

# BEATING FRAUD IS EVERYONE'S BUSINESS: COMMENTS ON THE GREEN PAPER

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Social Security Benefits are a form of negative income tax. This is demonstrated by the proposed benefit, Working Families Tax Credit, which will be handled by the Inland Revenue rather than the Department of Social Security. It is possibly a forerunner of a merger between the two departments, so that all benefits, tax and NIC can be dealt with in one place. Advisers may be similarly expected to handle all aspects of a combined benefits/tax system. In a similar way that income tax has tax planning, tax avoidance and tax evasion, so social security benefits have benefit planning and benefit fraud. Benefit avoidance sounds wrong, so let us call it unacceptable benefit planning.

Contribution planning, avoidance and evasion is similarly around. There are regular attempts to stop the avoidance of NIC by paying staff in gold bars, wines, trade debts, gilts near maturity, etc. These attempts are rather feeble by only blocking the specific avoidance scheme. They could all be stopped by disallowing any deduction in the companies' accounts unless NIC was payable. The Contributions Agency will merge with the Inland Revenue from April 1999. It will be interesting to see how the two different philosophies interact and whether this is the first stage of treating NIC just like income tax with the same periods (year to 5th April) and a common definition of earnings

The recent Green Paper "Beating Fraud Is Everyone's Business" is an opportune moment to look at some of the issues surrounding benefit fraud. [This paper is available on the internet: [open www.open.gov.uk](http://www.open.gov.uk), look up Social Security in the

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index and then visit their Headquarters web site.]

Politicians have recently woken up to the fact that there is extensive benefit fraud with little effective action against it. Not only does this undermine public confidence in the welfare system, but also takes money away from those who need it. This reflects a culture within the DSS unlike the Inland Revenue or Customs and Excise who have been fighting fraud for years.

Estimates of benefit fraud vary from £2 billion to £7 billion. (It is not surprising the variation is so wide as they are based on surveys.) By any measure these are huge sums: £2 billion is the yield from 1p of the basic rate of income tax. Eliminating the higher estimate for benefit fraud would give the Chancellor of the Exchequer the option of reducing the basic rate from 23% to 20%.

The objectives stated in the Paper are:

1. To minimise the opportunity to commit fraud in the first place.
2. To work across boundaries with
  - (a) all government departments and local authorities
  - (b) banks and insurance companies who have experience of large scale organised fraud.
3. To enhance public support for the welfare state.

Fraud is a mixture of low value fraud (new employee continues to claim unemployment benefit) which is not perceived by much of the public as terribly wrong, medium level fraud (landlord creates 20 fictitious identities to claim housing benefit), and large scale sophisticated fraud organised by gangs of criminals.

Detection rates are low because there is not an anti-fraud culture. Housing Benefit is paid by local authorities, some of whom do not even have an anti-fraud policy. In many local authorities there have been no prosecutions at all for housing benefit fraud. So it is not surprising that housing benefit has a poor record, the estimate is that £900 million of the £10 billion paid out is the result of fraudulent claims. There should be a league table of local authorities' success rates. Should local authorities continue to administer housing benefit when their detection rates are so poor? The public is less aware of frauds by landlords and employers but the Paper fails to give any reasons.

## **Enforcement and Sanctions**

The Paper states "that very few fraudsters are ever effectively penalised for their action. Over the last few years an average of only 12,000 cases were prosecuted, and 35% of successful prosecutions in Magistrates Courts lead only to conditional discharge. Practice among local authorities is mixed: some have never prosecuted anyone for Housing Benefit fraud."

The difficulty of obtaining a conviction let alone a worthwhile sentence is very similar to the position in the seventies and eighties when the failure to submit VAT returns on time was a criminal offence. This was considered at length in the Keith Report (Cmnd 8822 of March 1983, in particular chapters 16 and 18). This led to the replacement, in most cases, of criminal proceedings by civil penalties for VAT offences. The Inland Revenue have moved down a similar route with automatic civil penalties under self-assessment.

The advantages of civil penalties are a lower standard of proof, a better recovery of monies lost, plus interest and penalties. Appeals against an award of penalties should go to the Social Security Tribunal. There is a case for arguing that such appeals should go to the General Commissioners for Income Tax (as they have experience in dealing with mitigation of civil penalties, are more informal and some benefits are to be paid by the Inland Revenue, e.g. the first to be announced is Working Families Tax Credit from October 1999). All penalties must be fully mitigable (for co-operation, gravity of offence) and the Tribunal must be able to substitute its own figures, i.e. the right of appeal is *de novo* not quasi-judicial review.

