

Treasury Committee

Oral evidence: Her Majesty's Revenue and Customs Annual Report and Accounts, HC 314

Thursday 14 September 2017

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Members present: Nicky Morgan (Chair); Charlie Elphicke; Stephen Hammond; Mr Alister Jack; Kit Malthouse; John Mann; Alison McGovern; Catherine McKinnell.

Questions 1-148

Witnesses

I: Mr Jon Thompson, Chief Executive and Permanent Secretary, HM Revenue and Customs, Mr Jim Harra, Director General, Customer Strategy and Tax Design, HM Revenue and Customs, and Mr Nick Lodge, Director General, Transformation, HM Revenue and Customs.

Written evidence from witnesses:

– None

Examination of witnesses

Witnesses: Mr Jon Thompson, Mr Jim Harra and Mr Nick Lodge.

Q1 Chair: Good morning. Thank you very much indeed for coming in. You are at our first formal Treasury Select Committee hearing of the new Parliament. It is very nice to see you all here. Before we start with the questions, perhaps you could say your names and your positions at HMRC.

Mr Thompson: I am Jon Thompson. I am the chief executive officer of HMRC.

Mr Harra: I am Jim Harra. I am the director general for customer strategy and tax design at HMRC.

Mr Lodge: I am Nick Lodge. I am the director general for transformation at HMRC.

Q2 Chair: Many thanks for coming in. Obviously you have a number of different responsibilities, many of which the Committee will want to ask about today and in future sessions. I do not think it will surprise you if we start with questions on customs and the future of customs arrangements in light of the EU negotiations. I am going to start on that. First, I would like to ask Jim something. When you last appeared before the Committee in February, you said that the resourcing implications of leaving the EU with no customs arrangement or transitional arrangement in place—the day one scenario—were still being scoped. I wonder whether you could give the Committee an update on that scoping and that preparation for the day one scenario.

Mr Harra: That work continues to refine that view. We have already recruited some additional staff in customs, particularly in policy, to support the negotiations and the planning and also in Nick's area on the transformation programmes to get ready. As far as operational staff are concerned, we are still working through that. There is still time before you would have to bring those people online. You can make some sort of crude projections based on the expected increase in the number of customs declarations, but in fact what really matters is the number of international traders and how capable and ready they are to comply. That is what we are working through to quantify that and to ensure that we do that in good time to start bringing people on board. We are starting some small recruitment of operational staff now for general customs work that will help us to be ready for day one as well.

Q3 Chair: You will have seen the Chancellor's evidence that he gave to the Economic Affairs Committee in the Lords yesterday. He was asked whether the customs would function in March 2019 in a "no deal" scenario. He said, "We recognise that the timescales are very challenging...not everything...will be in place on day one. But we will have a working system". Is that a fair assumption from the Chancellor that



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there will be a working system? Have you got an idea of what might not be in place on day one in that scenario?

Mr Harra: If the UK left the EU with no negotiated deal, I am sure that there are things that the UK Government would want to do unilaterally to improve our customs system. Some of those things could be in place from day one or relatively shortly afterwards, but others could take longer for us and Trade to put in place. There is no doubt that any day one arrangements would not be the ideal or what the UK would want in the longer term. That is why the Government would like to negotiate an interim period before any changes are made to give us and Trade time to make one change with no cliff edge. However, it is our job to ensure that there is a functioning day one model in place that enables trade to flow, enables us to collect the revenues and enables the UK to have a secure border. Inevitably, a balance will have to be struck between those three things. It would not be possible to have in place on day one something that I, as a customs administrator, for example, would be happy with in the long term.

Q4 **Chair:** In terms of the negotiations happening at the moment, is there an ideal time by which it will be clear what the situation will be in March 2019, to enable you to start putting things in place? Is there an internal ideal deadline, if you like, for having things sorted in the negotiations?

Mr Harra: Yes. The negotiations on the future partnership have not yet started. We have obviously been advising the Department for Exiting the EU and Ministers on what their choices are and getting the UK ready in terms of its negotiating position on that. A future partnership paper has been produced. What we would like to see sooner rather than later is a decision on the interim period. We think that an early decision on that would help HMRC and UK traders and, we think, EU member states and their traders as well, because otherwise people are going to have to plan for a contingency at the same time as it is our policy not to have to invoke that contingency. So the sooner the negotiations can agree on an interim period, the better for everyone.

Q5 **Chair:** Do you think that there is a balance to be struck in the resourcing implications for HMRC between, as you say, preparing for the transitional or interim period and preparing for no deal? How are you making those judgments internally about how much to spend on each possible scenario?

Mr Harra: Our position at the moment is that we do not want to make any spend that would not be useful in all these scenarios. For example, the big spend that we are incurring at the moment is on the customs declaration service. That was something that was needed in any event and we may have to scale it to deal with a much larger number of declarations than was previously planned, but that would be the case under a number of the scenarios. But we will reach a point, where both we and Trade may well have to start incurring expenditure that may turn out not to have been required, because if time is too short, we will have to start spending on a contingency that might not be invoked.



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Q6 Chair: This may be hard to answer at this stage, but time is short. At what point, pre-March 2019, do you have to start pressing a button, to make a decision regardless of what is happening in negotiations, one way or the other?

Mr Harra: I think that probably towards the end of this calendar year, or in the spring, we will need to start reaching out to traders who might be impacted by having to make customs declarations for the first time, for example, and working with the ports, the hauliers and everyone who would be affected by that. Whereas if an interim period is agreed, we might be able to do that a lot later or potentially never, depending on the negotiated outcome. I think it is a matter of probably a few months before we have to start incurring expenditure, and probably see others incur expenditure, that might not turn out to be necessary.

Q7 Chair: You mentioned that it is about what happens with not just us, but our EU partners or EU traders. I wonder what confidence you have that customs authorities in other EU countries are also planning, and if you are having conversations with counterparts across the EU on this, particularly, obviously, France.

Mr Harra: I would say that is a significant concern. We do have regular dealings with our counterparts in other member states, because we are a member of the customs union and we are meeting them and working with them all the time. But when it comes to post-Brexit arrangements, other member states have been clear that that is a matter for the Commission and the Commission's negotiating team to deal with. So we are not having significant discussions with other customs authorities in the EU about what their arrangements will be post-Brexit, but clearly, just as there is a task for the UK to deliver, there will be a task for them as well. More insight into their preparedness for that will be very useful to us, but we don't currently have it.

Chair: Stephen, do you want to talk about future customs arrangements?

Q8 Stephen Hammond: Obviously we have seen the paper published by the Government. The Committee is interested in a number of aspects of the customs paper. But on the first point, could you state for the Committee what involvement HMRC had in the production of those papers, how much you were consulted by the Government and, indeed, what consultation there was on the two options for the future that the Government have set out—their two key options?

Mr Thompson: We have an extensive and very deep relationship with the Treasury. We formally have a policy partnership, so that Treasury Ministers can receive joint information from Treasury officials and HMRC officials together. Generally, we work on propositions where officials between the two Departments agree, but occasionally Ministers are exposed to slight differences of opinion. But in this regard we had complete visibility of the paper. We were very heavily involved in its production.

Q9 Stephen Hammond: Given Mr Harra's response to the Chair a moment



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ago about the lack of discussions internationally with other customs agencies, how much has that hampered the production of this paper?

Mr Harra: Just to understand what this paper is, and it is obviously from the—

Stephen Hammond: I have had the pleasure of reading it.

Mr Harra: It is not a position paper; it is a future partnership paper. The future partnership negotiations have not yet begun, so it is very much the UK painting its picture of the options for a future partnership that it would like to explore in those negotiations when they begin. The EU have not yet published any future position from their point of view. This is not something that we would have been doing jointly with other customs authorities. What is fed into it is a lot of insight about what we think the UK and other customs authorities can do and also what UK trade and foreign trade can do, based on our knowledge of dealing with them over a long time. It is certainly not a joint paper; it is very much a UK paper.

Q10 **Stephen Hammond:** I understand that it was never intended to be a joint paper. I was just trying to get to whether the paper would have been better informed had you had discussions with other customs authorities.

Mr Harra: No. I am not convinced that it would have been. It is a UK position paper and I think you would expect it to reflect the UK's interests, but it is based on our knowledge of customs law and practice around the world.

Q11 **Stephen Hammond:** As you know, the paper sets out two potential options: the highly streamlined customs arrangement and a new customs partnership. One has an attempt to minimise the administrative burdens. The other effectively eliminates the customs border entirely by charging an applicable tariff. Could you state for the Committee that you believe both of those to be deliverable options? What are the issues in terms of delivering either of them?

Mr Thompson: We believe that they are both deliverable. They are, as the paper says, very different in implementation terms. The new customs partnership is more innovative, and the paper is very clear that that is technologically breaking new ground, so our assumption is and the advice we gave to Ministers is that that would take longer to implement. Whichever option you go for, there are issues for HMRC, there are issues for importers and exporters, and then there are issues beyond the UK's direct control. You already mentioned some of those—what about member states and so on? If you break it into those three parts, there are different impacts on the highly streamlined arrangement versus the new customs partnership, but in the end it largely comes down to technology, processes, people and money. They play out slightly differently depending on which one you adopt. With the highly streamlined option, we believe you can get there quicker than you could with a new customs partnership, because that is very innovative. It is unprecedented. We were asked to

provide something innovative and creative and that is the option that was developed.

- Q12 **Stephen Hammond:** But if I look at the options for frictionless trade, assuming that we could negotiate that sort of deal, clearly the customs partnership will be beneficial. My hon. Friend over there is about to ask you about some of the issues about delays. The customs partnership model avoids the need for customs checks and the setting up of a whole new infrastructure at particular entry points. Although it would take slightly longer to implement, it must be the more favoured model.

Mr Thompson: The highly streamlined model?

- Q13 **Stephen Hammond:** No, the partnership model.

Mr Thompson: I don't think we have a particular preference. We just need to be clear in terms of the advice that we have given to Ministers, which is that if the European Union and the United Kingdom were to negotiate a new customs partnership, we absolutely would try in all scenarios to avoid new infrastructure. That is definitely one of our goals. A new customs partnership requires quite an innovation.

Let us make this real. You bring something to Felixstowe where the contents need to be split between those that are going to remain in the United Kingdom and those that are going on onward transfer to the European Union. At that point you begin to have dual systems for everything, whereas at the moment you have a single system. Therefore, that requires not only us but everyone who is involved in that supply chain to run multiple systems at the same time, because there may be different tariff regimes.

Essentially, the new customs partnership means we are running the EU tariff system at the UK border. That is why it is quite innovative and different, and it requires new technology.

- Q14 **Stephen Hammond:** That is effectively what we do at the moment with the CTC, isn't it?

Mr Thompson: Sure.

Mr Harra: Just to say that the Government have said that they have no preference at this stage between the two options.

- Q15 **Stephen Hammond:** Ah. The Government did express a preference last week, so I will come back to that in the moment.

Mr Harra: The Government have put the options out there to inform the dialogue that we will hopefully have sooner rather than later with the EU. In terms of international customs regimes, the future partnership is unprecedented. However, as you have pointed out, we are in an unprecedented position, where we currently operate the EU's tariffs at our border and do not have any customs controls between us and the rest of the EU. In terms of the level of change UK trade would feel, it may not be as unprecedented as it may appear.



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- Q16 Stephen Hammond:** Chairman, if I may, I have two final questions. First, Mr Thompson said that it would take longer to implement the customs partnership rather than the customs arrangement. What is the timescale in terms of implementation and your readiness and preparedness? How much knowledge do you need of which way the Government intend to go, and how long would it then take you to implement either system?

