THE FDA IN HMRC

Funding the Nation: Optimising HMRC

Who we are

The Association of Revenue and Customs (ARC) is both an independent trade union and the HM Revenue and Customs (HMRC) section of the FDA, the trade union for managers and professionals in public service.

ARC represents 2,900 members in HMRC, at HO and above, as well as trainees in grade 7 entry schemes. Its members include senior officials, lawyers and tax professionals, collectively taking responsibility for the collection of UK taxes, and tackling tax evasion and avoidance, at the highest and most complex level.

We are partners with HMRC in consultation and negotiation. HMRC also recognises ARC as a stakeholder on professional matters within HMRC.

ARC is firmly committed to the principles of equality and diversity in both employment and the delivery of services.

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THE FDA IN HMRC

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Foreword

As the UK's tax administration, HMRC stands at the heart of the functioning of government - transmuting the words of policy and legislation into the hard cash needed to fund public services.

A tax administration can never aspire to be loved by the public but it can - and should - be respected and admired. HMRC has much to be proud of – it has over recent years delivered an increasing flow of revenues to the Exchequer while maintaining the tax gap (the totality of taxes that go unpaid for whatever reason) at an internationally low level. But the department continues to face many challenges – the move to digital, demands for better customer service, change and complexity of the tax system as well as new forms of tax evasion and avoidance.

The pressure on HMRC to do more for less – and on government to manage the public finances without increasing tax rates – will continue after this year's General Election. I am therefore delighted to support the work that ARC has done with this report in identifying the challenges HMRC faces.

The report offers some practical choices for HMRC to the government in the new Parliament. It does not shy away from the trade-offs involved.

This report should be welcomed as a contribution to the future of HMRC and how the department can remain one of the world's most respected tax administrations.

Sir Edward Troup,

Former Executive Chair and Permanent Secretary, HMRC

About this report

This report provides a guide to help any future governments to equip HMRC properly for the future. It does not seek to propose new tax policies or policy changes. Instead, we look at how to ensure that HMRC is supported to deliver an optimum tax administration function that can best support the delivery of public spending priorities.

The report has five core sections:

1. The report sets out how HMRC has changed over the last decade, the new challenges it has faced and how it has responded to them.
2. Identifying the fundamental principles of an effective modern tax authority.
3. Looking at the "in-tray" for any incoming Minister or Permanent Secretary, identifying the core work streams and projects that will be central to their day-to-day experience of running HMRC, with some suggestions on where there remain ongoing issues.
4. Proposing actionable recommendations aimed at transforming HMRC into a world-leading, highly effective tax administration.
5. The impact assessment on the recommendations, to show that they can be achieved with sensible levels of investment and high yields over the longer term.

HMRC: Funding the nation

HMRC has a unique role to play in supporting our public infrastructure. As the HMRC mission statement notes "we have a vital purpose: we collect the money that pays for the UK's public services and help families and individuals with targeted financial support." It is the funding brought in through HMRC that finances almost everything else. In this way, HMRC is foundational - it provides the financial basis on which the rest of government operates.

It is therefore a national priority to ensure that HMRC is optimised to deliver effective, fair and efficient tax collection. In practice, this means facilitating compliance, correcting mistakes, tackling fraud and abuse, protecting society from harm, and supporting wider government economic aims through a better tax administration system. These are all stated aims that HMRC holds, but currently there are barriers to actually achieving these goals.

The UK is in a difficult position politically and economically. National and international events have impacted economic growth, driven up inflation and put public finances under pressure. We have seen a squeeze on public spending, declining quality of public services and increased pressures on households. Politicians of both major parties have said that there is little financial headroom in order to fund their priorities.

The Institute for government's (IfG's) most recent annual survey of public services states in stark fashion that "Public services that have for years been creaking are now crumbling."

To enable the government's plans to invest in growth, tackle fraud, and support customers and our economic recovery, HMRC must be fully supported and properly equipped to face new technological challenges.

This report sets out what a world-class tax administration should look like. It has been developed to help this and future governments better understand HMRC, and provoke informed discussion about how best to support it.

We recognise that there are likely to be difficult choices for any government about how best to support HMRC. In particular, questions about how to find the right balance between resourcing direct customer service and compliance interventions, the use of data and AI, and digital services.

To aid decision-making, this report drills down into where HMRC is performing well, and where additional support and investment would deliver better returns. Our aim is to ensure that the government has a clear understanding of what a modern tax administration should look like and what HMRC should be able to deliver for it.

Executive summary and recommendations

HMRC is unique as a government department. It is the UK's tax collector, helping to fund government services and provide benefits. Collecting the right amount of tax, at the right time, is one of HMRC's core missions. Collecting the right amount of tax is what pays for our roads, our hospitals, the salaries of nurses and teachers across the country.

Because of this critical role in underpinning the rest of government, it is critically important that HMRC functions at the highest possible level. This report details where, over the last decade, HMRC has had challenges, and provides insight into where HMRC will face obstacles in the future. It is designed to provide a pathway for HMRC to future proof itself for a government of any political stripe.

The report identifies that HMRC's workload has changed significantly over the last decade to mirror changes in the wider economy, as well as demographic pressures. HMRC now manages more complex tax administration, and more frequently, than it has had in previous decades.

This reflects increases in the number of people paying the more complex taxes to administer:

- For corporation tax, there has been a 38% increase in the number of taxpayers between 2014 and 2021 (most recent available data).
- For capital gains tax there has been a 50% increase in the number of taxpayers between 2014 and 2021 (most recent available data).
- For inheritance tax there has been a 116% increase in the number of taxpayers between 2014 and 2023/2024.
- For VAT there has been a 24% increase in the number of taxpayers between 2014 and 2023/2024.

Over the last twenty years, HMRC has increasingly focused on interventional compliance. This compliance work, where HMRC looks to actively recover unpaid taxes through direct engagement with customers, has been remarkably successful. Between 2005 and 2017, HMRC reduced the tax gap - the percentage of unpaid taxes - from 7.8% to roughly 5%. This huge improvement coincided with large investments for HMRC up until the Spring Budget 2015. Post-2015, investments in HMRC have been significantly smaller.

However, this focus on compliance investment has been accompanied by chronic underinvestment in the HMRC systems which help underpin voluntary compliance, the ease of filing a tax and the ability to quickly and easily resolve any queries.

We identify core issues with customer services, and suggest methods of working which would help to reduce these issues in the future. We estimate that the direct cost of HMRC's current 24 minute average customer hold time and poor postal services is costing UK businesses around £1bn per annum.

We identify the cost of HMRC's legacy systems and technology issues to its own staff. A survey that we undertook of HMRC staff found that 15% of the workforce lose more than four hours to poor technology each week (10% of their working time). Across the whole department, the same survey found that HMRC staff lose more than 4 million working hours to poor technology each year.

As a result, the experience of dealing with HMRC has, according to its core stakeholders, worsened, even as its compliance performance has maintained. During this post-2015 period HMRC has broadly kept up with expectations for increasing compliance yield, but without meaningfully taking a dent out of the tax gap.

We suggest a large-scale investment into HMRC which would help resolve some of these issues. We estimate investment of £910m would return £11.3bn to the Treasury over the course of a parliament and would meaningfully reduce the tax gap. Critically, this investment would include £210m for HMRC customer services. Some of this expected return could also be put to use in upgrading HMRC's legacy systems and technologies, which would over the long-term increase HMRC's productivity. Even after these investments there would be significant sums for a government of any stripe to invest in the core public services that are so critical to the functioning of our society.

The recommendations are:

- Large-scale investments into compliance, with an equivalent investment in customer service to close the Tax Gap
- A long-term staffing and skills plan
- An ongoing technology plan
- A clear data strategy
- Develop a clearer strategy for tax administration

1 HMRC over the last decade

HMRC has changed significantly over the last decade. It has had to respond to major structural changes in society, including the wholescale digital transformation of our economy and impact that this has on the delivery of services, behaviour of consumers and on how the global business community interacts.

Navigating extreme challenges

Over the last decade, HMRC has been at the forefront of supporting the country to navigate the most difficult of times. Whether this was the challenge of implementing wholescale reforms to our borders and customs arrangements following our exit from the European Union, managing the impact of political volatility on our economy both following instability at home and abroad, or delivering a critical part of our national response to the Coronavirus pandemic, HMRC has played a critical role.

HMRC: CRITICAL TO OUR COVID CRISIS RESPONSE

HMRC was essential to managing the Covid pandemic. The Prime Minister's announcement on 16 March 2020 telling us to work at home where possible immediately saw HM Treasury (HMT) and HMRC kick into gear to support households and families during this unprecedented period. Within six weeks a wages support scheme was designed and launched, ultimately developing one of the most comprehensive and generous support packages for households in the world.

Over the two years of the pandemic, HMRC and HMT jointly delivered more than 80 temporary tax easements and schemes - from furlough to VAT deferral, self-employed grants to statutory sick pay rebates, £500 payments supporting working tax credits households to tax relief for people working from home. The implementation of the furlough scheme was only possible as the result of data received by HMRC's Real Time Information (RTI) scheme. This illustrates the importance of investing in digital tax services.

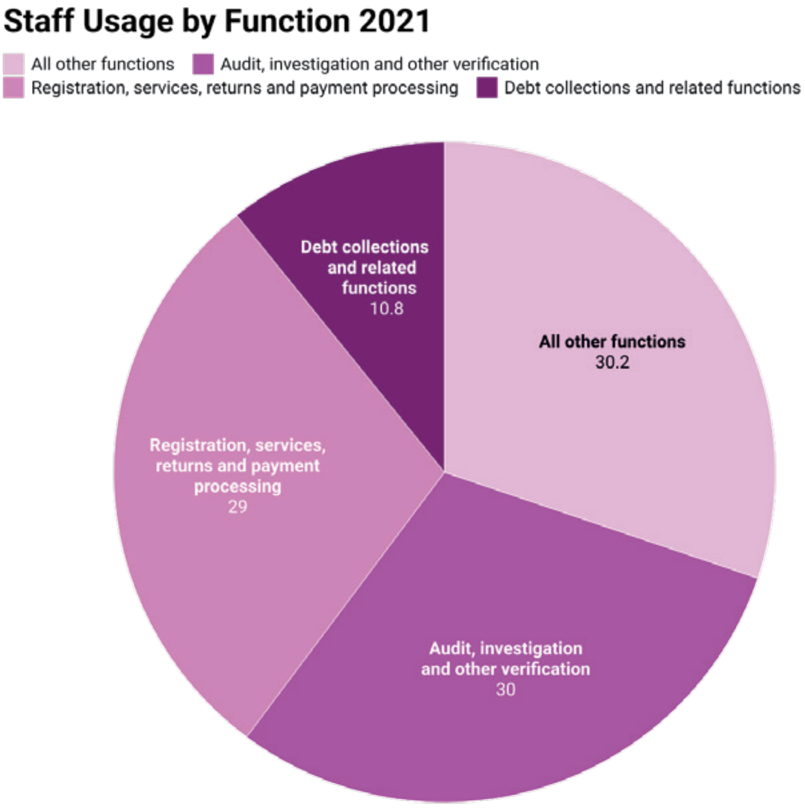
HMRC was critically involved in the development of policy, providing the core data insights for the Self-Employment Income Support Scheme (SEISS) and the Coronavirus Job Retention Scheme (CJRS), more commonly known as furlough.

