

Summary

The revenue departments are responsible for key financial and regulatory relationships between the Government, individuals, and businesses. They collect the bulk of tax revenue and are involved in payments to citizens and in enforcing a range of regulations from the minimum wage to protecting the UK's borders against terrorist weapons. As a result, the effectiveness of the way they are organised is central to the implementation of many Government policies.

The two organisations' structures and roles have evolved over a long period and are still evolving – e.g. the recent extension to the Revenue's role to cover tax credits. Traditionally, information and knowledge were held on paper and customer contact was face to face or by letter. Technology and customer preferences are changing this – information is increasingly held electronically and contact is often by telephone or the Internet.

Through the similarity of their role there is considerable overlap in functions – both are involved in policy to some degree, but more importantly, both are responsible for the administration of large scale operations involving educating and advising individuals and businesses; collecting and processing large amounts of data; managing large financial flows between Government and individuals/businesses; and ensuring compliance with financial and other regulatory obligations.

Although the commonality of their basic functions has meant considerable similarity in the way they operate, there are also significant differences. The review's functional analysis draws these out. While both deploy significant numbers of staff on compliance work, a large part of the Revenue's workforce is focussed on transactional activity. This reflects their larger and more diverse customer base. In Customs a larger proportion of staff are engaged in activities related to tackling non-compliance.

There is some overlap in customer bases – both deal with large numbers of businesses – though each department also has its own specific groups of customers. The largest businesses have substantial dealings with both departments and pay a large proportion of taxes, either directly or through their administration of income tax, national insurance and tax credits for their employees.

Because both departments deal with large numbers of customers, both are involved in large-scale operations throughout the country. An objective for both is to do this in a way that limits the burden on those customers.

Together the revenue departments have almost 100,000 staff, almost 20% of the civil service, so the efficiency with which they operate is also crucial for the overall efficiency of Government.

There is no single international model of best practice, but there are patterns, including: the integration of VAT administration with other taxes; a trend away from organisation of administration by tax type towards organising by function and customer; the exploitation of new technology; and, in terms of governance, most revenue administrations reporting to the finance ministry or treasury.

INTRODUCTION

2.1 This Chapter includes description and analysis of the revenue departments’:

- role, structures, and efficiency strategies;
- functions, which underpins the review’s analysis;
- customers, the overlap between them, and their needs;
- compliance strategies; and
- international comparators.

Departments’ roles

2.2 The Revenue is responsible for collecting Income, Corporation, Capital Gains, Inheritance, and Petroleum Revenue Taxes, as well as Stamp Duty. In recent years it has taken on new businesses including National Minimum Wage compliance, and has taken over some functions from what is now the Department for Work and Pensions (DWP):

- the National Insurance Contributions Agency, in April 1999;
- the Family Credit Unit, now the Tax Credit Office, in October 1999; and
- the Child Benefit Office, in April 2003, formerly the Child Benefit Centre.

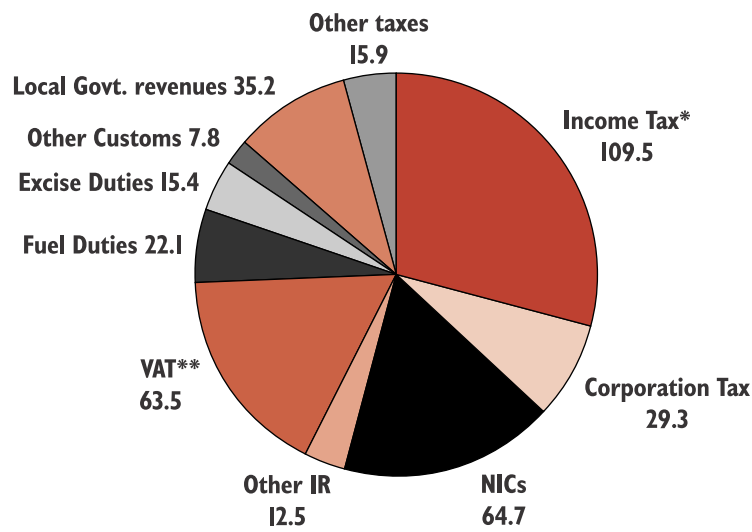
2.3 Customs is responsible for collecting VAT, Customs Duties, Insurance Premium Tax and the excise duties on fuel, tobacco, alcohol, and betting and gaming. It has also been given responsibility for a range of environmental taxes – climate change levy, aggregates levy and landfill tax – and for developing the new lorry road-user charging scheme (see Box 2.2 for latest developments). Chart 2.1 shows the estimated breakdown of tax receipts.

Revenue collection

2.4 In 2002-03 net taxes and social security contributions to Government amounted to £375.8 billion, made up of £216.0 billion from the Revenue, £108.7 billion from Customs, and a further £51.1 billion from other sources (local government taxes, vehicle licence duty etc.). In that year the revenue departments were thus responsible for collecting almost £325 billion or 86% of net taxes and social security contributions. The ratio of tax to GDP was 35.6% in 2002-03.¹

¹ Figures in this paragraph can be found in the Pre-Budget Report, December 2003, available at www.hm-treasury.gov.uk.

Chart 2.1: Government tax receipts, 2002-03 (£ billion)



*Income tax figure net of tax credits **VAT figure net of £43 billion of repayments
 Source: See Table 3.3 in Chapter 3 - 'Receipts', 'End of Year Fiscal Report' December 2003

ORGANISATIONAL STRUCTURE

Legal status 2.5 Tax is a long-standing activity of the state – one historian has called it the “price of civilization”² – and the revenue departments are among the oldest Government departments. The departments’ statutes establish Commissioners constituting a Board who have powers of “care and management” for various taxes and other functions (i.e. the powers necessary to collect taxes, and engage in law enforcement). The Commissioners are accountable for the exercise of these powers to Parliament and to the Chancellor, as ‘non-ministerial departments’ (see Chapter 6). The revenue departments have no statutory role in providing policy advice, but they do in practice provide such advice.

Staff 2.6 The performance of the staff of Customs, the Revenue, and the Treasury is key to their continued success (see Box 2.1). The three departments plan to employ around 100,000 people in 2003-04, representing almost a fifth of the civil service.³ The Revenue currently employs 68,700 people,⁴ three times the 21,600 who work for Customs. Chart 2.2 shows staffing levels over time. Key to understanding recent trends is the new business that the Revenue has taken on since 1999, particularly tax credits and national insurance contributions.

² Sabine, B.E.V. *A Short History of Taxation*, 1980 (Institute of Taxation).

³ This total includes the Valuation Office Agency and staff on short-term contracts. These are not included in the more widely quoted Public Expenditure Statistical Analyses (PESA) time series.

⁴ These and subsequent detailed figures use PESA data, available at www.hm-treasury.gov.uk or www.statistics.gov.uk. Staff numbers in this review are full time equivalents.