Mr Thompson: In terms of our estimate of a highly streamlined option, it is worth understanding a bit more about it. It is a basket of different changes, some of which avoid or try to minimise new frictions, and some of which keep existing facilitations between us and the European Union. In terms of that basket of changes—Jim and I gave evidence to the Public Accounts Committee yesterday—some of it could be ready immediately because it would be a continuation of an existing situation, some would take a year, some two years and some up to three years. The basket itself could be phased in over a three-year period. There is an interesting question about when exactly is the starting date, and I don't think we should necessarily assume that the start date is April 2019. There is a series of preconditions, of which we have advised Ministers, that says that if you can, for example, give us a clear legislative framework, and we are clear about what the negotiations are, we can start the work ahead of April 2019. I appreciate that everyone is focused on when are you going to finish, but we have begun to switch in terms of our advice to Ministers about what is the elapsed time for us to undertake the task.

In relation to the new customs partnership, our assessment is that that is more like a five-year implementation. There are some around us who think that it might take longer than that.

- Q17 Stephen Hammond:** Thank you. Finally, although Mr Harra said that the Government had not expressed a preference, last week David Davis expressed not exactly a preference, but said that the customs partnership represented blue-sky thinking and the customs arrangement was perhaps a more practical option and perhaps the more likely one. Two things: is there anywhere else in the world or any other system that you can point us to so that we can have a look at something that would be similar to or is a partnership currently operating? And do you agree with his assessment that the customs arrangement is the more practical option for the UK?

Mr Harra: As I said, it is unprecedented, which means that I cannot point to anyone else with similar arrangements. The highly streamlined model is much more recognisable to customs people as that is a customs system, however our starting position is very, very different from anyone else building a customs arrangement because we start from a position where we are effectively operating large parts of that partnership. To some extent, you are looking at what you unpick as well as at what you build, but when those negotiations start it remains to be seen what the EU thinks of those two models or any other models that it wishes to put forward. It will take time before that becomes clear.



Mr Thompson: In response to your question about what else we had a look at, we have had a look at the US and Canada, Norway and Sweden, Switzerland and Germany, and Switzerland and the EU in general. We have had a look at the top ranked customs organisations on the World Bank ranking—Singapore and Australia. One of the great advantages of Singapore is that they have managed to put together all Government agencies that have an interest on the border in a so-called single window. If you are an importer or an exporter, you have a one-stop shop and do everything that you need to do and progress on. At the minute, the situation with HMG is that there are as many as 26 different Government organisations involved who have an interest in the border, some of which are not very well known or appreciated. So we have started some even more blue-sky thinking about how difficult it would be to integrate all 26 into a single window, but that is a very long-term project, although I can talk more about it if you want.

- Q18 **John Mann:** May I clarify a few points? The word unprecedented has been used the most. You are sounding somewhat less certain than when it is a smaller change. It was a big change when Gordon Brown brought in tax credits. It was a big shock to the system. This Committee was told that everything would go very smoothly, and it did not. I am hearing a lot more uncertainty from you now in terms of your competence and capability to handle this change—you, Mr Harra, are the one who keeps using the word unprecedented—what is your competence and capability to handle it in terms of expertise and resource? Do you have the expertise and do you have the resource? Are either of those problems that you have identified to Ministers?

Mr Thompson: Which option are we on, Mr Mann? Do we have the money or the resource for the new customs partnership—the unprecedented one—at this point? To be frank: no, we don't. We would need to increase our capacity and capability to implement that project, and that would require legislative cover and money. We have been in extensive conversations with Treasury Ministers about what that might mean. But we need to be clear: we were asked for options, so we put two options out, and we have been clear to Ministers about what they might mean. If that was the option that was negotiated, we would stand up a project to do that. I have been reasonably clear with Mr Hammond about giving you some sense of how long it would take, and we need to be clear that it is technologically challenging and probably a project in the hundreds of millions of pounds.

- Q19 **John Mann:** Resource is one thing. Resource can be provided if Government choose to. That is an easy decision, if Government choose to do so, but capacity is not the same as resource. So what is your capacity for dealing with this?

Mr Thompson: For that option?

John Mann: Yes, as an example.



Mr Thompson: We would need additional capacity to implement that option.

John Mann: You are there defining capacity as resource, in terms of infrastructure, skill base and expertise.

Mr Thompson: If you want me to answer the question the other way round, when I took this job, the Chancellor of the Exchequer explained to me that there are two parts to it: running HMRC, which is a pretty enormous operational delivery Department, and transforming HMRC, in what McKinsey has described as the largest organisational transformation programme in Europe. So you put those two things together. Then, of course, we decided to leave the European Union and at the moment that has been added on top. As an executive team, there will be a point—not yet but between Christmas and the new year—when we will have to say, “If what you want is to do all this, we are going to have to look at what the base-load was and reprioritise and advise Ministers further,” because, as you will get into later in the hearing, there is an unprecedented level of technological change in HMRC. We are attempting to digitise the entire tax system at the moment and this would be added on.

Q20 **John Mann:** But this is exactly the point I am getting at. We might have very different views on what policy should be, on how we vote in Parliament on Brexit and on other issues, including resources, but this Committee wants to know, in terms of the definition of capacity, what gives? What are you capable of doing? Going back to the tax credits—a much smaller change—then it was clear that there was no capacity there. Government could have thrown even more money at the problem, but it would not have solved it, because the systems simply were not good enough. It was not resource that was the problem. So here, what is going to give and, even if something gives, do you have the capacity? I am trying to be fully clear on your advice to this Committee, so that we can take a view on it.

Mr Thompson: I think I am being very clear that we are very aware of that risk. We know that it is there. We have flagged it up but, until we are clearer about where exactly we are going on customs and what the timescale is, we cannot crystallise a decision that says we now have too much to do, if you like, against the capacity that we have got. We are absolutely conscious of that. We have flagged that risk to the Treasury because we think at some point, as I said before, between Christmas and the end of the current financial year, we are going to have to decide whether we can simply subsume all the further change that is required for Brexit.

Q21 **John Mann:** My final question—I could go on about the same subject and issue forever. Is there a possibility, looking at what your capacity is, including the skill base and the technological infrastructure you currently have and the lead-in times to transform and change that, that you are going to have to say, “No. That may be your policy but we can’t deliver this”? Is that a possibility? If so, how high a possibility is it?

Mr Thompson: It is a possibility. If we are transparent with you, although we have said that we have got the largest organisational transformation programme in Europe, that breaks into 15 programmes. If you get to the next level down, there are 250 individual projects that make up the programmes that make up the programme.

We have been going through a process, as a team, of prioritising those from one to 250, so that at some point, as I have been clear, in the last quarter of the current financial year, we can say, "Okay. We are now reasonably clear that we now need to add a number of different projects. We need to draw a line somewhere in this list and say that we are going to have to lose the bottom 'n' projects, and engage Ministers on what that means in terms of the agenda they previously had."

Q22 **Chair:** In terms of time, you talked about between Christmas and the end of the financial year. So really between late December and 31 March 2018—within the next six months—you have to know which model is going to be followed and which agreement has been reached with the EU, in order to start working, or put in place the infrastructure to be able to deliver a customs system on day one.

Mr Harra: I think I said that in the context of standing up operational resources for coping on day one. If you assume there are going to be customs controls operated between the UK and the EU, whether negotiated or not, that is the timescale where we need to firm up on our resource planning and begin recruitment. That is different from introducing the negotiated changes after a period.

I would add that, in relation to customs capability itself, the UK's is an extremely highly regarded customs authority. The World Bank ranks us the fifth most efficient in the world. Jon has talked about looking at Singapore, which is above us in those rankings, so we are pushing up the rankings there. We are also highly respected by UK trade. I would say that within the customs union we have, together with a few like-minded member states, been thought leaders in terms of pushing the EU to modernise their customs system and have something much more business and trade focused.

I believe we start from a very good position as a well-respected customs authority, but there is no doubt that introducing the Brexit changes alongside everything else the Department has to do is a big challenge.

Q23 **Chair:** Jim, earlier you said you had a crude estimate of the number of additional staff needed for day one. Can I push you a bit further on that? What is that estimate? Hundreds, thousands?

Mr Harra: Okay. I am quite happy to talk about that. I would say first that it is crude; it is based on a crude extrapolation: if your customs declarations multiply fivefold, if you multiply your resources fivefold, what would that come out at? That would come out at an extra 3,000 to 5,000 people. Do we believe that is what we really need? No, I don't think we do because we know that, even if the number of declarations grows, a large

number of those will be made by existing international traders whose compliance we already manage.

On the other hand, there are probably about 130,000 new businesses that will be dealing with customers for the first time and there is a big challenge in reaching and supporting them and getting them able to comply with their obligations, certainly on a transitional basis, as well as an ongoing basis.

Q24 Chair: Thirty thousand new businesses who don't have to deal with customs at the moment?

Mr Harra: There are about 130,000.

Chair: Sorry.

Mr Harra: There are about 130,000 businesses that currently import and export with the EU only, and therefore they do not have to engage with customs processes. If there are customs processes in place between the UK and the EU in the future, those 130,000 businesses need to come on board. That is on top of the 170,000 that are already operating customs processes, so it is a big increase in the trader base.

Q25 Alison McGovern: I have some brief follow-up questions. Jon, you said that there is a risk that you do not have the capacity that John Mann was talking about, and that you flagged up that risk to the Treasury. Who did you flag it up to?

Mr Thompson: Yes. At the minute, we are in conversations with officials at our level about this risk, but we will need to crystallise this in the last quarter, as I said, and then we will need to give some advice to Ministers.

Q26 Alison McGovern: What have the responses been from Treasury officials?

Mr Thompson: There is an acknowledgement that you cannot simply take 250 existing projects and add on a significant number of additional ones. We have to implement more aspects of leaving the European Union: I know you are focused on customs here, but there are three other areas for us. They are indirect taxation, data and information sharing and the welfare state, because we are still responsible for tax credits and child benefit. I think we are talking about having 50 to 70 additional projects that we will have to accommodate. In order for us to be able to do customs we are currently sitting with nearly 30. The focus has been on a programme called CDS—Customs Declaration Service—but there are a number of others too.

We are just being realistic with you, and I am trying to be very straight with Mr Mann and with you about the fact that you cannot run an organisation at this scale with this level of transformational ambition and just subsume all this. I don't think that is a credible answer from me as the chief executive, and we need to get down to this conversation in quarter four.



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Q27 Alison McGovern: One final question on this point: can you give an example of the kind of change project that would be dropped in order to do this? What is at the lower end of your change projects and could be lopped off?

Mr Thompson: We would give a higher priority to those current projects that raise revenue or that have a direct impact on customers—Making Tax Digital, for example, would be higher up. We have a range of projects that raise revenue: the fulfilment house due diligence scheme, for instance—we gave evidence on that yesterday to the Public Accounts Committee. Lower down our list would be those changes that do not necessarily have a direct impact on customers or on revenue; they would have a lower priority.

Q28 Alison McGovern: For example?

Mr Thompson: I am trying to avoid your question, aren't I? I don't think it would be right for me to give you an example, and then later on say, "Oh, well, I've changed my mind." I am being clear that we absolutely recognise the risk; it is definitely something we need to do; we know what the timescale is. If and when we are going to drop a public policy, it is for Ministers to say that they will de-prioritise that. It is not really for me to do that here.

Q29 Chair: We may return to that list of projects, and which ones drop off the bottom, in the future. I wanted to ask you a question about the position paper that was published over the summer. My question is about the preparation and drafting of it, rather than what is in the paper itself. How involved was HMRC in the drafting of that paper?

Mr Thompson: Very. I think Mr Hammond asked me that question.

Q30 Chair: What does "very" mean—that you drove it?

