National Audit Office

DEPARTMENTAL OVERVIEW 2019

HM REVENUE & CUSTOMS

MARCH 2020

HM REVENUE & CUSTOMS (HMRC)

This overview summarises the work of HMRC including what it does, how much it spends, recent and planned changes, and what to look out for across its main business areas and services.

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The National Audit Office (NAO) helps Parliament hold government to account for the way it spends public money. It is independent of government and the civil service. The Comptroller and Auditor General (C&AG), Gareth Davies, is an Officer of the House of Commons and leads the NAO. The C&AG certifies the accounts of all government departments and many other public sector bodies. He has statutory authority to examine and report to Parliament on whether government is delivering value for money on behalf of the public, concluding on whether resources have been used efficiently, effectively and with economy. The NAO identifies ways that government can make better use of public money to improve people's lives. It measures this impact annually. In 2018 the NAO's work led to a positive financial impact through reduced costs, improved service delivery, or other benefits to citizens, of £539 million.

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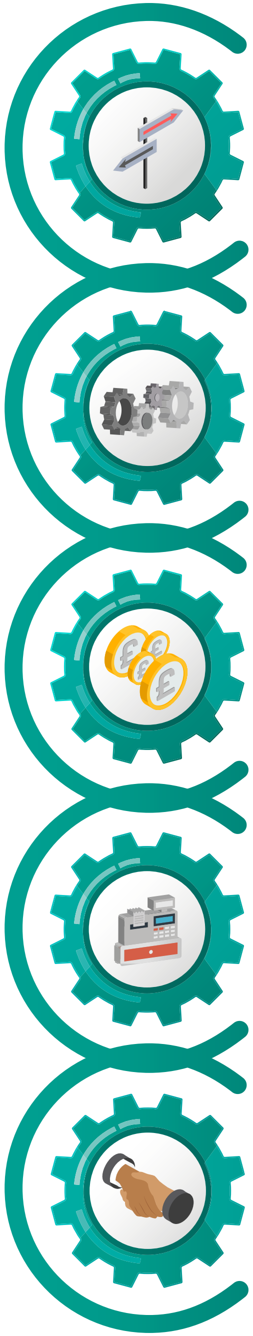
About HM Revenue & Customs (HMRC)



HMRC's role

HMRC is the UK's tax, payments and customs authority. It collects the money that pays for public services and helps families and individuals with targeted financial support.

HMRC's objectives

HMRC's objectives, as agreed by the government, are to:

- collect revenues due and bear down on avoidance and evasion;
- transform tax and payments for its customers; and
- design and deliver a professional, efficient and engaged organisation.

Tax revenue

HMRC reports to Parliament on revenues collected in its Trust Statement, published in its Annual Report and Accounts. In 2018-19:

- HMRC reported £627.9 billion in revenue, an increase of £22.1 billion (3.6%) on 2017-18.
- The UK tax gap was £35 billion, 5.6% of total tax liabilities in 2017-18. The tax gap is the difference between the amount of tax that should, in theory, be paid to HMRC, and what is actually paid.

Benefits and Tax Credits

HMRC paid £40.1 billion to its customers in 2018-19, the main part of which was on Personal Tax Credits (£22.3 billion) and Child Benefit (£11.5 billion).

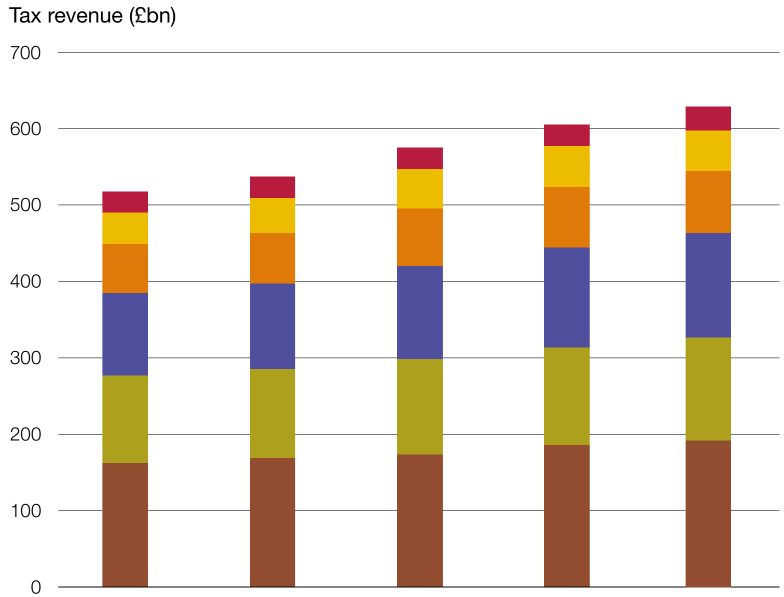
Partners

HMRC works with HM Treasury to produce tax policy advice for HM Treasury ministers.

HMRC supports the Office for Budget Responsibility to provide predictions of revenues to Parliament in Budgets and Spring Statements.

UK tax revenues, 2014-15 to 2018-19

UK tax revenues have increased over the past five years



	2014-15	2015-16	2016-17	2017-18	2018-19
Hydrocarbon oils	27.2	27.7	28.0	27.9	28.0
Corporation Tax	41.4	45.5	51.1	53.3	53.5
Other	64.1	66.2	75.1	79.5	81.8
VAT	113.9	116.0	124.4	128.6	135.6
National Insurance Contributions	108.0	112.0	122.5	130.5	135.0
Income Tax	163.1	169.4	173.8	186.0	194.0
Total revenue	**517.7**	**536.8**	**574.9**	**605.8**	**627.9**

Note

1 Figures shown in nominal terms.

Source: HM Revenue & Customs, Annual Report and Accounts from 2014-15 to 2018-19

How HMRC is structured

HMRC is a non-ministerial department. This is intended to ensure that the administration of the tax system is fair and impartial.

With effect from 29 October 2019, Jim Harra became HMRC's Chief Executive and First Permanent Secretary, and the Principal Accounting Officer for HMRC.[1] With effect from 15 October 2019, Melissa Tatton became HMRC's Tax Assurance Commissioner (whose role is to strengthen the governance of tax disputes).

