is also working with a specialist firm to provide advice on data matching to further reduce levels of open cases.

Improving the accuracy of processing

3.13 The Department needs to process taxpayers' information at various stages in the operation of PAYE, for example where an employee changes job or requires a new tax code. The Department's Quality Monitoring Exercise (QME), an independent monthly check on the accuracy of processing, has shown that PAYE processing accuracy is well below target. The majority of PAYE cases are processed automatically, but around 30 per cent require manual intervention which is more prone to error. The Department achieved a marginal improvement in processing accuracy in 2007-08 to 83.4 per cent (82.1 per cent in 2006-07) but still below its target of 93 per cent.

3.14 The main cause of inaccurate processing is the Department's failure to update tax codes following the processing of Self Assessment returns. This is currently a manual process and delays in taking action can mean taxpayers' codes are incorrect. Subject to the Department's PAYE records being transferred into the National Insurance Recording system in October 2008, it plans to automatically update tax codes after it processes Self Assessment returns from April 2009.

3.15 The Department's efforts to improve the quality of its coding decisions through the introduction of a spreadsheet tool, "Coding Assistant", have yet to realise the benefits in full. Although its use is mandatory, the Department has found that usage of 'Coding Assistant' is lower than expected and it has introduced new arrangements to monitor its application.

The taxation of small pensions

3.16 Our 2006-07 Report noted that some pensioners have not been paying tax on all of their taxable pension income since 1983. This shortfall is due to the provision of incorrect advice to pension providers by the Department, inappropriate local agreements and failures by local offices to implement agreed procedures. The Department estimates it has potentially not collected income tax on 420,000 pensions and that the tax loss is some £135 million a year.

3.17 The Department informed pension providers that their returns for the 2007-08 tax year must include details of every pension in payment, irrespective of the amount and of any prior local arrangement not to report certain pensions. It received these returns as part of its normal collection of PAYE end of year data which ended in May 2008.

3.18 We reported last year, the Department intended to take no action in relation to untaxed pensions for years up to and including 2006-07. It planned to collect tax for 2007-08 and subsequent years under PAYE by establishing the correct tax code to be applied for 2008-09 and collecting any underpayment of tax for 2007-08 in a later year.

3.19 The Department reviewed this timetable following its decision to defer the PAYE computer changes until October 2008 (see 3.8 above). As a consequence of this deferral the Department will not be able to collect expeditiously the tax due in respect of 2007-08 during 2008-09, as it originally planned. In the absence of the computer changes it considers significant clerical resources would be needed to establish the correct tax code for 2008-09. All of this work would need to be done manually and involve the redeployment of resources, affecting the service provided in other areas. The delay in correcting tax codes and notifying these changes to pension providers would also increase the risk of inconsistent treatment of individuals. It would also prevent the Department giving reasonable notice of the unpaid tax to the taxpayers concerned. For these reasons, following legal advice, the Department exercised its management discretion to waive the tax due for 2007-08.

3.20 The Department now intends to collect tax on these pensions for 2008-09 and future years. It will use end of year information supplied by pensions providers in April and May 2009 to issue correct tax codes for 2009-10. Any underpayments for 2008-09 and 2009-10 will be collected in 2010-11 and later years. The availability of information on pensions for 2007-08 gives the Department a better opportunity to provide the affected pensioners with an explanation before changes are made. Even after allowing for this deferral, the Department recognises that the changes could place some taxpayers in difficulty and it plans to collect underpayments over a longer period of time in cases of hardship.

Developments in the administration of Self Assessment

Introduction

3.21 Self Assessment was introduced in 1996 for taxpayers with a number of sources of income and with less straightforward financial affairs. In 2007-08 the Department collected £30.2 billion tax through the system, after repayments. Our 2006-07 Report commented on a number of issues in the Department's administration of Self Assessment, including the progress made in delivering online services, taxpayers' compliance with their obligations, repayments and self assessment debt. In 2008 we have examined the Department's progress in dealing with these issues.

The self assessment process

3.22 Under Self Assessment, the primary responsibility for calculating the tax liability rests with the taxpayer rather than the Department. Taxpayers are required to complete returns to establish how much income tax they should pay and to provide the Department with the information it needs to validate this calculation. Taxpayers have a statutory obligation to submit their returns for the preceding tax year by 31 January. The Department operates a statutory penalty regime for taxpayers who fail to meet this deadline.

3.23 Over the years the Department has made changes to the self assessment process to ease the compliance burden on taxpayers. In April 2008, the Department issued a re-designed main return for the 2007-08 tax year, which is simpler and reduces the number of pages that some taxpayers are required to complete.

3.24 In 2008 the Department is introducing measures, recommended in Lord Carter's 2006 review of its Online Services, to increase the number of taxpayers who file electronically and to help manage the peak pressures. These involve:

- bringing forward the deadline for filing paper returns to 31 October (without changing the 31 January deadline for filing electronic returns) to provide an incentive for online filing;
- withdrawing approval for computer generated paper 'substitute' returns; and
- reducing the period for the Department to enquire into returns from 12 months from the 31 January filing deadline to 12 months from the date the return is filed to remove a perceived disincentive for early filing.

Filing of self assessment returns

3.25 The Department had two Public Service Agreement (PSA) targets relating to the timely receipt of self assessment returns and online filing. In 2007-08, the Department did not meet its challenging target for improving the percentage of self assessment returns filed on time, but significantly exceeded its target for the percentage of returns filed online as shown in **Figure 2 overleaf**. This is in part as a result of changes since 2004-05 which removed 1.6 million taxpayers with relatively simple tax affairs and a better record for filing self assessment returns.

2 Self Assessment Returns Issued and Performance against Filing Targets

	2005-06		2006-07		2007-08	
Returns issued (million)	9.08m		9.28m		9.32m	
Filing Targets	**Target %**	**Result %**	**Target %**	**Result %**	**Target %**	**Result %**
By 2007-08 increase percentage of Self Assessment returns filed on time to at least 93 per cent	90.6	90.3	91.5	89.2	93.0	88.6
By 2007-08 increase the percentage of Self Assessment returns filed on time and online to 35 per cent	25.0	24.3	29.0	35.1	35.0	46.0

Source: HM Revenue & Customs

3.26 The Department's system for the online filing of Self Assessment returns was introduced in 2000 and has been at the forefront of its drive to engage with the taxpayer through the internet. There has been a continuing increase in levels of online filing since the system was introduced. In 2007-08, 46 per cent of returns (3.8 million) were filed online, which was significantly in excess of the Department's target of 35 per cent.

3.27 The Department experienced difficulties with the Self Assessment online system on the 31 January 2008 filing deadline. This disruption arose because of a capacity problem in one of the computer systems supporting the online service which meant the system was not available to some taxpayers on 31 January 2008. Whilst a record number of 204,000 taxpayers were able to file online on 31 January, the Department estimates between 10,000–15,000 taxpayers who attempted to file their returns online were unable to do so.

3.28 The Department planned for a significant increase in filing of returns around the 31 January deadline. The Department secured assurances from its supplier that the online service could be supported at the expected volumes at the peak period. However, on the day the hardware problem meant that the level of customer attempts to use the online service could not be supported. The Department and the supplier have reviewed how online services are tested to ensure peak demands are met in the future. In April 2008, the Department delivered a planned update to its Self Assessment online system, as part of its programme to place it on a new computer platform. The Department confirms that this change has addressed the hardware problem it had at the end of January. It is also undertaking a wider review of lessons learned to enhance the speed with which it responds to such events.

3.29 Of the 9.3 million returns issued for the 2006-07 tax year, around 11.4 per cent were outstanding after the 31 January filing deadline. The results for 2007-08 of 88.6 per cent of returns filed on time were slightly lower than those in the previous three years and significantly below the Department's target of 93 per cent. The Department attributes this fall in performance to the removal from Self Assessment of taxpayers with relatively simple tax affairs, who had a better record of filing and paying on time and its decision to limit media advertising in 2007-08 because of limited resources.

Improving the accuracy of self assessment processing

3.30 The Department processes all self assessment returns to establish if taxpayers have paid the right amount of tax and to recover additional amounts due or to repay any overpayment. It also updates taxpayers' records and, in PAYE cases, individuals' tax codes to ensure that the right tax is deducted from employees' future earnings. The Department has improved its rate of accuracy in processing Self Assessment returns. In 2007-08 the Department accurately processed 97.6 per cent of Self Assessment returns (96.5 per cent in 2006-07), exceeding its target of 97.5 per cent.

Taxpayers compliance with their obligations

3.31 The Department undertakes an annual random enquiry programme to assess the accuracy of filed returns. Based on the latest results available for 2002-03, 34 per cent of filed returns were inaccurate. The Department estimates that between £2.9 billion and £3.7 billion tax was therefore at risk because of inaccurate returns. The random enquiry programme covers only registered Self Assessment taxpayers and is not intended to provide an estimate of under-declared income from people working in the informal economy or taxpayers who are engaged in other employment for which they are not declaring their income. In addition, enquiries will not always identify the full extent of non-compliance, especially where Third Party Information is not available to verify the data supplied by taxpayers. The Department is investigating whether the estimates of tax at risk from the random enquiry programme could be reliably adjusted to take account of the incomplete detection of underreported tax liabilities. The Department is also taking action to improve the timeliness of its estimates of tax at risk to better assess the effectiveness of its compliance activities.

Making repayments

3.32 Repayments arise when the tax paid, on account or by deduction at source (for example through the Pay As You Earn system), exceeds the individual's tax liability. In 2007-08 £4.0 billion Self Assessment repayments were made. The value of repayments has remained relatively constant since 2002-03, but they have fallen as a percentage of receipts from 17 per cent to 12 per cent. Our previous Reports have noted weaknesses in the Department's controls over repayments, including a historic lack of formalised accountabilities, deficiencies in management information and a failure to follow standard procedures.

3.33 The Department has established a Direct Tax Repayment Fraud Delivery Group which covers all income tax repayments. The Group meets monthly to progress an Action Plan to make improvements to the repayments process and so reduce risks. The Department has also taken steps to address continuing failures to follow existing procedures and processes. It has set up assurance arrangements to check that instructions are being followed. As part of its Pacesetter Programme, it is implementing standard processes across its main activities with regular "workplace assessment checks".

3.34 In our 2006-07 Report we noted that the Department had evidence of organised criminal activity to obtain fraudulent repayments, sometimes submitting self assessment returns even though none have been requested (unsolicited returns). It introduced improved controls in April 2007 to monitor these returns and introduced a new risk assessment process for all repayments and those at greatest risk are checked before the payment is made.

