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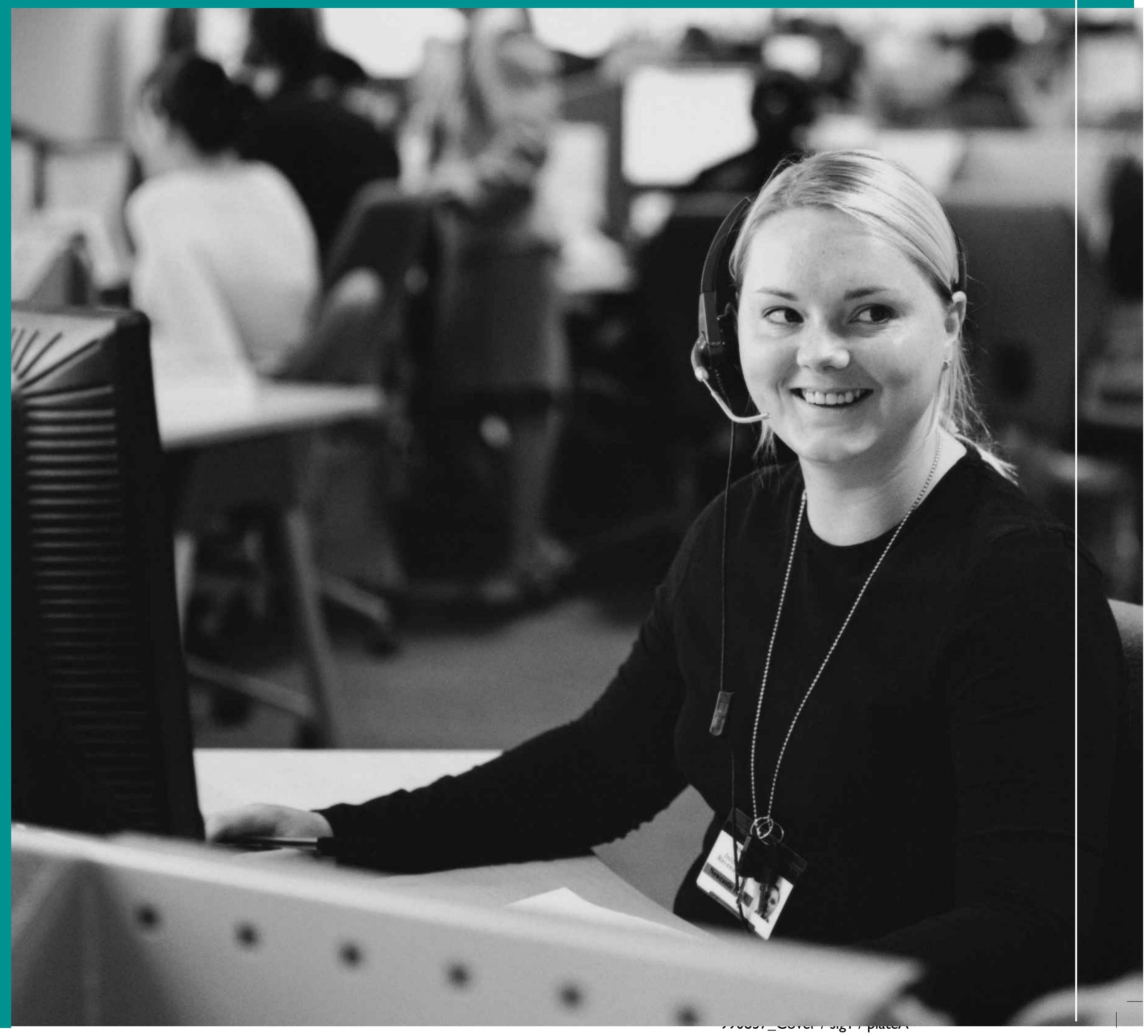
Inland Revenue Annual Report and Accounts for the year ending 31st March 2004 One hundred and forty sixth report

TSO

Inland
Revenue

Annual Report and Accounts

For the year ending 31st March 2004



Contents

990837_Cover / sig1 / plateB

990837_Text / Sig: 1 / Plate A

146th Report of the Commissioners of **Her Majesty's Inland Revenue**

Ordered by the House of Commons to be printed 21 October 2004

The Commissioners of HM Inland Revenue have the honour to present their Annual Report and Accounts, pursuant to the Government Resources and Accounts Act 2000 c20. s.6 and the Exchequer and Audit Departments Act 1921 c52. s.2, for the year ended 31 March 2004

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Inland Revenue Annual Report and Accounts 1
990837_Text / Sig: 1 / Plate A

Chairman's Introduction

Welcome to this year's Annual report, my first as Executive Chairman.

2003-04 was a year of immense change. Following the Chancellor's acceptance of the recommendations of the O'Donnell review, work started on the creation of the new integrated tax Department - Her Majesty's Revenue and Customs.
In January 2004 we signed a contract with our new IT suppliers - Capgemini - following a competition acknowledged as a model of second-generation Public Sector procurement. We also responded positively to the recommendations made by Sir Michael Lyons and Sir Peter Gershon in their respective reviews. Plans are being made to move more people out of London and the South East, and for efficiency savings across the Department. Throughout 2003-04 the Department's ability to rise to these and other challenges has been impressive. It has been a year of considerable success.

Our Contribution

We collected net tax of over £155 billion and NICs of over £75 billion, and we paid out tax credits gross of over £13 billion and child benefit of over £9 billion. The Inland Revenue is a huge, complex business and we can be proud of the economic contribution we are making to both individual customers and the UK as a whole.

The Inland Revenue has evolved to become an integral part of the Government's social agenda. We deliver tax credits encouraging people into work, and enforce the National Minimum Wage (NMW) ensuring a fair deal for all workers. It is true that the early months of child and working tax credits brought frustration for both customers and staff, but we overcame these difficulties and now over six million families are benefiting. Our NMW compliance teams identified minimum wage failures in 40% of the cases investigated, putting right wage arrears of over £2.5m for nearly 10,000 low paid workers.

We can also be proud of the positive impact we have on the communities within which we work. Our involvement with Business in the Community and the Prince's Trust demonstrate our high standard of responsible business practice. I firmly believe that responsible organisations are more likely to prosper and thrive and I am delighted that throughout the organisation the business benefits of Corporate Social Responsibility are actively recognised.

Successes - Our Services

The opening of two new contact centres has also impacted positively on local communities providing 1,000 employment opportunities in Bathgate and Newcastle and increasing our capacity to answer customer calls by 35%. Our commitment to responding to customer needs has resulted in the contact centres remaining open from 8am-8pm, 7 days a week, 362 days a year. Such initiatives highlight our customer-driven approach and commitment to providing a modern, more intelligent service.

£230 billion

We collected net tax of over £155 billion and NICs of over £75 billion

We have fully embraced the drive to put services online and are at the forefront of the Government's e-agenda, increasing efficiency and responding to the growing demand for online services. Some 400,000 customers made their tax credits claims online.

Customer service activities are also benefiting from our IT advances; over 1m Self-Assessment tax returns were filed electronically. Work to increase our understanding of our customers is also producing returns. We continue to make it easier for people to understand and fulfil their obligations whilst continuously refining our methods for tracking down those who aim to cheat or avoid the system.

Board and Organisation

As a consequence of the changes to the Department there has also been significant change within the structure of the Board.

I would like to take this opportunity to acknowledge the efforts of Ann Chant whose skill as Acting Chairman, experience and support ensured the smooth transition to my appointment along with Paul Gray, Deputy Chairman, on 1 September 2004.

I feel it is also important to recognise the achievements of two former Board members who retired earlier this year. Michael Johns CB, Chief Executive of the Valuation Office Agency, committed himself to the highest standards of public service for over 36 years, including 6 serving as a Commissioner on the Board of the Inland Revenue. Andrew Hudson was appointed the new Chief Executive of the VOA from June 2004.

And, of course, Nick Montagu, Chairman of the Board of the Inland Revenue from July 1997 to March 2004. Nick provided the Department with strong leadership and it is a testament to his success that I have joined a robust, diverse Department well able to meet the challenges ahead.

Looking Ahead

I anticipate that the coming year will be even more exciting and challenging. We have already started the process of integration and are currently working with Ministers to develop the legislation required to formally create Her Majesty's Revenue and Customs. We will all be part of a more agile, customer-focused organisation with the capability to increase efficiency, increase compliance with the law and reduce compliance costs. Both Paul and I are looking forward to leading Revenue and Customs colleagues through the changes ahead and onto further success.

David Varney
Executive Chairman

Inland Revenue Departmental Board

David Varney

Chairman and Executive Chairman designate HM Revenue and Customs. David joined Shell in 1968 beginning a 28-year global career that spanned several continents. In 1990 he was appointed Head of Marketing, Branding and Product Development for Shell International Petroleum and in 1991 was appointed a Managing Director of Shell UK with responsibility for downstream activities. He was appointed a Director of Shell International Petroleum in 1996. In June 1996 David joined BG as Chief Executive designate of the proposed BG plc and was appointed chief executive the following year. He steered the group to a significant uplift in performance and oversaw the successful demerger of Lattice plc. In 2001, David was appointed Chairman of mmO2 which provides mobile communications to over 20 million customers in the UK, Germany and Ireland. In 2002 he was appointed Chairman of Business in the Community which promotes responsible business practice in the UK.

Paul Gray CB

Deputy Chairman and Deputy Chairman designate HM Revenue and Customs. Paul joined H M Treasury in 1969 as an economist. In the late 1970s he spent two years as a corporate planner with Booker McConnell Ltd. Between 1988 and 1990 he was Economic Affairs Private Secretary to the Prime Minister. In 1990 Paul returned to the Treasury working on monetary policy, serving as a member of the EU Monetary Committee. He then became Head of Personnel and Central Services, and was also a non-executive director of Laing Management Ltd. From 1995 to 1998 he was Director of Budget and Public Finances. In 1998 Paul joined what was then the Department of Social Security (DSS) as head of policy. Before taking up his current post, he was Second Permanent Secretary and Managing Director, Pensions and Disability in the Department for Work and Pensions (DWP) playing a major role in forming DWP through the merger of the former DSS, the Employment Service and parts of the Department for Education and Employment (DfEE).

Ann Chant CB

Ann has Board level responsibility for Change Management. Ann joined the National Assistance Board in 1963. She was Chief Executive of the Contributions Agency in 1991, Child Support Agency 1994-1997 and Managing Director of Business in the Community 1997-1999. During 1999-2000 she led a quinquennial review of the Public Trust Office and a review of the Office of the Legal Services Ombudsman before her appointment to the Inland Revenue in 2000 as Deputy Chairman with Board level responsibility for strategic service delivery, closer working and consumer champion role.

990837_Text / Sig: 2 / Plate B
4 Inland Revenue Annual Report and Accounts
Inland Revenue Departmental Board
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990837_Text / Sig: 3 / Plate A

Dave Hartnett CB
Dave has Board level responsibility for Revenue Policy. Dave joined the Inland Revenue in 1976. Worked for nearly 10 years on investigation work before becoming Director of Claims Branch in 1991. In 1994 he was appointed Director of the Financial Intermediaries and Claims Office moving in 1996 to lead the technical team on personal taxation. In1998 he was appointed Director of Capital and Savings, with tax policy responsibility for capital taxes, savings, pensions, share schemes, charity tax issues and stamp duty. He led the 2000 quinquennial review of the Valuation Office Agency before his current appointment in 2000.

Helen Ghosh
Helen has Board level responsibility for Corporate Services. She joined the Department of the Environment (now the Office of the Deputy Prime Minister) where she worked on a wide range of housing, local government and urban regeneration programmes. More recently, she was Director of the Children's Group in the Department for Work and Pensions where she had responsibility for delivering the DWP aspects of the new tax credits project and arrangements for the transfer of the Child Benefit Centre. Helen was Head of the Machinery of Government Secretariat in the Cabinet Office before her current appointment in 2003.

Steve Heminsley
Steve has Board level responsibility for Strategic Service Delivery.
Steve spent 28 years working in a range of jobs in the Department of (Health and) Social Security. In 1990 Steve became Finance Director of Contributions Agency. In 1995 he transferred to Child Support Agency as Planning and Support Services Director. In November 1997 he was appointed Strategy and Planning Director with the Benefits Agency. In 1999, Steve was appointed Director for Pensions and Children's Services and in April 2000 became DSS Pensions Director with responsibility for Strategy, Stewardship and Delivery. In June 2001 he moved to Inland Revenue as Director of National Services.

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Inland Revenue Departmental Board 5

990837_Text / Sig: 3 / Plate A

990837_Text / Sig: 3 / Plate B

Inland Revenue Departmental Board

Kate Owen
Non-Executive member. Kate is Vice President, Executive Development, BP. She has worked in both the public and the private sector; mainly in the retail industry before joining BP. She was directly involved in the change and transformation of BP throughout the 1990s as, successively, Head of its Culture Change Team and Head of Learning and Organisation Development. Kate is also actively involved with a number of outside bodies in both public and private sectors.

Pat Stafford
Non-Executive member. Pat has wide marketing and management experience in the private sector. Previous responsibilities include Group Marketing Director at BUPA, Managing Director of Corporate Positioning Services and Head of Brands Management at British Airways. Currently Pat has a portfolio of interests and is a Non-Executive Director of the National College for School Leadership, a governor of Luton University, and a mentor and member of the Prince's Youth Business Trust.

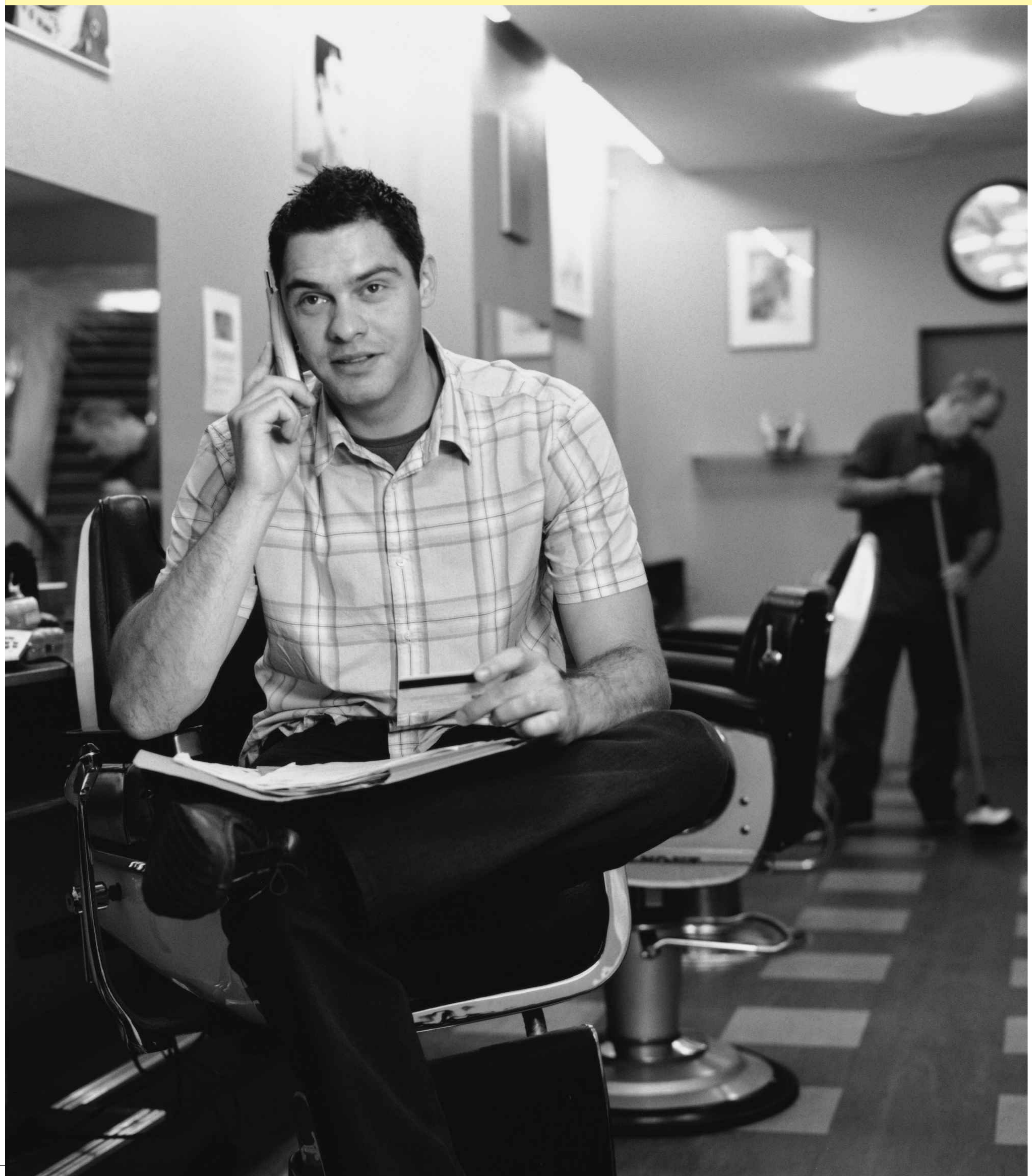
Organisation chart

DAVID VARNEY
Chairman

PAUL GRAY CB
Deputy Chairman

- **STEVE HEMINSLEY** – Strategic Service Delivery
  - **Service Delivery Support & local services** – Marjorie Williams
  - **IR Southern England** – Keith Cartwright
  - **IR Central England** – Ed Mckeegan
  - **IR London** – Geoff Lunn
  - **IR Northern England** – Richard Cooke
  - **IR Northern Ireland** – Tina Gallagher
  - **IR Scotland** – David Hinstridge
  - **IR Wales** – Graham Black
  - **National Services** – Tony Sleeman CBE
  - **Contact Centres** – Ian Gerrie
  - **National Insurance Contributions Office** – Steve McGrath
  - **Child Benefit and Tax Credit Operations** – Jim Harra
  - **Receivables Management Service** – Gordon Smith
  - **Large Business Service** – David Garlick
- **HELEN GHOSH** – Corporate Services
  - **Chief Information Officer** – Steve Lamey
  - **Business Services** – Barry Glassberg
  - **Support Services** – Arthur Durrant
  - **Accommodation** – Robina Dyall
  - **Finance** – Stephen Jones
  - **Internal Audit** – Melvyn Neate
  - **Human Resources and Learning** – Alison French
  - **Information Resources** – Gwenda Sippings
  - **Marketing and Internal Communications** – Gary Jones (Acting)
  - **External Communications and Media** – Steve Field (Acting)
- **ANN CHANT CB** – Change Management
  - **Portfolio Management** – Steve McManus
  - **Transition Programme** – Mary Aiston
  - **Performance Improvement** – Steve Johnson
  - **Communication and Engagement** – Nicola Walters
- **DAVE HARTNETT CB** – Revenue Policy
  - **Personal Tax** – Tony Orhnial
  - **Business Tax** – Trevor Evans
  - **Capital and Savings** – Gabs Makhlouf
  - **Savings, Pensions, Share Schemes** – Caroline Rookes
  - **Capital Taxes** – Jonathan Leigh-Pemberton
  - **Stamp Taxes** – Jim Ferguson
  - **Charities** – Mark Nellthorp
  - **Trusts** – Andrew Edwards
  - **International** – Stephen Banyard
  - **Centre for non-residents** – Charles Hall
  - **Energy** – Ian Stewart
  - **Cross Cutting Policy** – John Middleton
  - **Tax Law Rewrite** – Robin Martin
  - **Analysis and Research** – David Ulph
  - **Special Compliance Office** – Richard Alderman
  - **RP Corporate Services** – Neil Munro CBE
  - **RP Strategy and Co-ordination** – Peter Michael CBE
  - **Better Guidance** – Roger Hurcombe
- **ANDREW HUDSON** – *Chief Executive* Valuation Office Agency
  - **Deputy Chief Executive Local Taxation Director** – David Park
  - **Finance, Technology and Planning** – John Keelty
  - **Modernisation** – Paul Sanderson
  - **Human Resources** – Steve Hartnell
  - **District Valuer Services** – John Wilkinson
- **PHILIP RIDD** – Solicitor
  - **Legislation** – Steve Bousher
  - **Taxes** – Ebrahim Ali
  - **General Legal Services** – Andrew Gunz

Annual Review



Annual Review
8 Inland Revenue Annual Report and Accounts
990837_Text / Sig: 4 / Plate B

Review of the Revenue Departments

In July 2003 the Chancellor of the Exchequer announced a major review of the Departments dealing with tax policy and administration: HM Customs and Excise, the Inland Revenue, and HM Treasury. The review's remit was to examine the best organisational arrangements for achieving the Government's tax objectives. It was led by Gus O'Donnell, Permanent Secretary HM Treasury.

The report examined the work of the Revenue Departments and challenges in improving tax administration, better use of information and tax policy making.

The report recommended the creation of a new Department, integrating HM Customs and Excise and the Inland Revenue, new policy making arrangements between the new Department and HM Treasury and a new accountability framework.

The Chancellor in his March 2004 Budget announced that the Inland Revenue will merge with HM Customs and Excise to form a new Department, HM Revenue and Customs (HMRC). The new Executive Chairman designate, David Varney and Deputy Chairman designate, Paul Gray took up their appointments (initially as Chairman and Deputy Chairman of the two existing Departments) on 1 September 2004. Planning to merge appropriate functions is underway in advance of a new Act of Parliament that will give the new Department legal status which, subject to Parliamentary time is expected to be passed in 2005. Following the outcome of Spending Review 2004 a Public Service Agreement for the period 2005-2008 for the new HMRC was published on 12 July 2004.

HMRC Public Service Agreement (PSA)

Aim

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.

Objectives and Performance Targets

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.

1. *By 2007-08 reduce the scale of VAT losses to no more than 11% of the theoretical liability.*
2. *By 2007-08*
   - *reduce the illicit market share for cigarettes to no more than 13%*
   - *reduce the illicit market share for spirits by at least a half; and*
   - *hold the illicit market share for oils in England, Scotland and Wales at no more than 2%*
3. *By 2007-08, reduce underpayment of direct tax and national insurance contributions due by at least £3 billion a year*
4. *By 2007-08, increase the percentage of individuals who file their Self-Assessment returns on time to at least 93%*

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.

Who is Responsible for Delivery?

Under existing arrangements the Boards of Inland Revenue and HM Customs and Excise are accountable to the Chancellor of the Exchequer. The Paymaster General and the Economic Secretary to the Treasury are responsible for delivering this PSA.

In Budget 2004, the Chancellor announced the creation of a single integrated tax department, HM Revenue and Customs. Once the new Department has been established, ministerial responsibility for delivering this PSA will be announced.

The Paymaster General and the Economic Secretary to the Treasury are also responsible for delivering the HM Revenue and Customs contribution towards the Chancellor's Departments agreed efficiency target set out in the Chancellor's Departments chapter of the 2004 Spending Review White Paper.

990837_Text / Sig: 5 / Plate B

Gershon Review

One of the new Department's top priorities over the next few years will be to deliver the savings that it has committed to, in response to the Gershon Review. This was a review of efficiency in the public sector led by Sir Peter Gershon (then head of the Office of Government Commerce). The remit was to review new ways of providing Departments and other parts of the public sector with incentives to exploit opportunities for efficiency savings, and so release resources for front line public service delivery.

We are required to focus on the following areas for delivering efficiency savings:

- Transactional Services
- Back Office
- Procurement
- Productive Time

Following the outcome of this review and the Spending Review 2004, the new HMRC is committed to delivering annual efficiency savings of at least £507 million by the end of 2007-08. It is also committed to achieving staff reductions of 16,000 gross (12,500 net after redeploying 3,500 staff to frontline areas of work) within the same time scale.

These savings will be achieved, inter alia, by:

- delivering substantial efficiencies in transaction processing through the implementation of an ambitious e-programme including mandatory online filing of End of Year PAYE returns by employers – facilitating a shift from manual to electronic processing
- consolidating the rationalisation of corporate services (back office) functions and the implementation of electronic services such as e-HR
- delivering continued year-on-year savings through improved negotiation and management of the procurement of goods and services, and of its major estates and IT contracts
- looking to exploit the additional opportunities generated by the integration of Inland Revenue and HM Customs & Excise.

Lyons Review

In his 2003 Budget, the Chancellor announced that he and the Deputy Prime Minister had asked Sir Michael Lyons to advise ministers on the scope for relocating public sector jobs out of London and the South East. The Independent Review of Public Sector Relocation reported in March. Our approach was recognised as continuing a long " history of reorganisation on business efficiency and quality grounds", which started with relocating PAYE processing work out of London to London Provincial Districts in the 1960s.

In response to the review, HMRC has committed to relocating 1,950 posts by 2008 and, in total, 4,250 posts by 2010. Our initial plans build on existing programmes for improving our service to customers and initiatives to rationalise our London presence. Beyond that we will be looking to exploit the additional opportunities offered by the formation of the new Department.

Business Direction and Core Purpose

We are enablers as well as regulators, ensuring that everyone understands and receives what they are entitled to and understands and pays what they owe, so that everyone contributes to the UK's needs.

We do this by being objective and knowledgeable and efficient and clear and human and reasonable.

PSA Targets 2003-2006

Our Public Service Agreement targets for 2003-2006 are:

1 Improve the number of individuals and businesses who comply with their obligations and receive their entitlements.
2 Reduce the costs of compliance for small businesses.
3 Ensure by 2005 that 100% of services are offered electronically, wherever possible through a common government portal, and promote take-up for key services.
4 Achieve annual efficiency savings of at least 2.5% a year until March 2006, without detriment to accuracy or customer satisfaction.
5 Achieve a 2.5 point improvement in customer service by March 2006 as measured by an annual customer service index.

Our 2003-04 performance against these targets is shown on pages 26 to 33.

Revenue Collection 2003-04

Inland Revenue collected net tax receipts[1] and national insurance contributions of £230.8 billion in 2003-04, £12.1 billion higher than 2002-03, and paid out tax credits of £13.6 billion gross.

Net tax receipts were £155.5 billion in 2003-04, £4.3 billion higher than 2002-03. The increase in receipts was mainly due to higher receipts from income tax, reflecting modest growth in earnings, partially offset by lower receipts from corporation tax. There was a decline in corporation tax yield because extra payments from the transition to quarterly instalments finished in 2002-03 and corporate profits, particularly for 2002, were still depressed following the decline in share prices and related financial activity.

National insurance contributions were £75.2 billion in 2003-04, £7.8 billion higher than 2002-03 reflecting the 1 per cent increase in rates from April 2003.

The overall cost of collecting tax and National Insurance Contributions for 2003-04 fell to 1.04 pence per £ collected (1.11 pence in 2002-03).

A total of £0.58 billion was remitted or written-off as irrecoverable in the year to 31 October 2003, compared with £0.52 billion in the year to 31 October 2002 (see Appendix 1, Tables 15 and 16).

Compliance Assurance

Non-compliance with obligations to file accurate returns and claims has the potential to undermine the integrity and fairness of our tax system. Our aim is to minimise the extent of non-compliance whilst keeping the compliance burden on the compliant to a minimum.

A key element in our response is our programme of enquiries, but other ways in which we can assure better compliance range from enabling activities to inform, educate and support taxpayers, through to referral for criminal proceedings in the most serious cases of fraud.

The reasons for non-compliance are many and varied. They range from ignorance, misunderstanding and error, through indifference and carelessness, to conscious and deliberate evasion or fraud. To respond appropriately to the many challenges to compliance, and so keep the compliance burden to a minimum, we need to understand who our customers are and what influences their behaviour. And to be able accurately to assess the risks of non-compliance.

In support of our aims we have taken a number of steps in 2003-04:

- We continued actively to develop our enabling programme aimed at improving voluntary compliance. For example: a new leaflet distributed to employers provides them with clear guidance on the correct treatment of tips, gratuities and service charges in respect of Tax, VAT, National Insurance, and National Minimum Wage.
- We continued to refine our risk assessment processes and tools. In particular, we have developed a management information system to assess the effectiveness of our risk assessment processes, inform the development of good ideas and disseminate best practice.
- We introduced new ways of working such as the use of mixed grade teams to improve the effectiveness and efficiency of our enquiry work.

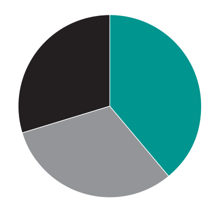
The success of these and our programmes to improve our compliance work are reflected in the improvement in overall yield this year (see Appendix 1, Table 4).

We adopt a policy of selective prosecution for serious offences and publicise our results. You can find out more about the cases we prosecute by reading our Prosecutions Releases on our website (www.inlandrevenue.gov.uk). In 2003-04 we prosecuted 110 cases, 99 of them successfully. We confiscate assets in appropriate criminal cases and in 2003-04 we obtained 7 confiscation orders worth £2.4m.

Wherever possible, we contribute to the fight against all types of crime, assisting the police, the Serious Fraud Office and the National Criminal Intelligence Service where appropriate. During 2003-04 we made over 11,000 disclosures under the Anti-Terrorism and Security Act 2001 and the Proceeds of Crime Act 2002.

Some of the work we do to help people report the correct tax liability will increase the yield for the Exchequer. Over and above that, we record the amounts by which we adjust liabilities as a result of action against non-compliance. In 2003-04 this figure was £4.6 billion.

Additional liability from work tackling non-compliance



1 The figures for net tax receipts treat payments of tax credits (working and child tax credits plus working families' and disabled person's tax credit) as negative tax to the extent that the credits are less than or equal to the tax liability of the family. Payments exceeding this liability are treated as public expenditure. In addition, directly payable corporation tax credits included in tax repayments in the trust document are also treated as public expenditure.

990837_Text / Sig: 6 / Plate B

The yield from our Large Business Office (LBO) increased this year to £1,789 million. As explained in last year's report, headline yield figures are significantly influenced by exceptional results achieved in a handful of cases.

Paying Entitlements

By the end of 2003-04, six million families were benefiting from new tax credits, 100% of the numbers expected to benefit. This includes those families with children getting their increased support through income support or jobseekers allowance. 5.7 million tax credits awards were made in 2003-04, including over 400,000 awards which ended during the year. In addition, the Department took on the responsibility for payment of support to over seven million families claiming child benefit and guardian's allowance. £13.5 billion was paid out by the Department in tax credits and £9.4 billion by way of child benefit.

The Department provided support during the year to help familiarise customers with the new tax credits system, for example, through newsletters and publicity to remind them about reporting changes that could affect their award. In addition, work continued on preparations for the end of year process to finalise 2003-04 tax credits awards and renew claims for 2004-05. Work also continued on plans to begin paying child tax credit to families who are currently receiving financial support for their children through income support or income-based jobseeker's allowance.

Compliance Assurance

In the first year of child and working tax credits our aim has been to ensure claimants have provided accurate information about their income and circumstances, or advised us of any change of circumstances in good time. To do this we:

- carried out verification checks on all claims
- wrote or telephoned childcare providers in all cases where tax credits are paid to help with the costs of childcare
- applied sophisticated risk assessment to identify potentially non-compliant cases for investigation, with the highest risk cases being investigated before making an award.

During 2003-04, we investigated 105,057 cases. Based on the information then available about entitlement, the excess tax credit identified by this work and paid out by the time we intervened amounted to £66,738,470.

Policy Developments

Corporation Tax (CT) Reform

In 2002 the Government initiated a programme of consultation with business on reform of corporation tax, with the aim both of improving the competitiveness and fairness of the CT regime and of maintaining its robustness in the face of international pressures, particularly challenges under European law. Consultation documents were published in 2002 and 2003 that considered potential areas of domestic reform and the reform of corporation tax in its broader international and European context.

Extensive consultation with business and business representative bodies based on these documents led to legislation in this year's Budget in two main areas:

- a widening of eligibility to management expenses and
- a package of transfer pricing reforms that gave certainty to business on the interaction of these rules with EU law.

The Government remains committed to modernising the CT system, including reform of the "schedular" system, the capital/income divide and the tax differences between trading and investment companies. Detailed legislative proposals will be published later in 2004, focusing on those areas where the system may create unjustified barriers to modern commercial activity. There will also be continuing dialogue on the longer-term development of the CT system in the evolving international context.

Modernising PAYE Processes for Customers (MPPC)

In April 2002 the Government announced that recommendations contained in Patrick Carter's Review of Payroll Services would be implemented. Regulations were laid in September 2003 to mandate online filing of large and medium employers' end of year returns and to incentivise voluntary online filing by small employers.

The MPPC programme was constituted to deliver the new business processes, IT infrastructure and support for employers to give effect to those regulations.

Beyond that, over the period to 2006-07, the programme will also modernise other elements of our PAYE processes and introduce a new more flexible computer platform for PAYE. The programme is strongly aligned with our PSA framework; it will achieve significant internal efficiency savings, improve customer service in PAYE for both employers and employees, simplify compliance for small business and encourage increased e-engagement in one of our major lines of business.

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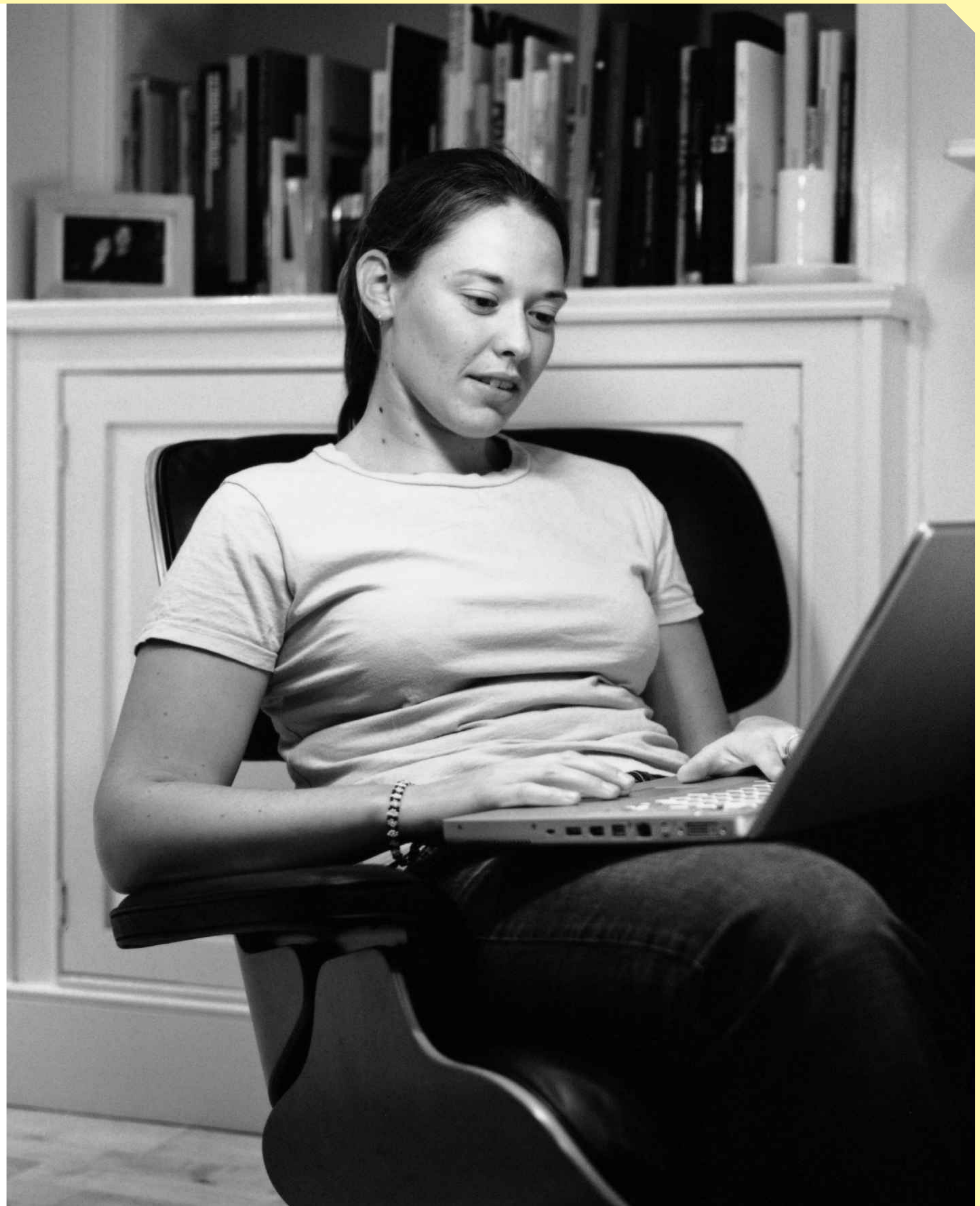
Customers can now log on to use our online services 24 hours a day.



Customers can now log on to use our online services 24 hours a day.

Annual Review 13

990837_Text / Sig: 7 / Plate A

Modernising Stamp Duty
The objectives behind the modernising of stamp duty are to create a regime which is fairer, efficient and which supports e-business. The legislation was included in Finance Act 2003. Following some further consultation over the summer of 2003 and the introduction of regulations in November, Stamp Duty Land Tax was implemented on 1 December 2003.

In implementing the changes, we were determined that they should have as little direct impact as possible on both the property market and the property purchaser. This was achieved through our decisions to manually process the returns initially and to apply a 'light touch' to considering whether we could accept partially completed returns. By June 2004 we had processed over 1 million returns and, under the light touch arrangements, provided customers with feedback on how to correctly complete returns on over 150,000 occasions.

Construction Industry Scheme (CIS)
Following representations by the industry, it was announced in the 2003 Pre Budget Report that the scheme would not be introduced until April 2006. Draft primary legislation was published on 4 February 2004 and was included in Finance Bill 2004. Draft regulations were also published on the same date and will be finalised in autumn 2004. A programme team was put in place to handle the implementation of the scheme.

Several consultation groups, including representatives of the industry and other interested parties, have met on a regular basis to discuss details of the legislation and the operation of the scheme. A number of changes have been made to the details as a result of comments from these groups. The consultations will continue through to implementation of the new scheme.

Under the new scheme, an Inland Revenue run verification service will replace the cards and certificates in CIS and periodic returns will replace the vouchers used in the current scheme. A new employment status declaration will also be introduced.

The reformed scheme will reduce the burden of operating the scheme on construction businesses, improve the industry's compliance with its tax and National Insurance obligations and help the industry to get the employment status of its workers right.

Pension Simplification
The broad principles of a proposed new simplified taxation regime for pensions were set out in a consultation paper issued in December 2002. The broad thrust of these were well received, but a number of comments were received on matters of detail. A second document was issued in December 2003, which provided technical information and details of how the new pensions regime would operate. This document proposed a number of changes to the original proposals, in response to comments received on the December 2002 document. Both the proposed changes, and the Government's flexibility in responding to comments on the first document, were warmly welcomed.

We continued to consult closely with the industry and other interested groups on the detail of the proposals, and to work in partnership with private sector secondees to develop a fuller understanding of the impact of the proposals in pensions administration. We were, in particular grateful to the NAPF and ABI for their invaluable help in this area.

In the Budget on 17 March 2004 the Chancellor announced that legislation to simplify the taxation of pensions would be included in the 2004 Finance Bill. He also announced that, in response to industry concerns, the implementation date would be delayed until 6 April 2006.

International
We have supported Ministers in Europe through:
- ongoing work in the EU Code of Conduct working group, chaired by the Paymaster General
- a co-operative dialogue with relevant UK dependent and overseas territories in relation to the taxation of savings and the Code of Conduct
- changes to the EU rules on co-ordination of social security; in particular NICs, child tax credit and child benefit, and in facilitating smooth implementation of those co-ordination rules for people moving from one Member State to another
- proposals to improve the ability of business to operate within the EU, including active participation in the Joint Transfer Pricing Forum and other EU working groups.

In the Organisation for Economic Co-operation and Development (OECD), we are heavily involved in the Committee's work on harmful tax practices, exchange of information, transfer pricing, permanent establishments, and the OECD model tax convention to eliminate double taxation.

We presently have bilateral treaties with 108 jurisdictions.