Box 2.1: the modern tax administrator

The success achieved by the revenue departments in tackling non-compliance and working with customers to help them understand their rights and meet their obligations is due to the dedication of staff at all levels of the two organisations. Both departments have achieved significant change in recent years. Innovative approaches to compliance and new ways of working with business, for example through dedicated phone lines or in professional large business teams, have meant that both departments are developing human resources policies that support new and professional skill sets across their organisations. The functional analysis in Annex B identifies a number of common skill sets.

The capacity to make successful changes is based on leadership and professionalism at all levels in the organisation, including:

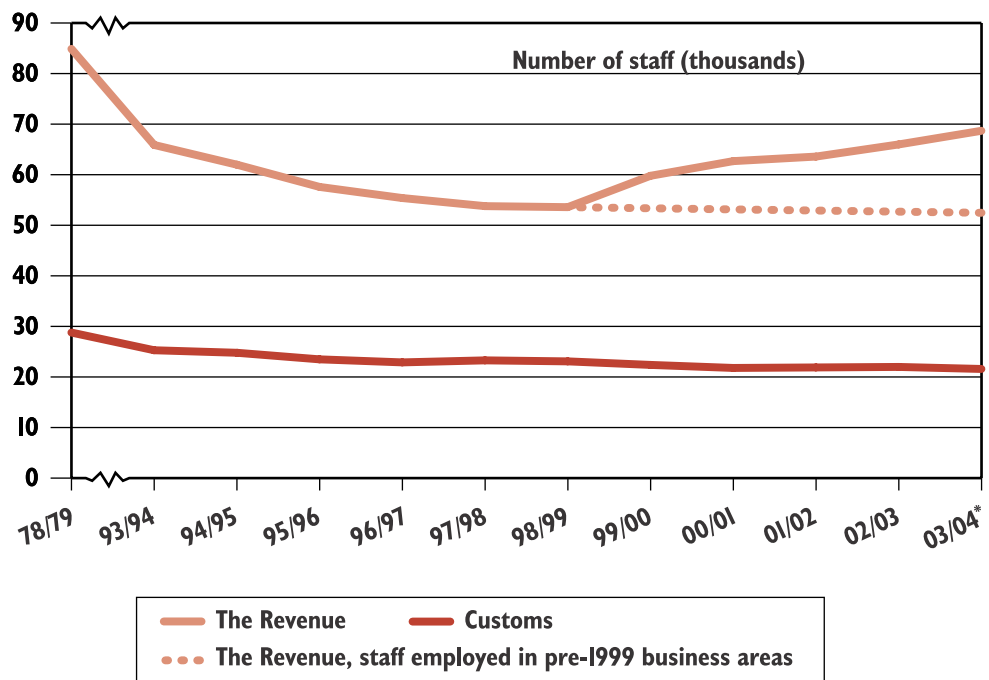
- senior managers explaining the organisational vision in a local context;
- audit staff whose expertise protects revenues;
- contact centre staff who provide the professional support and advice customers need to meet their tax obligations;
- back office staff who use their skills to ensure money is banked on time and high quality information is available for risk assessments; and
- support staff who ensure the smooth running of the departments.

As a result of their different histories and tasks, Customs and the Revenue have distinct cultures. For example, Customs' involvement in law enforcement activities has helped to condition its culture. VAT is collected in real time – this too has conditioned Customs' culture. By way of contrast, the Revenue's main taxes are retrospective. Whatever changes are made, it is important that the differences of the departments are recognised and their respective strengths celebrated.

2.7 In comparison with the Revenue and Customs, the Treasury is a very small department. It employs around 1,000 staff,⁵ who work primarily on policy. Just over 1% of staff work on tax policy in the three departments, with more than 90% of these in the revenue departments.⁶

⁵ Home Civil Service Staff In Post, Summary April 2003, available at www.civil-service.gov.uk/statistics

⁶ These percentages are approximate because of problems in deciding, for example, the exact proportion of a person's time spent working on tax policy.

Chart 2.2: Revenue department staff levels⁷

*Estimated outturn

Source: Table 5.2, *Public Expenditure Statistical Analyses 1998–2003* and Review calculations.

Structure of departments

2.8 Reflecting the legacy of paper-based systems and the tradition of face-to-face contact with customers, both departments retain a substantial network of offices across the UK. Both departments are restructuring their office networks with e-programmes and enablement permitting rationalisation and enhanced efficiency and flexibility, particularly in transactional functions. The departments are aiming to take a more systematic approach to channelling customers to the most appropriate means of contact, whether face-to-face, via the telephone, or the Internet, and a more strategic approach to risk, which puts a premium on flexible deployment of resources.

2.9 The costs of tax collection are smaller than compliance costs for taxpayers, but are still important – money spent on tax administration is money not spent on other public services. The cost of collection varies greatly, depending on the nature of the tax. Cost/yield ratios have fallen over time as efficiency has increased.⁸

The Revenue's local network

2.10 The Revenue has some 40,000 staff in its local service network, based in 350 offices of varying size (down from a 1990 peak of around 600 offices). These are grouped into 71 areas and 7 regional commands. All provide a range of services and carry out compliance work, enabling and regulating customers by area. This network includes 286 Inland Revenue Enquiry Centres that deal with customers face-to-face. In the light of the widening scope of their work, the Revenue is taking initial steps towards broadening its presence, for example by taking space in some Jobcentre Plus offices or in one-stop shops with other departments and non-governmental organisations.

⁷ 'Staff employed in pre-1999 business areas' exclude transfers of staff from the Contributions Agency, Benefits Agency and the Child Benefit Centre, and transfers of staff to work on tax credits. Overall, the numbers of staff deployed on pre-1999 business have fallen despite growth of work in these areas.

⁸ Source: annual reports.