As the National Audit Office put it: "The employment support schemes provided essential support to the economy during the COVID-19 pandemic, and they achieved their primary objective of preventing millions of job losses. They were introduced at commendable speed as part of the government's emergency response."

The pace of the response, and the need to get early payments, meant that some risks were incurred on error and fraud. There are lessons to be learned on evaluating risk profiles at speed and the need for good quality data to prevent fraud and error.

An increased focus on compliance

Whilst funding for other departments has been cut in real terms, HMRC has remained relatively stable in terms of its size and its funding. This is largely as a result of strategic investments in HMRC compliance which means that the number of compliance staff is now a third of the total of HMRC employees. This is broadly in line with the OECD average.



Source: Tax Administration 2023 : Comparative Information on OECD and other Advanced and Emerging Economies | OECD iLibrary (oecd-ilibrary.org)

Compliance takes place in two ways, first through the voluntary compliance of taxpayers and members of the public. This group is made up of the vast majority of taxpayers who pay the correct amount of tax on time and is facilitated by things such as a tax administration's general communications, clarity around what tax needs to be paid, and the ease of filing a tax return. Mechanisms such as automatic PAYE deductions have been crucial to simplifying the experience of tax for customers and improving voluntary compliance. The second type is interventional compliance, which is where a taxpayer has failed to pay the correct amount of tax on time and where HMRC needs to engage with that customer in order to ensure compliance. This can involve direct communications with an individual taxpayer, ranging up to enquiries and even court cases to recover unpaid taxes. In this report where we refer to compliance staff or compliance yield, we are referring to interventional compliance.

As a result, HMRC's compliance yields have increased every year. There are many factors in why governments are keen to increase compliance. The O'Donnell Review, which underlay the creation of HMRC in 2005, stated: "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." These factors, as well as HMRC's strong performance in compliance, which increases government revenues, has led to governments investing more heavily in compliance than in other areas of HMRC performance.

Since 2010, HMRC has directed multiple separate large investments into HMRC:

- £900 million at Spending Review 2010;
- £800 million at Summer Budget 2015;
- £155 million at Autumn Budget 2017;
- £292m at Autumn Spending Review and Budget 2021;
- £79m at Autumn Statement 2022; and
- £163 million at Autumn Budget 2023, to address a range of compliance, collection, avoidance and evasion activity, including tackling enablers and facilitators of tax fraud.

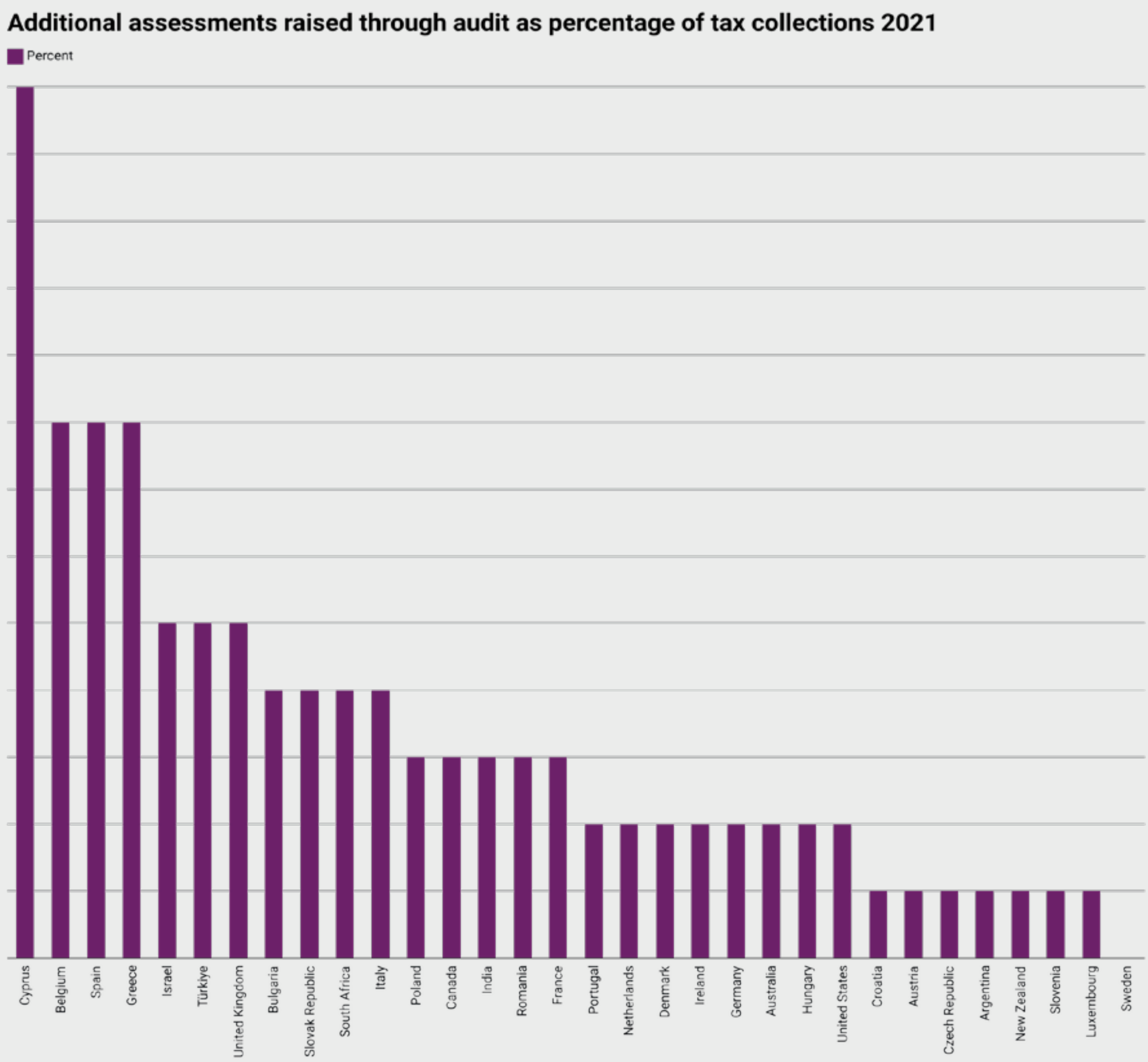
These investments have predominantly focused on compliance. The Spring budget 2024 repeated this pattern of focusing purely on returns through a large-scale investment into debt management.

Investment in HMRC has delivered significant returns

As the Organisation for Economic Co-operation and Development (OECD) shows, HMRC is one of the more effective tax administrations at raising new assessments from its compliance work.

The OECD notes that HMRC generates comparatively more than an average tax administration does from its compliance work. In 2022/23 it undertook 248,000 investigations into individuals and small businesses (an increase from 232,000 in 2021/22).

Source: Tax Administration 2023 : Comparative Information on OECD and other Advanced and Emerging Economies | OECD iLibrary (oecd-ilibrary.org)



This means that each investment in HMRC has generated strong returns. As the table below shows, on average, HMT has historically received a return, dependent on the type of compliance involved, of at least £6.30 for every £1 invested in HMRC compliance related activities.

It is not straightforward to predict future yield, as there may be diminishing returns. However, there is clear evidence that HMRC can do more to increase revenues for the government. There are also additional after-effects of the pandemic which HMRC thinks has somewhat artificially lowered its compliance yield. However, there is no obvious reason why the overall return on investment should decrease going forward.

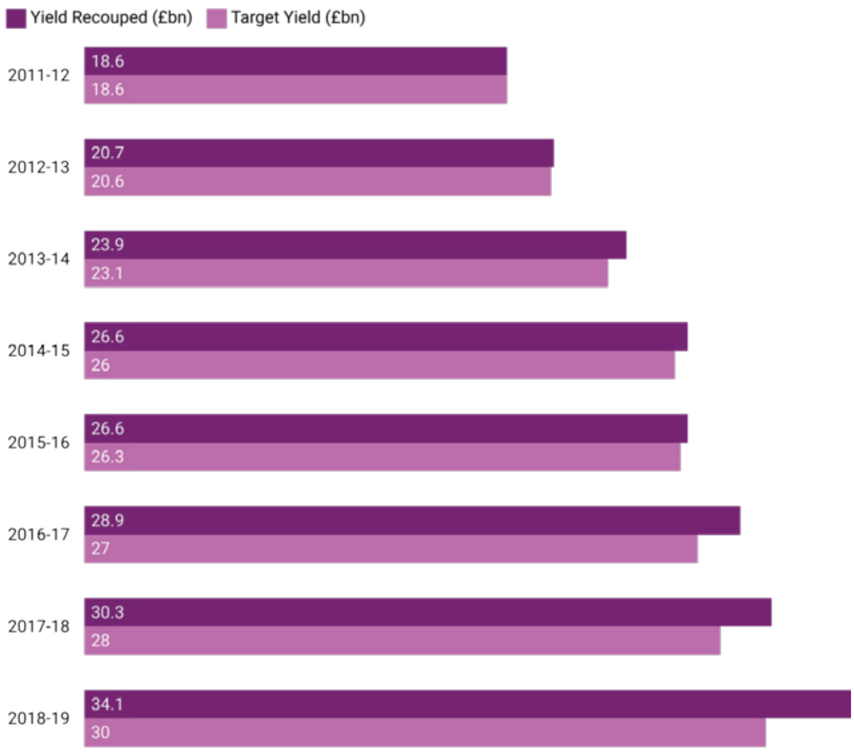
HMRC Return on Investment from Compliance

Compliance RoI per customer segment	2019-20	2020-21	2021-22
Individuals	7.8	6.3	6.6
Wealthy individuals	11.6	15.8	11.4
Small businesses	15.2	11.0	13.8
Mid-sized businesses	18.5	11.9	13.0
Large businesses	75.2	60.0	39.2
Total	21.8	17.4	15.5

Source: State of Tax Administration 2023 – TaxWatch (taxwatchuk.org)

Overall, the picture on compliance over the last decade is a positive one.

