HM Revenue
& Customs

Jim Harra
Chief Executive and First Permanent Secretary

Room 2/75
100 Parliament Street
London
SW1A 2BQ

Email perm.secs@hmrc.gov.uk

Dame Meg Hillier MP
Chair of the Committee of Public Accounts

By email

24 January 2023

REPORT ON HMRC'S MANAGEMENT OF TAX DEBT

Dear Dame Meg,

Below is our update to recommendations 1 and 3 from the Committee's report of 21 March 2022.

Recommendation1: *'Within the next six months, HMRC should develop, and share with the Committee, a plan to manage the increased levels of debt back down to pre-pandemic levels within a specific timeframe'*

We have made strong progress in settling the debts that amassed during the pandemic. As noted in my letter of 30 November 2022, of the debt that peaked at £72 billion in August 2020, 80% has now been resolved. We will continue to pursue the balance over coming months with a view to securing payment either in full or into a payment arrangement, and pursuing enforcement action where appropriate.

Since the Committee published their report in March 2022 there have been significant changes to the economic conditions we are operating in. The Bank of England has forecast that the UK economy is expected to be in recession throughout 2023 and into 2024 while Consumer Price Index inflation is forecast to remain above 10% in the near term.

The factors that are driving inflation, such as rising energy costs and labour shortages, are having a noticeable impact on the indebtedness of small and medium sized enterprises (SMEs).

The challenging economic conditions outlined above are applying an upward pressure to the tax debt balance. Despite clearing new tax debt at record levels we have seen a steady increase in the level of tax debt so far in 2022-23; the November 2022 debt balance stood at £45.7 billion, up from £39.4 billion in April of 2022.

We continue to analyse the trends in our debt balance but we know that the volume of new tax debt is primarily driven by late payment as opposed to late filing, which suggests customers remain compliant with their tax obligations, but face genuine cashflow difficulties. We know that some of our process create spurious debts and where we identify these systematic issues we act quickly to remedy them.

Even though we are clearing debts at a record rate, new debt is currently surpassing our ability to resolve it in the short term. This is a broad-based problem driven by increasing debt across all taxes rather than being attributable to a discrete issue.

For example, corporation tax, which has been the subject of the largest change, has seen late payment increasing by 22.8% comparing the period 2018/19 – 2019/20, to 2021/22. Together these trends indicate an ongoing strain on companies' ability to pay.

The debt balance is currently 6% of total receipts. As set out in our letter to the Committee of 30 November 2022, we are unable to forecast what it will be in future due to the broad factors that drive it, but we expect it to be at an elevated level for the rest of 2022-23 and into 2023-24. This is because the economic conditions have become increasingly challenging and also the tax burden has increased.

The Office for Budget Responsibility is expecting tax receipts to increase by 20% between 2022-23 and 2027-28 and we expect this increase to be reflected in the debt balance.

Strategic approach to managing tax debt:

We have developed a strategic approach to managing tax debt that provides a framework for the improved management of debt over the coming years.

Our objective remains to support customers in short term financial difficulty to manage their way out of debt quickly and sustainably. For those who are able to pay but choose not to, who do not engage with us or where a business has little chance of recovery, we will take enforcement action to collect the tax that is due.

Throughout this strategic approach we retain our commitment to be a responsible creditor. This means that we clearly articulate the options and consequences to debtors, especially individuals, who are in problem debt. We will continue to champion industry best practice and the Government Debt Standard so we can ensure equitable outcomes for both debtors and the Exchequer.

The approach has been developed with the aim of minimising the tax debt as a proportion of liabilities. We have identified our key challenges and identified four pillars around which, strategic choices and initiatives will be prioritised, namely prevention, tailoring, effectiveness and efficiency, and adaptability. These four pillars will inform our future debt collection activity.