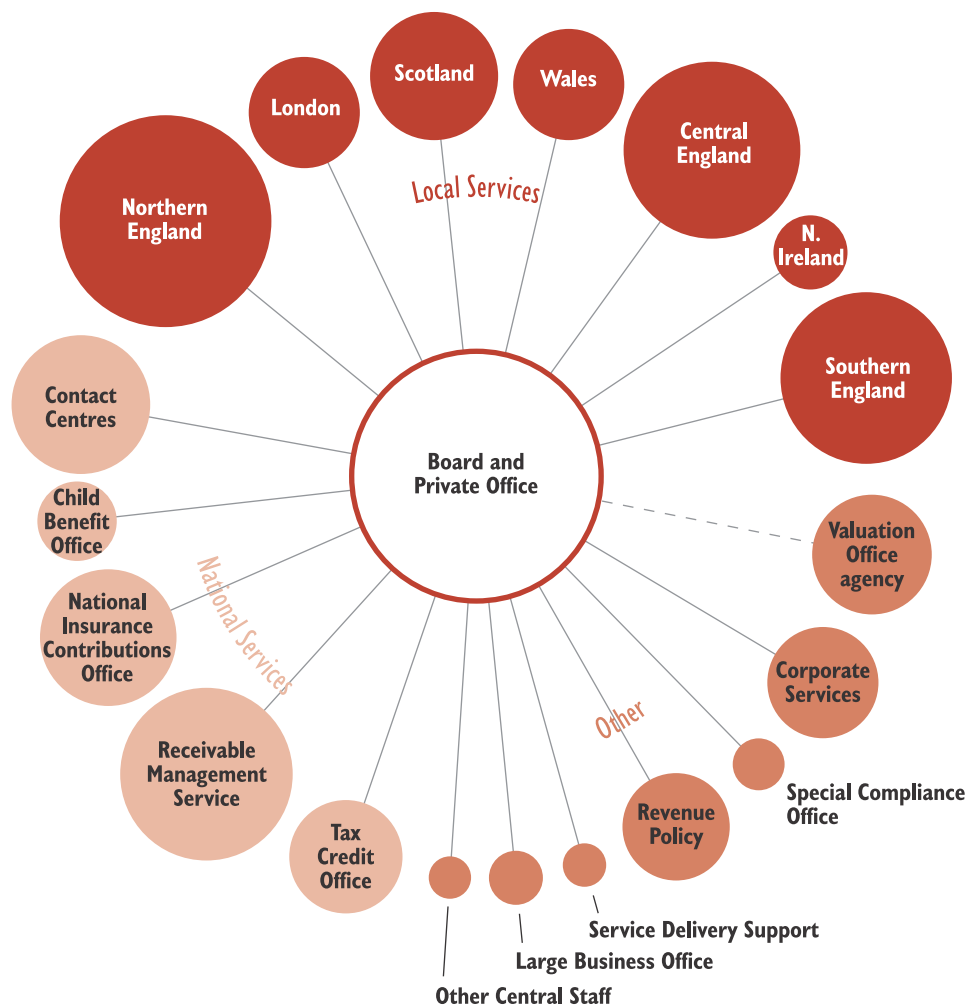
The Revenue's national services

2.11 Complementing their local network, the Revenue employs around 23,000 staff in national services. These include:

- the National Insurance Contributions Office at Longbenton in Newcastle, whose 5,000 staff increasingly do national processing in addition to NIC related work;
- the Tax Credit Office with facilities in Preston, Liverpool and Belfast;
- a concentration of existing activities such as 'receivables' (i.e. payments and debt recovery) in Shipley, Cumbernauld and Worthing; and
- around 5,000 staff in an expanding national network of telephone Contact Centres, including those specifically set up to deal with tax credit enquiries.

2.12 A further 7,500 staff, many based in London, provide specialist policy advice or support functions (such as human resources and legal advice). Chart 2.3 provides a scaled representation of the Revenue's structure and staffing.

Chart 2.3: The Revenue structure and staffing



Source: Review team based on in-year Revenue data 2003-04.

Total staff (PESA): 68,700 (excludes Valuation Office agency)
Figure is to scale (except 'Board and Private Office'); e.g. Northern England = 11,800

2.13 Both departments have offices that specialise in managing revenue from the largest taxpayers. The Revenue's Large Business Office (LBO) employs 830 staff in several sites and deals with around 800 large business groups and 2,900 large employers. In 2001-02 the LBO accounted for 59% of Corporation Tax receipts.

The Revenue's strategy

2.14 The Revenue has aimed to increase flexibility, with the capacity to redistribute work between areas and regions to maximize processing efficiency. At the same time it has moved to exploit economies of scale in some areas, which has freed up resources in the network for other activities (for example tax credits) and helped to achieve efficiency savings.

2.15 The Revenue has a number of electronic services, including Internet filing for self-assessment and Corporation Tax and online tax credit claims. The Revenue's services have accounted for 98% of traffic through the Government gateway since it was set up in April 2001⁹ – around 13% of the eight million self-assessed Revenue customers filed electronically this year.¹⁰ Most of the Revenue's staff do not have external e-mail, to enable contact with customers, although there are steps underway to address this.

Customs' organisation

2.16 Customs has recently restructured around its two main business streams, Business Services and Taxes (BST) and Law Enforcement (LE). BST has about 11,000 staff in around 140 offices throughout the UK, organised in seven regional commands. Within this, around 2,000 staff undertake centralised work on debt management and registration or work in contact centres. Other staff undertake a range of location-specific work (based on risk or work demands) including tax compliance, frontier admissibility and customs controls. The largest component of this location-specific work is VAT audit,¹¹ based mainly in the big cities.

2.17 Customs' Large Business Group (LBG) deals with 1,050 of the UK's largest companies, and employs around a thousand staff. In 2002-03 it accounted for 34% of total VAT receipts, more than 90% of excise duties and over 50% of customs and international trade duties. Altogether some 56% of the total revenue collected by the department goes through the LBG.¹²

2.18 Customs employ 7,500 staff in LE, based nationally and at the UK's frontiers, around half of which work directly on frontier detection. The remainder work on tackling revenue fraud in its different forms, and countering Class A drugs and other prohibitions and restrictions. Box 2.2 sets out the proposed changes to arrangements for tackling serious and organised crime.

⁹ Source: Office of the e-Envoy.

¹⁰ Source: the Revenue.

¹¹ The term 'audit' is used in this review to describe assurance work by Customs and enquiries by the Revenue.

¹² Source: Customs.

Box 2.2: the Serious Organised Crime Agency

On 9th February the Government announced that a new agency dealing with serious organised crime would be established. The agency will combine the responsibilities currently shared by:

- the National Criminal Intelligence Service;
- the National Crime Squad;
- Home Office work on organised immigration crime; and
- Customs' intelligence and investigation work on serious drug trafficking and recovering related criminal assets.

The agency will develop a comprehensive strategy for reducing the harm caused by serious organised crime and draw on best practice and skills from all the existing agencies to focus on those criminals and criminal markets causing most harm. It will work closely with the revenue departments, which will continue to be responsible for tackling revenue and tax fraud.¹³

The agency will need to establish close links with the UK's border authorities, but as border controls are exercised for a wide variety of reasons, many of them distinct from organised crime, these authorities will not be subsumed within the new agency. Revenue from customs and excise duties, including tobacco and alcohol duties, which raise almost £17 billion each year, are heavily dependent upon the protection afforded at the border. Equally important is the economic imperative to ensure that international trade is facilitated in a way that ensures the UK remains a good place to do business. For these reasons the new tax organisation will maintain its frontier role whilst working with the other agencies that undertake controls at UK borders (Special Branch and the new organised crime agency itself). The Home Secretary will therefore announce shortly in his White Paper on Organised Crime ways in which these border agencies can work more coherently and effectively together through closer inter-agency collaboration.