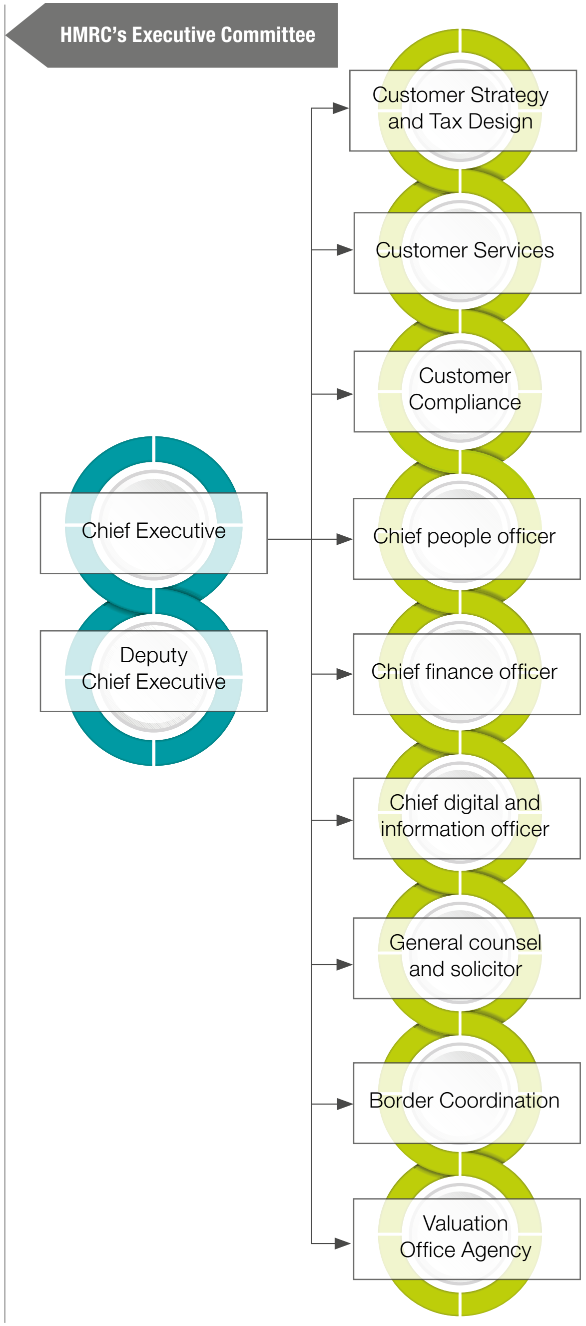
HMRC's Board provides support, challenge and assurance to HMRC's Executive Committee (ExCom). Board members are the chair and five other non-executives, the Permanent Secretary and the chief finance officer.

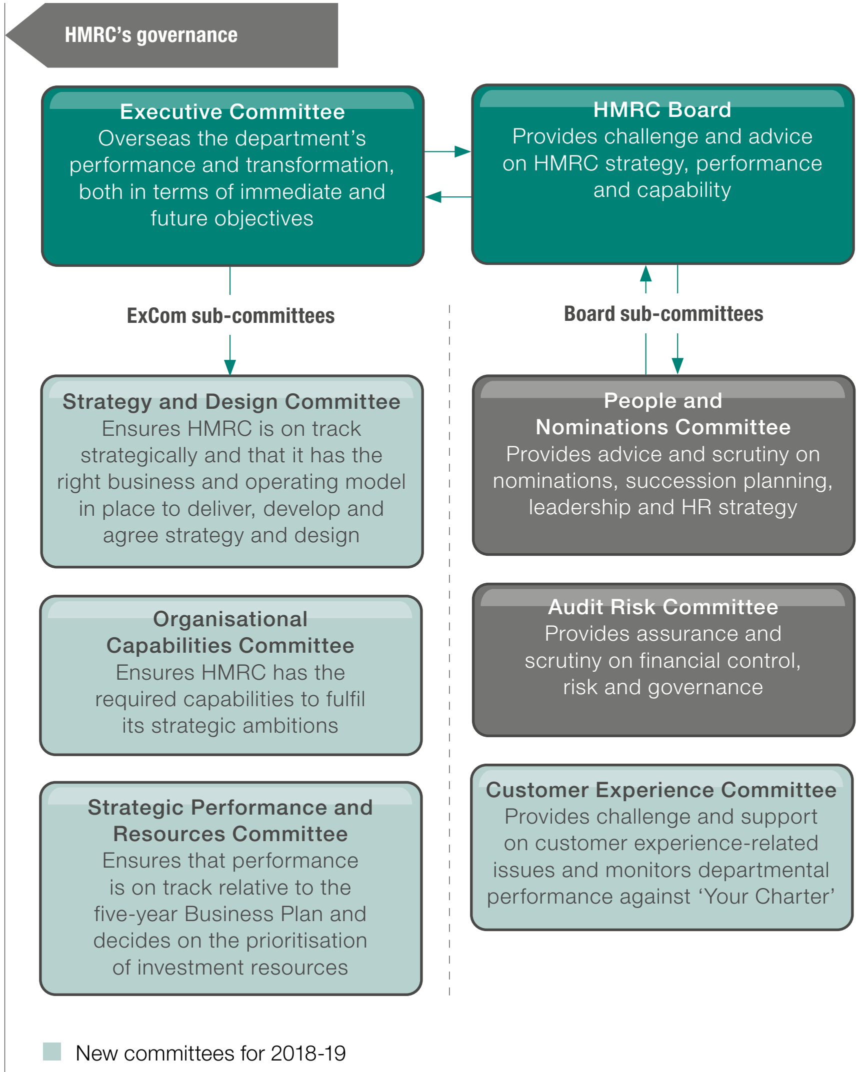
HMRC has three arm's length bodies. The Valuation Office Agency is an executive agency of HMRC. Revenue and Customs Digital Technology Services Limited and R.N. Limited are both non-departmental public bodies.[2]

ExCom is HMRC's most senior decision-making body. The Chief Executive and Deputy Chief Executive, together with the director generals who lead HMRC's business groups, make up ExCom. ExCom oversees and assures all of HMRC's work and is responsible for setting and delivering its strategic objectives.

1 On 18 July 2019, HMRC announced that Sir Jonathan Thompson will step down as HMRC Chief Executive in the Autumn.

2 R.N. stands for Revenue Nominees.





Source: HM Revenue & Customs, *Annual Reports and Accounts 2018-19*, HC 2394, July 2019

Where HMRC spends its money

As well as collecting taxes, HMRC administers Personal Tax Credits and Child Benefit. Of the £44.1 billion spent by HMRC in 2018-19:

- £40.1 billion related to payments to HMRC's customers, the main part of which was on Personal Tax Credits (£22.3 billion) and Child Benefit (£11.5 billion); and
- £4.0 billion were running costs.

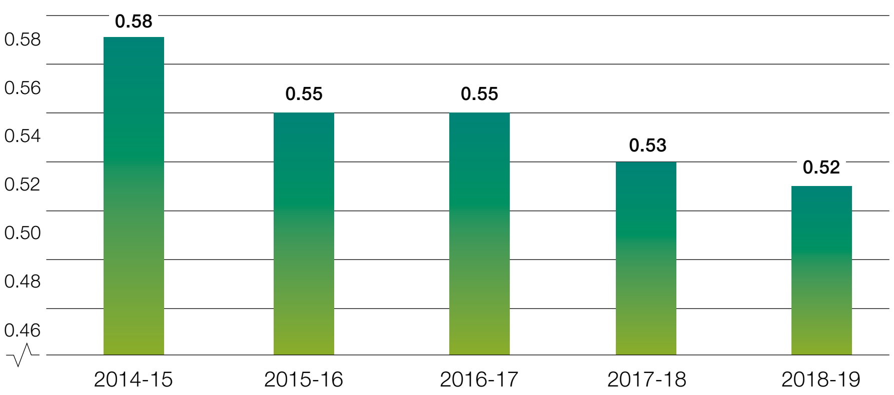
The amounts paid out through Personal Tax Credits have fallen in the past five years, from £29.1 billion in 2014-15 to £22.3 billion in 2018-19, as people transfer to Universal Credit. Total amounts of Child Benefit paid have remained around the same level for the past five years.

The average number of full-time equivalent persons employed during 2018-19 was some 57,300 for the core department. This average has fallen from some 58,900 in 2014-15.

