



House of Commons
Treasury Committee

**Government Response
to the Committee's
Tenth Report on
Inland Revenue
Matters (HC 834)**

**Eighth Special Report
of Session 2002–03**

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The Treasury Committee

The Treasury Committee is appointed by the House of Commons to examine the expenditure, administration and policy of the HM Treasury and its associated public bodies.

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Contacts

All correspondence for the Treasury Committee should be addressed to the Clerk of the Treasury Committee, 7 Millbank, House of Commons, London SW1P 3JA. The telephone number for general enquiries is 020 7219 5769. The Committee's email address is: treascom@parliament.uk.

Eighth Special Report

On 23 July 2003, the Treasury Committee published its Tenth Report, *Inland Revenue Matters*, as House of Commons Paper No. 834. We have now received a response from the Government (dated 18 September 2003) which is appended below.

APPENDIX: MEMORANDUM FROM HM TREASURY

Restricting the use of offshore tax structures

1. The conflicting evidence given to the Committee by the Chairman of the Inland Revenue and the Paymaster General has not resolved the vital question of whether in future the tax haven status of bidders for Government contracts can or cannot be taken into account. Clearly this is unacceptable. We now expect the Paymaster General, as minister responsible for the Inland Revenue, to act urgently to clarify the position. (Paragraph 9)

The Committee asked for clarification as to whether in future the tax haven status of bidders for Government contracts can be taken into account. It would be feasible to impose a contract condition (notified in advance) prohibiting a successful bidder from using certain tax arrangements, provided that the restriction did not discriminate directly or indirectly between bidders from the EU or other States party to the Government Procurement Agreement (the GPA). As the recent letter to Accounting Officers (DAO(GEN)08/03, attached) makes clear, in implementing this approach, departments should seek specialist advice to address the specific situation relevant to the case in hand. But in order to provide further guidance to departments on the practical implementation of this approach, and to demonstrate to the Committee the approach the government intends to take in practice, a model contract condition has been developed. Flexibility would need to be applied on a case-by-case basis in drafting this condition to cater for specific circumstances. Significant departures from the general approach would need to be justified on a case-by-case basis; taking account of the general approach set out in DAO(GEN)08/03.

The model contract condition would require that:

The Contractor shall ensure that neither it nor any company or person associated with it has in place any arrangements involving the use of offshore companies or other offshore entities the main purpose or one of the main purposes of which is to achieve a reduction in UK tax of any description which would otherwise be payable by it or them on the payments made under the contract or on any transaction connected with or resulting from the contract.

The Contractor shall immediately notify the contracting authority of any proposal for it or any company or person associated with it to enter into any arrangements involving the use of offshore companies or other offshore entities which would result in a reduction in UK tax of any description which would otherwise be payable by it or them on the payments made under the contract or on any transaction connected with or resulting from the contract, whether or

not in the opinion of the Contractor the main purpose or one of the main purposes of the arrangements is to achieve a reduction in UK tax of any description.

Prospective bidders would be notified of the condition in advance, and would be required – as part of the bidding process – to assure the government that they are, or would be, in a position to comply with it. These arrangements do not alter the existing protections for taxpayer confidentiality.

The government believes that this approach represents a sensible and legally robust approach to the concerns expressed by the Committee in its work on this issue.

The implementation of tax credits

2. We acknowledge, as we did in our report on the Budget, the scale and importance of the benefits that the new tax credits represent. We recognise that processing some 4.5 million applications is a significant administrative undertaking. But it is clear that some applicants have not received the service from the Inland Revenue that they were entitled to expect. At 2 July some 220,000 applications (just under 5% of the total) had not been resolved. Over 100,000 of these unresolved applications had been received more than a month earlier. As a result of delays, the Revenue have made nearly 200,000 emergency payments through their local offices, but cannot at this stage say how many families these relate to. (Paragraph 19)

The Government is pleased that the Committee acknowledges the scale and importance of the benefits that the new tax credits represent. However, the Government recognises that some claimants did not receive the service they were entitled to expect. Both the Government and the Inland Revenue have apologised to those claimants. The Government supports the priority given by the Inland Revenue to getting payments made to people who claimed tax credits. The remaining unresolved claims include those where the Inland Revenue has asked for additional information from claimants but where this has not yet been provided. The Inland Revenue responds as soon as it can after the claimant provides the additional information requested.