2.19 Customs performs a dual role in relation to the 90 million plus passengers and 4.5 million freight units that arrive at UK air and seaports and by rail each year. Almost all are legitimate movements and are a vital part of the UK economy. Each year smugglers attempt to move billions of pounds worth of illicit goods through the UK's ports and airports, and terrorists are alert to weaknesses in the country's controls. Customs therefore has to process legitimate trade and travel with the minimum of inconvenience, whilst operating border controls to confront smuggling threats which not only cost the country billions in lost revenue but also threaten the UK's security.

2.20 Customs employs over 3000 staff on border detection duties against all forms of smuggling and almost as many again on international trade and statistics regulatory work. It is the largest of the UK's border authorities and has the broadest role, covering every type of traffic (goods and people) entering the UK with a remit to both regulate legitimate trade and confront the smuggling of all types of contraband.

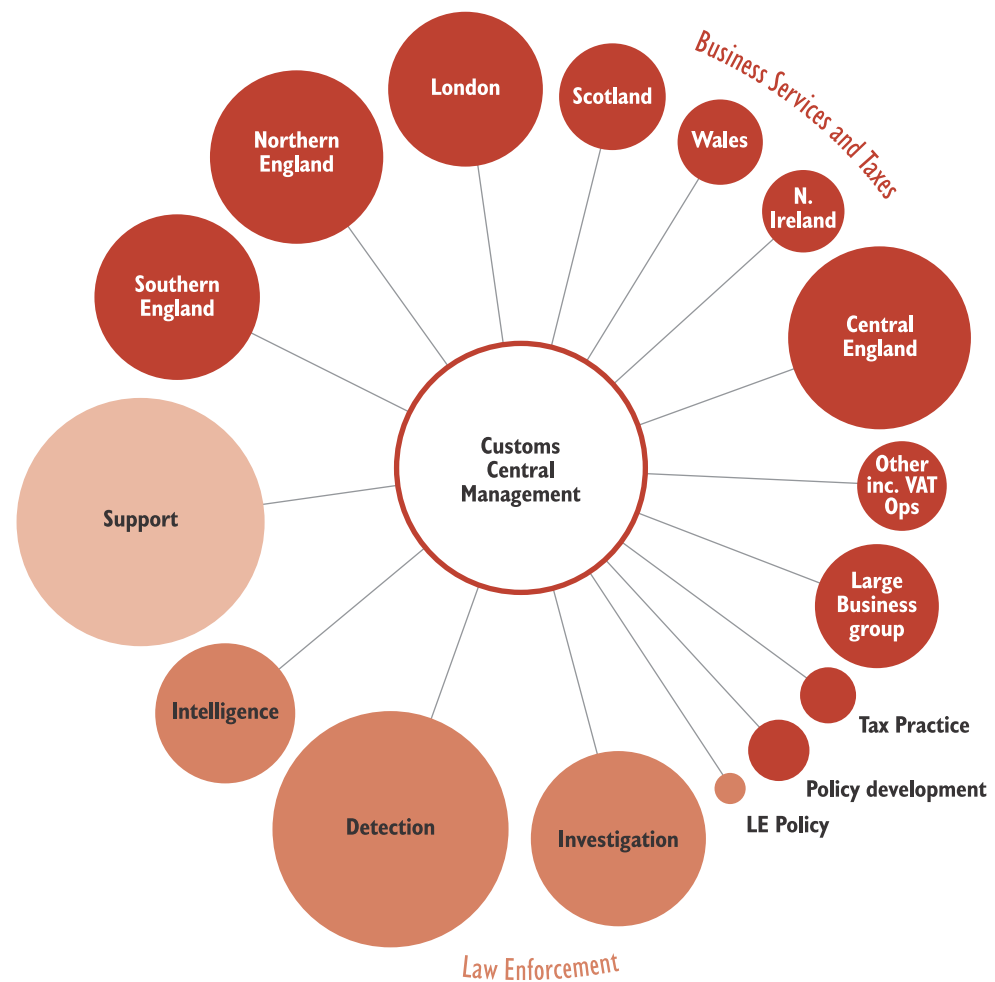
2.21 The remaining Customs staff of around 4,000 provide support services from the centre such as IT, human resources, legal services, finance, central transaction processing and strategy. Chart 2.4 provides a scaled representation of Customs' structure and staffing.

¹³ Source: press release of 9th February 2004, available on www.homeoffice.gov.uk

Customs' strategy 2.22 Customs' approach has been to concentrate non location-specific work into a few, larger sites to obtain economies of scale, improve service quality, and enable location-specific workers to focus on their activity. For law enforcement, regional sites have been established that allow for maximal coverage for 'strike teams' operating on a hub and spoke system.

2.23 Customs is in the early stages of implementing a new strategic operating model incorporating all their capabilities and business processes. This is driving a substantial IT and E-business programme, as set out in Chapter 4.

Chart 2.4: Customs structure and staffing, projected full year, 2003-04



Source: Review team based on Customs data.
 Total staff (PESA): 21,600
 Figure is to scale (except 'Customs Central management'); e.g. Northern England = 1,982

ANALYSIS BY FUNCTION

2.24 The key revenue activities of Customs and the Revenue are, at root, similar. Information comes into the departments from customers through their tax returns, tax credit and Child Benefit claims, applications for registration, requests for advice and other customer contacts. The customer profile is updated and, in the cases where risks to revenue or payment are identified, one of a range of actions may be triggered: a visit or desk-based audit; an offer of education and/or advice, other compliance activity (e.g.

phone calls or written reminders); debt management action; or investigative action to deal with fraud and other illegal activity. At the end of the process money is collected or paid out. Each of these activities may generate further information to update the customer's profile and so enable risks to be reassessed.

2.25 Reflecting this, the review's assessment of current and proposed organisational arrangements is based on dividing the departments' main revenue activities into functions. These facilitate comparisons across the revenue departments, although given the complexity and scale of the departments, this generic model may not match up exactly with business units across the full range of functions. The functional approach draws upon international best practice in the analysis and assessment of tax administrations, as used by organisations like the IMF and OECD.¹⁴