HMRC reports that the efficiencies it has delivered, together with increasing revenues, mean that the cost of collecting taxes in the UK is less than a penny for every pound collected – down from 0.58 pence in the pound in 2014-15 to 0.52 pence in the pound in 2018-19.

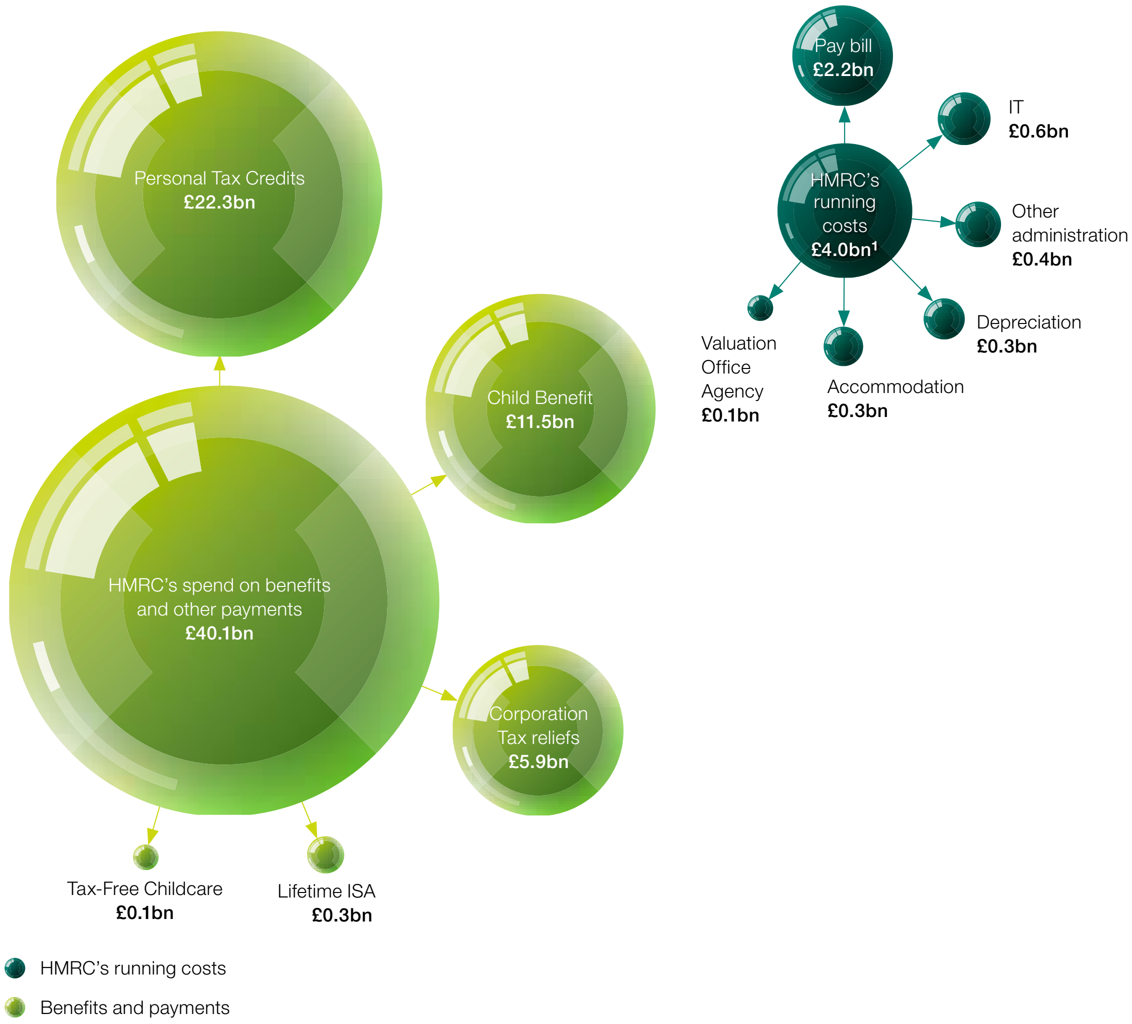
HMRC's reported cost of tax collection 2014-15 to 2018-19

Pence per £ collected



Source: HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2394, July 2019, page 58, Figure 9

Analysis of HM Revenue & Customs' (HMRC's) total net expenditure 2018-19



Note

1 Does not equal sum of individual items listed due to rounding

Source: HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2394, July 2019, pages 56 and 207

Major programmes and developments

HMRC's transformation

HMRC is four years into its transformation programme, with the aim of becoming one of the most digitally advanced tax administrations in the world.

During 2018-19, HMRC sought to decentralise management of its transformation programme by transferring responsibility to relevant business areas. HMRC's three main business areas are Customer Strategy and Tax Design, Customer Compliance and Customer Services. HMRC considers that transferring responsibility to these areas will strengthen accountability, help to realise planned benefits and improve customer service outcomes.

HMRC introduced Making Tax Digital for VAT – submission of digital VAT returns and mandatory digital record-keeping for VAT for businesses with taxable turnover over the VAT threshold of £85,000 – on 1 April 2019. HMRC reported that more than one million businesses had signed up to use the service as at 21 August 2019. HMRC delayed the roll out of the Income Tax and Corporation Tax elements of the Making Tax Digital for Business programme following a government policy announcement in July 2017. The government announced in March 2019 that it would not be mandating Making Tax Digital for any new taxes or businesses in 2020. HMRC also decided to close its Compliance for the Future programme in 2018-19.

HMRC's transformation programme has a significant digital component. Our cross-government report *Challenges in using data across government* (June 2019) noted that government needed accurate, timely and proportionate data if it was to take the next step towards more sophisticated approaches to using data that can reap real rewards. The report also noted that HMRC's sharing of real-time Pay As You Earn (PAYE) information with the Department for Work & Pensions was an example of a good data-sharing arrangement.

(See page 16).

Devolved administrations' tax powers

HMRC works with the governments and tax authorities in the devolved administrations to help ensure effective tax administration across the UK.

Since the devolution of Income Tax powers to Scotland from 2016-17, and Wales from 2019-20, the administration of the Income Tax system has become more complex. For Scottish taxpayers, tax due on non-savings and non-dividend income is calculated using the applicable Scottish rates and bands. For Welsh taxpayers, tax due on non-savings and non-dividend income is calculated using the applicable Welsh rates. Income from savings or dividends remains subject to the whole-of-UK tax rules.

For 2018-19, the Scottish Government introduced two new bands – a new starter rate set at 19% and an intermediate rate set at 21% – as well as setting different Income Tax rates and thresholds to the rest of the UK.

Income Tax rates in Wales remain in line with the rest of the UK.

From 2020-21, the Scottish Government will be assigned receipts from the first 10p of the standard rate of VAT and the first 2.5p of the reduced rate of VAT in Scotland.

HMRC has made preparations to enable Northern Ireland Corporation Tax rate-setting powers if the legislated devolution regime is implemented.

(See page 15).

EU Exit

HMRC hosts the cross-government Border Delivery Group, which is responsible for scoping, planning, coordinating and ensuring delivery of the necessary change plans to ensure the border works effectively after the transition period.