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A new treaty with Australia was signed on 21 August 2003 and came into force on 17 December 2003. The protocols with Mauritius and New Zealand entered into force on 22 October 2003 and 31 March 2004 respectively. We signed a revised treaty with France on 28 January 2004. During this year, we opened negotiations with the Cayman Islands, Greece, Hong Kong, Iran, Luxembourg, Poland and Serbia and Montenegro. We continued negotiations with Bahrain, Belgium (protocol), Croatia, Georgia, Namibia, Netherlands, Saudi Arabia and Slovenia.

Child Trust Fund

In his 2003 Budget the Chancellor announced the introduction of the Child Trust Fund (CTF) under which children born from September 2002 will receive Government payments to invest in savings and investment accounts. This is a key element in the Government's savings policy: the aim of the CTF is to strengthen the savings habit of future generations and ensure that all children have a financial asset on reaching adulthood.

We have been working closely with Treasury and other Government and local authority colleagues. Following extensive consultation with financial institutions and other interested parties, legislation was introduced in November 2003. The Child Trust Fund Act 2004 came onto the statute books in May 2004. In May 2004 CTF regulations were laid and comprehensive guidance for financial providers was made available. Revenue and Treasury delivered a number of joint presentations to the financial industry and groups working with parents in June and will continue working with these groups leading to the launch.

The CTF Project Team is working to ensure that business and IT systems and clear communication materials are in place ready for the launch of CTF. CTF vouchers and information packs will be issued from January 2005 so that CTF accounts can be set up ready for April 2005.

Financial education is a key component of the CTF and children will receive financial education about the CTF through links with the school curriculum. Information will be made available for parents, teachers and children over the lifetime of a child's CTF account. There will be a dedicated CTF website later this year that will provide information about the CTF so that parents, family and friends understand about CTF accounts.

Disclosure Proposals

The Government announced proposals for new disclosure rules in the 2004 Budget. These will require promoters of certain tax schemes to report details to the Inland Revenue. The aim of the new rules is to enable the Revenue to find out more quickly about potential avoidance schemes, and enable the Government to make a swifter and better targeted response. The disclosure rules represent a new tool to tackle tax avoidance by increasing transparency in the avoidance market. And they will act as a disincentive to the creation of contrived and artificial schemes that rely on confidentiality and whose main purpose is to avoid tax.

The Revenue has worked with stakeholders to design carefully targeted rules, which will focus on financial and employment based arrangements; areas where the Exchequer is at greatest risk from serious tax avoidance. However, individuals and businesses remain entitled to plan their tax affairs efficiently so that they do not incur higher tax liabilities than they need to. The disclosure rules have been designed to minimise any impact on that sort of straightforward tax planning. The rules will not affect the tax treatment of specific transactions.

Legislation to implement the new rules was included in the Finance Act 2004.

Local office organisation and contact centres

The programme to reconfigure our IT systems and accommodation to support area management of our local office network is on course towards completion in March 2005, on time and within budget. The contact centre network grew to 22 centres, with one more, shared in an innovative arrangement with Bradford Metropolitan Council, to open in November 2004. The incoming telephone calls of about 75% of areas are now handled by contact centres and most of the rest of this telephone traffic will be taken over by contact centres in 2005. The area management structure and contact centre network played a big part in helping with the introduction of the child and working tax credits.

The area management and contact centre structure make it possible to look ahead to 2008 and make some interim planning assumptions. The Departmental Management Committee has endorsed an outline vision of an organisation with work done locally only if it needs to be done there; most compliance and processing work centralised in a number of strategic zones around the country, and all supported by a 'virtual' contact centre network.

Customer Support

In our face-to-face contact through our Enquiry Centres we have focused on delivering high-quality services to those customers who need it, while promoting other options such as internet and phone where these better suit their needs.

Business Support Teams (BSTs) continued to offer a range of services to assist employers and the self-employed:

- over 105,000 businesses, of which more than 56,000 were employers, either received one to one assistance or chose to attend workshops on a specific topic
- BSTs delivered 5,300 general presentations at which almost 69,000 businesses attended
- at 583 exhibitions around the UK, approximately 28,000 people visited BST stands
- BSTs dealt with 19,000 phone calls requesting assistance.

We have enhanced the interactive training packages and calculators on the CD-ROM for employers, and are planning in the coming year to include more specific targeted help for new employers facing payroll responsibilities. We now offer our EmployerTalk events at 13 locations nationwide: these events allow employers to hear of forthcoming changes and to discuss them with Inland Revenue experts, and evaluation evidence shows that they meet employers' needs very successfully.

Following the Review of Links with Business, the number of groups adopting the New Compliance Process(NCP) principles with our Large Business Office (LBO) has continued to expand. In addition, a programme of 'Compliance Reviews', building on the NCP principles of transparency and openness, is being rolled out in the coming year. The case team and the group will engage in dialogue to determine a common understanding of tax risks and the nature of the LBO's response to address those risks. This builds on the 'ringmastering' role of the case director in the LBO as the knowledge and the relationship they have established with the group is enabling case teams to work increasingly with the group to resolve issues in 'real time'.

Working Together

Tax advisers are a key group of our customers who are well placed to contribute to the improvement of the tax system. Working Together is a partnership between tax advisers and the Revenue and operates at both national and area level. This partnership approach continues to make a difference to the way we do business, right across the Department.

The vast majority of area offices are actively engaged in Working Together via regular meetings with local tax advisers. In addition to identifying areas of the tax system that could be improved, these meetings encourage two-way communication, strengthen working relationships and support our commitment to be more enabling and responsive to our customers' needs.

The enquiry workshops, which we mentioned in last year's Report, are being held throughout the country, using the Enquiry Toolkit which was developed by tax advisers and the Revenue working collaboratively. These have proved a welcome and effective method of breaking down many of the myths and misunderstandings surrounding Enquiry work. We are continuing to jointly develop events aimed at promoting greater understanding between the profession and the Department.

Complaints

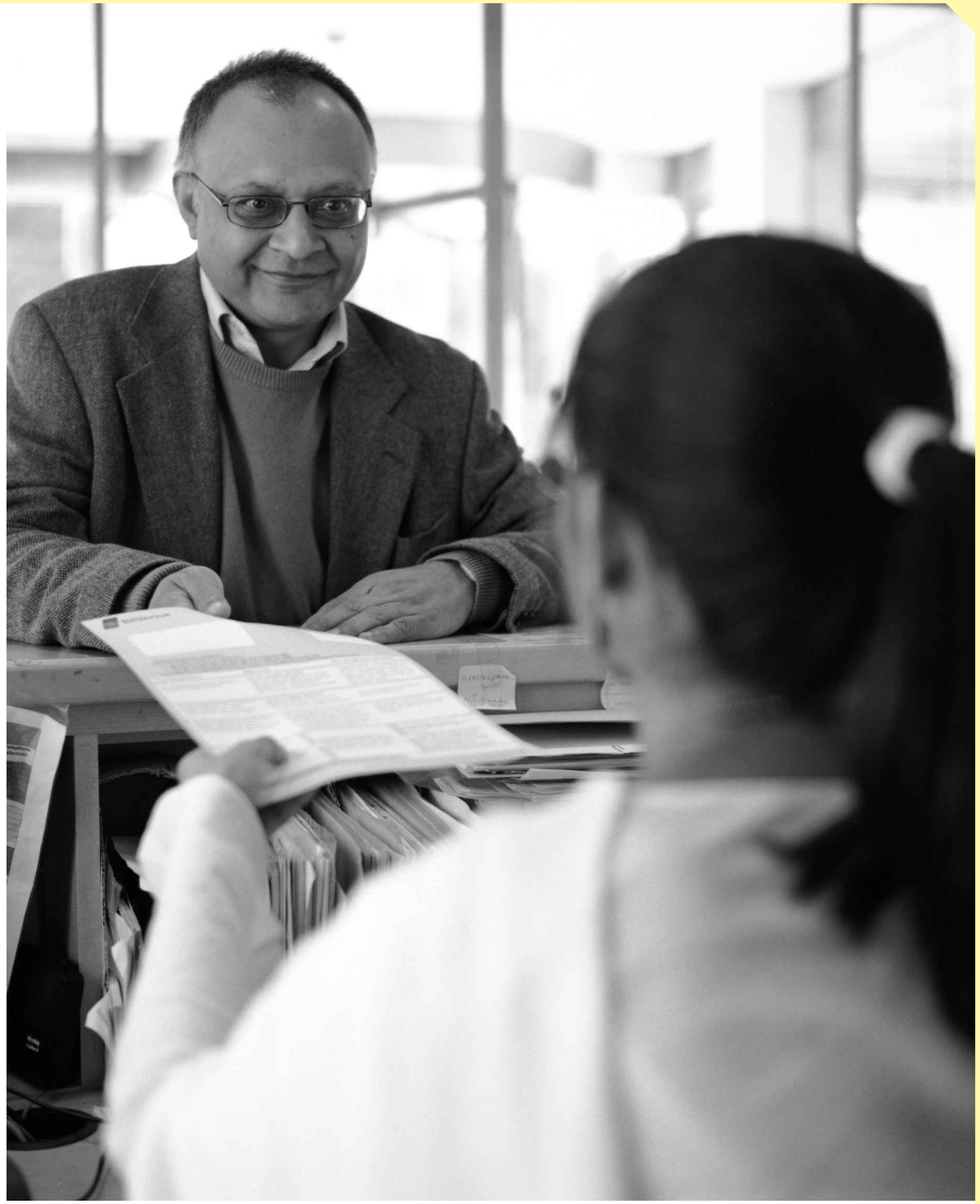
Virtually every adult in the UK now conducts business with us and the number of complaints represents a fraction of one per cent of our customer base.

We received 64% more formal complaints in the year – up from 42,000 last year to 68,700. Under our Code of Practice 1 'Putting things right' we have paid a total of £2.42 million to about 18,000 of our customers who incurred additional costs as a direct result of our mistakes or unreasonable delay.

However, during the year we also received 65,174 letters of compliments.

We resolved 99.5% of the complaints we received through our internal complaints procedures. Complaints taken up by the Adjudicator and the Ombudsman have remained much the same.

In our face-to-face contact through our Enquiry Centres we have focused on delivering high quality services to those customers who need it.



In our face-to-face contact through our Enquiry Centres we have focused on delivering high quality services to those customers who need it.

Annual Review 17

990837_Text / Sig: 9 / Plate A

The Adjudicator

The Adjudicator Dame Barbara Mills QC can be contacted at Haymarket House, 28 Haymarket, London SW1Y 4SP.

Details of complaints going to the Adjudicator are given below.

Complaints to Adjudicator

	2002-03	2003-04
Number of complaints about the Inland Revenue, including the Valuation Office Agency	1,634	**3,376**
Number of cases taken up for full investigation	370	**387**
Number of concluded investigations	373	**366**
% complaints settled wholly or partly in favour of customer	45	**35**
% complaints settled wholly in favour of the Inland Revenue	52	**61**
% complaints withdrawn or suspended	3	**4.5**

Complaints to the Ombudsman

Customers can ask a Member of Parliament to refer their complaint for investigation by the Parliamentary Commissioner for Administration, the 'Ombudsman'.
In 2003-04 the Ombudsman received 186 new complaints about the Inland Revenue compared to 145 in the year before. Of these, 47 (52 last year) were settled informally and 11 (12 last year) settled by statutory investigations of which 6 (9 last year) complaints were classified as wholly or partly justified.

Performance Improvement

Business Reviews have again delivered productivity improvements and efficiencies in key business areas. Notably, we have identified opportunities to

- rationalise Trust offices, centralise processing and introduce new management arrangements to raise productivity, reduce overheads and improve customer service
- pilot more effective management and response processes for handling postal enquiries in local and national offices, to reduce the need for postal contact and to encourage better use of other contact channels
- increase the effectiveness of the Department's telephone contact with customers within the context of the departmental channel strategy
- bring together the review findings of contact by telephone, post and face-to-face, to inform departmental planning on contact channel management.

We have also

- ended the staff suggestions scheme (which was no longer producing the innovative outcomes needed) with a view to piloting a new process to harness local innovation based on business priorities in 2004-05
- introduced a new value-based approach to benefits realisation, working in collaboration with finance and business stream colleagues to deliver measurable results
- introduced a new corporate approach to continuous improvement based on best practice and focussed on key business activities, with a cost/benefit ratio guide to ensure value for money.

Closer Working

Closer Working continued to bring benefits. Our Joint Shadow Economy Teams (JoSETs) include Job Centre Plus investigators alongside Revenue and Customs & Excise (C&E) colleagues:

- achieved a Revenue tax yield £2.38m and worked 216 joint 'Ghost' cases
- secured 3,476 VAT Registrations, with C&E arrears totalling £26.5m.

We introduced a defined standard for Closer Working in respect of compliance information intended to consolidate Closer Working in a business as usual position.

All of the Closer Working lessons learnt will be invaluable as we and Customs take forward implementation of the recommendations of Gus O'Donnell's review of the two Department's work.

Information Technology

Information technology is vital to the operation of the Department. We rely on effective computer support to do our current business and implement our future plans.

Key Developments in 2003-04
The Inland Revenue announced on 11 December 2003 that Capgemini had been selected as the Department's preferred supplier for the ASPIRE contract. The Inland Revenue and Capgemini signed the ASPIRE contract on 5 January 2004.

The ASPIRE contract commenced on 1 July 2004 and will run through to 30 June 2014. The contract covers the provision of the Department's IT services.

Key Achievements in 2003-04

We have continued to make good progress in delivering high-quality and user-friendly electronic services to our customers. We are particularly encouraged by the growth in take-up of our online service, notably more individuals filing Self Assessment (SA) returns online, and more employers filing end of year PAYE returns online. During the year ending 5 April 2004, over 1.1 million SA returns for 2002-03 were submitted electronically. Nearly 90% of users have told us that they are satisfied with our online SA service and would use it again.

In addition, our corporation tax online service has been extended so that companies and their agents can now send company tax returns plus attachment (accounts/ computations) online.

Strategic IT Partnerships

ASPIRE

The ASPIRE contract for the provision of the Department's IT services commenced on 1 July 2004 and will run for 10 years with options to award continuations to the contract for up to 8 years from 1 July 2014.

The scope of the ASPIRE contract is focused on the delivery and development of a range of technology services including, but not limited to:

- IT/IS and voice services
- change services
- business services closely related to IT/IS and voice services.

These services are intended to facilitate and support:

- current patterns of business
- new patterns of business, including the development of online services
- transformational changes in the shape, size and organisation of the Department's business.

The ASPIRE contract is sufficiently flexible to enable new requirements and methods of doing business to be developed without the need to resort to changes in basic contract terms.

EDS

Our strategic partnership contract with EDS was awarded in 1994 for ten years. The contract came to an end on 30 June 2004.

Up until this date, EDS continued to be critical to service delivery. Service targets were generally met or exceeded though there were the well publicised difficulties with the service for child and working tax credits at the start of the tax year 2003-04.

In general, Live Services have been reliable. EDS continued to provide IT support for the child and working tax credits service and in particular brought stability to the live service following the initial problems.

They have also supported our Mission Critical projects and programmes, such as Modernising PAYE Processes for Customers, Child Trust Fund, a new child benefit system and the Construction Industry Scheme reform.

Accenture

The Department continues to have a contractual relationship with Accenture through a PFI contract which supports delivery of our National Insurance business through the National Insurance Recording System (NIRS2). This contract is due to come to an end in early 2005, when the provision of NIRS2 services will be subsumed into the ASPIRE contract.

NIRS2 is one of our largest systems and is essential to both our own business and that of the Department for Work and Pensions (DWP). It processes end-of-year returns from employers and supports the maintenance of approximately 70 million individual contribution accounts which underpin entitlement to benefits and pensions.

We work closely with the DWP to ensure that the NIRS2 system supports the business requirements and strategic direction of both Departments.

During the year we introduced system changes to deliver State Second Pension and to allow for the Budget Changes i.e. the 1% increase in National Insurance for employees and employers. We also took an active role in contributing to the DWP's Pension Service transformation programme by providing a browser access to NIRS2 for Jobcentre Plus staff which achieved significant business benefits. We also commenced a six-year Deficiency Notice exercise to advise around 10 million customers of deficiencies in their National Insurance records. In the coming year we are to re-introduce the annual Deficiency Notice exercise and also further contribute to DWP's Pension Service transformation programme with the development of Pension Entitlement on-line and real time pension forecasting.

The partnership with Accenture ensured successful delivery of two large tranches of system changes during the year.

Business Continuity

We have continued to improve our resilience and our capability to respond to and recover from events that disrupt our business. During 2003-04 the emphasis began to move

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from the development of business continuity plans, towards proving the effectiveness of the plans through a programme of rehearsals and exercises.

Procurement and Commercial Activities

During 2003 we reported the highest percentage savings of all Government Departments, having contributed £133m Value for Money (VFM) gains against the Office of Government Commerce's (OGC) £1 billion procurement savings target in the previous three years. For the financial year 2003-04 we reported further Departmental VFM gains of over £132m, a significant achievement.

In response to the Gershon Efficiency Review we have identified further efficiencies to be made in procurement and back office functions by 2010. We are developing plans to deliver these.

Further savings are also expected through the integration of the Department with HM Customs and Excise. We already have joint policies and contracts in place, and are looking to increase collaboration in a number of areas ahead of formal integration.

Many of our contracts are also open to Other Government Departments (OGDs), which enables us to maximise buying power and achieve economies of scale. For example, a range of OGDs/agencies use our travel/fleet management contracts and around 10 OGDs, including the Department for Work and Pensions and the Cabinet Office, buy IT hardware and software through our e-IROS contract. From June 2003 to April 2004, over £96m was spent through this contract, of which £67m was by OGDs, thus achieving significant volume discounts for all participating authorities. In January 2004, we moved from our own consultancy contracts to OGC's S-CAT, again to maximise value for money.

We have continued to support wider Government and OGC activities, including:

- involvement in pan-Government strategic supplier management and negotiations
- development and sharing of best commercial practice
- actively supporting the Government's e-procurement strategy, including OGC's Zanzibar project, which will provide on-line access to the government marketplace and a "purchase to pay" facility
- championing faster and more innovative procurement and enabling Small and Medium Enterprises (SMEs) to bid for Government business (following the recommendations of the Better Regulation Task Force).

Further details can be found in our 2004 Spring Departmental Report.

Sustainable Development and Environment

We continue to make progress towards meeting the Government's sustainable development targets, for example by:

- working towards the 31 March 2008 target for 10 per cent of our total electricity to be from renewable sources that are Climate Change Levy exempt, although our consumption continues to rise
- ensuring a utilities usage database for gas, electricity, solid fuel, oil and water is available to building managers intending to increase the number of Environmental Management Systems in place across the estate (subject to business case approval following pilot study, implementation will commence at those sites with the most significant environmental impacts)
- raising awareness of 'green' procurement issues among Departmental buyers including the greater use of recycled products
- taking on board the 'Quick Wins' recommendations both within our own and our PFI procurement sections
- joining the 'Watermark' initiative and implementing site surveys, and incorporating their recommendations commencing with those sites which would benefit the most
- working closely with our PFI contractors in implementing the Food, Bio-diversity, Energy and Waste targets.

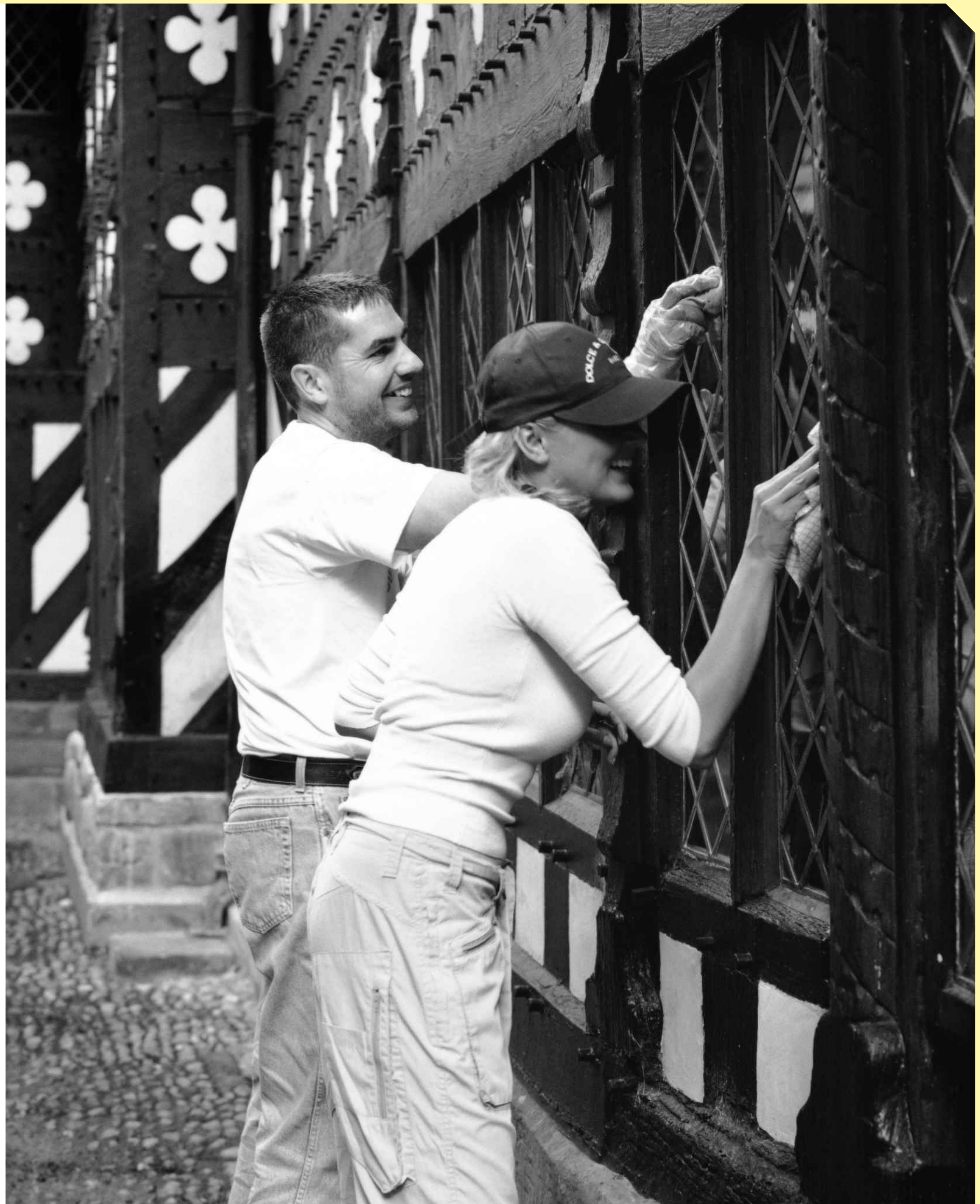
Further details can be found in our 2004 Spring Departmental Report and on the Internet site.

Corporate Social Responsibility (CSR)

Our purpose is to serve all communities in the UK and we continue to strive to be recognised as an organisation that the public feel they can approach for help, guidance, fair treatment and professional service.

We are pleased that our efforts have achieved recognition with applications made during the year for our work on Diversity, Environmental Impact, Education and Lifelong Learning and Collaborative Action each subsequently winning a Big Tick Award in the Business in the Community (BitC) 2004 Awards for Excellence. The Collaborative Action entry, submitted jointly with other companies and organisations who are members of the Preston Community Impact Group, achieved the top award of National Example of Excellence.

Many staff take advantage of the opportunity of a day's paid leave to contribute personally to the local community.



Many staff take advantage of the opportunity of a day's paid leave to contribute personally to the local community.

Annual Review 21

990837_Text / Sig: 11 / Plate A

We were also awarded a silver standard and placed in the top 10 in The BitC Race for Opportunity Index and received a Sponsor Award from The Prince's Trust for our work in the North East.

In the coming year we plan to be one of the first Government Departments to complete the BitC Corporate Responsibility Index, a business management tool developed to support organisations to improve their impact on society and the environment. We will be critically examining gaps in performance and where improvements are needed.

For a number of years we have recognised the value of managing our impact on society and the environment through our operation and services and their interaction with key stakeholders such as employees, customers, local communities, suppliers and others.

We continue to work with local communities through our partnerships with the Prince's Trust, Business in the Community the Employer in the Community Network and others. Over 10 people are seconded to charities and we supported more staff through the Prince's Trust Team programme than any other employer in the UK with over 250 staff participating.

We have also developed links with The Prince's Trust Business Programme to provide young people starting up in business co-ordinated access to our range of services and advice.

Much of our community involvement such as tax surgeries for people with disabilities and pensioners in sheltered accommodation, work with local schools, and local Asian language broadcasts is intrinsic to our core business. Social awareness runs deep in the Revenue: over 10% of our people participate in Payroll Giving, raising over £850,000. Many staff take advantage of the opportunity of a day's paid leave to contribute personally to the local community and take part in team development as part of local community projects. These range from sharing our IT skills to replanting a garden for children with special needs.

As a major estate holder, our sustainable development policies ensure that our environment and estate management is to the highest standard. We encourage green procurement of recycled products, and are working hard to reduce water use, gas emissions and recycle waste.

Attracting, retaining and developing a workforce that reflects the communities we serve is critical to our success and our approach is to make diversity a direct means of delivering quality public services.

Work with local schools and with community projects has helped us break down negative perceptions of us as an employer and initiatives to recruit through disability press, work placements for unemployed people, and ethnic radio stations have assisted in employing a more diverse workforce.

Training and development is an important strand to help breakdown barriers that deter individual progress and we offer mentoring opportunities, development programmes and secondments to encourage staff to shape their own careers.

Our former Chairman, Nick Montagu was the Civil Service Diversity Champion. In 2003 as part of the first ever Diversity Week, offices across the country organised events to challenge prejudice in areas such as disability, gender and ethnicity. Our Diversity Awards highlighted and celebrated some of our best practice and externally recognised achievements.

People and Knowledge

We gave details in our Spring Departmental Report of our work on our strategic approach to people issues, focusing on:

- enhancing Leadership and Management Capability
- developing the right skills and knowledge
- building a flexible workforce
- taking forward strategic HR planning.

We are committed to:

- improving our management capability, essential to the future morale and productivity of our people
- increasing the skills and flexibility of our workforce, in line with Government's White Paper "21st Century Skills – Realising Our Potential" as a route to better delivery of our business
- a strategic view of our workforce and locations in line with the Chancellor's Lyons, Gershon and O'Donnell Reviews.

The three year pay deal negotiated in 2002 has served us well. It has given us a period of stability on pay which has contributed to the positive tone in our dealings with the trade unions. The first year of the team bonus scheme ended on 31 March 2004 and the results will inform the shape of the scheme for 2004-05. We have completed the research on the pay and grading review commenced in 2003, and this will be incorporated in the work of developing policy on pay and related matters for the new HMRC.

990837_Text / Sig: 12 / Plate A

HR Transformation

This year has seen some significant changes to the way Human Resources provides a service to our people. Building on the findings and recommendations of the Better Quality Services (BQS) Review of HR we have introduced a transformation programme to take forward reform and re-organisation.

We have moved towards establishing a single HR organisation with its own management structure. HR will no longer be delivered from units in the various business streams. This will ensure consistency in the application of HR policies and processes and avoid duplication of effort.

We have developed a model for the future HR structure based on the concept of shared service centres located at strategic sites. Six specialist delivery teams will be represented at some or all of the shared service centres and will work on:

- Recruitment
- Personnel and Career Management
- Employee Relations and Performance
- Diversity, Conduct and Health
- Senior Civil Service (SCS) Personnel Services
- Reward and Recognition.

As part of HR transformation we have appointed HR business partners. These are located in the business and are an intrinsic part of the leadership and management of the business unit. They form a bridge between HR and the business and take responsibility for strategic people issues. Their role is central to the development of customer focussed HR service delivery.

The transformation programme is underpinned by e-HR which we introduced this year to everyone in the Department (and to be released to colleagues in the Valuation Office Agency during 2004-05). Payslips and personal details are available “on -line” and staff can update personal details. Managers can also view and update their team structures. Further functionality will be introduced during 2004-05.

Sickness absence

Our internal indicative figures show that sickness absence days per person has increased slightly by 0.2 over the previous year. We are addressing this by continuing the work of the national team in managing long-term sickness absences cases, and by working proactively with managers to increase awareness of the impacts and costs of sickness absence. We are working with the HSE in piloting their risk assessment approach to managing work-related stress. We are represented at Board level on the Health, Safety and Productivity Ministerial Task Force, which will look specifically at ways to reduce sickness absence levels across Government Departments.

We continue to meet our targets for Ill Health Retirements. The figure for 2003 was 163 against a target of 279.

Diversity - making best use of all our people

Diversity is an essential element of how we serve our customers, and recruit and retain our staff. We continue to embed diversity into our business processes and have recently conducted a review to determine our success with this. We are using the results from this to inform future diversity strategy, particularly in relation to integration with Customs & Excise.

The Department views the implementation of the Race and Northern Ireland Equality Schemes as a key part of its business activities. Throughout the year we have continued to develop effective mechanisms through which to build good relations with representative groups and to improve customer services. We incorporate diversity aims and objectives within the departmental planning process to demonstrate the links between our business processes and diversity actions.

The equality schemes and diversity initiatives have continued to be sponsored from the top of the organisation by our acting Chairman, Ann Chant. Our Panel of Diversity Champions, drawn from senior managers in key business areas, meets regularly to maintain impetus on our equality schemes and direct our diversity strategy.

Our 2004 representation statistics illustrate an increase in the proportion of women in the SCS and in managerial grades. Similarly the proportions of people from ethnic minorities are showing a steady increase in a number of grades. We have continued to offer development programmes, such as Breakthrough, to help us develop still further the talent within our workforce. Positive messages of encouragement to people from under-represented groups are included in the marketing for this programme. We are tracking the careers of participants and early results show significant achievements in promotion and increased job satisfaction.

The Equality Commission for Northern Ireland

Our Race and Northern Ireland Equality Schemes are key to making diversity central to the way we deliver our services and create a positive environment for our people. The disciplines of these Schemes put us in a stronger position to measure customer satisfaction across diverse customer groups and to improve customer service and the position of our staff.

990837_Text / Sig: 12 / Plate B

As an employer we have also built our diversity and equality policies into our HR systems and procedures. We are improving our internal monitoring systems to enable us to measure our commitment to equality of opportunity under our Race Equality Scheme in HR processes and policies. We have worked with other organisations, public and private sector, to share learning and good practice, such as our disability roadshows and innovative work on diversity proofing.

We are pleased that the Department was recognised on the Castle Award for pay equality and achieved a gold standard award from Opportunity Now for its contribution to gender equality over the past year.

Recruitment

7,779 people were recruited to the Revenue in 2003-04. During the year we developed new streamlined recruitment processes for Bands E and D that will bring benefits to the Department in terms of speed and efficiency in selecting good quality candidates for our work force. The Talent Recruitment Programme aimed at graduates was also developed and launched this year that resulted in a significant increase in graduate applicants over previous years. Enabling candidates to apply for the Talent Programme on the internet proved beneficial, so this style of recruitment will be rolled out to other specialist areas over the coming months.

Inland Revenue Learning

We have delivered over 200,000 days training for our staff this year, to equip them with the skills and knowledge to deliver both business as usual and new business. Major national initiatives have included training in preparation for renewals of Tax Credits and in customer handling skills for staff in Enquiry Centres. We have also continued to embed learning as part of our business with staff from the learning support function working closely with managers at all levels to ensure that we harness learning opportunities for staff so that we can continually improve our performance.

Staff Usage

Staff usage (including non-permanent staff, but excluding overtime and the Valuation Office Agency) was 72,961 in 2003-04. This represents an increase of 5,680 over the comparable figure for 2002-03. The increase arose from the transfer of the Child Benefit Office to the Inland Revenue on 1 April 2003, the introduction of the child and working tax credits, workload increases and extra staff to tackle non-compliance.

National Minimum Wage

The Inland Revenue has enforced the National Minimum Wage (NMW) on behalf of the Department of Trade and Industry (DTI) since 1 April 1999. To date more than £16m in wage arrears have been identified for workers who had not been paid the minimum wage prior to our investigation.

NMW Compliance

The 16 NMW compliance teams follow up all complaints about non-payment of minimum wage. In addition they investigate a number of employers who have been identified through our risk programme as more likely to be non-compliant. Over 5,500 investigations were completed in 2003-04. The incidence of non-compliance detected rose by 8% in 2003-04 to 40% and we continue to place a high premium on the quality of the work undertaken by our compliance officers.

This investigation work helps to ensure:

- equal treatment for workers across all trade sectors in the UK
- a level playing field for business in the UK
- employers understand their obligations under NMW law.

Detailed results of this work are in Appendix 1.

Valuation Office Agency

In 2003-04 the Valuation Office Agency (VOA) continued preparatory work on three future property revaluations for local taxation - a rating Revaluation in 2005, a council tax Revaluation in Wales in 2005 and a council tax Revaluation in England in 2007, while dealing with appeals against the existing current rating and council tax lists. Overall six of its eight key targets were achieved with narrow misses on the other two.

These challenges continue into 2004-05 and beyond and the Agency has consequently moved into a period of significant staff expansion. Supporting this, improvements have been made in training, development and organisational areas improving productivity, and in particular introducing more flexible working methods involving greater movement of work out of London and the South East.

On the revaluation fronts, much greater emphasis has been placed on greater transparency and earlier and more understandable communication of new rateable values and council tax bandings. This is consistent with an overall communications strategy based upon customer choice - a range of traditional and online options for interaction with the Agency.

990837_Text / Sig: 13 / Plate A

Technology continues to support all our operations, but a new major development during 2003-04 was the testing of an Automated Valuation Model (AVM) to support the 2007 council tax Revaluation in England which will be the largest single implementation of this technology anywhere in the world.

Income from our valuation work for the Inland Revenue and other Government Departments and public bodies again exceeded target, but increased emphasis was directed towards improving business systems and customer care. A survey of government departments and public body clients revealed a 96% level of satisfaction with the overall service received.

A summary of the Agency's results is in Appendix 1. The Agency's own Annual Report published in September 2004 contains more detail about the Agency's performance in 2003-04.

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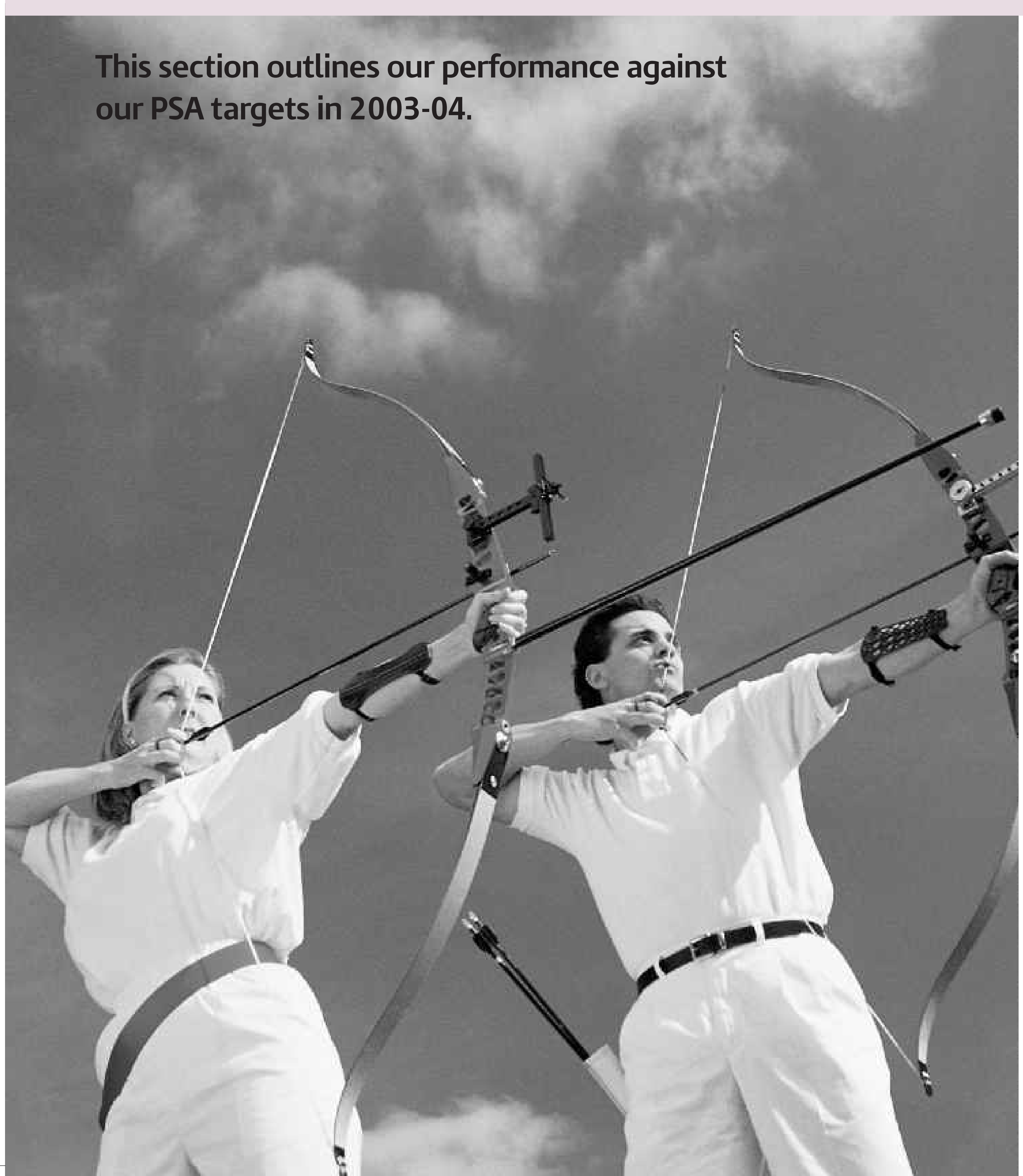
Annual Review 25

990837_Text / Sig: 13 / Plate A

Public Service Agreement (PSA) targets Performance report 2003-04

This section outlines our performance against our PSA targets in 2003-04.



Public Service Agreement (PSA) targets Performance report 2003-04

This section outlines our performance against our PSA targets in 2003-04.

26 Inland Revenue Annual Report and Accounts

990837_Text / Sig: 13 / Plate B

990837_Text / Sig: 14 / Plate A

PSA Target 1

PSA Target 1. Deliver improvements in the number of individuals and businesses who comply with their obligations and receive their entitlements.

2003-04 results and 2004-05 targets

We assess performance against this high level outcome by our performance against our supporting Service Delivery Agreement (SDA) targets. In 2003-04 we met or exceeded 18 out of 23 Service Delivery Agreement (SDA) targets that support this PSA. Management information for five further SDA targets relating to companies was not available in 2003-04 to enable targets to be set. The table on page 29 shows results for 2003-04 and our targets for 2004-05.

Payment and Filing

Our Taxpayer Payment and Filing Initiative (TPFI) co-ordinates research and delivery of improved performance on payment as well as filing for employers and individuals. In 2003-04 TPFI was extended to include companies. We achieved excellent results in payment and filing meeting all SDA targets. A highlight was that we received the highest number of SA returns, nearly 8.6 million, by the due date of 31 January.

Our success was assisted by the following initiatives:

- commissioning research to identify those customer segments most at risk of late filing of SA returns and tailoring timely educational telephony campaigns to contact those customers
- sponsoring automated telephone number tracing which has helped increase initial debt and SA return recovery output at the Receivables Telephone Centre (RTC) by up to 24%
- including SA payment and filing deadline reminders for self-employed customers with NIC quarterly bills.
- encouraging prompt filing of PAYE End of Year returns by extending our national advertising campaign to run from the beginning of April to mid May. This encouraged 1.34 million employers to file on time, an increase of 5%
- bringing forward the issue date of reminders to file End of Year returns and enclosing a single sheet leaflet to raise awareness of both timely and accurate filing
- using our SA advertising campaign on national TV, radio and press coverage to remind taxpayers to pay and file on time.