Mr Thompson: Jim?

Mr Harra: This is a paper that covers much more than just the customs arrangements at the Irish border, so clearly it was co-ordinated by the Department for Exiting the European Union, but HMRC fed into the customs elements of this, and we had a very heavy hand in the development of what is in the paper, quite apart from the drafting of it.

Q31 Chair: HMRC is a non-ministerial Department, and a lot of the time you are engaged in administration once the policy has been set by others. In this case, it sounds as though you are actually engaged in policy preparation, discussion and drafting for the public.

Mr Thompson: It is probably worth saying, given that this is the first time we have all met, that the constitution of HMRC is best described as a bit odd. It is technically a non-ministerial Department. Mr Hammond asked me earlier about the future customs arrangements paper. We have a formal policy partnership with the Treasury, so that Treasury Ministers get advice, which includes whether or not we can implement the policy that is being considered. Therefore, the two Departments work very closely together in terms of the advice that goes to Ministers. Sometimes we do



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not necessarily agree and we are allowed to give that difference of opinion to Ministers, because we do not want Treasury Ministers to announce something and then for us to say, "Sorry, we can't implement that."

Although it is technically true that we are a non-ministerial Department, that mostly plays out in terms of the operation of the Department. There are a number of decisions, which in a ministerial Department I would refer to a Secretary of State, that I either take myself or share with the executive committee or, on occasion, with a non-executive majority board. So the difference is in the day-to-day running of the Department, if you are used to working in a ministerial Department. I was permanent secretary of the Ministry of Defence; I put more to the Secretary of State than we ever do to the Chancellor of the Exchequer. There are also some other very strange things about what the Act that set us up says, the role of the commissioners and my role as an accounting officer, but we have settled the governance through a practical working solution. Sorry to get into that.

Q32 Chair: No, that is fine. What was the timing of the drafting of the position paper? I think David Davis has said it took 12 months. When did you really start to get heavily involved and when did the sessions on the actual drafting of the paper take place?

Mr Harra: I cannot quite recall. We set up our EU transition unit within about 10 days of the referendum result. That included focusing on Ireland and what the solutions to that might be, working with my customs experts and policy team. There was quite a degree of iteration with Departments like DExEU over a period of time. Those were not drafting discussions, but exploratory discussions about the options. I cannot quite recall when everyone started taking their caps off their pens and drafting the paper, but it is the product of a year's work.

Q33 Mr Jack: I want to turn now to Northern Ireland and Ireland. Obviously, it is potentially a very sensitive subject—there is the Good Friday agreement and a lot of trade between us and Ireland. There is a point of entry in my constituency—the port of Cairnryan—so I clearly have a specific interest in that. You talked about the policy paper, which is guided, to a large degree, by one objective: to avoid any physical border infrastructure in either the United Kingdom or in Ireland for any purpose, including agricultural movements and so on. I just want to know, who set that objective?

Mr Harra: Both the UK Government and the EU negotiators have made it clear that having no return to the borders of the past at exit is an objective they want to achieve. The Prime Minister has set that as one of her top priorities. When we set out our options for Northern Ireland, we were looking at how we can meet that objective while, at the same time, creating an acceptable and manageable level of risk for customs and other matters.

When the Government published their future partnership paper on customs with the EU, they acknowledged that if you simply put one of



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those options in Ireland they would not achieve that objective. Therefore, you have to go further and come up with further options that recognise the special situation at the Irish border. That is what the separate position paper does; it acknowledges that you have to push further than we would propose for customs generally to achieve that objective.

Q34 Mr Jack: And does it require the EU to set aside its rules to achieve that objective?

Mr Harra: It will certainly require the EU to go further than is currently the case, if you were simply to implement its existing union customs code when we leave. I do not believe that would achieve the objective and I think the EU recognises that. However, we have tried to put forward an option that we think achieves the objective you want while having manageable risk both to the EU and the UK. That option is really based on the fact that a lot of the movements across the Irish border by small businesses are movements in a local economy, not movements of international trade as people would normally understand the term.

Q35 Mr Jack: Picking up on that, there are exemptions for small traders and for the firms who are declared to have trusted trader status, but there are those who fall outwith that, not least agricultural transporters—there are a lot of beef, dairy and sheep movements across the border. How do you catch them? How do they carry on their trade?

Mr Harra: Matters of regulatory equivalence in food and plant health are not really my area, because they go beyond customs controls. The key thing the paper says in relation to customs is that, for small businesses operating in that local economy, there should be no customs infrastructure or processes that they have to engage with. For larger traders, where we recognise that there may well be customs responsibilities that we or the EU would expect them to comply with, we have come up with propositions on how they can do that well away from the border, so that no physical checks or physical infrastructure at the border are involved, but meet customs control none the less.

Q36 Mr Jack: Are cameras and number plate recognition systems physical infrastructure?

Mr Harra: Our view is that the proposition in the paper would not require any new infrastructure, such as cameras or number plate recognition, for customs administration.

Q37 Mr Jack: They would not be required.

Mr Harra: No.

Q38 Mr Jack: Mr Thompson, you mentioned Switzerland and Germany and Switzerland's partners, and Norway and Sweden. Are there any examples internationally that compare to the situation in Northern Ireland and the Republic of Ireland?

Mr Thompson: I am not sure.



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Mr Harra: I am not aware of any. Both the EU and the UK recognise that the situation in Northern Ireland is unique, and that the 1998 agreement and the peace process based on it are unique as well. Clearly, there are areas where there is local trade and some small territories where customs procedures do not really apply to movements across the border, so there are some parallels, but the position paper recognises that to achieve the objective in Northern Ireland, both the UK and the EU will have to go further than the “normal” customs process, which is the highly streamlined process set out in the other paper.

Q39 **Mr Jack:** Do UK customs or UK border control—I know it is not your area—have any presence in the Republic of Ireland now at points of entry?

Mr Harra: The UK certainly does not have any presence in the Republic of Ireland—it might be quite controversial if we did. There are no customs processes between the Republic of Ireland and Northern Ireland at the moment, because both are in the EU. There is an excise border there—there are different excise duties in Ireland and the UK and there can be some issues at the Irish border with smuggling, which have to be managed. We co-operate very well with the Irish authorities in doing that. Generally speaking we do that away from the border, so they do not require any routine checks, but they are intelligence-led and risk-led and we do intervene. In the case of excise, the duty rates between Ireland and the UK have for some considerable time been pretty similar, so the smuggling risk is not that significant, but it is an excise border already.

Q40 **Mr Jack:** Okay. In the future, there will be different tariffs and there already are different excise duties, so what is to stop it being a back door for the EU into the UK and vice versa in 10, 15 or 20 years’ time?

Mr Harra: We do not yet know whether there will be any tariffs. That will be the subject of trade negotiations—

Q41 **Mr Jack:** I am not saying now. I can envisage a tariff-free arrangement, but things change.

Mr Harra: I think the proposition set out in the position paper recognises that possibility. That is why it does not suggest a wholesale exemption for every movement across that border. What it tries to do is identify a set of movements that are not really international trade and do not pose a significant economic back-door risk to either jurisdiction, but it recognises that there will have to be controls in place for larger traders and then comes up with solutions whereby those controls can be operated away from the border.

Q42 **Mr Jack:** Okay—and away from the ports, Belfast and Cairnryan?

Mr Harra: Obviously, Belfast and Cairnryan are both in the UK. The Government have stated they have absolutely no intention of creating any sort of customs processes between Northern Ireland and Great Britain.

Q43 **Catherine McKinnell:** Given the unprecedented nature of what is being proposed, do you think the March 2019 deadline for delivery is realistic?



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Do you have any specific concerns about that?

Mr Harra: What is unprecedented is the customs partnership, and it definitely cannot be delivered by April 2019.

Mr Thompson: Sorry, you mixed together two different options—

- Q44 **Catherine McKinnell:** No, I mean in terms of Northern Ireland and your answer, which was that you cannot think of any other international examples, and given the unprecedented nature of the relationship between the EU and the UK via the land border.

Mr Harra: Some elements of the proposition for Northern Ireland will take some time to implement. It is of course part of the withdrawal negotiations, as opposed to the future partnership negotiations, so there is the prospect of early agreement on that. That goes back to what Jon said: when you can finish depends on when you start. It would be ideal if we could get a start on that and get early agreement. That is why the Irish situation is part of the withdrawal negotiations that are under way now.

- Q45 **Catherine McKinnell:** So it is realistic to expect an agreement before the March 2019 deadline.

Mr Harra: I am not responsible for the negotiations but I very much hope so, yes.

- Q46 **Catherine McKinnell:** Concerns have been expressed by Irish customs enforcement that they would need significant resource in order to deliver, if that is not achieved. In terms of capacity, which we have discussed, but also resource, do you feel you have sufficient resources to deliver on the sort of timescales that are required to ensure a smooth transition?

Mr Thompson: This is a subset of Mr Mann's points. The answer is exactly the same as it was for Mr Mann and Ms McGowan—McGovern, sorry.

- Q47 **Charlie Elphicke:** Jim, let's turn to customs systems, which you have ownership of. Let me paint a picture: it is 29 March 2019 and the talks have collapsed in acrimony; there is no deal, but this has to be ready on day one. Can you look this Committee in the eye and say, "Yes, we'll be ready."?

Mr Harra: Nick might want to come in because he is responsible for delivering the change, but yes, we have been working on what that contingency option would be, impacting the IT changes that would be required, and increasingly engaging with trade ports and traders and others involved in customs to ensure that we have something in place on day one that balances the three objectives that I described. But undoubtedly the ideal is that we have an interim period to make change.

Mr Lodge: We have mentioned CDS—the customs declaration system—a few times in this discussion. That is the big new customs system that is coming into replace CHIEF, which is the current system, as you know. We made a decision to do that before the referendum, as Jon said, so the delivery of that is well under way. It is to a tight deadline and there is no pretending otherwise. That brings its own risks, so we are absolutely not



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at all complacent about it, but at the moment, the delivery of the CDS is on track. In fact, next month we will start to test that with the community service providers—the people who operate at some of the ports and airports—so we will start to have the beginnings of a live system in its live environment as we begin to do the testing. That is well under way. We understand the need to have some contingency wrapped around that, which I can talk about a bit more if you would like me to. We also understand the need in particular places—for example, roll-on/roll-off—to talk about exactly what day one would look like there. The position paper set out the Government's preference for that and we will need to engage with port authorities, hauliers and shippers, and everybody else in the chain, to understand how much of that is feasible to have in place. Where it is not feasible to have all those elements in place, we will need to work out exactly what the arrangements will be. That is the process we are embarked on now.

- Q48 **Charlie Elphicke:** So it is a tight timescale for the system to be implemented. Jim, to help the Committee, can you paint a picture of what it would look like if the system were not ready, for whatever reason, on that day, in a no deal, no transition scenario?

Mr Harra: The basis for the day one model will have to be the customs declaration service or the existing CHIEF service, which works very well but is not designed to cope with the scale of declarations that would be involved, although, as Nick mentioned, we are looking at scaling that up as a contingency—so as well as the potential of dual running, with CDS and CHIEF, also relying on CHIEF in the event, which we do not believe is likely, that CDS would not be there.

The key challenge, for example, in ro-ro ports, in contrast with container ports, is that in a lot of them there are no port inventory systems in place. Although someone can make a customs declaration to us under CHIEF or CDS, understanding which vehicle the goods are on that that declaration relates to is not possible without those port inventory systems. Therefore, you would rely on much less ideal, much more manual processes to try to manage the risks at the border. What we want is the time to implement a full solution that enables us to link declarations to the vehicle that is carrying the goods, clear them so that all that traffic can flow off the ferry and we know what, if any, lorry we need to check. The day one model would involve us taking some risk with that.