Debt management

3.35 Self Assessment taxpayers are required to pay any outstanding tax by the 31 January after the end of the previous tax year. In 2007-08, 88.3 per cent of Self Assessment taxpayers paid amounts owed on time, against the Department's target of 89.8 per cent. The Department attributes this shortfall in performance to the removal from Self Assessment of taxpayers who had a better record of paying on time, as noted in paragraph 3.29. **Figure 3** provides an analysis of self assessment receipts and the average monthly debt since 2004-05.

3.36 Self Assessment taxpayers can appeal against assessments, penalties, surcharges or amendments. These items are "stood over" as not collectible and not forwarded for collection until the appeal is cleared. The Department records details on work lists, which should be monitored so that liabilities can be adjusted and charges released for collection promptly. The Department's latest available estimate of the value of Self Assessment disputed charges stood over was £1.1 billion.

3.37 In 2007, Internal Audit raised concerns about the management of Self Assessment charges 'stood over'. It found that these were given little attention and substantial backlogs of uncleared items had built up. While these items may not necessarily give rise to a debt, delays in forwarding these amounts for collection can make it harder for the Department to subsequently collect debt and potentially lead to a loss of revenue. In response, the Department has undertaken a review of the end to end process for handling standovers in order to introduce improvements and is now starting to address these issues. The Department is also considering how it can increase levels of automation in the process to speed up how it handles certain items.

3 Self Assessment Debts

Year	Self Assessment Receipts £bn	Average Monthly Debt[1] £bn
2004-05	21.84	2.68
2005-06	23.43	2.89
2006-07	26.59	3.13
2007-08	30.23	3.21

Source: HM Revenue & Customs

NOTE

1 The cyclical nature of Self Assessment means that a monthly average figure debt over the year provides a more representative measure of overall level of debt to be collected than a snapshot at a point in time.

Conclusions

The collection of income tax through PAYE

3.38 Following the introduction of online filing in 2005, the Department continues to improve its processing of employer end of year returns. By 31 October 2007 it had processed 92.5 per cent of 2006-07 returns received, and 98.6 per cent of returns received from employers met the Department's quality standards. It still needs to develop better management information to support its governance of the end of year filing process. Following the automation in May 2007 of changes to tax codes for benefits in kind it has updated 72 per cent without manual intervention. The Department needs to ensure it can promptly process those cases which cannot be cleared automatically.

3.39 In 2008 the Department is planning to transfer its processing of PAYE for individuals on to the National Insurance Recording System and so allow it to bring all information on individuals' employment and pensions income together. The Department originally planned this change for April 2008, but deferred it until October 2008 to allow more time to assure supporting systems. The Department's implementation of computer system changes to modernise PAYE processing, including the introduction of online filing in 2005 and the bringing together of taxpayer P14 records in 2007, has in the past met with initial difficulties leading to increased workloads. It needs to ensure that it has tested fully its arrangements for the transfer of processing to the National Insurance Recording system.

3.40 At the end of the tax year, the Department's computer system may identify discrepancies in taxpayer records or be unable to match a return to a record and so it will establish an 'open case' for manual checking. Delays in clearing 'open cases' can mean that taxpayers are not notified on a timely basis of additional tax payable or refunds due. At the end of March 2008 the Department had 16.2 million open cases, which exceeded its revised target of 12.5 million. Computer system developments did not deliver the reduction expected, staff were released to other work and there was lower than anticipated overtime. The Department plans to reach a steady state position by 2010 where there are no backlogs for 2006-07 and earlier years and the open cases for each tax year will normally be cleared within a year. The number of cases that will require manual intervention following the implementation of the computer changes cannot be predicted with absolute certainty, so the Department needs to consider the processing resources necessary to clear the backlog of 'open cases', should this exceed its current estimate.

3.41 Since 1983 the Department has not collected all the tax due from some pensioners because of a failure to apply the PAYE regulations properly. It estimates that this error could affect some 420,000 pensions with a tax loss of some £135 million per annum. It has taken steps to correct the tax treatment, but because of the deferral of the transfer of processing to the National Insurance Recording System, the Department will not now be in a position to correct tax codes until 2009-10. The Department has exercised its management discretion to waive the tax due for 2007-08 because it could not now give the taxpayers concerned reasonable notice of the tax payable. It will therefore not collect the estimated £135 million of tax due for 2007-08 as it originally planned. It will start to tax these pensions from 2008-09.

The collection of income tax through Self Assessment

3.42 The Department is introducing a number of important changes to the Self Assessment process in 2008. It has introduced a shorter, simplified return for the 2007-08 tax year and will bring forward the deadline for those who file paper returns from 31 January to 31 October. The Department did not achieve its previous target for the submission of returns by the 31 January deadline, although this target was always a challenge following the removal from Self Assessment of certain taxpayers with a better compliance record. The Department has planned publicity campaigns to remind taxpayers of the new deadline.

3.43 The Department has made good progress in the number of returns filed online. In 2007-08, 46 per cent of returns (3.8 million) were filed online and on time significantly exceeding its target of 35 per cent. A record number of 204,000 taxpayers submitted online returns on 31 January, but between 10,000 and 15,000 taxpayers could not because of a capacity problem in the computer systems supporting the service. The Department and its supplier have updated the Self Assessment online system and reviewed the testing of online services to ensure peak demands are met in the future. It is also reviewing the wider lessons learned to enhance the speed with which it responds to such events.

3.44 The Department's latest estimates based on the 2002-03 tax year indicate that 34 per cent of filed returns were inaccurate putting between £2.9 billion to £3.7 billion tax at risk. This estimate is based on registered Self Assessment taxpayers and does not cover under-declared income from people working in the informal economy. The Department needs to produce its estimates of tax at risk more quickly so that it can better assess the effectiveness of its compliance activities. The Department should develop a strategy for increasing the levels of accuracy in filed returns.

3.45 Self Assessment taxpayers can appeal against assessments, penalties, surcharges or amendments. These items are "stood over" as not collectible and not forwarded for collection until the appeal is cleared. The Department's latest estimate of the value of these amounts is £1.1 billion. The Department's Internal Audit found that "stoodover" items were given little attention and substantial backlogs of uncleared items had built up. The Department reviewed the process for handling standovers to identify areas for improvement and is now starting to address these issues.

PART FOUR

Value Added Tax

Introduction

4.1 Value Added Tax (VAT) is levied on the supply of goods and services within the United Kingdom and Isle of Man. Registered businesses pay VAT on the goods and services they purchase (input VAT) and may, subject to VAT regulations, offset it against the VAT charged on the sale of their own goods and services (output VAT). If output VAT exceeds input VAT, businesses pay the balance to the Department. If there is an excess of input VAT, businesses claim a repayment from the Department. In 2007-08 the Department collected net VAT receipts of £81.2 billion, and processed around eight million VAT returns, as shown in **Figure 1**.

4.2 Our 2005-06 Report focused on the Department's efforts to combat missing trader fraud, including action taken to prevent fraudsters from entering the VAT system. The 2006-07 Report provided an update on the Department's progress in tackling missing trader fraud and also outlined the actions taken to improve and strengthen the VAT registration process.[1] During 2007 the Department took much longer to process VAT registrations which led to an increase in complaints from legitimate traders and professional advisors. As part of our work in 2007-08 we have examined the Department's progress in addressing these delays. This report covers:

- the statutory framework for VAT;
- the VAT registration process;
- VAT registration performance;
- the main causes of the processing delays; and
- the Department's action plan.

1 Net VAT receipts/Budget forecast

Year	Budget Forecast (£billion)	Net VAT Receipts (£billion)
2004-05	73.1	73.0
2005-06	76.3	72.9
2006-07	76.5	77.4
2007-08	80.0	81.2

Source: HM Revenue & Customs and HM Treasury Financial Statement and Budget Reports

NOTE

Net VAT receipts reflect cash received and therefore do not match the Trust Statement income figure which is prepared on an accruals basis.

The Statutory Framework for VAT

4.3 The EU Principal VAT Directive provides the general legislative framework for EU Member States to administer VAT. Under the VAT Act 1994, traders are required to register for VAT if their taxable business turnover has exceeded a defined threshold in the previous twelve months, or is expected to exceed the threshold in the next 30 days. From 1 April 2008 the Government increased this threshold from £64,000 to £67,000.[2] If traders fail to notify the Department of their liability to be registered in time, they may incur a late registration penalty. Traders operating below the threshold or intending to trade may also opt for voluntary VAT registration, provided their goods or services are 'taxable supplies' for VAT purposes. In 2007-08 around 30 per cent of registration applications were voluntary.

1 Comptroller and Auditor General's Reports: 2005-06: *VAT missing trader fraud* (HC 1159); 2006-07: *Value Added Tax* (HC 626).
2 HM Treasury, Budget 2008, Chapter A Budget Policy decisions, March 2008 (HC 388).

4.4 Traders cannot charge or reclaim VAT before the Department has processed their applications. Nor can they show VAT as a separate item on any invoice they issue. They can include an amount equal to the VAT which they will be able to charge after registration. This can be done from the date they are liable to be registered, before the certificate of registration containing their VAT number is received. Once registered, traders are required to send the outstanding VAT invoices to their customers within 30 days. These arrangements allow businesses to function while waiting for a VAT registration number. The inability to charge VAT before registration is a fundamental of the structure of the tax. VAT can only be charged by a registered business. However, the Department recognises that where there are extensive delays, these arrangements are cumbersome and costly for businesses to operate and can delay the recovery of VAT incurred by the trader.

The VAT Registration Process

4.5 Traders who apply to register for VAT can do so on paper VAT 1 forms, or electronically through the Department's website. The Department's National Registration Service (NRS) is responsible for ensuring that registration applications, deregistrations and registration amendments (variations), are processed promptly and accurately. The Department now processes VAT registration applications at two regional Registration Units.[3] The Wolverhampton Unit deals with routine applications, and the Grimsby Unit processes the more complex applications, such as group registrations. Two other Registration Units, at Newry and Carmarthen were originally scheduled to stop processing registrations work from April 2007, as part of the Department's reorganisation plan, but remain in operation to assist with the workload.

4.6 The Department aims to support the needs of customers, provide advice and guidance and to ensure that processes are effective to meet demand. But it must balance this customer-focused approach against the requirement to reduce losses owing to VAT fraud and other non-compliance. The Department has a Public Service Agreement (PSA) Target to reduce, by 2007-08, VAT losses to no more than 11 per cent of the theoretical VAT liability. An important part of the Department's strategy to prevent missing trader fraud, labour provider fraud, and other types of evasion, is to stop criminals from entering the VAT system in the first place. It subjects all applications to an initial, semi-automated risk assessment process to identify potentially fraudulent applications, the first of up to three levels of checking, determined by the risk they represent, as shown in **Figure 2 overleaf**.