HMRC Compliance yield versus target



Source: Tackling the tax gap (nao.org.uk)

Overall staffing numbers have reduced

HMRC is the third largest department by headcount, with a payroll of just over 60,000 civil servants (FTE) in various roles. HMRC has 23,000 employees in compliance-related fields alone. Despite the success of delivering improved compliance, HMRC's overall staffing numbers have reduced, with significant reductions in non compliance-focused staff.

The total numbers of civil servants has fluctuated over the past decade or so, dropping from a total full time equivalent (FTE) payroll of 67,000 employees in 2011 to under 57,000 in 2018 and back to 61,000 today. Over the past 12 months, HMRC saw the greatest absolute reductions in staff numbers, with 1,520 fewer FTE employees. This is part of a planned post-COVID reduction in HMRC's headcount. Year-on-year comparisons show that this drop is primarily due to reductions in lower grade employees. This is aligned with HMRC's goal to digitise and reduce manual administrative tasks.

Source: Civil service staff numbers | Institute for Government

However, within the workforce itself, the number of total professionals (including tax professionals) has increased, while customer service employees have remained roughly the same over the past decade. And HMRC has one of the lowest salary costs as a percent of total operating expenditure. Currently, the UK is 50th out of the 57 economies ranked by the OECD on this metric.

The workforce is more skilled

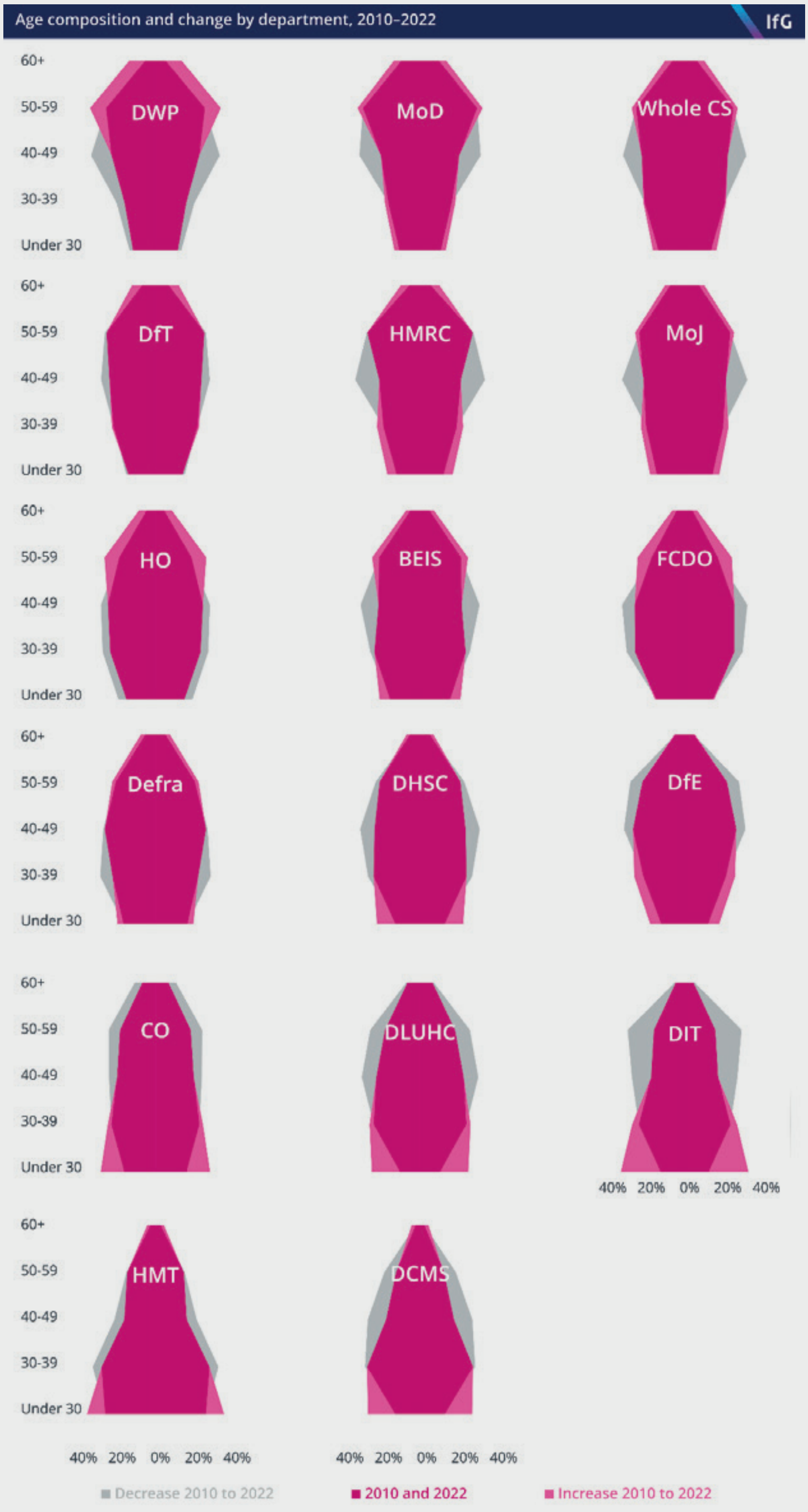
Over the previous decade, the grades at which HMRC has employed its workforce have increased. The percentage of the workforce in grade 6/7 or above has gone up from 6% in 2011 to 14% in 2024. This reflects the increased complexity of the work of the department and the greater level of experience and skills required. HMRC, however, does not keep a count of how many of its staff have a professional tax qualification, nor of how many have its highest qualification the Tax Specialist Programme.

HMRC has an increasing need for highly skilled financial and investigative skills. Highly skilled workers are more able to resolve tax concerns, leading to higher efficiency across the department. Tax professionals have also stressed the need for specialist knowledge around research and development-related tax reliefs.

The workforce age profile shows the need for active management

A significant number of staff are aged over 60, with a disproportionate share in their 50s. This means that as people take retirement, many experienced staff will need to be replaced over the coming decade. With the exception of at Senior Officer level, HMRC's workforce is older than the civil service as a whole. This is particularly true at Senior Civil Service grade, where the median age is between 50 and 59 and where over half of senior civil servants are in their 50s or 60s. Across the civil service as a whole, the median age is just 48.

As the table above shows, HMRC is one of the oldest departments in the government. As the Institute for Government (IfG) puts it, "Big delivery departments – the Department for Work and Pensions (DWP), the Ministry of Defence (MoD), HM Revenue and Customs (HMRC), the Ministry of Justice (MoJ) and the Home Office (HO) – have older workforces; over a third of their staff are aged over 50, approaching nearly half at MoD and DWP. These departments are also getting older."



Source: Age of the civil service | Institute for Government

HMRC By Age Group

	16-29	30-39	40-49	50-59	60+
HMRC overall	17.40%	23%	22%	28%	10%
Senior Civil Service	*	11%	35%	47%	7%
Grade 6	1.00%	18%	31%	41%	9%
Grade 7	8.00%	26%	27%	33%	6%
Senior Officer	8.00%	22%	26%	35%	8%
Higher Officer	17.00%	29%	22%	24%	7%
Officer	22.00%	24%	19%	24%	10%
Administrative Officer	23.00%	18%	19%	27%	13%
Administrative Assistant	*	4%	15%	40%	39%

Source: HMRC: Public Sector Equality Duty compliance 2021 to 2022

Workload has increased significantly

HMRC has one of the UK's largest customer service operations of any government department. However, demand has increased more quickly than its customer services, eg growing numbers of higher rate taxpayers.

There have been large increases in the numbers of payers of other kinds of taxes:

- For corporation tax, there has been a 38% increase in the number of taxpayers between 2014 and 2021 (most recent available data).
- For capital gains tax there has been a 50% increase in the number of taxpayers between 2014 and 2021 (most recent available data).
- For inheritance tax there has been a 116% increase in the number of taxpayers between 2014 and 2023/2024.
- For VAT there has been a 24% increase in the number of taxpayers between 2014 and 2023/2024.
- IPT has remained roughly flat over the last decade.

The workload is exacerbated by the rise of the gig economy and ease of self employment, which has grown significantly over the last 20 years (though falling during the COVID pandemic). This has driven an increase in self assessment tax returns and put additional pressure on staff.

There has also been an increase in the overall numbers of taxpayers, which has risen by 18% over the last 10 years to 35.9 million. However, over the same time period, the number of higher rate taxpayers is up by over 40% and the number of additional rate taxpayers has nearly tripled over the same time period. These individuals have disproportionately more complex tax affairs needing support.