- Q49 **Charlie Elphicke:** Looking at CDS, I think it is right to say that there are 55 million customs transactions at the moment. If we left the customs union, that would rise to 255 million and CHIEF could handle only 100 million, so CDS is mission critical on delivery, is it not?

Mr Thompson: Yes.

- Q50 **Charlie Elphicke:** Given that that is the case, the Institute for Government, in a report published at the weekend called "Implementing Brexit: Customs"—I do not know whether you have read it—

Mr Thompson: Yes.



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- Q51 **Charlie Elphicke:** It says that CDS “is critical to customs after Brexit. It is under real pressure and successful delivery is in doubt.” That is reinforced by the NAO, which has said in its report: “What is clear is that the timeline for completing the CDS programme under its current scope allows very little flexibility should the programme overrun or unexpected problems occur.”

Mr Thompson: Yes, so the IFG—

- Q52 **Charlie Elphicke:** Should we accelerate it?

Mr Thompson: Hang on a minute. The IFG is working off the NAO report, not unreasonably. The NAO report was published in July, based on fieldwork in February, so there was a big gap between the NAO doing the work and publishing the findings. We are now sitting here in September. That project has moved fairly significantly forward since the fieldwork in February. Indeed, Nick and I are expecting to give evidence to the PAC on this at the back-end of October.

The programme is in a stronger place than it was. It is still regarded as amber—that is an independent assessment by the Infrastructure and Projects Authority, which is part of the Cabinet Office. We have made some significant steps forward. Our estimate is approximately 50% of CDS is built and ready to go. As Nick said, the first two of the community service providers, the one that provides services to Dover and the one that provides services to Felixstowe, begin access to the system in October, so that they can do their work. I think that the prospects for it being implemented have risen since February.

Although we said that it needed to be completely up and running in January, actually, the beginning of the phased introduction is formally in August 2018. I do not believe, to answer your question straightforwardly, that we can accelerate it any further than that—not safely.

- Q53 **Charlie Elphicke:** Even if we had extra resources?

Mr Thompson: No.

- Q54 **Charlie Elphicke:** So there’s nothing to be done? It is January 2019 or bust?

Mr Thompson: As Mr Mann said in relation to tax credits, I am wary about being confident about technology projects. Technology projects are complicated in their very nature. There are unforeseen things with technology projects. There was a worldwide study of 5,000 IT projects, half in the public sector, half in the private sector. The public and private sector projects performed roughly the same, but I am not prepared to commit myself entirely on every single work and say, “It is all fine and dandy.” That is a mistake. Something will happen in technology, which means that you need to have appropriate contingencies and so on, so I am not prepared to go any further than where we are now. We are reasonably confident that it will happen. It is currently rated amber. It is on time, but I cannot guarantee to you, and nor would I to Ministers, that everything is going to be fine, because there is still another year to go.



Mr Lodge: We are planning for that contingency. We have always planned to have a phased introduction of CDS and to run CHIEF alongside it. The two can run alongside each other for a good length of time after March 2019, so we have that built in. We are building the functionality for supplementary declarations—about 80% of the declarations—that are the traffic that currently goes through the CHIEF system first. That is planned to be ready to be tested with the trade from December 2017. That will give us a good level of contingency and confidence and we are planning further contingency around increasing the capacity that CHIEF can handle alongside all of that. We are absolutely saying that we are on track with CDS, but as Jon said, we have to plan for the eventuality that something happens that we cannot quite foresee now. It is a tight timetable, and although there is no reason to say here today that it will not be delivered on time, we could hit risks or problems later on and we have to prepare for that. We have some really strong contingency arrangements to make sure that we are ready for day one.

- Q55 **Charlie Elphicke:** I put it to you that Brexit and getting the systems right is not some kind of routine Government reorganisation that one thinks about on Thursday afternoon; it is the most important national project since the second world war. If the system and we are not ready, would it be fair to say that the entire economy goes rapidly into gridlock, along with all the roads to the channel ports?

Mr Thompson: We do not anticipate that. I think Jim was fairly clear that the Government's objectives are the security of the United Kingdom, the free flow of trade and the raising of revenue. If we got to 29 March 2019 and something unforeseen happens and we are in a really difficult situation, and you are invoking a genuine contingency on the last possible day, you would have to prioritise those three objectives, wouldn't you? You would have to take some risk with those three objectives: of security, free flow of trade or revenue, which will you prioritise and which will you take some risk against?

- Q56 **Charlie Elphicke:** Putting aside CDS, I think there are 57 HMRC IT systems operating at the border. Of these, 25 require changes in the light of Brexit.

Mr Thompson: Yes.

- Q57 **Charlie Elphicke:** How are they going?

Mr Thompson: We have a portfolio that is looking at those. We have listed them all out and we know exactly where we are. We think that, essentially, some are just an amendment. We think there are three that need to be re-implemented. That programme is in roughly the same space; it is on track. But again, given that there are 25 of those, although we are on track and it is going well, I am never prepared to give anyone a guarantee—you, Ministers or anyone else, for that matter.

- Q58 **Charlie Elphicke:** In relation to the risk of disruption at ports, at which EU ports you think there is the greatest potential for disruption? What sort of talks have you had with your counterparts in, say, France and



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Belgium about port community systems and those sorts of things, to make sure that declarations are managed and that traffic can flow?

Mr Thompson: I have visited 11 ports so far, and I have another half a dozen in the diary. I have been to Dover three times now.

Kit Malthouse: Lucky chap.

Mr Thompson: I have been to Hull, Liverpool, Felixstowe and a number of others. The truth is that they are all very different. To answer your question straightforwardly, I think our major concern is the closed loop system that is Dover to Calais. I have been to Calais, Coquelles and Folkestone, too, to see how the Eurotunnel works, and Jim has been with me. At this point, the Dover to Calais closed loop system is the area we are focusing on the most. We have had some excellent conversations with the chief executive at Dover. I have met him and we are in an ongoing discussion about where we might be going exactly and what we might need to do. As Jim said, the situation on the other side of the channel is more problematic. I know you know this because it is in your constituency: everyone is focused on Operation Stack, but there is also a risk of a French Operation Stack because you cannot get through Calais to get to Dover, and that while everything is fine to leave the UK, you cannot get in. We need to make sure that that system is balanced, because it only takes something like two hours to stop.

Q59 **Charlie Elphicke:** Have you also looked at the issues surrounding infrastructure and, in particular, have you had contact with the National Infrastructure Commission? Have they taken an involvement in this?

Mr Thompson: We do not believe that any additional infrastructure is required for customs purposes at Dover, but I am aware that you've asked this question in a number of different ways. It is perfectly possible that other Government Departments may need additional infrastructure, either in or around the Dover area. We do not believe that we need any.

Q60 **Charlie Elphicke:** Have you had contact with the National Infrastructure Commission on this matter?

Mr Thompson: Not that I'm aware of.

Mr Harra: We have had discussions with the Department for Transport, which would have the lead responsibility for any infrastructure requirements. I have had conversations with the director general—my opposite number there—on what our requirements may or may not be and what the requirements of others would be. Across Government, we are trying to co-ordinate all of that impact on the ports, so that they don't hear from HMRC, Border Force, the Department for Transport and others. We are putting that all together, but I personally haven't dealt with the commission.

Q61 **Charlie Elphicke:** Chair, may I suggest that we take evidence from the commission as an oral hearing? I think that will be very valuable, because it is a massive national project, and it is vital that we see what they have been doing about it.

Chair: Yes.

Mr Thompson: Would you indulge me in going slightly further? I think there is an important question that needs to be wrestled with here, which is: in April 2019, are French lorries full of wine going to Sainsbury's any more risky than they were in March 2019? We need to think about this through that sort of risk lens. Now, you may want to say—we would agree with this—over time the risk may rise at the UK border, but in the initial phases there is almost certainly no change to the risk equation at all. In which case, given that the number of vehicles stopped at Dover is rather small, does it really make any significant difference, given the objectives that Jim has set out about security, free flow of trade and revenue? In which case, the vast majority of the lorries going through now could go through in the future.

- Q62 **Charlie Elphicke:** There are two practical points. First, do you agree we should keep mutual recognition of food? Secondly, do you agree that the border should be seen as a tax point and not a search point, from a customs point of view?

Mr Thompson: I'm not sure I understand the second question.

Mr Harra: The first one is not for HMRC. On the second one, I think, broadly speaking, I do agree with that. Our approach to managing border revenue risks is to do as much of that away from the border as we can. There clearly are ways that you can manage those risks—for example, at traders' premises and through trusted trader regimes. That does not involve opening and rummaging through lots of containers and lorries at the border, which is resource-intensive and disruptive, and arguably of limited effect. Clearly, doing physical checks at the border has to play its part, but it is something that we have always looked to minimise. That is one of the reasons why we are regarded as one of the most efficient customs authorities in the world.

- Q63 **Chair:** Does the answer to your question, Jon, not also depend on what is happening on the other side of the border? The UK may take a view on whether risk has increased between day minus one and day plus one, but it also depends on what the French, or people on other borders, have decided to do in terms of searching and taxing.

Mr Thompson: Yes, and we ought to be transparent with you. Let's say we go with Mr Elphicke's question, where we leave, there is no deal and we are in that situation. The risk may not change on the first day, but the risk will change over time, because we know, from all the work we do, that those who want to defraud the taxpayer can be relatively adaptable in terms of what they do. It wouldn't take very long before they can work out, "Nothing has changed here, so I will continue to send lorry-loads of cigarettes without the appropriate excise." We need to think about time scales and risk in this, and I don't think it's as clear—as black and white—as 1 April 2019, from our perspective.

Mr Harra: I would add that one of the priorities, which Jon mentioned, that the Department has is regards information sharing. One of the ways



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that fluidity between the UK and the rest of the member states works so well now is because we have very good systems that share information and intelligence. To manage the risks on day one without disrupting trade, it is important that we secure those for the future as well.

- Q64 **Charlie Elphicke:** Before we move on to One Government at the Border, to pick up on your remarks, Jon, about those defrauding the taxpayer, in the light of your evidence yesterday, do you think there is a strong and compelling case that there ought to be joint and several liability for VAT to be collected by online traders?

Mr Thompson: The Government have called for evidence in that regard. We think the solution is a split payment solution, so that when you pay for your goods online, the merchant acquirer removes the tax at that point, so that the seller gets the net amount and we get the revenue. There was a call for evidence for that. Evidence was provided to that. We have kept that evidence open and we are about to marshal that to go towards Ministers. We cannot actually implement that under existing European Union law. Ministers may have that flexibility at some point in the future, after we have left the European Union.

- Q65 **Charlie Elphicke:** Turning to the One Government at the Border project, you head the border planning group. Can you tell the Committee the progress of that, in trying to draw together 30 different Government Departments and 100 local authorities?

Mr Thompson: We formally stopped the project once known as One Government at the Border in order to really focus on three things. First, the remit I was given by the Prime Minister was: if we think about a contingent situation for April 2019, working across all Government Departments, would that actually work? In relation to the negotiated outcome, can we now integrate all of that at some point beyond 2019? Ultimately, at some unspecified date, could you implement a sort of Singaporean model in the UK?

If you like to think about it in those three phases, we are very focused on the contingency planning element of that. What is it like? I chair a group of 25 people on a regular basis. We have added some additional capacity, including another director general to HMRC. The team that is looking at that are working across a number of different Government Departments to understand how the transport implications would work with Border Force, and how it would work with HMRC and customs, and so on and so forth.