Enquiry Work

Success in three of the four stretching SDA targets represents a very good achievement from our enquiry work. This has been supported throughout the year by advancements in operational performance indicators, and is further reflected in the improvements in yields and yield costs shown in Appendix 2 of this report. In particular these results are the consequence of:

- our efforts to strengthen risk assessment skills and processes
- our focus on addressing more complex compliance risks.

As these measures reveal the work completed over a number of years, in bringing enquiry cases to settlement, our effort to improve the quality of case management processes is not yet fully reflected in the results. We expect to see that improvement displayed in achievements against continued stretching targets in 2004-05.

Tax Credits

Over six million families are now benefiting from the new tax credits. This means that tax credits are already reaching all those we expected to receive them.

We have written to claimants telling them how they should finalise their award for 2003-04 and how to make their claim for 2004-05. This renewals process has been supported by a media campaign designed to encourage timely responses from claimants.

Child Benefit

We have continued to support customers wishing to receive their Child Benefit by direct payment, and now have arrangements with 85% of customers to pay directly into their bank accounts.

National Insurance Contributions

Improved control and input of returns by fast keying and Intelligent Character Recognition (ICR) for transmission to the National Insurance Recording System has improved the speed of processing the expected 17.4 million paper End of Year Returns (P14s).

PSA Target 1

Tax Repayments

For 2003-04, we increased our target of 97% turnaround in 20 days to 97% in 15 days. We missed this target because resources in the dedicated repayment offices were diverted to new tax credits activity. We were not able to recover, despite our determined efforts to clear the backlog quickly. This did not affect the demanding accuracy target of 96%, which we exceeded.

Spend to Save

Since April 2003 we have been taking forward the additional compliance work funded by the Chancellor in his 2003 Budget. In return for additional ring fenced funding of £66m we have given the Government additional yield commitments of £1.6 billion over the three years 2003-04 to 2005-06.

This work has been targeted at a range of known compliance risks:

- **Offshore Fraud** - our Special Compliance Office has created two teams to recover tax evaded by individuals who have used offshore trusts to conceal untaxed profits. They work closely with a dedicated team in Capital & Savings that is pursuing unpaid Inheritance Tax arising from these trusts. The first year of this work showed very encouraging results although the yield recovered was slightly below target. The shortfall was quickly made up in the first few months of 2004-05 and we are confident that the three-year yield will be recovered.
- **Corporate Avoidance** - Our Large Business Office (LBO) has used a small amount of additional funding to improve our effectiveness in tackling the largest cases of tax avoidance. A number of external specialists have been recruited on fixed term appointments and we are confident that significant yield recoveries will be achieved and the three-year target will be met. The complex and litigious nature of this work makes predicting the flow of yield very uncertain. As a result our first year results were below the target we set. In contrast, since April 2004 we have recovered sufficient yield to more than make up the first year shortfall and meet the entire second-year target.
- **National Insurance Avoidance** – We have set up a National Avoidance Unit that will co-ordinate how we tackle a large number of NICs avoidance schemes. Specifically we are tackling around 13,000 schemes that rely upon exotic assets or trusts to avoid NICs. The scale of this task exceeded our estimates and although we have made significant progress our yield recovery is behind schedule. Over the past several months we have substantially increased the pace of this work to get us back on track.
- **Outstanding Returns and Revenue debt** - Overall in this area we met the first year targets. Nevertheless we are not complacent and we have looked very carefully at the expected yield trajectories of this work to ensure that the target yield will be recovered. We have increased the targets in some areas to compensate for slightly over optimistic assumptions in others and we remain confident that the three-year target will be achieved.

Our overall assessment for the first year is that whilst the yield recovered is behind what we hoped to achieve in the first year, we are working hard to make up the shortfall and remain confident that we will deliver the promised yield. However, it is a three-year package and inevitably the investigation of fraud and complex avoidance schemes (and the recovery of very significant tax and NICs liabilities) takes time and is difficult to accurately predict.

In March 2004 the Chancellor announced a further three-year investment totalling £115m in return for yield commitments of £2 billion over the three years 2004-05 to 2006-07. In keeping with the Government's approach to public finance, a lower estimate of £1.7 billion was included in the Budget forecast.

As well as enabling us to tackle other kinds of non-compliance from that undertaken in 2003-04 it has given us the opportunity to make a substantial investment in improved technology to support our use of data and performance measurement. This will not only increase our effectiveness in assessing tax risk, but will also substantially improve our ability to assess the performance of our teams and systems in identifying and tackling non-compliance across all of our business.

We have also been able to fund a package of enabling measures intended to improve tax receipts and reduce our costs by helping small traders to get their returns right without the need for a formal enquiry.

As this funding will lead to significant structural change in how we approach non-compliance issues, the additional yield benefits will continue to be realised well after the three-year funding period.

SDA Target	2003-04 Target	2003-04 Result	2004-05 Target
Compliance			
% of ITSA returns filed by the due date[1, 2]	90.6	90.6	90.6
% of ITSA returns filed within 12 months of the filing date[2]	96.9	97.5	97.5
% SA taxpayers who pay by due date	89.3	89.8	89.5
% SA taxpayers who pay within 12 months of due date	98.6	98.7	98.7
% of employers returns filed by the due date	74.5	80.7	80[4]
% of employers returns filed within 12 months of the due date	95.2	97.3	95.2
% of employers who pay by the due date[3]	52.1	52.8	52.1
% of employers who pay within 12 months of the due date	96.8	97.7	96.8
% of Companies returns filed by due date	-	76.9	77[4]
% of Companies returns filed within 12 months of the due date	-	87.6	89
% of Companies who pay on time	-	57.9	58
% of Companies who pay within 12 months of the due date	-	92	93
% of Companies that submit accurate returns[5]	-	-	-
% of individuals who submit accurate returns	70	70	70
% of employers who submit accurate returns	58	60	60
% of enquires worked to a fully satisfactory standard	89.5	85	89.5
% of our risk-based full enquires which result in the detection of non-compliance	76	78	78
New Tax Credits			
% of all new claims/renewals/Changes of Circumstances decided within 5 working days of receipt[6]	55	79.1	55
% of all new claims/renewals/Changes of Circumstances decided within 30 working days of receipt[6]	95	94.4	95
% of all new claims/renewals/Changes of Circumstances decided accurately[7]	90	78.6	90
Child Benefit			
% of all claims cleared in 5 working days	-	-	62(new)
% of claims cleared in 36 working days	95	92.7	93
% of all reported changes of circumstance cleared within 14 working days	95	97.9	95
% accuracy of processing claims	98	98.3	98
% accuracy of processing change of circumstances	96.5	96.9	96.5
NICs			
% of notifications recorded by:			
– 31 December	94	99.4	97[8]
– 31 March	98	99.8	98
Repayments			
% of repayments received in specialist repayment offices (IROs) dealt with within 15 working days	97	91	97
% of tax repayments in IROs calculated accurately	96	96.9	97

1 Target based on returns issued at 31 October. We count returns received before close of play on 1 February 2004. This reflects the decision in the case of Steeden-v-Carver, which means that we cannot impose late filing penalties until 24 hours after the statutory filing date of 31 January.
2 We also exclude an estimate of returns never received by taxpayers.
3 Result reflects the % of employers paid up to date 4 working days after the due date. From April 2004 changes to management information systems will enable accurate data to be provided for employers who pay by the due date (19th of each month).
4 Target based on period of grace covered by ESCB46, where penalties will not be charged provided returns are received on or before the last business day within seven days following the statutory filing date.
5 The first year for the companies accuracy target will be 2004-05 but baseline data on which to set the target is not yet available.
6 Our management information systems measure these results against 7/42 calendar days, which broadly equate to 5/30 working days, excepting claims made where there is no entitlement.
7 This does not include cases where there is insufficient evidence to establish the accuracy measure.
8 This target is measured by establishing the number of items that have been posted as a percentage of items that have been received by 31 December (previously based on the number of items received at 31 March).

PSA Target 2

PSA Target 2. Deliver reductions in compliance costs of small businesses.

For the purposes of this target small businesses are taken to be those with fewer than 50 employees. We measure progress against the target by estimating the costs and savings of all substantial changes to the tax system that are introduced year by year and which affect small business. These estimates are based on a Regulatory Impact Assessment (RIA) of each legislative change which is prepared according to Cabinet Office guidelines. The cumulative effect of these estimates is then calculated to determine progress against the target.[1]

During 2003-04 we consulted on the reform of a number of key areas of the tax system where there is potential to reduce compliance costs. These included:
- Income Tax Self Assessment
- Corporation Tax
- Construction Industry Scheme
- Pensions
- Company vans
- Research and development tax credit.

As a result of these consultations, and of making other legislative changes, 19 RIAs were published in 2003-04 showing recurrent savings for small business of £24.70m and non-recurrent costs of £56.45m. Recurrent savings recur each year and non-recurrent costs are the one-off costs of initial implementation, in relation to the relevant change. One of the changes concerned will have practical effect from April 2006 and beyond, and the savings involved will therefore fall outside the period covered by the current Spending Review. In relation to measures implemented so far, recurrent savings of £3.7m and non-recurrent costs of £1.45m will be achieved in the current Spending Review period.

We have also:
- provided further help to businesses and employers by providing electronic tools to help with the calculation of payroll and corporation tax
- carried out a pilot of the issue of shorter self-assessment tax returns to employees and certain self employed persons
- simplified the administration of employee share schemes
- revised the rules on payments by employers towards the costs of home working by employees
- produced re-written PAYE Regulations under the Tax Law Re-write Programme
- introduced the National Insurance Contributions and Statutory Payments Bill in November 2003, to streamline the administration of tax and NICs
- produced new web based guidance about tax and NICs chargeable on expenses and benefits

In addition, we are undertaking work to assess the benefits of other minor legislative changes and the non-legislative measures we take to reduce compliance costs for small business.

2004-05

Work is in hand to take forward further initiatives in 2004-05 that will contribute towards meeting the target. These include:
- further consultation on corporation tax reform
- a further Bill under the Tax Law Re-write programme
- consulting on the practical aspects of moving to direct payment of the working tax credit, removing the need for employers to administer this through the payroll
- consulting on modernisation of the Accrued Income Scheme
- providing information and support for small employers who want to qualify for a financial incentive if they file their end-of-year returns on-line.

We will also be carrying out a rolling programme of post implementation reviews to ascertain whether the compliance cost predictions in published RIAs were reasonable in the light of implementation of the policy. Representative bodies will be assisting with this process.

1 All measurement is calculated in terms of prices relating to the first year of the target.

990837_Text / Sig: 16 / Plate A

PSA Target 3

PSA Target 3. Ensure by 2005 that 100% of services are offered electronically, wherever possible through a common Government portal, and promote take-up for key services.

We made further significant investments in developing, enhancing and promoting electronic services during the year.

We continue to make it easier and more attractive for our customers to do business with us electronically. Take-up of the electronic services that we offer is increasing significantly. More than 1 million Self Assessment tax returns were filed electronically in 2003-04. Take up of online services for new tax credits was also high, with some 22% of initial claims in 2003-04 received over the Internet.

Inland Revenue website www.inlandrevenue.gov.uk

Our award winning website, one of the most-visited in the UK, with up to 1 million hits a week, was rebuilt during 2003-04. The customer driven design includes new screens, clearer information structure, and improved navigation.

The approach across the whole site allows customers to navigate by who they are (individual, employer etc.) or by intention (I want to ….) or by subject (tax credits, self assessment etc.) or by any combination of these three. This means it is much easier for users both to find information they want and to use the transactional online services. Feedback from users has been positive.

Self Assessment (SA) Online

Take-up of the SA Online filing service increased sharply as a result of improvements to the user-friendliness of our online return. We are very encouraged by the substantial number of people now choosing to file by this method. In the year to 5 April 2004, more than 700,000 SA returns for 2002-03 were submitted over the Internet, more than twice the number in the previous year. In the meantime, the Electronic Lodgement Service (for use by SA customers' agents) has also continued to grow steadily, with almost 400,000 returns filed this way in the year to 5 April 2004.

During 2003-04 we made a number of further improvements to the SA Online service. We:

- gave taxpayers and agents the facility to view SA statements online
- extended the service to include filing of Trust and Partnership returns
- improved registration and enrolment services generally.

Nearly 90% of SA Online users have told us that they are satisfied with our online service and would use it again.

PAYE Online for Employers

We continued to encourage employers, agents and payroll bureaux to engage with us electronically via in-year forms, end-of-year returns, and electronic payment. 6.4 million employee summaries (P14s) were received online during 2003-04. Online validation has improved the quality of data we receive.

We also invested in major enhancements to the online filing experience, in readiness for April 2004, and in preparation for the first phase of mandatory online filing from April 2005.

Tax Credits Online

Customers can check whether they qualify for tax credits, submit an online claim form, and notify changes of circumstances. About 400,000 claims were received through this channel.

Corporation Tax (CT) Online

As well as being able to file CT returns over the Internet, companies or their agents can view their CT payments and liabilities.

Joined-up Government

We have maintained our commitment to 'Joined-up Government' through our active participation in **www.BusinessLink.gov.uk** which provides easy to follow information on tax, national insurance and payroll.

More information

More information about our e-services is available at:**www.inlandrevenue.gov.uk/ebu/index.htm**

990837_Text / Sig: 16 / Plate B

PSA Target 4

PSA Target 4. Achieve annual efficiency savings of at least 2.5% per year until March 2006, without detriment to accuracy or customer satisfaction.

These SR2002 efficiency savings are expressed in terms of savings in the Department's administration costs. In monetary terms, this requires the Department to make savings of £68.5m in 2003-04, £137.0m in 2004-05 and £205.4m in 2005-06.

Savings fall under 3 generic types :

- where we deliver new work for which we were not funded
- where we did the same amount of work as planned for less money than we had planned
- where we have absorbed a volume growth in work without additional funding.

2003-04

Against a target of £68.5m in 2003-04 we delivered £80m of efficiency savings:

- £51m (64%) was from new work for which we were not funded - for example Modernising Stamp Duty, Child Trust Fund, Pension Simplification, Reform of CIS and ASPIRE costs.
- £29m (36%) was from doing the same work as planned for less money than planned. Savings from Better Quality Service Reviews fall under this heading as does the Modernising Corporate Support Review. That delivered savings of £11m per annum of which a significant proportion was from reducing travel and subsistence costs in the business. We invested about £1m of these savings into additional Video Conferencing facilities across the Department to reduce unnecessary travel costs.
- We have identified certain areas where there has been workload growth beyond that for which the Department was funded in SR2002. We have not quantified this for 2003-04 but plan to do so for 2004-05 and 2005-06.

Accuracy & Customer Satisfaction

For some elements of the Department's efficiency saving, for example the productivity improvements made through travel and subsistence and procurement savings, there will obviously be no adverse impact on accuracy or customer satisfaction. For other elements of the efficiency gain it is much harder to establish a direct causal link with accuracy levels and even more so with reported customer satisfaction. Both are affected by many other factors. To track the impact we do have clear measurements of accuracy and quality across a very wide range of our activities. We also have a measure of customer satisfaction in the Customer Service Performance Indicator (CSPI). Looking at these measures we can say that results have held up well in what has been a very challenging year for the Department.

We have also done some work that will allow us to arrive at a more coherent view of the impacts of our efficiency activities on accuracy and customer satisfaction in the future.

PSA Target 5

PSA Target 5. Achieve a 2.5 point improvement in customer service by March 2006, as measured by an annual customer service index.

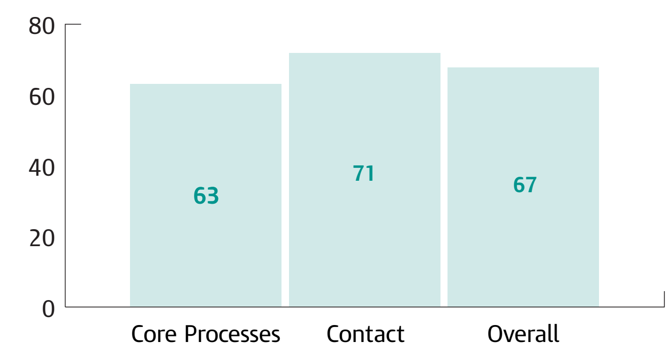
2003-04

The customer service performance indicator is based on an annual survey of our main customer groups. It reflects their perception of the ease of dealing effectively with the processes, forms and guidance which are core to their group, and the accessibility, speed, clarity and usefulness of help the Revenue provides to them in writing, over the phone, face to face or by internet. The survey is monitored closely and used to help inform business/operational decisions. The method used to aggregate scores from nine customer groups means that it measures trends over time.

The benchmark score, which was set in 2001-02, was 68.6. Results from the 2002-03 exercise showed an improvement of 1.2 points to 69.8.

The 2003-04 survey produced an indicator (rounded down) of 67 (out of 100).

This can be broken down between core processes and contact as shown in the diagram.



This represents an overall decrease of 2 points on last year's indicator, attributable mainly to contact issues, as the score for core processes remained the same as last year.

For tax credits customers, this appears to relate mainly to the difficulties experienced during the introduction of the child and working tax credits. It is also likely that resources used to support new tax credits business during this time impacted on the contact results for other customer groups.

Internal Audit Report on PSA Targets

For 2003-04 Internal Audit (IA) undertook a programme of work to validate the results across a range of Departmental targets. This work covered named PSA/SDA targets as well as those targets that underpin the Department's aims and objectives at the detailed business level. This work includes evaluation of the underlying systems controls and risks and testing of reported performance to ensure that published results are accurate. IA undertook research on the Departments new and developing targets to enable validation to be undertaken in future years. IA also worked with the National Audit Office in looking at the underlying availability and quality of the information streams that feed the reported results across all PSA targets. Improvements (e.g in documentation and risk management) are in hand to refine the data systems which help to ensure the reliability of reported results. IA reported the findings to the relevant senior managers and made recommendations to address the weaknesses found.

Financial Statements and Auditor's Report

Contents

Footnote: In previous years we have produced separate (but very similar) Statements on Internal Control for both the Resource Acccount and Trust Statement. For this year there is a single, combined Statement on Internal Control.

Financial Statements and Auditor's Report
Contents
Statement on Internal Control 35
Resource Accounts 44
Trust Statement 92
Comptroller and Auditor General's Standard Report 110
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34 Inland Revenue Annual Report and Accounts
990837_Text / Sig: 17 / Plate B

Statement on Internal Control

Scope of Responsibility

1. As Accounting Officer, I have responsibility for maintaining a sound system of internal control that supports the achievement of the Inland Revenue's policies, aims and objectives, whilst safeguarding the public funds and departmental assets for which I am personally responsible, in accordance with the responsibilities assigned to me in Government Accounting.

2. As Chairman of the Inland Revenue, I am accountable to the Chancellor, and to the Paymaster General, to whom the Chancellor has delegated responsibility for the day-to-day oversight of the Department. The Paymaster General is kept informed of significant issues facing the Department in the course of regular bi-lateral meetings that she has with me and the other Board members.

3. The Valuation Office Agency (VOA) is an Executive Agency of the Inland Revenue. 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 the Inland Revenue is set out in the VOA's Framework Document, and in a separate Memorandum of Understanding between myself and the VOA's Chief Executive.

The Purpose of the System of Internal Control

4. The system of internal control is designed to manage risk at 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 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 the Inland Revenue for the year ended 31 March 2004 and up to the date of approval of the annual report, Resource Accounts and Trust Statement, and accords with Treasury guidance.

5. The main elements of the Department's control framework are set out below.

5.1 Control Environment

(a) I have a clearly defined 'Statement of Accounting Officer Responsibilities', which forms part of the Revenue's Resource Accounts and Trust Statement.

(b) There is a departmental committee structure, with clear terms of reference and defined membership. At the beginning of the year we had four non-executive members on the Departmental Board, one of whom chairs the Departmental Audit & Security Committee (DASC). Two of the non-executives have since moved on, but we have delayed any decision on replacing them in view of the transition to the new HM Revenue & Customs. The DASC meets three times a year. The Departmental Management Committee (DMC) usually meets fortnightly, depending on business need, to consider the plans and strategic direction of the Department. The Departmental Finance Committee (DFC) met six times during 2003-04. DFC considers how best to deploy financial resources, and has an external non-executive member with extensive relevant financial experience. We also have a Departmental Project Investment Committee, and a Departmental Human Resources Committee.

(c) Following the Chancellor's announcement in March 2004 to integrate the Inland Revenue with HM Customs & Excise to form the new HM Revenue & Customs (see (f) below), we have created a Transition Committee to oversee all aspects of the integration. This Committee is composed of the executive Board members from the Revenue and Customs.

(d) Accountability frameworks are in place for all Directors. These frameworks clarify generic corporate accountabilities, and complement our primary mechanisms for business accountabilities, which are the operating plans for each business area, and the individual performance agreements that are agreed annually. We had planned to extend these accountability frameworks to Board members during 2003-04, but this was not taken forward in the light of the Review of Revenue Departments, and the subsequent decision to integrate (see (f) below). We will be looking afresh at the accountability arrangements for the new HM Revenue and Customs.

(e) We provide detailed guidance on standards of behaviour and conduct, diversity and equal opportunities on the Revenue intranet. In addition, we make managers aware of their responsibilities for the prevention and detection of fraud through fraud awareness workshops and presentations.

New Business Developments

(f) Integration with Customs & Excise

On 2 July 2003 the Chancellor announced a major review of the Revenue and Customs & Excise, lead by Gus O'Donnell, Permanent Secretary to the Treasury. As a result of the review, the Chancellor subsequently announced that the two Departments would be merged to create a new department - HM Revenue and Customs. On 1 September 2004 I was appointed Executive Chairman of both the Revenue and Customs, with Paul Gray as my deputy, and I will become Executive Chairman of HM Revenue & Customs when it is created.

The O'Donnell report recognised that there were significant risks in merging the two departments, in particular to 'business as usual' and in disruption to projects already planned, but took the view that these risks were outweighed by the long-term benefits. It concluded that with strong management, the risks could be managed effectively.

A Transition Committee has been set up (see (c) above) to lead the process towards integration. And we have already begun to integrate activity in a number of areas, such as Finance, HR and Governance. Throughout this transition activity, we will continue to focus on our core business activities, to ensure that we maintain a satisfactory level of customer service.

(g) New Strategic IT Partner

Following a procurement exercise, we announced in December 2003 that Capgemini[1] has been selected as the Department's new strategic IT supplier. The new contract came into effect on 1 July 2004. Right from the start, we recognised the very significant risks involved in moving to a new IT partner, especially during the transfer period, and we put in place a number of mechanisms to make sure that these risks were managed effectively.

1 Capgemini UK Plc, formerly known as Cap Gemini Ernst & Young UK Ltd

990837_Text / Sig: 19 / Plate A

We have put in place governance arrangements to ensure that this new partnership delivers the transformation that is essential for the Revenue (and, from April 2005, HM Revenue & Customs) to deliver improved customer service.

(h) Child Benefit Office

On 1 April 2003 the Revenue took over responsibility for payment of Child Benefit. Around 2,200 people transferred from the Department for Work and Pensions to create the Child Benefit Office, which has been integrated with the Tax Credit Office. CBO pays over £9 billion per annum in Child Benefit and Guardian's Allowance to over 7 million families, 85% of whom now receive payment directly into their bank, building society or Post Office card account.

5.2 Risk Management

(a) The Department has an established process for managing the significant risks that we currently face.

Capacity to Handle Risk

(b) A key plank of our strategic risk management process continues to be the 6-monthly risk stocktakes at DMC (Board and senior Directors) meetings. These have been effective in reinforcing at Board level the importance of having a clear and structured view of key risks when reviewing performance or for decision making.

(c) But we also recognised that we needed to introduce more 'challenge' into our review of the top risks. Drawing on the experience of other organisations, we have set up a Risk Review Group (RRG) of senior Directors to look at risk reports in detail, and bring forward recommendations for discussion at DMC on how to reduce our risk exposure. The RRG meets monthly, so that they can keep abreast of the rapidly changing exposure to our top risks.

(d) Risk management guidance is provided to all staff through the intranet, and a Risk Support team provides additional advice and support. In recognition of the key role of members of the RRG and other senior managers in managing our biggest risks, we have delivered a training workshop that aims to tackle the cultural and behavioural barriers to effective risk management.

The Risk and Control Framework

(e) During the year we drew the elements of our risk management strategy into a single document, which has been approved by DASC and DMC. This strategy, which is provided to all staff through our intranet:

- sets the context for risk management in the Department;
- provides an overview of the risk management processes in the Department, including how risks are to be identified, evaluated and managed; and
- sets out the roles and responsibilities of key individuals in the risk management framework.

(f) Risk management is a mandatory element of our business planning process. The commissioning note for the annual planning round:

- explains why risk management is important;
- sets out the requirements for business planning areas; and
- emphasises the positive aspect of risk – identifying opportunities.

(g) At six-monthly intervals, Directors from across the Department update their top risks on the Corporate Risk Register. This Corporate Risk Register informs the discussions at DMC and RRG, and assists in determining whether action is needed to reduce our exposure on specific risks.

(h) During the year, our risk priorities have included:

- the introduction of the new Tax Credits, and managing the impact of this on our day-to-day work;
- the transition to our new IT partner; and
- delivery of our change objectives, against a background of finance and resource constraints.

5.3 Control Activities

We have comprehensive procedures covering all aspects of the conduct of business. Financial procedures are set out in the Finance Manual and the Inland Revenue "Guide" for staff, which are available on our intranet.

5.4 Information & Communication

(a) The Information Resources Strategy Governance Group of senior Directors, chaired by the Director General, Corporate Services, has been established to oversee activities and endorse and enforce decisions and new procedures. The Information Resources Directorate has taken on responsibility for the Data Protection Unit, the Departmental Library and the Records Management Unit, in addition to its core team of tax and information professionals and the Performance and Management Information Programme (see details at para. 7 below). It has been involved in issuing guidance and making connections to help people manage data, information and knowledge better.

(b) Development work on our Balanced Scorecard, which provides the Board with regular performance information on our strategic business drivers, was effectively completed in April 2004. Since September 2003 the Board have received a bi-monthly Departmental Overview Report based on an analysis of information from the Scorecard, Risk Register and Programmes. From March 2004, the Report has also been presented to DMC at their quarterly stocktake meetings. This process is now under review to ensure appropriate information is provided for senior managers in HM Revenue & Customs.

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38 Inland Revenue Annual Report and Accounts

990837_Text / Sig: 19 / Plate B

990837_Text / Sig: 20 / Plate A

(c) Board members and Directors have been active in explaining to staff the detail and implications of our Core Purpose and the transformation agenda through:

- articles in internal publications;
- attendance at Departmental conferences and seminars;
- personal visits to local offices; and
- telephone open days for staff.

(d) This year we have begun to pilot a new team meeting process, starting in Scotland. A cascade method of face-to-face briefings with managers and staff enables key corporate messages that are approved by the Board to be delivered to staff in a local context.

(e) We have continued to communicate our Core Purpose to our staff, to ensure that everyone has a clear understanding of what we are primarily here for. By April 2004 approximately 98% had completed modules designed to help them understand our Core Purpose and our Business Direction.

(f) The Department has established an accountability framework for all PSA targets. Each target is assigned to a Board member and a senior Director. For each individual PSA target, there is monitoring of progress and analysis of exceptions. Internal Audit review a selection of targets each year to provide independent assurance on the accuracy of reported results. During the year, Internal Audit and the National Audit Office carried out a joint review of the data systems that underpin the PSA targets, and we are considering the issues identified.

5.5 Monitoring

(a) We have a security assurance process that requires Directors to certify annually that their teams have carried out mandatory security checks. These checks, which are detailed in the Security Assurance Manual, cover the following main areas:

- Buildings and fixed assets;
- IT and information systems;
- Financial Control; and
- People.

(b) As part of Internal Audit's ongoing programme of assurance activities they monitor the use of the Department's corporate IT systems to identify and deter misuse. They also monitor access to the Internet. Internal Audit work closely with project managers to ensure that all new IT systems provide robust audit trail data to permit monitoring in live service.

(c) The Director of Internal Audit meets regularly with Board members and senior Directors, and I will shortly be having an initial meeting with him. He reports in Spring and Autumn to the DASC, to standards defined in the Government Internal Audit Manual. These reports include his opinion on the adequacy and effectiveness of the Department's system of risk management, control and governance.

(d) Following the Spring and Autumn DASC meetings, the non-executive Board member who chairs the DASC, along with the Director of Internal Audit, presents her Certificate of Assurance to me. This Certificate highlights areas where, in her opinion, the risk exposure needs to be reduced. This Certificate of Assurance is then incorporated in to the Director of Internal Audit's Assurance report, as a record of the assurance provided to me.

(e) Our Quality Programme supports the development of individual skills and the enhancement of processes in core business areas. It provides a clear structure for managing the quality of work, and the development of the necessary staff skills to deliver a quality service to customers. The programme is developing a risk-managed approach, which will allow managers to focus resources on areas where they can be used most effectively to gain performance improvements. We are putting in place a plan to address those areas of performance where our Quality results have been unsatisfactory.

(f) We have an annual programme of Regularity & Propriety reviews, with a briefing to the Director of Finance on the effectiveness of internal financial controls.

(g) To ensure compliance with OGC and Treasury requirements on delivering programmes and projects, we conduct Gateway reviews and other assurance activities, with the reports being sent to OGC where required (High Risk and Mission Critical). This ensures that I can attest that none of these projects suffer from the National Audit Office/OGC "Common Causes of Failure". Internal Audit participates in these assurance activities. We also conduct a 6-monthly Improvement Planning Assessment of our Centre of Excellence, with the reports being sent to OGC. Internal Audit validated the results of the March 2004 Assessment.

(h) The Revenue has a code of practice, COP1, which tells customers how they can complain and how to use the Revenue's complaints procedures when a mistake has been made. If the customer remains dissatisfied, the procedures enable them to refer their complaint to the independent Adjudicator. The Adjudicator reports quarterly on the outcome of cases referred to her. In her 2004 Annual Report, the Adjudicator described the Revenue's complaints handling as "cutting edge", which reflects the Revenue's commitment and customer focused emphasis to complaints handling and improving services. The Parliamentary Commissioner for Administration (the Ombudsman) provides an additional service for complainants and also reports on the Revenue's performance.

Review of Effectiveness

6. As Accounting Officer, I have responsibility for reviewing the effectiveness of the system of internal control. My review of the effectiveness of the system of internal control is informed by the work of the internal auditors and the executive managers within the Department who have responsibility for the development and maintenance of the internal control framework, and comments made by the external auditors in their management letter and other reports. As a new Accounting Officer, I have taken advice on the effectiveness of internal control from my Departmental Board, DMC and the Risk Review Group (see 5.2 (b) & (c) above), and from the chair of DASC (see 5.5 (d) above), and plans to address weaknesses and ensure continuous improvement of the system are in place. Details of significant internal control issues are set out below.

7. In the Statement on Internal Control last year we highlighted the steps we were taking to improve the quality of our management information, including the creation of the Performance and Management Information Programme. We made better performance and management information a priority area in our 2004 Spending Review (SR04) proposals, and are in the early stages of three major projects agreed in the Spending Review settlement, all of which should provide better and more joined-up information as part of our overall transformation of data and information:

- **PSA performance information** to support the new SR04 agreement by enabling the Department to set targets, forecast, plan and manage performance, and have a clear view of the levers available to improve performance, the marginal costs and benefits attached to them and the resource required. The first release is planned for April 2005;
- **Cost and resource information** to support all areas of the Department, through a programme to develop better use of financial information to improve performance. Again, the first release is planned for April 2005; and
- **A strategic information centre** to provide support for analysis and knowledge communities, to ensure that the Department obtains the maximum value from data, to link with other data sources in government where legislation permits, and to provide expert data management. This initiative is being taken forward as part of the transition to HM Revenue & Customs.

Tax Credits

8. The introduction of the new Child and Working Tax Credits in April 2003 did not go as smoothly as intended. The well-publicised problems with our IT systems caused delays in processing claims, which resulted in many claimants not receiving their payments on time. The position has improved significantly since then, and the IT platform has now been stable for several months. However, we are still dealing with some of the problems that arose during this period, including:

- Over/under payments: a computer problem, which has now been corrected, resulted in a significant number of over and underpayments[2]. The underpayments have been corrected. Lower value overpayments have been written-off. The remaining higher value overpayments will be handled on a case-by-case basis;
- Reconciliation issues: problems with the IT system prevented the daily reconciliation of payments made with payments authorised. In August 2004 we introduced a new process to ensure that we can reconcile on a daily basis. We have identified the discrepancies for the whole of 2003-04. By mid-September 2004 we had cleared 60% of the backlog for the 2004-05 year, and we expect to have identified all of the remaining discrepancies by the end of September 2004. We are making the account postings to rectify customer records as soon as possible.

9. We identified error rates of 10% to 14% by value during part of 2001-02, in applications for Working Families' and Disabled Person's Tax Credits, which led the Comptroller and Auditor General to qualify his opinion on the Trust Statement in 2002-03. The new Tax Credits were introduced in 2003-04 and we believe that differences between the new and old systems will allow us to avoid some of the errors found in applications for the original credits. We will only get an accurate picture of the level of claimant error and fraud when we have completed investigations into a random sample of finalised 2003-04 awards. Until then, we have been checking a small sample of unfinalised awards to ensure that our risk assessment processes are effective in identifying high-risk cases. The C&AG has concluded that, until there is evidence that the error rate has been sufficiently and demonstrably reduced, he must qualify his opinion on the Trust Statement in respect of Tax Credit payments.

Payments to National Insurance Funds

10. Because of errors in administrative processes going back to the mid 1990s, we have not paid over to the Great Britain and Northern Ireland National Insurance Funds (NIF) the full amount shown in the NIF Accounts as due. Over that period, we have instead paid some £1bn to the Exchequer. Had it been paid over at the right time, the NIF would have invested it in Government Securities and earned additional investment income, which we are in the process of quantifying, although there has been no overall loss to the Exchequer. We have removed the source of these errors and are in discussion with the Treasury over corrections to be made.

2 See Note 3(iii) to the Trust Statement

Deletion of PAYE Open Cases

11. We have become aware that a well established housekeeping routine on our PAYE computer databases has deleted some records before the usual final review to check whether any tax remains overpaid or underpaid for the relevant year. The routine has now been corrected, but we need to carry out further work to establish the full impact, including the number of records affected. When we have this information, we will be in a position to decide how best to deal with the problem.

David Varney
Accounting Officer

15 September 2004

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15 September 2004

Statement on Internal Control 43

990837_Text / Sig: 22 / Plate A

Resource Accounts

Consolidated Resource Accounts for the year ending 31st March 2004

Contents

44 Inland Revenue Annual Report and Accounts

Resource Accounts

Consolidated Resource Accounts for the year ending 31st March 2004

Contents

Annual Report to the Resource Accounts 45
Statement of Accounting Officer's Responsibilities 50
Statement on Internal Control 52
The Certificate and Report of the Comptroller and Auditor General 53
The Accounting Schedules:
Schedule 1 - Summary of Resource Outturn 55
Schedule 2 - Operating Cost Statement 58
Schedule 3 - Balance Sheet 59
Schedule 4 - Cash Flow Statement 60
Schedule 5 - Resources by Departmental Aim and Objective 62
Notes to the Departmental Resource Accounts 63
Accounts Direction given by HM Treasury 91

990837_Text / Sig: 22 / Plate B

990837_Text / Sig: 23 / Plate A

Annual Report to the Resource Accounts

Scope

These Resource Accounts include expenditure and income relating to the core Department and the Valuation Office Agency (VOA). The Inland Revenue has a close relationship with the Department for Work and Pensions (DWP) and its counterpart in Northern Ireland, the Department of Social Development (DSD), as they are responsible for the payment of benefits based on National Insurance Contributions. Expenditure relating to the collection of National Insurance Contributions is included in the Operating Cost Statement while associated income recovered from the National Insurance Funds is included as Appropriations in Aid (A in A). Receipts and payments of direct taxes and National Insurance Contributions and payments of Tax Credits are accounted for in the Trust Statement which is on pages 92 to 108 of the Board's Annual Report for 2003-04.

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

The Resource Accounts include the activity of tax appeal tribunals which, as non-departmental public bodies, are strictly outside the boundary of these accounts. The costs, however, are not considered to be material.

The Inland Revenue publish two departmental reports. The Inland Revenue's Departmental Report published in Spring 2004 (Cm 6225) sets out the Department's spending plans for 2004 to 2006 and reports progress on its objectives and performance. The Board's Annual Report for 2003-04 (HC 1062) is published to report performance in the preceding financial year and includes the audited annual financial statements. These reports are available from The Stationery Office and the Inland Revenue website (www.inlandrevenue.gov.uk). Details of the Valuation Office Agency's objectives and performance can be found in its Annual Report and Accounts; its Forward Plan provides information about future priorities and developments.

Operating and Financial Review

The Department's Aim and Objective for 2003-04 were:

Aim

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

Objective

To collect the right revenue and give the right entitlements, at the right time. This Objective is subdivided into five activities as described in Schedule 5 of this account (see page 62).

The Inland Revenue's performance is assessed through its Public Service Agreement (PSA), Service Delivery Agreement (SDA) and other work targets. The Department's PSA for the period 2003-2006 (set out in the Spending Review (SR) 2002) contained five key targets. Full details of performance against those targets are reported in pages 26 to 33 of the Board's Annual Report for 2003-04.

Events in 2003-04

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

The Inland Revenue assumed responsibility for Child Benefit from 1 April 2003 (payments in excess of £9 billion per year). The costs of administering Child Benefit and the programme expenditure itself have been accounted for in the Department's Resource Accounts.

The Chancellor announced his intention to introduce the Child Trust Fund (CTF) in the April 2003 Budget. The CTF is a savings and investment account for children and will be available from April 2005 for eligible children born on or after 1 September 2002. A child is eligible for a CTF account if Child Benefit has been awarded to them or they are in care, and they are living in the UK. A provision as at 31 March 2004 of £399.9 million has been included in these Resource Accounts. This relates to payments that would become due between 1 September 2002 and 31 March 2004 on the basis that the legislation was due to be enacted (the Child Trust Fund Bill received its Royal Assent in May 2004).

Following a review of Departmental capacity, plans for the Modernising PAYE Processes for Customers (MPPC) programme (which subsumed the Patrick Carter Review of Payroll Services) were deferred. The Carter proposals are now planned to be implemented as part of new End of Year processes in April to June 2005. The wider new PAYE regime to be delivered by MPPC is now due to be implemented in October 2006.

Total resources consumed for the year were £12,594.0m, £269.2m (2.0%) below the amount authorised by Parliament. This underspend was mainly split between the administration of the core Department (£124.2m) where a change in revaluation index for computer software produced a significant saving and Child Benefit and Child Trust Fund (£134.4m), which was within 1.3% of the estimate in the first year that the Department took responsibility.

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46 Inland Revenue Annual Report and Accounts

990837_Text / Sig: 23 / Plate B

990837_Text / Sig: 24 / Plate A

The following three main events will affect future accounting periods:

- In March 2004, the Government accepted in full the recommendations of the review of the Revenue Departments, led by Permanent Secretary to the Treasury, Gus O'Donnell. The key recommendations of the review were:
  - Creation of a new Department, integrating HM Customs and Excise and the Inland Revenue, tasked with improving customer services, particularly reducing compliance costs, improving compliance with tax law, and increasing efficiency. David Varney has been appointed chairman of this new department with Paul Gray as his deputy. Further information is given on page 9 of the Board's Annual Report for 2003-04.
  - Clearer roles and responsibilities for tax administration within a new accountability framework and annual remit laid down by Ministers; and
  - Transfer of tax policy functions to the Treasury, to improve the ability of the Government to respond to modern tax challenges and create a greater delivery focus in the new department.
- The commercial competition to replace our IT contracts with EDS and Accenture resulted in selection, in December 2003, of Capgemini UK PLC, trading as "Capgemini", formerly known as Cap Gemini Ernst & Young UK Ltd., as the Department's new IT partner with effect from July 2004. The new contract aims to facilitate business change to deliver our strategic objectives, and to deliver high standards of IT infrastructure. Under the new contract, the Department will account for charges for computer hardware used by Capgemini as operating costs, whereas under the Department's former contract with EDS the computer hardware to which corresponding charges related was treated as under a finance lease and hence accounted for as a capital asset. The effect of this change will be to reduce capital expenditure during project development, with the costs of hardware being included within IT operating costs.
- The joint Private Finance Initiative (PFI) with HM Customs & Excise to relocate a substantial part of our Head Office function, in late 2004, to 2 Parliament Street, London. This is in addition to the existing PFI accommodation contracts.