Our approach is aligned to the Tax Administration Strategy which was published in 2020. The Tax Administration Strategy announced that HMRC would explore over the longer term more appropriate timings and frequency for the payment of different taxes and this was followed by a call for evidence on timely payment. The approach outlined below allows us to manage the more growth in the debt balance. I have also outlined below two major investment programmes that are supporting us in delivering our ambition to minimise the debt balance.

The four pillars of the strategic approach are:

Prevent	**Tailoring**	**Effective and Efficient**	**Adaptability**
To prevent debts arising we must facilitate payment on time, design tax policy to minimise debt and allocate payments to the correct liability.	We will bring together all relevant information about a debtor to make an informed decision on the next best step. Applying the optimal intervention will reduce ineffective interventions and increase the amount of debt we can clear.	So debts are cleared as quickly as possible we will ensure the steps and processes involved are as efficient as possible both for our staff and for debtors.	We recognise that we operate in uncertain times, so we will ensure that we structure and operate our payment and debt management functions to be adaptable and resilient.

List of key activities:

Below is the key activity taking place under each pillar.

<u>Prevent:</u>

Key to prevention is timely and accurate payments. The introduction of penalty and interest reform for VAT from January 2023, should encourage payment on time and quicker resolution of debts.

In addition, we know that payments made by customers that are not correctly allocated to a charge lead us to believe there is a debt where there is not one, requiring manual work to allocate them following customer contact. We are improving the allocation of payments through the Intelligent Payment Project, which is being delivered in phases.

The first phase created the payment database that will make the information available for allocations in the future. The second phase, which will create data links that enable automated payment error correction functionality, will be delivered in 2023/24.

<u>Tailoring:</u>

In my letter of 22 December 2022, I outlined our commitment to improving our use of customer segmentation to inform our debt collection activity. We are transitioning from a single customer journey to six journeys, each tailored to a specific customer segment depending on both ability and propensity to pay.

One of these six journeys is the 'new debtor' journey, whereby debtors who have never been in debt before with HMRC are placed onto a specialist pathway for their first ‘debt’ experience with us. From here, customers with over two years filing history are separated from customers with less than two years. This allows us to separate customers who are likely making errors from those in new financial distress, and tailor our interactions accordingly.

The pattern of interventions here is tailored to provide support and education to help customers in need or to show customers how to pay correctly. However, those who can pay but choose not to we will immediately progress to more assertive debt collection measures including in person visits and enforcement action. These tailored approaches will be implemented across our four main tax regimes from February 2023.

We will also pilot flexible and dynamic customer journeys which use real time feedback loops of how successful our interventions have been, to inform segmentation amendments to optimise customer journeys. This is existing technology, based on reinforcement learning algorithms which widely used in the debt collection industry and other sectors.

Introducing dynamic customer journeys is at the heart of the tailoring strategic pillar and will also enable changes to be made under the other strategic pillars.

Dynamic customer journeys have the potential for the biggest impact on the volume and value of tax debt resolved. If we can get the first intervention right, the efficiency savings flow through the rest of the debt operating model.

In my letter of 22 December 2022, I provided an update on our pilot of private sector credit reference agency (CRA) data. We have found that CRA data improves the accuracy of our customer segmentation for individuals with Self-Assessment debt and we are in the process of exploring opportunities to purchase this data on a multi-year basis. We are also exploring opportunities to obtain additional CRA data about small and medium-sized companies, to assess whether it improves our ability to pay analytics for businesses.

We are exploring additional ways to use data from our compliance interventions, such as the customer’s behaviour and attitude towards tax compliance, to further inform and improve segmentation. This will enable us to strengthen our approach to deliberately non-compliant customers while offering support to those who need it, reducing harm and increasing deterrent and fairness.

<u>Effective and Efficient:</u>

Where a customer is willing and able to pay their tax debt, in full or by instalments, we need to ensure the steps and policies involved maximise efficiency for our staff and our customers so debts are cleared as quickly as possible.

Expanding HMRC’s self-serve offering will give more people and businesses greater flexibility to manage their debt, online. This includes setting up and managing any payment arrangement online, rather than having to call HMRC’s contact centre. This is a key strand of activity under this pillar.