HMRC is also responsible for a number of key border-related projects. Most significant is making the necessary changes to the Customs Handling of Import and Export Freight (CHIEF) customs system and implementing the Customs Declaration Service (CDS) as its long-term replacement. Others include making changes to the Excise Movement and Control System (EMCS), and developing a new system to identify and collect VAT due on goods in small parcels arriving in the UK.

(See pages 7 and 13).

Customer service

HMRC achieved four of its customer service targets in 2018-19 and missed four (two of these narrowly). Its targets focus on services for individuals. HMRC reported the dip in phone and post performance was due to recruitment challenges and the need to divert resources towards EU exit work.

To protect customer service, HMRC has reprioritised projects, shifted resources to respond to peaks in demand and committed to keeping recruitment processes under review.

HMRC aims to tailor customer support to customer needs, whilst promoting the long-term trend towards digital services, including developing digital customer support services. To date, the volume of customer calls has not fallen as quickly as HMRC anticipated.

(See page 12).

Exiting the European Union

HMRC is responsible for delivering the changes to the customs, VAT and excise systems the UK will need as a consequence of leaving the EU. The delays to the UK's withdrawal from the EU has meant HMRC has had to adjust its delivery plans to fit with the shifting timetable.

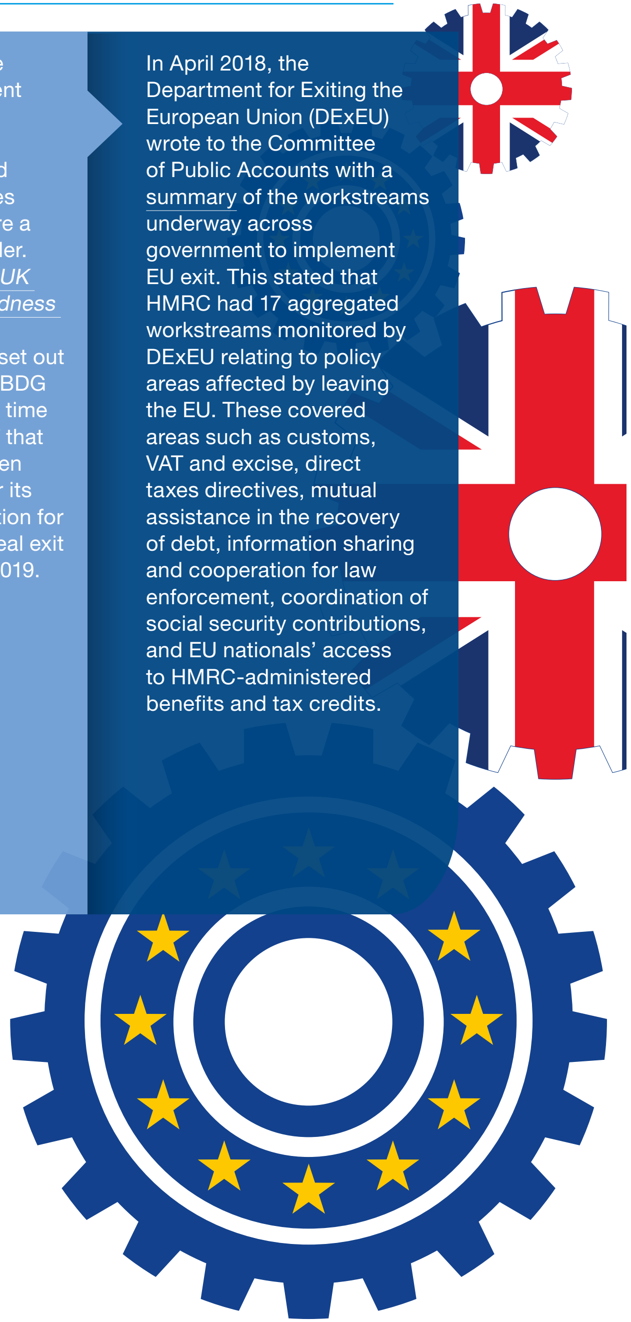
In 2018-19, HMRC reported that it had spent £261.7 million compared with its £261 million allocation for EU exit preparations, predominantly on staffing and IT costs. The additional £0.7 million was taken from HMRC's wider funding. The government initially allocated £375 million to HMRC for EU exit-related work in 2019-20, of which £25 million was for the Border Delivery Group (BDG).

At 31 March 2019 the department had around 5,400 full-time equivalent employees (including contractors) working on EU Exit preparations, including staff seconded from other teams in HMRC and other government departments. These staff were working in areas such as developing and implementing relevant changes to border systems and infrastructure, as well as communicating these changes to traders and intermediaries such as hauliers. A summary of our recent reports on HMRC and the UK border is set out on page 13.

During 2018-19 HMRC provided support to withdrawal negotiations as well as advising ministers on the policy, legal, IT and operational implications of leaving the EU.

HMRC hosts the cross-government BDG, which is responsible for coordinating and assuring changes needed to ensure a functioning border. Our report, *The UK border: preparedness for EU exit* (October 2019), set out the actions that BDG had taken at the time of publication of that report, against ten priority areas for its work in preparation for a possible no-deal exit on 31 October 2019.

In April 2018, the Department for Exiting the European Union (DExEU) wrote to the Committee of Public Accounts with a summary of the workstreams underway across government to implement EU exit. This stated that HMRC had 17 aggregated workstreams monitored by DExEU relating to policy areas affected by leaving the EU. These covered areas such as customs, VAT and excise, direct taxes directives, mutual assistance in the recovery of debt, information sharing and cooperation for law enforcement, coordination of social security contributions, and EU nationals' access to HMRC-administered benefits and tax credits.



Tax revenues and expenditures

HMRC's 2018-19 financial statements

HMRC is responsible for collecting the majority of tax revenue and its financial information is reported in two separate accounts. The Trust Statement reports the revenues, expenditures, assets and liabilities related to the taxes and duties for the financial year. The Resource Accounts report the costs of running HMRC together with payments of Child Benefit and Tax Credits.

Comptroller and Auditor General's (C&AG's) opinions

The C&AG:

- concluded that the figures in HMRC's Trust Statement are true and fair and that HMRC has used income and expenditure for the purposes Parliament intended;
- concluded that in 2018-19 HMRC had framed adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out; and
- qualified his opinion on the regularity of HMRC's Resource Accounts due to the material level of error and fraud in Personal Tax Credits expenditure.

Key figures

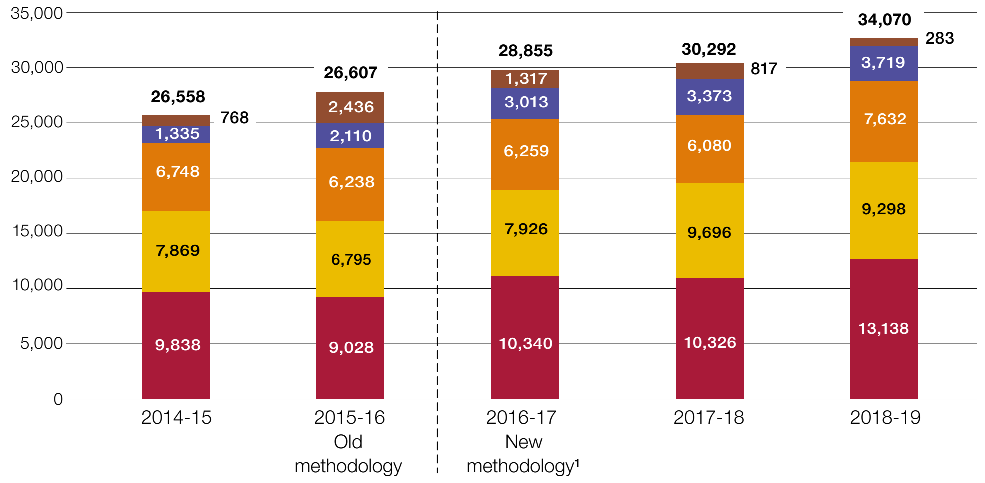
The **total revenue** HMRC reported in 2018-19 was £627.9 billion (£605.8 billion in 2017-18). This figure is net of £116.2 billion of **repayments** to taxpayers (£110.1 billion in 2017-18).