2.26 The eight key functions are:

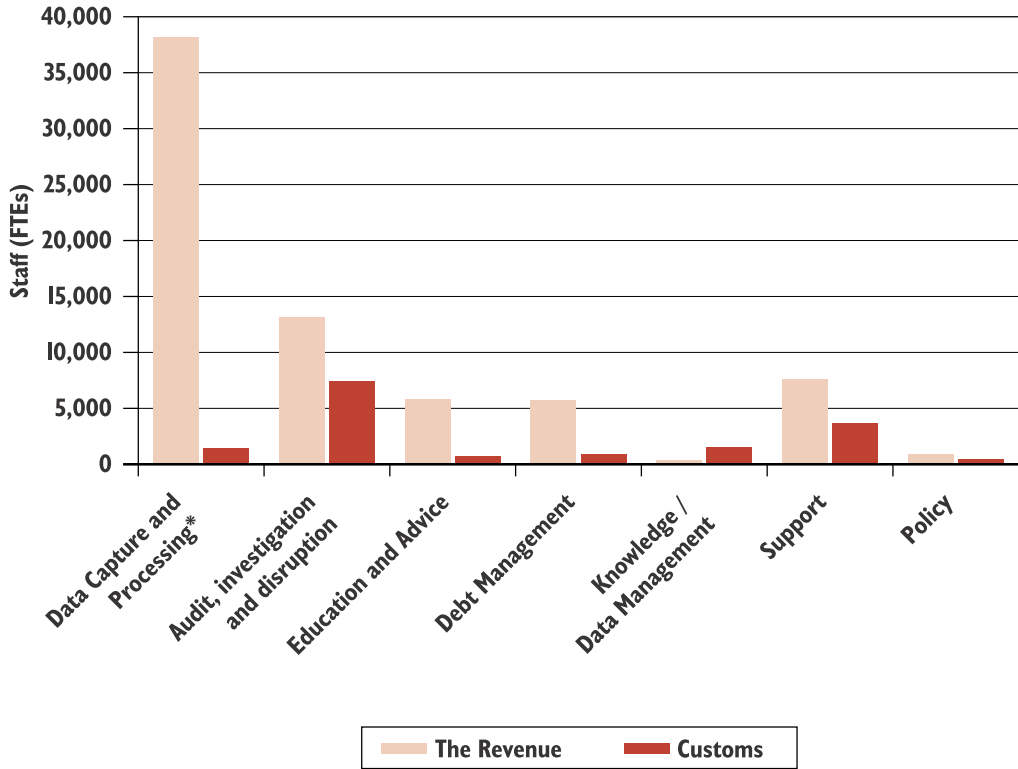
- knowledge and information (the focus of Chapter 4);
- policy (the focus of Chapter 5);
- data capture and processing;
- receipts and payments;
- audit, investigation, and disruption;
- education and advice;
- debt management; and
- support services (all covered in Chapter 3).

2.27 Chart 2.5 illustrates the numbers of staff in the Revenue and Customs across these functions. This makes clear the extent to which large numbers of staff in the Revenue are engaged in processing-related activity, reflecting the size of its customer base, the range of its business, and its nature. In contrast Customs' activities largely relate to compliance, reflecting their focus on risk management.

2.28 The contrast should not be exaggerated, and may in part reflect definitional differences, but is indicative of the different ways in which the departments approach their similar revenue tasks. Their internal structures are a consequence of the differing operational challenges they face, and their different customers. But it also highlights the scope that exists to examine how the departments might learn from each other's methods, and to consider how they – and the Treasury – work together to achieve the Government's objectives.

¹⁴ A functional approach to analysis should be distinguished from the IMF and OECD's recommendation that tax administration should be primarily organised around customers – see Chapter 3.

Chart 2.5: Staff activity by function¹⁵



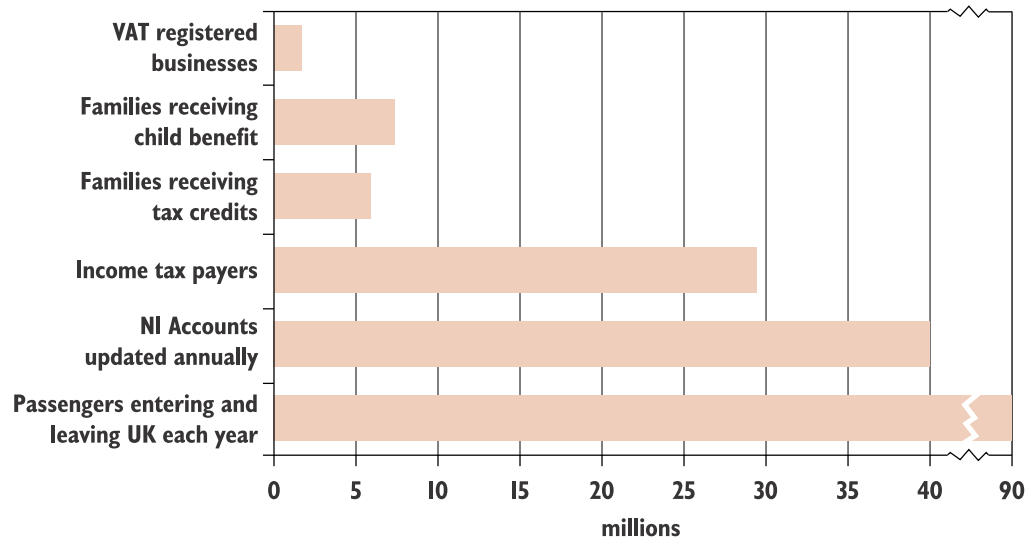
Source: Review team based on Revenue and Customs data. * Includes receipts and payments function.

¹⁵ This chart examines functions that are common to the revenue departments, and therefore excludes some Customs staff including those working on frontiers. As a functional, rather than an organisational analysis, it does not map across to Charts 2.3 or 2.4. In this Chart the numbers for the receipts and payments function have been merged with data capture and processing.

CUSTOMERS

2.29 The revenue departments interact with a huge number and range of customers (see Chart 2.6). Working with the departments, the review has developed a picture of overlap between their customers.¹⁶

Chart 2.6: Main customer groups of the Revenue and Customs¹⁷



Source: Review team based on data from Revenue and Customs.

2.30 The main interactions of the departments are with:

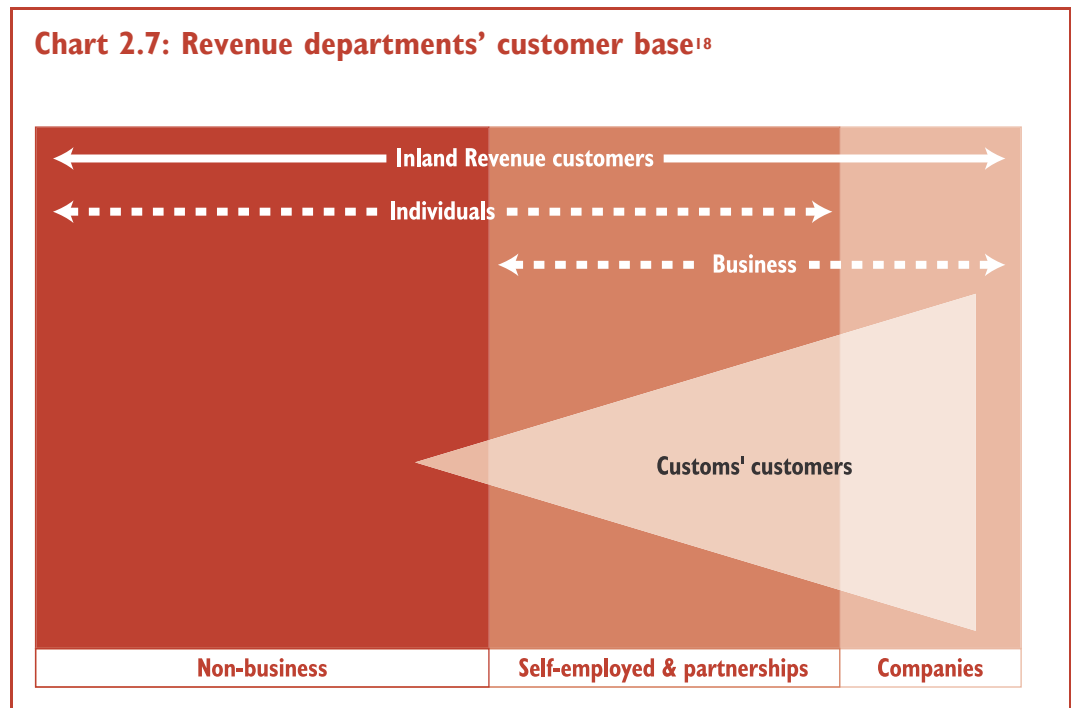
- households, based on income (tax credits – the Revenue);
- individuals, based on employment and savings income and wealth (e.g. Income Tax, National Insurance Contributions, Inheritance Tax, and student loan repayments – the Revenue);
- individuals and businesses, based on profits from business activities (Corporation, Capital Gains and Income Tax, and National Insurance Contributions – the Revenue);
- individuals and businesses through other activities – e.g. travelling, or moving goods, across borders (Customs); trading or carrying products subject to customs controls (Customs); employing staff at a particular wage rate (the Revenue); and