3. Over 400,000 applicants (or 7% of the total) received their first payment on a later date than the one they had been notified of. In addition, hundreds of thousands of people received a payment before they received their award notice. For over 90% of applicants, the introduction of the new tax credits has worked smoothly. But for a significant number there have been problems which certainly added to anxieties. The Government has rightly apologised to these families, while the Revenue is working hard to remedy the problems. A ‘flagship project’ in the important reform programme that will integrate tax and benefits got off to an unfortunate start. (Paragraph 20)

The Government is on record as having apologised to families who did not receive the service they were entitled to expect. It acknowledges that some payments to be made by the end of the first week of tax credits were made later than the notified date on award notices (though still within that week or within a day or two of the end of that week). It also acknowledges that many people received their payment before their award notice and that award notices only started going out in large numbers in March. This was because the

Revenue needed to do some important final checking of award notices before they were printed and issued. This will have caused confusion for some claimants but the Government judged that it was better to get payments to families rather than to delay payment until the award notice had been issued.

4. The scale of the difficulties faced by some applicants is illustrated by the demands placed on the helpline. We note the Revenue's evidence that no call centre could have handled the number of call attempts at their peak, up to two million in a day. The inability of members of the public to get through quickly, or in some cases at all, only added to their anxieties. (Paragraph 25)

The Government acknowledges the difficulties people experienced trying to call the helpline and has apologised to those who did not receive the service they were entitled to expect. The service has now improved very considerably and callers are now normally able to get through to an adviser on the day they call.

5. We support efforts to improve the helpline service, a service which has clearly been unacceptable. We expect the Revenue to review its communications function and to analyse in detail the volume of calls received on the helpline and the problems to which those calls related. This review must be done rapidly to determine how to reduce the need for applicants having to ring the helpline in the first place. (Paragraph 26)

The Government acknowledges the difficulties people experienced trying to call the helpline and has apologised to those who did not receive the service they were entitled to expect. The Inland Revenue continues to analyse calls and the reasons for them to help it to improve the service it offers.

6. We did not take specific evidence on the issue, but we note also there is a question as to whether it is appropriate for a helpline such as this not to be free of charge to the user. We ask the Government to consider this point. (Paragraph 27)

The Government notes the Committee's conclusion. The local rate charge for calls to tax credit helplines follows the Inland Revenue's other helplines where calls are also charged at local rate.

7. We welcome the Paymaster General's commitment to look very closely at the question of compensation for people who did not receive the service that they were entitled to expect. We expect people who have incurred costs as a result of delays or errors due to the Revenue in paying tax credits to be compensated swiftly and in full. (Paragraph 29)

The Government notes the Committee's recommendation and confirms that it has asked Inland Revenue to handle claims for compensation in accordance with its standard code of practice for redress.

8. According to the Revenue the main cause of the problems being experienced by applicants for the new tax credits is the IT system, which was designed and implemented by EDS. Staff using the IT system to process applications and respond to queries from applicants have suffered slow response times and system downtime of up to four hours a day while the system is flushed to clear internal queues. This level of

performance is wholly unacceptable and it has led to pressures which at times have swamped both the system and the staff. (Paragraph 36)

The Government notes the Committee's conclusion. It agrees that system performance was unacceptable initially. The IT system is now working much better with significantly improved response times.

9. These IT difficulties were not identified by the testing undertaken before the system went into operation and were a bolt out of the blue for the Revenue. We are extremely concerned that problems of this scale could arise at the last moment without any warning. We expect the Department and EDS, working together, to remedy the problems and establish why the trial tests failed to show potential problems. We expect the Revenue to give us a full account of all the downtimes experienced, their causes, and the corrective measures being taken, together with their costs. (Paragraph 37)

The Government notes the Committee's recommendation and agrees that it is very important for the causes to be understood, so that lessons can be learned to ensure greater IT stability and reliability and smoother implementation of future IT releases. The Inland Revenue are assessing the experiences and causes and on completion of this we will inform the Committee.

10. The Department have little time to learn the necessary lessons to ensure that they will be able to cope next year when the first end-of-year reconciliations and resulting under or overpayments of tax credits are due to be processed. (Paragraph 38)

The Government agrees that it is very important that the Inland Revenue applies any lessons from the introduction of tax credits for the future.

11. EDS are part of the consortium working for the Department for Work and Pensions developing the computer system for the new Pension Credits starting this Autumn. We expect the Revenue to ensure that the Department for Work and Pensions are fully apprised of all the problems the Revenue have experienced with the tax credits IT system. EDS need to demonstrate to the Department for Work and Pensions that the problems experienced with the new tax credits will not recur this autumn. (Paragraph 39)

The Government agrees with this recommendation of the Committee and has asked the Inland Revenue, as a matter of priority, to ensure that it communicates fully with the Department for Work and Pensions about the lessons it has learned.

12. We note the evidence from the Revenue and the Paymaster General that they will consider the question of extra costs attributable to the performance of the IT system and explore the question of redress with EDS. We believe that the Revenue and Paymaster General have a clear duty to pursue vigorously a compensation claim from EDS. We do not expect the additional costs that have been incurred as a result of failure by EDS to be borne by the British taxpayer. (Paragraph 40)

The Government notes the Committee's views. The Inland Revenue has opened discussions with EDS on the question of redress.