The Inland Revenue's website (www.inlandrevenue.gov.uk) includes the published Investment Strategy.

990837_Text / Sig: 24 / Plate B

Management

The Chairman of the Board of Inland Revenue is accountable to Gordon Brown MP, Chancellor of the Exchequer. Dawn Primarolo MP, the Paymaster General, has day-to-day responsibility for the Department.

During 2003-04, the Statutory Board of the Inland Revenue comprised:

Chairman	-	Sir Nicholas Montagu KCB	retired 19 March 2004
Acting Chairman	-	Ann Chant CB	from 20 March 2004
Deputy Chairman	-	Ann Chant CB	until 19 March 2004
	-	Tim Flesher	until 11 April 2003
	-	Dave Hartnett CB	from 12 April 2003
Director General	-	Helen Ghosh	from 2 April 2003
Chief Executive Valuation Office Agency	-	Michael Johns CB	retired 31 March 2004

The Statutory Board was assisted during the year by an additional executive member Steve Heminsley, and non-executive members Rene Carayol, Dorothy Dalton, Kate Owen and Pat Stafford forming the Departmental Board. Andrew Hudson, who became Chief Executive of the Valuation Office Agency on 7 June 2004, is a member of the Inland Revenue Departmental Board and signed the Valuation Office Agency accounts for 2003-04. Kate Owen chaired the Departmental Audit and Security Committee (DASC).

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

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

Public interest and other

- Pensions

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

- Policy on employment of disabled persons

The Department's policy on the employment of disabled persons is included in the Corporate Social Responsibility Statement concerning diversity and is reported on page 20 of the Board's Annual Report for 2003-04.

990837_Text / Sig: 25 / Plate A

- Policy on diversity and equal opportunities

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

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

- Policy on payment of suppliers

Where there is no contractual provision or other understanding or accepted practice governing the timing of payment, the Department will pay within 30 days of receipt of goods or services or on the presentation of a valid invoice or similar demand for payment, whichever is the later. During 2003-04 99.07% (2002-03 99.35%) of suppliers were paid within 30 days. Interest charges amounting to £2,516 for 30 invoices (2002-03 £27,086 for 37 invoices) were paid in respect of late payment of commercial debts.

- Provision of information to and consultation with employees

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

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

- Auditors

The Comptroller and Auditor General audits these Resource Accounts in accordance with section 6 of the Government Resources and Accounts Act 2000.

The notional charge for these audit services as disclosed in these accounts is £0.3m (2002-03: £0.3m).

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

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

David Varney
Accounting Officer

15 September 2004

Statement of Accounting Officer's Responsibilities

Under the Government Resources and Accounts Act 2000, the Department is required to prepare Resource Accounts for each financial year, in conformity with a Treasury direction (see page 91 of this Annual Report), detailing the resources acquired, held, or disposed of during the year and the use of resources by the Department during the year.

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

In my role as Chairman of the Board of Inland Revenue, HM Treasury has appointed me as the Department's principal Accounting Officer with responsibility for preparing the Department's accounts and for transmitting them to the Comptroller and Auditor General.

In preparing the accounts, as Accounting Officer, I am required to comply with the Resource Accounting Manual prepared by HM Treasury, and in particular to:

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

In addition, HM Treasury has appointed an additional Accounting Officer to be accountable for that part of the Department's accounts relating to specified requests for resources and the associated assets, liabilities and cashflows. The appointment does not detract from my overall responsibility as Accounting Officer for the Department's accounts.

The allocation of Accounting Officer responsibilities in the Department was:

Sir Nicholas Montagu KCB to 19 March 2004 (Ann Chant CB from 20 March 2004):-

Request for Resources 1:
Enabling businesses and individuals to understand and comply with their obligations in respect of their dealings with the Inland Revenue.

Request for Resources 3:
Providing payments in lieu of tax relief to certain bodies.

Request for Resources 5:
Providing for payments of Child Benefit and associated non-cash items.

990837_Text / Sig: 26 / Plate A

Michael Johns CB to 31 March 2004 (David Park 1 April 2004 to 6 June 2004, Andrew Hudson from 7 June 2004):-

Request for Resources 2:
Growing a contribution to the good management of property where the public interest is involved.

Request for Resources 4:
Making payments of rates to Local Authorities on behalf of certain bodies.

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

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Trust Statement and the Resource Accounts, is shown on pages 35 to 43.

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52 Inland Revenue Annual Report and Accounts
990837_Text / Sig: 26 / Plate B

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

I certify that I have audited the financial statements on pages 55 to 90 under the Government Resources and Accounts Act 2000. These financial statements have been prepared under the historical cost convention, as modified by the revaluation of certain fixed assets, and the accounting policies set out on pages 63 to 67

Respective Responsibilities of the Accounting Officer and Auditor

As described on pages 50 to 51, the Accounting Officer is responsible for the preparation of the financial statements in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder and for ensuring the regularity of financial transactions. The Accounting Officer is also responsible for the preparation of the other contents of the Accounts. My responsibilities, as independent auditor, are established by statute and I have regard to the standards and guidance issued by the Auditing Practices Board and the auditing profession's ethical guidance.

I report my opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Government Resources and Accounts Act 2000 and Treasury directions made thereunder, and whether in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them. I also report if, in my opinion, the Annual Report on pages 45 to 49 is not consistent with the financial statements, if the Department has not kept proper accounting records or if I have not received all the information and explanations I require for my audit.

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

I review whether the statement on pages 35 to 43 reflects the Inland Revenue's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of opinion

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

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

Opinion

In my opinion:

- the financial statements give a true and fair view of the state of affairs of the Department of Inland Revenue at 31 March 2004 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the year then ended, and the statements have been properly prepared in accordance with the Government Resources and Accounts Act 2000 and directions made thereunder by the Treasury;
- in all material respects the expenditure and income have been applied to the purposes intended by Parliament and the financial transactions conform to the authorities which govern them.

I have no observations to make on these financial statements.

John Bourn
Comptroller and Auditor General

23 September 2004

National Audit Office
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Schedule 1 Summary of Resource Outturn 2003-04 (£millions)

	2003-04							2002-03
	Estimate			Outturn				
	Gross expenditure	A in A	NET TOTAL	Gross expenditure	A in A	NET TOTAL	Net total outturn compared to estimate: saving/ (excess)	Restated Prior year Outturn*
RfR 1: Administration	3,099.7	(411.5)	2,688.2	2,975.5	(411.5)	2,564.0	124.2	2,503.7
RfR 2: Valuation Office Agency	191.3	(191.3)	-	187.0	(187.0)	-	-	-
RfR3: Payments in lieu of Tax Relief	173.0	-	173.0	162.6	-	162.6	10.4	192.6
RfR 4: Payments of Local Authority Rates	34.9	(3.7)	31.2	34.0	(3.0)	31.0	0.2	26.9
RfR5: Child Benefit and Child Trust Fund	9,970.8	-	9,970.8	9,836.4	-	9,836.4	134.4	9,261.9
Total Resources	**13,469.7**	**(606.5)**	**12,863.2**	**13,195.5**	**(601.5)**	**12,594.0**	**269.2**	**11,985.1**
Non-Operating Cost								
A in A (see note 7)	**-**	**-**	**3.3**	**-**	**-**	**1.8**	**1.5**	**7.4**
Net Cash Requirement (Schedule 4)	**-**	**-**	**12,496.3**	**-**	**-**	**12,284.9**	**211.4**	**2,514.6**

Reconciliation of Resources to Cash Requirement (£millions)

	Note	Estimate	Outturn	Net total outturn compared to estimate
Net total resources		**12,863.2**	**12,594.0**	**269.2**
Capital :				
Acquisition of fixed assets	11 and 12			
Cash purchase		205.9	122.8	83.1
Finance lease		-	54.0	(54.0)
Investments		-	-	-
Non operating A in A				
Proceeds of fixed asset disposals		(3.3)	(1.8)	(1.5)
Accruals adjustments:				
Non cash items	4	(198.9)	(566.1)	367.2
Capital repayment of finance leased assets		-	(54.0)	54.0
Changes in working capital other than cash	13	(392.9)	65.8	(458.7)
Changes in creditors falling due after more than one year [1]	17	-	54.2	(54.2)
Use of provisions	18	22.3	16.0	6.3
Net Cash Requirement (Schedule 4)		**12,496.3**	**12,284.9**	**211.4**

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

* The prior year figure has been restated as per note 2. The Net Cash Requirement of £2,514.6m in 2002-03 is shown net of the transfer of £9,303.2m from the Department for Work & Pensions in respect of transferred Child Benefit (See Schedule 4).

The notes on pages 63 to 90 form part of these accounts.

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

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

		Forecast 2003–04		Outturn 2003–04	
		Income	Receipts	Income	Receipts
	Note				
Total	6	**(41.2)**	***(41.2)***	**(83.9)**	***(83.9)***

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

Resource expenditure for the year was £269.2m below the amount authorised by Parliament, mostly relating to programme expenditure and also to underspends on central initiatives and projects. In relation to the overall Inland Revenue estimate there was no significant variance that requires explanation.

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

The net cash requirement was £211.4m less than estimated. Variances are explained as follows:

- Acquisition of fixed assets. The "cash purchase" and "finance lease" expenditure combined provides a net saving of £29.1m due to a delay in work on major IT projects.
- Proceeds of fixed asset disposals were £1.5m lower than estimate. Motor vehicle sales proceeds dropped as the Department now uses mainly leased vehicles. Slower replacement of IT has reduced proceeds from sale of IT equipment.
- Non-cash items. An error in the supplementary estimate (HC350) attributed £370m to Child Trust Fund creditors instead of provisions. This misclassification of the Estimate does not impact upon the cash position. The correct estimate for this item should have been £568.9m, which would have produced an outturn within £2.8m (0.5% of the estimates).
- Changes in working capital other than cash. See note for non-cash items above. The estimate was overstated by £370m as stated above, the net excess is therefore £88.7m. The major contributor to this net excess is a £90m net increase in working capital due to changes in Child Benefit and Child Trust Fund debtors and creditors which resulted from a review of these items on transfer to this Department. This was partly offset by savings elsewhere.
- Use of provisions. Net saving £6.3m. Payment of two provisions were overestimated; legal claims (£1.5m) and Age Related Rebate compensation (£4.4m).

Prior-period Adjustments

- Restatement of the 2002-03 comparatives to include the transfer of functions from the Department for Work and Pensions and the Northern Ireland Social Security Agency in respect of Child Benefit. Please refer to Note 2, for details.
- There were no other prior-period adjustments in 2003-04.

990837_Text / Sig: 29 / Plate A

Actual outturn - resources and cash

Actual outturn - resources:

RfR 1: Administration: Actual amount net resources outturn £2,564,077,452.02. Actual amount of savings in resource over Estimate: £124,091,547.98.

RfR2: Valuation Office Agency: Actual amount net resources outturn £nil. Actual amount of savings in resource over Estimate: £nil.

RfR3: Payments in Lieu of Tax Relief: Actual amount net resources outturn £162,631,938.14. Actual amount of savings in resource over Estimate: £10,368,061.86.

RfR4: Payments of Local Authority Rates: Actual amount net resources outturn £30,976,863.72. Actual amount of savings in resource over Estimate: £233,136.28.

RfR5: Child Benefit: Actual amount net resources outturn £9,836,363,580.48. Actual amount of savings in resource over Estimate: £134,466,419.42.

Actual outturn - cash:

Net cash requirement: Outturn net requirement £12,284,881,981.69 which is £211,370,018.31 less than Estimate.

The actual receipts surrenderable to the Consolidated Fund were £83,899,295.00. Of this amount, £nil has been applied to the Excess Vote, leaving a balance of £83,899,295.00 surrenderable to the Consolidated Fund.

Please also see Note 6.

Schedule 2 Operating Cost Statement for the year ended 31 March 2004 (£millions)

	Note		2003-04		Restated* 2002-03
Request for resources 1 & 2 -					
Administration costs:					
Staff costs	3	1,871.0		1,696.5	
Non-staff administration costs	4	1,275.2		1,363.9	
Gross administration costs		**3,146.2**		**3,060.4**	
Operating income	7	(599.8)		(581.9)	
Net administration costs			**2,546.4**		**2,478.5**
Programme costs					
Request for resources 5 -					
Child Benefit and Child Trust Fund:					
Expenditure	5	9,838.2		9,243.5	
Less: Income		–		–	
		9,838.2		**9,243.5**	
Request for resources 3 -					
Payments in lieu of tax reliefs:					
Expenditure	5	162.6		192.6	
Less: Income	7	–		-	
		162.6		**192.6**	
Request for resources 4 -					
Payments of Local Authority Rates:					
Expenditure	5	34.0		30.0	
Less: Income	7	(3.0)		(5.3)	
		31.0		**24.7**	
Net programme costs	5		**10,031.8**		**9,460.8**
Net operating cost	9		**12,578.2**		**11,939.3**
Net resource outturn	9		**12,594.0**		**11,965.0**

* Certain prior-year figures have been restated. See note 2.

All income and expenditure are derived from continuing operations.

Statement of Recognised Gains and Losses for the year ended 31 March 2004 (£millions)

	2003-04	2002-03
Net gain/ (loss) on revaluation of tangible fixed assets	34.9	3.9
Total recognised gains and losses for the financial year	**34.9**	**3.9**

The notes on pages 63 to 90 form part of these accounts.

990837_Text / Sig: 30 / Plate A

Schedule 3 Balance Sheet as at 31 March 2004 (£millions)

	Note	31 March 2004		Restated* 31 March 2003	
Fixed assets:					
Tangible assets	12		**555.5**		**447.7**
Debtors falling due after more than one year	15		**136.4**		**143.9**
Current assets:					
Stocks & Work-in-Progress	14	2.8		5.9	
Debtors	15	207.2		186.6	
Cash at bank and in hand	16	74.6		159.1	
		284.6		351.6	
Creditors (amounts falling due within one year)	17	(458.2)		(592.7)	
Net Current (Liabilities)/Assets			**(173.6)**		**(241.1)**
Total assets less current liabilities			518.3		350.5
Creditors (amounts falling due after more than one year)	17	-		(0.1)	
Provisions for liabilities and charges	18	(461.0)		(46.6)	
			(461.0)		(46.7)
			57.3		**303.8**
Taxpayers' equity:					
General fund	19		16.6		298.6
Revaluation reserve	20		40.7		5.2
			57.3		**303.8**

* Certain prior-year figures have been restated. See note 2.

David Varney
Accounting Officer

15 September 2004

The notes on pages 63 to 90 form part of these accounts.

990837_Text / Sig: 30 / Plate B

Schedule 4 Cash Flow Statement for the year ended 31 March 2004 (£millions)

	2003-04	Restated* 2002-03
Net cash outflow from operating activities (Note a)	(12,093.9)	(11,591.4)
Capital expenditure and financial investment (Note b)	(121.0)	(128.7)
Receipts due to the Consolidated Fund which are outside the scope of the Department's activities	66.2	80.8
Payments of amounts due to the Consolidated Fund	(102.2)	(81.0)
Financing from the Consolidated Fund (Note c)	12,164.6	11,758.6
Financing from the National Insurance Fund (Note c)	1.8	1.7
Increase/(decrease) in cash in the period	(84.5)	40.0

Notes:

a See the table below giving a reconciliation of operating cost to operating cash flows.
b See the table below giving an analysis of capital expenditure and financial investment.
c See the table below giving an analysis of financing and reconciliation to the net cash requirement.
* Certain prior-year figures have been restated. See note 2.

a) Reconciliation of operating cost to operating cash flows

	Note	2003-04	Restated* 2002-03
Net operating cost		12,578.2	11,939.3
Less interest on finance leased assets		-	(0.2)
Adjustments for non-cash transactions	4a	(566.1)	(326.7)
Adjustments for movements in working capital other than cash	13	65.8	(33.0)
Use of provisions		16.0	12.0
Net cash outflow from operating activities		**12,093.9**	**11,591.4**

b) Analysis of capital expenditure and financial investment

	2003-04	2002-03
Tangible fixed asset additions	176.8	161.2
Finance lease acquisitions	(54.0)	(25.7)
Proceeds of disposal of fixed assets	(1.8)	(7.0)
Interest element of finance lease	-	0.2
Net cash outflow from investing activities	**121.0**	**128.7**

* Certain prior-year figures have been restated. See note 2.

The notes on pages 63 to 90 form part of these accounts.

Schedule 4 Cash Flow Statement for the year ended 31 March 2004 (£millions) (continued)

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

	2003–04	Restated* 2002–03
From the Consolidated Fund (Supply) - current year [1]	12,218.8	2,486.9
From the Consolidated Fund (Supply) - prior year	-	1.3
Capital element of payments in respect of finance leases and on-balance sheet PFI contracts	(54.2)	(32.8)
Net transfers in respect of Child Benefit	-	9,303.2
	12,164.6	11,758.6
Financing from the National Insurance Fund	1.8	1.7
Net financing	**12,166.4**	**11,760.3**
(Increase)/ decrease in cash (see note 16)	**84.5**	**(19.9)**
Net cash flows other than financing	**12,250.9**	**11,740.4**
Adjustments for payments and receipts not related to Supply:		
Amounts due to the Consolidated Fund - received and not paid over	24.4	38.9
Amounts due to the Consolidated Fund - received in a prior year paid over	(42.8)	(8.8)
Financing from the National Insurance Fund	(1.8)	(1.7)
Supply-financed repayments of financing		
Capital element of payments in respect of finance leases and on-balance-sheet PFI contracts	54.2	32.8
Transitional Adjustments (see note 13)	-	16.2
Transfer from Department for Work & Pensions in respect of transferred Child Benefit	-	(9,303.2)
Net cash requirement (Schedule 1)	**12,284.9**	**2,514.6**

Notes
1 Amount of grant actually issued to support the net cash requirement = £12,218,783,700.87
* Certain prior-year figures have been restated. See note 2.

The notes on pages 63 to 90 form part of these accounts.

Schedule 5 Resources by Departmental Aim and Objective for the year ended 31 March 2004 (£millions)

	2003-04			Restated* 2002-03		
	Gross	Income	Net	Gross	Income	Net
Aim: To administer the tax system fairly and efficiently, make it as easy as possible for individuals and businesses to understand and comply with their obligations and receive their tax credit and other entitlements.						
Objective: To collect the right revenue and give the right entitlements, at the right time. We have subdivided this objective into the following five activities:						
Activity 1 - bringing into the Exchequer the taxes, National Insurance Contributions and other receipts, maintaining contributory records and disbursing tax reliefs and credits, disbursing Child Benefit claims, for which the Revenue are responsible.	3,006.4	(424.4)	2,582.0	3,046.4	(425.4)	2,621.0
Activity 2 - providing Ministers with high quality analysis and advice on direct tax and National Insurance Contribution policy reflecting the Government's tax objectives.	50.5	-	50.5	60.9	-	60.9
Activity 3 - providing high quality valuation services for rating, Council Tax and other public sector purposes.	187.0	(191.2)	(4.2)	161.6	(172.4)	(10.8)
Activity 4 - collecting and making payments of Local Authority rates in respect of Government departments and others.	34.8	(3.6)	31.2	30.0	(5.3)	24.7
Activity 5 - providing for payments of Child Benefit and Child Trust Fund endowments.	9,918.7	-	9,918.7	9,243.5	-	9,243.5
Intra departmental consolidation adjustment	(16.4)	16.4		(15.9)	15.9	
Net Operating Costs (Schedule 2)	**13,181.0**	**(602.8)**	**12,578.2**	**12,526.5**	**(587.2)**	**11,939.3**

See note 21 for the basis of the distribution of capital employed, administration costs and income amongst activities.

* Certain prior-year figures have been restated. See note 2.

The notes on pages 63 to 90 form part of these accounts.

990837_Text / Sig: 32 / Plate A

Notes to the Departmental Resource Accounts

1. Statement of Accounting Policies

The financial statements have been prepared in accordance with the 2003-04 *Resource Accounting Manual* (*RAM*) issued by HM Treasury. The accounting policies contained in the *RAM* follow UK Generally Accepted Accounting Practice (UK GAAP) for companies to the extent that it is meaningful and appropriate to the public sector. Where the *RAM* permits a choice of accounting policy, the accounting policy 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 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 stock where material at their value to the business by reference to their current costs.

1.2 Basis of Consolidation

These accounts comprise a consolidation of the core Department and the Valuation Office Agency, which fall within the Departmental boundary as defined in the *Resource Accounting Manual* (RAM) (Section 1.5) issued by HM Treasury. Transactions between entities included in the consolidation are eliminated. Financial information about the Valuation Office Agency is published separately from these Resource Accounts in the Agency's annual report and accounts.

The transfer of the Child Benefit function from the Department for Work and Pensions and the Northern Ireland Social Security Agency has been accounted for using the principles of merger accounting, which apply from the transfer on 1 April 2003; comparative figures have been restated to reflect the change in structure of the Department.

1.3 Tangible Fixed Assets

1.3.1 General

Except for furniture utilised by the core Department (see below), tangible fixed assets are stated at the lower of replacement cost and recoverable amount. Expenditure on tangible fixed assets of over £1,000 is capitalised. On initial recognition they are measured at cost including any costs such as installation directly attributable to bringing them into working condition. Appropriate indices are applied to each class of asset shown in note 1.4 for all assets which have not been formally valued during the year. Following revised guidance from the Office for National Statistics, a new index has been applied to all software IT assets and this has resulted in an increase in the value of these assets as at 31 March 2004.

1.3.2 EDS Held Computer Equipment

The computer equipment used by our former computer services partner, Electronic Data Systems Ltd. (EDS), was subject to a finance lease (note 23). These assets appear on the balance sheet and are analysed on the fixed asset note (note 12). In accordance with Treasury guidance these assets, which were transferred to Capgemini UK PLC, trading as "Capgemini", formerly known as Cap Gemini Ernst & Young UK Ltd. on 1 July 2004, have been professionally valued at their open market value by ATIS REAL Weatheralls Ltd.

1.3.3 Property Assets

Property assets were transferred from the Inland Revenue to Mapeley STEPS Ltd., in March 2001, under a twenty-year Private Finance Initiative (PFI) contract. Other freehold land and buildings included in note 12 relate to costs of refurbishments of properties occupied by the Valuation Office Agency.

1.3.4 Furniture

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

1.3.5 Computer Software

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

1.4 Depreciation

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

EDS held computer equipment (until 31 March 2003)	5 years (desktop) and 7 years (mainframe)
(from 1 April 2003) *	remaining period of lease
Leasehold buildings	period of the lease
Building refurbishments	4 to 7 years
Office equipment and furniture	10 years
Desktop computer equipment	5 years
Other computer equipment	5 years
Vehicles	3 or 7 years
Developed software	up to 10 years

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

1.5 Stocks and Work-in-Progress
Stocks and work-in-progress are valued as follows:

- Work-in-progress relates to the Valuation Office Agency only and is an accounting estimate determined by applying the lower of selling price or an outturn unit cost for each type of work to the number of outstanding cases at year-end.
- Stock purchases have been accounted for as administration expenditure in 2003-04, whereas such expenditure was reported as an asset in prior years.

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

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

1.8 Capital Charge
A capital 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 (2003-04: 3.5%, 2002-03: 6%) on the average carrying amount of all assets less liabilities excluding cash balances.

1.9 Foreign Exchange
Transactions that are denominated in foreign currencies are translated into sterling at the rate of exchange ruling on the date of the transaction and any gain or loss on exchange is borne by the Department.

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

1.11 Leases

Where substantially all risks and rewards of ownership of a leased asset are borne by the Department it 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.

1.12 Private Finance Initiative (PFI) Transactions

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

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

1.13 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 rates set by HM Treasury (currently 3.5 per cent).

1.14 Early Departure Costs

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

1.15 Provision for Doubtful Debt

A general provision for doubtful debts has been made in respect of legal costs that have been awarded to the Department. These costs arise as a result of legal proceedings against taxpayers for the recovery of outstanding tax liabilities. A provision is made in respect of penalty debtors (note 1.17) to allow for penalties which are expected to be remitted and in respect of Child Benefit debtors to allow for potentially uncollectable amounts. These provisions have been estimated having regard to the level of debts not recovered during 2003-04.

1.16 Value Added Tax

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

1.17 Penalty Debtors

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

1.18 Child Benefit

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

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

Where an overpayment of benefit is established, a debt is created and programme expenditure in the Operating Cost Statement is reduced accordingly. Where possible, overpayment of debt is recovered from future benefit entitlement. Debt which is deemed irrecoverable is written-off in accordance with the Department's normal remission policy, and recorded as expenditure within the Operating Cost Statement. (See also note 1.15.)

1.19 Child Trust Fund

The Chancellor announced his intention to introduce the Child Trust Fund (CTF), in the April 2003 Budget. A provision as at 31 March 2004 has been made in respect of payments that would become due between 1 September 2002 and the balance sheet date, for which no claim has yet been submitted.

2. Transfer of functions from the Department for Work and Pensions and the Northern Ireland Social Security Agency

On 1 April 2003 responsibility for the payment of Child Benefit to parents and guardians was transferred from the Department for Work and Pensions (DWP) and the Northern Ireland Social Security Agency (NISSA). The staff and certain assets relating to delivering this service were also transferred to the Inland Revenue on that date.

The aggregate value of liabilities transferred was £227.8m and the General Fund and Reserves were reduced by this amount. Assets and liabilities were taken over at their book value in the accounts of the Department for Work and Pensions and the Northern Ireland Social Security Agency. No significant accounting adjustments were required to achieve consistency of accounting policies. No cash consideration was received for the assets and liabilities transferred.

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

Restatement of Balance Sheet and Operating Cost Statement at 31 March 2003

Balance Sheet

	Published accounts at 31 March 2003	Functions transferred from DWP	Functions transferred from NISSA	Restated at 31 March 2003
	£m	£m	£m	£m
Fixed Assets				
Tangible assets	445.3	2.4	-	447.7
Debtors falling due after more than one year	135.2	8.7	-	143.9
Current assets				
Stocks & Work-in-Progress	5.9	-	-	5.9
Debtors	144.2	39.5	2.9	186.6
Cash at bank and in hand	159.1	-	-	159.1
Creditors (amounts falling due within one year)	(311.8)	(270.4)	(10.5)	(592.7)
Total assets less current liabilities	577.9	(219.8)	(7.6)	350.5
Creditors (amounts falling due after more than one year)	(0.1)	-	-	(0.1)
Provisions for liabilities and charges	(46.2)	(0.4)	-	(46.6)
Net Assets/(Liabilities)	**531.6**	**(220.2)**	**(7.6)**	**303.8**
Taxpayers' Equity				
General Fund	526.4	(220.2)	(7.6)	298.6
Revaluation Reserve	5.2	-	-	5.2
	531.6	**(220.2)**	**(7.6)**	**303.8**

Operating Cost Statement

	Published accounts at 31 March 2003	Functions transferred from DWP	Functions transferred from NISSA	Restated at 31 March 2003
	£m	£m	£m	£m
Administrative costs				
Staff costs	1,659.9	34.2	2.4	1,696.5
Other administration costs	1,293.9	69.5	0.5	1,363.9
Gross administration costs	2,953.8	103.7	2.9	3,060.4
Operating income	(581.9)	-	-	(581.9)
Net administration costs	**2,371.9**	**103.7**	**2.9**	**2,478.5**
Programme costs				
Expenditure	222.6	8,937.0	306.5	9,466.1
Income	(5.3)	-	-	(5.3)
Net Programme costs	**217.3**	**8,937.0**	**306.5**	**9,460.8**
Net Operating Cost	**2,589.2**	**9,040.7**	**309.4**	**11,939.3**

3. Staff Costs and Numbers

3.1. Staff Costs

Staff costs consist of:	2003–04	Restated* 2002–03
	Total[1]	Total
	£m	£m
Wages and Salaries	1,558.3	1,419.0
Social Security Costs	109.8	89.6
Other pension Costs	200.5	185.5
Sub-total	**1,868.6**	**1,694.1**
Inward Secondments	3.7	3.2
Less recoveries in respect of outward secondments	(1.3)	(0.8)
Total net costs	**1,871.0**	**1,696.5**

1 Staff consist entirely of officials
* Certain prior-year figures have been restated. See note 2.

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

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

For the year ended 31 March 2004 employers' contributions of £201,037,867 were payable to the PCSPS (2003: £182,483,108) at one of four rates in the range 12.0 to 18.5 per cent of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. Rates will remain the same in 2004-05, subject to revalorisation of the salary bands, but will increase from 2005-06. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

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

Contributions due to the partnership pension providers at the balance sheet date were £nil. Contributions prepaid at that date were £nil.

175 persons retired early on ill-health grounds; the total additional accrued pension liabilities in the year amounted to £233,605.

3.2. The average number of whole-time equivalent persons employed (including senior management, staff on secondment or loan into the Department, but excluding staff on secondment to other organisations) during the year was as set out below. The staff in post as at 31 March 2004 was 87,652. This number is based on headcount whereas the numbers below are based on whole-time equivalent.

	2003–04 Number	Restated* 2002–03 Number
Assessment & Collection of Taxes, National Insurance and Tax Credits	70,878	66,738
Child Benefit	1,610	1,875
Tax policy	554	535
Valuation	4,434	3,841
Payments in Lieu of Tax Relief	2	2
Payments of Local Authority Rates	2	2
Total	**77,480**	**72,993**

* Certain prior-year figures have been restated. See note 2.

For the year ended 31 March 2004 employers' contributions of £201,037,867 were payable to the PCSPS (2003: £182,483,108) at one of four rates in the range 12.0 to 18.5 per cent of pensionable pay, based on salary bands. The scheme's Actuary reviews employer contributions every four years following a full scheme valuation. Rates will remain the same in 2004-05, subject to revalorisation of the salary bands, but will increase from 2005-06. The contribution rates reflect benefits as they are accrued, not when the costs are actually incurred, and reflect past experience of the scheme.

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Restated* 2003–04 Number 2002–03 Number
Assessment & Collection of Taxes, National Insurance and Tax Credits 70,878 66,738
Child Benefit 1,610 1,875
Tax policy 554 535
Valuation 4,434 3,841
Payments in Lieu of Tax Relief 2 2
Payments of Local Authority Rates 2 2
Total 77,480 72,993

* Certain prior-year figures have been restated. See note 2.

70 Inland Revenue Annual Report and Accounts

990837_Text / Sig: 35 / Plate B

3.3. The salary and pension entitlements for the year to 31 March 2004 of the most senior members of the Inland Revenue are detailed below: -

A. Remuneration

	2003-04		2002-03	
	Salary including performance pay[a]	Benefits in kind [b]	Salary including performance pay[a]	Benefits in kind [b]
	£000	(Rounded to the nearest £100)	£000	(Rounded to the nearest £100)
Sir Nicholas Montagu KCB	150-155 (155-160 full year equivalent)	-	145-150*	-
Ann Chant CB	130-135	-	120-125	-
Tim Flesher CB	5-10 (115-120 full year equivalent)	-	115-120*	-
Dave Hartnett CB	145-150	-	120-125*	300
Helen Ghosh	90-95 (110-115 full year equivalent)	-	-	-
Steve Heminsley	95-100	2,800	-	-
Michael Johns CB	120-125	-	110-115*	-

Notes:

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

b - The estimated monetary value of benefits in kind covers any benefits provided and treated by the Inland Revenue as taxable income. Mr Heminsley had the private use of an allocated car in the circumstances permitted by the Civil Service Management Code.

* Prior-year salaries have been restated on the basis of taxable pay. In the 2002-03 accounts salaries were based on pensionable pay.

B Pension Benefits

	Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
	Real increase in pension and related lump sum at 60	Total accrued pension at age 60 at 31 March and related lump sum	CETV at 31 March 2003 [1]	CETV at 31 March 2004 [1]	Real increase in CETV after adjustment for inflation and changes in market investment factors	Employer contribution to partnership pension account including risk benefit cover
	£000	£000	(Rounded to the nearest £k)	(Rounded to the nearest £k)	(Rounded to the nearest £k)	(Rounded to the nearest £100)
Sir Nicholas Montagu KCB	0-2.5	70-75	1264	1330 *	16	-
	Plus 5-7.5	Plus 215-220				
	Lump sum	Lump sum				
Ann Chant CB	0-2.5	60-65	1068	1145	27	-
	Plus 2.5- 5	Plus 185-190				
	Lump sum	Lump sum				
Tim Flesher CB	0-2.5	45-50	758	768	1	-
	Plus 0-2.5	Plus 135-140				
	Lump sum	Lump sum				
Dave Hartnett CB**	2.5-5	40-45	615	711	61	-
	Plus 5-7.5	Plus 120-125				
	Lump sum	Lump sum				
Helen Ghosh	5-7.5	25-30	327	438	94	-
	Plus 17.5-20	Plus 85-90				
	Lump sum	Lump sum				
Steve Heminsley	2.5-5	35-40	530	606	47	-
	Plus 7.5-10	Plus 110-115				
	Lump sum	Lump sum				
Michael Johns CB	0-2.5	50-55	803	871*	35	-
	Plus 5-7.5	Plus 160-165				
	Lump sum	Lump sum				

* £1,330k is the CETV at the date of retirement of Sir Nicholas Montagu KCB on 19 March 2004. £871k is the CETV at the date of retirement of Michael Johns CB on 31 March 2004.
** Opted to join classic plus

Notes:

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

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

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

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

[1] Columns 3 & 4 of the preceeding table show the member's Cash Equivalent Transfer Value (CETV) accrued at the beginning and the end of the reporting period. Column 5 reflects the increase in CETV effectively funded by the employer. It takes account of the increase in accrued pension due to inflation, contributions paid by the employee (including the value of any benefits transferred from another pension scheme or arrangement) and uses common market valuation factors for the start and end of the period.

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

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

	Age	Salary	
	Years	£000	£000
		2003-04	**2002-03**
Rene Carayol	45	15.0 -20.0	15.0-20.0
(Non-executive Board Member)			
Dorothy Dalton	55	5.0-10.0	15.0-20.0
(Non-executive Board Member			
until 30 September 2003)			
Kate Owen	53	15.0-20.0	15.0-20.0
(Non-executive Board Member)			
Pat Stafford	43	20.0-25.0	20.0-25.0
(Non-executive Board Member)			

4. Non-staff administration costs

	Note	£m	2003-04 £m	£m	Restated* 2002-03 £m
Rentals under operating leases:					
Hire of plant and machinery			4.0		3.8
Other operating leases			24.9		11.3
			28.9		15.1
Interest charges					
Finance Leases			-		0.2
PFI service charges:					
Operating lease contracts			214.7		221.4
Non cash items (Note a)					
Depreciation and amortisation of fixed assets:					
Tangible fixed assets		129.7		97.5	
EDS share of discount on asset purchase		-		-	
Barter deal prepayments		5.9		4.6	
Profit on disposal of fixed assets		(0.6)		(1.1)	
Loss on disposal of fixed assets		1.4		4.6	
Net (profit)/loss on revaluation		(28.5)		96.2	
Cost of capital charge		16.1		28.8	
DWP/NISSA internal charges [1]		-		64.8	
Auditors remuneration and expenses [2]		0.3		0.3	
Amounts provided for liabilities and charges	18	20.2		25.2	
Amounts provided for early departure costs	18	8.1		5.3	
Unwinding of early departure costs discounting		0.7		0.5	
			153.3		326.7
Other expenditure:					
Travel, subsistence and hospitality			53.0		51.5
Accommodation expenses			113.4		109.6
Administrative staff related costs			7.7		6.0
Printing, postage & stationery			116.3		114.6
Telephone expenses			27.3		25.8
IT Services and consumables			317.8		268.6
Legal costs			27.3		25.5
Consultancy			60.6		49.3
Contracted out services			17.0		16.5
Publicity			20.7		25.1
Post Office services			65.0		16.5
Bank charges			17.3		5.2
Losses			5.2		20.2
Special payments			4.5		28.8
Other miscellaneous expenditure			25.2		37.3
			1,275.2		**1,363.9**

1 DWP and NISSA had a policy of allocating overheads in respect of corporate costs, this represents the Child Benefit portion charged in 2002-03.
2 These are notional amounts and there was no non-audit work. The comparative values for 2002-03 do not include any proportion for the audit fees for the DWP Resource Accounts.
* Certain prior -year figures have been restated. See note 2.

Note

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

	2003–04
	£m
Other administration costs - non-cash items (as above)	153.3
Other non-cash amounts charged to operating expenditure	412.8
Total non-cash transactions	**566.1**

5. Net programme costs

		2003–04		Restated* 2002–03
	£m	£m	£m	£m
Child Benefit and Child Trust Fund:				
Child Benefit	9,379.3		9,180.3	
Child Benefit (Lone Parent) Premium	45.8		61.5	
Guardians Allowance (Funded from NIF)[1]	1.8		1.7	
Child Trust Fund Endowments (Provision)	399.9		-	
Interest on capital	11.4		-	
		9,838.2		9,243.5
Payments in lieu of tax reliefs:				
Life assurance premium relief, mortgage interest relief, private medical insurance premium relief, and vocational training relief	18.1		17.8	
Remitted Stamp Duty	0.2		0.5	
Transitional payments to charities	51.4		87.8	
Supplement on payroll giving to charities	7.9		7.5	
Stakeholder pensions	85.0		79.0	
		162.6		192.6
Payments of Local Authority Rates	32.5		30.0	
Payments of Local Authority Rates (Provision)	1.5		-	
Less: Programme Income (Note 7)	(3.0)		(5.3)	
		31.0		24.7
Total Programme Costs		**10,031.8**		**9,460.8**

1 Guardians Allowance is funded by the National Insurance Fund and therefore does not appear in Schedule 2.
* Certain prior-year figures have been restated. See note 2.

Resource Accounts 75
990837_Text / Sig: 38 / Plate A

6. Analysis of income payable to the Consolidated Fund

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

	Note	Forecast 2003–04 Income £m	*Receipts* £m	Outturn 2003–04 Income £m	*Receipts* £m
Operating income and receipts – excess A in A		(1.2)	*(1.2)*	(16.0)	*(16.0)*
Non-operating income and receipts – excess A in A		–	–	(0.1)	*(0.1)*
Subtotal		(1.2)	*(1.2)*	(16.1)	*(16.1)*
Other operating income and receipts classified as A in A		–	–	(1.6)	*(1.6)*
Other non-operating income and receipts classified as A in A	Schedule 4	(40.0)	*(40.0)*	(66.2)	*(66.2)*
Other amounts collectable on behalf of the Consolidated Fund		–	–	–	–
Excess cash surrenderable to the Consolidated Fund		–	–	–	–
Total		**(41.2)**	***(41.2)***	**(83.9)**	***(83.9)***

76 Inland Revenue Annual Report and Accounts

6. Analysis of income payable to the Consolidated Fund

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

990837_Text / Sig: 38 / Plate B

7. Income and Appropriations in Aid

7.1 Operating income

Operating income not appropriated in aid (i.e. surrenderable to the Consolidated Fund) is analysed for resource budget purposes between that which is included in public expenditure and that which is not (see note 8). In 2003-04 all operating income not classified as A in A was within public expenditure.