¹⁶ This task is complicated by differences resulting from the nature of the different taxes. In the way it is organised and the way it collects VAT, Customs talks in terms of businesses, while the Revenue distinguishes between corporate entities (which pay Corporation Tax) and unincorporated businesses such as partnerships and sole traders, which fall within the Income Tax self-assessment regime. Comparisons can therefore be difficult, and are further complicated by factors such as so-called 'intending to trade' businesses that may be known to Customs but not yet to the Revenue, and other differences in process – for example, the Revenue receives returns both from partnerships as a unit and from the individual partners. The review uses the term 'business' to cover incorporated and unincorporated businesses except where otherwise specified.

¹⁷ The figures in this Chart are the latest available for 2002 or 2003. Many of these categories overlap, and so the figures cannot be summed to produce total customer numbers.

- individuals and businesses through sales of goods and services, but largely collected from businesses (Value Added Tax, and excises – Customs, and transaction taxes such as Stamp Duty – the Revenue).

Customer overlap 2.31 The overlap in customers between the departments is largely through the taxes on the income of individuals and taxes on business profits on the one hand, and taxes on individuals and businesses through sales of goods and services on the other. This means that almost all the customers common to the departments are businesses of one sort or another, except in the relatively small (in terms of numbers but not revenue) category of potential fraud and criminality by individuals. The Revenue’s business customer base of perhaps five million business and self-employed individuals entirely includes Customs’ customers on the (UK) VAT and excise side (see Chart 2.7).



Large businesses 2.32 The most important overlap is among incorporated companies, where between 70% and 95% of companies are customers of both departments. About one million companies have dealings with both departments, including all the largest businesses. These one million companies:

- contribute just over 20% of direct tax yield;
- contribute around 70-80% of the yield from VAT; and
- administer a large proportion of total income tax, national insurance contributions and tax credit payments for their employees.

2.33 Overall, the customer overlap between the revenue departments is significant in terms of revenue value, customer experience, and tax and wider policy.

¹⁸ Not to scale. Customers of the revenue departments are those whose information is held by the departments. The departments also deal with entities such as trusts and charities, intermediaries such as employers accounting for PAYE, and agents and professional advisers.

Customer needs

2.34 Most people are not enthusiastic about paying taxes, but customers are generally positive about contact they have with individuals in both departments. However, there is still scope for improvement (see Box 2.3).

Box 2.3: customer survey findings and guidance

The Revenue and Customs measure overall customer satisfaction, and score well in surveys. While relatively high in overall terms, the departments recognise that there is more that could be done to improve customer experience. Poor service and associated customer dissatisfaction can arise when contact is made but staff do not have access to the customer's tax history. Equally, having the right information about taxpayers allows the departments to make appropriate interventions at the right time, providing support to those who want to be compliant and tackling threats to the tax base from those who do not. In such cases, the result is better customer service and lower compliance costs for the compliant.

Contact with Customs on audit visits scores highly in the departments' customer surveys, both in terms of professionalism and education and advice offered during the visit. A recent survey of the Revenue 'brand' noted that customers who had been in touch with them recently felt that there was a change for the better.¹⁹ This was particularly evident among tax credit recipients and those contacting Revenue help lines.

Businesses would, however, also like a greater appreciation of their commercial pressures and particular circumstances, including options that help seasonal and small businesses manage their cash flow more effectively.

Guidance should range from providing a simple introduction to start-up businesses and, at the other end of the scale, explaining technical complexities to private sector agents in accessible language. The Revenue's Better Guidance programme aims to address these issues. Customer surveys have found that the single most important improvement that departments could make to support business would be to provide more timely information, advice and service.²⁰

More than three quarters of those surveyed prefer telephone contact for queries, but individuals are often unsure of the right number to call. For example, on PAYE issues, customers might have to make several calls to deal with something that they regard as a single transaction. The Revenue intends to move to a single contact number (as Customs has already done for its tax enquiries) but this highlights the difficulty that customers have in recognising and understanding organisational boundaries in the revenue departments.

Transforming customer service

2.35 Increased use of call centres and the Internet provide an opportunity to meet customer needs by matching guidance and other services to particular circumstances. At the same time, the departments can use telephony to collect customer and tax information in a more coherent way. Customer surveys show that businesses would like to provide information once only, but have concerns about information sharing leading to increased powers. They are interested in being able to view and amend the data the Government holds, and would like easier access to advice and information on legislation.

¹⁹ Customs Business Needs Surveys 2001-2002, available at www.hmce.gov.uk, and Revenue's customer service performance indicator 2002-2003, summarised in the Inland Revenue Annual Report 2003 available at www.inlandrevenue.gov.uk

²⁰ Inland Revenue: Brand Tracking, 2003, Research Business International exercise on behalf of the Revenue.

Compliance costs 2.36 Customer service can be seen as one of the factors that contribute to the costs paid by taxpayers as part of the process of complying with their obligations. These costs are referred to as compliance costs (see Box 2.4). While these are difficult to measure, they are significant, and this review makes recommendations aimed at reducing them.

Box 2.4: compliance costs

The review was given a remit to examine whether, through closer working between the revenue departments or through organisational changes, costs to compliant taxpayers and businesses could be reduced.²¹

Compliance costs are inevitable in any taxation system. They include costs arising from a taxpayer's need to obtain advice, purchase specialist software and put time into keeping records for tax. Taxpayers who are anxious about complying fully with their obligations also experience psychological costs. Compliance costs fall disproportionately upon small businesses, the cost per employee being up to ten times higher for micro and small businesses than for larger businesses, which benefit from economies of scale in their compliance systems (although this is not to say that compliance costs on large business are not significant).