Number of people in self-employment (thousands)

Source: Understanding changes in self-employment in the UK - Office for National Statistics (ons.gov.uk)

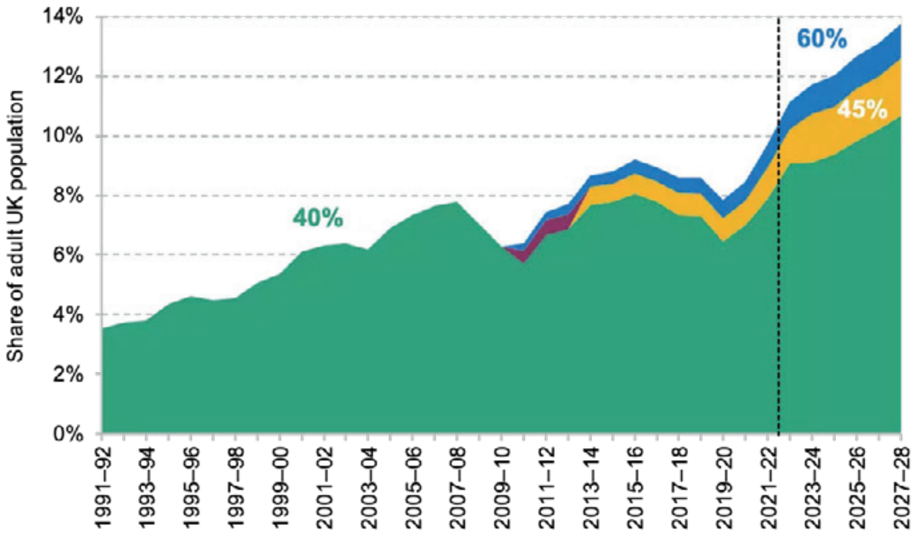
As the Institute for Fiscal Studies (IFS) has noted: "In 1991–92 just 3.5% of UK adults paid the 40% higher rate of income tax. By 2022–23 11% were paying higher rates, with that figure set to reach 14% by 2027–28"

Gross increase in taxpayers

Tax year	All Income Taxpayers	Higher Rate Taxpayers	Additional Rate Taxpayers
2013 to 2014	30.4m	4.20m	0.31m
2017 to 2018	31.2m	4.21m	0.39m
2023 to 2024	35.9m	5.59m	0.86m

Table: Table 2.1 Number of individual Income Tax payers by marginal rate, sex and age • Source: HMRC • Created with Datawrapper

This has brought more occupations within the scope of higher tax rates. The IFS points out: "As a result, while in the 1990s essentially no nurses and just 5–6% of teachers paid higher-rate tax. In 2027–28 more than one in eight nurses and one in four teachers are set to be higher-rate taxpayers."



This customer base generates very large amounts of transactions and communications with HMRC. In 2022/23 there were more than 38 million phone contacts and more than 16 million items of correspondence that needed a response. Given the digitalisation of services, this is a reduction from 2013 where HMRC received 79 million phone calls and 25 million items of post. Many of these are repeated interactions because of a failure to resolve or respond fully to any given enquiry.

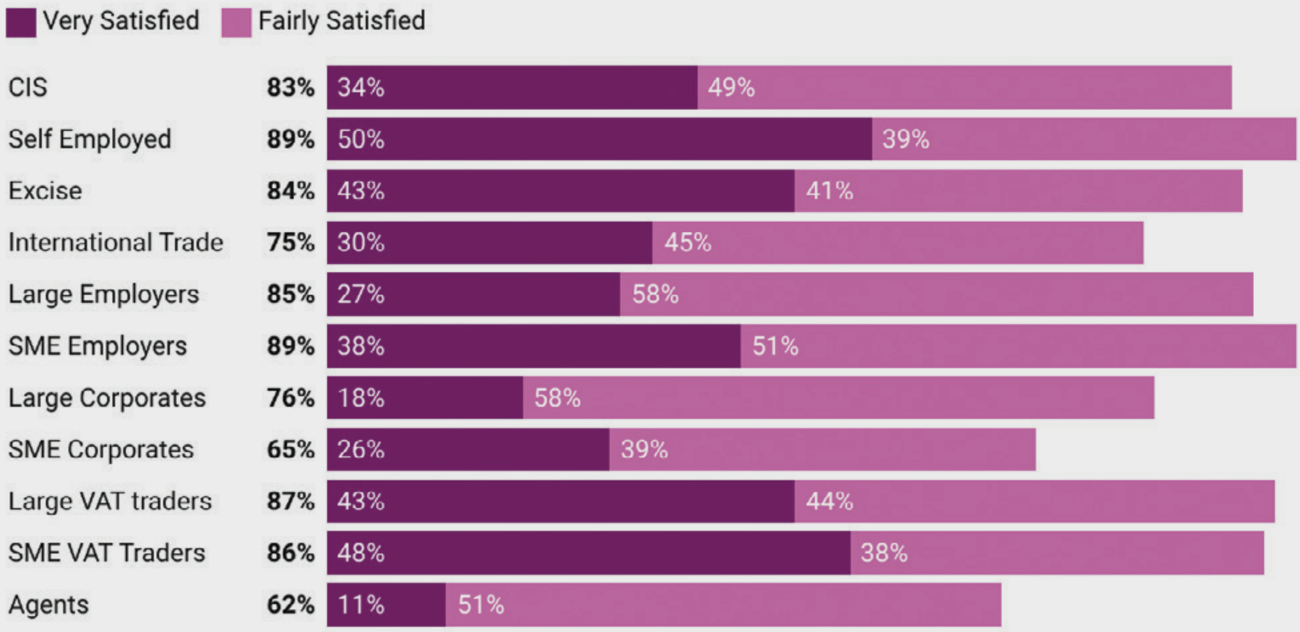
This workload is only likely to increase further. The Office for Budget Responsibility (OBR) has estimated that an additional 3 million taxpayers will be brought into the 40p tax rate over the next year. An additional 900,000 pensioners may be brought back into the tax system over a similar time period because of frozen income tax thresholds. In the immediate term a reduced dividend allowance and increased interest rates is likely to mean that additional taxpayers will be required to self assess, due to having additional taxable income. An additional factor in tax administration complexity is the different rates set by devolved governments, which remain administered by HMRC.

Customer satisfaction has deteriorated

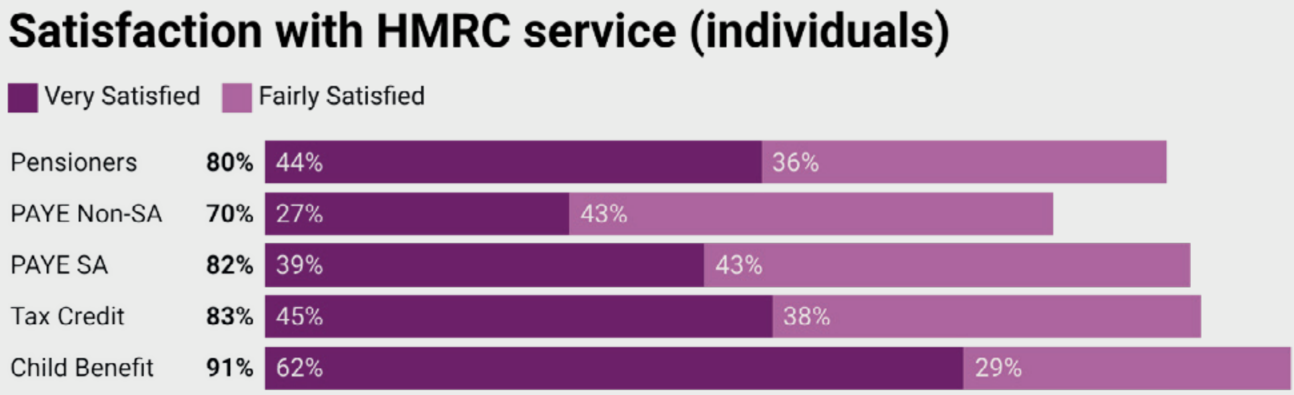
Increased demand has reduced customer satisfaction. A 2007 survey gave high levels of customer satisfaction for business and individuals.

In the 2007 Customer Satisfaction survey, HMRC performed relatively well across the majority of its customer bases. With the exception of Agents, it was common for HMRC to see satisfaction rates approaching 90% with its customer service.

2007 HMRC Customer Service Satisfaction Survey



Source: HMRC Customer Service Survey 2007: results - GOV.UK (www.gov.uk)



It is notable that today's customer satisfaction with HMRC has dropped to 79% on average. HMRC's target for customer satisfaction is only 80% which shows a remarkable acknowledgement that HMRC is unable to reach previous levels of customer satisfaction, present 16 years ago.

To give an indication of the comparative levels of satisfaction. Most recently, for small businesses, positive ratings of overall experience decreased to 76% in 2021; for agents, ratings decreased to 48% in 2021; and for individuals, ratings decreased to 62% in 2021.

HMRC Individuals, Small Businesses and Agents customer survey 2022

Confidence in the way HMRC does its job	
Individuals	43%
Small Businesses	54%
Agents	35%
HMRC applies penalties and sanctions equally:	
Individuals	34%
Small Businesses	39%
Agents	49%

Source: HMRC annual report and accounts 2022 to 2023 (publishing.service.gov.uk)

This is primarily due to a mismatch between increasing numbers of customers, an enforced channel shift towards digital, and a net reduction in customer service staff numbers.

This reduction is likely because of deteriorating standards of customer services. In 2013, average customer hold times on the phone lines were 4 minutes and 42 seconds. Today that is 24 minutes and is increasing.

This has led to decreasing levels of trust in HMRC. The Asssociation of Chartered Certified Accountants' (ACCA's) Public Trust in Tax reports, for example, have found that trust in HMRC increased during the pandemic in line with international comparators. But trust in HMRC has fallen off subsequently, whereas trust has increased across the rest of the G20. For example, in 2021 the UK had a net favourability of +24.3%. This has now fallen to +16.8%. Across the same time period in the G20, net favorability for local tax administrations went from +25.6% to +28.3%. While they are not able to definitively state that this is because of deteriorating levels of customer support, they think that it likely makes up a part of this decline.

Customer support is more complex

Customer services are more complex to provide today than they were a decade ago. In 2013, HMRC only had two main ways in which it communicated with its customers: over the phone and by post. There were some face to face contact at local enquiry centres but this was withdrawn in 2014.

Today, the introduction of online filing, personal and business tax accounts, and Application Programme Interfaces (APIs) have helped produce a channel shift towards digital interactions, adding a third channel to HMRC's customer service. This will only accelerate with continued investment into Making Tax Digital (a part of the government's tax administration strategy). HMRC personal and business tax accounts, and app, were accessed almost 200 million times in fiscal year (FY) 2022/2023 compared with 61.6 million times in 2016/2017.

This channel shift has, by some metrics, reduced demand for HMRC services. In 2013, HMRC received over 60 million phone calls and 9.5 million letters. In 2017/18, the number of phone calls had reduced to 46.7 million, but with an increase to 18 million pieces of post. In 2024, these numbers stand at 38 million phone calls and 16 million letters. HMRC should aim to make as many interactions as possible self-service and over the long-term, this should reduce demand for customer services. However, it is clear that standards of service currently need to be improved.