2003–04				
	Reconciliation to Operating Cost Statement			
	Resource Outturn A in A	Transfer of estimate cover from Inland Revenue	Payable to Consolidated Fund	Operating Cost Statement Income
	£m	£m	£m	£m
Administrative income:				
Fees and charges to external customers	(175.6)	-	-	(175.6)
Fees and charges to other departments and the National Insurance Fund	(377.0)	-	(16.5)	(393.5)
Other income - bank interest	-	-	(1.1)	(1.1)
Operating leases external income	(2.1)	-	-	(2.1)
Operating leases OGD income	(27.5)	-	-	(27.5)
	(582.2)	-	(17.6)	(599.8)
Programme income:				
Payments of Local Authority Rates	(3.0)	-	-	(3.0)
Total	**(585.2)**	**–**	**(17.6)**	**(602.8)**

2002–03				
	£m	£m	£m	£m
Administration income:				
Fees and charges to external customers	(185.9)	-	-	(185.9)
Fees and charges to other departments and the National Insurance Fund	(349.2)	-	(25.2)	(374.4)
Operating leases external income	(1.6)	-	-	(1.6)
Operating leases OGD income	(20.0)	-	-	(20.0)
	(556.7)	-	(25.2)	(581.9)
Programme income:				
Payments of Local Authority Rates	(3.1)	-	(2.2)	(5.3)
Total	**(559.8)**	**–**	**(27.4)**	**(587.2)**

7.2 Non-operating income not classified as Appropriations in Aid

Non-operating Appropriations in Aid

	2003–04	2002–03
	£m	£m
Principal repayment of voted loans	-	-
Disposal of fixed assets	(1.8)	(7.4)
	(1.8)	**(7.4)**

8. Administration cost limits

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

	2003-04		2002-03	
	Outturn	Limits	Outturn	Limits
	£m	£m	£m	£m
RfR 1 Administration	2,975.6	3,096.0	-	-
RfR 2 Valuation Office Agency	187.0	191.3	-	-
Total within administration cost control	3,162.6	3,287.3	-	-
Administration expenditure excluded from administration cost limit	-	-	-	-
RfR 1 Administration income allowable within the administration cost limit	(68.5)	(56.7)	-	-
RfR 2 Administration income allowable within the administration cost limit	(191.2)	(191.3)	-	-
	2,902.9	**3,039.3**	**-**	**-**
RfR 1 Total administration outturn (Gross Limit)	2,907.1	3,039.3	2,546.3	2,644.6
RfR 2 Total administration outturn (Net Limit)	(4.2)	-	(16.7)	(6.6)
Total administration outturn	**2,902.9**	**3,039.3**	**2,529.6**	**2,638.0**

The prior year comparisons are not available as the Administration cost limit control regime changed in 2003-04.

9. Reconciliation of net operating cost and net resource outturn

	2003-04	Restated* 2002-03
	£m	£m
Net operating cost	12,578.2	11,939.3
Remove non-supply income scored as Consolidated Fund extra receipts (CFERs)	17.6	27.4
Less Child Benefit Guardians Allowance	(1.8)	(1.7)
Net resource outturn	**12,594.0**	**11,965.0**

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

10. Analysis of net total resources by spending body

This analyses funding by the Department to the relevant spending body.

Spending Body	2003-04		Restated* 2002-03	
	Estimate	Outturn	Estimate	Outturn
	£m	£m	£m	£m
Core Department	12,832.0	12,563.0	2,709.2	11,938.1
Valuation Office Agency	31.2	31.0	28.5	26.9
	12,863.2	**12,594.0**	**2,737.7**	**11,965.0**

* Certain prior -year figures have been restated. See note 2.

990837_Text / Sig: 40 / Plate A

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

2003-04

	Capital expenditure	A in A	Net Total
	£m	£m	£m
Administration	163.1	(1.6)	161.5
Valuation Office Agency	13.7	(0.2)	13.5
Total	**176.8**	**(1.8)**	**175.0**

2002-03

	£m	£m	£m
Administration	151.6	(3.1)	148.5
Valuation Office Agency	9.6	(0.9)	8.7
Total	**161.2**	**(4.0)**	**157.2**

12. Tangible fixed assets

	Freehold Land & Buildings	Office & Computer Equipment[2]	Vehicles	Furniture & Fittings[1&2]	Developed Computer Software	Software being developed	EDS held computer equipment[2]	Total
Cost or valuation:	£m	£m	£m	£m	£m	£m	£m	£m
At 1 April 2003 Restated*	10.6	145.9	5.3	132.0	270.3	111.4	184.8	860.3
Additions	1.7	18.7	-	9.2	4.9	88.3	54.0	176.8
Assets completed	-	-	-	-	141.4	(141.4)	-	-
Disposals	(0.5)	(11.8)	(3.4)	(0.2)	(16.3)	-	-	(32.2)
Revaluation [3]	0.2	(4.6)	(0.3)	2.7	193.7	-	(66.4)	125.3
At 31 March 2004	**12.0**	**148.2**	**1.6**	**143.7**	**594.0**	**58.3**	**172.4**	**1,130.2**
Depreciation								
At 1 April 2003 Restated*	(5.9)	(86.7)	(3.1)	(72.2)	(130.9)	-	(113.8)	(412.6)
Charged in year	(2.1)	(24.2)	(0.3)	(9.6)	(51.0)	-	(42.5)	(129.7)
Disposals	0.1	10.6	2.3	0.2	16.3	-	-	29.5
Revaluation [3]	(0.1)	1.2	0.1	2.6	(106.0)	-	40.3	(61.9)
At 31 March 2004	**(8.0)**	**(99.1)**	**(1.0)**	**(79.0)**	**(271.6)**	**-**	**(116.0)**	**(574.7)**
Net book value:								
At 31 March 2004	**4.0**	**49.1**	**0.6**	**64.7**	**322.4**	**58.3**	**56.4**	**555.5**
At 1 April 2003	**4.7**	**59.2**	**2.2**	**59.8**	**139.4**	**111.4**	**71.0**	**447.7**

1 See note 1.3.4 for accounting policy for furniture.

2 Balances at 1 April 2003 have been restated to reflect the transfer of £2.4m Child Benefit assets from the Department for Work & Pensions - note 2 shows this restatement. All EDS equipment under the new outsourcing contract was transferred at a value similar to its value as at 31 March 2004.

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

13. Movements in working capital other than cash

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

	2003–04	2002–03
	£m	£m
(Decrease) / increase in stocks/work-in-progress	(3.1)	1.1
(Decrease) / increase in debtors	19.0	(4.2)
Decrease / (increase) in creditors falling due within one year	49.9	(29.9)
	65.8	(33.0)
Transitional adjustments: movement in working capital not related to net operating costs consists of:		
Amounts due to the Consolidated Fund[1]	-	
Movement in working capital related to the acquisition/ disposal of tangible fixed assets[1]	-	
Amounts receivable that will be due to the Consolidated Fund when received[1]	-	
Total transitional adjustment[1]	-	16.2
Net decrease in working capital other than cash	65.8	(16.8)

The movements in working capital other than cash used in the Cash Flow Statement comprise the entries in the table above, with the exception of the transitional adjustment of £16.2m.

1 The detailed analysis of the transitional adjustment figure, £16.2m, is not available.

14. Stocks and work-in-progress

	2003–04	2002–03
	£m	£m
Stocks	-	3.6
Work-in-progress (see accounting policy Note 1.5)	2.8	2.3
	2.8	**5.9**

Stock purchases have been accounted for as administration expenditure in 2003-04, whereas stock balances were reported as assets in prior years. The impact on net resource outturn in 2003-04 is £2.2m.

15. Debtors

	2003–04	Restated* 2002–03
	£m	£m
Amounts falling due within one year:		
Trade debtors	7.1	5.1
Deposits and advances	20.3	9.9
VAT	29.8	34.0
Other debtors excluding Child Benefit	24.3	47.4
Other debtors - Child Benefit	37.4	15.6
Prepayments and accrued income excluding Child Benefit	11.2	13.4
Prepayments and accrued income - Child Benefit	42.3	26.4
PFI Barter deals	6.1	4.8
Tax penalty debtors (note 1.17)	28.7	30.0
Amounts due from the Consolidated Fund in respect of supply	–	–
	207.2	**186.6**
Amounts falling due after more than one year:		
Other debtors	1.6	1.9
PFI Barter deals	134.8	142.0
	343.6	**330.5**

Loans have been advanced to staff in accordance with rules established for Government Departments. At 31 March 2004 these totalled £3,261,060 (31 March 2003 £3,338,592) and were made to 4,994 (31 March 2003 5,015) members of staff.

* Certain prior -year figures have been restated. See note 2.

16. Cash at bank and in hand

	2003–04	2002–03
	£m	£m
Balance 1 April	159.1	139.2
Net change in cash balances:	(84.5)	19.9
Balance at 31 March	**74.6**	**159.1**
The following balances at 31 March are held at:		
Office of HM Paymaster General	43.2	159.3
Commercial banks and cash-in-hand	31.4	(0.2)
Balance at 31 March	**74.6**	**159.1**
The balance at 31 March comprises:		
Cash due to be paid to the Consolidated Fund	–	–
Amounts issued from the Consolidated Fund for supply but not spent at year end	50.2	116.3
Consolidated Fund extra receipts received and due to be paid to the Consolidated Fund	24.4	42.8
	74.6	**159.1**

17. Creditors

	2003–04	Restated* 2002–03
	£m	£m
Amounts falling due within one year:		
Other taxation and social security	(39.6)	(33.1)
Trade creditors	(28.7)	(32.0)
Other creditors excluding Child Benefit	(7.1)	(6.1)
Other creditors – Child Benefit	(66.1)	(70.8)
Accruals and deferred income excluding Child Benefit	(83.1)	(81.3)
Accruals and deferred income – Child Benefit	(159.0)	(210.1)
Finance leases	–	(0.2)
Amounts issued from the Consolidated Fund for supply but not spent at year end	(50.2)	(116.3)
Consolidated Fund extra receipts received and receivable and other due amounts to be paid to the Consolidated Fund	(24.4)	(42.8)
	(458.2)	**(592.7)**
Amounts falling due after more than one year:		
Finance leases	–	(0.1)
Total	**(458.2)**	**(592.8)**

* Certain prior-year figures have been restated. See note 2.

18. Provisions for liabilities and charges

	Early Departure Costs	Child Trust Fund	Legal claims	Accommodation Costs	Other	Total
	£m	£m	£m	£m	£m	£m
Balance at 1 April 2003 (restated to include the Child Benefit provision)	(15.6)	–	(7.1)	(6.1)	(17.8)	(46.6)
Provided in the year	(8.1)	(399.9)	(7.1)	(5.3)	(15.8)	(436.2)
Provisions not required written back	–	–	1.5	0.3	4.7	6.5
Provisions utilised in the year	10.2	–	0.2	0.7	4.9	16.0
Unwinding of discount	(0.7)	–	–	–	–	(0.7)
Balance at 31 March 2004	**(14.2)**	**(399.9)**	**(12.5)**	**(10.4)**	**(24.0)**	**(461.0)**

Early Departure Costs

The Department meets the additional costs of benefits beyond the normal PCSPS in respect of employees who retire early by paying the required amounts annually to the PCSPS over the period between early departure and normal retirement date. The Department provides for this in full when the early retirement programme becomes binding on the Department by establishing a provision for the estimated payments discounted by the Treasury discount rate of 3.5 per cent in real terms (2002-03: 6 per cent). 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. The opening balance has been restated to include the provision made in respect of the Child Benefit employees transferred into the department. The amount included was £439,397.

990837_Text / Sig: 42 / Plate A

Legal Claims

A provision of £7.1m (2002-03: £4.1m) has been made for 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 26.

Child Trust Fund

The Child Trust Fund Act received Royal Assent in May 2004; it establishes tax-free savings and investment accounts for eligible children born on or after 1 September 2002. The Government will make payments into a Child Trust Fund account for each eligible child, enabling the accumulation of assets to be made available upon attaining the age of 18. Child Trust Fund accounts will be available to the public from April 2005. A provision of £399.9m has been made in respect of this in these Resource Accounts for amounts that will become due for the period from 1 September 2002 to 31 March 2004 .

Other

Overpaid Age Related Rebates (ARR's) - a provision for the estimated compensation payments of £8.8m to Pension Providers has been retained. This is in respect of those who suffered financial loss when the Department delayed the recovery of overpaid ARR's. This provision was recognised in the 2002-03 Resource Accounts and was also recorded in the losses statement. The initial estimate of compensation was overstated by £4.3m and this forms part of the written back amount in the above table.

Accommodation Costs - a provision of £7.3m has been made (2002-03: £3.7m) mainly for buildings-related claims within the STEPS PFI contract 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 26.

Annual Leave Compensation - a provision of £14.0m has been made in respect of possible future claims for statutory leave.

Payment of Local Authority Rates - a provision of £1.5m has been made in respect of 2003-04 invoices that are under discussion to agree liability. This programme expenditure is not included in note 4 of this account.

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

		2003–04		Restated* 2002–03	
		£m	£m	£m	£m
Net operating cost for the year (Schedule 2)		(12,578.2)		(11,939.3)	
Income not appropriated in aid payable to Consolidated Fund		(17.6)		(27.4)	
Child Benefit Guardians Allowance		1.8		1.7	
Non A in A income from disposal of fixed assets		-		(3.0)	
			(12,594.0)		(11,968.0)
Parliamentary funding					
Drawn Down		12,168.5		2,371.9	
Transferred from DWP and NISSA in respect of transferred Child Benefit				9,120.8	
Deemed Supply		116.3		142.6	
			12,284.8		11,635.3
Transferred to general fund of realised element of revaluation reserve (see Note 20)			(0.6)		15.8
Non-cash charges:					
Cost of capital	Note 4 and 5	27.5		28.8	
Auditors' remuneration	Note 4	0.3		0.3	
			27.8		29.1
Prior-period adjustments			-		-
Net decrease in General Fund			**(282.0)**		**(287.8)**
General fund at 1 April			**298.6**		**586.4**
General fund at 31 March (Schedule 3)			**16.6**		**298.6**

* Certain prior -year figures have been restated. See note 2.

20. Reserves

	2003–04 Revaluation reserve	2002–03 Revaluation reserve
	£m	£m
Balance at 1 April	5.2	17.1
Arising on revaluation during the year (net)	34.9	3.9
Transferred to General Fund in respect of realised element of revaluation reserve	0.6	(15.8)
Balance at 31 March	**40.7**	**5.2**

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

990837_Text / Sig: 43 / Plate A

21. Notes to Schedule 5

The Inland Revenue's capital is employed exclusively for administration purposes. Its distribution amongst activities is therefore not markedly different from the proportion of the related gross administration cost.

Administration costs have been attributed to activities in accordance with the Department's normal management accounting practices.

The income allocated in Schedule 5 includes receipts which cannot be appropriated in aid (Consolidated Fund Extra Receipts CFER); this differs from the income shown in Schedule 1 which does not include CFER.

22. Capital Commitments

	2003–04	2002–03
	£m	£m
Contracted capital commitments at 31 March for which no provision has been made	21.3	8.1

23. Commitments under leases

23.1 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.

	2003–04		2002–03	
	Land & buildings	Other	Land & buildings	Other
	£m	£m	£m	£m
Obligations under operating leases comprise:				
Expiry within 1 year	-	43.3	-	2.0
Expiry after 1 year but not more than 5 years	-	1.5	-	42.8
Expiry thereafter	193.2	359.7	179.5	-
	193.2	**404.5**	**179.5**	**44.8**

23.2 Finance leases

The Department's obligation under finance leases are as follows:

	2003-04	2002-03
	£m	£m
Obligations under finance leases comprise:		
Rentals due within 1 year	-	0.2
Rentals due after 1 year but within 5 years	-	0.1
	-	**0.3**

The Inland Revenue entered into a contract in 1994 with EDS, to obtain Information Technology (IT) services. This contract involved the sale of existing IT equipment to EDS and the transfer of Inland Revenue staff who operated that equipment and provided the associated services. The contract provided for the use of those computer systems in delivering the IT services to the Department and certain risks in relation to these assets remained with the Inland Revenue. As a consequence the contract was regarded as a finance lease. This contract operated for a period of ten years. From 2001-02 the Inland Revenue exercised its right under its contract with EDS to buy out the future finance lease obligations of some of the EDS held assets without affecting the legal status of the lease contract. On 30 June 2004 the contract with EDS ended and was replaced with a new PFI contract with Capgemini UK PLC, trading as "Capgemini", formerly known as Cap Gemini Ernst & Young UK Ltd.

24. Commitments under PFI contracts

The Department has entered into the following PFI contracts:

24.1 Operating leases

Description of Scheme	Estimated Capital Value £m	Contract Start Date	Contract End Date
Manchester New Office Structure - Serviced office accommodation for 1900 staff.	32	September 1998	September 2013
Glasgow New Office Structure - Serviced office accommodation for 290 staff.	10	December 1998	December 2013
Edinburgh New Office Structure - Serviced office accommodation for 320 staff.	10	November 1998	November 2013
Stockport New Office Structure - Serviced office accommodation for 400 staff.	6	May 1999	May 2014
St John's House Bootle - FICO - office accommodation for 700 staff.	12	May 2000	May 2025
National Insurance Records System (NIRS2)	134	May 1995	April 2004
Newcastle Estate Development	175	January 1998	December 2023
Newcastle Estate Development with DWP	-	April 1998	April 2027
Strategic Transfer Estate to Private Sector	271	April 2001	March 2021

The Inland Revenue and HM Customs & Excise entered into an agreement with Exchequer Partnership 2 (EP2) in September 2002 relating to the refurbishment and subsequent provision of serviced office accommodation in the east end of the property at 2 Parliament Street (formerly referred to as Government Offices Great George Street (GOGGS)). The east end of the building was in operational use until vacated by HM Treasury in August 2002. The refurbishment is due to be completed in 2004-05 and Inland Revenue and HM Customs & Excise staff are expected to start occupying the building in late 2004. As a result, the PFI asset, as represented by the refurbishment of 2 Parliament Street, has not been included in the balance sheet as at 31 March 2004 and the final accounting treatment for this asset has still to be agreed between Inland Revenue, HM Customs & Excise and HM Treasury. The cost in 2004-05 in respect of 2 Parliament Street of about £2.6m is not included in Notes 23.1 and 24.2.

24.2 Charges to the Operating Cost Statement and future commitments

The total amount charged in the Operating Cost Statement in respect of operating lease PFI transactions was £220.6m (2002-03 £226.0m) and the payments to which the Department is committed during 2004-05, analysed by the period during which the commitment expires, is as follows:

	2003–04	**2002–03**
	£m	£m
Expiry within 1 year	43.3	-
Expiry within 2 to 5 years	-	42.8
Expiry within 6 to 10 years	10.6	-
Expiry within 11 to 15 years	1.1	11.1
Expiry within 16 to 20 years	178.6	142.3
Expiry within 21 to 25 years	2.8	26.1
	236.4	**222.3**

25. Other financial commitments

These refer to transactions which are not leases or PFI contracts. The values for 2002-03 were disclosed as non-cancellable contracts entered into by the Department for the maintenance of IT equipment. These have been reclassified for 2003-04 as Operating Leases, and have been included within Note 23.1.

	2003–04	**2002–03**
	£m	£m
Expiry within 1 year	-	51.3
Expiry within 2 to 5 years	-	12.0
Expiry thereafter	-	-
	–	**63.3**

26. Contingent liabilities disclosed under FRS 12

At 31 March 2004 Contingent Liabilities existed in respect of:

Accommodation costs: certain leases within the STEPS PFI contract give rise to potential liabilities, such as dilapidations, in seventeen cases estimated at £4.2m (2002-03: £1.4m in four cases).

High Court legal action where there is a possibility of losing the proceedings £2.2m - 5 cases (31 March 2003 £3.1m - 5 cases)

Action where appointed liquidators have been guaranteed costs with a view to recovery of outstanding tax liabilities £1.2m - 179 cases (31 March 2003 £1.1m - 169 cases)

Discussions continue between the Inland Revenue, HM Customs and Excise and Mapeley STEPS Contractor Ltd about certain minor elements of charges relating to properties transferred in 2001 under a 20 year private finance initiative contract. Charges relating to the major elements of this contract are unaffected. The Department expects the financial impact of any changes relating to those elements still under discussion not to be material to these accounts.

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

27.1 Quantifiable

The Inland Revenue has not entered into any quantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort. There are therefore no contingent liabilities arising within the meaning of FRS 12.

27.2 Unquantifiable

The Inland Revenue has entered into no unquantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort.

88 Inland Revenue Annual Report and Accounts

26. Contingent liabilities disclosed under FRS 12

At 31 March 2004 Contingent Liabilities existed in respect of:

Accommodation costs: certain leases within the STEPS PFI contract give rise to potential liabilities, such as dilapidations, in seventeen cases estimated at £4.2m (2002-03: £1.4m in four cases).

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27.2 Unquantifiable

The Inland Revenue has entered into no unquantifiable contingent liabilities by offering guarantees, indemnities or by giving letters of comfort.

990837_Text / Sig: 44 / Plate B

28. Losses and special payments

Losses Statement	**£m**
Losses are made up of:	
Child Benefit irrecoverable overpayments (53,745 cases)*	4.8
Law costs remissions (66,445 cases)	4.5
Payment made for obsolete forms (1 case)	0.5
Others (4,791 cases)	0.2
Total [124,982 cases]	**10.0**

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

Details of cases over £100,000:

Stores losses
£499,000 - Payment made for obsolete forms.

Special Payments

	£m
Total [19,669 cases]	**4.5**

£0.3m included in the above relates to ex-gratia payments to Child & Working Tax Credit customers for delays in payment (10,909 cases).

Details of cases over £100,000:

£105,000 & £169,000 - Extra-Statutory payments made in respect of the delayed processing of Age Related Rebates;

£120,000 & £151,000 - Upper limb disorder payments for injury sustained in the workplace;

£157,000 - Ex-gratia payment made following a complaint of alleged misdirection in relation to National Insurance liability;

£224,000 - Extra-Statutory payment made in respect of EDI claims from one pension provider following the switch-off of an electronic data-link preventing correct payments being made.

29. Related Party transactions

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

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

Ms Gwenda Sippings is the Director of Information Resources for the Inland Revenue, her step-brother-in-law is a director at Capgemini. Capgemini was successful in a contract tender to provide Information Technology services to the Inland Revenue, with effect from July 2004. Gwenda Sippings had no involvement with the review of tenders; negotiations; or any other aspect to establish this contract. The Department's commitment under this contract is reported at note 23 to this account.

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

990837_Text / Sig: 45 / Plate B

30. Financial Instruments and Investments

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

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

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

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

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

Fair Values
The book values of the Department's financial assets and liabilities at 31 March 2004 are not significantly different from their fair values. They have accordingly not been shown separately.

Investments
The Department has no financial investments.

31. Late payment of commercial debts

Interest charges amounting to £2,516 for 30 invoices (2002-03: £27,086 for 37 invoices) were paid in respect of late payment of commercial debts.

32. Entities within the departmental boundary

The entities within the boundary during 2003-04 were as follows:

- **Supply-financed agencies:** Valuation Office Agency
- **Non-executive NDPB's:** None
- **Other entities:** None

The Annual Report and Accounts of the Valuation Office Agency are published separately and are published under HC reference 811.

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

1. The Board of Inland Revenue shall prepare Resource Accounts for the year ended 31 March 2004 in compliance with the accounting principles and disclosure requirements of the edition of the Resource Accounting Manual issued by HM Treasury (the Resource Accounting Manual) which is in force for that financial year.

2. The Department's Resource Accounts shall be prepared so as to give a true and fair view of the state of affairs at 31 March 2004 and of the net resource outturn, resources applied to objectives, recognised gains and losses and cash flows for the financial year then ended. The Resource Accounts shall also be prepared so as to provide disclosure of any material expenditure or income that has not been applied to the purposes intended by Parliament or material transactions that have not conformed to the authorities which govern them.

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

4. The Resource Accounts shall be transmitted to the Comptroller and Auditor General, by a date agreed with the Comptroller and Auditor General and the Treasury, but in any event no later than 30 November 2004, for the purpose of his audit examination and report.

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

6. This Direction supersedes the Resource Accounts Directions for the Board of the Inland Revenue dated 15 July 2003.

David Cruden
Head of the Central Accountancy Team
HM Treasury

13 May 2004

990837_Text / Sig: 46 / Plate A

Resource Accounts 91

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

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David Cruden
Head of the Central Accountancy Team
HM Treasury

13 May 2004

Trust Statement

Trust Statement for the year ending 31 March 2004

Contents

Foreword

1. About the Trust Statement

This statement shows how much money the Inland Revenue has collected from or paid to individual and corporate taxpayers, and other Government Departments, and the disposition of these funds. It is published in accordance with an accounts direction issued by HM Treasury on 13 May 2004, under the Exchequer and Audit Departments Act 1921 (see page 108).

Also included in this statement is information on National Insurance Contributions (NIC) collected by the Department of Inland Revenue and paid over to the National Insurance Funds (NIF) of Great Britain (GB) and Northern Ireland (NI) and to the National Health Service (NHS). Accounts for the National Insurance Funds are published separately as House of Commons Papers.

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

This statement captures the cash transactions of the following activities, which the Department was responsible for in 2003-04:

- collecting Income Tax, Corporation Tax, Capital Gains Tax, Petroleum Revenue Tax, Inheritance Tax, Stamp Taxes, and National Insurance Contributions;
- administering Working Tax Credits and Child Tax Credits;
- administering Oil and Gas Royalties; and
- collecting Student Loan repayments.

The Chairman of the Board is directly accountable to the Chancellor of the Exchequer, Gordon Brown MP. Dawn Primarolo MP, Paymaster General, has day-to-day responsibility for the Department.

2. Board of Inland Revenue

Details of the statutory and departmental Board during 2003-04 are shown on pages 4 to 6 of the Board's Annual Report.

David Varney
Accounting Officer

15 September 2004

990837_Text / Sig: 47 / Plate B

Statement of Accounting Officer's Responsibilities for the Trust Statement

Under the HM Treasury direction of 13 May 2004, set out on page 108 of this report, the Board of Inland Revenue is required to prepare for each financial year a Trust Statement, prepared on a cash basis, which shall properly present the collection and allocation of taxes, duties, National Insurance Contributions and Tax Credits administered by the Department.

When preparing the statement, the Board of Inland Revenue shall have regard to the example format shown in the appendix to this direction, and shall also agree the format of the supporting notes, including a statement of the policies adopted in respect of any material items the disclosure of which is necessary for a proper understanding of the statement, with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in “Government Accounting” and other guidance as issued by the Treasury and, for Tax Credits, by the Organisation for Economic Co-operation and Development (OECD).

As the Chairman of the Board of Inland Revenue I am the Department's Accounting Officer. My responsibilities as a Departmental Accounting Officer, including my responsibility for the propriety and regularity of the public finances for which I am answerable and for the keeping of proper records, are set out in the Accounting Officer's Memorandum issued by HM Treasury and published in "Government Accounting".

David Varney
Accounting Officer

15 September 2004

Statement of Accounting Officer's Responsibilities for the Trust Statement

Under the HM Treasury direction of 13 May 2004, set out on page 108 of this report, the Board of Inland Revenue is required to prepare for each financial year a Trust Statement, prepared on a cash basis, which shall properly present the collection and allocation of taxes, duties, National Insurance Contributions and Tax Credits administered by the Department.

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David Varney
Accounting Officer

15 September 2004

94 Inland Revenue Annual Report and Accounts

990837_Text / Sig: 47 / Plate B

990837_Text / Sig: 48 / Plate A

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Trust Statement and the Resource Accounts, is shown on pages 35 to 43

Statement on Internal Control

The Department's Statement on Internal Control, covering both the Trust Statement and the Resource Accounts, is shown on pages 35 to 43

Trust Statement 95

990837_Text / Sig: 48 / Plate A

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

I certify that I have audited the Trust Statement on pages 98 to 108 under Section 2 of the Exchequer and Audit Departments Act 1921. These financial statements have been prepared under a cash basis and the accounting policies set out on pages 99 and 100.

Respective Responsibilities of the Board of Inland Revenue, Accounting Officer and Auditor

As described on page 94, the Board of Inland Revenue is responsible for the preparation of the Trust Statement in accordance with the Exchequer and Audit Departments Act 1921 and Treasury directions made thereunder. The Chairman of the Board of Inland Revenue is responsible for ensuring the propriety and regularity of public finances and for keeping proper records. My responsibilities, as independent auditor, are established by statute and guided by the Auditing Practices Board and the auditing profession's ethical guidance.

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

I review whether the statement on pages 35 to 43 reflects the Inland Revenue's compliance with Treasury's guidance on the Statement on Internal Control. I report if it does not meet the requirements specified by the Treasury, or if the statement is misleading or inconsistent with other information I am aware of from my audit of the financial statements. I am not required to consider, nor have I considered whether the Accounting Officer's Statement on Internal Control covers all risks and controls. I am also not required to form an opinion on the effectiveness of the Department's corporate governance procedures or its risk and control procedures.

Basis of opinion

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

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity

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

I planned and performed my audit so as to obtain all the information and explanations which I considered necessary in order to provide me with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by error, or by fraud or other irregularity

and that, in all material respects, the payments and receipts have been applied to the purposes intended by Parliament and conform to the authorities which govern them. In forming my opinion I also evaluated the overall adequacy of the presentation of information in the financial statements.

Qualified opinion arising because the financial statements include tax credit payments that have not been applied to the purposes intended by Parliament.

I qualified my audit opinion on the Inland Revenue's Trust Statement for 2002-03 in respect of payments of Working Families' and Disabled Person's Tax Credits. This was because a Departmental exercise in 2000-01 had indicated that they had overpaid some 10-14 per cent by value, representing £510 to £710 million overpaid for a full year because of claimant error and fraud.

Payments of new Tax Credits during 2003-04 amounting to £13.5 billion were provisional until awards were finalised during the renewals process planned to be completed mainly from April to September 2004. A Departmental exercise on 2003-04 provisional Tax Credits awards helped inform the Department's understanding of claimant error and fraud and the strategies needed for tackling them. However the Department considered they were not able to make reliable quantified estimates from this exercise. Only after claimants have confirmed their circumstances and their awards are finalised is it possible for the Department to undertake its planned work to determine finally the level of claimant error and fraud. The Department plans to establish the level of claimant error and fraud in respect of 2003-04 by July 2005.

Whilst recognising that the design of the new Tax Credits and supporting systems should result in sizeable reductions in claimant error and fraud compared with earlier years, no reduction can be demonstrated until the Department have done the work they plan. I have therefore concluded that the probable level of error in 2003-04 remained unacceptably high, leading me to qualify my audit opinion on the Trust Statement account in respect of Tax Credit payments. Details of this are in paragraphs 2.24 to 2.26 of my report on the Inland Revenue's accounts.

In my opinion:

- the financial statements properly present the receipts and payments of the Board of Inland Revenue in respect of taxes, duties, National Insurance Contributions, tax credits and certain other items for the year ended 31 March 2004 and the balances held at that date, and have been properly prepared in accordance with section 2(3) of the Exchequer and Audit Departments Act 1921 and directions made thereunder by Treasury; and

- except for the probable level of error leading to significant amounts of overpayments of tax credits referred to above, in all material respects receipts and payments have been applied to the purposes intended by Parliament and conform to the authorities which govern them.

John Bourn
Comptroller and Auditor General

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

23 September 2004

990837_Text / Sig: 49 / Plate B

Trust Statement for the Year Ended 31 March 2004

	Notes	2003-04	2002-03
Receipts: (Gross)		£m	£m
Taxes and Duties	2(i)	174,395	166,627
National Insurance Contributions	2(ii)	75,514	67,712
Working and Child Tax Credits treated as negative taxation	3(i)	(3,980)	-
Working Families' and Disabled Person's Tax Credits treated as negative taxation	3(ii)	(11)	(790)
Student Loan Recoveries	4	106	44
Certificates of Tax Deposit	4	269	232
Total Receipts		**246,293**	**233,825**
Payments:			
Repayment of Taxes and Duties	2(i)	15,131	14,742
Working and Child Tax Credits treated as payments of entitlement	3(i)	9,512	-
Working Families' and Disabled Person's Tax Credits treated as payments of entitlement	3(ii)	78	5,668
Refunds of National Insurance Contributions	2(ii)	300	302
Transfer of NIC to the National Insurance Fund	2(ii)	58,892	58,510
Transfer of NIC to the Northern Ireland NIF	2(ii)	1,202	1,126
Transfer of NIC to National Health Service	2(ii)	15,156	7,603
Student Loan Transfers to Department for Education & Skills	4	75	-
Certificates of Tax Deposit	4	268	234
Total Payments		**100,614**	**88,185**
Net Receipts		145,679	145,640
Balance at 1 April brought forward		(516)	(258)
Surrendered to the Consolidated Fund in year	7	(145,555)	(145,898)
Closing Balance	5	**(392)**	**(516)**
Balance at 31 March represented by:-			
Cash at bank and in hand	6	84	90
Revenue payments not cleared at the Bank of England		(475)	(611)
Advances for Revenue Purposes		-	(3)
Other items		(1)	8
Closing Balance		**(392)**	**(516)**

The notes on pages 99 to 107 form part of this statement.

David Varney
Accounting Officer

15 September 2004

990837_Text / Sig: 49 / Plate B

98 Inland Revenue Annual Report and Accounts

Trust Statement for the Year Ended 31 March 2004

	Notes	2003-04	2002-03
Receipts: (Gross)		£m	£m
Taxes and Duties	2(i)	174,395	166,627
National Insurance Contributions	2(ii)	75,514	67,712
Working and Child Tax Credits treated as negative taxation	3(i)	(3,980)	-
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Advances for Revenue Purposes		-	(3)
Other items		(1)	8
Closing Balance		(392)	(516)

The notes on pages 99 to 107 form part of this statement.

David Varney
Accounting Officer

15 September 2004

Notes to the Trust Statement

NOTE 1 Statement of Accounting Policies

1.1 This statement has been prepared on a cash basis, in accordance with the accounts direction issued by HM Treasury (see page 108) under the Exchequer and Audit Departments Act 1921. It properly presents the collection and allocation of taxes, duties, National Insurance Contributions and Tax Credits administered by the Department and any other items that fall outside the boundary of the Department's Resource Accounts. Except where described below, the statement shows the actual amounts received and repaid in the year and the corresponding balances.

1.2 These accounting policies have been applied consistently in dealing with items considered material in relation to the statement. Where further amounts of taxes, duties and National Insurance Contributions are received in subsequent years or where amounts received in the current or earlier years are repaid, such items are recorded in the year of receipt or repayment. This complies with the principles of Government Accounting.

1.3 Under Self-Assessment, taxpayers have separate liabilities to Income Tax, Capital Gains Tax, National Insurance Contributions Class 4 and Student Loan repayments. Inland Revenue systems record taxpayers' total liability, but do not provide actual allocations to these four categories in time to inform the preparation of this statement. The actual total for Self-Assessment receipts is, therefore, allocated to these categories using estimates based on historical patterns of actual allocations (see Note 2iii) and re-allocations between these categories of amounts received in previous years. The same allocation proportions used to calculate gross receipts are used to allocate repayments/refunds.

1.4 The figures for Tax Credits paid via employers are estimated based on the amount employers have been instructed to pay and adjusted for amounts awarded in March 2004 and paid by employers in April 2004. Payments via employer were suspended part way through the 2002-03 year and no adjustment is needed for the beginning of 2003-04.

1.5 Working Tax Credits (WTC), Child Tax Credits (CTC), Working Families' Tax Credits (WFTC) and Disabled Person's Tax Credits (DPTC) are treated as negative tax to the extent that the Tax Credits are less than or equal to the Income Tax liability of the family unit and as public expenditure (referred to as "Payments of Entitlement" in the statement) to the extent that credits exceed the liability. This definition is consistent with OECD classification rules and international best practice for the calculation of net taxes and social security contributions.

1.6 Tax Credits payments under the Tax Credits Act 2002 are provisional until entitlements are finalised after the financial year end by the Department's renewals process. Any resultant underpayments identified are paid as lump sums. Overpayments identified are normally recovered from future tax credit awards over one or more years (subject to annual limits intended to minimise hardship to claimants) or by other recovery processes. The amount of underpayments and overpayments identified can only be quantified in the following accounting year and consequent payments, recoveries and any amounts written off are reported in that year's and later years' accounts. During 2003-04 no new WFTC/DPTC awards have been made but some payments relating to 2002-03 were made in 2003-04 and are therefore included in the 2003-04 Trust Statement.

1.7 The Department of Inland Revenue may, with the agreement of the relevant Secretary of State, accept qualifying assets on behalf of the Department for Culture, Media and Sport, in settlement of Inheritance Tax liabilities. The value of assets accepted in lieu of Inheritance Tax liabilities is not accounted for in the statement. They are, however, recorded in Note 2(v).

1.8 HM Treasury has directed that income arising from the levying of penalties should be matched against the expenditure incurred in determining and collecting those debts. This excludes penalties where the Department and the taxpayer have agreed a settlement without recourse to the Commissioners. Income generated from penalties is recorded in the Department's Resource Account as either Appropriations in Aid or as payable to the Consolidated Fund.

1.9 National Insurance Contribution receipts exclude amounts deducted by employers in respect of Statutory Sick Pay, Statutory Maternity Pay, Statutory Paternity Pay, Statutory Adoption Pay and Personal Pension related rebates and incentives which are accounted for in the National Insurance Fund Accounts.

1.10 Student Loan receipts are estimated on the basis of the end of year employer returns processed before the statement is finalised. These returns include information on Student Loan repayments. The actual value of Student Loan repayments is established later in the following year and the difference between the estimate and the actual receipt is incorporated into the receipt figure disclosed in the statement for the following year.

NOTE 2

2(i) Taxes and duties	Note	Receipts 2003-04 £m	Payments 2003-04 £m	Net Receipts 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m
Income Tax*		127,200	9,283	117,917	119,632	9,311	110,321
Capital Gains Tax		2,265	40	2,225	1,652	56	1,596
Corporation Tax	3(v)	33,208	5,314	27,894	34,070	4,963	29,107
Inheritance Tax		2,661	157	2,504	2,497	143	2,354
Stamp Taxes		7,676	131	7,545	7,653	104	7,549
Petroleum Revenue Tax		1,385	206	1,179	1,123	165	958
		174,395	**15,131**	**159,264**	**166,627**	**14,742**	**151,885**

*An estimate of Tax Credits Paid Via Employers is added back to Income Tax receipts, see note 2(vii).

2(ii) National Insurance Contributions	Receipts 2003-04 £m	Payments 2003-04 £m	Net Receipts 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m
Great Britain	74,050	292	73,758	66,397	293	66,104
Northern Ireland	1,464	8	1,456	1,315	9	1,306
	75,514	300	75,214	67,712	302	67,410
Transfer to GB NIF			(58,892)			(58,510)
Transfer to NI NIF			(1,202)			(1,126)
Transfers to NHS			(15,156)			(7,603)
			(36)			**171**

Refer to Accounting Policy note 1.9.

2(iii) Self Assessment

The following amounts have been received and repaid via the Self-Assessment scheme. These amounts have been included within tables 2(i) and 2(ii) above.

	Receipts 2003-04 £m	Payments 2003-04 £m	Net Receipts 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m
Income Tax	19,818	4,046	15,772	19,937	3,878	16,059
Capital Gains Tax	2,262	29	2,233	1,642	51	1,591
NIC Class 4 - GB	2,136	125	2,011	1,945	118	1,827
NIC Class 4 - NI	82	5	77	88	5	83
Self Assessment Revenue	**24,298**	**4,205**	**20,093**	**23,612**	**4,052**	**19,560**

Refer to Accounting Policy note 1.3.

2(iv) Unallocated Receipts

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

The total of such items was £1,665m at 31 March 2004 (£1,357m at 31 March 2003). The comparative figure for 2002-03 has been restated (from £1,459) due to a change in the recognition of year-end balances.