Compliance costs are influenced by policy as well as administration, and reducing them is an objective of both. Reducing compliance costs is not straightforward as there are trade offs with countering avoidance, fraud and using incentives to promote other Government objectives. The main drivers of compliance costs are:

complexity of rules	...requires the taxpayer to make more judgements, keep additional records and spend more time learning.
change	...requires taxpayers to understand new rules and could also require updates to their record keeping and software.
avoidance and evasion	...drives up compliance costs for all taxpayers because of the resultant activity by departments and changes to the law to close loopholes and improve enforcement.
education and start-up costs	...as taxpayers have to learn about their obligations, and build these into their systems, a cost disproportionately incurred by start-up businesses.
processes and systems	...as the level and extent of customer focus in the organisation will affect the burden of compliance, as will the number of people a taxpayer has to deal with in order to comply.
compliance activity	...taxpayers selected for audit or further investigation will have to devote time and resources to this.

The revenue departments have strategies to reduce compliance costs, and both have PSA targets to deliver reductions in compliance costs to businesses. They are taking this forward by ensuring that compliance costs and regulatory impact are considered at an early stage in all proposed policy and operational changes.

²¹ The Treasury Select Committee is conducting an inquiry into the administrative costs of tax compliance - see www.parliament.uk/parliamentary_committees/treasury_committee.cfm

Small business needs... **2.37** Research shows that the majority of small businesses most value stability in the tax system, certainty that they have complied with the rules, minimum possible contact with the revenue departments and as little disturbance as possible in discharging their obligations. The distinction between direct and indirect taxes, and the Revenue and Customs, are not of interest in themselves to small businesses.

...and support **2.38** There is a real economic incentive to ensure, at the very least, that interactions with Government are straightforward for small businesses. Business start-ups might appreciate more support to help them understand their obligations and assistance available. For established businesses it could involve helping them recognise the next tax threshold and, at relevant points in their business life cycle, offering options that help them manage commercial pressures.

Promoting enterprise **2.39** More ambitiously, there is potential to transform the way that Government works with small businesses. By providing a more coherent entry system for new businesses and refining customer analyses to identify fast-growing businesses, the system could mitigate risk for both parties and provide incentives for growth.

COMPLIANCE

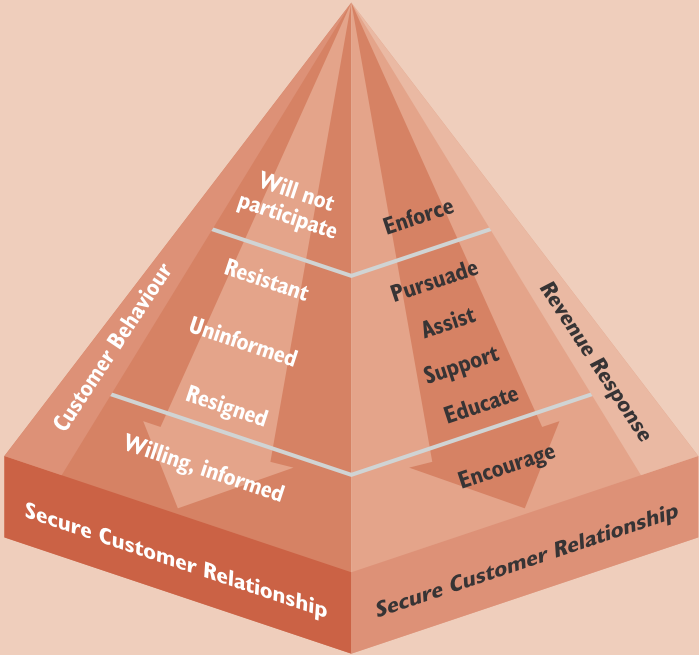
2.40 Over recent years the departments have increasingly embraced the idea of a compliance spectrum as the basis of their approaches to risk (see Box 2.5). This is used to segment and analyse customers to determine relative risk and respond accordingly. The objective is to encourage customers to either remain or become voluntarily compliant. Those customers who:

- are already compliant are best offered encouragement and support to help them stay that way. Systems should be as easy to use as possible, tax administration staff and policy makers must demonstrate an appreciation of customers' needs, and advice must be available as and when they want it;
- are finding it difficult to comply, but basically want to do so, need support. They might benefit from targeted education to help them understand their obligations, reminders and/or easy payment options to ensure they pay and submit returns on time, or help with temporary cash flow difficulties through time-to-pay and similar arrangements. There might also be scope for light-touch compliance activity to leverage particular groups;
- use unacceptable planning methods to avoid their tax obligations (e.g. by exploiting unintentional loopholes and working against the spirit of the tax system) need to be challenged. The intention is to make tax law clearer and ensure a level playing field for all taxpayers by either litigating or legislating in cases of avoidance;
- are occasionally but deliberately non-compliant (e.g. evade taxes) need to be made aware that they will be caught out. The aim is to make non-compliance a difficult and costly option to deter those who might be tempted to chance it. Such customers should experience frequent audits and be subject to increased attention from tax administration staff; or
- deliberately set out to defraud the Government, by either suppressing their tax liabilities or through systemic attacks on the tax system, should be dealt with firmly. The aim is to use investigation, prosecution and in Customs' case, disruption, to make such activities as uneconomic as possible.

Box 2.5: compliance diagrams

Both departments picture the risks they face and their responses to these risks in terms of a spectrum of compliance. The Revenue illustrates its approach in terms of a pyramid, drawing on the model of the Australian Taxation Office, while Customs uses a compliance continuum.

The Revenue’s compliance pyramid



Customs’ compliance continuum

C O M P L I A N T	Taxpayer behaviour	Simple Errors	Negligence	Opportunism	Avoidance	Serious non-compliance	F R A U D U L E N T
	Reason	Ignorance / busy / lack of time	Lack of interest	Predictability of Customs’ interest (or lack of)	Planned legal opportunism	Serious debtors	

Source: the Revenue and Customs

Balancing customer facilitation and revenue protection

2.41 This approach presents a challenge. If systems are to be streamlined and simplified for compliant customers, there is a risk of increasing the incidence of fraud by the non-compliant. If the opposite approach is taken, and systems are designed to protect against fraud, then compliant customers are disadvantaged and their costs go up. Both Customs' and the Revenue's strategies, therefore, seek to strike the difficult balance between customer facilitation and revenue protection, in a changing world where the threats from avoidance are becoming ever more sophisticated.

2.42 Strategies for e-business and network organisation will be key to achieving greater efficiency as well as effectiveness. New information systems should enable the departments to make step changes in their risk analysis and case management that will allow them to focus on and respond appropriately to their customers' needs. However, 'whole customer' risk analysis between Customs and the Revenue is not factored into existing plans, except to a limited extent through closer working. This explains Chapter 4's emphasis on the need to develop a whole customer view of business, to benefit the revenue departments and their customers.