You are right; if you go to many ports, the majority of interventions that happen at the local port are from the local district council or other local authority responsible for animal health. To be specific, I went to Felixstowe the other day. Approximately three quarters of the interventions on containers there are from Suffolk Coastal District Council, who are looking at it from an animal and plant health perspective. So we all think about it as Border Force and HMRC and Transport, but it is actually the local authority that is implementing some aspects of European Union legislation. They are the people who mostly open the containers.



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- Q66 **Charlie Elphicke:** Other countries have drawn together border control and tax at the border into one single department, such as the Department of Homeland Security in the United States, and in Australia. Is it not time for us to do the same here?

Mr Thompson: It's conceptually possible for the Government to pull together 26 different organisations at some point into a so-called single window, so that if you are an importer or an exporter, you go to one place, do everything you need to do and you are done. We need to be transparent with you: that is a mega-project. You would need to be thinking about that as a project that costs somewhere between £500 million and £800 million. It would take five to seven years to implement. We have been asked to work out whether there is a business case for that. There would be a noticeable change to GDP in my opinion, because it would make it much smoother to import and export if you only had to go to one place instead of multiple different Government Departments.

- Q67 **Charlie Elphicke:** So a department for homeland security could boost growth for the United Kingdom?

Mr Thompson: I didn't say that. What I said was—

- Q68 **Kit Malthouse:** That's exactly what you said.

Mr Thompson: I didn't exactly say that, did I? What I said was—

- Q69 **Kit Malthouse:** A noticeable effect on GDP.

Mr Thompson: It is my view that if you had a single window, then surely it would be better for businesses if they only had to go to one place and get everything you needed to get. For example, you may have to go to the Food Standards Agency, the Border Force or HMRC, or, you know, the Government Diamond Office, and so on and so forth. You can conceptualise that that is a really good idea. Whether we can bring it about? We think two countries have been able to do it: Singapore and Australia. We have hired the team that implemented the Singaporean option to see if they could be done in the United Kingdom.

Chair: It is certainly good for their bottom line in terms of income for consultancy fees for some time to come. I think we have already talked about one mega-project; we don't want to get on to another one. I am going to bring in Alison, who is going to talk about the customs code and has a couple of follow-up questions from other things as well.

- Q70 **Alison McGovern:** I've got loads of questions. To follow up what Charlie said, to be absolutely clear, we currently have 26 Government bodies at the border. You are interested in a single window, but One Government at the Border has formally stopped as a reform project.

Mr Thompson: We stopped that project because I don't think it was appropriate. It did not take enough account of the fact that we were leaving the European Union. We then started a different project.

- Q71 **Alison McGovern:** I just want to be clear: One Government at the Border has stopped.



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Mr Thompson: Correct. We have substituted a different project, which I am currently in control of.

- Q72 **Alison McGovern:** That's helpful, thank you. Jim, I wanted to go back briefly to the border of Northern Ireland. You said something very interesting. In the context of what is purely local trade, you want to distinguish between local traders and what could be classified as international trade. What is your definition of local trade? What meets that test?

Mr Harra: That is the underlying base on which the proposition is built: a lot of the movement by small businesses is in effect people operating in a local economy where there is no visible border at the moment.

- Q73 **Alison McGovern:** How are you defining that?

Mr Harra: That is something that we would have to negotiate with the EU because we and they have to be happy with it. We have set out in the paper the kind of things we would want to look at. In my view, if you were capturing less than 80% of the movement across that border, you are not pushing this hard enough.

There are a number of criteria you could use to identify the businesses: it might be by size of turnover or employee base or movements across the border. I suspect you might mix and match those. My aim would be to ensure that every business that is trading locally in the area around the border and is not moving goods into the UK or the EU can benefit from the—

- Q74 **Alison McGovern:** To be clear, businesses close to the Northern Ireland border will have to meet some criteria that will have to be agreed with our negotiating partners in the European Union. Is that correct?

Mr Harra: No. The UK could apply it unilaterally; but of course, it would then work only one way, which would not achieve the objective that we need. This does have to be something that is agreed in order for us to get the maximum benefits from it.

To give you an example: today, someone in the Republic of Ireland can phone a plumber in Northern Ireland; he or she can go across the border with some copper pipes and their tools in the back of their van and not have to worry about customs. In theory, when we leave the EU, if we do not do something about that, they will have to make customs declarations in relation to the temporary movement of their tools. It's madness.

- Q75 **Alison McGovern:** I understand what life is like in that area. What I am asking you is to confirm that, in that precise example, the ability of that plumber to continue trading, as they do now, is dependent on them meeting some criteria, which you will specify and agree with our European partners, if they wish to.

Mr Harra: The UK would, either unilaterally but ideally in conjunction with the EU, say people like that do not have to worry about customs.

Q76 Alison McGovern: But if that does not happen, they will—yes or no.

Mr Harra: If the EU said, “No. Customs controls are going to have to be applied by the Irish to those people,” then they will not have achieved their stated objective of a frictionless border.

Q77 Alison McGovern: Moving on, clearly we would want to have such a definition of local trade. There is a time question here. Obviously, people who might seek to exploit such a definition of local trade as a back door might not turn up on day one, but, as the years roll by, isn’t it the case that having such a definition of local trade might open an opportunity for people who wanted to undermine any constraints that are placed on international trade, as part of our new customs policy?

Mr Harra: It is inevitable that a risk that people will focus on is that any exemption for small businesses here will be exploited in some way—for example, to create the back door that was mentioned. We will need to come up with realistic assessments of the extent of that risk and realistic ways of managing and mitigating that risk, which do not involve routine checks at the border.

Q78 Alison McGovern: You said earlier that you were not anticipating, and that the Government did not have an ambition for, different tariffs to be applied. In the context of this border, it could be smooth because you were not anticipating different tariffs. Is that policy guidance that you have received from Ministers?

Mr Harra: No, I’m sorry, I didn’t say that. What I said was that we do not know that there will be tariffs between the UK and the EU. That is a matter for trade negotiations between us. Clearly, if there were no tariffs between the UK and the EU, it would make it even easier to justify the kinds of easements at the Irish border that we have talked about. But even if there were, we have come up with a proposition where you can move goods under customs control in larger traders that does not involve physical infrastructure at the border.

Q79 Alison McGovern: Okay, but I am asking whether you have received indications from Ministers about that point on tariffs, because you will appreciate that if we are going to remain with the status quo on tariffs, it is hard to understand what all this discussion about how to manage the change is for. If we are going to have different tariffs, there will be practical consequences for people in that area.

Mr Harra: We do not know whether there will be tariffs between the UK and the EU, or whether the UK will have tariffs with the rest of the world that are different from the tariffs that the EU has. We have to plan for different eventualities.

Chair: Will you move on to the Union customs code?

Q80 Alison McGovern: Turning to the Union customs code and the potential for having a UK customs policy, you mentioned the UK as a customs policy thought leader and indicated that that has been the case within the current system. Could you say how that has happened?



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Mr Harra: In a period of about 10 years, the EU negotiated changes to its customs code and created the Union customs code, which is now being implemented, with Nick leading the CDS project to help the UK do that. That contains a number of improvements for trade, compared with the old customs code, which were hard fought for by the UK and some other member states. The UK's view of the Union customs code is that it contains important improvements that we managed to negotiate. It does not live up to its early promise and the UK would have been happy to see further facilitations in it that are not there, but it is an improvement on what we have had before. It is what we are in the middle of implementing and what UK Trade is in the middle of implementing. Therefore, it makes sense for it to form the base of the UK's customs regime from the end of March 2019. Thereafter the UK, either in a negotiated settlement or unilaterally, is likely to want to make improvements to it.

- Q81 **Alison McGovern:** Do we have the resources—this goes back to the capacity point from a different angle—for devising, running and organising a UK customs policy? Do we currently have the expertise in-house at HMRC?

Mr Harra: I believe we have a very expert customs authority. We have used that expertise for the last number of years to feed into the European Union rather than to create something in the UK, but the Union customs code and the improvements in it reflect, to a large extent, the hard work of experts in HMRC. If we start off on day one with a UK customs regime that looks very similar to that, it is something that we and Trade should be capable of running, because it is what we have been planning to do around that time in any event.

- Q82 **Alison McGovern:** In so far as we have continuity customs policy, we will be okay. If we are to reap any sort of benefits from Brexit, presumably you have had direction from Ministers that they would be minded to change UK customs policy.

Mr Harra: Undoubtedly, when the UK has its own customs regime it will want to change it over time. As I have said, there are certainly some improvements that the UK Government might want to make sooner rather than later. We would advise on those and on our capacity to absorb them and deliver them in a normal way, as we would with any tax policy change, for example. But starting off with a UK customs regime that looks a lot like the Union customs code is a sensible and practical thing for us and Trade to do, in the event that we have to operate our own from day one.

Chair: You may or may not be pleased to hear that we could carry on talking about customs and Brexit for, I suspect, a long time, and we may well return to it in future sessions.

- Q83 **Kit Malthouse:** It is obviously not deal or no deal; it is deal, specific deal or the biggest trade deal in the world, which is WTO rules, with which you are familiar, because we operate that for quite a lot of our trade already. So the translation across to WTO, which is what people are calling "no



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deal”, should not be that hard, in terms of comprehending what the rules and regulations and all the rest of it are. Is it the case, as you were implying, Mr Thompson, that whatever the arrangement is we have no obligation to operate a customs system, and that we could carry on after exit day as if we were pre-exit day and take our time as the risk or patterns of trade may change, as you say?

Mr Thompson: We could do that.

- Q84 **Kit Malthouse:** There is actually no “Oh my God, we are not ready” moment. If it takes another couple of months, it is not going to have a significant effect.

Mr Harra: Under international law, we would be expected to move goods across borders under customs controls when they are crossing from one customs territory to another. In an administrative sense, the UK would be expected to operate customs. That is not the same as tariffs and everything. It is the UK’s choice what it negotiates or does unilaterally in that area.

- Q85 **Kit Malthouse:** Even if there are tariffs of some kind, we have no obligation to collect them.

Mr Harra: I think as a customs authority, the World Trade Organisation and the World Customs Organisation would expect you not only to have tariffs, but to enforce them. But all customs authorities have flexibility and discretion about how they go about doing that: how they manage the risks; the extent to which they do things physically at the border, as we talked about before; and the extent to which they do things post-clearance or pre-clearance. There is a lot of flexibility.

- Q86 **Kit Malthouse:** It is perfectly possible for us to have our own transition period, notwithstanding what the EU decides to do. We could say, “Day one is essentially exactly the same, because our systems are not quite ready. We will migrate to the new systems over three or four months.” That is our cost and our lookout, not anybody else’s. There is a balance between the three pillars, as you said, and an element of the media and some politicians are trying to confect the idea of panic about the day—the drop-dead day. Actually, what you seem to be implying is that we could be more sensible about the levels of risk and say that will not actually be one day. We could take a bit more time if we needed to and there would be no significant effect.

Mr Thompson: We could, but I think what Mr Elphicke was digging away at was that it takes two parties to dance. If you think about Dover and Calais, we could say, “We will take the risk. Everything can come in. It’s fine.”

Kit Malthouse: Which is what we do now.

Mr Thompson: It’s a closed-loop system. We are not in control of what happens on the other side of the border, which is a significant element of the risk. In answer to the Chair’s opening questions, there are three risks: an organisational risk, a UK supply chain risk, and what happens beyond

the UK. You could take that position in the United Kingdom, but what happens on the other side?

- Q87 **Kit Malthouse:** Yes, but there's not a lot we can do about the other side, as we have learned from the strikes, problems and issues in Calais. There is not a lot we can do about that; it is down to the French and the EU authorities. In terms of your readiness, I thought you were implying that there is an element of talking about a cliff edge on customs—a hard stop after which everything will be chaos if we don't get it right—but that that is not actually true and it is within our power to say that we can operate the same system for three, four, five or six months.