Inadequate sentences from the magistrates court merely encourage others to defraud in the knowledge that any retribution is likely to be derisory and depresses the morale of investigators.

Where a property is used for housing benefit *fraud* (i.e. creation of false identities), the property should be liable to seizure in a similar way that a vehicle used for smuggling can be seized by Customs and Excise (see Customs and Excise Management Act 1979 section 88.... a full list is in Note 69 of the Keith Report and Chapter 36, in particular 36.3.11).

Other recoveries could be made from future benefits to be paid to the individual or even coded in under PAYE. The US authorities are much stronger. A person who erroneously claims Earned Income Credit (the US version of Working Families Tax Credit on which our system is based) due to "reckless or intentional disregard" of the tax rules is denied Earned Income Credit, even if otherwise eligible., for the

next two years, or, in the case of fraud, ten years.

### **Method of Payment**

Money saving schemes like making payment direct into bank or building society accounts have made fraud much easier for false identities. I would suggest that all benefits should be collected in person but paid by cheque to a nominated bank account. The time spent in collecting in person will make multiple applications more difficult. The risk of being recognised will also be a deterrent. "Workfare" would also make it more difficult to claim unemployment benefit whilst working. Housing benefits paid direct to landlords makes multiple bogus applications easier. The Paper gives the case of the landlord who created 20 fictitious identities, thus collecting £100,000 per year in housing benefit. Unfortunately the Paper does not say why was this not spotted earlier and what changes have been made to detect this in the future. Nor does it say how much of the monies defrauded was recovered.

### **National Insurance Register**

There is an urgent need to make this secure and to remove the large number of bogus numbers. Bogus numbers, estimated at 5 million out of a total of 64 million, are created by taking on the identity of someone who has died, fake asylum applications, bribing DSS insiders and buying numbers from genuine holders leaving the country. Compare the National Insurance Register with Inland Revenue records, hospital records (for births and deaths), local newspapers (for births and deaths), voters lists (which are on CD-ROM since the last General Election), school attendance rolls, census records. The example in the Green Paper of someone collecting a relative's pension for years after their death, would have easily been detected by comparison with the General Records Office's index of deaths, or greater checks on pensions which are not collected in person for more than 12 months.

### **Exchange of Information**

The suggestion of working with banks, credit card and insurance companies has considerable implications for the rights of privacy and data protection. Whilst the DSS has issued a code of practice on data matching, only time will tell if this is sufficient.

The number of different organisations handling benefits (DSS, Employment

Services, Local Authorities and Inland Revenue) would suggest a need for their amalgamation. Organised gangs have been able to exploit their lack of co-operation. This resulted in an experimental specialist anti-fraud unit (the London Organised Fraud Investigation Team) to operate across boundaries which unfortunately was less than successful. There is a report of the Benefit Fraud Inspectorate into the effectiveness of this unit. Available on the DSS web site, it made depressing reading at how badly run it was but at least there was full identification of the problems.

### **Unacceptable Benefit Planning**

There is no mention of legal avoidance (unacceptable benefit planning) in the Paper which may be as costly as fraud. There are a number of examples of this in housing benefit. One case is that of *R v Manchester CC ex p Baragrove Properties Ltd* 23 HLR 337 which concerned a landlord who deliberately inflated his rents to between two and five times their market value knowing that the tenant would not object as the full amount would be paid by the local council.

### **Management**

Do taxpayers have an interest in the efficient running of a tax or benefits office? Most people are ambivalent, they like their tax repayments or benefits to come through quickly but are not so keen if they are investigated efficiently.

The Paper identifies insufficient co-ordination and co-operation with other government bodies and private sector firms facing similar types of fraud, e.g. insurance and credit card companies. This seems so obvious that it would suggest there is a major management problem which can only be changed by substantial changes in personnel at the top.

The Paper states that more fraud could be discovered by the use of more intrusive checks (but does not say what they are) and that there is a prior assumption that any claim is not fraudulent. There has been a naive assumption that all customers are honest. Other government departments regard it their duty to audit at least some of the claims irrespective of whether fraud is suspected. If you only investigate claims where there is already a suspicion of fraud, the level of successful fraud is not surprising.