Staff feel overstretched and undervalued

However, data from the Civil Service People Survey* presents a picture of a workforce that is overstretched and undervalued, causing staff retention risks:

- Two-thirds of HMRC workers did not agree that they were adequately paid for their skills
- Two-thirds also argued that they weren't adequately paid for their level of performance.
- 7% of staff said that they were looking to leave the department as soon as possible, with a further 10% saying they would like to leave within 12 months.
- A total of 41% of the workforce said that they would like to work somewhere else within three years, which was significantly higher than the civil service mean and median.

Staff churn, particularly at higher grades, is a problem across the civil service and this is equally true at HMRC. The recruitment and training of staff to high levels of specialisation often takes multiple years, particularly for taking on highly complex multi-year investigations of tax affairs.

*The data in this report is from the 2022 edition of the Civil Service People Survey. The 2023 edition had similar or worse results for HMRC staff than in 2022.

2 Delivering world class tax administration

In this section we set out the six high level principles which define a world class tax administration. Some of the principles set out here are already espoused by HMRC in its charter, some have been suggested by bodies external to the government. In summary, they lay out what an effective modern tax authority should look like. We suggest that a new government should assess how well HMRC matches these principles:

1. **Straightforward and accurate tax collection**
2. **Data based and risk aware**
3. **Technologically forward-thinking**
4. **Customer-oriented and collaborative**
5. **Trusting and trusted**
6. **Skilled and Empowering**

In some areas, HMRC is excelling. Estimating the tax gap, while its exact methodology is debated, is one area where the UK is a world leader in tax administration.

Principle one: Straightforward and accurate tax compliance

→ **Collecting the right amount of tax involves core elements; good design and guidance to enable voluntary compliance and enforcement. All are necessary for securing the correct amount of tax annually.**

To facilitate HMRC's good compliance work, the department additionally aims to make compliance as easy as possible as it can for individuals and its institutional customers. The aim should be to facilitate the highest possible levels of tax morale, the intrinsic willingness of individuals and companies to pay their taxes.

HMRC recognises nine strategic risks and also adopts a risk-based approach to tax compliance, under the umbrella of "Prevent, Promote, Respond". As the National Audit Office (NAO) notes, there are two main approaches to improve tax compliance: upstream compliance work to encourage voluntary compliance and prevent non-compliance before it happens; and downstream compliance work to identify and tackle non-compliance after it has happened. Broadly this aims to match resources to risks, recognising the need to balance rates of return, compliance yield targets, affordability and the need to cover different taxpayer groups. There may be delays between identifying new risks and the timing of a response.

It is clear that in some cases this risk assessment was incomplete or underestimated the scale and impact of risks, for example tax reliefs like Research and Development (R&D). For example the NAO stated, "The level of error and fraud in R&D small and medium-sized enterprises (SME) relief exposed significant weaknesses in HM Treasury's and HMRC's identification and understanding of the risks affecting reliefs with economic objectives; design of controls; and capacity and agility to respond quickly."

HMRC should review the operation of risk-based methodologies to ensure they are robust, including being able to collect and fully analyse data on both upstream and downstream compliance, recognising that there are some tax issues which are too small to justify significant resources to address the risk. Where this is true, HMRC should maintain a deterrence and monitor the position. In principle, it should always provide sufficient resources to manage the ensuing customer service that derives from its compliance work. But where resources are constrained it is not possible to have a formulaic approach to setting the right balance between the two. One approach will be to ensure that processes and policies consider the entire customer journey and that complexity, and compliance risks, are as far as possible designed out.

Principle two: Data Based and Risk Aware

→ A world-class tax administration should collect data in a manner that allows it to learn more about how to do more effective risking and compliance, improve tax administration, and to facilitate effective analysis of potential effects of changes to tax policy. Simultaneously, it should aim to balance collections costs for customers wherever possible. But, like customer service/compliance, there are inevitably tensions here that are best to be publicly acknowledged in any specific cases, possibly in any data impact assessment.

HMRC should, in consultation, consider if it is best placed to become a single-source of tax data across government. This would aim to create a file-it-once approach to taxes. Government should thus consider closer joint working or creating a single data requirement for HMRC, Companies House, and DWP. There is also scope to extend collaboration to sharing data with DWP.

Principle three: Technologically forward-thinking

→ A modern tax administration should not have any significant dependence on legacy technology systems. It should aim to be at the forefront of the public sector in its adoption of future technologies such as AI.

HMRC has identified this issue but not made sufficient progress. In 2011 it set out a three year programme to rationalise and streamline HMRC's IT estate, reducing the number of HMRC IT applications from 600 to approximately 150. That gap still needs to be closed. There is great potential for simplified, modern systems to improve efficiency and increase productivity. HMRC's legacy systems are currently a huge burden to its productivity and making HMRC's systems interface properly could result in lasting and important improvements. Historically the upgrades have been deprioritised, for example, reprioritising EU Exit put on hold 39 projects, including Making Tax Digital.

Looking to the future, HMRC should derive more value from the wide range of data sets it holds, with more use of software tools such as data mining, data intelligence and data analytics. Artificial intelligence will help improve productivity across both compliance, owing to the rules-based nature of tax, and in customer service. But once again there is the issue of funding the changes.

HMRC recently estimated that the vast majority of calls to its helplines – two-thirds of all Self Assessment calls – could be resolved by customers themselves online. It is highly likely that many of these queries could be routed through an artificial intelligence system.

CASE STUDY:

Using Technology to manage Customer Service Demand

United States – Chatbot

Chatbots, which have handled 2 million chats for collection in the past six years, are currently available in both English and Spanish on the Internal Revenue Service (IRS) web page. The chatbots provide taxpayers with self-service options to resolve their Collection notice without calling the IRS. Services offered include information about making a payment, notice clarification and responses to frequently asked questions, with the option to escalate to a live assistor.

The IRS also offers Collection voice bots, which have handled 8.2 million calls in the past 12 months in both English and Spanish, for taxpayers calling into the Automated Collection System (ACS) and Accounts Management toll-free lines that allow them to use natural language to speak with a bot in a simplified simulation rather than using menu prompts. Voice bots were an important factor in the IRS being able to answer 30% more calls in ACS last fiscal year. Eligible taxpayers can authenticate their identity in a few short steps to receive options to resolve their accounts, such as setting up a payment plan, obtaining a payoff amount, and receiving account transaction information. Additionally, taxpayers can receive unauthenticated services that provide taxpayers with information about making a payment, notice clarification and responses to frequently asked questions.

Taxpayers authenticate their identity by providing their Social Security Number, date of birth, and the caller ID number contained on their collection notice. The taxpayer is then prompted to create a Personal Identification Number that is used to navigate the process.

Principle four: Customer-oriented and collaborative

→ An effective tax administration should interface with customers in ways which encourage voluntary compliance and boost tax morale. User-centric design should be a key aspect of making this possible. Information should be clear, intuitive and easy to find, no matter which type of customer. Communication should be customer focused and clear.

HMRC must be committed to reflecting the needs of its customers. This is particularly the case for those who may be digitally excluded or have particular service needs. This means that multiple channels of customer service should be operational, and that these should be run to a high degree of customer satisfaction. Where there are ongoing failures to provide proper customer service, or to create customer-centric design, these should be quickly addressed. As the HMRC Technology Transformation Director Nic Harrison recently said: "Real experts on tax should still be available at the end of the phone, that's what the public wants. The real challenge is not letting perfect be the enemy of good. We should have digital services that work most of the time for most people, but we then need to make provision for people that need extra help, whether through accessibility issues or plain 'I just don't understand this.'"

Principle five: Trusting and trusted

→ A world-class tax administration should aim to interact with its customers in a way that increases trust in the effectiveness of the organisation. This in turn will underpin voluntary compliance. It should acknowledge that trust is a two-way street and that to build trust with its customers, it must, where there are lower levels of risk, trust them.

HMRC should aim to ensure that it improves its trust among both the general public and its professional customers. It should look to best practice internationally to evaluate where trust in HMRC is breaking down and so that it can increase voluntary, honest compliance. This requires HMRC to be trusting of its customers. For example, it should grant high levels of visibility for agents over their clients' affairs.

Principle six: Skilled and Empowered

→ An effective tax administration would have staff that are highly skilled. It would also have clear plans for the shape of its workforce which take account of its current and future needs. Its staff should then be empowered to resolve customer issues as quickly and efficiently as possible.

The government should recognise the range of work HMRC does and the need to fully train and develop HMRC staff across all of its disciplines, from compliance, to customer service, to digital. There should be clear structures of progression, skill acquisition and accountability with clear metrics for both personal and team progression.

SURVEY: What do HMRC staff think needs improving in the department?

We surveyed HMRC staff about their views on HMRC. We received over 750 responses from ARC, other union and non-union members. Those surveyed represented grades from HO trainee, to Fast Streamers, up to members of the Senior Civil Service.

The clearest message from HMRC staff was that internal processes were a barrier to their ability to effectively fulfil their roles. When asked if they agreed with the position "Current departmental processes and systems inhibit my productivity", 81% of HMRC staff agreed. This was followed by a lack of staff and poor quality technology inhibiting their ability to work.

We gave staff an opportunity to give us their open-ended view about what HMRC, as an employer, could do to improve their efficiency and morale. We have grouped their responses into the following areas:

A focus on the core mission:

- Staff called for effective and clear communication of HMRC's core goals and clear guidance on how their role fits into that overarching goal.

- For compliance work in particular there was an emphasis on focusing on high-impact cases, or using innovative working methods (including predictive analytics through AI) to tackle smaller issues, and to make better use of all of HMRC's organisational powers to tackle non-compliance.

Reduction in bureaucracy and clarity of processes:

- Staff called for a reduction in bureaucracy by clarifying processes and points of sign off. They said that there were too many layers of internal approval that did little to change the substance of their work.
- Automation of simple tasks, they argued that there was a proliferation of form-filling and basic administrative work which could be automated.

Technological efficiency and integrations:

- Staff called for the quality of data collected to be enhanced and to make it more accessible to staff for analysis.
- Staff argued for better integrated and more efficient IT systems that streamline tasks rather than complicating them. They argued that this would help them work effectively on their core compliance or customer service goals. This includes faster systems, better case management tools, and a unified platform that reduces the need to use multiple systems for a single task.
- Suggestions include moving away from tools like SharePoint and Caseflow if they are not meeting the needs of the staff.

Training and Professional Development

- There was a strong emphasis on more comprehensive tax technical training, programs dedicated to compliance work, data analysis and management skills, risk identification and other professional development (CPD) to keep staff updated.