National Insurance Contributions Deficiency Notices

13. National Insurance Contributions deficiency notices are the means of informing people about gaps in their contribution records and how much they need to pay if they want to ensure that the year counts towards their entitlement to the basic state pension. Given the significant implications for people's pensions, we are astonished that no minister was consulted or informed of the decision to suspend deficiency notices at the time it was taken in 1998 by the Contributions Agency, then the responsibility of the Department of Social Security. This is a striking example of the failure of some Next Steps agencies to understand the nature of accountability to Ministers. (Paragraph 48)

The Government notes the Committee's conclusion and agrees that DSS Ministers should have been consulted at the time when the issue of deficiency notices was suspended in 1998.

14. Following the transfer of responsibility for this function to the Inland Revenue in April 1999, the Paymaster General became the responsible minister. We are very concerned that it took her officials until March 2003 to inform her of the problem, particularly when it appears ministers in another department no longer responsible for this matter, the then Department for Social Security, were being briefed by their officials. We expect the Treasury to improve the practices of the executive members and strengthen the Board of the Revenue at an early date to make sure no similar failures occur again. (Paragraph 49)

The Government notes the Committee's recommendation.

15. The Revenue's own review of events has identified multiple failings in the organisation that suggest the National Insurance Contributions Office has been acting as a law unto itself without regard for proper accountability to senior management or ministers. We are extremely concerned that such failings could pass unnoticed for so long and we expect urgent action to be taken to implement all the recommendations put forward in the review. We recommend that the Paymaster General takes full responsibility for the implementation of the necessary changes so that these breakdowns in communication are not repeated. (Paragraph 52)

The Government notes the Committee's view. All recommendations of the internal review have been accepted and are being implemented.

16. Individuals should not suffer as a result of mistakes made by officials. We therefore welcome the steps that have been announced to ensure that people who do wish to pay additional contributions would be given the same opportunities to improve their pension position as if deficiency notices had been sent out on time. We also welcome the Paymaster General's assurance that the Department will do everything possible to ensure nobody loses out. (Paragraph 55)

The Government notes the Committee's conclusion. Arrangements have been made to ensure that all those who would have received a deficiency notice will be contacted and given the same chance to make voluntary contributions. The Paymaster General has undertaken to report to the Committee with further details of the timetable for issuing new deficiency notices, in the light of results of a pilot exercise run over the summer.

Information Technology

17. The underlying problems for both the introduction of the new tax and benefit arrangements and the suspension of National Insurance Deficiency Notices have arisen from inadequacies of IT systems. Similar problems have arisen before in other Government Departments. We recommend that the Office of Government Commerce review both the processes for arriving at specifications of IT systems and the contractual arrangements for their provision, to determine ways in which the introduction and operation of IT systems in the Treasury and other Government Departments could be improved. (Paragraph 56)

OGC has an active programme focused on the skills and best practice needed to improve the successful delivery of IT projects in central government, of which major components are the establishment of Centres of Excellence, the introduction of a Project and Programme Management specialism, the avoidance of big-bang implementation and clear personal responsibilities at Ministerial and SRO levels. These have been endorsed by a meeting of the Cabinet in December 2002. In addition we are working with the Trade Association (Intellect) to improve the performance of the IT industry, encourage more open relationships and improve the interaction between suppliers' bidding and clients' evaluation behaviour.

The recent announcement from HM Treasury explains that PFI in the IT sector will be replaced by a set of procurement options appropriate for different types of IT project. Over the summer, OGC and the Treasury will be drawing up guidance on a range of models for government IT partnering projects.

OGC already does provide guidance on Requirements Definition in our Successful Delivery Toolkit, which we next plan to update in 2004/5 clarifying when to use an output based specification. But we are aware that existence of guidance is not sufficient to achieve successful delivery and OGC now puts the bulk of its effort into working with Departments to help them embed best practice, rather than just publishing it. This year our main focus is on the building of relevant skills within Departments and the establishment of the PPM Centres of Excellence, together with using the Gateway process to ensure that the common causes of project failure are being addressed in every case.

Accountability to Treasury ministers

18. We were surprised by the evidence from Sir Nicholas Montagu that he had not seen the Paymaster General between the late autumn 2002 and March 2003. We entirely concur with the Paymaster General that problems should be reported when they occur, rather than await the availability of a possible solution. The practice of the Inland Revenue in not advising Ministers of problems until they have solutions will cause further problems in future. We do not consider it to be 'best practice' from the standpoint of the parliamentary accountability of Ministers. We urge an immediate reconsideration by the Revenue. (Paragraph 59)

The Government notes the Committee's conclusion and their recommendation. On checking their diaries, the Paymaster General and Sir Nicholas Montagu did meet in this period and spoke on the telephone. They speak with one another whenever is required.