Mr Thompson: For imports.

Kit Malthouse: Yes.

Mr Thompson: Yes, but Mr Elphicke gave you the numbers of declarations. The rise from 55 million to 250 million in the worst-case scenario includes everything going, including exporters into the European Union now. If we do not get that element right, there is a significant risk.

- Q88 **Kit Malthouse:** But are we obligated to collect export declarations?

Mr Thompson: No, I'm saying that you now have a new barrier, potentially, in this scenario. In your scenario, I am now an exporter and I want to take my Somerset cheese to Austria or somewhere, and I have to cross the Dover to Calais border. How am I going to do that? If I have to make a customs declaration as it currently stands, I have to fill in 55 data fields. I may or may not—

- Q89 **Kit Malthouse:** But a customs declaration to whom?

Mr Thompson: To the European Union.

Kit Malthouse: But there is not a lot we can do about that. We are talking about your system—

Chair: We are talking about the 130,000 businesses for whom this is new.

- Q90 **Kit Malthouse:** No, I understand that, but we are talking about your readiness and what you can control and what you are doing. For instance, as I understand it, we currently have an export system. If I want to export to the United States, I have to fill in an export declaration for you.

Mr Thompson: Yes.

- Q91 **Kit Malthouse:** I probably also have to fill in one for the United States.

Mr Thompson: Correct.

- Q92 **Kit Malthouse:** But if we needed some slack in the system, you do not need to operate that system for the EU, do you? You are not obligated to operate an export system to the EU.

Mr Harra: I think on day one we would envisage being a customs territory with a customs border, and we would have to have customs processes in



place, such as those declarations. You have flexibility in the extent to which you do checks, and how you manage the risk to your revenues of people evading those processes. Today we make risk-based choices all the time. We do not stop and search every lorry or container coming into the UK. We use intelligence and other risk assessment to identify the ones we want to zero in on, and to the extent to which you do that you have discretion to flex. I think that is what Jon talked about—within that flexibility you can then balance the three priorities that the UK Government will have.

- Q93 Kit Malthouse:** That is what I am saying. Ultimately, you are saying that there is flexibility around the date and the implementation of the full suite, because the risk will not increase an hour after we leave the EU.

Mr Thompson: One of the ultimate contingencies we could take, in relation to the series of questions we have been asked about CDS, is to say: "Forget the revenue. Hypothetically speaking, we have three objectives. Forget the revenue; just let everything in." Now, that is a theoretical position that we could take. There is £3 billion on the line for that position, but it is theoretically possible—I am not sure we would recommend that to Ministers, but you need to balance those three parts. If your objective was the free flow of trade into the United Kingdom, then you might want to say, "We will take the risk on the revenue." What we don't know is how that works the other way round.

- Q94 Kit Malthouse:** This would be revenue that you are not currently collecting? I am not talking about trade outside the EU, just trade coming from the EU. There is no revenue at the moment.

Mr Thompson: Correct.

- Q95 Kit Malthouse:** You are saying that there may be revenue in the future that would need to be collected. But if there is not, or if we decide that we do not want the revenue, because fundamentally it will just feed through into consumer prices and prices would go up, could we just say, "We decline to charge anything at the border," notwithstanding the fact that they may not reciprocate?

Mr Thompson: Let's be clear: we are not responsible for international trade or tariffs, but hypothetically speaking, yes, the UK Government could decide not to have any tariffs for imports from the European Union.

- Q96 Chair:** But there are still 130,000 businesses. I will move on, because we have half an hour to cover the other topics, but can you confirm that from your experience of dealing with the French and other EU authorities, the point is that for the 130,000 businesses you talked about that currently do not have to fill anything in because they are exporting to the EU, we have no control over what the other European parties or EU member states might decide to put in place after March 2019?

Kit Malthouse: That's what I just said.

Mr Harra: Based on past experience, the European Commission will expect the customs authorities of France, and the authorities of other

countries with UK-facing borders, to administer their controls and collect their revenues.

Chair: There will be new burdens on those businesses that they may not be—

- Q97 **Kit Malthouse:** But we are not talking about what the EU does; we are talking about what our system is doing, and the point I am trying to make is that we have flexibility about the date. We have the idea that there is a panic about the date, but we could say, "It will take us another three months," and there would be no significant effect.

Mr Thompson: Theoretically, there are workarounds that we could put in place that would mean that April 2019 is not an absolute drop-dead date. In relation to Mr Elphicke's questions about whether it will be ready, whether we could beef up CHIEF, whether CDS would be ready and so on, one of the ultimate contingencies would be to say, "We will implement a manual workaround whereby, when you get to the UK border, you are going to have to have a bit of paper."

Charlie Elphicke: A point of information: calculations by Civitas are that tariffs would bring in about £13 billion of revenue to the Exchequer, which is twice as much as it would be the other way round, for our exports to the European Union.

Kit Malthouse: I want to move on to Making Tax Digital.

- Q98 **Chair:** I will move on to childcare first, and then we will discuss Making Tax Digital and HMRC strategy. Very briefly, on childcare, Mr Thompson, we swapped letters over the summer about the readiness and what was happening before the 31 August deadline. Thank you for the letters you sent about the information. Are you able to update the Committee on some of the numbers in that letter—for example, the number of accounts where there were still problems and the amount of compensation that has been paid out in particular?

Mr Thompson: I will bring Nick in, because he has the close of business numbers from yesterday.

Chair: Absolutely.

Mr Lodge: If I go through your letter in order and shout out some numbers: 289,000 parent applications; 236,000 eligible parents in the system now. We talked in the letter about some cases where people's applications had been held up because of technical issues; we have 457 of those up to the end of August. They get created because of the issues with the system. They get created on a rolling basis and we clear them on a rolling basis, so there are 457 up to August and I think about another 1,298 from the beginning of September, which we will clear through and are being cleared through the system as I speak. We are now dealing with those on a rolling basis.

In terms of codes for 30 hours of free childcare eligibility, where the deadline was 31 August for the September term, the Government set a



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target of 200,000 codes being issued. We issued 216,000 codes. We made sure that where people were experiencing any difficulties in accessing the service, they could phone us or print out a form and post it to us to get a code issued manually, so we made sure that people had those codes. I think that worked tolerably well.

In terms of people using the system sometimes getting an error screen, we have marginally reduced the incidence of that. We have plans in place to reduce that further because that is obviously incredibly frustrating for people. Overall system availability is at 95% since we launched the system on 21 April, so up to 12 September that has been running at 95% and some of the downtime—that 5% when it has not been available—we clearly planned to be in the dead of night, in order not to inconvenience people as much.

Q99 **Chair:** What about compensation? I think in the letter it was £45,000. Has that gone up?

Mr Lodge: That figure is now just shy of £71,000 to 238 customers. We have some in train that we are processing—about another 70—so there are roughly 300 customers receiving that compensation. I think compensation is really a bit of a misnomer. Just to be clear, that is where we will pay manually the top-up that people would otherwise have got, rather than people getting it through the system, where they have had a difficulty in accessing the system. At the same time, for every complaint we get we look at redress, for example if people have incurred costs on top of that. So just short of £71,000 has gone to 238 customers, but another 70 or so are going through the system, which will add to that number. We have written to people to point them to the compensation when we know that they have had difficulties. We have some material on gov.uk that is quite accessible, with a form and some guidance about what to do.

Mr Thompson: I would like to apologise to you, because I think we slightly misled you with the use of the word “compensation”. It is not compensation in the sense of redress; it is us making the payment that you otherwise would have got if you could have opened your account.

Q100 **Chair:** Could you break that down? I thought there were also some payments for people who have incurred financial costs because of the system being slow, not getting their code or whatever it might be. I suppose that is covering the costs that they would not have incurred if the system had worked for them first time.

Mr Lodge: The £71,000 that I mentioned is in lieu of a top-up payment that they would otherwise have got, had the system worked for them as intended. We then, over and above that, look at whether someone has incurred extra costs. For example—

Q101 **Chair:** Mostly childcare, because their provider has not been able to—

Mr Lodge: That’s a separate matter. We have issued all the codes that we needed to issue for that. The kind of redress that we would pay out would

be if somebody had incurred costs such as spending lots of time on the phone to us, or other sorts of costs.

Q102 **Chair:** How much is that? Are you able to break down those figures?

Mr Lodge: Yes, that is £3,915.

Q103 **Chair:** I have a final question before we move on. You mentioned 95% in terms of accessibility. The Minister spoke in the House about 93% accessibility. What figure are you aiming for? I suspect most parents would like there to be 100%.

Mr Lodge: The figure I am quoting for service availability is the percentage of the time that the service has been available, up and running, and has not been down. That is running at 95%. Ideally, we would like it to be more like 99.9%, so it is below where we would want it to be. It has been down more often than we would want it to be—we have had to take it down to make improvements. I am not sure what the 93% you quoted relates to—whether it is the same currency or something different.

Chair: He said that the system for the childcare service “was operational 93% of the time during which people could apply.” So it does sound like they are similar.

Mr Lodge: The current figure is 95%.

Chair: Thank you.

Q104 **Kit Malthouse:** Obviously, there have been enormous changes to Making Tax Digital, which is great. Presumably, you heard the sigh of relief from the business community across the board, as I did, so thank you for that. Is corporation tax outside the scope for the moment, or is it intended that from 2020 CT will come into MTD—or is that a decision yet to be taken?

Mr Harra: I think that a decision is yet to be taken about what happens in 2020. What the Government have done is give a commitment that there will be no further obligations placed on businesses in relation to MTD before 2020. I think we need to replan what will happen in 2020. In particular, I think income tax, where the systems are in place and where we have a voluntary pilot ready to get underway, is probably the area that would have bigger benefits for us than CT. That is why the original scheduling had income tax going before it. One of the things we will want to look at in 2020 is when income tax comes on board, and when will corporation tax.

Q105 **Kit Malthouse:** When you say income tax, you don’t mean income tax for the ordinary person doing a self-assessment tax return?

Mr Harra: For small businesses.

Q106 **Kit Malthouse:** Unincorporated businesses, and presumably partnerships too?

Mr Harra: Yes.

Q107 **Kit Malthouse:** So LLPs and all the rest of them?

Mr Harra: Right.

Q108 **Kit Malthouse:** So that may come in in 2020, though you are not sure yet.

Mr Harra: There is no decision on that, but clearly we have the systems up and running and the software is there. We can tell you about the plans—

Q109 **Kit Malthouse:** Are you still going to run the pilots?

Mr Lodge: Yes, the pilot for income tax is still running; it is in the early stages. It has been running since April and we will broaden that, invite more people to it and do some more communications around that to allow people to come and use it on a voluntary basis. Essentially, all the functionality is there and has been tested end-to-end with agents and individual businesses.

Q110 **Kit Malthouse:** As was discussed in the House just this week, you are going to encourage voluntary participation. So because your theory is that it is a fantastic boon for business, you could be in the old self-assessment situation where you get very high voluntary participation, which would remove any need for mandation until you get above a certain level. But that decision will not be taken until you get towards 2020.

Mr Lodge: A decision on mandation will not be taken but we will encourage as many people as possible to come in.

Q111 **Kit Malthouse:** Obviously, every business that is VATable will participate in the scheme. Does that mean an end to the annual VAT reporting scheme?

Mr Harra: Just to be clear, the businesses that are being mandated to use this for VAT from 2019 are those with a turnover above the VAT threshold—currently £85,000—which is about a million businesses. There are about another million businesses registered for VAT but their turnover is below that figure and it will be voluntary for them whether they use that.

Q112 **Kit Malthouse:** It is voluntary below £85,000 turnover?