4.7 These checks led to the refusal of 6,577 registration applications in 2007-08 (6,073 in 2006-07), as shown in **Figure 3 overleaf**. These figures include applications rejected because the trader did not respond to the Department's request for additional information. This total probably included suspect applications from fraudsters. The Department's implementation of tighter registration controls, together with other measures, has helped to reduce significantly the cash losses arising from missing trader fraud. The Department estimated these losses at between £1 billion and £2 billion in 2006-07, compared to between £2 billion and £3 billion in 2005-06.[4]

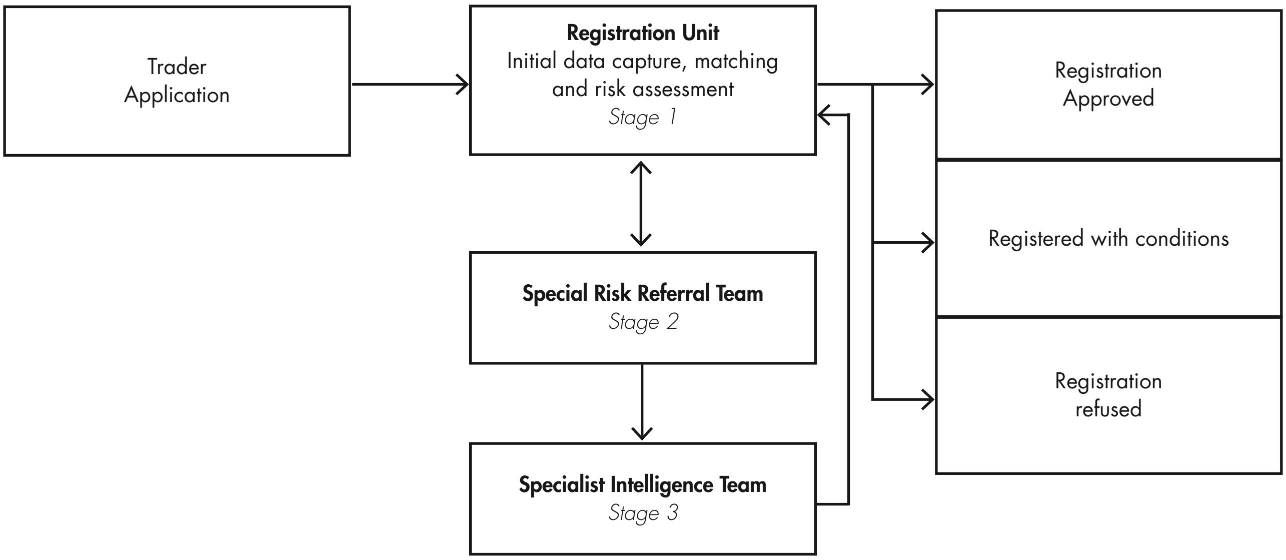
VAT Registration Performance

Completeness and accuracy target

4.8 Under the Public Service Agreement the Department had a target to increase the proportion of applications for VAT registration that were complete and accurate to 50 per cent by March 2008.[5] In 2007-08 it exceeded this target with around 70 per cent of applications deemed accurate and complete, compared with 27 per cent in 2005-06, as shown in **Figure 4 on page R33**. The redesign of the main registration application form (VAT 1) and clearer guidance has made it easier for applicants to understand and complete the forms. The Department also changed the way it gathers the underlying data to measure its performance, which has helped improve the completeness and accuracy of its performance reporting.[6] In September 2006, the Department set up a Registration Working Group comprising all internal stakeholders, to coordinate efforts to improve customer service to legitimate traders applying for registration.

3 There is a separate team – the Non-Established Taxable Persons Unit (in Aberdeen) – which deals with applications from businesses that are located outside the UK but which make taxable supplies within the UK and are, therefore, required to account for UK VAT.
4 HM Revenue & Customs Paper – *Measuring Indirect Tax Losses* 2007.
5 HMRC PSA 2005-08, Objective II, Target 6b.
6 Comptroller and Auditor General: *Fourth Validation Compendium Report Volume 2* (HC 22-II) p40.

2 The VAT registration process



Source: HM Revenue & Customs

NOTES

During the initial Stage 1 checking, the Registration Units may contact traders to ask for further information before continuing to process the application. This occurs, for example, where the application is incomplete, unclear, or evidence of intent to trade or of economic activity is needed to make the risk assessment decision. Some 95 per cent of applications require no further risk assessment and the processing is completed. The rest are referred for Stage 2 checking. Only around 1 per cent of all applications are referred to the Specialist Intelligence Team.

If the Registration Unit does not have sufficient evidence to refuse an application but still has concerns about a trader, it can impose conditions on the registration, such as requiring a financial guarantee or shortening the first VAT period to enable the Department to make an early assessment of compliance.

3 VAT registration checks and outcomes

	2005-06	2006-07	2007-08
New registration applications received	284,804	285,176	274,607
Missing Trader Risk Applications			
New applications subject to detailed checking by specialist risk and intelligence teams	8,672	10,635	10,986
New applications refused on suspect grounds[1]	2,271	4,382	5,083
Businesses registered with specific conditions	1,230	2,320	1,973
Labour Provider Risk Applications			
New applications subject to detailed checking by specialist risk and intelligence teams	1,189	809	1,208
New applications refused on suspect grounds[1]	1,242	1,691	1,494
Businesses registered with specific conditions	446	246	270

Source: HM Revenue & Customs

NOTE

1 Includes suspect fraudulent applications refused by Registration Units without referral to Risk and Intelligence Teams, and those refused following further checks.

Processing targets

4.9 The Department has revised its methodologies and targets to measure the timeliness in processing VAT registration applications. In 2005-06, against a target of 95 per cent, the Department processed 97 per cent of applications from traders within 15 working days. However, this target did not accurately reflect processing times as the calculation only started from the date the Department considered the application to be complete and accurate. It recognised that processing times were much longer for applications not complete and accurate on receipt and, in December 2006, set a new and challenging target of processing 95 per cent of all applications within 14 calendar days by March 2008, as shown in **Figure 5**. This was subsequently revised to 70 per cent in August 2007. In making this change, the Department recognised that some applications would take longer to process, either because they were not complete or accurate or because they would need additional checking for risk reasons. The Department has reported its performance against these targets both to the Joint VAT Consultative Committee (JVCC)[7], and to Parliament in answers to questions from individual Members. The Department had good reasons for changing its internal targets and measures but the changes made it difficult for stakeholders to monitor like for like performance over time.

4 VAT registration performance

	2005-06	2006-07	2007-08
Number of new registration applications received	284,804	285,176	274,607
Percentage of applications received electronically	13%	20%	30%
Percentage of applications that were deemed complete and accurate for the PSA target	27%	49%	70%
Percentage of applications processed within target 14 days [Not measured in 2005-06]	N/A	27%	40%

Source: HM Revenue & Customs

NOTE

The increase in online applications has contributed towards the increase in complete and accurate applications.

5 VAT registration processing: measures and targets

Period	Details of measure	Target
Up to April 2006	Customs and Excise Charter Standard: Process complete and accurate applications within 15 working days of receipt	95%
April 2006 to November 2006	HMRC Standard: Process complete and accurate applications, or contact for further information, within 21 calendar days of receipt	95%
December 2006 to July 2007	Process or identify as high risk, within 14 calendar days of receipt	30% by March 2007 95% by March 2008
August 2007 to date	Process all applications within 14 calendar days of receipt	70% by March 2008

Source: National Audit Office

7 The JVCC was established in 1990 with the aim of bringing together HMRC and representative trade and professional organisations. Designed to be a platform for all parties to exchange views and discuss the operation of VAT policy and law, it also presents an opportunity for feedback on proposed changes in the Department.

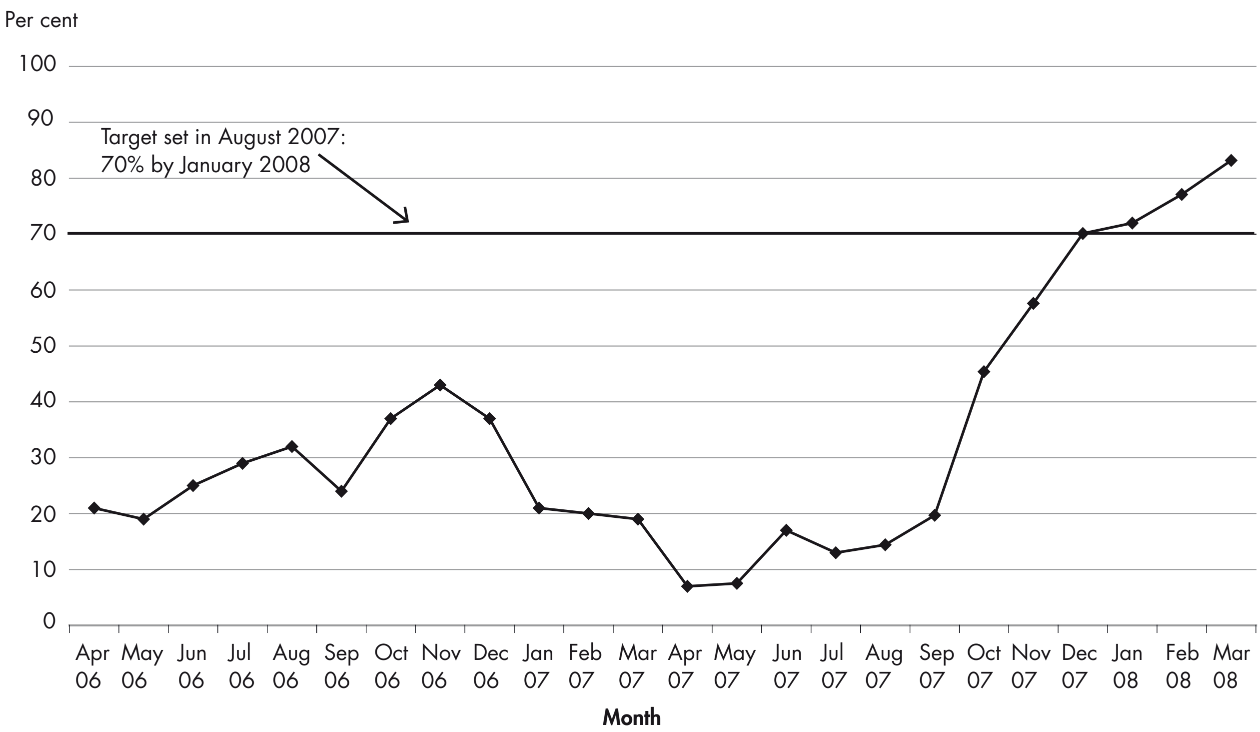
Improvements to processing VAT registrations

4.10 In early 2006 the Department recognised that it needed to improve its performance in processing applications for VAT registration. Between April and August 2006, it processed fewer than 30 per cent within 14 calendar days, as shown in **Figure 6**. The Department took the following measures to improve its performance.