Pay and Recognition:

- Staff were of the view that churn is an ongoing problem within the department. They suggested that progression was often slow and that pay was not commensurate with the complexity of the tasks that they worked on.

Culture, workforce and flexibility:

- Many employees express a desire for more flexibility in their working arrangements, particularly the ability to work from home more frequently to save on commuting time and enhance work-life balance.
- There was a call for additional management training to improve the skills of leaders.

3 Current challenges for HMRC in delivering excellence

To deliver a world-class tax administration in line with the key principles set out in section 2 will require HMRC to address the key barriers and challenges it currently faces. This section therefore focuses on the specific areas of HMRC's ongoing work and programmes that will be critical to address for any incoming government or HMRC Chief Executive.

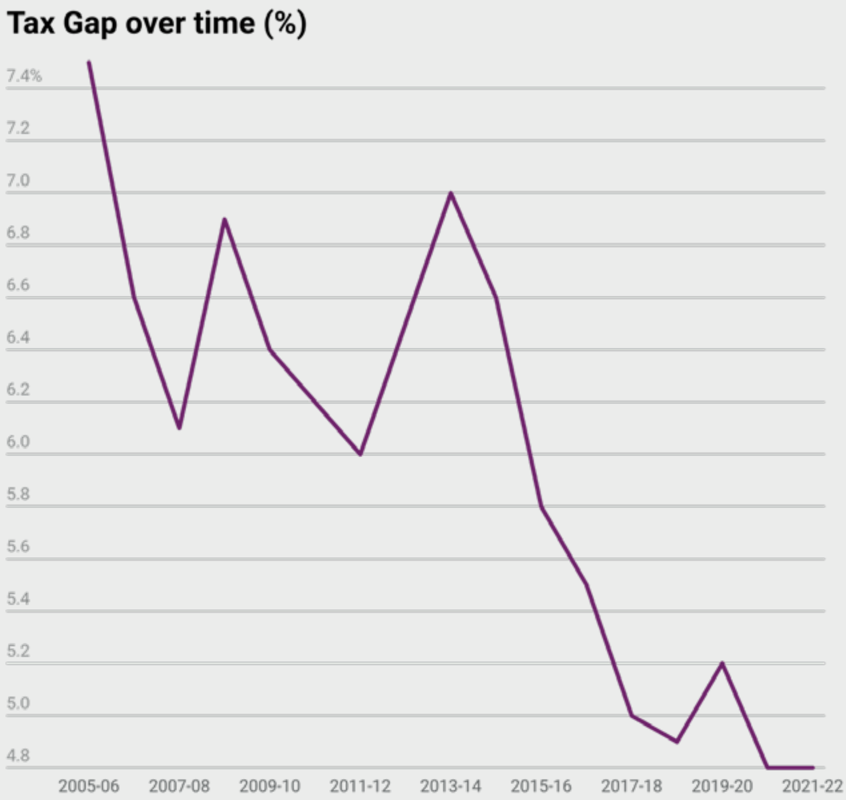
Given the breadth of the work of the department, the list is not exhaustive. Instead, it reflects the areas of HMRC's work that have been raised by core HMRC stakeholders that we have engaged with over the course of writing this report. As a result, it allows us to substantiate how the principles laid out in the previous section can be applied to HMRC's day-to-day operations.

1 Collecting the right amount of tax and closing the rest of the tax gap

Each year HMRC estimates (in line with the techniques required to be Official Statistics) how much tax it should collect versus how much it actually does. This is known as the tax gap. The tax gap is an estimate of the relative size and nature of non-compliance (after HMRC's compliance activities).

There are some difficulties in both the conceptual framework of a tax gap and how it is measured. It is backward-looking and calculated at a very aggregate level (reflecting the combined actions of compliance staff, customer service staff as well as non-HMRC factors such as the state of the economy and the nature of tax policy choices) and so cannot directly link to the performance of individual teams. Nonetheless, it can be used to give a strategic overview. It is viewed as relatively robust, as a number of countries use a very similar metric, including many of the largest economies in the world. Over the long term, HMRC has been effective at managing the tax gap down from 7.5% to 5%.

Over the last five years, the trend has been somewhat different. In percentage terms, the tax gap has stayed at around 5%, while in cash terms, the amount brought in has increased. In 2021/2022, HMRC collected £814bn in taxes, with an estimated gap of 4.8% or £34bn.



Source: Measuring tax gaps 2023 edition: tax gap estimates for 2021 to 2022

In cash terms, the largest contributors to the tax gap are:

- Income tax, National Insurance contributions (NICs) and Capital Gains - £12.7bn (tax gap percentage 3.0%)
- Corporation tax - £10.6bn (tax gap percentage 13.3%)
- VAT - £7.6bn (tax gap percentage 5.4%)

The vast majority of the tax gap - £27.9bn (77.9%) - is owed by businesses. Small businesses make up the lion's share, owing £20.2bn, with mid-sized and large businesses owing £3.8bn and £3.9bn respectively. The IFS has estimated that over half of this gap is owed by under 4% of small businesses. In particular, there has been a large increase for corporation tax. In 2011/12 it was estimated at 8.8% (£1.1bn); by 2021/22 it had risen to 29.3% (£8.4bn). The causes of this are not fully understood but, given the base, it is likely to be the result of error or mistakes, or failure to take reasonable care, as well as any conscious decisions to evade.

In terms of behaviours, evasion, criminal activity and the hidden economy are the most prominent part of the tax gap, making up 30%. Failure to take reasonable care accounts for a very similar proportion of the tax gap at 30%, increasing its share of the tax gap from 24% in 2019 to 2020. Error accounts for the third largest share, at 15% of the overall tax gap in 2021 to 2022.

As discussed in the first section, previous strategic investments in HMRC compliance has produced significant yields in terms of increasing the tax take. However, investments have been relatively ad hoc. This is a cross-governmental problem and is the result of both political and economic reasons. HMRC does think strategically about its workforce, but it needs the long-term planning and spending power to produce, and pay for, a clear long-term staffing plan with clear identification of which parts of the tax gap should be tackled. This may lead to a more effective delivery of compliance yield.

CASE STUDY:

United States - Using AI to close the Tax Gap

As part of the Inflation Reduction Act, the US invested a significant amount into compliance yields.

Given the rules-based nature of tax policy, they have focused on improving compliance through pairing tax experts with machine-learning.

"The complex structures and tax issues present in large partnerships require a focused approach to best identify the highest risk issues and apply resources accordingly. In 2021, the IRS launched the first stage of its Large Partnership Compliance (LPC) program with examinations of some of the largest and most complex partnership returns in the filing population. The IRS is now expanding the LPC program to additional large partnerships. With the help of AI, the selection of these returns is the result of groundbreaking collaboration among experts in data science and tax enforcement, who have been working side-by-side to apply cutting-edge machine learning technology to identify potential compliance risk in the areas of partnership tax, general income tax and accounting, and international tax in a taxpayer segment that historically has been subject to limited examination coverage. By the end of the month, the IRS will open examinations of 75 of the largest partnerships in the U.S. that represent a cross section of industries including hedge funds, real estate investment partnerships, publicly traded partnerships, large law firms and other industries. On average, these partnerships each have more than $10 billion in assets."

2 Productivity in customer service and Making Tax Digital

One area of concern about HMRC has been the changing nature of its customer service. Many of those experts who spoke to us said that they had seen long-term declines in the quality of HMRC's customer services and this is reflected in the survey data in the first chapter.

In our conversations with stakeholders, much of this decline has become more perceptible as a result of three large events: Brexit, and the additional resources that have been shifted to border and customs enforcement; the ongoing digitalisation of customer services; and the pandemic. Since the pandemic, the time it takes for HMRC to resolve customer issues has increased, and it has continued to worsen since.

Simultaneously, HMRC seasonally closed the agent-specific telephone line, and the self-assessment line. These were aimed at producing a channel shift for those customers who have the most interaction with HMRC over the phone onto webchat and other methods of interaction. While it is impossible to evidence a counterfactual, core stakeholders argued that this change has caused worsening and slower customer services.

More recently, the freezing of tax bands will lead to higher numbers of taxpayers in higher rates, which leads to an increase in the number of enquiries to HMRC. As Permanent Secretary of HMRC Jim Harra told the Public Accounts Committee in December: "there will be about four million additional income tax payers. There will be about three million more in the higher rate and about 400,000 more in the additional rate. All that creates more of a pressure [...] the key pressure on HMRC is that more taxpayers, and more taxpayers engaging in the part of the tax system where they have to actively engage with it, means more contact with the tax system and therefore more contact with HMRC." The NAO reports that in 2022-23, HMRC received over 38 million phone calls from taxpayers and their agents, and received 16 million pieces of customer correspondence. It is clear that delays to this volume of phone calls has implications for the wider economy.

CASE STUDY:

an indicative calculation of the external costs of HMRC customer service

The average waiting time for HMRC phone calls is 24 minutes. HMRC received 38 million phone calls last year. This means that across the UK, 15.2 million (working) hours are spent on hold to HMRC.

The average output per hour in the UK in 2021 was £43.59 per hour worked. This suggests that just on this single measure the current length of time customers spend simply waiting for HMRC to answer the phone could be costing the UK economy £660m per year. There are likely to be other costs, such as seeking advice from other areas (from agents to charities like Low Income Tax Reform Group), or incorrect application of the rules through continued misunderstandings (e.g. VAT ratings of goods or services).

Assuming the writing and posting of a letter to HMRC, followed by any actions needed to resolve an enquiry takes an average of two hours, and that this could be cut in half by either engagement online or over the phone. The UK economy could be losing another £480m per year from engaging with HMRC by post.

Even as it has seen massive upticks in utilisation, digitalisation of HMRC's customer service, has yet to decrease demand for the telephone service, which has increased around 10% a year over the previous two years.

This all comes against a backdrop of relative under-investment in HMRC's customer service staffing levels, as the House of Commons Public Accounts Committee highlighted:

> **"In the last five years, HMRC has reduced its customer service staff numbers from 25,500 to 19,500. During the pandemic, HMRC's performance in replying to post or handling calls fell significantly, partly because it did not have sufficient customer service staff to manage the pressures that the pandemic brought. We were surprised to learn that at times in the past, HMRC has simply closed its telephone line when it could not cope with demand."**

Making Tax Digital will inevitably be a part of the future of HMRC customer service, and there is an additional opportunity through the use of Artificial Intelligence to further improve HMRC's customer service productivity.