Mr Harra: Yes.

Q113 **Kit Malthouse:** But there is the annual scheme lot in the middle who are below £1.3 million turnover, is that right?

Mr Harra: Yes. The intention is that, as a result of the mandation from 2019, no one will be required to make more frequent updates to HMRC than they currently do. If there is anyone in a scheme that currently does not involve them having to do quarterly updates, we will look at making sure that we do not place new obligations on people.

Q114 **Kit Malthouse:** Right. But for new businesses coming into that bracket,



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the option of annual reporting for VAT will be closed.

Mr Harra: I'm not—

Kit Malthouse: There is the scheme for annual reporting for VAT where you effectively pay—well, it's normally for people who are on a reclaim. You pay your VAT upfront and then you do a difference correction at the end of the year, so you are in advance. What is the plan for that scheme?

Mr Harra: I'm not 100% sure. I would have to get back to you on that.

Mr Thompson: Could we write to you so that we are very clear about where we are?

Q115 **Kit Malthouse:** Okay. A number of small businesses are in that particular sphere. It will not be a huge number, but they may be affected. It is kind of you to check.

It would be very interesting for us to get feedback from you, on an ongoing basis, on how the pilots are going. One of the most contentious issues—well, now it won't apply—was the compliance cost. Because that was largely related to income tax or corporation tax, that seems largely to have gone, but it would be good to get an update from you—you come in regularly—armed with information about the number of people who are voluntarily participating. Notwithstanding the previous Committee's criticism of the scheme, we all recognise that moving digitally is probably the right thing to do.

I have only one other question on that. VAT quarterly reporting is standard—everyone is used to that. I am still not sure what the rationale for quarterly reporting on income tax is. Is it still purely the errors?

All Witnesses: Yes.

Q116 **Kit Malthouse:** That was the other contentious issue: your claim that all the errors were in your favour. As you run the pilots, the data will start to emerge as to whether your forecasts of future revenue were accurate or not.

Mr Harra: I should say that we do not claim that all errors involve a lot of tax to HMRC. We recognise that there are errors that go the other way. The original policy costings for this measure were the net effect of those two.

Q117 **Kit Malthouse:** Yes, but the net gain to the Revenue was in the hundreds of millions in the original phase. That net gain must have dropped quite significantly on the scorecard.

Mr Thompson: The OBR will update that at the next fiscal event.

Q118 **Kit Malthouse:** So you don't have the number at the moment?

Mr Thompson: The OBR will update it at the next fiscal event.

Q119 **Kit Malthouse:** Right, thanks very much.



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Your annual accounts were qualified again, sadly, on the basis of the overpayment, or the inaccuracy in the administration of the tax credit system. The estimate is that you are overpaying just over £1.5 billion of tax credits and underpaying £210 million, so there is a net loss effectively of £1.3 billion. Have you specific targets for the reduction in that number? Do you think that you will ever get to a position where you can eradicate it? As a chartered accountant, I would like you to have true and fair accounts.

Mr Thompson: Let me be completely frank with you. I think I have done this three times in the Public Accounts Committee. It is my opinion that the tax credit system is deeply flawed. The policy was deeply flawed. It was trying to achieve too many things with a benefit that has an annual cycle, which then requires reconciliation at the end of the year of everything that has changed in the last 12 months. Given that people's lives change dynamically in the course of the year, a significant number of people get to the end of the year and discover that they have either an over or underpayment. Therefore, the level of fraud and error—mostly error—in the system is very high.

The target is to get to 5%. We are not going to be able to get to that. It is my opinion that, for however long tax credits are in place—remember that the Government strategy is to ultimately migrate everything to universal credit, so there will be an end to tax credits under current plans—that will be qualified. I do not see any prospect of us getting below 5%. In fact, if anything, I think the level of error and fraud will rise to somewhere between 7% and 8% under decisions made by previous Treasury Ministers.

Q120 **Kit Malthouse:** You reckon that the overpayment amount will rise towards £2 billion?

Mr Thompson: Let me give you a specific example. There was a policy change made in relation to the self-employed, so that if you are self-employed, you can apply for tax credits, but a new test was applied that that self-employment should be commercial and profitable. That test would—Ministers were completely aware of this—reduce the total number of tax credits paid out by half a billion pounds. So your overall benefit bill would come down, but you would get a higher level of error in the resulting population. The choice to be made by the previous Chancellor of the Exchequer was, what did he want? Did he want the £500 million less public spending, and was he prepared to therefore accept that you would have a higher error and fraud rate? That is the choice that was made. Our estimate is that that will add at least 1% to the overall fraud and error rate.

In terms of the second area where we were heading in the wrong direction, the previous version of this Committee took quite a lot of evidence on something called Concentrix, where we had engaged a private sector company to administer some elements of tax credits. It went wrong. We terminated the contract, and it's all on the record about what happened. Ministers decided to not replace that capacity in HMRC with



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additional employees, and therefore all round you have less capacity to look at fraud and error, and there is another 1% in that as well. So if anything, the direction of travel is that the rate of error and fraud in tax credits will rise over the next two years, heading towards something around 7.5%.

Q121 Kit Malthouse: Right—wow. Alongside our byzantine tax code causing error, loss and tax gaps, we now have the tax credits system increasing costs, effectively, for the Exchequer.

Mr Thompson: I'm being completely transparent with you.

Kit Malthouse: I understand. That's what we're here for.

Mr Thompson: Nick and I have given evidence to five previous Select Committees on this. I have been consistent on the record that this is a deeply flawed policy and that the Government has a long-term strategy to replace it.

Q122 Kit Malthouse: The problem we have is that in the public accounts and the forecasts we see, we do not see a line in the Treasury scorecard that says, "£750 million cost of extra overpayment on tax credits." We don't see that. It will be hidden in the general growth in tax credits, which people then put down to what is happening in the economy, rather than the system actually being bust, and that is costing us as much as anything else.

Mr Thompson: You're right. I'm not responsible for laying down the estimates, and I do not work at the Treasury, but I am an accountant. It would be in the estimate of what we are going to spend on tax credits.

Kit Malthouse: Right, so it's in there. Maybe we should ask for it to be separated out.

Q123 Alison McGovern: This is a crucial point that Kit has raised. Can you just confirm that the increase you are talking about is overpayment, which would be error, not fraud? That is the aspect of error and fraud that you are worried about—error, not fraud.

Mr Harra: Fraud has actually decreased. In our measure of error and fraud, the part that is fraud in our latest estimate for 2015-16 went down, but the element that is error increased.

Q124 Alison McGovern: So the answer to my question is yes, basically.

Mr Harra: Yes.

Q125 Alison McGovern: Jon, this is to you. You say that tax credits need a policy redesign—you have been on the record—and that there is a fundamental flaw in the system. That flaw, the detail of which I will come to briefly in a second, is effectively passported on to universal credit in any case.

Mr Thompson: I couldn't honestly answer that question, because I am not responsible for universal credit.



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Q126 Alison McGovern: Okay, let's take a step back to that flaw. Essentially, the reporting flaw you described is that tax credits are effectively resolved on an annual basis, but the amount that people are eligible for under the policy fluctuates within that year. So we have a policy that is badly designed for the realities of our current labour market.

Mr Thompson: Yes, that's what I'm on record for. In relation to tax credits, it is a badly flawed policy in relation to the lives of the people who are receiving the benefit.

Q127 Alison McGovern: So essentially, what was said a moment ago about an increase in hyper-flexibility in working or what some call zero-hours contracts makes the situation worse because it is misaligned with the policy as it currently exists.

Mr Thompson: I don't think we are in a position to give you a straight answer to that. What I am saying is that people have lives where they move in and out of employment, they do or don't have some childcare, they move in with someone and then they move out, they move address. All of those factors are built into a benefit that is only in an annual cycle, where the award you get is provisional for a year and then it is reconciled.

The single biggest reason that MPs write to me is to say, "I have this constituent who has got this overpayment, who did not know anything about it, and now it is crystallised because they are no longer eligible for tax credits." Remember, if you are overpaid in one year, it is taken back as a deduction from the second year, so in a sense you may or may not recognise that you are getting an underpayment. If you come out of tax credits, it crystallises the debt. Let's say you move into full-time employment and you are no longer eligible for tax credits. At that point, we say, "We'll stop tax credits. You have got this £2,300 overpayment—you owe us." Previously, that would have been deducted from your ongoing award.

I am being very frank with you because we have done this five times before. The Government's long-term plan is to stop tax credits and replace them with universal credit. Meanwhile, we have to try to do our best to administer this but it is not straightforward. It is not straightforward for claimants either; it is quite a difficult benefit.

Chair: Do you have a final question?

Q128 Alison McGovern: It's not really a question. It is a rebrand: universal credit is the same system, and you know it.

Mr Thompson: I can't comment on that. I'm not running the Department for Work and Pensions.

Q129 Kit Malthouse: I have a final theme about the transformation and HMRC relations with the business world. One issue that arose out of Making Tax Digital was the nature of the relationship between business and the Revenue, and the fact that people felt nervous about quarterly reporting because they are frightened of the Revenue and unwilling to communicate unadvised. Presumably, you have all read the Hardman

lecture from 2015 by Robert Mass. I don't know if any of you have read it.

Mr Harra: I had the pleasure of being present when he gave it.

Kit Malthouse: Chair, I am happy to send you a copy.

Chair: Thank you. That's very kind of you.

Q130 **Kit Malthouse:** Robert Mass is a very well-respected tax practitioner who has been at the game for 50-odd years. Those of us in the profession know of him well. He pointed out that the relations certainly between the professions and the Revenue had hit an all-time low and had changed significantly. I wondered whether you had been tracking opinion of the Revenue, both in business and the professions, since then and what it was telling you.

Mr Harra: First, as well as being present when Robert gave his lecture, I responded to it in 2016, so please read mine as well.

Chair: I'll have to ask you for that one, too, please, Kit.

Mr Harra: We do survey businesses about their experiences of dealing with HMRC. Small businesses have got quite high levels of satisfaction when they engage with us. Tax agents traditionally report much lower levels of satisfaction in their engagement with us. There is a challenge for HMRC in relation to small businesses because there is a very, very large number of them.

Broadly speaking, we leave most of them alone most of the time. When we do engage with them, sometimes that is support and help but sometimes that is investigation. One of the aims of Making Tax Digital is that we want to reduce the extent to which small businesses make errors and, therefore, reduce the extent to which they get unwelcome interventions from HMRC that are trying to put those errors right.

My response to Robert Mass was actually a challenge to the tax agent community to step up and do more to help businesses get their tax right. This is an industry where 75% of small businesses probably use an agent, but a lot of them are still presenting to us as non-compliant.

Q131 **Kit Malthouse:** That's true, but he made some quite serious allegations about the Revenue effectively gaming the system—that it wasn't about what tax was due but about what tax could be got, and that that created antagonism between the two. Would you be able to share with us that opinion data about views of the Revenue, split by small business, large business and professionals?

Mr Harra: Yes. I am pretty sure that we already publish it, in which case we'll send you a link. If we don't already publish it, I will send you the information.

Kit Malthouse: That will be very kind, thank you.

Chair: That feeds in quite well to our final set of questions on your



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strategy, which I think was published earlier this summer.

Q132 John Mann: Just to clarify an issue that is out there, is it the case that you receive monthly information from employers on student loan repayments? If you do, do you pass that on to the Student Loans Company every month and if not, why not?