2(v) Inheritance Tax transactions

Cash and assets accepted in lieu as described in Note 1.7 were:

	Receipts 2003-04 £m	Payments 2003-04 £m	Net Receipts 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m
Receipts and Payments	2,661	157	2,504	2,497	143	2,354
Assets accepted in lieu of Inheritance Tax liabilities	17	-	17	14	-	14
	2,678	**157**	**2,521**	**2,511**	**143**	**2,368**

2(vi) Stamp Taxes

In November 2003 Stamp Duty Land Tax was introduced and the following amounts for this tax are included within Stamp taxes (shown in table 2(i)):

	Receipts 2003-04 £m	Payments 2003-04 £m	Net Receipts 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Receipts 2002-03 £m
Stamp Duty Reserve Tax	2,386	116	2,270	2,306	84	2,222
Stamp Duty	3,913	14	3,899	5,347	20	5,327
Stamp Duty Land Tax	1,377	1	1,376	-	-	-
	7,676	**131**	**7,545**	**7,653**	**104**	**7,549**

2(vii) Income Tax

Income Tax receipts include a notional element for amounts deducted by employers from Pay As You Earn (PAYE) to pay Tax Credits to employees, amounting to:

	2003-04 £m	2002-03 £m
Actual cash received	125,801	118,052
Tax Credit paid via employers (PVE)	1,449	1,661
PVE funded by Inland Revenue	(50)	(81)
Receipts	**127,200**	**119,632**

NOTE 3 Tax Credits

3(i) Working and Child Tax Credit Payments

		Receipts 2003-04 £m	Payments 2003-04 £m	Net Payments 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Payments 2002-03 £m
Working		-	4,647	4,647	-	-	-
Child		-	8,845	8,845	-	-	-
		–	**13,492**	**13,492**	**–**	**–**	**–**
Of which :	Negative Tax			3,980			-
	Payments of Entitlement			9,512			-
				13,492			**–**
	PVE			1,449			-
	Direct Payments			12,043			-
				13,492			**–**

The amount of Working Tax Credit paid via employers in 2003-04 includes an estimated £146 million paid in March 2004 from receipts due to be paid to the Inland Revenue in April 2004. The corresponding amount for March 2003 is zero as payment via the employer of Working Families' and Disabled Person's Tax Credit had ceased by February 2003.

3(ii) Working Families' and Disabled Person's Tax Credit Payments

	Receipts 2003-04 £m	Payments 2003-04 £m	Net Payments 2003-04 £m	Receipts 2002-03 £m	Payments 2002-03 £m	Net Payments 2002-03 £m
Working Families'	-	87	87	4	6,306	6,302
Disabled Person's	-	2	2	-	156	156
	–	**89**	**89**	**4**	**6,462**	**6,458**

	Negative Tax 2003-04 £m	Payments of Entitlement 2003-04 £m	Net Payments 2003-04 £m	Negative Tax 2002-03 £m	Payments of Entitlement 2002-03 £m	Net Payments 2002-03 £m
Working Families'	11	76	87	753	5,549	6,302
Disabled Person's	-	2	2	37	119	156
	11	**78**	**89**	**790**	**5,668**	**6,458**
Of which:						
Paid Via Employers	-	-	-	211	1,450	1,661
Other	11	78	89	579	4,218	4,797
	11	**78**	**89**	**790**	**5,668**	**6,458**

3(iii) Tax Credit over/under payments

The computer system supporting new tax credits generated a number of incorrect payments to claimants when it first became operational in April 2003. The errors in the system were largely corrected at the end of May 2003, but in the meantime around 455,000 households received excessive payments of tax credits totalling some £94 million. In addition, 23,000 households were underpaid by a total of £8 million. The underpayments have been corrected.

Having regard to longstanding practice on 'official error', and the heavy preponderance of small overpayments in these cases, the decision was taken to write-off all incorrect overpayments where the total involved was less than £300. This decision means that 373,000 households will not be asked to repay the tax credits they have been overpaid. The amount written-off is £37 million. The £300 limit was selected so as to minimise the total cost to public funds. Costs taken into account for this purpose included both the cost of writing off overpayment below the limit and the likely cost of the attempted recovery of overpaid tax credits in cases where the total overpayment was equal to or greater than the limit.

Records in the remaining 82,000 cases where the total overpayment was £300 or more have been corrected and those cases are subject to normal recovery action. Some of these overpayments may not be recovered, for example where official error is accepted. Further information on the recovery of these higher value overpayments will be disclosed in the 2004-05 Trust Statement.

Other tax credit write-offs are reported in the Board's remission list on page 157 of the Board's Annual Report. This is not audited by the National Audit Office.

3(iv) The cost of managing and paying Tax Credits

In 2002-03 the costs of setting up the infrastructure for paying Working Tax Credits and Child Tax Credits were £153m. These costs are excluded from the cost of managing and paying tax credits, shown in the tables below.

	2003-04	2002-03
	£m	£m
Working Tax Credit	139	-
Child Tax Credit	264	-
Total	**403**	**–**

	2003-04	2002-03
	£m	£m
Working Families' Tax Credit	3	139
Disabled Person's Tax Credit	-	4
Total	**3**	**143**

3(v) Company Tax Credits

The Corporation Tax receipts at note 2(i) are net of Research & Development, and Contaminated Land Tax Credits.

The estimated figures for these are:

	2003-04	2002-03
	£m	£m
Contaminated Land	5	1
Research & Development	216	220
Total	**221**	**221**

NOTE 4 Other Items

	Receipts 2003-04	Payments 2003-04	Net Receipts 2003-04	Receipts 2002-03	Payments 2002-03	Net Receipts 2002-03
	£m	£m	£m	£m	£m	£m
Certificates of Tax Deposit:						
Issues	146	145	1	59	59	-
Redemptions	123	123	-	173	175	(2)
Student Loans	106	75	31	44	-	44
	375	**343**	**32**	**276**	**234**	**42**

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

Payments to DfES of loans recovered restarted in 2003-04 after being suspended to recoup an estimated overpayment of £47.25m at the end of 2001-02. Latest estimates, based on end of year returns processed up to the beginning of July 2004, in respect of the 2003-04 tax year, indicate that recoveries are substantially higher than expected and the final amount is expected to be £110m. This leaves a net underpayment of £30.4m to the DfES at 31 March 2004 which will be dealt with by paying to DfES any underpayment relating to 2003-04 together with payments based on the estimate of loans recovered in 2004-05. HM Treasury approval to hold an underpayment has been granted.

The income for 2003-04 has been reduced by £3.4m to account for a revision to the closing balance at 31 March 2003 from an overpayment of £1.1m to an overpayment of £4.5m following the processing of year-end returns in respect of 2002-03.

NOTE 5 Trust Statement balance

The balance at 31 March 2004 is made up of the following elements :

	2003-04	2002-03
	£m	£m
Amount with the Consolidated Fund	(1,617)	(1,744)
Amount due to the National Insurance Funds	1,195	1,231
Amount due to the DfES in respect of Student Loans	30	(1)
Amount due to the National Loans Fund in respect of Certificates of Tax Deposits	-	(2)
Balance at 31 March carried forward	**(392)**	**(516)**

NOTE 6 Cash at Bank and in Hand

Cash at Bank and Tax Receipts at 31 March 2004 included £0 (31 March 2003 : £73,000) which relates to closing balances on the Euro bank accounts.

NOTE 6 Cash at Bank and in Hand

Cash at Bank and Tax Receipts at 31 March 2004 included £0 (31 March 2003 : £73,000) which relates to closing balances on the Euro bank accounts.

Balance at 31 March carried forward (392) (516)
Amount due to the National Loans Fund in respect of Certificates of Tax Deposits - (2)
Amount due to the DfES in respect of Student Loans 30 (1)
Amount due to the National Insurance Funds 1,195 1,231
Amount with the Consolidated Fund (1,617) (1,744)
£m £m
2003-04 2002-03

The balance at 31 March 2004 is made up of the following elements :

NOTE 5 Trust Statement balance

106 Inland Revenue Annual Report and Accounts

990837_Text / Sig: 53 / Plate B

NOTE 7 Consolidated Fund

Under the direction of HM Treasury, repayments of taxes and duties and the payment of Tax Credits are reported in the statement when a payable instrument has been issued. Under the reporting requirements for the Consolidated Fund Statement, repayments of taxes and duties and payment of Tax Credits are reported when the payable instruments have been encashed by third parties through the Department's bank accounts. The difference represents the net year-on-year movement in the value of payable instruments that have been issued but not encashed. The following tables reconcile the amounts recorded in the two statements:

Period Ending 31 March 2004	Note	Receipts	Issued Payments	Net Receipts (Issues)	Movement in Unencashed Issues	Net Receipt (Encashed)
		£m	£m	£m	£m	£m
Income Tax	2(i)	127,200	9,283	**117,917**	(69)	117,848
Capital Gains Tax	2(i)	2,265	40	**2,225**	-	2,225
Corporation Tax	2(i)	33,208	5,314	**27,894**	(6)	27,888
Inheritance Tax	2(i)	2,661	157	**2,504**	(2)	2,502
Stamp Duties	2(i)	7,676	131	**7,545**	-	7,545
Petroleum Revenue Tax	2(i)	1,385	206	**1,179**	-	1,179
		174,395	15,131	**159,264**	(77)	159,187
WTC	3(i)	-	4,647	**(4,647)**	21	(4,626)
CTC	3(i)	-	8,845	**(8,845)**	41	(8,804)
WFTC	3(ii)	-	87	**(87)**	(12)	(99)
DPTC	3(ii)	-	2	**(2)**	-	(2)
		174,395	**28,712**	145,683	**(27)**	**145,656**
				Opening Balance		**(1,294)**
				Closing Balance		**1,193**
				Paid to Consolidated Fund		**145,555**

Consolidated Fund Statement closing balance (Encashed basis)		1,193
Revenue payments not cleared at the Bank of England	475	
Adjustment for non-Consolidated Fund balances	(51)	424
Amount due as per Note 5 (Issued basis)		**1,617**

Period Ending 31 March 2003	Note	Receipts	Issued Payments	Net Receipts (Issues)	Movement in Unencashed Issues	Net Receipt (Encashed)
		£m	£m	£m	£m	£m
Income Tax	2(i)	119,632	9,311	**110,321**	1	110,322
Capital Gains Tax	2(i)	1,652	56	**1,596**	-	1,596
Corporation Tax	2(i)	34,070	4,963	**29,107**	(1)	29,106
Inheritance Tax	2(i)	2,497	143	**2,354**	-	2,354
Stamp Duties	2(i)	7,653	104	**7,549**	(1)	7,548
Petroleum Revenue Tax	2(i)	1,123	165	**958**	-	958
		166,627	14,742	**151,885**	(1)	151,884
WFTC	3(ii)	4	6,306	**(6,302)**	(182)	(6,484)
DPTC	3(ii)	-	156	(156)	(4)	(160)
		166,631	**21,204**	145,427	**(187)**	**145,240**
				Opening Balance		**(636)**
				Closing Balance		**1,294**
				Paid to Consolidated Fund		**145,898**

Consolidated Fund Statement closing balance (Encashed basis)		1,294
Revenue payments not cleared at the Bank of England	611	
Adjustment for non-Consolidated Fund balances	(161)	450
Amount due as per Note 5 (Issued basis)		**1,744**

990837_Text / Sig: 54 / Plate B

Accounts Direction given by The Treasury in accordance with Section 2(3) of The Exchequer and Audit Departments Act 1921

1. The Board of Inland Revenue shall prepare a Trust Statement for the financial year ended 31 March 2004, which shall properly present the collection and allocation of taxes, duties, National Insurance Contributions and Tax Credits administered by the Department. When preparing this Statement, the Board of Inland Revenue shall have regard to the example format shown in the appendix to this Direction, and shall also agree the format of the supporting notes, with the Treasury. Regard shall also be given to all relevant accounting and disclosure requirements given in "Government Accounting" and other guidance as issued by the Treasury and, for Tax Credits, by the Organisation for Economic Co-operation and Development.

2. The Trust Statement shall be transmitted to the Comptroller and Auditor General, by a date agreed with the Comptroller and Auditor General and the Treasury, but in any event no later than 30 November 2004, for the purpose of his audit examination and report.

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

4. This Direction supersedes the Trust Statement Directions for the Board of the Inland Revenue dated 15 July 2003.

David Cruden 13 May 2004
Head of the Central Accountancy Team
HM Treasury

108 Inland Revenue Annual Report and Accounts

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HM Treasury

990837_Text / Sig: 54 / Plate B

Comptroller and Auditor General's Standard Report 2003-04

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

John Bourn
Comptroller and Auditor General

1 October 2004

Comptroller and Auditor General's Standard Report 2003-04

Contents

Comptroller and Auditor General's Standard Report 2003-04
Contents
Executive Summary 112
Part 1: Scope of the Audit and Recent Developments 115
Part 2: Child and Working Tax Credits 121
Part 3: Stamp Duty Land Tax 136
Report of the Comptroller and Auditor General 2003-04 111
990837_Text / Sig: 56 / Plate A

Executive Summary

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

2 No tax collection system can ensure that all those who have a tax liability comply with their obligations. As part of the Department's Public Service Agreement targets they aim to reduce the number of individuals and businesses who do not comply. The National Audit Office's work in 2003-04 provided overall assurance that the Inland Revenue's regulations and procedure continued to provide an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out subject to the following reservations:

- those I have recorded about tax credit error;
- other specific matters in this report.

3 The Inland Revenue prepared Resource Accounts and a Trust Statement account of taxes and tax credits. I qualified my audit opinion on the latter in respect solely of error rates on tax credits (see paragraphs 2.24 - 2.26). I gave an unqualified audit opinion on the Resource Accounts.

4 I also present to Parliament Value for Money reports on the economy, efficiency and effectiveness with which the Department have used their resources. Since my last report on the Department's accounts in November 2003, I have reported on External Fraud against the Inland Revenue (HC 429), on the Strategic Transfer of the Estate to the Private Sector - STEPS - project (HC 530), and on the Recovery of Debt by the Inland Revenue (HC 363).

5 This report records audit observations on Tax Credits and Stamp Duty Land Tax. The main points arising from these examinations were as follows.

Child and Working Tax Credits

6 I concluded in my report on last year's Inland Revenue accounts that the new Tax Credits represented a major challenge for the Department, and the level of problems caused to claimants and employers as the system went live in April 2003 demonstrated that there were undetected gaps in the design of the testing regime for the system. I noted that the Department's consideration with EDS – its then IT service provider - of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the new Tax Credit system, and the possibility of legal action. Those discussions were still continuing in November 2003 at the time of my report for that year and the Department then hoped to resolve them shortly.

7 The Department had not resolved the discussions on compensation when I concluded this year's report. The Department and EDS told me that a structured process of confidential discussions on these matters was continuing as I concluded this report. In order not to prejudice their discussions I have not examined these matters further.

8 In planning the major annual exercise to renew Tax Credit awards, which took place mainly from April to September 2004, the Department aimed to address the lessons learned from the system problems of the previous year. The extent of its success in that renewal process and in avoiding significant problems, will be seen fully only later in 2004-05 when the renewals process is finished and reviewed.

990837_Text / Sig: 57 / Plate A

9 The new Tax Credits have proved relatively easy for people to access but many have found it difficult to understand exactly how much they are due - a problem made worse for those who have been paid the wrong amounts. The administration of the new Tax Credits has proved complex in parts, reflecting the underlying design of the new Tax Credits and the desire to provide support that is responsive and tailored to a wide range of circumstances.

10 I qualified my audit opinion on the Department's Trust Statement account for 2002-03, in respect of Working Families' and Disabled Person's Tax Credit payments, as a Departmental exercise had estimated that overpayments resulting from claimant error and fraud amounted to 10-14 percent by value. The Department told the Committee of Public Accounts that error rates under the new Tax Credits might be half of those under the previous Tax Credit schemes. They have not yet estimated the level of financial error on the new Tax Credits and so I have no evidence that error has yet been reduced significantly to enable me to give an unqualified audit opinion. I have therefore qualified my audit opinion on the 2003-04 Trust Statement account in respect of the new Tax Credit payments.

11 The Department plans to test Tax Credit claims and to quantify the financial implications of claimant error and fraud. They expect a result in respect of 2003-04 to be available by July 2005 in time to inform the Accounting Officer when considering the accounts for 2004-05. The Department could undertake work earlier than that so as to have a broad indicator of those levels. In 2003-04 the Department undertook an exercise on the 2003-04 provisional Tax Credits awards which helped inform their understanding of claimant error and fraud and the strategies for tackling them. The Department, however, was not able to draw reliable quantified estimates from this exercise.

12 Some essential controls over the new Tax Credits did not work in 2003-04, including the daily reconciliation of payments authorised with payments made, which was planned as a fundamental daily check on processing. The Department retrospectively completed reconciliations for 2003-04 in September 2004 and this work has resulted in the correction of a significant number of claimants records. The Department plan to introduce fully automated daily reconciliations in the second half of 2005.

13 The Department had to move staff from other tax work to help when the new Tax Credits system problems arose in the first half of 2003-04. It plans to recover fully from the impact of the initial Tax Credits problems by the end of 2004-05. It will need to ensure that the recovery plans are not frustrated by further extensions of the new Tax Credit IT systems. Business as usual collecting taxes must not be allowed to suffer and the Department must ensure that their responses to system problems do not undermine their reputation for integrity of processing taxpayers' affairs.

Stamp Duty Land Tax

14 The Department modernised stamp duty on land and buildings with the introduction of Stamp Duty Land Tax on 1 December 2003. New legislation, together with regulations and consequent administrative procedures and checks, sought to minimise recognised stamp duty tax avoidance. These measures, however, did not fully close all the known tax avoidance opportunities.

15 There was a tight timetable for consultation, legislation and system development for Stamp Duty Land Tax. The Department properly recognised six months before the implementation date of 1 December 2003 the need to develop rapidly and deploy manual contingency arrangements, while a fully automated system continued to be developed, tested and delivered. The Department considered that deferring delivery of the automated system was necessary to meet the overall timetable. The new tax was implemented without the introduction of an automated system and the success of the interim, manual arrangements is a credit to those involved. Government departments have experienced previous problems with tight IT project timetables and there would have been advantages had the Department been able to introduce the IT system to the original timetable. There are lessons to be learnt from tight timetables which need to be allowed for when planning future projects.

16 The Department is developing IT systems to remedy the limitations in procedures and controls during manual running. During that period some compliance work was undertaken to a lower level than planned and the Department plans to introduce a more comprehensive approach. This will only be fully effective once the IT systems are in place. The Department need to remedy the current limitations and ensure that this work is undertaken comprehensively for the future.

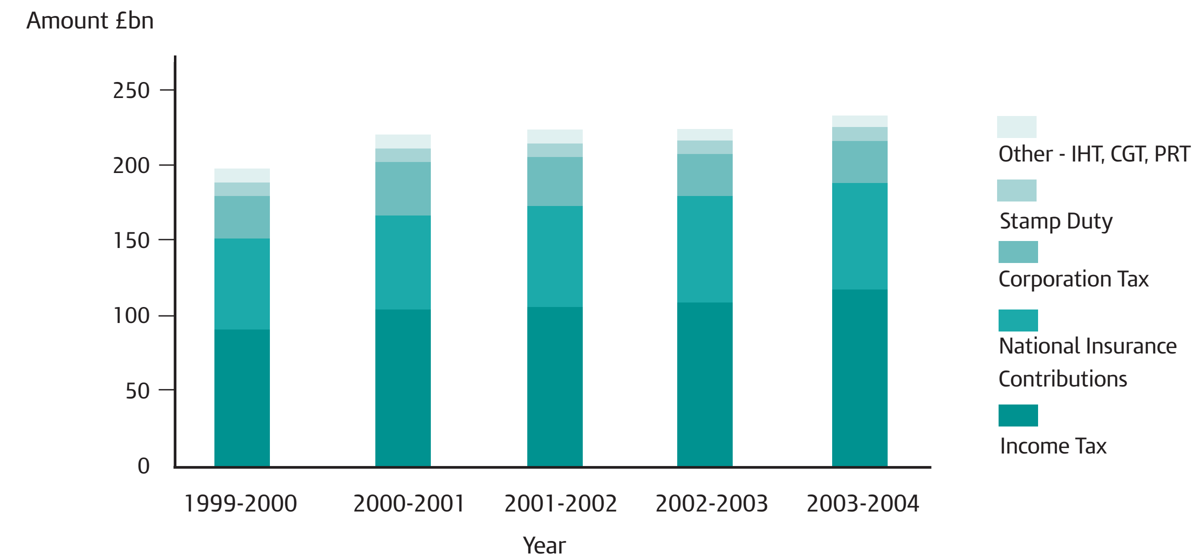
17 The Department has found difficulties in an important area where it had hoped to reduce avoidance, because EU law limits its ability to take action. The Department should continue to review the tax revenues still at risk even though they have introduced these new arrangements and identify new ways of countering avoidance of Stamp Duty.

Part 1: Scope of the Audit and Recent Developments

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

1.2 In 2003-04 the Department collected some £230 billion. Figures 1 and 2 show the trends in collections from 1999-2000 to 2003-04. The receipts from Income Tax, National Insurance, Petroleum Revenue Tax and Inheritance Tax have increased in 2003-04 whilst receipts from Corporation Tax have decreased in absolute terms and as a proportion of total revenue. The Government projects that the trend of declining corporation tax receipts will be reversed in 2004-05 and forecasts an increase to £34.8bn in 2004-05, in line with their projections of increases in company profits. Receipts from Stamp Taxes are similar to 2002-03.

FIGURE 1: Inland Revenue main Tax and National Insurance Receipts



Source: Inland Revenue accounts

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

	1999-2000 £bn	2000-01 £bn	2001-02 £bn	2002-03 £bn	2003-04 £bn
Income Tax (Gross of tax credits)	94.0	106.0	108.7	110.3	118.0
National Insurance Contributions	58.4	62.7	65.3	67.4	75.2
Corporation Tax	34.4	32.4	32.0	29.1	27.9
Stamp Taxes	6.9	8.2	7.0	7.5	7.5
Inheritance Tax	2.0	2.2	2.4	2.4	2.5
Capital Gains Tax	2.1	3.2	3.0	1.6	2.2
Petroleum Revenue Tax	0.9	1.5	1.3	1.0	1.2
Total receipts	**198.7**	**216.2**	**219.7**	**219.3**	**234.5**
Tax Credit payments	-1.1	-4.6	-5.7	-6.4	-13.5

Source: Inland Revenue accounts

1.3 Stamp Duty Land Tax is discussed in Part 3 of this report. Petroleum Revenue Tax, Inheritance Tax and Capital Gains Tax remain small revenue streams in comparison with Income Tax and Corporation Tax.

Audit Approach and Coverage

1.4 The National Audit Office review periodically existing and new systems and significant changes to them, and undertake test examinations of individual transactions and balances as necessary. The audit approach seeks to emphasise aspects of management control over business and tax streams, including accountability; corporate governance procedures; quality assurance procedures; risk analysis of the tax or business stream; and the Department's identification of obstacles to the assessment and collection of the management information on the tax or business stream.

1.5 The National Audit Office also review Departmental progress in response to recommendations for business and tax streams arising from my reports, those of the Committee of Public Accounts and the National Audit Office's work in previous years. Figure 3 summarises the main work of the National Audit Office in 2003-04. The results of my work not detailed in this report and suggestions of further improvements in controls that could be made have been notified to the Department in management letters.

990837_Text / Sig: 59 / Plate A

FIGURE 3: National Audit Office coverage 2003-04

	Areas Examined
Working Families and Disabled Person's Tax Credit	Closure of these schemes
Child Tax Credits and Working Tax Credit	See Part 2 of this Report Introduction of the schemes Payment and compliance arrangements
Stamp Duty Land Tax	See Part 3 of this Report Introduction of the duty from December 2003 Payment and compliance arrangements
National Minimum Wage	Review of the Department's procedures
Corporation Tax	Review of certain developments
Money Laundering	Review of the Department's procedures
Tax write-offs, Remissions and Standovers	Review of the Department's procedures and reporting
Corporate Governance and Information technology	Examination of the Department's internal controls, including the further development of governance arrangements and the management of information available to support the Accounting Officer's Statement on Internal Control. Management of IT related risks
Management Information	Review of progress with the Department's Performance and Management Information Strategy.
Thresholds and Allowances	Review of aspects of the Departmental procedures for setting thresholds and allowances

Source: National Audit Office

Changed IT Services Partner

1.6 Information Technology (IT) is essential to the administration of taxes and most Departmental IT services are operated by private sector IT service providers. During 2003-04 the Inland Revenue concluded its procurement exercise, ASPIRE, to establish a new technology contract and from 1 July 2004 Capgemini replaced EDS as the Department's primary supplier of IT services. The Department's contract with Accenture for IT support for National Insurance systems will be rolled into the ASPIRE contract in early 2005. The ASPIRE contract was awarded initially for 10 years and the immediate challenge was to ensure a smooth and successful transition. The Inland Revenue formed a senior team to oversee and assist with this transition to ensure that current systems and ongoing projects were not jeopardised.

Review of the Inland Revenue and HM Customs & Excise

1.7 In July 2003 the Chancellor of the Exchequer announced a major review of the organisations dealing with tax policy and administration: HM Customs and Excise, the Inland Revenue and HM Treasury. The report of the review - the Review of the Revenue Departments (the O'Donnell review) - was published in March 2004. It recommended that a new customer-focused tax service should be established, integrating the Inland Revenue and HM Customs and Excise, tasked with improving customer services, reducing compliance costs, improving compliance with tax law and increasing efficiency. HM Treasury will strengthen its responsibility for tax policy, with support from the new department. The Review's recommendations were strategic rather than a detailed blueprint for implementation.

1.8 The main recommendations of the report directly relevant to my work were that management should:

- structure the new department as far as possible around customers and functions rather than taxes, so that customer needs can be better met and compliance improved, for example by establishing an integrated large business office, and more specialised service to small businesses;
- develop a better focused PSA target on customer service and compliance costs, supported by work to develop understanding of compliance costs;
- develop a better focused PSA target on compliance across the tax stream, supported by work to develop understanding of the tax gap and other compliance measures;
- look to identify economies of scale and scope by developing new national services, and reviewing the local office network, including with other departments; and
- establish a unified information strategy, with strong information governance arrangements and a joint knowledge centre, as part of a re-engineering of business processes.

And that:

- the Treasury should have lead responsibility and accountability for tax policy and the new department should lead on policy maintenance; and
- a Framework Document should be published setting out who is accountable to whom and for what, in the new department.

1.9 The report noted that the Departments were currently engaged in significant developments that entailed risks. It acknowledged that integrating the Departments to form the new department and implementing the recommendations might cause problems for revenue collection in the short term as a result of disrupted priorities; resources focussed on change rather than delivery; customer confusion; and poor change management. Organisational changes might cause a reduction in revenues as the effectiveness of compliance activity might be impaired in the short term and there might be a reduction in deterrence. The review report said that vigilance would, obviously, need to be maintained and that the risks to revenue could be mitigated through good planning and management. Legislation setting up the new Department is expected in 2005.

990837_Text / Sig: 60 / Plate A

Compliance and Enforcement Initiatives

1.10 As announced in the Chancellor's Budget 2004, the Department has introduced a new compliance package for direct tax and National Insurance Contributions. The Inland Revenue estimates for the purposes of the fiscal projections of the additional revenue were that the proposals should generate an additional £3,840 million over the five years to 2008-09. The package provided for additional resources to invest in a new performance and management information system which was intended to enhance and better manage the information needed for compliance work. Around two thirds of the revenue impact would depend on this system. The package would also provide for an increase in staff capacity in areas that posed particular compliance risks.

1.11 The package focused on improving compliance through:

- better use of management information to improve both the targeting and effectiveness of corporation tax and other enquiry work in the Large Business Office and the Inland Revenue network offices;
- measures to raise awareness of tax obligations, including a publicity campaign and new forms of contact with taxpayers;
- measures to identify those liable to tax who hide some or all of their sources of income from the Inland Revenue, and to work closely with them to help them become and remain compliant; and
- expanding specialist teams in specific high-risk areas such as taxpayers with complex personal tax affairs.

1.12 The Inland Revenue put in place arrangements to monitor and evaluate the new package and will also monitor the action by operational management intended to realise the estimated benefits. Given the importance of the contribution of the performance and management information system to the package of measures as a whole, I noted that it was important that the Inland Revenue succeed in their plans to convert time freed up by the system into increased effectiveness in handling tax cases and higher tax yield.

The Construction Industry Scheme

1.13 In my report on the Inland Revenue accounts last year, I recorded the Department's preparations for and consultation on the planned introduction of a new Construction Industry Scheme for the tax year 2005-06. In December 2003, the Chancellor announced that it would be introduced a year later, for April 2006. The National Audit Office will continue to monitor progress in developing and implementing the Department's proposals.

Closure of the Working Families' and Disabled Person's Tax Credit Schemes

1.14 In April 2003, the Government introduced Child Tax Credit and Working Tax Credit to replace Working Families' Tax Credits and Disabled Person's Tax Credits. These former Tax Credits were seen as interim steps pending the introduction of the new Tax Credits. The Department paid out only some £18 million in the period from April 2003 to October 2003 in relation to backdated claims on the former tax credits. The Department is winding down the IT systems used to support the former Tax Credits, but will not fully decommission the system until April 2005 in order to provide support for any ongoing work e.g. appeals.

1.15 In my 2003 report, I commented on the extent of applicant non-compliance with Working Families and Disabled Person's Tax Credits and I concluded that the probable rate of error in 2002-03 remained unacceptably high, leading me to qualify my audit opinion on the Trust Statement account. I discuss the introduction of the new Tax Credits in more detail in Part 2 and my conclusion that I have had again to qualify my audit opinion in respect of tax credits.

Deleted taxpayer records

1.16 The Department became aware in the autumn of 2003 that a well established and accepted housekeeping routine on the PAYE computer databases had for a number of years deleted some records before the usual final review to check whether any tax remains overpaid or underpaid for the relevant year. This means that some customers will not have received the repayment to which they may have been entitled and others may owe tax which has not been collected. As the records have been deleted there is no way of identifying those whose records were open when the process was run. This routine has been corrected. The Department is carrying out further work to establish the full effect, including a statistically valid sample exercise to determine the average level of repayment due. It will then decide how best to deal with the problem.

990837_Text / Sig: 60 / Plate B

120 Report of the Comptroller and Auditor General 2003-04

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Part 2: Child and Working Tax Credits

2.1 The Government introduced Child Tax Credit and Working Tax Credit (the new Tax Credits) in April 2003 as part of the reforms of the tax and benefit systems aimed at relieving child and in-work poverty. They are designed to tailor support to families' specific circumstances, and to respond to their changing needs, providing most support when their need is greatest. They replaced the Working Families' and Disabled Person's Tax Credits which were introduced in October 1999, and the Children's Tax Credit. This part of my report examines the first full year of payment of the new Tax Credits and the implications of system problems in 2002 and 2003.

2.2 The Department estimated that 6 million families would benefit from one or both of the new Tax Credits during 2003-04 (5.75 million families would benefit from Child Tax Credit, including families getting the support for their children through their benefits and 1.35 million families would benefit from Working Tax Credit, with some families benefiting from both). The Department estimates that the annual cost of Tax Credits to the Government is £16 billion. The Department paid £13.5 billion in Tax Credits in 2003/04 with the remaining expenditure incurred by the Department for Work and Pensions. From April 2004, families in receipt of Income Support and Job Seeker's Allowance began to receive Child Tax Credit instead of receiving the child premia in their benefits. The administrative cost to the Inland Revenue of Tax Credits in 2003-04 was £406 million, and involved around 7,300 staff.

Child Tax Credit and Working Tax Credit

2.3 Claimants apply for Tax Credits by completing a claim form. The Department verifies information shown on claims, conducting routine and risk based checks, making more detailed examinations where they think claims are incorrect (either before payment or afterwards), and arranging payments to eligible claimants. The main features of the Working Tax Credit and Child Tax Credit are summarised in figures 4 and 5 below. A Tax Credit award runs until the end of the tax year, unless the claimant ceases to be eligible before then. Awards can be adjusted during the year to take account of changes in circumstances. Claimants must notify certain changes in circumstances to the Inland Revenue within three months, for example significant reductions in childcare costs or those changes that bring an award to an end. Other changes, for example, an expected change in household income, do not have to be reported during the year, although the Department encourages claimants to report changes likely to affect their award to keep awards in-line with entitlement. Any increase in entitlement can be backdated for up to three months. Any reduction in entitlement is backdated to the date when the change in circumstances occurred.

Adjusting Tax Credit awards and accounting for payments

2.4 After the end of the 2003-04 tax year the Department asked claimants to review their circumstances for the year on which their award was based, to notify the Department of any changes if necessary and to report their income for that year. The Department then finalised the 2003-04 award, recalculating it in the light of the circumstances and income for the year and making any adjustments necessary to the 2003-04 award and to future payments. This process is similar to the treatment of tax returns in as much as entitlement is finalised after the end of the tax year. Tax Credit underpayments for 2003-04 have been paid as a lump sum, whilst overpayments are being recovered from future awards, if possible, or directly from claimants, subject to the Department's wider procedures. Hence, Tax Credits awards made during 2003-04 were provisional until finalised after the year-end. The Department shows in its Trust Statement account for 2003-04 the amount of cash paid to claimants during the year, based on the provisional awards made. The total of final, adjusted awards cannot be known until much later in the cycle. As 2003-04 was the first year of the new Tax Credits, there was no track record of previous years on which to estimate the likely level of adjustments that would be necessary.

990837_Text / Sig: 61 / Plate B

FIGURE 4: Main Features of Child Tax Credit
Child Tax Credit

Available to those aged 16 or over, ordinarily resident and present in the UK whether working or not, and who are responsible for at least one child.

Normally paid directly into the bank account of the main carer

Elements	2003-2004 Annual Rates	2004-2005 Annual Rates
Family Element (one per family)	£545	£545
Higher Family Element (in first year of child's life)	£545	£545
Child Element (for each child)	£1,445	£1,625
Disability Element (for each disabled child)	£2,155	£2,215
Severe Disability Element (for each severely disabled child)	£865	£890

The Family Element is reduced by 6.67p for every £1 of income over £50,000, in most cases.

For families entitled to only Child Tax Credit, the Child Element is reduced by 37p for every £1 of income over a limit of £13,230 (£13,480 for 2004-05). For families entitled to both Child Tax Credit and Working Tax Credit, the child element is withdrawn at that rate after Working Tax Credit has been fully withdrawn.

Source: National Audit Office

FIGURE 5: Main Features of Working Tax Credit
Working Tax Credit

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

Paid via the employer if the claimant is an employee, otherwise paid direct to claimants such as the self-employed. The childcare element is paid direct to the main carer

Elements	2003-2004 Annual Rates	2004-2005 Annual Rates
Basic Element	£1,525	£1,570
Second adult and Lone Parent Element	£1,500	£1,545
30 Hour Element	£620	£640
Disabled Worker Element	£2,040	£2,100
Severe Disability Element	£865	£890
Element for claimants aged 50 and above, working 16-29 Hours	£1,045	£1,075
Element for claimants aged 50 and above, working 30+ Hours	£1,565	£1,610
Childcare Element - childcare costs cannot exceed £135 per week for one child and £200 per week for two or more children	70 % of costs	70 % of costs

A claim is reduced by 37p for every £1 of annual income over a limit of £5,060 (£5,060 2003-2004).

Source: National Audit Office

Introduction of the schemes

2.5 The Department started to distribute claim forms for the new Tax Credits in August 2002 and commenced payment in April 2003. The Government intended that Child Tax Credit payments and payments of the childcare element of Working Tax Credit would generally be made directly into claimants' bank accounts. However, large volumes of giro cheque payments were made to claimants where bank account details were missing or misstated on claim forms, and where claimants had not received expected payments due to problems with the IT system supporting the new Tax Credits.

2.6 When the claimant is an employee the elements of Working Tax Credit apart from childcare are paid via the employer. However, the Chancellor of the Exchequer announced in the 2004 Budget that this method of payment was to be phased out and replaced by direct payment by the Inland Revenue. One of the original objectives of making payments via employer was to reinforce the principle that tax credits were a reward for work. The Government has since accepted, in principle, that the benefits to business justify moving to payment direct to claimants. The intention was to reduce the cost of payroll administration, which had been a concern raised by employers. The seventh 2003-04 report from the Treasury Select Committee on the Administrative Costs of Tax Compliance estimated that this change would reduce the compliance costs for business by around £90 million a year. Consultation with employers groups about the arrangements for withdrawal of payments via employers is continuing.

System problems at the start of the new Tax Credits

2.7 My Standard Report for 2002-03 highlighted serious problems during the introduction of the new Tax Credits systems affecting stability, speed, and availability, which delayed the processing of claims. Claimants encountered problems, including delays in receiving award notices and payments. The telephone helpline was overloaded during the first few months of the new Tax Credits, however its performance improved over the remainder of the year. It took longer to process claims and changes of circumstances and the Department transferred staff from other work to help clear the backlog and to deal with the increased number of queries.

2.8 The Department engaged technical consultants in July 2003, following the problems experienced with the introduction of the new Tax Credits IT system, to assess its technical robustness and resilience and to make recommendations to help reduce the risks of similar problems as the system was further developed. EDS had already taken forward work to remedy some of the weaknesses by the time the consultants reported in October 2003.

Compensation from EDS for unsatisfactory system performance

2.9 As mentioned in my report last year, the Department's consideration with EDS of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the system, and the possibility of legal action. The Department and EDS told me that a structured process of confidential discussions on these matters was continuing as I concluded this report. In order not to prejudice their discussions I have not examined these matters further.

Overpayments and Write-offs

2.10 The Department wrote to the Chairman of the Public Accounts Committee in March 2004 advising that in April and May 2003 a software error caused the system to generate incorrect payments resulting in overpayment of Tax Credits to some 455,000 households, amounting to some £94 million. Of this amount, the Department are to write-off overpayments individually less than a threshold of £300, affecting some 373,000 households and worth some £37 million. They are seeking recovery of larger amounts from some 82,000 households, amounting to £57 million.

2.11 The Department set the recovery threshold following extensive mathematical modelling of the likely costs of handling enquiries, recovery action, appeals, payments in cases where hardship could be argued, and complaints. These costs were balanced against estimated recoverable amounts and write-offs. The Department currently estimate their administrative costs of dealing with this system problem at around £10 million.

2.12 Of the possible recoverable amount, the Department expect further write-offs of £8 million to £ 14 million as some recipients could claim successfully that the overpayment was the result of official error (a mistake by the Department where the recipient could reasonably have thought that the payment was right). These cases are to be decided on an individual basis. For claimants still receiving Tax Credits, recovery will generally be made by deduction from the ongoing awards typically over one year and often over two years. The reduction will be by no more than 25% for claimants entitled to more than the family element of Child Tax Credits and no more than 10% if they are entitled to the maximum award. This is to avoid claimants being placed into hardship.

2.13 The Department reported to Parliament the £37 million written-off and provision for future write-offs in notes in their 2003-04 Trust Statement account. Final amounts of actual write-offs will be recorded in the accounts for 2004-05. Figure 6 sets out the currently estimated figures and costs, including those reported in the notes to the 2003-04 Trust Statement. The Department is continuing work to refine these estimates. The Department's policy for recovery of overpayments is set out in "Code of Practice 26: What happens if we have paid you too much tax credit." The relevant extracts are in Annex 1 to this Report.

FIGURE 6: Overpayments of the new Tax Credits

	Number of cases	Value
Overpayments	455,000	£94m
Written off cases below £300	373,000	£37m
Administrative costs	-	£10m
Cases where recovery sought	82,000	£57m
Further write-off on Official Error grounds	-	£8m-£14m
Total cost	-	**£55m-£61m**

Source: Inland Revenue

Interim payments

2.14 At the beginning of 2003-04, to help respond to the system problems, the Department made interim payments by giro cheque in order to prevent hardship when claimants had not received Tax Credit payments. Claimants could be paid up to five weeks' worth of Tax Credit at their local office if they had not received a payment or their claim had not been processed. In addition, the Department made interim payments in a number of other circumstances throughout the year, including situations where the normal payment mechanisms had broken down and payment did not reach individuals. They also made additional tax credits payments to prevent hardship where payments had been reduced following the adjustment of an award; the effect of these payments is that only part of an expected overpayment is recovered by the end of the year leaving the balance to be recovered in the following year. In total, the Department estimates that it made approximately 500,000 interim Giro payments with a value of £170m and that of these, around 65,000 payments with a value of £20m were made to prevent hardship following reduction of an award.