Repayments are a necessary part of tax administration and can arise for a variety of reasons. For instance, HMRC may demand payments on account from taxpayers before their full liability is assessed, which can lead to repayments. VAT-registered taxpayers can claim back VAT on certain purchases they have made, where they relate to the sale of goods and services.

In 2018-19 HMRC achieved £34.1 billion (2017-18: £30.3 billion) of **compliance yield** against a target of £30 billion. Compliance yield represents HMRC's estimate of the additional revenues it has generated, and the revenue losses it has prevented, as a result of specific enforcement and compliance activity.

HM Revenue & Customs' (HMRC's) compliance yield has increased over the past five years

Compliance yield (£m)



Cash expected	Additional revenue due when HMRC identifies past non-compliance, with a reduction to any revenue that HMRC knows will not be collected (for example, in some instances when a business becomes insolvent).
Revenue losses prevented	Revenue that HMRC prevented from being lost to the Exchequer (for example, by stopping fraudulent repayment claims and disrupting criminal activity).
Future revenue benefit	Estimated effect of HMRC's compliance work on customers' future behaviour.
Product and process yield	Estimated annual impact on net tax receipts of legislative changes to close tax loopholes and changes to HMRC processes that reduce opportunities to avoid or evade tax.
Accelerated payments	Disputed amounts of tax that people using tax avoidance schemes are now required to pay upfront within 90 days, as well as an estimate of the behavioural change that this policy has generated.

Note

1 From 2016-17, and in response to an National Audit Office recommendation, HMRC recorded future revenue benefit for the future year or years in which it had an impact on Exchequer receipts, rather than, as it had done previously, the year in which HMRC completed the compliance intervention. HMRC has published a technical note that gives a more detailed explanation.

Source: HM Revenue & Customs, *Annual Report and Accounts 2018-19*, HC 2934, July 2019

Tax revenues and expenditures *continued*

The tax gap

What is the tax gap?

The tax gap is the difference between the amount of tax that should, in theory, be paid to HMRC, and what is actually paid.

Why is there a tax gap?

The tax gap arises for a number of reasons. Some taxpayers make simple errors in calculating the tax that they owe, despite their best efforts, while others do not take enough care when they submit their returns. Legal interpretation, evasion, avoidance and criminal attacks on the tax system also result in a tax gap. It is impossible for HMRC to collect every penny of tax that is owed – for example, it cannot collect outstanding tax from businesses that become insolvent.

How big is the tax gap?

HMRC estimated that the UK tax gap as a percentage of total tax liabilities was 5.6% (£35 billion) in 2017-18. This is the most recent available estimate, published in June 2019. There has been a long-term reduction in the overall tax gap, from 7.2% in 2005-06 to 5.6% in 2017-18. Between 2015-16 and 2017-18, the overall percentage tax gap has remained relatively stable, showing an increase of 0.3%.

How is HMRC tackling the tax gap?

Of the £35 billion tax gap, the largest proportion (40%) can be attributed to small businesses, followed by large businesses at 22%. HMRC is seeking to tackle the underlying causes of the tax gap – reducing error by making it easier for individuals to pay tax through online digital services, and by launching Making Tax Digital for VAT-registered businesses, which requires them to keep digital records and submit their VAT return using compatible software. The NAO is planning to publish a report on HMRC's work to tackle the tax gap in 2020.

How does HMRC estimate the tax gap?

HMRC produces its estimate of the tax gap figure in line with the values, principles and protocols set out in the Code of Practice for Official Statistics. HMRC uses a range of internal and external data and different analytical techniques to produce annual estimates, which it revises as more accurate data become available. The estimates are based on the information available but there are many sources of uncertainty and potential error.

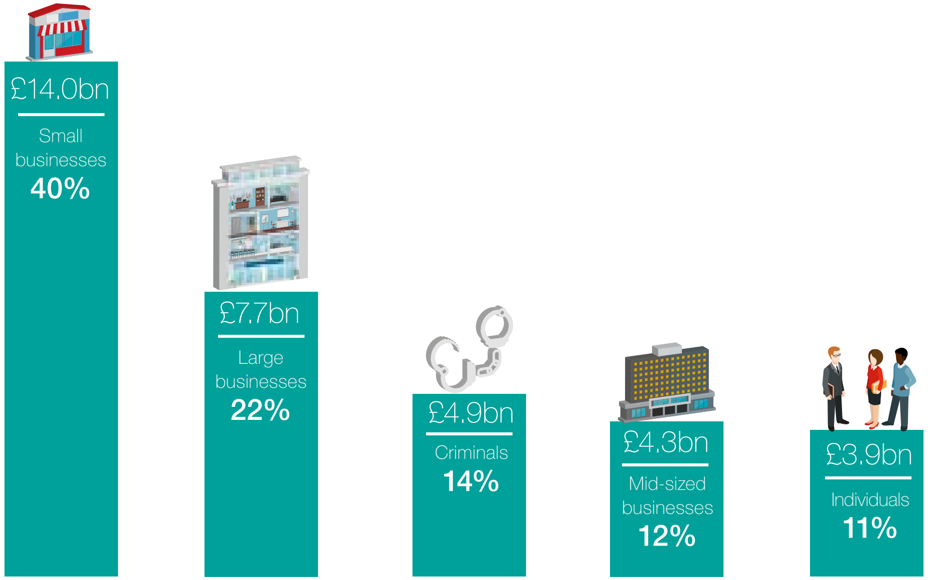
The tax gap estimates only cover the taxes administered by HMRC, so exclude taxes and duties administered elsewhere (council tax, business rates and Vehicle Excise Duty) as well as charges, such as the congestion charge. The estimates also exclude error and fraud in Tax Credits. HMRC does not include base erosion and profit shifting (BEPS) in the tax gap where it represents tax loss that cannot be addressed under UK law.[1] More details about HMRC's tax gap methodology are available online.

1 The Organisation for Economic Co-operation and Development (OECD) defines BEPS as "tax planning strategies that exploit gaps and mismatches in tax rules to make profits disappear for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid".