Mr Thompson: We receive information from employers much more frequently than that. We can tell what the situation is relatively frequently. We have the ability to give that information to the Student Loans Company on a more regular basis. The question is whether they can ingest it. We could provide that information, and a range of Departments have updated information from us. In fact, we have moved beyond that. There are now some technology application programme interfaces where essentially you can build a live bridge between two live systems. There are aspects of our law enforcement where the Home Office has live access to HMRC data, so we could provide that information to the Student Loans Company. There is an ongoing project that would give them information on a more regular basis, but the question is whether they can ingest it.

Q133 John Mann: Should Parliament consider giving you responsibility and jurisdiction over student loans?

Mr Thompson: Earlier you were concerned about our capacity and capability, so I am not particularly here for a land grab. We have plenty of other things to do.

Q134 Alison McGovern: People's capacity is relative.

Mr Thompson: We believe that we collect 82% of all student loan repayments. We give that information to the Student Loans Company. The other side of it is clearly a Department of Education policy-led question, but could we do the administration of it? Probably, yes—but that's not me saying I want some more things to do.

Q135 John Mann: That's clear. Thank you.

On your July 2017 strategy, are we going to see the end of the tax return and if so, when?

Mr Thompson: I can't quite remember whether the previous Chancellor did or did not say it was the end of the tax return.

Mr Harra: The previous Chancellor certainly did set out the vision for the end of the tax return. Our view is that digital accounts—we have talked about digital accounts for small businesses, but we also have a programme of digital accounts for other taxpayers—mean that in the future the vast majority of taxpayers should be able to update their tax affairs much more frequently and much more in their own time, rather than as an annual set-piece event. We have recently introduced a new simplified way of assessing tax that should enable us to take people out of self-assessment and assess them in a much easier way. Longer term, digital accounts mean that the vast majority of people should not have to make it an annual event. Do I think that the wealthiest, most complex

taxpayers will end up not having an annual tax return? I am not so sure; I think we may well keep it for those people because of the risks they pose.

Mr Thompson: To be really clear, our goal is to significantly reduce the number of people doing self-assessment over the next five years. At the minute, there are 11 million and we think that number needs to come down fairly significantly.

Q136 **John Mann:** To?

Mr Thompson: Well, it can't be zero, but it should be in the low single millions.

John Mann: The low single millions?

Mr Thompson: Yes. We have an internal plan about—

Q137 **John Mann:** Under 5 million?

Mr Thompson: Under 5 million, yes. I would expect it to come down quite a long way. That is the aspiration I think we should have. We have done initial planning about the point at which we would get the necessary data to take people out. For example, is there a point when we have enough data about landlords to say, "We have sufficient information to prepopulate, so we are reasonably assured that they could come out."? People have to fill in self-assessment for all kinds of strange and unusual reasons; if you are a minister of religion, you have to fill one in. We are currently going through the criteria and trying to map it out—if it is 11 million now, how low could we get it by the end of this Parliament? I think it will be quite significantly lower.

Q138 **John Mann:** Is there any one change that we could make in Parliament to assist that process significantly?

Mr Thompson: I don't know. Can we take up the challenge of writing to you?

Kit Malthouse: There must be issues. For instance, quite a lot of people fill out a tax return—

John Mann: It may be something that is not particularly obvious to the Committee.

Mr Thompson: Anyone whose surname begins with "m", possibly.

Chair: Jolly good!

Q139 **Kit Malthouse:** What about claiming gift aid? A lot of people do tax returns just because they have made big gift aid declarations and there is no other way to get the relief.

Mr Harra: Yes, if you are a higher rate taxpayer and you want the higher rate relief on your gift aid payments, currently a self-assessment return is the way you do that. We do actually code some of those out in pay-as-you-earn codes. That is a key example of how we would want people not to have to fill in an annual tax return.

Q140 John Mann: Other than that, is there any other single improvement that customers could expect, following the successful implementation of your current new strategy?

Mr Thompson: I think where we are heading—obviously subject to Parliament—is that the personal tax account and the business tax account will be the primary means by which people will interact with us. It depends on how far you want to go with Making Tax Digital over a period of time, but we have got 13 million active personal tax accounts now and 3 million business tax accounts open with 5 million users. So we have gone from nowhere to 18 million users of tax accounts in less than two years.

It is also worth saying that currently there are 17 different things you can do in a personal tax account. You can see your national insurance history, a forecast of when you are going to get your pension and how much you are going to get—there is a whole range of different things.

The ultimate for me on the business side would be the single financial account, where you can see all your relationship as a business with HMRC in a single place, whereas at the minute, you can have multiple different relationships with us. I think there are currently 198—Jim may have to correct me here—different taxes. I don't know what kind of business you would have to be running for that, but clearly if we can begin to navigate ourselves to a single financial account, you can see your relationship with us and we can see our relationship with you all in one place. That is the ultimate goal here on the business side.

What that requires for us is to significantly rewire all the technology to think not about tax products but customers and how you bring it all together. I think the ultimate of this strategy—the manifestation for customers—would be that. There are already millions of people doing this, and I would expect that number to continue to grow. It will not be everyone in due course, but I think it is a very popular product.

Q141 John Mann: One of your strategy aspirations is to have a more sustainable workforce. What is your definition of sustainable?

Mr Thompson: I am slightly uncomfortable about the level of turnover, frankly. It is surprisingly high—I am not including those people we are stimulating through redundancy and office closure. It is bobbing around 10%. That is a bit too fluid for me. So part of the transformation of HMRC is to try to be really clear about where we need to intervene on the transactional level—you can try to do that digitally with us—while we work more in the value-added space, and therefore people have, as it were, a more sustainable career with us because it is higher-skilled work, which is generally higher-paid work.

We are investing in technology, we are investing in buildings, we are investing significantly in training, and therefore we hope that people will stay with us longer and build a career. The future regional centre model—13 regional centres—means that there are thousands of people working in a single place, which means that you could fairly easily change between different business strains, whereas if you are currently working in a local



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office, your opportunities are much more limited. Part of that here is to give people a more rewarding career, a longer career with us, a higher-skilled career with us, and hopefully they will stay with us longer.

Q142 John Mann: I recall in this Committee in 2009 the then Minister struggling to explain why staff morale was so low. That has been seen to be an ongoing issue. You have got all these other exciting duties and challenges. In terms of your human resource policy, how high a priority is it to have more people staying longer, maintaining their expertise and not being poached by the private sector? If I may say so, a fairly sophisticated human resource strategy is needed for that. How are you going to do that? How big a priority is that, in terms of the range of other things?

Mr Thompson: In terms of running HMRC, people make HMRC work. We have a great workforce; it is very signed up to the mission. We have more than 90% endorsement of the mission of what we are about, which is: we collect the revenues that pay for public services. However, you are right to say that overall morale and engagement of the workforce was indeed the lowest in the civil service in 2015; we were 99th out of 99. Last year, we saw that begin to pick up, and on all aspects of the staff survey we saw people more engaged. There are some specific things we have done to get people more involved in what the change programme is and so on, and we moved up to 94th. When you are 99th and you have moved up, that is a good thing, right? There are green shoots there.

We know what staff think. We have a quarterly survey in which people can give us very frank views on whatever they think the problems are. We have tried to develop a more open culture, in which people like us, specifically, travel a lot more, listen a lot more and talk a lot more about what is going on and so on and so forth. In the end, we have reframed and redone the HR strategy. There are now seven elements to it, which was agreed just before Christmas, and we have a new chief people officer, so I am reasonably hopeful about the future.

John Mann: Perhaps your staff will get a pay increase. Some of them think they deserve a pay increase, but it is for us, not you, to decide those policies.

Mr Thompson: Thank you.

Q143 John Mann: The final questions are on tax avoidance and your target to raise additional revenues by tackling tax avoidance and securing prosecutions. You have set out some targets, and I have two questions on them. First, are you going to meet your aspirations? Will we see this money coming back in? If not, why not?

Mr Thompson: The measure of this is the so-called compliance yield. The compliance yield for 2016-17 was £28.9 billion, which was up by just over 5% from 2015-16, when it was £26.6 billion. Ministers have given us some indication about where they think that is going for the rest of the Parliament. We would expect that to continue to rise.



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In the spending review of 2015, the Chancellor of the Exchequer invested a little over £2 billion in the transformation of HMRC, in exchange for £9 billion-worth of benefit for the Exchequer, with £7 billion of that in additional compliance yield. I think the future for compliance yield continues to be upward. In relation to the current year, we are currently slightly ahead of the target for 2017-18, so I think there is really excellent work here to increase compliance yield.

In relation specifically to prosecutions, the number of prosecutions has continued to rise year on year for several years. There were 886 last year, and the target set by Ministers was for us to reach 1,000 per year within the lifetime of this Parliament. So we are prosecuting more people and compliance yield continues to grow.

On the balance within the organisation, in terms of where the staff are, we think the digital solution means we can be more efficient on the customer services side, so those staff are being, if you like, reinvested in the compliance side of the business, so there are more people on the compliance side.

Q144 John Mann: My final question is on priorities. We have seen some fairly horrific stuff with the hurricanes that hit British overseas territories and dependencies. Some of those, which we are rightly spending a lot of money giving assistance to, are the worst of the tax havens. Of course, those who profit by hiding their money away there are not the ones living there and suffering the hurricanes, who we are helping out.

There is obviously a bit of a mismatch; we are paying lots of money to help out those areas, yet we are not necessarily getting a great deal of assistance, in terms of assisting you, in finding who is hiding money there. How big of a priority will trying to open up and ensure that people are paying their fair dues and not hiding their money in places like the British Virgin Islands be for yourselves in the next year or two?

Mr Thompson: I think that is an excellent question for the Department's leading tax professional.

Mr Harra: Thank you. When it comes to multinationals, the UK Government have been out in the lead in the G20 and the OECD in their international work to reduce profit shifting by multinationals. In the UK, they have unilaterally introduced measures to be at the forefront of enacting measures for BEPS and, in the case of the diverted profits tax, have led the way unilaterally to tackle that. It is an international problem that requires international effort to be solved. We have made progress. For example, between 2010 and 2017, HMRC recovered £53 billion in additional tax from large businesses that would not have been paid if not for our intervention, but clearly there is much more to do at an international level. The BEPS project that the G20 and the OECD are leading has more work to do to develop new solutions, in particular for the digital economy. To the extent that the project has come up with solutions, the key thing now is to make sure that everyone implements

them. The UK has led by example, but we must make sure that other countries do the same.

John Mann: I'm sure we can come back to that in more detail at a future meeting.

Chair: Alison has one final question, which either requires a number or that you write to us.

Q145 **Alison McGovern:** A simple factual question with no preamble required: what is your hourly pay gender pay gap?

Mr Thompson: Grade by grade, the gender pay gap is within 2% at all grades. You should not necessarily assume that women are paid less than men, grade by grade.

Kit Malthouse: It could be the other way round—there could be a gap between men and women.

Alison McGovern: So what's the gap?

Q146 **Chair:** Is that something that you declare publicly already?

Mr Thompson: No, but we can give it to you grade by grade, if you want. You have to do this grade by grade—for the same grade of job, do we pay the same for you and me?

Q147 **Alison McGovern:** I don't think we should get into a debate about this. I disagree with you. But let's not get into a debate—why don't you write to us with the facts?

Mr Thompson: Fine. We do not believe that we have a pay gap problem. We are a majority female employer. Although you are seeing two male directors general, as at 2 o'clock this afternoon we will have seven women as directors general and three men. I will happily give you all the data you want.

Q148 **Kit Malthouse:** Would it be possible to tell us what the gender balance is in each grade?

Mr Thompson: Sure.

Chair: I think organisations will have to declare it anyway, according to the regulations that are coming in.

I thank all three of you very much for coming in to speak to us today. I am sure that we will get well acquainted over the course of this Parliament. In particular, you might be seeing quite a lot more of Jon. For now, thank you very much for your time today.