In November 2022 we extended the existing Self-Serve Time to Pay (SSTTP) service to employers with PAYE debt, and we are in the process of building a SSTTP service for VAT, planned to be launched in spring 2023. Eligibility is restricted by debt value and length of plan while we understand customer behaviour and introduce further enhancements such as affordability assessments to the online service.

We are also exploring ways to further increase the level of functionality within SSTTP with a view to enabling more customers to be able to better manage their tax debt. This could include adding features such as the ability for customers to amend their instalment plan to include additional debts, change payment dates and amounts and include future liabilities.

Other initiatives that have gone live in January 2023 include the introduction of webchat and digital assistant enabling more customers to contact us in their preferred way, making us more efficient and effective.

<u>Adaptability</u>:

We have a strong record when it comes to adapting to unforeseen challenges and economic shocks. During the pandemic our response was fast and highly effective, as recognised by the NAO in their report of November 2021.

As we begin to develop the tailoring aspect of the strategy our ability to adapt effectively to national or local emergencies in the future will be greatly enhanced and allow us to target support even more effectively.

We will have invested £39.7 million up to March 2023 in delivering a new debt case management system through the Debt Transformation Programme. This is a five-year programme to replace the aging debt case management system (IDMS) that underpins all our debt management activity.

This substantive upgrade to our systems will allow us to respond to challenges more effectively through the additional customer insight it can offer front-line staff, increased levels of automation and improvements to usability.

The improvement of our case management and wider investment in our technical capability will deliver the platform for the automated analytics capability set out in the tailoring pillar of the tax debt strategy, in addition to modernising our debt collection process. The new case management system is due for completion in 2025/26 and we have received ring-fenced funding from HM Treasury (HMT) for this.

At Spring Statement 2022 we secured funding for an additional 500 staff over the next 3 years to increase our debt management activity and enhance our adaptability. This will deliver an additional £1.83bn over the scorecard period. The recruitment process has been completed and the staff are now in place.

Phoenixism

Recommendation 3: *'HMRC should provide the Committee with a summary of substantive work it has undertaken to:*

- *Estimate the number of rogue companies at risk of defaulting and the value of the tax at risk*

- *Ensure commensurate resources are in place to prevent such fraudulent activity'*

Alongside our approach to tackling tax debt we are also taking specific action with regard to phoenixism.

A significant majority of business failures are primarily driven by economic circumstances. However, company owners/officers may also try to abuse the insolvency framework to evade payment of debts due to creditors.

Phoenixism is where the same business and / or directors trade successively through a series of companies where each becomes insolvent or is wound up in turn only to continue the same business as a new, separate company, with the deliberate intent to evade paying debts.

As a major creditor in many insolvencies, this represents a risk to HMRC and therefore something we need to consider as part of any debt strategy. Our approach is to counter the risks arising from phoenixism by using data and information to target those individuals behind the abuse, rather than the corporates themselves, which often become empty shells, and prevent the abuse occurring or reoccurring. We will achieve this by delivering two main objectives:

- Predict where contrived insolvency is likely to occur and proactively target interventions that reduce HMRC's debt exposure and minimise losses, using new analytical tools and risking models that build upon our learning from estimating the size of the tax risk posed by phoenixism (for example, by obtaining financial securities from suspect companies).
- Identify where contrived insolvency has occurred and recover the debt as well as taking action to prevent future insolvencies recurring by exploiting data, including from our new insolvency case management system, to drive targeted enforcement activity maximising use of the full range powers and tools available to us. For example, using powers in Finance Act 2020 making directors liable for the debts owed by the company as well as those of any new companies, preventing those responsible from abusing the UK's corporate governance framework

I shared our estimate of the size of the phoenixism risk with the committee in my letter dated 30 November 2022. This will inform our planning to treat and manage the risk.

Yours sincerely

JIM HARRA
CHIEF EXECUTIVE AND FIRST PERMANENT SECRETARY