- In March 2006, it introduced the 'Lean' efficiency project at Wolverhampton Registration Unit to identify and remove inefficiencies in working practices and provide a more flexible and effective service. It also aimed to create further capacity at Wolverhampton to cater for the additional work expected from the closure of the Newry and Carmarthen VAT Registration Units. The Department expected the new processes to be operational for all core registration work by March 2007 and it achieved this goal.
- It restructured the way it carried out the risk advisory function on registration applications. Before September 2006, registration staff based at each of the Units initially assessed all applications supported by experienced risk advisors. The Department created a new centralised registration risk referral team, under the control of the Risk and Intelligence Service, which took over responsibility for the Stage 2 risk assessment process (Figure 2). The new team released registration resources to deal with straightforward applications and allowed the risk advisors to be redeployed.

4.11 When the Department implemented these initiatives, it also strengthened its range of anti-fraud measures, to reduce the growing threat of missing trader fraud. These measures included introducing revised risk assessment criteria, to help the Registration Units identify better those registration applications that were potentially suspect.

6 Applications processed within 14 calendar days



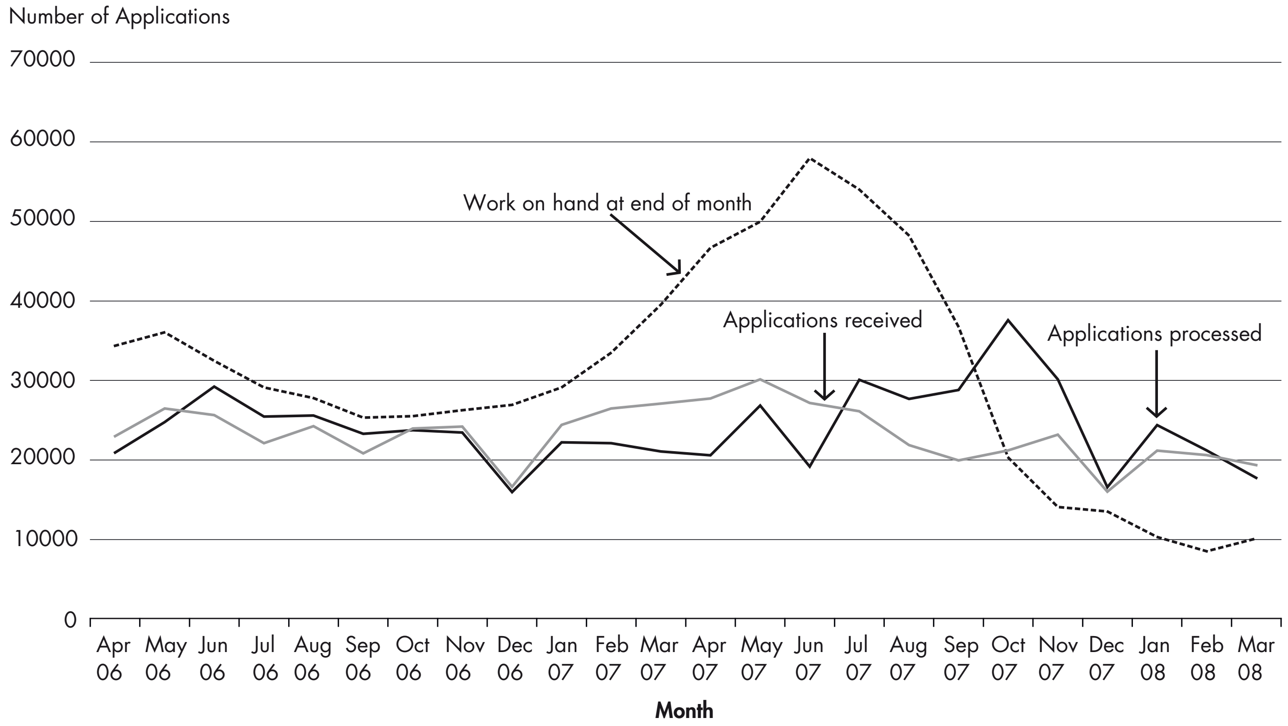
Source: National Audit Office analysis of HM Revenue & Customs data

4.12 The Department recognised that it would take time to embed the improvements in processing and aimed to deliver improvements in performance by March 2007. It also considered more immediate solutions to help improve processing times, including the redeployment of experienced staff or increasing the use of overtime. But it decided not to pursue these and instead focused on the underlying problems described in paragraph 4.10 to increase performance in the long term. These measures brought initial improvements in autumn 2006, but the Department's performance then declined significantly in the first half of 2007.

- The number of applications processed within 14 calendar days decreased from 42 per cent in November 2006, to its lowest point of around 7 per cent in April 2007.
- The average number of days taken to process an application rose from 29 days in March 2007 to around 42 days in August 2007.
- The level of work on hand increased from around 29,000 applications in January 2007 to a peak of about 58,000 in June 2007, as shown in **Figure 7**.

4.13 As performance declined during early 2007, the Department recognised that it would need to take further action to ensure that straightforward applications from legitimate traders could be processed within 14 days. In July 2007, it introduced a detailed plan that has led to a significant improvement in dealing with these cases. The following paragraphs outline the principal factors that contributed to the build up in processing delays and the measures the Department took to improve performance.

7 VAT registration: work on hand



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

NOTE

Work on hand is defined as the number of registration applications received but not yet completely processed. This definition includes applications received but on which work had not yet commenced.

The Main Causes of the Processing Delays

4.14 A combination of factors came together at around the same time to contribute to the delays in processing VAT registration applications.

Risk assessment procedures

4.15 The Department's tighter registration procedures, introduced in 2006, helped to significantly reduce VAT losses arising from missing trader fraud. But these tighter criteria and some poorly targeted risk parameters resulted in more applications, including from legitimate traders, requiring additional information or being referred to Risk and Intelligence for further checks. The newly formed Stage 2 Team had to cope with a significant increase in applications referred by the Registration Units when staff were being trained and, initially, had limited access to some of the necessary IT systems. All these factors added to the time taken to process applications.

Staffing

4.16 Reorganisation of the Registration Units from four to two sites caused short term staffing problems. From January 2007, the Department steadily transferred registration processing services from Newry and Carmarthen to Wolverhampton and Grimsby. But staff numbers in Wolverhampton and Grimsby fell, through general staff turnover and the workforce-change efficiency programme. One of the efficiency initiatives was to reduce contract staff across the Department and to redeploy permanent staff to fill the vacancies. Registration was adversely affected, since a large number of contract staff, some of whom were experienced, had been doing the work for around three years. The contract staff left in March 2007 but the Department found it difficult to redeploy permanent staff. For instance, at Wolverhampton only two members of staff volunteered for redeployment and a shortfall of 30 full time staff equivalents resulted. Furthermore, there was a lead time of several weeks before non-VAT staff, who were redeployed, were fully operational. There was no overtime budget to cover this contingency.

Increase in applications

4.17 In the 2006 Pre-Budget Report the Government announced action to tackle the growth in Managed Service Company (MSC) Schemes.[8] The Government considered that these Schemes were being used to avoid paying the correct amount of income tax and national insurance contributions. To circumvent the new measures some practitioners switched their operations from Managed Service Companies to those which they believed the Department would class as Personal Service Companies (PSCs). PSCs were not covered by these new measures but were still subject to the pre-existing legislation. Many of these newly converted PSCs applied for VAT registration. The Department countered this switch in the 2007 Finance Bill, but it had to process around 20,000 applications from companies purporting to be PSCs.

Computer problems

4.18 Early in 2007 the Department experienced problems with the registration workflow systems. These are relatively old and there were periods when the systems were not operational or not operating at full speed, which contributed to the registration delays. Temporary manual solutions were introduced to address some of these problems, but this inevitably increased processing times.

Management information

4.19 Before August 2007 the Department was unable to monitor accurately the number of registration applications on hand, for the following reasons:

- Staff shortages meant that some applications were not entered promptly on to the registration computer system.
- The computer data was not robust. It incorrectly included old cases that had been recorded twice and refused registrations that had not been properly closed on the system.
- Unfinished applications were not captured within the Department's processing targets. The Department therefore only identified significant delays that had occurred after processing, in some cases long after the Registration Units had received the application.

8 An MSC is a type of intermediary company through which the services of workers are provided to an end client. The definition of an MSC was clarified as a result of the consultation. It is now statutorily defined in Chapter 9, Income Tax (Earnings and Pensions) Act 2003, as inserted by the Finance Act 2007.

4.20 In August 2007, the Department carried out a manual count of unprocessed applications, which identified 48,224 applications on hand, much higher than the normal expected workload, as shown in Figure 7. This result showed that the Department needed robust management information to assess the extent of the processing problems. The Registrations Units have since performed more frequent manual counts to monitor the position. As at March 2008 there was still a discrepancy of some 9,000 between the manual count and the data recorded on the VAT registration computer system. In the longer term the Department aims to use the computer systems to monitor work on hand and is currently performing data cleansing exercises to ensure that they record reliable information.

The Department's Action Plan

4.21 In July 2007, the Department agreed an action plan to address the problems in processing VAT registration applications, as shown in **Figure 8**. It set the following targets to be achieved by January 2008:

- process 70 per cent of all applications within 14 calendar days; and
- reduce the number of applications not started from around 32,000 to nil.