The Paper says that "those claiming benefit must understand their duty to back their claims with evidence". This statement reflects the laid-back management style. It should not need a Green Paper to decide that no evidence equals no benefit.

The Paper states that fraud has been seen as unimportant, which suggests poor management determined not to take effective action about it. A culture such as this is passive aiding and abetting the fraudster. The Paper states that most current staff are aware of fraud, but extraordinarily does not explore why nothing has been done about it.

Underlining the importance of security in job descriptions and performance appraisals is unlikely to improve staff attitudes to anti-fraud work. What is needed is sufficient numbers of staff who are not bogged down with other work. Staff are motivated, like bosses, by better pay and a system of pay which rewards the genuine hardworkers.

Trained staff will only be retained if pay and other conditions are substantially improved. The Inland Revenue suffered a vast leakage of fully trained Inspectors when pay fell behind. Virtually all VAT work for traders is done by ex Customs officers who left because of poor pay and conditions of service. What financial incentive is there for staff to discover fraud? A bonus based on 25% of the monies recovered (or 10% of benefits at risk) would be highly effective. Where outsiders discover fraud, e.g. Post Office staff suspicions about the number of change of address forms led to the discovery of a £130,000 fraud, substantial rewards would encourage more to report their suspicions.

There is nothing in the paper on the number of staff needed, academic qualifications or length of training to be provided.

### **Internal Fraud/Weaknesses**

The Paper makes no mention of internal fraud. Different government departments experience different levels of fraud. This usually takes the form of bribes, e.g. Michael Alcock in the Inland Revenue, assisting outsiders to submit false claims or making up false claims without involving outsiders.

The Paper gives an example of a gang who dishonestly obtained benefit order books, altered some of the details and obtained approximately £14 million. It is not clear whether this was the result of internal fraud or not. The paper does not tell us how the books were obtained, how this was eventually detected and what changes have been made to detect this earlier in the future. How are weaknesses in the system identified? (Are there substantial rewards for staff who identify these where it is not part of their normal duties? An effective reward system based on 10% of the benefits at risk would soon flush them out.) How are weaknesses corrected and within what timescale?

There is an obvious disadvantage in publicising methods of fraud as this may lead to showing other people how to commit fraud.

### **Merger of Income Tax Benefits**

Fraud and incorrect claims would be reduced if there was a determined effort to simplify the system and to make it compatible with the positive tax system.

The complexity of modern life makes the single/living together distinction anachronistic. The single/living together distinction does not fit in with the direct tax system where you are required to be legally married to claim married couple's allowance, to benefit under an intestacy, or to use the spouse exemption for Inheritance Tax. Whilst the income tax system has got rid of the view of the wife as the husband's chattel through independent taxation, the benefits system is more archaic. The income tax system has done much to remove the penalties of being married (mortgage relief per property no longer per claimant), whilst the benefits system still penalises marriage and living together (and hence encourages lone parents).

### **Public Attitudes**

Only 20% of people consider that failure to declare occasional earnings whilst on benefit is a serious matter. For many, claiming benefit whilst working is the only way of escaping the unemployment and poverty traps (every pound you earn results in the loss of more than one poundsworth of benefits). I consider benefit fraud to be the poor man's legal avoidance. Until firm action is taken against the higher earners avoiding substantial sums in income tax, there will be little change in public attitudes. All the time that Inheritance Tax is seen as a voluntary tax for the wealthy, then benefit fraud is seen as similarly acceptable behaviour

### **Conclusion**

The Paper states that by 2020 the social security system will have been re-built to achieve the objectives set out in the Paper. This seems such a long time in the future that I feel there is no real desire for change, and anyway the present senior management will have long retired.

Overall, this Green Paper is long on hype with too little specifics on how to deliver, too little identification of how problems arose. There is very little on internal fraud,

need to move staff regularly, splitting of functions and better internal controls. My impression is of a department stuck in a time warp compared to the Inland Revenue or Customs, insulated from the real world of less than honest customers.

I think the final word should be left to the Commissioner of the Metropolitan Police<sup>2</sup> who claimed that low pay for police (£16K for new policemen) was almost an "invitation to malpractice". How many social security staff and benefit claimants earn less than £16,000 per year?