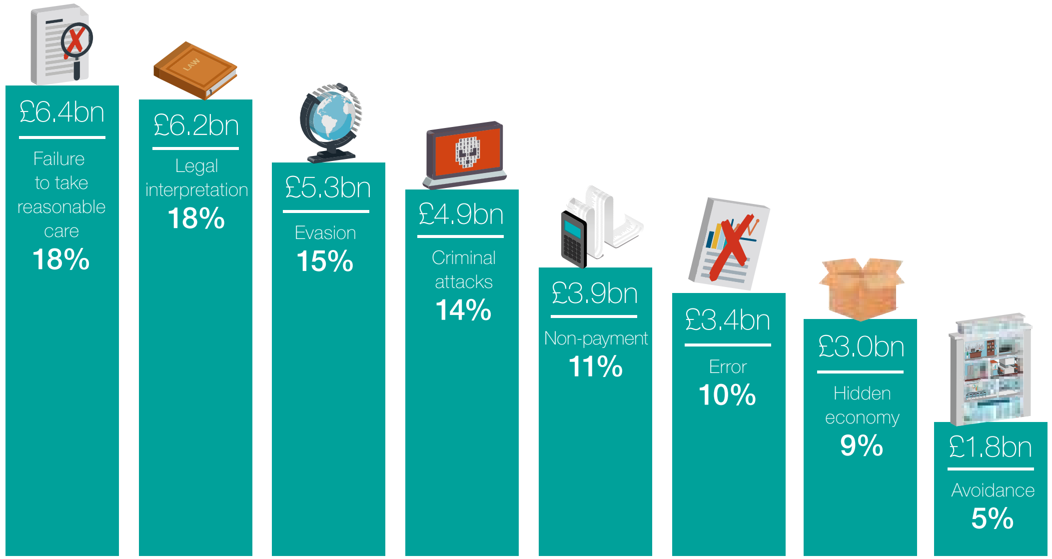
Tax revenues and expenditures *continued*

The tax gap *continued*

Tax gap by customer group – value and share of tax gap, 2017-18



Tax gap by behaviour – value and share of tax gap, 2017-18



Note

1 Percentages do not sum to 100 due to rounding.

Source: HM Revenue & Customs, Measuring tax gaps 2019 edition, Tax Gap estimates for 2017-18, June 2019

Tax revenues and expenditures *continued*

Tax reliefs

What are tax reliefs?

All tax systems include tax reliefs. Many tax reliefs are an essential part of defining the scope and structure of a tax by providing rules which establish where the tax burden is, and is not, intended to fall (known as structural reliefs). Other tax reliefs are used to help or encourage particular types of individuals, activities or products in order to achieve economic or social objectives (known as tax expenditures or non-structural reliefs). There are more than 1,000 tax reliefs in the UK.

The role of HMRC and HM Treasury in tax reliefs

Ministers propose policy changes to introduce or amend tax expenditures as part of the Budget. Parliament undertakes scrutiny of tax policy including tax expenditures as part of the Budget process and through the work of the Treasury Select Committee. HM Treasury and HMRC (the exchequer departments) are responsible for all aspects of the effective working of the UK tax system including tax expenditures. HM Treasury is responsible for strategic oversight of the tax system and HMRC is responsible for administering the system. The Accounting Officers of HM Treasury and HMRC are accountable to the Committee of Public Accounts for the economy, efficiency and effectiveness of the resources they use to discharge their responsibilities, including the work they carry out to manage tax expenditures.

The NAO published two reports on tax reliefs (in April and November 2014) which drew attention to the scale of tax reliefs and called for greater oversight by HMRC, in partnership with HM Treasury. The NAO published its latest report on tax reliefs in February 2020 (*The management of tax expenditures*).

How much do tax reliefs cost?

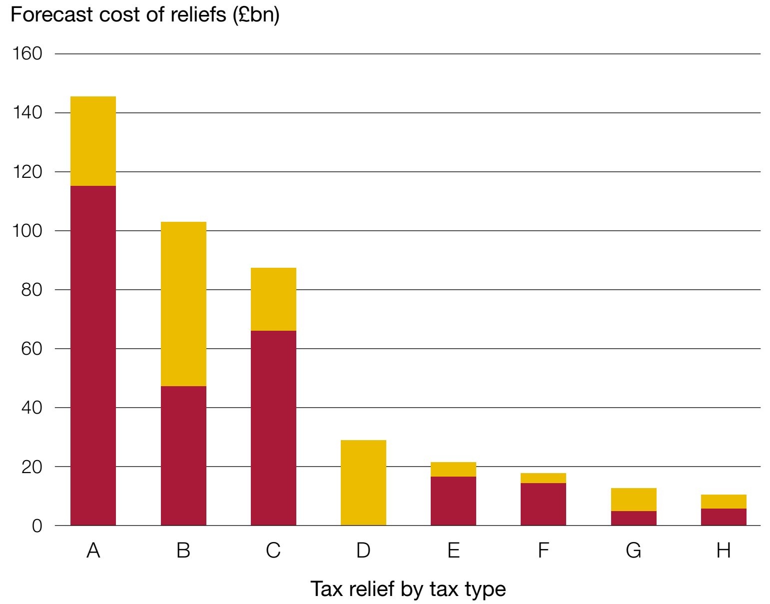
In October 2019, HMRC reported the estimated costs of 85 structural reliefs and 111 tax expenditures. These reliefs are forecasted to cost £426 billion in 2018-19, of which £271 billion was for structural reliefs and £155 billion was for tax expenditures. Whilst HMRC does not have the information to report costs for other tax reliefs, it has committed to publishing more information on the costs of tax expenditures. The chart opposite shows estimated cost of tax reliefs by tax type.

Aggregating the costs of tax reliefs in this way gives some sense of the overall scale, but it does not reflect the amount of tax that would be generated if they were removed because some taxpayers would change their behaviour and there may be wider economic impacts. HMRC reports the cost of individual reliefs in the annual tax reliefs statistics publication, which can be accessed at: www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs.

The Office for Budget Responsibility noted, in its *Fiscal risks report* – July 2019, that tax expenditures – those reliefs designed to promote policy objectives, such as investment in research and development (R&D) – cost around 8% of gross domestic product (GDP), a cost that has been rising and which receives less scrutiny than conventional public spending.

Cost of tax reliefs by tax type for 2018-19

HM Revenue & Customs (HMRC) has reported estimated costs for 196 tax reliefs, which are forecast to cost £426 billion in 2018-19



	A	B	C	D	E	F	G	H
Tax expenditures	30	56	21	29	5	3	7	4
Structural reliefs	115	47	66	0	17	14	5	6

A = Income Tax
B = Value Added Tax
C = National Insurance Contributions
D = Capital Gains Tax
E = Income Tax and Corporation Tax
F = Inheritance Tax
G = Corporation Tax
H = Other

Note

1 Most 2018-19 cost estimates for individual reliefs included in the aggregates above are projections based on previous years' actuals.

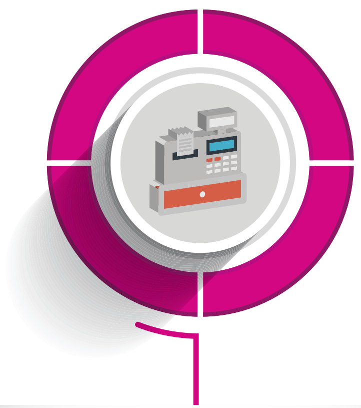
Source: National Audit Office analysis of HM Revenue & Customs, *Estimated costs of tax reliefs*, October 2019

Customer service performance 2018-19

HMRC reported it achieved four of its customer service targets in 2018-19 and missed the other four (missing two of these narrowly). Its targets focus on services for individuals. HMRC has acknowledged the dip in phone and post performance, reporting that recruitment challenges and the need to divert resources towards EU Exit work were significant factors in this. It reported that it has shifted resources to cope with peaks in demand, but that the challenge will continue into 2019-20. HMRC's reported performance in 2018-19 is set out below.