8 Department's Action Plan

Key Action Points	Implementation
Reassigning all new registration work to a single site Registration Unit. Backlogs transferred to other Registration Units for processing.	All new low risk paper applications processed at Wolverhampton. Other Registration Units, Grimsby, Newry and Carmarthen focussed on processing the backlogs. In December 2007 all new online applications were processed at Wolverhampton. Prior to this date they were directed to the old 'postcode ordained' Registration Units.
Increasing staffing levels on pre-registration work in Wolverhampton, by filling 72 full time posts by 10 August 2007.	Redeployment of trained staff from other registration areas, such as deregistration and variations. New staff recruited and overtime budget also made available.
Productivity improvements in the processing centres.	Registration process streamlining was already underway, via the 'Lean' process. Additional staff at Wolverhampton increased its processing capacity. External consultants were appointed to review current registration processes and to identify areas for further improvement.
Risk parameters to be reviewed and updated to ensure they reflect current intelligence on fraud risks, which, among other things, should lead to a reduction in the number of unnecessary referrals back to applicants – and the delays these cause.	Risk parameters were reviewed and amended in July 2007. The key criterion was to amend the risk parameters without jeopardising the risk controls. Certain types of registrations applications were also deemed to be low risk, which meant that around 30 per cent of the 55,000 backlog of registrations could then be cleared without further checks. Risk teams assigned responsibility for deciding additional information requirements needed to assess risk.
Completing some stabilisation of the current VAT IT systems in August, with other improvements due in November.	Measures implemented to stabilise the current IT systems as planned. In addition the Department is costing options to replace and upgrade parts of the system, which will provide improvements in the medium term.
Identifying and setting internal processing targets for the Stage 2 and 3 checks.	New targets for the length of time taken to process high risk applications, Figure 9.

Source: HM Revenue & Customs

4.22 The Department acknowledged that it would take until October 2007 before its customers would see marked improvements. It had to tackle its existing backlogs before it could improve the service for new applications, and the Registration Units also had to train new and redeployed staff before they could start to work on registrations. To provide traders with up to date information on performance the Department reported on its website, usually on a monthly basis, the average processing times for applications. The Department also used its regular consultative forum, the Joint VAT Consultative Committee, to outline the action plan and to report progress. By January 2008 it had made significant improvements in processing registration applications, around 72 per cent were processed within 14 days. By March this figure had risen to 83 per cent, as shown in **Figure 9**.

4.23 The Department's implementation of its action plan reduced the delays in processing of VAT registration applications. But it has also adversely affected other parts of the VAT registration operations. For example, moving staff around within the Registration Units has slowed the processing of VAT de-registrations. By December 2007 work on hand had risen to around 100,000 of these cases, against a normal monthly intake of some 7,000 cases. The Department deployed some new staff to work on the de-registrations but as they did not have previous VAT experience, they could not deal with cases as quickly as the fully trained staff. The Department has acknowledged that any backlog in deregistering traders could in turn delay the issue of final tax assessments to those customers who were leaving the VAT system. However, it has sought to mitigate the effect of any such delays by focussing on cases with large outstanding debts. The Department recommenced de-registration work at Wolverhampton in November 2007, following the recruitment of further staff, and in January 2008 transferred deregistration work to Newry and Carmarthen. It is aiming to clear the backlog by October 2008.

Conclusion

4.24 The Department faces two key challenges on VAT registrations. Firstly, to facilitate trade by ensuring that registration applications are processed as quickly as possible. Secondly, to ensure that potential fraudsters are prevented from entering the system. Since 2004-05, the Department has faced a sustained attack from fraudsters and has strengthened, among other things, its registration controls to prevent fraudsters from obtaining a VAT registration number.

4.25 In 2006 the Department introduced long term measures to increase registration performance which was initially successful but deteriorated significantly in the early part of 2007:

- The level of work on hand increased from around 29,000 in January 2007 to a peak of 58,000 in June 2007;
- The number of applications processed within 14 calendar days fell to its lowest point of 7 per cent in April 2007; and
- The average number of days taken to process an application rose from 29 days in March 2007 to around 42 days in August 2007.

9 Action plan: performance targets and progress to date

Measure	Target	Position as at July 2007	Position as at January 2008	Position as at March 2008
Applications processed within 14 calendar days	70%	13%	72%	83%
Average number of days to process an application	14 days	39 days	16 days	11 days
Number of not started applications	0	c32,000	1,181	2,977
Proportion of applications requiring further risk checks	<10%	11.94%	2.52%	2.34%
Average number of days to process applications undergoing Stage 2 and Stage 3 checks	January: 60 March: 50	189	61	42

Source: HM Revenue & Customs

NOTE

The Department does not have an agreed target for work on hand, but it is closely monitored. The figures as at January and March were 10,316 and 10,131 respectively. The average number of applications received per month in 2007-08 was around 23,000.

4.26 A combination of factors contributed to this deterioration in registration performance.

- Increased checks to counter the threat from fraudulent traders, together with other measures helped the Department to tackle missing trader fraud, reducing the estimated VAT losses by £1 billion. But some risk parameters were poorly targeted, resulting in more legitimate applications being subjected to delays whilst being checked than might otherwise have been necessary.
- These additional checks coincided with the reorganisation of the Registration Units which did not happen as planned and resulted in significant staff shortages. The Department released experienced casual staff before it had redeployed permanent staff from other parts of the Department. This situation was exacerbated by an increase in general staff turnover. Staff also took longer to process applications against a background of increased computer problems, and a significant increase in applications from traders seeking to circumvent legislative changes.
- The restructured risk team initially took longer to process the registration applications owing to the inexperience of the new team and the lack of access to the appropriate computer systems.
- The VAT registration computer systems could not provide reliable information on the level of work on hand as the data was not robust. Also, staff shortages meant that some applications were not entered promptly on to the registration computer system. The Department was not fully aware of the increase in work on hand until it undertook a manual exercise in August 2007, which assessed the level at 48,000 applications.

4.27 In July 2007, the Department prepared an action plan to improve the registration performance by January 2008. The long lead time reflected the need to tackle the existing backlogs and to allow time for new staff to be fully trained. As at January 2008 the Department had made significant improvements in processing registration applications, achieving its target of processing 70 per cent of applications within 14 days. By March this figure had risen to 83 per cent. But the focus of resources on improving this part of the registration service has not been without detriment to the timeliness of the de-registration process, where performance has dropped.

4.28 The Department has now prepared an action plan to address the de-registration backlog and is continuing to monitor the registration staffing position. It has also prepared a contingency plan which will be implemented should the registration problems re-emerge. In the longer term the Department aims to use the computer systems to monitor work on hand and is currently performing data cleansing exercises to ensure that they record reliable information.

PART FIVE

Excise Duties – The Alcohol Strategy

Introduction

5.1 Excise duties are levied on beer, wine, spirits and other alcohol products, cigarettes and other tobacco products and mineral oils. Duty is payable on UK transactions and imports, and in most cases, on the quantity rather than the actual value. The detailed rules are set out in various EU Directives but, subject to agreed minimum rates, each EU Member State may determine its own rates of excise duties.

5.2 UK alcohol duties on beer and spirits are based on alcoholic content. Rates for cider and wine are structured in bands according to the alcoholic content of the product and whether it is sparkling. The Government announced, in Budget 2008, that alcohol duty rates will rise by 2 per cent above the rate of inflation in each of the next four years.

5.3 In 2007-08, the Department collected total alcohol revenue of £8.3 billion comprising: spirits £2.4 billion, wine £2.6 billion and beer and cider £3.3 billion. Since 2005-06, the Department's yield from alcohol duties has increased by £0.5 billion (6 per cent), broadly in line with the forecasts contained in the Annual Budget Report, as shown in **Figure 1**.

5.4 In 2004, the Committee of Public Accounts recommended[9] that the Department should:

- disclose estimates of the alcohol fraud as a range to reflect the inherent uncertainties;
- develop alternative methodologies and identify new data sources to prepare estimates of beer and wine fraud;
- work more closely with alcohol producers to allow resources to be targeted more effectively at the point where alcohol is diverted in the supply chain;

1 Alcohol Net Receipts/Budget Forecast

	2005-06		2006-07		2007-08	
	Net Receipts (£ billion)	**Forecast (£ billion)**	**Net Receipts (£ billion)**	**Forecast (£ billion)**	**Net Receipts (£ billion)**	**Forecast (£ billion)**
Spirits	2.3	2.5	2.2	2.3	2.4	2.3
Wine	2.3	2.3	2.4	2.4	2.6	2.5
Beer and Cider	3.2	3.4	3.2	3.4	3.3	3.4
Total Alcohol	**7.8**	**8.2**	**7.8**	**8.1**	**8.3**	**8.2**

Source: National Audit Office analysis of HM Revenue & Customs and HM Treasury Budget Reports

NOTE

Net receipts reflect cash received and therefore does not match the Trust Statement income figure which is prepared on an accruals basis.

9 Thirty-Second Report of Session 2003-04 (HC 284).

- discuss with the trade the effectiveness of its current anti-fraud measures and the opportunity for further regulatory or operational improvements;
- improve communication between anti-fraud teams throughout the Department; and
- identify likely additional costs arising from the introduction tax stamps and take appropriate steps to mitigate these costs.

5.5 We have examined the Department's management of alcohol duties and the steps that the Department has taken to implement the Committee's recommendations. This report covers:

- administration of the alcohol duty suspended system;
- alcohol diversion fraud;
- measuring the illicit alcohol market;
- the alcohol strategy;
- operational measures;
- regulatory measures: duty stamps;
- recent developments; and
- future developments: excise movement and control system.

Administration of the Alcohol Duty Suspended System

5.6 Commercial brewers, distillers and other producers based in the United Kingdom are legally required to register their production premises with the Department. Businesses may also import alcohol from other EU and non EU Countries. Excise duty is liable at the time the alcohol is either produced or imported. Under EU Single Market legislation (Council Directive 92/12), businesses can hold alcohol or move it between registered premises or excise warehouses (including those in other EU Member States) without payment of duty. This is known as duty suspension and enables authorised traders to defer payment nearer to the time when they release their goods for consumption. Other businesses may acquire duty suspended alcohol from other EU Member States, under the Registered Excise Dealers and Shippers Scheme and the Occasional Importers Scheme. However, they must pay excise duty either on receipt of the goods or prior to the goods being received, as shown in **Figure 2 overleaf**.

Alcohol Diversion Fraud

5.7 The duty suspension arrangements facilitate legitimate trade by allowing the 'free' movement of alcohol and avoid the need for routine fiscal controls at frontiers, including frontiers between EU Member States. Since the mid 1990's, fraudsters have exploited these arrangements. Excise diversion fraud occurs where goods intended for export or delivery to another excise warehouse under duty suspension are diverted for consumption in the UK without the UK duty being paid. Because of their relatively high duty rates, the highest risk products tend to be white spirits (notably vodka and gin) and Scotch whisky. Fraudsters tend to sell their Illicit alcohol through licensed premises, usually at, or close to, normal duty paid prices. The Department has found that large organised crime syndicates and small scale operators alike are committing alcohol duty frauds. The Department has identified three main types of excise diversion fraud: inward, outward and inland, as shown in **Figure 3 overleaf**.