The Paymaster General also meets regularly with other members of the Board of Inland Revenue to discuss a variety of issues.

19. It is not clear what purpose was served by the Deputy Prime Minister's theoretical role in the STEPS PFI contract. The Deputy Prime Minister had no knowledge of the substance of the contract or the offshore tax arrangements. In fact the deal was signed off on his behalf by Inland Revenue and Customs officials. We want the 1997 Statutory Instrument to be reconsidered. We would expect contracts of this size to be approved by Ministers. Ministerial accountability cannot exist without ministerial knowledge. (Paragraph 63)

Most departments do not have landholding powers in their own right. All land and property held by government must be vested in an individual who has designated landholding powers. For example the Secretary of State for Defence, for Health, for Foreign and Commonwealth Affairs and the Minister of Agriculture, Fisheries and Food all have landholding powers. These powers derive from different legislative routes and are restrictive as to the purposes for which land may be acquired and held.

Property used for administrative purposes by all central government departments is now held in the name of the Deputy Prime Minister, as the First Secretary of State or predecessors (see below). He took over this responsibility under the Transfer of Functions (Transport, Local Government and the Regions) Order 2002 (SI 2002/2626) in November 2002. The First Secretary of State (FSS) holds land as a corporation sole. The responsibilities were previously vested in the name of the Secretary of State for Transport, Local Government and the Regions. Before that the relevant individuals have included the Secretary of State for the Environment, the Minister of Public Buildings and Works, the Minister of Works back to the Commissioners of Works. Under the Commissioners of Works Acts 1852 and 1894 the First Commissioner of Works held the government's "for the public service" landholding powers. This provides one of the widest definitions of landholding powers of any Secretary of State.

Since the 1990s individual departments have exercised full responsibility for their property occupation as principals and have been fully accountable. As provided in the 2002 Order, the seal of the First Secretary of State may be authenticated by the signature of any Secretary of State, or by a person so authorised under the Statutory Instrument. Contracts are executed by the First Secretary of State by the attachment of the corporate seal. In December 2002 a list of Ministers and categories of officials authorised to authenticate the seal was produced by the First Secretary of State.

Use by officials of the Secretary of State's name and seal has occasionally been the subject of legal challenge. It is essential that the authorisation given by the Secretary of State is observed. . Departments have been advised to ensure that they have a clear authorisation trail. For documents requiring the First Secretary of State's seal the Treasury Solicitor has drawn up standard legally acceptable attestation clauses. Departments have been advised through the *Deeds and Sealing Guide* (2000) (published by Property Advisers to the Civil Estate – then an agency of OGC) and more recently through OGC Information Note 01/03. Previously advice on deeds and sealing was contained in Treasury Dear Accounting Officer letter (GEN) 1/96.

In the subject case the seal was duly authenticated by an appropriately authorised official in accordance with the terms of the then extant Statutory Instrument. A business case for the transaction had been approved by Ministers. The contract was in the event signed by three Commissioners on behalf of the two Statutory Boards and two Senior Civil Servants in Inland Revenue and Customs and Excise authorised to authenticate the seal.

Government sees no need to reconsider the extant Statutory Instrument (SI 2002/2626) which reiterates the established law concerning the sealing of documents by a Secretary of State or a person authorised by him.

20. Senior managers waited several months before informing the responsible minister of the problems regarding the suspension of deficiency notices. This is a further example in a growing list of failures of communication between ministers and officials and reinforces our previous calls for action to be taken to ensure appropriate standards of governance and accountability are met. We therefore welcome the announcement of a fundamental review of the revenue departments that will specifically look at a new framework for accountability for those working on tax, to set out more clearly the roles and responsibilities of all those involved, including ministers. We expect the review to be conducted in a timely fashion. We further expect the Treasury to publish at the earliest possible opportunity a clear timetable for implementing any changes to the accountability regime covering those working on tax policy. The series of failures in administration that this report has scrutinised strongly suggests that Treasury Ministers should attach a very high priority to reform in the revenue departments. (Paragraph 65)

The Government notes the Committee's conclusion. As previously stated the initial conclusions from the Review will be available at the time of the Pre Budget Report so that the next steps can be considered.

21. In a report on Customs and Excise in February 2000, our predecessors concluded that the merger of the Inland Revenue and Customs and Excise "would improve compliance with taxation, reduce businesses' compliance costs and reduce the Government's revenue collection costs". The report recommended "that such a merger should proceed". We welcome the fact that this will now be explored as part of the review announced by the Chancellor into the best organisational arrangements for delivering the Government's tax objectives, and we intend to follow the progress of this review closely. (Paragraph 66)

The Government notes the Committee's conclusion.

22. This inquiry has raised serious questions about how the Department has been led. (Paragraph 67)

The Government notes the Committee's view.

HM Treasury

18 September 2003

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