Compensation to Claimants

2.15 The Department deals with claimants who have encountered problems with their Tax Credits claims and who complain under the Code of Practice used for all complaints cases, Code of Practice 1: Putting things right. By the end of March 2004 of 32,000 complaints made, the Department had dealt with 27,500 cases and authorised compensation in 10,800 of these, totalling £370,000, an average of £34.

2.16 The fourteenth 2003-04 report from the Committee of Public Accounts on the New Tax Credits (published 22 April 2004) noted that the Department viewed their compensation arrangements for claimants as being voluntary and spontaneous. The Committee recommended that if the number compensated this way proved to be unrealistically low, the Department should draw attention to compensation available for claimants who were likely to have been most disadvantaged. The Department noted that they have measures in place to monitor compensation arrangements where claimants did not receive the service they were entitled to expect and will continue to monitor the position as claimants' awards for last year are finalised.

Controls over Processing and Error Rates

2.17 In my last report I noted that the Department had not successfully performed the planned daily reconciliations of payments authorised against payments made due to the problems experienced at the introduction of the new Tax Credits. Reconciliation work on payments from April to early December 2003 resulted in corrections of a significant number of computer records in January and March 2004. Corresponding reconciliation work on payments from December to March 2004 was completed in September 2004 and the Department planned to correct the few computer records affected in October 2004 so as not to coincide with other system developments. For 2004-05, the Department introduced revised reconciliation arrangements in August 2004. The Department plan to introduce fully automated reconciliations in the second half of 2005.

2.18 The system problems experienced during the launch of the new Tax Credits and the volume of incorrect payments discovered raises concerns about the accuracy of the Department's initial information held about claimants. The Department made checks on the accuracy of the processing of claims and changes of circumstances in 2003/04 as part of their Public Service Agreement targets. As highlighted in Figure 7, results show that the accuracy of processing the new tax credits claims in 2003-04 was lower than under the Working Families and Disabled Persons Tax Credits and did not meet the Departments' Public Service Agreement target.

FIGURE 7: Accuracy of processing and calculating awards

	2000-01 %	2001-02 %	2002-03 %	2003-04 %
Target Accuracy	92	92	93	90
Working Families Tax Credit	93.7	87.1	85.2	n/a
Disabled Persons Tax Credit	98.0	95.0	90.9	n/a
The new Tax Credits	n/a	n/a	n/a	78.6

Source: Inland Revenue

2.19 The Public Services Agreement target for processing accuracy remains at 90% for 2004/05. The Department informed me that it aims to meet this target and that it is taking a number of steps to improve its performance.

- The Department has set up a dedicated team to identify and resolve issues that affect processing accuracy.
- Internal guidance and procedures have been revised, based on experience from the first year of the new Tax Credits.
- The Department now includes controlled testing of any new processing procedures as the system is extended and new functions are added.
- A number of system problems identified by the checks have been rectified.

Claimant and Employer Compliance with Obligations and Fraud Estimates

2.20 In addition to the risks from incorrectly processing claims and calculating awards, the Department needs to manage the risks of claimant and employer non compliance with tax credit obligations. The Department carries out continuous compliance checks throughout the claims process, including:

- verification of information shown in all tax credits claims and changes of circumstances before any payment is made;
- automated risk assessment of all claims and changes of circumstances before any payment is made, with in-depth investigation of selected claims and changes of circumstances where the Department considers that they may be incorrect;
- further risk assessment post-award, with in-depth investigation of selected awards
  - during the course of the year where it is discovered that they may be incorrect
  - after the year-end when they have been finalised, both where it is discovered that they may be incorrect and on a random basis.

126 Report of the Comptroller and Auditor General 2003-04

990837_Text / Sig: 63 / Plate B

2.21 During 2003-04 the Department had two main compliance investigation targets on high risk claims: 1500 pre-award examinations and 100,000 post award examinations. The Department met both these targets and the results of this work detected that excess tax credits of £66.7 million had been paid out, based on the information available at that time. The Department have adjusted awards to correct the claimant's error, but the money is not recoverable directly because the amount of the overpayment cannot be finalised before the year end and the figure may be amended as a result of later changes. The Department did not design this work to provide any quantification of the likely level of fraud or financial overpayments and underpayments as a result of compliance failures.

2.22 As the Department increased its knowledge about the new Tax Credits claimants, certain routine based checks were relaxed where the Department considered that the risks of improper payment were outweighed by delays in completing these checks. The Department has subsequently found that a small number of incorrect payments were made as a result of relaxing these checks, although the Department did not maintain records of the value of these in all cases.

2.23 The amount of Tax Credit expenditure paid via employers shown by the Department in their Trust Statement Account is based on awards made by the Department. The Department could only know that these amounts were actually paid out to claimants by checking that employers made payments in accordance with the instructions issued by the Department. The Department sought to obtain assurance by reconciling a sample of amounts reported as paid by employers to the Departmental record of awards. The work is continuing at the time of my report and early indications are that the reconciliation rate is around 80% in terms of the number of cases. Estimates of the overall financial errors are very much less significant and contain appreciable uncertainty because the work is continuing. Given that this is the first reconciliation exercise for the new Tax Credits, and the transitional state and early problems of the new Tax Credits for 2003/04 - the first year for both employers and staff - the Department believe the reconciliation rate is reasonable. Final results for this exercise will be available later in 2004 and the Department and the National Audit Office will consider them further at that time. They will also examine at that time estimates of the overall financial value of the overpayments and underpayments by employers, and any case for further work by the Department.

Qualified audit opinion

2.24 I qualified my audit opinion on the Trust Statement account for 2002-03 in respect of payments of Working Families' and Disabled Person's Tax Credits. This was because a Departmental exercise in 2000-01 had indicated that they had overpaid some 10-14 per cent by value, representing £510 to £710 million overpaid for a full year because of claimant error or fraud.

2.25 Payments of new Tax Credits during 2003-04 were provisional until awards were finalised during the renewals process planned to be completed mainly from April to September 2004. Only after claimants have confirmed their circumstances and their awards are finalised is it possible for the Department to undertake work to determine finally the level of claimant error and fraud. The Department has plans for a programme of work to provide more information on the level of claimant error and fraud in respect of 2003-04 by July 2005 in time to inform the Accounting Officer when considering the accounts for 2004-05. The Department could undertake earlier work than that so as to have a broad indicator of those levels. In 2003-04 the Department undertook an exercise on the 2003-04 provisional Tax Credit awards which helped to inform the Department's understanding of claimant error and fraud and the strategies for tackling them. The Department, however, was not able to draw reliable quantified estimates from this exercise.

2.26 The nature of the new Tax Credits, for example the fact that they are based on annual income for a tax year, enables cross-checking of income provided by claimants with other data sources maintained by the Department. In addition, the design of the new Tax Credits system provides for a number of automatic risk and verification checks on claims which were not present in the former Tax Credits systems. The Department told the Committee of Public Accounts in December 2003 that the checks inherent in the new systems should reduce the levels of claimant error and fraud. The Department said they would be disappointed if the move to the new Tax Credits meant that there were not an immediate halving of error rates and a subsequent constant improvement. Whilst recognising that the design of the new Tax Credits and supporting systems should result in sizeable reductions in error and fraud, no reduction can be demonstrated until the Department have done the work they plan. I have therefore concluded that the probable level of error in 2003-04 remained unacceptably high leading me to qualify my audit opinion on the Trust Statement account in respect of Tax Credit payments.

Further Development of the Tax Credits systems

2.27 The Department planned a number of major stages to the delivery of the Tax Credits systems to support new functions. Each major delivery of new software (including changes to existing software) is known as a "Release". Releases 1 and 2 allowed claims, awards and payments to be processed and figure 8 sets out the timetable and main content for each subsequent Release, which continue to pose further significant challenges. There may also be further releases of system enhancements thereafter.

FIGURE 8: Timetable and content of Tax Credits system releases

	Main content	Delivery date
Release Three Planned for Nov 2003	• Preparation of the awards renewals process • Support for the Department's Compliance Activity • Additional support for Employer Funding • Changes to accounting reports • Provision for Management Information Systems	• Nov 03 • Jan 04 • Nov 03 • Nov 03 • Part delivered Jan 04
Release Four- (awards renewal) April 2004	• Main system to support the finalisation and renewal of awards	• Apr 04
Release Five October/November 2004	• Remaining elements of the system to complete the renewals process • Additional support for transfer to Tax Credits of those receiving the child elements of Income Support and Job Seekers' Allowance (Department of Work and Pensions schemes)	
Release Six April 2005	• Additional support needed for debt recovery • Improvements in accounting arrangements for giro payments • System to support payment of Child Trust Funds	

Source: Inland Revenue

2.28 The Office of Government Commerce have a central role overseeing major system developments that are critical to government programmes, and conduct Gateway reviews during project development. They carried out two Gateway reviews since the new Tax Credits went live for payments in April 2003. The first review (Review 4a) was carried out prior to the implementation of Release 3 in November 2003. It made a number of recommendations, including the need to complete detailed planning for Release 3. The review also noted that the Department faced issues in acting as an intelligent customer. It recommended a review of whether current expertise was too thinly stretched to provide an appropriate challenge and assurance on IT work undertaken by the supplier. The second review (Review 4b) was carried out prior to the implementation of Release 4 in April 2004. It found that several recommendations were outstanding from the previous review, although the Department emphasised that those appropriate to the Release 4 timeframe had either been implemented or were varied in the light of experience. It also made recommendations in respect of Release 4, including the need to complete documentation to inform decisions on implementation. The review also noted exemplars of good practice in the Programme, including the embedding of risk-based judgements to inform decision making, and a comprehensive risk and issue management process.

2.29 The Department felt that in general terms Release 3 was successfully implemented in November 2003, whilst recognising that planned provision of management information was delayed. The Department developed alternative solutions as interim measures that they found to work well. Some of the remaining management information functions to support Departmental compliance work were implemented in January 2004 and some in April 2004.

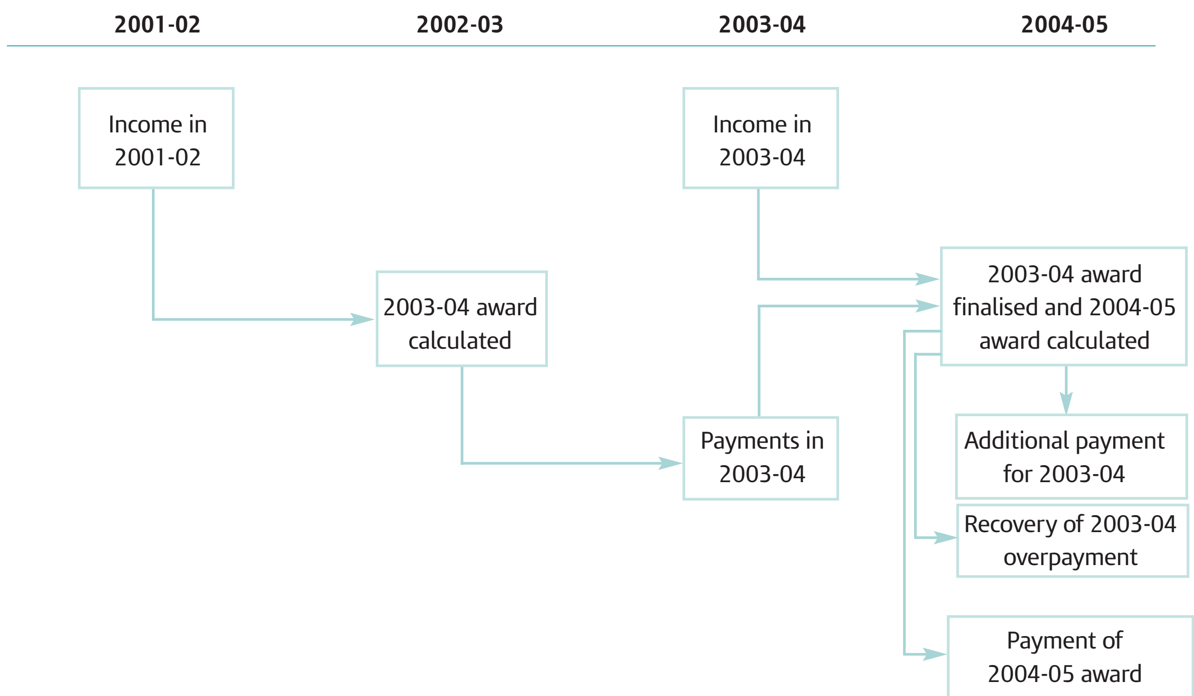
990837_Text / Sig: 65 / Plate B

Tax Credit Award Renewals

2.30 Release 4 was implemented in April 2004 and introduced the main software to support the Tax Credits renewals process. The renewals process was originally scheduled to run from April - July 2004, but Ministers decided in July 2003 to extend the process until September 2004. The aim was to ensure that adequate time was allowed for the entire process - both for claimants (for example, to gather together the relevant information about income) and the Department (for example, to process the replies and deal with queries from claimants).

2.31 The Department issued renewal packs to around 5.7 million households who had received Tax Credits in 2003-04 and requested a reply in around two-thirds of those cases to confirm circumstances and give actual income for 2003-04. In the remaining cases, where the provisional award was limited to the family element (£545p.a.), no reply was required if circumstances had not changed and income had not changed enough to affect the amount of the award. These households received a notice setting out the circumstances on which their claim was based and the income range in which the award is unaffected. Some 400,000 cases related to households whose award ended during 2003-04, and a reply was required to confirm actual income for the year and circumstances during the period of that award. Figure 9 highlights the stages involved in the process of calculating and renewing tax credit awards.

FIGURE 9: Timeline for claiming, payment and renewals of the new Tax Credits



Source: National Audit Office

2.32 Following a review and learning lessons from earlier Tax Credits system releases, the Department set up two extra call centres and took on additional staff to cope with processing and enquiries about the process and finalised awards. Figure 10 shows progress in processing renewals.

FIGURE 10: Renewals Processing volumes (cumulative millions in 2004)

	April	May	June
Renewals packs distributed	2.5	5.6	5.7
Responses received where reply expected	0.2	1.4	2.3
Finalisations	0.0	0.8	1.5

Source: Inland Revenue

Employers

2.33 In my 2002-03 report I noted that employers had a significant workload preparing for and running the new Tax Credits payments through their payroll systems. Some employers initially experienced many problems with the timing and frequency of Tax Credit award notifications received from the Department. The situation improved after the early weeks on the new Tax Credits, although some employers reported further, more localised problems later in the year and said that the volume of amendments to awards was greater than anticipated. The Department holds regular formal consultative meetings with employers' representatives at which these and other issues are discussed and provides advice through its helpline for employers.

Departmental Recovery in areas other than Tax Credits

2.34 In my 2002-03 report I noted that problems with the new Tax Credits systems had adversely affected tax administration business. In 2003-04 the new Tax Credits programme was responsible for internal overtime costing some £8.1 million to support the Department's business recovery effort. Staff who would not normally have worked on the new Tax Credits were transferred from their normal duties to deal with:

- entering data from Tax Credit claim forms onto the system;
- the unexpected length of phone calls received at the Helpline as a result of system problems;
- claimant visits to the Inland Revenue Enquiry Centres; and
- to fill vacancies created by other moves.

2.35 By the end of 2003-04, recovery was well underway and the Department met most of their operational targets. Some operational targets could not be met because of the diversion of resources and were therefore reduced eg. in telephone, postal and face-to-face customer contact. The diversion of resources also meant that some aspects of quality were affected. The Department missed the Public Service Agreement target for the percentage of enquiries worked to a fully satisfactory standard.

2.36 Some targets were also reduced in other areas of the Department affected by staff transfers to support tax credit work. This included staff normally engaged on customer contact, tax compliance work and some processing. It also included work on PAYE open case clearance (the Department's final check after the tax year-end that the pay and tax details for people in the PAYE system are correct). The Department told the Committee of Public Accounts in 2002 that they had set up machinery specifically to tackle arrears of open cases. The Department had aimed to reduce the number of open cases to 5.7million on hand by the end of 2003-04. However, by the end of 2003-04, the Department had 6.9 million open cases. The Department recognise the challenge for them is to ensure that progress is made in 2004-05 to achieve substantial reduction in the number of open cases. All revised targets are published in the Board's report for the year ended 31 March 2004. It will not be clear until the end of 2004-2005 whether all aspects of recovery have been completed and the Department is back on track.

Conclusions

2.37 I concluded in my report on last year's Inland Revenue accounts that the new Tax Credits represented a major challenge for the Department, and the level of problems caused to claimants and employers as the system went live in April 2003 demonstrated that there were undetected gaps in the design of the testing regime for the system. I noted that the Department's consideration with EDS – its then IT service provider - of the underlying technical problems had to have regard to the discussions between them about compensation for the unsatisfactory performance of the new Tax Credit system, and the possibility of legal action. Those discussions were still continuing in November 2003 at the time of my report for that year and the Department then hoped to resolve them shortly.

2.38 The Department had not resolved the discussions on compensation when I concluded this year's report. The Department and EDS told me that a structured process of confidential discussions on these matters was continuing as I concluded this report. In order not to prejudice their discussions I have not examined these matters further.

2.39 In planning the major annual exercise to renew Tax Credit awards, which took place mainly from April to September 2004, the Department aimed to address the lessons learned from the system problems of the previous year. The extent of its success in that renewal process and in avoiding significant problems, will be seen fully only later in 2004-05 when the renewals process is finished and reviewed.

2.40 The new Tax Credits have proved relatively easy for people to access but many have found it difficult to understand exactly how much they are due - a problem made worse for those who have been paid the wrong amounts. The administration of the new Tax Credits has proved complex in parts, reflecting the underlying design of the new Tax Credits and the desire to provide support that is responsive and tailored to a wide range of circumstances.

2.41 I qualified my audit opinion on the Department's Trust Statement account for 2002-03, in respect of Working Families' and Disabled Person's Tax Credit payments, as a Departmental exercise had estimated that overpayments resulting from claimant error and fraud amounted to 10-14 percent by value. The Department told the Committee of Public Accounts that error rates under the new Tax Credits might be half of those under the previous Tax Credit schemes. They have not yet estimated the level of financial error on the new Tax Credits and so I have no evidence that error has yet been reduced significantly to enable me to give an unqualified audit opinion. I have therefore qualified my audit opinion on the 2003-04 Trust Statement account in respect of the new Tax Credit payments.

2.42 The Department plans to test Tax Credit claims and to quantify the financial implications of claimant error and fraud. They expect a result in respect of 2003-04 to be available by July 2005 in time to inform the Accounting Officer when considering the accounts for 2004-05. The Department could undertake work earlier than that so as to have a broad indicator of those levels. In 2003-04 the Department undertook an exercise on the 2003-04 provisional Tax Credits awards which helped inform their understanding of claimant error and fraud and the strategies for tackling them. The Department, however, was not able to draw reliable quantified estimates from this exercise.

2.43 Some essential controls over the new Tax Credits did not work in 2003-04, including the daily reconciliation of payments authorised with payments made, which was planned as a fundamental daily check on processing. The Department retrospectively completed reconciliations for 2003-04 in September 2004 and this work has resulted in the correction of a significant number of claimants records. The Department plan to introduce fully automated daily reconciliations in the second half of 2005.

2.44 The Department had to move staff from other tax work to help when the new Tax Credits system problems arose in the first half of 2003-04. It plans to recover fully from the impact of the initial Tax Credits problems by the end of 2004-05. It will need to ensure that the recovery plans are not frustrated by further extensions of the new Tax Credit IT systems. Business as usual collecting taxes must not be allowed to suffer and the Department must ensure that their responses to system problems do not undermine their reputation for integrity of processing taxpayers' affairs.

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Report of the Comptroller and Auditor General 2003-04 133

990837_Text / Sig: 67 / Plate A

990837_Text / Sig: 67 / Plate B

Code of Practice 26

When might we not recover an overpayment

We may decide that you should not be asked to pay back all or part of an overpayment if

- you were paid too much because of a mistake by us and it was reasonable to think your award was right, or
- it would cause hardship to you or your family if you had to pay the tax credit back. We may so accept payment over a longer period of time in a case of this kind.

If we have made a mistake

If we find that, because we have made a mistake, we have not paid you all the tax credit you are entitled to, we will pay you the extra tax credit in a single sum straightaway.

We will not ask you to pay back an overpayment if it arose because we made a mistake and you could reasonably have thought your award was right. This would include cases where we instructed your employer to pay you the wrong amount of Working Tax Credit, provided you could reasonably think you were being paid the right amount.

Some mistakes by us that lead to overpaid tax credit may happen because you gave us some information and we did not act upon it. If you tell us about a change, you can expect to get a revised award notice from us within a few days. But if you tell us something and we do not act upon it within 30 working days, and you could reasonably think your tax credit award was correct, we would not ask you to pay back the additional tax credit you were paid.

It would have to be reasonable to think that your tax credit award was correct. For example, if we were paying you tax credits on the basis of the wrong number of children, that is the sort of thing we would expect you to spot on your award notice and tell us about. And we would also expect you to tell us if your employer was paying you more tax credit than your award notice said you were entitled to.

In deciding whether it was reasonable to think your award was correct, we will consider all the circumstances of your case.

We will take the same approach where the mistake that led to the overpayment was made by another Government Department.

Cases where payment would cause hardship

After considering the facts in individual cases, we may decide not to collect all or part of an overpayment of tax credit, or to allow you more time to pay, if payment would cause you and your family hardship.

If we are collecting an overpayment from 2003-04 from your payments in 2004-05, we will not normally accept that you should be expected to pay less than the 10 or 25% of payments that applies to your circumstances. If, exceptionally, you think there are particular reasons why payment at those rates would cause you hardship, you should contact us to discuss your case.

If you do contact us to say that payment would cause you hardship, we will look sympathetically at your proposals for paying us what you owe but we must take account of all the circumstances before we make a decision. We may need to talk to you before we make a decision and may ask for more information.

134 Report of the Comptroller and Auditor General 2003-04

Code of Practice 26

When might we not recover an overpayment

We may decide that you should not be asked to pay back all or part of an overpayment if

- you were paid too much because of a mistake by us and it was reasonable to think your award was right, or
- it would cause hardship to you or your family if you had to pay the tax credit back. We may so accept payment over a longer period of time in a case of this kind.

If we have made a mistake

If we find that, because we have made a mistake, we have not paid you all the tax credit you are entitled to, we will pay you the extra tax credit in a single sum straightaway.

We will not ask you to pay back an overpayment if it arose because we made a mistake and you could reasonably have thought your award was right. This would include cases where we instructed your employer to pay you the wrong amount of Working Tax Credit, provided you could reasonably think you were being paid the right amount.

Some mistakes by us that lead to overpaid tax credit may happen because you gave us some information and we did not act upon it. If you tell us about a change, you can expect to get a revised award notice from us within a few days. But if you tell us something and we do not act upon it within 30 working days, and you could reasonably think your tax credit award was correct, we would not ask you to pay back the additional tax credit you were paid.

It would have to be reasonable to think that your tax credit award was correct. For example, if we were paying you tax credits on the basis of the wrong number of children, that is the sort of thing we would expect you to spot on your award notice and tell us about. And we would also expect you to tell us if your employer was paying you more tax credit than your award notice said you were entitled to.

In deciding whether it was reasonable to think your award was correct, we will consider all the circumstances of your case.

We will take the same approach where the mistake that led to the overpayment was made by another Government Department.

Cases where payment would cause hardship

After considering the facts in individual cases, we may decide not to collect all or part of an overpayment of tax credit, or to allow you more time to pay, if payment would cause you and your family hardship.

If we are collecting an overpayment from 2003-04 from your payments in 2004-05, we will not normally accept that you should be expected to pay less than the 10 or 25% of payments that applies to your circumstances. If, exceptionally, you think there are particular reasons why payment at those rates would cause you hardship, you should contact us to discuss your case.

If you do contact us to say that payment would cause you hardship, we will look sympathetically at your proposals for paying us what you owe but we must take account of all the circumstances before we make a decision. We may need to talk to you before we make a decision and may ask for more information.

990837_Text / Sig: 67 / Plate B

Code of Practice 26 (continued)

What factors we will take into account

When we consider whether it would cause you and your family hardship if we tried to recover an overpayment, or whether we should agree to you paying back the amount over a period of time, we will take account of

- your current and future income and essential living expenses
- your savings, investments and other assets which you could use over the short to medium term to make the payments - these might make it more appropriate to delay payment than not ask for payment at all
- your other liabilities, for example, repayments of your mortgage, rent or rent arrears, overpayments of social security benefits or other debts
- whether you are due to make other payments to us, and how paying the current debt over a period of time might affect them
- how long it will take you to pay back the overpayment
- your previous payment history with us
- whether paying what you owe us would result in you not being able to afford essential services, such as gas, electricity or water, immediately or over time, because you would not be able to continue paying those bills if you were paying back your debt to us
- whether you have a child or children under five or a chronically ill or disabled person in the family whose health could be affected by your paying back the debt, even over an extended period
- any other factors which are relevant.

Source: Inland Revenue

Part 3: Stamp Duty Land Tax

Introduction

3.1 Stamp duty is a tax on documents that transfer land, buildings and shares and securities. Duty on land and buildings has existed for over 300 years. Since the early 1990s, transfers of shares and securities have also been subject to taxation, mainly Stamp Duty Reserve Tax. This part of my report looks at the Department's modernisation of stamp duty on land and buildings, with the introduction of Stamp Duty Land Tax on 1 December 2003. Stamp duty on shares and securities was not affected by this reform.

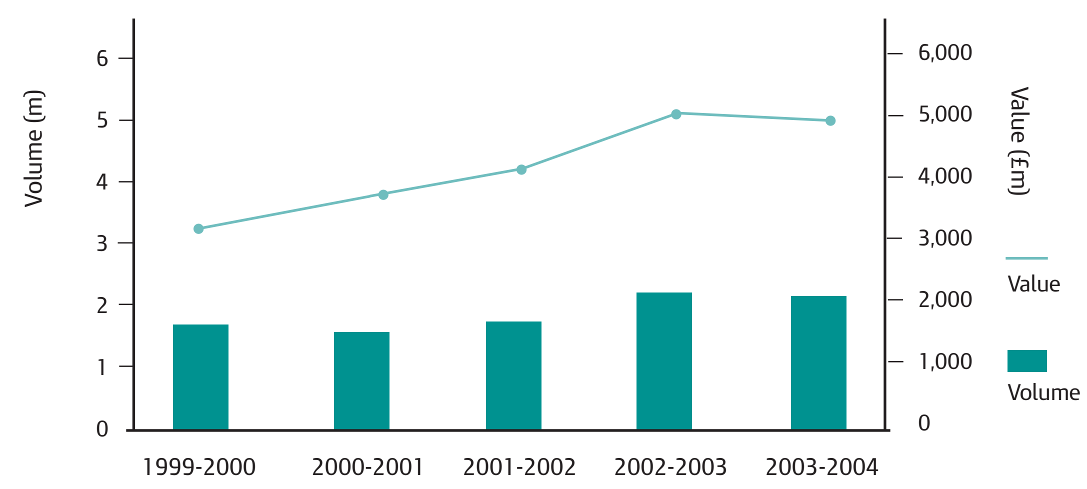
Stamp Duty on Land and Buildings

3.2 Under the former system, stamp duty on the sale or lease of land and buildings was a tax on the documents that transferred title to property. The documents were presented for stamping to the Department's Stamp Office, in order to register legal title with HM Land Registry. Prior to Stamp Duty Land Tax, the charge to stamp duty was not attached to an individual, but to documents. As stamp duty was a charge on documents, it could be avoided if the transaction was documented in a certain way. Furthermore, the charge was not attached to any particular person, making enforcement difficult even if non-payment was identified.

3.3 From the late 1990s, the Department identified an increasing risk to the stamp duty tax base. During this period, rates for stamp duty increased from a single rate of 1% for all transactions to 1%, 3% and 4% dependent on value. Avoidance of stamp duty through sophisticated tax planning techniques became more attractive, particularly in the commercial sector. By 2000, the Department found that despite the increases in tax rates, the stamp duty yield from the commercial sector was relatively unchanged, while in the residential sector it had risen in line with the increased tax rates. Together with other considerations such as electronic conveyancing and more efficient administration, Ministers decided to modernise and reform the duty.

3.4 Figure 11 shows the value and volume of stamp duty transactions on land and buildings. The volume of transactions has increased in the last five years by 26 per cent, from 1.6 million to over 2 million. Over the same period, the revenue from stamp duty has increased by 60 per cent, from £3.2 billion to £5.1 billion, reflecting the increases in stamp duty rates and rise in UK property prices.

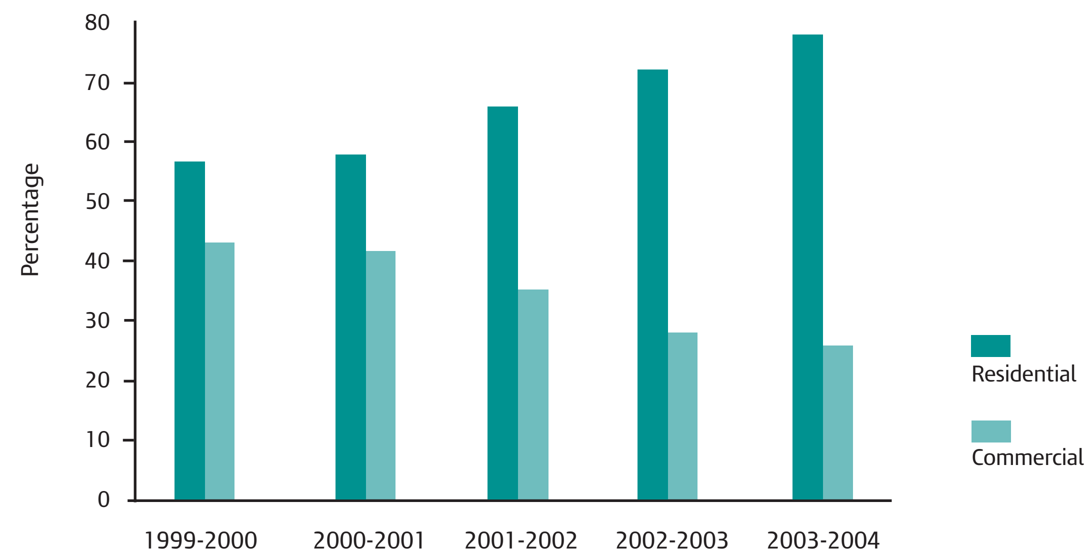
FIGURE 11: Volume and value of Stamp Duty on Land and Buildings



Source: Inland Revenue

3.5 Figure 12 shows the estimated percentage share (by value) of stamp duty between residential and commercial transactions. The percentage for commercial transactions has been decreasing, from 43% in 1999-2000 to an estimated 26% in 2003-04. This decrease demonstrates the relatively flat trend in the value of stamp duty from commercial transactions, compared with the significant increase in stamp duty from residential transactions.

FIGURE 12: Stamp Duty Share by Residential and Commercial Transactions



Source: Inland Revenue

FIGURE 11: Volume and value of Stamp Duty on Land and Buildings

Source: Inland Revenue

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FIGURE 12: Stamp Duty Share by Residential and Commercial Transactions

Source: Inland Revenue

Report of the Comptroller and Auditor General 2003-04 137

990837_Text / Sig: 69 / Plate A

990837_Text / Sig: 69 / Plate B

3.6 Figure 13 shows the main stamp duty rates applicable to land and building transactions up to November 2003. A higher threshold of £150,000 for the 1% rate for all residential transactions in designated disadvantaged areas was introduced on 30 November 2001. For non-residential transactions in designated disadvantaged areas only, stamp duty was abolished in March 2003.

FIGURE 13: Stamp Duty on Land and Property to 30 November 2003

(a) Conveyance or transfer of property

Rate%	Bands
Nil	£60,000
1	£60,001 - £250,000
3	£250,001 - £500,000
4	Over £500,000

(b) New Leases

There were two elements of stamp duty on new leases:

(i) Lease Premium

The rate of duty on the lease premium was the same as for transfers of property above, with a few limited exceptions.

(ii) Lease Rental

Term of Lease	Rate (% of average annual rent)
Under 7 years	1 (Nil if annual rent less than £5,000)
7 to 35 years	2
35 to 100 years	12
Over 100 years	24

Source: Inland Revenue

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Source: Inland Revenue

138 Report of the Comptroller and Auditor General 2003-04

990837_Text / Sig: 69 / Plate B

Stamp Duty Land Tax

3.7 The objectives for modernisation of the tax were published in a consultation document issued in April 2002 and are summarised below:

- *Fairness*

  Ministers were concerned about the increase in stamp duty avoidance, particularly the use of artificial arrangements on commercial property transactions. This was unfair to the compliant majority, especially small businesses and individuals.

- *E-business*

  Reform was necessary to facilitate the introduction of electronic conveyancing to make the property purchasing process simpler, quicker and more efficient through the submission of just one form to pay any stamp duty and register the property.

- *Modernisation*

  A revised legal framework for stamp duty was needed to bring it in line with other taxes, with a modern enforcement and compliance regime, and creating a tax charge based more on the substance of transactions rather than their legal form.

3.8 The major changes introduced with Stamp Duty Land Tax (SDLT) are outlined in Figure 14. The primary legislation for the introduction of the new arrangements was the Finance Act 2003. More detailed regulations covering exemptions, reliefs and anti-avoidance rules were issued in November 2003, a month before the introduction of SDLT on 1 December 2003. Further provisions for SDLT covering anti-avoidance were contained in the Finance Act 2004. These included rules to deal with partnership transactions so that they would be treated, as far as possible, in a similar way to other property transactions.

FIGURE 14: Major changes introduced for SDLT

- no requirement for legal documents to be sent to the Department's Stamp Office for stamping;
- introduction of a chargeable purchaser and a chargeable transaction triggered by completion, or substantial performance, of contracts;
- bringing the enforcement and compliance regime in line with other taxes, i.e. "process now, check later";
- new compliance powers of investigation and a range of appeal rights in line with other taxes;
- specific provisions to tackle avoidance of stamp duty, particularly for leases and commercial transactions;
- a standard notification and payment procedure, processed centrally, with plans for electronic transactions and e-conveyancing at a later stage; and
- a simpler lease duty, removing distortions in the previous regime, which led to decisions being tax driven rather than business driven.

Source: National Audit Office

3.9 Under SDLT the transaction must be notified to the Department, together with the payment, if appropriate, within 30 days of completion or substantial performance of the contract. The purchaser/lessee submits a standard Land Transaction Return, in most cases via a solicitor or other professional agent. The Department then issues a certificate which allows the purchaser/lessee to register title at the land registries.

3.10 The Department is a key stakeholder in the Government's project for full electronic conveyancing, led by HM Land Registry. Full e-conveyancing is some years away, but HM Land Registry expects to start a limited pilot in 2006-07. Payment of SDLT, filing of a Return and registration of the transaction will become part of one process when full e-conveyancing is available.

3.11 Figure 15 shows the rates introduced with SDLT.

FIGURE 15: Stamp Duty Land Tax from 1 December 2003

(a) Conveyance or transfer of property

Rate (%)	Residential	Non-residential
Nil	£60,000	£150,000
1	£60,000 - £250,000	£150,001 - £250,000
3	£250,001 - £500,000	£250,001 - £500,000
4	Over £500,000	Over £500,000

The threshold for non-residential transactions was raised from £60,000 to £150,000. The rates for disadvantaged areas remain unchanged, with non-residential transactions continuing to benefit from complete exemption.

(b) New Leases

(i) Lease Premium

The rate of duty on the lease premium remains the same as for transfers of property above.

(ii) Lease Rental

The tax charge of lease rental was changed to 1% of the net present value of total future rent payments.

Rate (%)	Net present value of rent	
	Residential	Non-residential
Nil	£60,000	£150,000
1	Over £60,000	Over £150,000

Source: Inland Revenue

Consultation Process for SDLT

3.12 A consultative document on modernising stamp duty on land and buildings was published in April 2002. Subsequently, the Department established a consultative committee and several subcommittees, with delegates from the property and banking sectors, the tax and legal professions and other Government departments. The consultation process continued throughout 2002 and 2003, including the publication of draft legislation in November 2002. The Department carried out separate consultations in 2003 on the proposed duty on leases and (following the publication of draft legislation in October 2003) on partnerships. Consultation on partnerships continued into 2004 and, more generally, consultation has continued with the three Law Societies representing England and Wales, Scotland and Northern Ireland.

3.13 Consultation on the introduction of any new tax is likely to result in a variety of opinions being expressed, some reflecting particular interests. The SDLT consultation process was criticised by some sector representatives and concerns were expressed that the initial consultations ended arbitrarily in 2003. They also considered that the initial provisions had not been thought through, particularly the proposed new lease duty and that some proposals would have proved unworkable in practice. The introduction of some regulations as late as November 2003 ended a period of uncertainty for business and the professions, although this was cited in the specialist media as symptoms of the perceived rushed introduction of SDLT.

3.14 The Department considered the consultation process to have been a success overall, and that the break in the initial consultation was necessary as some issues were identified such as on lease duty, that needed further consideration by the Department and ministers. The consultation also helped in the identification of many avoidance loopholes and confirmed the relatively light stamp duty tax burden on the commercial sector.

Regulatory Impact Assessment

3.15 The Department published a Regulatory Impact Assessment on SDLT on Budget Day March 2004, to assess the costs and benefits of the proposed changes. The Department stated that the introduction of SDLT would bring many benefits to business. For example, the increased threshold at which stamp duty is payable for commercial transactions.

3.16 The Department has not estimated compliance costs of the new arrangements, on solicitors and conveyancers or on businesses. The previous form for stamp duty was one page, asking eighteen questions and requiring legal documentation to be provided to allow the Department to obtain additional information to supplement that provided by the form. By comparison, the new Land Transaction Form consists of six pages and seventy questions, with supplementary forms for particular transactions and/or further details. The Department consider that the majority of transactions are straightforward and therefore will only require completion of relevant questions, with no need to provide underlying documentation. Nonetheless, they acknowledge that some unquantified costs may arise, as shown in Figure 16.

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FIGURE 16: Costs of SDLT compliance to business

- costs of notifying liability to SDLT, although the Department do not consider these to be significantly greater than previously;
- costs from complying with the Department's enquiries into transactions, especially as commercial transactions are more likely to be complex;
- Anti-avoidance provisions result in SDLT creating a tax liability on transactions that previously escaped liability. The Department estimate that this could result in up to five per cent of all commercial property deals becoming unviable where the opportunity to avoid tax has been removed.

Source: National Audit Office

3.17 The Department's Regulatory Impact Assessment describes the effect of SDLT on small businesses. The Small Business Service of the Department of Trade and Industry is clear that there are benefits to many small firms from a number of the changes introduced, such as the increased threshold at which SDLT is payable. However, they noted that although over 60% of small business leases will be exempt from tax, for some small businesses lease duty could increase three to eightfold as the tax is based on the net present value of future rent payments. The Assessment states that "a potential impact of these increases in lease duty is that some small firms may have to seek shorter leases or be less able or unable to afford rental property at all. A more comprehensive small firm impact test might have more closely identified the extent of this risk."

Anti-Avoidance Measures

3.18 The Department carried out work on the "tax gap" for stamp duty, estimating it at around £750 million per year. This estimate is based on comparisons of market data collated by property consultants with Departmental data. The Department believes that the introduction of SDLT will reduce the tax gap by about half. They estimate that the tax yield would increase by £330 million in 2004-05 and £430 million in 2005-06, through increased compliance, specific anti-avoidance measures and reform of the duty on leases. The Department is committed to keeping the tax gap under regular review.