5.8 In any fraud, the Department's challenge is to establish the point at which the alcohol is illegally diverted. One or more of the owners of the goods, warehouses or operators, employees and transporters may be complicit in the fraud. The loss of duty may not be evident for several weeks, as the Department is required, under EU law, to allow traders a set period, about a month, to declare alcohol movements. One or more of the warehouses involved could be in a different EU Member State.

5.9 Tax revenue is also at risk from other types of fraud and smuggling. Fraudsters may seek to mask their activities under the pretext that they are making legitimate acquisitions or imports under the Registered Excise Dealers and Shippers (REDS) or Occasional Importers Schemes. Fraudsters can abuse both of these schemes by running duplicate loads under the same paperwork. Smuggling is another means by which fraudsters illegally bring excise goods into the UK, though this is relatively rare. Fraudsters can smuggle alcohol by simply mis-describing the goods, or by concealing the alcohol goods among other products.

2 Outline of the Alcohol Duty Suspended System

Alcohol Produced/Distilled/Brewed in UK or Imported from Non-EU Countries

Excise duty is liable at this point unless held in duty suspended premises, or transferred to a duty suspended excise warehouse.

Imports from other EU Member States under duty suspension arrangements

These goods can only be received in the UK in one of three ways.

1

2

3

Registered Excise Dealers Scheme

Comprised of registered traders who have been approved by the Department to receive duty-suspended alcohol and must account for UK duty when goods are received.

Occasional Importers Scheme

Comprised of traders who import alcohol on an infrequent basis and must account for UK duty prior to receipt.

Duty Suspended Excise Warehouse

An excise warehouse is one that is approved by the Department for the storage of goods without the payment of excise duty. Owners of goods held in warehouse are legally required to be registered. Many alcohol products are deposited in such warehouses by the manufacturers themselves or by wholesalers to whom manufacturers may have sold in bulk. Goods can be bought and sold whilst held in the warehouse, without incurring payment of duty. There are three main reasons for which goods can be removed from an excise warehouse:

- **Release for Consumption in the UK** – Excise duty is payable at the point;
- **Transfer to another Duty Suspended Warehouse** – Either in the UK or another EU Member State. Dispatching warehouse keepers, owners, or hauliers of the goods must provide a financial guarantee to cover such movements. Goods dispatched between warehouses must be accompanied by an administrative document, which provides evidence, once stamped by the receiving warehouse, to confirm that goods have reached their intended location; and
- **Export to Non EU Countries** – Excise duties are not paid on exports. However, traders can reclaim excise duties, if already paid, under the excise drawback scheme.

Source: HM Revenue & Customs

3 Types of Alcohol Diversion Fraud

Inward diversion: fraud involving duty suspended goods from the EU diverted onto the UK home market without payment of UK duty.

Outward diversion: fraud involving duty suspended goods ostensibly for export which are diverted onto the UK home market without the payment of UK duty.

Inland diversion: fraud involving duty suspended goods moving within the UK which are diverted directly onto the UK market without the payment of UK duty.

Source: HM Revenue & Customs

Measuring the Illicit Alcohol Market

5.10 To measure the effectiveness of its Alcohol Strategy, the Department requires a means of estimating losses arising from fraud. Spirits fraud is estimated as the difference between the volume of spirits consumed in the UK, using data from the Office for National Statistics household surveys, and the volume of spirits on which duty has been paid. The calculation is complex, incorporating adjustments for underreporting on household surveys. This is a relatively untested area for Governments both across the EU and around the world. The United Kingdom is one of the few to try to make such estimates.

5.11 In the past, the alcohol industry has contested the accuracy of the Department's estimate of the total spirit market represented by illicit alcohol goods. The Department has since worked with the Office for National Statistics and the spirits industry to consider ways of improving the quality of its estimates. In 2006, the Office for National Statistics examined the feasibility of developing a specific survey designed to capture alcohol consumption, which is generally under-reported in the household surveys. It concluded that such a specific survey would not significantly address the problem of underreporting and the associated uncertainties. The Department has subsequently decided against taking forward a bespoke survey. It concluded that the costs of carrying out such research is likely to exceed the benefits and that a separate survey would not provide better information than the current surveys prepared by the Office for National Statistics.

5.12 The Department now publishes its estimate of the illicit spirit market as a range, consisting of an upper and lower bound within which the true level of fraud lies. Using operational intelligence, the Department has estimated the lower limit at a negligible level, and the upper limit using the Office for National Statistics data at £400 million. Because the year-to-year changes in the illicit market share are subject to uncertainty, the Department uses the mid-point to assess the long term illicit market trend, which fell from 8 per cent in 2001-02 to 5 per cent in 2005-06, as shown in **Figure 4**.

5.13 Owing to the delay in collecting and analysing survey data, the Department does not publish estimates of the illicit market performance until 18 months after the end of the relevant financial year. The Department therefore uses other techniques and information to monitor performance on a real time basis, such as comparing actual receipts to forecasts and analysing operational intelligence data. The Department is currently developing indicators that will provide additional information on the level of suspected fraudulent activity.

5.14 Beer and wine duties account for around 60 per cent of the alcohol duty collected. The Department does not yet have reliable estimates for beer and wine fraud. The methodology that the Department uses for estimating spirits fraud cannot be used for beer and wine, since experience shows that it produces unrealistic estimates. The Department has recognised that it can do more to provide a robust estimate of the scale of beer and wine fraud. It has met with associations representing the industry to discuss how it can improve and develop such estimates.

4 Spirits: Illicit Market and Associated Revenue Losses

	2001-02	2002-03	2003-04	2004-05	2005-06
Illicit Market Share:					
Upper Estimate	17%	14%	15%	7%	10%
Lower Estimate	–	–	–	–	–
Associated Revenue Losses[1]					
Upper Estimate	£600m	£500m	£600m	£250m	£400m
Lower Estimate	–	–	–	–	–
Mid-Point Share	8%	7%	8%[2]	4%	5%

Source: HM Revenue & Customs

NOTES

– Indicates estimates of negligible levels of fraud.

Figures are rounded to the nearest £50m or 1 per cent.

1 Includes both alcohol duty and VAT. This will overstate losses to the extent that VAT is collected on sales of illicit alcohol through normal retail outlets.

2 At the time the PSA Target was set in 2003-04, the estimated illicit market share was calculated at 7 per cent using a methodology which has since been revised.

The Alcohol Strategy

5.15 The Department launched its Alcohol Strategy in 2005 in response to increases in estimates of spirits fraud, then estimated at £250 million in lost excise duty. The Government provided additional resources to enable the Department to meet a challenging Public Service Agreement Target to reduce the market share represented by illicit spirits from 7 per cent in 2003-04 to 3 per cent by March 2008. The aim of the Strategy was to provide a coordinated national response to reduce alcohol (specifically spirits) fraud through operational and regulatory measures, as well as through improved cooperation with the legitimate trade. It also aimed to develop further best practice for intelligence and risk assessment. The majority of the measures introduced under the Strategy are focussed on improving controls across all alcohol products.

5.16 The Department has made progress in embedding the key elements of the Strategy and has developed new governance arrangements to ensure delivery of the Alcohol Strategy. A Directors' Working Group has overall responsibility for monitoring performance against the PSA target. Below this Group, the Department established an Alcohol Strategy Delivery Group (ASDG) responsible for the commissioning of projects (i.e. national and collaborative projects) to address high risk traders and activities, and to coordinate interventions across the Department as a whole. All the operational teams involved in delivering the strategy are represented on the ASDG, which minimises the possibility of overlap and allows the efforts of all teams to be concentrated on identified risks, as shown in **Figure 5**.

Operational Measures

Risk and Intelligence

5.17 The Alcohol Central Coordination Team (ACCT) has played an important role in the successes of the alcohol strategy. The Department established the ACCT to enable all alcohol risk information and intelligence to be coordinated, collated and used to inform the targeting of assurance and detection activity. The ACCT uses all available intelligence and tax information to profile the highest risk businesses for intervention. The Department's Local Compliance, Detection and other appropriate stakeholders, covering Direct Taxes, Excise and VAT, pool their ideas and resources to tackle the suspect businesses. This collaborative approach has allowed the Department to investigate irregularities using a combination of skills, knowledge and intelligence; enabling the Department to achieve results which may not have been realised if approached by one business stream of the department alone, as shown in **Figure 6 on page R46**.

Registrations

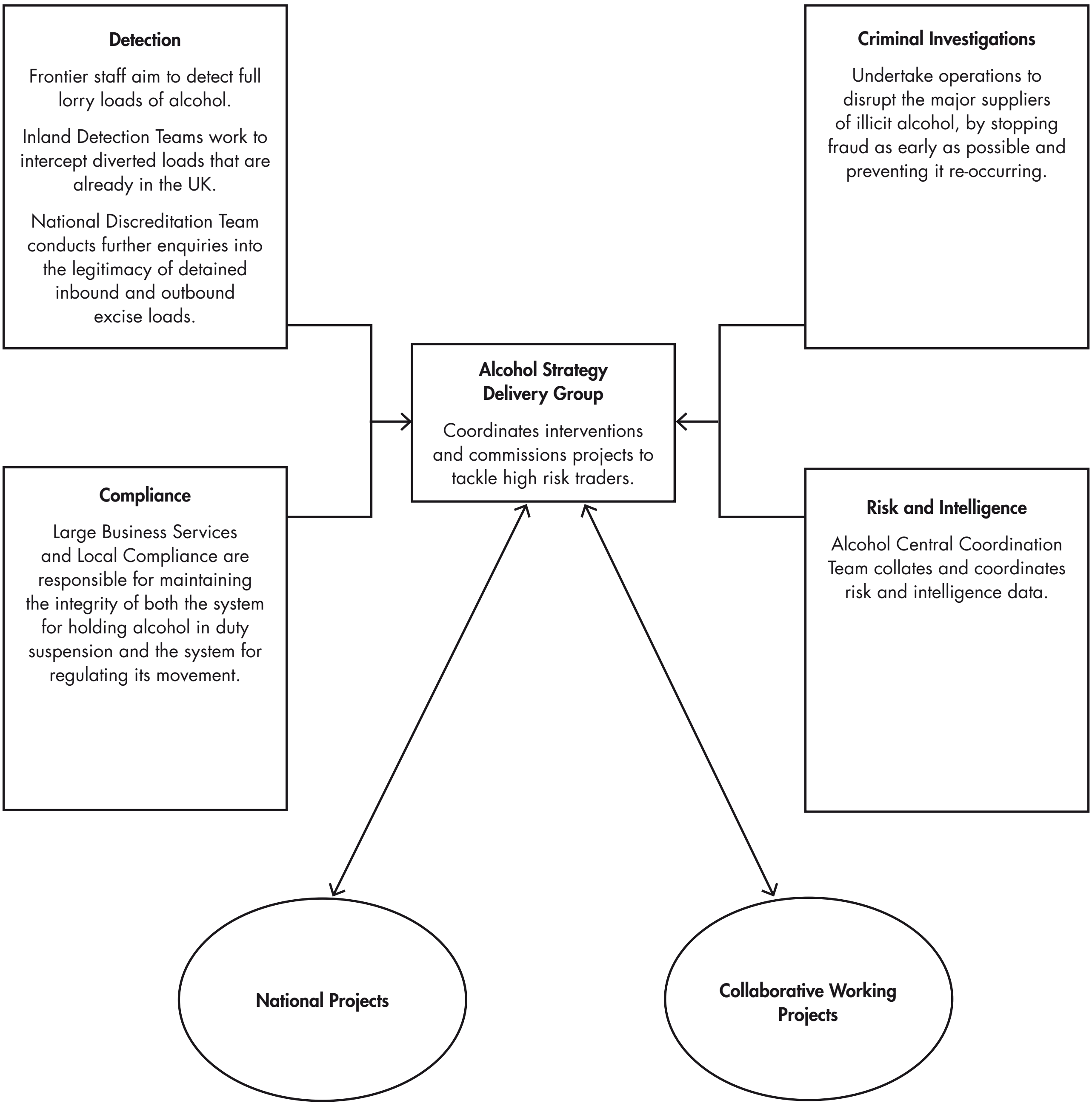
5.18 All traders involved in the duty suspended alcohol supply chain are legally required to be registered with the Department who, before approving the registration, will undertake checks to identify high risk traders and potential fraudsters. Specialist teams scrutinise registration applications, assesses them for risk and, where necessary, refer applications to compliance teams for additional enquiries. These compliance teams then recommend, based on their enquiries, whether the Department should accept the referred applications. To improve the quality and consistency of recommendations, the Department has established a small team of experienced compliance officers to review such recommendations. The team ensures that the Department has given proper consideration to all relevant aspects and, if not, refers the application back to the operational teams for further enquires. The specialist team also provides advice and support to operational staff. In 2007-08, the Department refused 165 applications out of a total 501 received.