HMRC's targets for 2018-19 measure how quickly HMRC responds, but do not indicate whether HMRC has been successful in answering the customer's question. From 2019-20 HMRC planned to change the way it measures customer service, to provide more information on customers' experience and satisfaction. HMRC has committed to publishing this information.

Claims



Average turnaround of Tax Credits and Child Benefit claims and changes of circumstances.

12.0 days for UK customers (target 22 days).

61.5 days for international customers (target 92 days).

Post

HMRC received 19 million items of post in 2018-19 (an increase of 5% on 2017-18, which HMRC reported is due to a reclassification of around two million work items previously not recorded as post). For those needing a response, it reported it turned around:

76.6% in 15 days (target 80%).

96.4% in 40 days (target 95%).

Phone calls

HMRC received 42.7 million phone calls in 2018-19 (a decrease of 9% on 2017-18).

For customers who need to speak to an adviser, HMRC reported the average speed of answering calls was **5 minutes 14 seconds** in 2018-19 (after automated messages) (target 5 minutes).

HMRC reported **19.7%** of its customers waited 10 minutes to be connected to an adviser after an automated message (target no more than 15%).

Performance reported against both phone measures declined compared to 2017-18 when HMRC's average speed of answering calls was 4 minutes 28 seconds, and 14.6% of customers waited 10 minutes to speak to an adviser.

Online services

HMRC's online services include the Personal Tax Account (for which 19.1 million customers have signed up since it launched in 2015), webchat, webinars and online 'iForms'.

HMRC reported **80.4%** of customers surveyed were either 'satisfied' or 'very satisfied' across all its digital services (target 80%).

HMRC reported it turned around **94.1%** of 1.6 million online 'iForms' within 7 days (target 95%).

■ Performance that met target ■ Performance that did not meet target

HMRC and the border

This page highlights points from our report *The UK border: preparedness for EU exit* October 2019, our memorandum *The UK border: preparedness for EU exit update* published in February 2019, and our October 2018 report *The UK border: preparedness for EU exit*.

A border is more than a line on the map – it is a combination of physical and virtual controls, which can take place away from the physical border. The focus of our work on the border has been on the progress that government had made in its operational planning and delivery of the changes to border controls required as a result of EU exit.

For HMRC this primarily meant assessing the development of customs systems and border infrastructure facilitating the flow of goods. HMRC is responsible for collecting tax and duties, and processing customs declarations for trade outside the EU. Border Force undertakes enforcement work at the border for HMRC, on behalf of the Chancellor of the Exchequer. HMRC also works with many other government departments with border responsibilities.

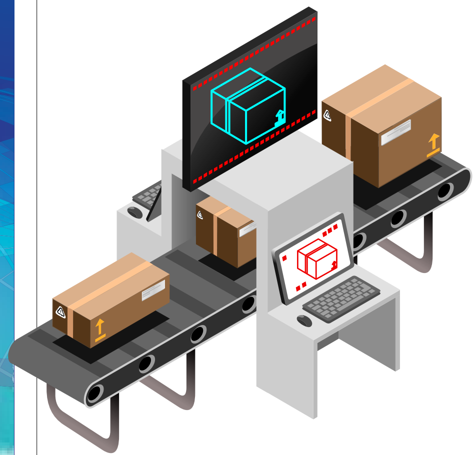
HMRC is currently implementing a new system to handle and risk-assess customs declarations, and account for payment of duties – the Customs Declaration Service (CDS) – which will eventually replace the existing Customs Handling of Import and Export Freight (CHIEF) system. In January 2019 HMRC made the decision to use the legacy CHIEF system as the primary customs system for EU trade in the event of 'no deal' rather than CDS. It confirmed that CHIEF had been successfully tested to manage increased volumes of up to 300 million customs declarations each year. HMRC is also working on developing, and implementing changes to, other key border systems, and putting in place the infrastructure necessary to enable movement of goods under the Common Transit Convention.

HMRC put in place temporary easements to help businesses adjust to customs controls and help maintain the flow of trade in the event of no deal. These included Transitional Simplified Procedures, which would have allowed businesses to delay the submission of full customs declarations and postpone the payment of customs duties when they imported goods from the EU to the UK; plus the phasing in of pre-arrival requirements for safety and security declarations for the import of EU goods.

Key facts

270 million

HMRC's revised estimate of the number of customs declarations it may need to process if the UK leaves the EU with 'no deal', compared with current volumes of 55 million.



150,000 to 250,000

traders (estimated by HMRC) who would need to make a declaration for the first time in the event of no deal.

Income Tax and devolution of powers

Income Tax is the largest single source of government revenue for funding public services.

HMRC collected Income Tax of £194 billion, together with £135 billion of National Insurance Contributions, in 2018-19. Together, these represent 52% of the total £627.9 billion of taxes and duties collected in the UK.

Most Income Tax is paid on earnings (2018-19: estimated 92.2%). This includes income from paid employment and pensions, profits from self-employment or property income. Interest and dividends are also subject to Income Tax.

The number of Self Assessment tax returns received by HMRC has been steadily increasing since 2010-11.

Self Assessment tax returns received by HMRC have increased from 9.8 million for the tax year 2010-11 to 11.5 million for the tax year 2017-18. HMRC considers this increase is due to a number of factors. These include:

- the growing population of self-employed individuals;
- a higher number of individuals with property income;
- an increase in the number of individuals with incomes of more than £100,000; and
- certain changes to tax policy, such as the introduction of the High Income Child Benefit Charge.

The way HMRC administers the Income Tax system has changed significantly over the past 10 years.

In light of developments in technology, rising taxpayer expectations and changes in the nature of employment, HMRC has enhanced its processes for assessing and collecting Income Tax. For example, it has significantly reduced the use of paper returns and it is making better use of the data it holds and data from third parties, such as banks and building societies.

HMRC has further plans to simplify the Income Tax process for taxpayers and improve accuracy and timeliness of tax collected.

This includes extending the mandation of Making Tax Digital for other taxes. The timing of this is for ministers to decide.

Our full findings on Income Tax are set out in Part Two of our 2018-19 *Standard Report* on HMRC, published in July 2019.

How different types of income are assessed within the tax system

Some people are in Pay As You Earn (PAYE), while others are in Self Assessment, or use both systems

PAYE

36.3 million taxpayers are part of the PAYE system only

People with income from:

- employers; or
- workplace or private pensions.

PAYE and Self Assessment

6.8 million taxpayers with other income besides their earnings have to submit tax returns

People with income from wages or pensions, plus:

- High Income Child Benefit Charge;
- tips or commissions;
- tax reliefs;
- property rental income;
- income from savings, investments or dividends; or
- foreign income.

Self Assessment

3.6 million, mostly self-employed, people who are part of the Self Assessment system only

People who:

- are sole traders or in business partnerships;
- have income from trusts;
- have an annual income greater than £100,000;
- have income from capital gains;
- have property income or expenses greater than £2,500; or
- have other untaxed income.