3.19 The Department intended to close a particular avoidance loophole involving the use of "special purpose vehicles". A special purpose vehicle is created (such as a new subsidiary company controlled by the parent company) to own the land to avoid stamp duty at four per cent on the transfer of land. As the transfer occurs within a qualifying group of companies, group relief on the sale (transfer) of the land is claimed and no stamp duty is payable. The land is then transferred to a third party purchaser through the sale of the subsidiary company's shares, attracting only a half of one per cent, the rate of stamp duty on shares. The Department believed the use of special purpose vehicles was growing and represented a serious threat to the stamp duty tax base.

3.20 The Department found after the consultations in 2002, that there were legal difficulties in the proposed approach under EU law. These have limited its ability to reduce avoidance through the use of special purpose vehicles. It believes that SDLT legislation makes the use of special purpose vehicles less attractive because there are extended recovery rules. This means that SDLT will be payable if the special purpose vehicle is transferred to a third party within three years (previously two years) of the original transfer or "sale" to a subsidiary company.

990837_Text / Sig: 72 / Plate A

3.21 The Department expects the new SDLT compliance and enforcement regime to have a more general deterrent effect, for example through the possibility of an enquiry (compliance review).

The introduction of SDLT

3.22 Early in 2002 the Department established a project board to manage the modernisation of this tax. The Office of Government Commerce and the Department's Internal Audit Office have been involved from a very early stage to review and advise on the entire process. The Office of Government Commerce have a central role overseeing major system developments that are critical to government programmes, and conduct Gateway reviews during project development. They initially reported on the management processes of the project and made several recommendations, accepted fully by the Department, including improvements to project governance, defining exactly what was to be delivered and addressing the lack of experienced project management resources. The Office of Government Commerce reported again in April 2004 and made further recommendations in respect of planning for the implementation of the automated system for processing SDLT.

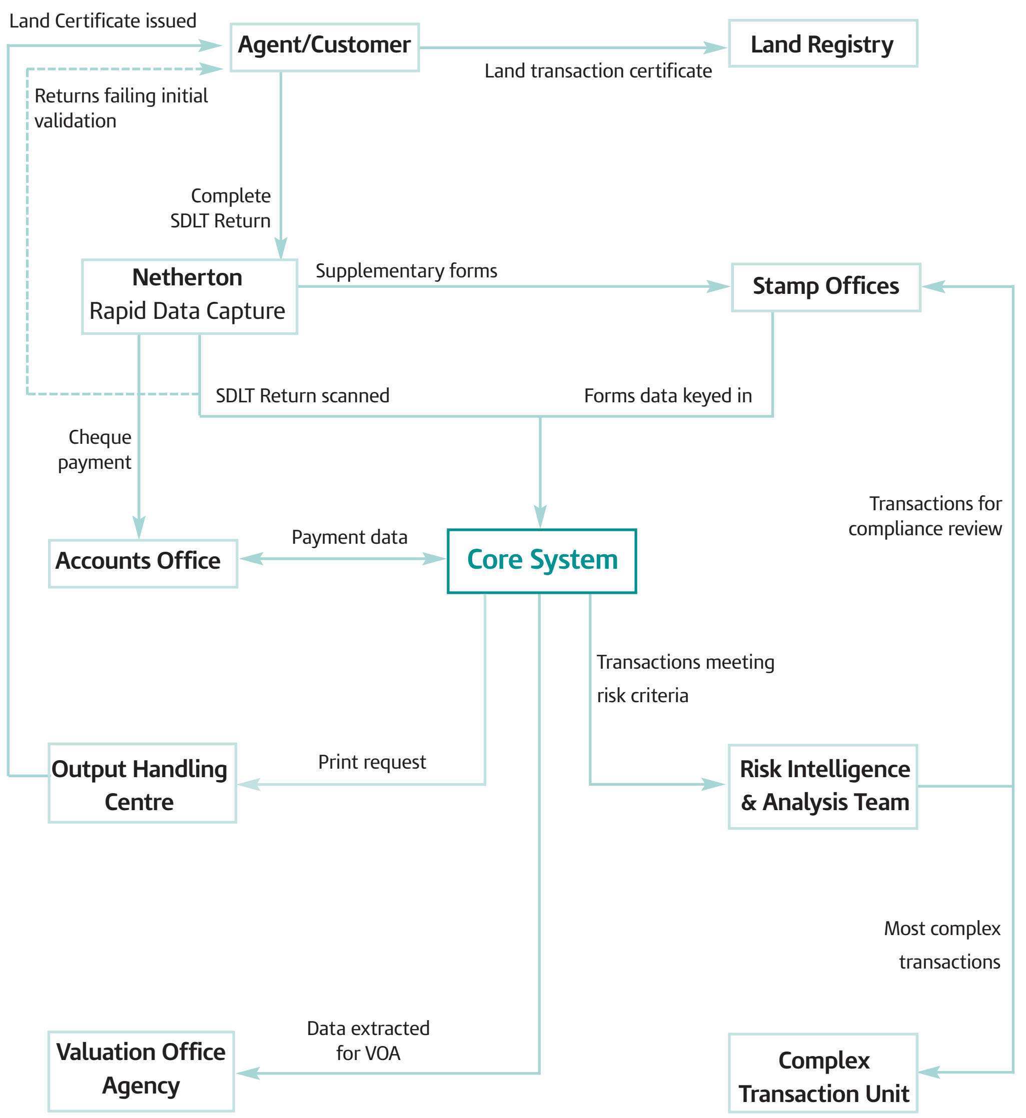
3.23 In July 2003 the Department appointed external consultants to oversee project management of the SDLT programme. The Department sought external expertise because it did not have sufficient capacity in this area. The Department stated that project managers with the right depth of experience were already engaged with other "mission critical" projects. It considered that experienced project management resource was vital due to the complexity of the project, very tight timetable and the risks of non-delivery. The Department's Internal Audit Office agreed that the consultant support was essential and that it considerably enhanced the project management process.

3.24 The Department originally intended to have in place a bespoke IT system in time for the introduction of SDLT on 1 December 2003. In June 2003, following consultation with EDS, its then IT services partner, it decided that there was a significant risk that the bespoke system would not be delivered on time. As the requirements were developed and became more clearly defined in early 2003, the Department concluded that the bespoke system would not be suitable and a package solution provided a closer match to the requirements. The Department therefore took the decision to purchase and reconfigure a software package to meet its needs. The Department believed that a package solution would reduce the risks to delivery and allow it to focus on development of key interfaces, such as for payment and accounting of transactions.

Processing SDLT returns and payments

3.25 Figure 17 illustrates the main processes for the automated SDLT system. Completed SDLT Returns are posted to the Department's Rapid Data Capture centre in Netherton, where they are scanned and the data captured. The Core system interfaces with other systems, for functions such as issuing certificates, matching Returns to payments, compliance and for transferring land/property data to the Valuation Office Agency.

FIGURE 17: Flowchart of SDLT processing



Source: National Audit Office

3.26 The Department originally intended the revised automated system to be operational in time for the launch of SDLT in December 2003. By the time of my report, this had not happened. The Department began a pilot of the automated system in July 2004, processing a limited number of freehold Returns (around 5% of transactions). Full automation for all freehold transactions (80-85% of transactions) is dependent on the results of the pilot and is now scheduled for the end of November 2004. The Department emphasised that it was following good project management practice by taking an incremental approach in order to minimise the risk of adverse impact on customer service.

3.27 Leasehold transactions have proved more problematic and system testing has revealed a high rejection rate. These problems were caused by the design of the original requirements. The Department identified necessary changes to the requirements following analysis of returns received under the manual process and test IT results. Work to resolve the problem is continuing, but a date has not yet been set for full automation of these transactions.

3.28 In view of the risk that the modified IT system would not be available by 1 December 2003, the Department began developing a manual processing system for SDLT in June 2003. The manual system generally mirrors the automated process illustrated at Figure 17, but with manually input data and manual interfaces with other functions. The NAO reviewed processes at the manual running office and found that the Department had implemented a relatively straightforward, but resource-intensive, system to process returns and issue certificates. Such a system is effective in administering the new tax as a short-term, interim measure. Moreover, it does provide a future business-continuity option if problems arise with the automated system.

3.29 Customers send Land Transaction Returns to the Rapid Data Capture centre in Merseyside, which forwards them to the manual office, where checks are performed on each Return against pre-determined criteria. Returns that are rejected outright, due to the omission of key data or payment, are returned to the customer with an explanation. Under the manual system, the Department initially set lighter criteria for rejection and a return was accepted where it would be rejected under the automated system. As part of the customer education process, these "partially correct" returns were accepted but a pro-forma letter was sent to the customer explaining the error. This light touch approach to compliance came to an end on 19 July 2004. After processing, the returns are forwarded to another area of the Department for data entry. Returns identified as high-risk are also sent to a risk and intelligence analysis team in Bristol for possible compliance review.

SDLT Compliance

3.30 SDLT gives the Department a modern enforcement and compliance regime. The legislation introduced a "liable person" and "notifiable transaction", in contrast to the charge on documents under the previous regime. The new tax gives the Department a nine-month period in which to initiate a compliance review, which may require the purchaser to produce information. The compliance strategy is based on risk criteria designed to identify high-risk transactions, such as transactions near the tax rate thresholds, non-cash consideration or where a relief is claimed. The Department intends to carry out a full compliance review of a sample of high-risk transactions. This was originally intended to cover 13,700 residential transactions and 8,000 non-residential transactions. For 2004-05, this has been significantly reduced due to the deferral of the automated system, resource considerations and the need to fully roll out training. The Department plans to cover the original number of transactions from 2005-06.

3.31 The Department has set up national compliance teams for SDLT, with specialist support from a stamp duty "Risk and Intelligence Analysis Team", which aims to identify potentially high-risk transactions for further analysis and compliance review. The Department has developed two sets of risk rules, one for the manual and one for the automated processing systems. The manual rules are less comprehensive than those for the automated system, as managing the full risk rules under manual processing would have been difficult. The Department established a Complex Transaction Unit to deal with the largest and most complex transactions.

3.32 The Risk and Intelligence Analysis Team manually sift the high-risk returns forwarded to them. Between December 2003 and April 2004 the team received around 91,000 returns representing 11.5% of total transactions in that period. Resource constraints initially limited the number of cases sent to the team. By the end of May 2004, an additional 59,000 cases had been received. The Department is developing a compliance information system, which is scheduled to come into operation in late 2004. Until that time the consistency and quality of risk assessment work undertaken on such a significant volume of returns may be at risk.

3.33 The NAO review of the compliance function found that the Department had identified transactions under many of the pre-determined risk criteria. Lease transactions are considered a risk due to their relative complexity and previous widespread avoidance, particularly for non-residential transactions. Under the new tax, leases were forecast to contribute to around half of the estimated increase in SDLT revenue. During an early stage of the manual processing arrangements, the Department identified lease transactions for compliance review by virtue of meeting other criteria and not solely because of their status as leases. This decision was taken to help manage the workload following the establishment of the new arrangements. The Department re-introduced lease transactions as a specific risk criterion in June 2004 as part of the selection process for potential enquiry cases. No statistics are yet available on the number of lease transactions forwarded for compliance review, although these will be available under the automated system. Self-certified transactions, for example purchases below the tax threshold, are notified directly to the land registries and from June 2004 the Department commenced checking around 190 self-certified transactions per month.

3.34 The Department originally considered referring all transactions greater than £1million (plus other criteria) to the Complex Transaction Unit. However, the Department found the volume of transactions too high and, on the basis of a revised risk-based approach to compliance, increased the limit to £5 million. Cases falling below the Complex Transaction Unit's threshold will be referred to other compliance teams. The NAO also noted that the Department had set very narrow criteria for reviewing transactions that are close to the SDLT tax thresholds. The Department is aware of the need to consider the impact and risks of this strategy on its ability to detect and deter non-compliance in this area.

3.35 The Department initially had a "light touch" compliance regime for the manual processing of returns. This means that some transactions were processed and certified that would be rejected under the automated system. This approach allowed time for solicitors and other agents to become familiar with the new forms and processes, prior to automation. The Department announced that, during the light touch period, penalties would not apply if the return was received within 40 days (normally 30 days). However, initially no penalties or interest were charged even for returns received after 40 days, because there was no cost effective means of automatically calculating and sending penalty/interest notices. The Department commenced a process to collect late filing (fixed) penalties on 1 June 2004. The full penalty determination and appeal process was still being finalised, as the Department had focused on the operational aspects of the new tax. The light-touch regime ended on 19 July 2004, when penalties and interest were charged after 30 days.

3.36 Some aspects of SDLT are complex, particularly the regulations on lease transactions and when they are notifiable. This reflects the complexity of tax avoidance arrangements. The complexity will challenge the ability of the Department to carry out enforcement and ensure compliance with the new rules. For instance, all new leases for seven years or more (and where consideration is payable) are notifiable transactions regardless of whether SDLT is payable. Leases for less than seven years and with a liability to SDLT are also notifiable. Figure 18 illustrates the notification requirements in certain instances.

3.37 The Department states that such rules are required to combat avoidance of SDLT lease duty, which was prevalent under the previous regime. There is widespread acknowledgement across the tax and legal professions that the new rules will significantly improve compliance rates. However, there are challenges for the Department in identifying transactions that are not notified, which will impact on its ability to tackle evasion of SDLT. An important role of the Risk Intelligence and Analysis Team will be to identify such transactions.

3.38 The new compliance regime for SDLT will involve closer working between SDLT compliance staff and others across the Department and HM Customs & Excise. Integration of the two departments should also assist in this.

3.39 The Department have introduced a wider compliance strategy for SDLT, where enquiries undertaken by tax inspectors on corporation tax or income tax self-assessment will also consider any transactions liable to SDLT. This wider compliance work in the more complex aspects of the tax, for example leases, will only be fully effective if there is active checking of transactions during tax enquiries. The Department is initially revising its training courses for tax inspectors to widen knowledge of SDLT and is actively seeking to improve procedures to highlight the importance of SDLT compliance work. The Department will keep these measures under review as the new arrangements become more established.

3.40 The NAO noted that there may be conflict between the timing of different tax enquiries. For example, SDLT has a nine-month enquiry period, whereas the timetable for other enquiries, such as corporation tax or income tax returns, is considerably longer. This conflict reflects the differing nature of the transaction-based SDLT. The Department stated that the arrangements for SDLT are more in step with the transaction-based enquiries undertaken by HM Customs & Excise and that this will be a factor for consideration as the two departments integrate. The Department also has “discovery powers” to re-open or initiate further enquiries if any additional information is received on the transaction at a later date.

3.41 The effectiveness of the Department’s enforcement and compliance regime for SDLT can only be evaluated fully at a future point in time.

FIGURE 18: SDLT rules on leases

Contingent/uncertain rents

- If the rent varies, e.g. based on a percentage of turnover, the lessee is required to submit an SDLT return based on an estimate of expected rental payments in the first five years. For the remainder of the lease term over five years, the highest amount of rent due for any consecutive 12 month period in the first five years is used in the net present value calculation. A further SDLT return will have to be submitted at the five year point, using the highest amount of rent paid in any consecutive 12 month period for the remainder of the lease term.

Rent increases within five years

- After submission of a SDLT return, any increases in rent in the first five years of a lease but not provided for in the lease are notifiable, with the lessee required to pay the additional tax.

Rent increases after five years

- All rent changes after 5 years of the lease term are ignored for the purpose of the tax calculation. For rental due after five years, the highest rent paid in any consecutive 12 month period is used in the calculation for the remainder of the term. However, if after five years the rent increases by more than 5% plus RPI, the increase is deemed the grant of a new lease and SDLT payable.

Assignment of leases

- If a premium is paid on the assignment of a lease, SDLT is also payable. Where a lease has benefited from a relief on the initial transaction, future assignment of the lease to another party is deemed as the grant of a new lease by the assignor. SDLT is payable by the assignee.

Extension of leases during their term

- The extension of a lease is treated as the grant of a new lease for the period by which the term of the lease is extended. This will be deemed a transaction linked to the original lease, requiring notification if the extended term is seven years or more.

Continuation of leases indefinitely

- Where the term of a lease ends and the landlord does not repossess the property, the continuation is treated as if the lease has become one year longer than the original term, and further years if it continues. These leases become linked transactions. Similarly, a lease granted for an indefinite period is deemed to be for an initial period of 12 months. If it continues thereafter the term is treated as increasing, a year at a time, also becoming linked transactions. All linked transactions are notifiable whenever the rents reach the SDLT threshold or the total term of the lease becomes seven years or more.

Source: Inland Revenue

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Conclusions

3.42 The Department modernised stamp duty on land and buildings with the introduction of Stamp Duty Land Tax on 1 December 2003. New legislation, together with regulations and consequent administrative procedures and checks, sought to minimise recognised stamp duty tax avoidance. These measures, however, did not fully close all the known tax avoidance opportunities.

3.43 There was a tight timetable for consultation, legislation and system development for Stamp Duty Land Tax. The Department properly recognised six months before the implementation date of 1 December 2003 the need to develop rapidly and deploy manual contingency arrangements, while a fully automated system continued to be developed, tested and delivered. The Department considered that deferring delivery of the automated system was necessary to meet the overall timetable. The new tax was implemented without the introduction of an automated system and the success of the interim, manual arrangements is a credit to those involved. Government departments have experienced previous problems with tight IT project timetables and there would have been advantages had the Department been able to introduce the IT system to the original timetable. There are lessons to be learnt from tight timetables which need to be allowed for when planning future projects.

3.44 The Department is developing IT systems to remedy the limitations in procedures and controls during manual running. During that period some compliance work was undertaken to a lower level than planned and the Department plans to introduce a more comprehensive approach. This will only be fully effective once the IT systems are in place. The Department need to remedy the current limitations and ensure that this work is undertaken comprehensively for the future.

3.45 The Department has found difficulties in an important area where it had hoped to reduce avoidance, because EU law limits its ability to take action. The Department should continue to review the tax revenues still at risk even though they have introduced these new arrangements and identify new ways of countering avoidance of Stamp Duty.

990837_Text / Sig: 75 / Plate A

Report of the Comptroller and Auditor General 2003-04 **149**

Conclusions

3.42 The Department modernised stamp duty on land and buildings with the introduction of Stamp Duty Land Tax on 1 December 2003. New legislation, together with regulations and consequent administrative procedures and checks, sought to minimise recognised stamp duty tax avoidance. These measures, however, did not fully close all the known tax avoidance opportunities.

3.43 There was a tight timetable for consultation, legislation and system development for Stamp Duty Land Tax. The Department properly recognised six months before the implementation date of 1 December 2003 the need to develop rapidly and deploy manual contingency arrangements, while a fully automated system continued to be developed, tested and delivered. The Department considered that deferring delivery of the automated system was necessary to meet the overall timetable. The new tax was implemented without the introduction of an automated system and the success of the interim, manual arrangements is a credit to those involved. Government departments have experienced previous problems with tight IT project timetables and there would have been advantages had the Department been able to introduce the IT system to the original timetable. There are lessons to be learnt from tight timetables which need to be allowed for when planning future projects.

3.44 The Department is developing IT systems to remedy the limitations in procedures and controls during manual running. During that period some compliance work was undertaken to a lower level than planned and the Department plans to introduce a more comprehensive approach. This will only be fully effective once the IT systems are in place. The Department need to remedy the current limitations and ensure that this work is undertaken comprehensively for the future.

3.45 The Department has found difficulties in an important area where it had hoped to reduce avoidance, because EU law limits its ability to take action. The Department should continue to review the tax revenues still at risk even though they have introduced these new arrangements and identify new ways of countering avoidance of Stamp Duty.

990837_Text / Sig: 75 / Plate B

Appendix 1
Results 2003-04

TABLE 1 Cost of collection (pence per £ collected)

	1999-00[1]	2000-01[2]	2001-02[3]	2002-03	**2003-04**
Income Tax	1.59	1.36	1.38	1.41	**1.42**
Corporation Tax	0.76	0.98	1.01	1.15	**1.25**
Petroleum Revenue Tax	0.24	0.15	0.20	0.26	**0.18**
Capital Gains Tax	1.49	1.33	1.44	2.73	**2.13**
Inheritance Tax	1.46	1.23	1.21	1.38	**1.25**
Stamp Taxes	0.11	0.09	0.11	0.17	**0.43**[4]
National Insurance Contributions (NICs)	0.57	0.59	0.67	0.66	**0.42**
Overall cost (pence per £ collected)	1.08	1.02	1.06	1.11	**1.04**
Tax Credits (pence per £ paid)[5]	3.29	2.94	2.53	2.21[6]	**2.96**
Child Benefit (pence per £ paid)	-	-	-	-	**0.55**

1 In the 1999-00 report, the published ratio for Income Tax also included NICs costs and receipts, in addition to Tax Credit costs and payments. Since NICs are now shown separately and the reporting of Tax Credits has also changed, the figures here for 1999-00 have been adjusted and exclude NICs.
2 The one-off STEPS receipt in 2000-01 has been excluded.
3 From 2001-02, ratios are now based on Resource spend rather than Cash.
4 The 2003-04 ratio was affected by temporary manual processing prior to the introduction of automated processing of SDLT forms.
5 The ratio for 1999-00 excludes payments of Family Credit and Disability Working Allowance also made between October 1999 and March 2000.
6 Excludes costs of preparing for child and working tax credits; if these are included the ratio is 4.58 pence per £ paid.

TABLE 2 Standards of service Local Offices

	2003-04 Target %	**2003-04 Result %**
Dealing with correspondence within 15 working days	77	78.7
% of post dealt with correctly and completely	80	86.2
Telephone calls answered within 20 seconds	90	92.4
Personal callers to Inland Revenue Enquiry Centres attended to within 15 minutes	85	86.2

TABLE 3 Contact Centres

During 2003-04 the level of demand from Tax Credit callers was much higher and more sustained than expected. The demand made it impossible for our contact centres to run on a "business as usual" basis and, in order to reflect the extraordinary measures that had to be adopted, the telephony targets were changed from call volume to caller accessibility measures. Our performance against these is shown below.

	2003-04 Target %	**2003-04 Result %**
% of new tax credits callers to be answered on the day of call	95	**99.7**
% of other callers to be answered on the day of the call	65	**87**
% of calls handled to be dealt with correctly and completely	75	**80**

TABLE 4 Results of work tackling non-compliance

Summary of additional liability

	2002-03 (£m)	**2003-04 (£m)**
Network offices		
Results in terms of additional tax, interest and penalties:		
Company enquiries		
full	78.5	92.0
aspect	422.9	490.8
SA enquiries		
business full	160.4	173.1
business aspect	86.2	82.4
non business	219.7	212.3
Employer reviews		
full	182.6	177.0
aspect	76.2	104.1
Intelligence work	18.0	21.4
Late filing penalties[1]	88.5	89.9
Total additional liability	**1,333.0**	**1,443.0**
Specialist offices		
Results in terms of additional tax, duty, interest and penalties:		
Tax Credit Office	WFTC-DPTC	CTC-WTC[4]
	32.2	66.7
Special Compliance Office[2]	345.1	387.7
Special Investigations Section	214.3	238.8
Capital Taxes	135.4	126.4
Saving, Pensions, Share Schemes	20.4	19.0
Stamp Taxes	36.3	35.6
IR Charities	6.7	11.4
IR Trusts	14.5	15.3
Profit Related Pay	1.5	-
Large Business Office[3] - CT	1,712	1,737.8
Large Business Office - Employer Compliance	51	51.7
International: Energy group	84.6	85.9
International: Business Tax group	285.9	335.0
International: Centre for Non Residents	13.9	15.7
Special Trade Investigation Units	10.2	12.9
Sub-total	**2,964.0**	**3,139.9**
Total estimated additional tax liability	**4,297.0**	**4,582.9**

1 These are amounts actually collected, rather than an amount based on the number of penalty notices issued. This is because the £100 late filing penalty is reduced to the amount of tax agreed to be due once the return is filed, if that is less than £100, and can be set aside altogether in certain limited circumstances (such as bereavement close to the filing date).
2 Includes yield from the work of the Foreign Entertainers Unit of £41.5m in 2002-03 and 47.1m in 2003-04.
3 The Large Business Office's work includes some very complex enquiries, which may take several years to settle. Yield figures from year to year vary, depending in particular on the number and tax effect value of complex enquiries brought to settlement.
4 This is the excess tax credits paid before we detected and corrected the customer's error, based on the information available about entitlement at the point of intervention. If the customer was never entitled to tax credits, the excess is directly recoverable. If the customer has some entitlement for the year, we will reduce or stop their payments to ensure that the amount paid for the year is as close as possible to their entitlement. If any of the overpayment identified at intervention remains when their entitlement is finalised at the end of the year, we may recover this from them either directly or by deduction from future tax credit payments.

TABLE 5 Estimated Yield-Cost Ratios[1]

	2002-03	**2003-04**
Network Offices		
Full enquiry work[2]		
Corporation Tax enquiries	2.0:1	**2.2:1**
Self Assessment business enquiries	1.3:1	**1.3:1**
Aspect Enquiry work		
Corporation Tax enquiries	8.7:1	**9.4:1**
Self Assessment business enquiries	3.4:1	**3.2:1**
Employer reviews	3.1:1	**3.2:1**
Other		
SA non business enquiries	6.0:1	**5.6:1**
Other Specialist Offices		
International: Business Tax group	114:1	**123.1**
International: Centre for Non-Residents	24.8:1	**20.1:1**
International: Energy group[3]	26.7:1	**24.9:1**
Special Compliance Office (civil cases)[4]	18.8:1	**18.4:1**
Special Investigations	350.1:1	**419.3:1**
Large Business Office - CT	55.7:1	**54:1**
Large Business Office - EC	6.8:1	**6.4:1**

1. In calculating these ratios the total of the additional amounts brought into charge from each activity is compared with the costs of salaries, accommodation and other direct operating overheads. Some of the additional amounts may not actually be collected.
2. Where serious irregularities are identified in full enquiry cases taken up in the network, the enquiries are passed to Special Compliance Office who work the cases to conclusion. The yield is reported with Special Compliance Office's yield, but the costs incurred in the network are included in the calculation of yield:cost ratios for full enquiry work. The additional amounts identified by the network at the time the case is passed over are around £40m in 2003-04 (£37m in 2002-03) .
3. This ratio is an aggregate of the results from Corporation Tax and Petroleum Revenue Tax activities.
4. The costs associated with criminal prosecution work have been excluded from the calculation. In 2002-03, 84 prosecutions were concluded at a unit cost of £148,504. For 2003-04 we concluded 110 prosecutions at a unit cost of £140,766.

NB
Yield/Cost ratios

Yield/cost ratios - the ratio between the cost of a particular enforcement activity and the amount of tax brought into charge as a direct result - are used as one of a number of factors to help management make considered judgements on the allocation of resources. They are useful in providing retrospective comparison of the cost-effectiveness of individual types of enforcement work. But the yield/cost ratio is not the only criterion in deciding how staff are deployed. While maintaining and improving cost-effectiveness is a major consideration, it is also important, for the sake of both fairness and deterrence, to maintain an effective presence in all areas where there may be non-compliance. Moreover, there are areas, notably prosecutions, where direct yield/cost ratios have little relevance.

No account is taken of the corrective or deterrent effects; although largely unquantifiable, they are almost certainly substantial. For instance people who have been investigated are likely to improve their standard of compliance in future years. Research on unincorporated businesses which have been investigated suggests that this improvement is maintained for at least five years, effectively doubling the direct yield.

TABLE 6 Criminal Proceedings 2003–04

Nature of offences	Guilty	Acquitted	No evidence offered	Proceedings stayed
False Accounts/Returns	9	1	0	0
False Claims/Deductions	2	2	0	0
PAYE: False Returns	7	0	1	0
Contrived Liquidations	1	0	2	0
Failure to Notify Chargeability	1	0	0	0
Tax Credits	56	1	2	0
Grabiner	8	0	0	0
Internal Fraud:				
Internal Staff	6[1]	0	0	0
Outside accomplices	9	1	1	0
TOTAL	**99**	**5**	**6**	**0**

1 In addition, disciplinary proceedings are taken against staff for serious misconduct, such as misuse of the Department's computer equipment, in cases where criminal proceedings are not appropriate.

TABLE 7 Compliance assurance

Cases taken up

	2003–04 Target	**2003–04 Result**
CT Full	4,673	**4,789**
CT Aspect	39,999	**41,083**
IT Full	35,600	**36,075**
IT Aspect	41,195	**42,769**
Personal	138,434	**142,603**
Employers Reviews	31,222	**31,500**

Appendix 1 153
990837_Text / Sig: 77 / Plate A

TABLE 8 Capital Taxes

	2003-04 Target	**2003-04 Result**
Customer Service		
Service Standards		
% of IHT Service post dealt with within 15 working days	80	80
% of IHT Service post dealt with within 40 working days	95	97
% direct dial telephone calls answered within 20 seconds	90	94
IHT Helpline calls dealt with correctly and completely	80	95
% of IHT death accounts processed within 7 working days	98	98
% of IHT death accounts dealt with within 3 months	95	96
% of taxpayer service work dealt with to an acceptable or better standard	95	92
Receivables management		
% of tax calculations paid within 90 days	94	**95**
Tackling non-compliance		
Number of enquiries into IHT accounts	3,450	**3,603**
IHT enquiry cost/yield ratio	1:22	**1:15**
% enquiries/valuations dealt with to a satisfactory or better standard	96	**95**
Share Valuation cost/yield ratio	1:14	**1:28**
Share Valuations settled	22,000	**23,605**

TABLE 9 Stamp Taxes

	2003-04 Target/ Forecast (F)	**2003-04 Result**
Stamp Duty Only		
Customer Service		
% of documents/correspondence processed within 5 working days of receipt.[1]	95.5	**90**
Compliance		
Intervention rate (%)[2]	1.28	**0.38**
Additional duty collected per intervention (£)	750	**1,728**
Accuracy rate (%)	97	**97**
Duty at risk (%)[3]	0.50	**0.52**
Cost Efficiency[4]		
Transactions processed per staff year (thousands)	11.7(F)	**7.2**
Cost of processing one transaction (£)	2.74(F)	**5.22**
Cost of collecting £100 of duty (£)	0.13(F)	**0.23**
Stamp Duty Reserve Tax Only		
Cost Efficiency		
Cost of collecting £100 of duty (£)	0.03(F)	**0.03**

1 This target was originally set on the assumption that the automated SDLT system would be operational from 1-12-03, date of introduction of SDLT. Our changed requirement to establish a manual processing office prior to the introduction of the automated process, impinged on our ability to achieve original target.
2 The proportions of documents for which we seek further information and/or alternative levels of duty.
3 The additional proportion of duty that should have been charged against duty that was charged, based on sampling.
4 The 2003-04 results were affected by temporary manual processing prior to the introduction of automated processing of SDLT forms.

TABLE 10 Oil Taxation

	2003-04 Target	**2003-04 Result**
Customer Service		
Correspondence turnaround		
% dealt with within 28 days	90	**93.3**
% dealt with within 56 days	98	**96.8**
% dealt with within 90 days	100	**98.6**
% North Sea clearance applications dealt with within 15 days	100	**100**
% repayments made within 28 days	100	**97.6**
Compliance		
% PRT returns dealt with within 10 weeks	100	**100**
% PRT assessments made by due date	100	**96.2**

Cost Efficiency	2002-03 Result	**2003-04 Result**
PRT returns	488	**622**
PRT Exp. Claims	472	**420**
CT Accounts	1,544	**1,597**

TABLE 11 Valuation Office Agency

	2003-04 Target	**2003-04 Result**
1. Valuation Accuracy		
Contain reductions in 2000 local Rating Lists to less than 7.5% in respect of compiled list appeals settled in 2003-04	7.5%	**6.1%**
And to a maximum of 4.7% of the total compiled list rateable value over the entire life of the 2000 Rating Lists	4.7%	**4.2%**
2. Revaluations		
Prepare for the forthcoming revaluation of non-domestic properties in England and Wales by completing 85% of the initial valuations required	85%	**91%**
Prepare for the forthcoming revaluation of domestic properties in Wales by completing 50% of initial bandings required	50%	**71%**
Prepare for the forthcoming revaluation of domestic properties in England by digitising data in respect of a minimum of three million properties	3.00m	**9.36m**
3. Rating Appeal Programming		
Make draft programmes available by 31 July 2003	Yes	**Yes**
Publish final programmes by 1 October 2003	Yes	**No**
And adhere to the start date in 95% of cases	95%	**97%**
4. Customer satisfaction		
Improve customer satisfaction, based on annual surveys, to 86% satisfaction	86%	**84.5%**
5. Value for money		
Improve productivity by 2.5%	2.5%	**2.9%**
6. Land Services		
Achieve a fee income of £17.8 million	£17.8m	**£18.1m**
ensuring that its share of VOA costs is covered	Yes	**Yes**
7. People satisfaction		
Improve staff satisfaction in working for the VOA in comparison with other places of work, based on annual surveys, by 2%.	Yes	**Yes**
8. Financial "break even"		
Recover full resource costs, including a return on capital of 3.5%, from fees and charges	Yes	**Yes**

TABLE 12 National Minimum Wage

Number of compliance cases completed

	2003-04
Tax Credit referrals	2,937
Complaints about non-receipt of NMW	1,886
Other	718
Total	**5,541**[1]

1 A reduced target for closed cases was agreed with DTI to reflect the continued drive to increase the quality of our compliance work..

TABLE 13 Helplines

Number of enquiries received

	2003-04[1]
Telephone	56,672
Written	981
e-mail	1,055
Total	**58,708**

1 Our dedicated Helplines handle enquiries from the public on all matters concerning the minimum wage. Figures cover the 3 NMW Helplines (Longbenton, Belfast and Glasgow).

TABLE 14 Complaints about non-payment of Minimum Wage

Number of complaints received

1999-00	2000-01	2001-02	2002-03	**2003-04**
4,682	2,365	1,722	1,998	**1,969**

TABLE 15 Amounts of Tax remitted or written off as irrecoverable

Remissions - Amounts written off £ thousands[1]

Year to 31 October[4]	Total	Income Tax	Surtax	Corporation Tax	Capital Gains Tax	Development Land Tax[3]	Inheritance Tax[2]	Other Duties
1994	1,159,375	849,594	18	265,383	42,413	1,155	787	25
1995	755,995	592,766	8	126,792	33,780	124	2,123	402
1996	585,820	471,005	3	90,032	23,475	216	1,000	89
1997	509,043	396,591	-3	94,351	15,583	0	2,496	25
1998	620,940	483,013	-2	110,241	23,234	0	2,457	1,997
1999	526,984	426,352	0	79,111	14,957	0	2,771	3,793
2000	421,228	322,886	0	86,910	6,329	0	1,907	3,196
2001	506,571	367,776	0	125,989	9,485	0	1,206	2,115
2002	522,734	386,263	0	125,676	7,065	0	1,597	2,133
2003	578,588	345,466	0	224,981	4,337	0	995	2,809

1 Throughout the table totals and subtotals have been rounded separately.
2 Includes Estate Duties and Capital Transfer Tax.
3 Development Land Tax ceased in 1997.
4 Inheritance Tax and Other Duties are for the year to the following March.

TABLE 16 Grounds on which Tax remitted or written off as irrecoverable

Remissions - Amounts written off £ thousands[1]

Year to 31 October	Total	Hardship[1]	Equity	Miscellaneous[2]	Insolvency	Composition Settlements[3]	Taxpayer Gone Abroad or Untraceable
1994	1,159,375	4,404	4,386	174,068	861,810	2,359	112,348
1995	755,995	3,957	3,713	85,863	582,076	862	79,524
1996	585,820	4,106	5,519	48,101	456,617	3,064	68,413
1997	509,043	2,707	6,001	36,979	410,996	3,206	49,154
1998	620,940	2,440	6,472	48,859	519,855	1,700	41,614
1999	526,984	2,240	6,490	35,642	449,217	1,160	32,235
2000	421,228	3,826	3,382	31,983	355,275	1,265	25,497
2001	506,571	2,276	6,118	40,102	415,990	2,397	39,688
2002	522,734	3,265	7,799	110,122	336,730	4,084	60,734
2003	578,588	3,635	8,188	34,610	502,787	2,898	26,470

1 The amount remitted on grounds of hardship includes cases of Official Error dealt with under Extra Statutory Concession A19. For 2003 there were 2,722 such cases involving £3,524,086. In addition for 2003, in a further 54,586 cases of Official Error, an estimated amount of £19,057,821 was left out of assessments on grounds of hardship.
2 Eg amount recoverable insufficient to justify the cost of proceedings.
3 Tax written off following acceptance of an amount less than the full tax assessed. In such cases the amount accepted in settlement of the liabilty is not less than the amount likely to be obtained as a result of formal proceedings.

990837_Text / Sig: 80 / Plate A

Appendix 2
Recruitment and Diversity statistics

Recruitment

TABLE 1 Recruitment in the year ended 31 March 2004

Band	Number	Male %	Female %	Ethnic Minority %	Disabled %
Senior Civil Service	11	73	27	0	0
B1	16	81	19	0	0
B2	52	52	48	1.9	0
T	23	57	43	0	4.3
C1	13	31	69	0	0
C2	23	52	48	4.3	0
D	648	47	53	7.2	1.5
E1	4,586	42	58	3.3	1.3
E2	2,407	38	62	6.3	2.8
TOTAL	**7,779**	**42**	**58**	**4.5**	**1.8**

TABLE 2 Use of the permitted exceptions to the Civil Service Commissioners' Code on Recruitment

Exception	Number	Reason
Conversion from short appointment to permanency	7	Changed circumstances with significant risk of impact on the business.
Secondments	10	
Re-appointments	23	
Disabled candidates appointed under modified selection	2	Guaranteed Interview Scheme
New Deal	7	Appointed under special scheme for New Deal job seekers

Our recruitment procedures, which are audited annually by our Internal Audit Office, ensure that we comply with the Civil Service Commissioners' Recruitment Code. There are no other exceptions to report other than those shown above.

Diversity

TABLE 3 Women

Band	1/4/98 %	1/4/99[1] %	1/4/00 %	1/4/01 %	31/3/02[3] %	31/3/03 %	**31/3/04 %**
Senior Civil Service	8.9	11.4	15.4	19.2	20.3	21.9	**23.7**
B & T[2]	22.6	22.6	23.6	24.5	25.6	27.1	**28.2**
C1	21.8	23.2	26.5	28.2	31.0	33.1	**34.9**
C2	36.6	37.4	39.0	40.0	41.6	42.5	**44.4**

TABLE 4 People from ethnic minorities

Band	1/4/98 %	1/4/99[1] %	1/4/00 %	1/4/01 %	31/3/02[3] %	31/3/03[4] %	**31/3/04[5] %**
Senior Civil Service	2.1	1.7	1.7	1.9	1.9	1.3	**2.7**
B & T[2]	1.5	1.7	1.4	1.5	1.6	2.9	**3.3**
C1	2.1	2.4	2.7	2.8	2.9	3.9	**3.4**
C2	3.4	4.0	4.0	4.1	4.2	5.8	**5.1**

TABLE 5 People with disabilities[4]

Band	1/4/99[1] %	1/4/00 %	1/4/01 %	31/3/02[3] %	31/3/03[4] %	**31.3.04[5] %**
Senior Civil Service	2.9	3.2	2.7	3.0	3.0	**5.4 (3.5)**
B & T[2]		2.8	2.9	3.0	4.3	**8.1 (5.1)**
C1	4.4	4.4	4.3	4.0	5.6	**10.4 (6.0)**
C2	3.8	3.8	3.7	3.6	5.4	**10.0 (5.8)**

Notes to Tables 3 to 5

1. Figures do not include NICO staff
2. Band T is primarily a training grade comprising people on development programmes leading to Band B.
3. Figures shown at 31 March 2002 because of database changes to reflect new Cabinet Office codes (post 2001 census)
4. Incomplete data following a re-survey of equal opportunities information.
5. Our disability and ethnicity figures are shown as a % of the known information. Until this year, for disability, the "not knowns" were added to the non-disabled figure and this is shown in brackets for comparison purposes.

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