Detection

5.19 The Detection team has a key role in tackling all types of excise fraud. This team, of around 4,000 staff, operates within the newly created UK Border Agency which the Government set up in April 2008, and which from April 2009, will be an executive agency of the Home Office.[10] The Department has agreed a delivery plan with the UK Border Agency for 2008-09, which sets out the contribution that the UKBA is expected to make towards achieving the objectives of the excise anti-fraud strategies, including the Alcohol Strategy. It plans to extend these arrangements to future years.

10 UK Border Agency (UKBA), brought together the border control capability of the Department; the Border and Immigration Agency; and UK Visas, to improve overall security at the border.

5 Key operational teams involved in tackling alcohol fraud



Source: HM Revenue & Customs

6 Illustration of a complex alcohol fraud case

This example relates to a trader moving duty suspended alcohol in and out of the UK.

The Department's review of the trader's business records established that the trader had complex associations with other companies, through shared directors and company secretaries. Working together, the Department's Local Compliance and Detection Teams identified the trader's involvement in inbound and outbound alcohol diversion fraud. The Teams established that eight consignments of duty suspended spirits had not reached their intended destination warehouse in Spain and had been diverted to the UK domestic market. An excise assessment of around £700,000 was raised on the trader to recoup the duty not paid.

The Department raised a further excise assessment, some £100,000, for a consignment of spirits destined for the Cape Verde Islands via Portugal which did not arrive. This also resulted in the Department applying sanctions to the movement guarantee of the haulier who it adjudged was also complicit in the attempted fraud. This action restricted the haulier's ability to move duty suspended alcohol.

Detection activity resulted in the seizure of two consignments of spirits, where the UK excise duty evaded would have been £220k. The Department noted that the alcohol did not bear duty stamps and that the trader had removed commercial lot codes to prevent tracing the product and goods.

The Department's Local Compliance case team also worked closely with Direct Tax colleagues who have subsequently carried out extensive research into the director and family members employed by the trader. The lifestyle of the director did not appear consistent with earnings. The Department found that family members could not have funded their homes and vehicles on the salaries they had disclosed to the Department. Its examination of the records at the premises initially resulted in the trader making a voluntary disclosure of an undeclared bank account, cash hoard, and the disposal of a previously unknown warehouse with an associated capital gain of £250,000.

The trader made a further voluntary disclosure which allowed the Department to identify a small business freight venture, an offshore account and four further bank accounts with balances between £15,000 and £250,000 in each account. Subsequently, the trader's accountant disclosed links to capital offshore accounts, with defalcations stretching back over a decade or more. The Department expects to recover duties in excess of £1 million.

Source: HM Revenue & Customs

Criminal Investigations

5.20 There has been a significant decrease in the number of people prosecuted for alcohol fraud, from eighty six in 2003-04 to one in 2007-08, as shown in **Figure 7**. Although considerable investigation resources have been deployed to other areas of greater revenue losses, such as VAT and Tobacco, alcohol fraud has featured in many operations. Information developed during these investigations has been used extensively to identify high risk traders and guide compliance and detection activity. Notwithstanding the decrease in the numbers of prosecutions the Department has continued to use other sanctions to tackle fraudsters, such as seizures, penalties, additional assessments, deregistration and confiscation orders. In 2007-08, the Department seized 5.2m litres of illicit alcohol, an increase of around 20 per cent compared with 2003-04, as shown in **Figure 8**.

5.21 In 2007-08, Local Compliance examined 160 high risk cases which the ACCT had identified. Of these, the Department only applied sanctions in 56 cases (i.e. 35 per cent). These cases were tackled by officers using civil procedures. But given the complexity of the cases and, in particular, the criminal nature of the activities, this proved challenging and resulted in a low hit rate. The Department has recently set up a Special Civil Investigations Team to tackle the main alcohol fraudsters identified by the ACCT, using the most appropriate sanctions available across all taxes. This new team works closely with other operational areas within the Department including Criminal Investigation.

Regulatory Measures: Duty Stamps

5.22 The Government's introduction of duty stamps for spirits facilitates the identification by consumers, traders and the Department of non-UK duty paid spirits.[11] Since October 2006, bottles that qualify for the scheme (35cl or larger, 30 per cent alcohol content or above) must display a stamp unless they passed the UK excise duty point before this date. The duty stamp is available in two formats:

- **A free standing stamp** – which is product specific, e.g. gin, vodka, rum with a unique serial number printed on its face; and
- **A label stamp** – which is incorporated into the bottle labels with a unique reference number for each stamp design.

11 Recommended in a report by John Roques, *The collection of excise duties in HM Customs and Excise*, July 2001.

7 Analysis of gangs disrupted, prosecutions and convictions

	2003-04	2004-05	2005-06	2006-07	2007-08
Gangs disrupted	24	4	2	0	0
Spirits – number of people prosecuted	24	7	9	5	1
Spirits – number of people convicted	21	0	9	5	1
Mixed cases – number of people prosecuted	62	1	0	0	n/a
Mixed cases – number of people convicted	34	0	0	0	n/a

Source: HM Revenue & Customs

NOTE

Mixed case is where more than one excise fraud is committed, e.g. both alcohol and tobacco goods were involved. From 2007-8 this is now reported by which ever contraband has the greatest duty liability.

8 Other sanctions used by the Department to tackle alcohol fraud

	2003-04	2004-05	2005-06	2006-07	2007-08
Assessments raised	£63m	£30m	£44m	£46m	£62m
Civil penalties issued	N/A	N/A	N/A	£23,000	£77,000
Confiscation orders	N/A	£13,000	Nil	Nil	£260,000
Number of vehicles seized	317	325	215	135	167
Number of approvals revoked or amended	N/A	N/A	N/A	67	54
Number of Commissioners' Directions imposed	N/A	N/A	N/A	21	31
Quantity of alcohol seized:					
Spirits (Litres)	407,858	303,252	237,904	384,078	548,291
Beer (Litres)	2,773,385	2,170,932	2,522,253	1,915,173	3,815,549
Wine (Litres)	1,134,567	629,034	292,945	303,048	854,508

Source: HM Revenue & Customs

NOTE

The table includes the outcome of all alcohol compliance assurance activities undertaken by Detection, Larger Business Services and Local Compliance.

N/A = Data not available.

5.23 Spirits for export from the UK must not be stamped or must have any duty stamp removed or voided, making outward diversion of stamped product much more difficult and high-risk for fraudulent traders. The Department is therefore able to focus on inward diversion through either the duty suspension system, Registered Excise Dealers and Shippers scheme or the Occasional Importer scheme) or smuggling, via targeted frontier and assurance activity.

5.24 The Department has made several interventions where it has intercepted and seized duty stamp spirits purported to be for export. Officers checking the security features embedded in the duty stamps have also identified and seized poor quality counterfeits. In early 2007, an individual was sentenced to eight months in jail for smuggling spirit bottle labels bearing counterfeit label stamps.

5.25 The Department has delayed the full enforcement of the regulations at the retail sector level because some of the 'fast moving' alcohol products released into the retail market before October 2006, and therefore unstamped, remained on the retail shelves for a considerable period of time. Once these have been sold the Department's task in identifying illicit spirit bottles will be easier.

5.26 The compliance costs set out in Regulatory Impact Assessment[12] were calculated on the basis of the industry paying for the duty stamp and were gross of any offsetting measures. However, the Government has sought to mitigate these costs by:

- incurring production and distribution costs of the duty stamps;
- withdrawing the requirement for duty stamps to be paid up front;
- freezing spirits duty rates;
- allowing spirit duty stamps to be incorporated in the label on a bottle rather than a strip over the bottle opening; and
- providing a £3 million capital investment fund to assist the industry. As at March 2008 only around £270,000 of this had been claimed. Some claims have been rejected as the criteria were not met.

5.27 In December 2007, the Department began a consultation process, to gather the views of the industry on the effect of duty stamps on the spirits market, the compliance costs associated with duty stamps and the manner in which the scheme was implemented. The outcome of the review is expected in the second half of 2008.

Cooperation with the Trade and EU Member States

Legitimate trader population

5.28 The Department and the legitimate trade work closely to reduce the opportunities for fraudsters to secure supplies of duty suspended alcohol. The main contributors have been the Joint Alcohol and Tobacco Consultation Group, the Joint Warehousing Fraud Task Force and the Joint Spirits Fraud Task Force, which provide an effective forum for feeding the trade's concerns back to the Department. Several Memoranda of Understanding (MoUs) have also been agreed with associations representing alcohol traders, which provide a framework for cooperation on a range of issues relating to alcohol fraud.