2.43 A fundamental part of the revenue departments' compliance strategies is to be proactive in helping individuals and businesses calculate their tax liabilities correctly and, as far as are reasonable, enable them to meet these liabilities. It is of course better for all concerned if as many taxpayers as possible get it right first time. Better guidance and effective channelling of customers to the services they need are two elements of this.

Returns on compliance activity

2.44 The additional revenue raised through work to tackle non-compliance is substantial and is split between general compliance work carried out in each department's network, and by specialist offices. The success of this work is vital in helping to finance public services, and in keeping down the tax burden on the compliant. For example, in the Revenue:

- in local offices the marginal yield on enquiry work currently appears to vary widely, with aspect enquiries²² on companies having on average more than six times the return of full enquiries into the self-employed;²³
- the Large Business Office collected around £1.76 billion in additional tax and duty for the tax year 2002-03;²⁴ and
- the Complex Personal Returns Unit, which focuses on the wealthiest individuals, is achieving high yield/cost ratios.

2.45 In Customs:

- the Large Business Group collected approximately £1.2 billion of the additional tax and duty collected in 2002-03; and
- high returns accrue from general compliance activity, as the additional tax recovered was 3.2% of total yield for 2002-03.²⁵

²² An aspect enquiry is a form of audit that falls short of a full, in-depth examination of the whole return. Instead it concentrates on one or more aspects of it. An aspect enquiry may develop into a full enquiry.

²³ Inland Revenue, Annual Report, December 2003, available at www.inlandrevenue.gov.uk

²⁴ Inland Revenue, Annual Report, December 2003, available at www.inlandrevenue.gov.uk

²⁵ Source: Customs.

2.46 Much of the general work that the revenue departments do can be seen as compliance related. ‘Additional revenue raised’ is a narrow measure of compliance activity. Compliance activity has a significant multiplier effect on the rate at which taxpayers comply. Although hard to quantify, the ‘deterrent effect’ could be up to five times the size of the direct effect of compliance activities.²⁶

2.47 Customs measures the success of its holistic approach through the much wider indicators of increased VAT yield and reduction in VAT losses. This focus on reducing the ‘VAT gap’ is relatively recent and represents a major change in how the department develops strategy (see Box 2.6).

2.48 The IRS has estimated that the US has a tax gap across all taxes of around 12.8% of total revenue, while Sweden estimates that it has a gap of around 8%.²⁷ It is likely that the UK has a tax gap of a similar order.

Box 2.6: the measurement of compliance and the tax gap

There are a number of economic and policy reasons to care about non-compliance. It:

- reduces the planned tax yield, potentially harming public services;
- redistributes the tax burden on an ad hoc basis. Since not all taxpayers avoid or evade tax, it is both unfair and can undermine incentives that the Government intends to provide through the tax system; and
- wastes public and private resources, through capacity devoted to devising and, in Government, countering, avoidance/evasion schemes rather than creating wealth.

An important indicator of high-level revenue collection effectiveness is the gap between the theoretical tax payable and the amount collected. This is known as the tax gap. The tax gap can be divided between: losses arising from a failure to collect identified liabilities; error, evasion and avoidance by known taxpayers that is not detected; and losses arising from the shadow economy and fraud from those unknown to the revenue departments (including systematic criminal attacks on the tax system e.g. VAT missing trader fraud).

Making estimates of the tax gap is methodologically and empirically difficult, although easier for indirect taxes where tax can typically be related to consumption. Direct tax gaps are particularly difficult to estimate because the aggregate figures for income, for example, are built on tax data.

(continued overleaf)

²⁶ National Audit Office Report, *HM Customs and Excise: Improving VAT Assurance* - 24 November 1999. HC 15 Session 1999-2000, available at www.nao.gov.uk

²⁷ US source: IRS (estimate for 1998). Swedish source: *Taxes in Sweden 2003: A summary of the Tax Statistical Yearbook of Sweden*, the Swedish Tax Agency, 2003 (estimate for 2000).

Box 2.6: the measurement of compliance and the tax gap (continued)

The IMF and the OECD believe that measuring the tax gap can help to give high-level focus to tax administrations on the objective of collecting tax, but it is by no means a panacea.²⁸ Even when tax gaps can be estimated, a great deal of further work is needed to develop detailed strategies that counter revenue loss, and then translate those into operational plans and decisions to allocate resources to risk.

2.49 The additional funding Customs received in the 2002 Spending Review has enabled more staff to be deployed on compliance-related activities. As a result, receipts are expected to rise from 85% to 88% of the theoretical VAT yield by the end of 2005-06 (or, put differently, VAT losses would reduce from 15% to 12%). This equates to around £2 billion in additional revenue and would bring the gap back to levels seen in the early 1990s. Similarly the Revenue has an ongoing programme of compliance and enforcement measures, announced in Budget 2003, focusing on areas of specific risk.²⁹

INTERNATIONAL COMPARISONS

2.50 International experiences illustrate the issues raised in the review, although they cannot necessarily be read across directly to the UK situation. While there is no single international best practice model for tax administration and policymaking (see Annex A), there are a number of general patterns. These include:

- the integration of the VAT management with other taxes, to improve overall effectiveness. Some of the small number of countries with separate management of VAT and other taxes have been integrating them (such as Denmark and Canada – Israel is also planning to integrate its administrations);
- a trend away from organisation of revenue administrations by tax type, and towards organising more by function or by customer, allowing for greater flexibility and improved services. Organising around customers and functions is facilitated by the integration of direct and indirect taxes. The review examined cases in Australia and Canada where audit activities are integrated between taxes and organised around customers;
- linked to this trend, a move towards adopting business identifiers, as a means of better joining up service for and data on businesses;
- there is often a management separation, either with separate organisations, or separate management structures, between frontier control and excise duties on the one hand, and the administration of direct taxes and VAT on the other, although a proportion of VAT and excise are collected at borders, and top management structures often cover both;
- all administrations are seeking to exploit new technologies with varying degrees of success; and

²⁸ Source: Review team interviews. See also Compliance Measurement – Practice Note, 10 May 2001, OECD Centre for Tax Policy and Administration Tax Guidance Series GAP004, available at www.oecd.org

²⁹ Treasury Press Notice, 9th April 2003, available at www.hm-treasury.gov.uk

- most revenue administrations sit below the finance ministry or treasury, and tax policy is usually led in that ministry, although in practice some policy is also done in the administrations. Revenue administrations tend to have a higher degree of separation from the finance ministry/treasury in English-speaking countries, where taxpayer confidentiality is a higher priority, than in continental Europe.

2.51 This Chapter has described areas of the work of the revenue departments that are explored in subsequent Chapters, and has highlighted some areas, such as customer needs and compliance costs, where there is scope for improvement. Building upon this description of the revenue departments today, the next Chapter makes the case for organisational change in the revenue departments to improve tax administration.