Simple Assessment

- People who have underpaid through PAYE and the underpayment cannot be collected by adjusting the tax code.
- People who only receive State Pension, from 2016-17, with an income above the Personal Allowance.

Notes

1 Income Tax regime only, excludes other forms of taxation. Data relate to the 2016-17 tax year.

2 Simple Assessment charges are issued for each tax year individually; 500,000 were issued in 2016-17 and 360,000 in 2017-18.

3 Figures are estimated based on sample data from HM Revenue & Customs' tax systems and represent the populations within each category regardless of whether they have a tax liability.

Source: Report by the Comptroller and Auditor General, *HM Revenue & Customs 2018-19 Accounts*, Session 2017–2019, HC 2934, National Audit Office, July 2019

Income tax and devolution of powers *continued*

Devolved taxation powers – Scotland and Wales

Scottish Income Tax

The Scotland Act 2016 gave the Scottish Parliament full power to determine the rates and thresholds (excluding the personal allowance) paid by Scottish taxpayers on all non-savings and non-dividend income from 6 April 2017. In 2017-18 Income Tax rules in Scotland differed from the rest of the UK for the first time: Scottish taxpayers paid the higher rate of tax (40%) as soon as they earned £43,000 – as opposed to £45,000 in the rest of the UK. Apart from this difference in thresholds, the rate of tax applied to each band remained the same. These powers represent a significant change from 2016-17, where the Scotland Act 2012 first introduced a Scottish rate of Income Tax by reducing UK Income Tax rates by 10% and giving the Scottish Parliament the power to apply its own additional rate. For 2018-19, the Scottish Government introduced two new bands – a new starter rate set at 19% and an intermediate rate set at 21% – as well as setting different Income Tax rates and thresholds to the rest of the UK.

Administration of Scottish Income Tax 2018-19

The NAO published a report in January 2020 on the *Administration of Scottish Income Tax in 2018-19*.
We concluded that:

- the outturn of Income Tax revenue for the Scottish rate of Income Tax for 2017-18 (£10.9 billion) is fairly stated;
- HMRC estimated that Scottish Income Tax revenue for 2018-19 would be £11.7 billion;
- HMRC has adequate regulations and procedures to secure an effective check on the assessment, collection and proper allocation of revenue, and that they are being duly carried out; and
- the amount repaid by the Scottish Government for the year ended 31 March 2019 (for administration costs, £2.8 million) is fairly stated.

2.5 million

Scottish taxpayers

2.0 million

Welsh taxpayers

Welsh Income Tax

The Wales Act 2014 amended the Government of Wales Act 2006 to give the National Assembly for Wales (the Assembly) the power to set the Welsh rates of Income Tax that will apply to the non-savings and non-dividend income of Welsh taxpayers from the 2019-20 tax year onwards. From April 2019, the UK basic, higher and additional Income Tax rates are reduced by 10 percentage points and the Assembly has the power to apply Welsh rates. The sum of the reduced UK rates and the new Welsh rates will determine the overall rate of tax paid by Welsh taxpayers. The Assembly set the Welsh rates of Income Tax at 10% across all bands, effectively matching the UK rates at 20% (basic rate), 40% (higher rate) and 45% (additional rate).

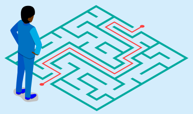
Administration of Welsh Income Tax 2018-19

The NAO published a report in January 2020 on the *Administration of Welsh Income Tax in 2018-19*.
We concluded that HMRC had taken appropriate steps for the introduction of Welsh Income Tax including establishing a project governance structure, maintaining a complete and accurate database of Welsh taxpayers and communicating with stakeholders. We found that the amount repaid by the Welsh Government to HMRC for the year ended 31 March 2019 (for implementation costs, £5.8 million) was accurate and fair.

The report did not consider the correctness of sums brought to account in relation to the Welsh rates of Income Tax, the adequacy of the rules and procedures put in place by HMRC or whether these rules and procedures have been complied with. These will be covered in later reports.

What to look out for[1]

01 Exiting the European Union (EU)



Dealing with the consequences of the UK leaving the EU is a huge and complex task for HMRC. In particular, HMRC will have to deliver the changes required to customs, VAT and excise systems. In doing so HMRC will have to cope with uncertainty relating to the timing and outcome of the negotiations, in addition to managing its business-as-usual activity. HMRC will need to work closely with other government departments to design and manage future border arrangements.

02 Delivering transformation

Delivery of HMRC's transformation programme remains challenging. In 2018 we reported that HMRC had reprioritised its transformation plans, to release capacity, reduce risks to delivery and reduce costs. In part, the reprioritisation was also due to the demands placed on HMRC in preparing for the UK's exit from the EU. Delivering its EU Exit responsibilities has required significant recruitment and redeployment of staff from other business areas during 2018-19. This has resulted in planned improvements to some of HMRC's compliance systems, and digital services being either deferred or stopped – it has closed its Compliance for the Future programme, and delayed elements of Making Tax Digital for Business. HMRC considers the transformation portfolio to remain "ambitious but deliverable", and will keep priorities and capacity under review.

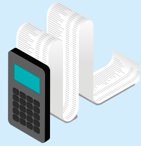
HMRC's transformation programme has a significant digital component. Our cross-government report *Challenges in using data across government* (June 2019) noted that the steps government needs to take to use data effectively are as much about good management, governance and planning within its existing activities, as they are about learning to work with new technologies.

03 Error and fraud

HMRC achieved levels below 5%, the target set by ministers for Personal Tax Credits error and fraud, between 2013-14 and 2016-17. Levels increased to 5.7% in 2017-18. Ministers have retained the target to restrict error and fraud to no more than 5% of entitlement for 2017-18, 2018-19 and 2019-20.

Under current plans, Universal Credit will fully replace Tax Credits by the end of 2024. However, HMRC will remain responsible for administering Tax Credits until all claimants, and any debt associated with their claims, have either moved to Universal Credit or left the Tax Credits regime. HMRC has reported that it has to balance spending on measures to prevent error and fraud in this diminishing expenditure stream with competing priorities. We expect the qualification of the accounts to continue as error and fraud will remain a significant issue until the closure of Tax Credits.

04 Changes to the tax base



HMRC recognises that it needs to re-orient its systems and processes to respond to the way people live, work and pay their taxes. Changes to the tax base include:

- increasing numbers of taxpayers moving into Self Assessment. HMRC considers that this is due to a number of factors – for example, the growing population of self-employed individuals, and certain changes to tax policy, such as the introduction of the High Income Child Benefit Charge. The number of Self Assessment tax returns received by HMRC has been steadily increasing since 2010-11, placing more administrative and cost burdens on both individuals and HMRC;
- continued expansion of the gig economy, moving people from PAYE into self-employment. One implication is National Insurance receipts, as the self-employed pay less in National Insurance Contributions than employees; and
- the growth of employment intermediaries and online platforms[2] have made the definition of 'employment' more fluid. HMRC carried out a consultation in 2018-19 to explore how online platforms could work with HMRC and taxpayers to help people who make money through the platforms understand and meet their tax obligations.

1 This document was finalised in early 2020 drawing on published sources and thus does not cover the impact of COVID-19 on HMRC and tax.

2 Online platforms are businesses that facilitate the sharing economy, facilitate the gig economy and connect buyers with individuals offering services or goods for sale.