5.29 The Department recently revised the existing memoranda, following discussions with the associations representing the spirits industry, to set out more clearly its responsibility in providing feedback to traders. It provides feedback in the form of quarterly newsletters on the progress of the MoUs, significant successes achieved by the Department's anti-fraud enforcement activities, and progress of new anti-fraud policy measures or regulations. The Department also clarified its information requirements to reduce the administration burden on traders and to enhance the quality of the information they supply.

5.30 Members of the Scotch Whisky and the Gin and Vodka Associations (which represent around 95 per cent of the spirits industry) were first to sign a memorandum in 2005. Other associations representing Bonded Warehousekeepers, United Kingdom Warehousekeepers and the Wine and Spirit Trade have also signed MoUs. The Department is looking to agree memoranda with the British Beer and Pub Association and Transporters, which would extend the MoUs to other sectors involved with the acquisition, distribution and sales of alcohol.

EU Member States

5.31 Cooperation with other EU Member States is essential in tackling both inward and outward alcohol diversion, and is governed by EU regulations. Tax/Customs Authorities may seek further assistance from their counterparts in other EU Member States, in establishing whether alcohol products have been delivered fully intact to the correct intended location. All EU Member States are legally required to respond to requests for information/cooperation within three months of receipt.

5.32 The Department's past performance in responding within this time frame has not been good. In 2007, the Department introduced new procedures for dealing with requests from, and sending requests to, other EU Member States. The National Verification Centre (NVC) coordinates all incoming requests. In addition, outgoing requests are now risk assessed and approved by the ACCT with the help of the NVC, to ensure that only high priority cases are referred, therefore reducing the administration burden on receiving Member States. The Department's performance in processing incoming requests has improved. In 2007-08, 74 per cent were replied to within the three month statutory deadline. There has also been a significant fall in requests sent to other EU Member States, from 2,859 in 2006-07 to 712 in 2007 08. This fall contributed to an increase in the proportion of the Department's requests responded to within three months, from 22 per cent in 2006-07 to 53 per cent in 2007-08, as shown in **Figure 9**.

12 £6 million in the first year and £4 million per year ongoing costs.

This improvement has also been facilitated via enhanced cooperation between the Department and other EU Member States.

5.33 The Department is currently examining further ways it can work with other Member States, for example, in joint operations. The problems facing the Department and why cooperation with other EU Member States is important are illustrated in **Figure 10**.

Recent Developments

Counterfeit activity

5.34 The Department's operational intelligence has identified an increase in counterfeit spirits. Counterfeit alcohol can be either brought into the country in commercial quantities or produced in the UK from duty-free denatured alcohol.[13] Counterfeits not only result in a loss of duty receipts to the Exchequer, but also present an increased health risk to the public. The Department has concluded that part of the increase in this activity could reflect signs that the current strategy is succeeding to prevent fraudsters from diverting genuine products. The Department has also noticed an increase in counterfeit alcohol being smuggled from Eastern European Countries.

5.35 To counter the threat arising from the misuse of UK produced denatured alcohol the Department has introduced a package of measures including tightening up the system for approving users of denatured alcohol. The Department has also increased the level of assurance work at existing approved distributors and users of denatured alcohol to ensure only bona fide businesses have access to alcohol.

9 Cooperation with other EU Member States

	2006-07	2007-08
Requests sent by the Department to other EU Member States	2859	712
Percentage of requests sent to other EU Member States which were replied to within 3 months	22%	53%
Requests received by the Department from other EU Member States	1608	1933
Percentage of requests received from other EU Member States which were replied to within 3 months	73%	74%

Source: HM Revenue & Customs

5.36 The Department is working with other EU Member States to raise awareness of the increasing threat of counterfeits and organised a conference in February 2008 to discuss the exchange of information on industrial and denatured alcohol suppliers. It has chaired a subsequent meeting with other Member States. One of the outputs from this collaboration is the exchange of information about transactions involving the movement of denatured alcohol between Member States. The information received will enable the Department to ensure that denatured alcohol entering the UK from another Member State has not been used for the illicit production of counterfeit spirits. The Department is also working with Local Authorities Coordinators of Regulatory Services and Trading Standards, and has developed protocol arrangements aimed at exchanging information to combat the threat to public health and UK revenues from counterfeit alcohol. **Figure 11 overleaf** provides an example of collaborative working.

Drawback claims

5.37 The Department identified that the duty drawback system was coming under threat with instances of beer duty refunds being claimed on goods that were ineligible as there was a lack of evidence to show that duty had been paid on the beer. The claims rose from around £3m in the first quarter of 2005-06 to around £10m in the corresponding quarter in 2006-07. Although the Department was aware of this increase in the level of claims, it did not take action immediately until it was raised by the National Audit Office during its routine audit work. It subsequently responded by strengthening its scrutiny procedures and by clarifying the evidential requirements needed to support a claim which allowed legitimate businesses to continue to submit claims whilst thwarting fraudulent claimants. This led to a reduction in the value of claims received to around £4m per quarter.

10 Example of an excise diversion fraud

The Department identified a case where a UK tax warehouse despatched a goods vehicle with an administrative accompanying document to France carrying a full load of alcohol products. The fraudster, however, swapped the full trailer for an empty one and diverted the goods illegally to the UK retail market. The empty trailer was taken to France where the administrative accompanying document was fraudulently stamped. The empty trailer was then loaded with cheap alcohol and returned to the UK, where the consignment was sold illegally in the retail market.

Source: HM Revenue & Customs

13 Alcohol used for industrial, medical and scientific uses are legally required to be made unsuitable for drinking by the addition of denaturants prior to dispatch to the end user. Once denatured to UK standards, all classes of denatured alcohol are relieved of duty.

11 An illustration of joint working between HMRC and Trading Standards

In 2007, the Department, working with local Trading Standard Officers, succeeded in shutting down an illegal distillery in the West Midlands, which was capable of producing thousands of litres of counterfeit whisky. Working together, the Department and Trading Standards raided a property in Holloway Bank, Wednesbury, seizing 200 litre-bottles and several large vats. The fraudsters had used potentially poisonous animal feed as a cheap alternative to grain during the distilling process.

Source: HM Revenue & Customs

Future Developments: Excise Movement and Control System

5.38 In 1998, EU Member States set up a Working Group to analyse the area of excise fraud, identify the weaknesses in current excise procedures and recommend areas for improvement. The Group's report noted weaknesses in the paper-based Administrative Accompanying Document (AAD) system for excise goods moving under duty suspension. In particular, the Group noted that the existing System for the Exchange of Excise Data (SEED), sponsored by the Commission, was updated and exchanged with other EU Member States only once a month and in some instances the data was not complete. Its usefulness in helping Tax Authorities tackle alcohol fraud was therefore limited, as fraudsters could disappear before Tax Authorities were aware that fraud had been undertaken. The Working Group concluded that an EU wide integrated computer system should be developed to monitor and control the movement of goods under excise duty suspension regulations. The Excise Movement and Control System (EMCS) will allow Tax Authorities access to real time information about consignments in transit, therefore enabling them to plan inspection visits in advance to check that goods have arrived at their correct destinations.

5.39 Following a joint Council of the EU and European Parliament decision to proceed with the project, all Member States agreed to phase in EMCS from April 2009 with the intention of the system being fully operational by January 2010. The Department believes that it is unlikely that the EU legislative timetable will meet this timescale and so the project may be delayed. It will not be possible for a Member State to operate a paper-based system when other EU Member States are operating an electronic system, as the movement of the excised goods from a Member State using the electronic system will require an electronic sign-off from the warehouse in the receiving Member State. Every Member State will, therefore, need to be equipped to provide this sign–off before the scheme can be introduced. The Department's development of its computer system is currently on schedule, and the first element is due for delivery in April 2009, with a second element due for delivery in October 2009. Notwithstanding the possible legislative delays, the Department will need to ensure that its computer system is fully operational by January 2010 if it is not to delay the introduction of the EMCS across the EU.

Conclusion

5.40 The Department launched its Alcohol Strategy in 2005 in response to increases in estimates of spirits fraud, estimated at £250 million in lost excise duty. It has made good progress in embedding the measures underlying the Strategy, which is underpinned by a robust governance system. The Department has a Public Service Agreement Target to reduce the illicit spirits market to three per cent by March 2008. The latest data available shows the illicit market share mid-point at five per cent in 2005-06, a decrease of three per cent since 2003-04.

5.41 The Department has addressed the recommendations made by the Committee of Public Accounts in 2004. In particular, the Department has:

- Revised its methodology for estimating the illicit spirits market. The United Kingdom is one of the few countries to try to make such estimates, which are inherently difficult. The Department has not yet found an acceptable method for measuring potential tax gaps for other alcohol products, such as beer and wine, which in total comprise around 60 per cent of the duties collected. The Department recognises that it needs to do more and is working with the industry to establish a robust methodology to estimate the extent of the illicit market for all alcohol products.
- Established Memoranda of Understanding (MoUs) with the alcohol industry to provide a framework for cooperation in tackling alcohol fraud. The Department intends to agree memoranda with the British Beer and Pub Association and Transporters, which would extend the MoUs to other sectors involved with the acquisition, distribution and sales of alcohol.

- Developed an internal coordinated response to tackle suspected high risk traders. The Alcohol Strategy Delivery Group (ASDG), comprising representatives of all the internal operational groups involved in tackling alcohol fraud, coordinates the Strategy and ensures that all teams work together either through national or collaborative projects. The Department has developed a delivery agreement with the newly established UK Border Agency for 2008-09, which sets performance targets and ensures that this new body will continue to play a full role in the development and implementation of the Alcohol Strategy.
- Introduced tax stamps in October 2006 to make it easier to identify illicit bottles of spirits. Measures have been introduced to mitigate the associated compliance costs. The Department has delayed the full enforcement of the legislation in the retail sector to allow legitimate unstamped spirits to be sold making it easier to identify illicit bottles, but it plans shortly to implement an assurance programme to detect and deter fraudsters.

5.42 The Department is also working with the European Union to tackle alcohol fraud. The Department's response to requests from other EU Member States has been reasonable, but there is still room for improvement. In 2007-08, the Department responded to 74 per cent of requests within the statutory deadline but recognises that it should aim to provide replies to 95 per cent of requests within the deadline. The Department is working with the European Union to improve the performance of other Member States in responding to requests from the United Kingdom, with on average, only 53 per cent of outgoing requests receiving replies within the statutory 3 month period.

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