However, there are important lessons to be learned and principles that should be taken forward in order to both rectify the issues with customer service currently, and to learn the lessons. In terms of design, it means involving core stakeholders in the development of its user experience and customer service from the outset of the design process. These processes are currently espoused by HMRC, but there have been notable failures to implement it properly.

Recent changes to helplines have, for example, produced critical reactions about their timing and impact on customers and agents.

CASE STUDY:
Making Tax Digital

Making Tax Digital (MTD) is HMRC's flagship digitisation programme. It is currently estimated that MTD's investment will bring in £2 for every £1 spent, despite being beleaguered by delays and cost increases. Some of these problems are derived from the failure to design the programme with the desires and requirements of its core stakeholders.

The Public Accounts Committee made the scale of the problem clear: "HMRC announced a fast timetable without anticipating the additional complexity and its subsequent work to design and test the system has been far too limited. Its pilot test had just 137 participants by 2023, falling far short of HMRC's aim to pilot the programme with 15,500 people."

"The report finds that the design of MTD has not taken sufficient account of the realities facing business taxpayers and agents. HMRC excluded £1.5 billion in upfront transitional costs for customers in its cost benefit analysis in its business case seeking further investment for the programme in May 2022. It also excluded upfront transitional costs of £640 million in its 2023 business case which was also seeking further funding. Its latest figures indicate business taxpayers could have to pay a total of more than £1.9 billion to comply with the new arrangements over the first five years"

"HMRC has increased its engagement with these stakeholders, but this only started in early 2023. Some stakeholders remain concerned about the engagement from HMRC on the design of the Self Assessment system and the impact on customers."

Investments in compliance generate higher levels of enquiries

Government should always recognise total costs of ownership of any new policy or project. These costs should include the cost of providing staffing for the customer service element of its compliance work. These should be built into the costs of future investments into compliance. HMRC compliance has a remarkably high yield but more could be done to manage additional customer service that arises from its work.

Customer service should maintain its standards during periods of channel transition

As the investment in Making Tax Digital shows, customer service provision should only decrease as a new system starts to reduce demand for customer services. Investment into new forms of customer service should not lead to lowering standards and quality as there is a channel shift between telephone and online, for example. This will allow for a smoother transition from one system to another and allow time for HMRC to explain new processes to its customers.

HMRC will always have to be multi-channel

While digital provision is necessary and is likely to improve HMRC customer service productivity in the long run, some issues and some customers require highly skilled individuals in a more person-to-person fashion. HMRC customer service is unlike communication about a consumer product, and the increased importance of communication with HMRC should be considered when designing how customers should be able to interact with it.

Design of customer service should have customer input from the outset

One core aspect of moving customers to a new channel should be to ensure an easier and faster experience for customers as well as reducing administrative burden on HMRC. As a result, customers and agents should be involved in designing what it is that they want and need from the service from the outset.

3 Upgrading and Updating Legacy Systems

One of the major causes of lower productivity within the department has been the legacy technology which underpins some of HMRC's systems.

A 2022 report noted that "HMRC has one of the largest and most complex IT estates in Europe with over 600 systems, 800 terabytes of data, 1,000 IT changes a month and a 24/7 IT operation. It serves 45 million citizens and more than 5 million business taxpayers."

The scale, therefore, of HMRC technological innovation is both large and important. According to the Infrastructure Projects Authority, HMRC has 21 major projects, 19 of which have digital technology at their core. This applies to both internal systems that collect, store and process data, and in how customers can connect to HMRC, including easy access to their own data, using devices they are familiar with (eg mobile phones or tablets.)

Legacy IT systems are costly and difficult to move away from but worthwhile both financially and politically, if the government takes a long-term view. The NAO is clear on this point:

> **"Tackling legacy systems is costly and complex, but continuing to use them is risky and leaves government facing greater costs and risks in the future, including possible service disruption and cyber-attacks."**

The NAO has found that moving from legacy systems has been a major cause of delays to the Making Tax Digital programme, in part because moving data from the legacy system has been very difficult.

A 2022 report stated: "The scale and complexity of these legacy systems is one of the root causes in delays to digitising HMRC customer services. Legacy systems must be overhauled to facilitate ongoing improvements in tax administration and this will require significant investments, likely to be over and above the resources currently allocated. This is essential in order for long term improvements in HMRC productivity as well as improving consumer-focused administration."

Many of these problems have been highlighted by agents, and are due to HMRC's underlying systems not interacting. Examples include:

- Capital gains tax (CGT) Payment for Property Disposal (PPD) service for reporting capital gains on UK residential property does not interact properly with self assessment. Similar problems have been noted around the Trust Registration Service; and
- the National Insurance and PAYE service (NPS) does not interlink with the self assessment system CESA. This results in problems such as duplicate (but different) income tax calculations from both systems and problems with class 2 NIC not being charged.

In the round, removing and replacing legacy systems are likely to provide a step change both in the efficiency of HMRC for its own direct costs, as well as making agent interactions with HMRC quicker and more effective.

CASE STUDY: The problem of poor tech

Our survey of HMRC members showed that technology was a significant barrier to their capacity to fulfil the functions of their role.

When asked whether they agreed with the statement ""Issues with technology inhibit my ability to work effectively" 55% of respondents agreed that it did.

When asked "How much time per week is your work delayed/inhibited by poor technology?" the mean response was 93 minutes per week. 15% of the workforce thought that technology inhibited their ability to work by more than four hours per week.

Replicated across the entirety of HMRC's full time equivalent staff of 61,000 full time equivalent staff, this is roughly equivalent to HMRC losing 90,000 working hours per week. Per year, this is equivalent to 4.4 million working hours to poor technology every year.

However, it is clear that there was an optimism about the use of technology in the department if it were properly implemented. When presented with a list of possible ways to increase HMRC's yield, 47% of respondents thought that improving technology would be an effective way, which followed on from more efficient internal processes (62%), and additional staff (58%).

4 Improving staff morale, upgrading skills, and improving staff productivity

The Civil Service Staff Survey and our internal survey of HMRC members in previous sections paint a clear picture of adepartment that feels constrained by numerous factors in achieving HMRC's core missions.

It is clear that skilling, staffing, and proper management and organisation of the departmentare central to its proper functioning and productivity.

There are numerous challenges for the department raised by our survey data:

Internal processes and accountability

The most common response raised by HMRC staff when discussing what inhibits their productivity are the structure and clarity of internal processes.

A common complaint among both staff and stakeholders was the lack of clarity and "ownership" of work. Staff often mentioned that tasks required several tiers of oversight and this created duplication of work within the department.

Industry stakeholders emphasised the lack of transparency about a single "case officer" or point of contact for their enquiries.

For staff, this additional "ownership" and accountability should be aligned with clearer metrics for progression within the department. This progression within the department would, they said, lead to more skilled and motivated staff, who would therefore be more likely to remain within the department.

These organisational problems are exacerbating a feeling within the department that it is understaffed.

This aligns with the views of our stakeholders who raised concerns about their inability to talk to staff who have the technical expertise to manage more complex complaints.

There were also concerns raised about how HMRC can better integrate its digital and tax skill requirements so that the digital teams are no longer siloed away from tax specialists who may be able to pre-empt design issues.

Skilling for tax technical training and digital transformation

A large majority of the staff in HMRC (85%) said that they were adequately or more than adequately skilled for the role that they are currently in.

However, a notable minority (13.5%) said that they were underskilled for their current role. In open text responses, there was a clear trend towards arguing for additional technical tax training, in particular for those who are not currently in compliance roles.

There were also calls for digital technology training for staff, particularly where HMRC is undergoing digitalisation of its services. HMRC is aware of this need and has recently rolled the majority of staff from its in-house digital provider – RCDTS - into the department.

4 Recommendations: An action plan for HMRC

We should be ambitious about what HMRC can deliver for a new government that is keen to work with the broad tax community, to ensure we resolve current challenges and adopt the principles of a world-class tax administration. But we need to recognise that many of the recommendations below are in necessary tension with others and require balancing against resources and capabilities, both inside HMRC and amongst customers and agents.

- Many customers prefer phone services to digital services.
- Is investment for the future in tension with maintaining current yield?
- Could HMRC become the single source of data across government consistent with it focussing on tax collection?
- Balance of customer service and compliance activity, and its type (eg upstream/downstream, or civil versus criminal)
- How to reconcile improving (perceived) customer service with greater digitisation

These are not easily resolved but it will be for any new government to make choices and set out what is expected from both taxpayers and HMRC, e.g. if compliance is the priority then customers may have to accept lower levels of customer service such as longer call waiting times.

1 Investment in high yield compliance processes in the short term to increase HMRC yields, with an equivalent investment in customer service

a) HMRC should identify the core areas of the tax gap that have remained high as well as areas where additional investment would raise high yields in compliance.

b) HMRC should look to drive up voluntary compliance as well as interventional compliance by improving trust in the department and by increasing its deterrent effect.

c) Alongside any investment in compliance, an analysis of the number of additional enquiries generated by this compliance work should be estimated and staffed for.

d) Consideration needs to be given to more efficient and proactive ways of managing HMRC enquiries. For example, where an agent is appointed, direct communication with an agent may clear up minor points but the wider use of email would facilitate this.

e) HMRC should immediately increase the visibility that agents have over their clients affairs so that they can carry out simple tasks (such as updating a PAYE coding notice) online and are able to see everything that their client can see. This should enable agents to more quickly and effectively manage needs and resolve issues.

f) Review the policy on the use of criminal investigations, and its resourcing, to ensure it delivers the aims of deterrence and tackling unacceptable behaviours (eg the use of false or forged documents).

2 A long term, large-scale investment in compliance, with an equivalent investment in customer service

a) While this short-term investment is ongoing, HMRC should identify how it could drive down the tax gap over the longer term

b) This should include further work to understand the causes of small business non-compliance, building on 2017 work. HMRC should evaluate long term trends in individual components and try to target specific elements of the tax gap. As an example, the Measuring tax gaps 2023 edition states: “The share of the tax gap attributed to small businesses has increased over the last 5 years, from 40% of the overall tax gap in 2017 to 2018 to 56% in 2021 to 2022.” This trend should be reversed and HMRC should aim, over a Parliament, to bring the tax gap for small businesses down to 40% again. By the end of a decade, the tax gap for small business should aim to be roughly the same as it is for mid-size businesses, around 11%. Historically, small business compliance yield has been around £11-15 per £1 invested, so we would estimate that an investment of £500m could yield £6.5bn per year, of which £6bn would be additional.

c) All investments in compliance should have an impact assessment made on how additional compliance investment will affect customer service. This knock on effect on customer service should then be funded alongside the investment into compliance.

3 A long-term staffing and skills plan

a) HMRC should identify the core changes that it perceives will occur over the next decade and it should be prepared to fund the relevant priorities and staffing for those changes. Many of the additional skills may revolve around digital and Artificial Intelligence skills and the department should be actively recruiting for these positions.

b) Training tax professionals takes time. Many tax professionals do not need the full three to fouryear tax professional programme but still require at least a year of training, as well as further practical experience before they become effective tax professionals in the department. Similarly, the digital skills required to build the digital interactions with customers also take significant upskilling of the current workforce.

c) While professional development of tax professionals at HMRC is often effective, HMRC should look at, where necessary, incorporating elements from external frameworks such as the International Ethics Standards Board for Accountants’ Continuing Professional Development, to ensure that its standard remains at the highest possible level.

d) There should be a long-term plan for HMRC staffing that sets out the expected numbers, grades and skills within each professional group. It should also have a development plan which aims to improve the skills of HMRC employees and empower its own staff to engage with customers over complex issues. Part of this should involve setting out the expectations for specific roles at specific grades, along with the training requirements and their provision (e.g. self-serve, online, inhouse or external). Customers need to be assured they are dealing with HMRC staff who are fully knowledgeable on any specific customer issue, provide accurate and relevant advice, and make the correct decisions.

e) Government should consider how it can best reduce departmental churn in HMRC so that we can retain the best talent and maintain institutional knowledge. This aspect of churn is separate from the area of career and professional development, where HMRC should be creating and following a strategic workforce plan to ensure it has the right balance of skills across all of the business areas, with staff formally acquiring the skills and competencies associated with specific roles. Such career development will often be linked to taking on new roles within the department.

f) Tax skills are highly prized, particularly in the private sector, and are transferable to a high proportion of professional service sector jobs. There are also no equivalent tax administration roles in the civil service. Consequently, losing tax professionals out of HMRC is a particular problem as those skills are lost to the government as a whole. As a result, these skills should be particularly highly prized by governments. Anecdotally, ARC has seen an increase in churn at the SCS level within HMRC.

4 An ongoing technology plan

a) HMRC should identify and publish which technological trends it considers could be incorporated into tax administration and customer service to drive up HMRC productivity. This should expand on and give details on the aspirations set out in HMRC's IT strategy.

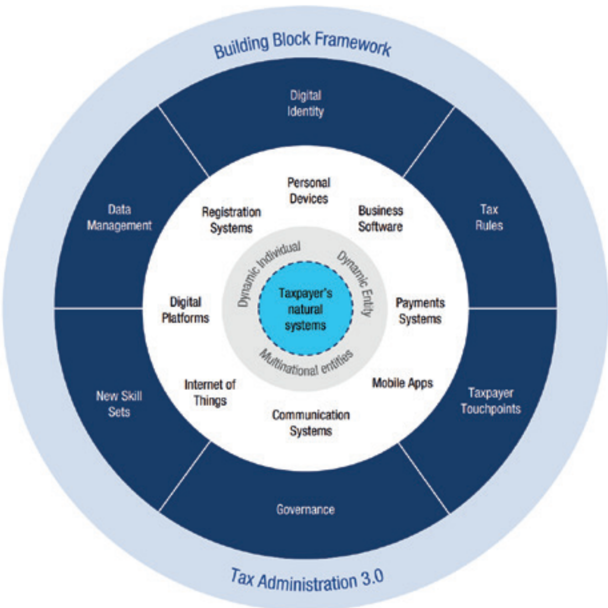
b) This should include, but not be limited to, an Artificial Intelligence plan, which should look specifically at increasing productivity in customer service and compliance work.

c) HMRC should identify which legacy technology systems are the highest priority to upgrade. This should prioritise areas which place the highest administrative burden on HMRC staff as well as create barriers to easier customer provisioning. This should emphasise and promote customer self-service and reduce the barriers for agents to do administrative work on behalf of their customers.

d) There should be an underlying alignment of the administrative parts of tax legislation. If taxes were levied on common bases using common timetables and time limits then a common database and integrated outputs would become simpler. (Work of a similar nature has just been launched - https://www.gov.uk/government/calls-for-evidence/the-tax-administration-framework-review-enquiry-and-assessment-powers-penalties-safeguards).

e) There should also be a single user ID across HMRC systems. For example, having a National Insurance Number and a Unique Taxpayer reference number creates unnecessary redundancy in the system.

f) The goal of this technology plan should be to increase HMRC's long term productivity and to facilitate easier compliance from willing taxpayers. It should follow the principles outlined in the OECD's Tax Administration 3.0 report. Consequently, all technological upgrades should be linked up: "This includes collaboration with other parts of government, with private sector parties and internationally. Tax Administration 3.0 identifies that a critical building block in this process is ensuring that the systems of tax administrations, taxpayers and businesses are connected in a way which allows data to move automatically through machine-to-machine based processes, including in real-time where appropriate."



5 A clear data strategy

a) Data should be collected efficiently and with purpose. One example in compliance would be that data collected from customers should be used to feed into common understandings of issues with tax returns and where there are breakdowns in voluntary compliance.

b) In line with the OECD principles, services, processes, and tax rules, should be embedded in the natural systems used by taxpayers in their daily lives and businesses. This will help improve voluntary tax compliance, it also reduces administrative burdens and frees up time that owners can use to grow their businesses.

c) For tax policy, HMRC needs to consider if it has the correct scope for itsdata collection. For example, currentlyHMRC can only collect data relevant to current policy. HMRC should consider if it also needs to collect data to better evaluate the impact of tax policy changes, as well as estimating deadweight costs and administration costs if implemented. HMRC should also make it easier for academics and outside researchers to access and evaluate tax data. There are many pieces of analysis that HMRC may not be able to do - or may not find it useful to do - for its own purposes. More open access for academics through collaborations would be beneficial in this regard.

d) However, this should be balanced with the collection costs for customers. Particularly in compliance related issues, HMRC must be sure that there is a clear reason why that data is needed and that the granularity of the data requested is proportionate to the potential compliance issue, or that the potential benefits outweigh costs to customers. Whenever possible, it should look to collect data from sources of information already provided or that are integral to business record keeping and accounting systems and software.

6 Develop a clearer strategy for tax administration

a) This report has steered clear of tax policy. However, it is clear that there is a relationship between tax policy and tax administration. More complex policies make administration and compliance policy more difficult.

b) The government has implicitly acknowledged the critical importance of simplifying tax administration at the 2024 Spring Budget, with promises to resolve problems with High Income Child Benefit Charge (HICBC), a new taskforce to look on to how best to administer R&D tax reliefs, and the reform of non-domicile tax status. (But the HICBC proposed moves to a "family based" system will probably create complexity in trying to reconcile household assessments with independent taxation.)

c) There are also clear ways in which the administration of taxes can be simplified. Clear forms, which have clearly structured formatting standards as well as clear processes, and IT support.

d) This work on simplification should have a clear an ongoing strategy, possibly with its own team within the department that can audit and make suggestions on improvements to the simplification of tax administration processes.

5 Impact Assessment

1 Compliance and customer service for amount invested

Initial Investment	Type of Investment	Historic yields ratio per pound invested*	Expected cash return (after one parliament)*
£500m	Small Business Compliance	Between 11.0 and 15.2	£6.5bn
£100m	Mid-size Business Compliance	Between 11.9 and 18.5	£1.5bn
£50m	Large Business Compliance	Between 39.2 and 75.0	£2.9bn
£50m	Individuals (including wealthy individuals)	Between 6.3 and 7.8	£350m
£210m	Customer Service	NA	-£210m

Totals

Total Investment	Average Yield*	Expected Cash Return
£910m	12.4:1	£11.3bn

* Yields are derived from the State of Tax Administration Report 2023 most recent estimates of compliance yields

* Expected cash return is taken at the mid-point between the upper and lower returns over the last 3 years.

* Yields from larger investments in 2010 brought in £26.6bn over a decade and 2015 brought in yields of £7.2bn up to 2020. These are ratios of between c. 27 and 9:1.

2 Technology and workforce investments

Investments in technology, and in the upskilling of the workforce are highly likely to drive real returns and productivity increases within the department. Over a single Parliament, these may not begin to make a return on investment. However, even Making Tax Digital, which has been beset by issues, is likely to return around 2:1. For legacy systems as the NAO put it:

"Tackling legacy systems is costly and complex, but continuing to use them is risky and leaves government facing greater costs and risks in the future, including possible service disruption and cyber-attacks."

For more forward-looking technological investments, such as the use of AI in customer service, other tax authorities have seen productivity improvements of up to 30%, while the Institute for Public Policy Research IPPR has identified other public services seeing up to 40% improvements in productivity owing to the use of AI.

As a result, we haven't scored the benefits or costs of technology or workforce plans. We think it is highly likely that they have a net cost over a single Parliament, but are substantially productive over two Parliamentary terms. Similarly, improvements to customer services should improve voluntary compliance and increase tax morale. A continuing and worsening service also likely aggravates costs significantly through lower voluntary compliance and low tax morale.

Conclusion

This report has argued that improving tax administration can be a useful tool for the next government. Ultimately, it is tax administration, and its hard-working administrators, that allow the government, of whatever party, to pay for every one of its public priorities.

Effective tax administration is critical for politicians who want to fund their priorities. Politicians of any party should be highly invested in both the effectiveness of their policies, in the practical operation of HMRC, and in the interaction between the two.

Overall, it is clear that investing with a view to the long term in HMRC will generate clear additional resources for a future government.

- Proper investment in compliance over a Parliament could generate a £11.3bn in revenue for a future Government;
- improving customer services could generate an additional £1bn in economic activity for the UK economy; and
- faster tribunal services could save the government over £400m per year.

In this way, the interests of a future government are well aligned with HMRC's practical, operational needs.

Whoever takes charge at the next election needs to be clear about their long-term view of the department, where they see scope for improvement, and how they can get there.

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