

TAXREP 16/01

REVIEW OF PAYROLL SERVICES.

*Based on the text of a memorandum submitted in July 2001 to the Inland Revenue
in response to a Consultation announced in June 2001*

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REVIEW OF PAYROLL SERVICES.

Comments on the Consultation announced by the Chancellor, Gordon Brown, in June 2001.

Introduction

1. On 18 June 2001 the Chancellor of the Exchequer, Gordon Brown, announced a review of the market for payroll services to small enterprises in the UK. The aim of the review is to identify ways of reducing the total cost to business and to the economy of compliance with payroll obligations. Set out below are the comments of the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to the questions raised. The questions which were asked are shown in italic.

General comment

2. The increasing complexity of tax legislation imposes an increasingly intolerable compliance cost burden on all employers. Research has shown that this affects small and medium sized businesses in particular. Recent responses by Government have all focussed on education and on trying to help such employers implement payroll procedures correctly. Unfortunately, this does not deal with the underlying problem.
3. The comments which follow were made in response to the specific questions raised in the announcement of the initial consultation.

Specific comments

Comment on the relationships between the internal information needs of businesses and the costs of complying with their obligations as employers.

4. Businesses need total wages cost per department for control purposes but this information does not necessarily flow from, nor overlap with, compliance related information.
5. There may be overlaps in the following areas:
 - Recording employee expenses such as mileage logs or entertaining
 - Recording days not worked – sick leave, holiday entitlement, statutory maternity and paternity leave
 - Hours and rates of pay, including the effects of EU Directives, such as the working time directive, and statutory redundancy entitlement.
 - Ensuring that other employer obligations have been complied with, including health and safety and training matters.

What services are available to and used by small enterprises to meet their obligations for running a payroll?

6. A small enterprise has three options for operating its payroll:

Manual;

- Manual payrolls are likely to be used by micro businesses or those businesses needing a separate payroll for a particular group of employees (directors, for example).
- Employers' packs are an integral part of the PAYE system and are particularly important for these businesses. We understand however that these packs do not always reach their intended destinations. The material covered may also be presented in an unsuitable form. The most obvious illustration is for individuals employing nannys. Nannys expect their pay to be specified in terms of net pay. It requires a considerable knowledge of algebra to calculate the income tax and national insurance position based on a given level of take-home pay. 'Net pay' PAYE tables are an obvious answer.
- If a business is operating a manual payroll, it is almost certainly likely to need more support from the Inland Revenue than one using a bureau. Such payrolls are most likely to be run by owner managers who do not have tax training. Even handling a change in PAYE coding creates an additional burden for such individuals.

Purchased computer package;

- Software is expensive for the smaller employer, with even Sage payroll costing £99 each year and requiring a PC and IT skills.
- Software exists but is still not seen as cheap by smaller enterprises. There may be a gap in the market for an Internet based solution, perhaps a free one via the open.gov portal?
- Provided that the operator has sufficient computer knowledge and a basic understanding of tax, a purchased package can be a cost-effective option. However, the fixed cost may not make it viable below a minimum number of employees. If a business provides benefits in kind, this can rapidly become too complicated.

Outsource to accountant, bureau or similar.

- The P11 is now a complicated document, accountants are seen as expensive (and themselves generally see payroll bureaux as a low profit support add-on rather than a good income generator)

- An option adopted by many who consider the money well spent, avoiding needing to acquire knowledge which is otherwise irrelevant to running their business. The complexity of tax legislation being responsible.

Comment on whether services are evolving to reflect new technology and what more might be done to improve the quality, reduce the costs and increase the accessibility of the services available, particularly to very small firms.

7. Internet filing may seem the way forward, but to many very small businesses, it is a step too far. Most can barely keep up with changing legislation without wanting to take on additional responsibility. There is also the problem of internet payment. Whilst many businesses have the facility to file forms and returns electronically, payment requires additional software and carries associated costs.

Comment on whether barriers exist to small firms using the most efficient means of performing the payroll task.

8. The barriers are simple: cost and complexity.
9. Compliance costs and complex and ever changing legislation are the most significant factors affecting small businesses. Different rules for PAYE and national insurance are an absurdity and indeed many would argue the case for combining the two taxes. Successive governments have persisted in introducing more compliance burdens on small businesses.
10. By setting up a bureaucratic and highly complex system for simultaneously collecting four taxes (PAYE, NIC, Student Loan repayments and Child Support) and paying out substantial Social Security benefits, the Government has inevitably created a market for smaller businesses to both supply and buy in calculation and payment services. Any attempt by the Government now to interfere in that market without changing the PAYE system will inevitably lead to greater cost and inefficiency.

What has been the impact of existing Government interventions such as Business Support Teams and the help provided through the Small Business Service and could the Government do more to help businesses meet their obligations more efficiently?

11. The initiatives mentioned have had very little real impact. The very businesses most burdened by payroll compliance are unaware of the existence of these initiatives. The Government has to face the fact that payroll operation is now a serious burden for the smaller business. The P11 is no longer simple, the employers pack is voluminous and no matter how user friendly it is made the volume of material is necessarily large. The amount of time that has to be devoted to understanding compliance responsibilities is the same for someone employing

one person as for someone employing twenty. Too many things are now dealt with through payroll (tax adjustments, student loans, stakeholder pensions, CSA deductions, tax credits etc) and this burden has increased significantly in the last few years. The choice for government is either to reduce the complexity of the system or to offer effective assistance.

12. A possible solution could rest upon the open.gov initiative. Coding and other information could be input directly by the Inland Revenue and gross or net pay (something all employers understand) could be input by the employer. There are confidentiality issues, but they are already being explored in other areas of the open.gov site. Employee information would be accumulated for the end of year returns, but as it would be disclosed anyway on the P35 under the current system there should be no worries about Big Brother. If a net pay figure has been used, the employer will simply need a monthly or quarterly calculation of the deduction to be paid over (print it out avoiding yellow books of payslips) and if gross, a calculation of net pay could be electronically sent back. In addition, a real time advice service for benefits in kind could also be offered.
13. Other solutions could be implemented for dealing with casual labour, so simplifying the time consuming and costly paper chasing exercise of the current P45/P46 process. This could work as follows:
 - A caterer wants to employ a waiter for an evening at a total cost to himself of £40.
 - Waiter is registered with the 'Government tax agency' and carries a swipe card.
 - Caterer swipes waiter's card and enters £40 into credit card type machine.
 - On a weekly/monthly basis, caterer settles his employment credit card bill for £40.
 - On a weekly/monthly basis, Government tax agency transfers a % x £40 to waiter's bank account, having deducted the correct tax and NI. As most people registered with the scheme will be lower or basic rate taxpayers, it should be possible to calculate a reasonable % to be deducted in this way, so that the year end settlement would be minimal and automatic.
14. The Business Support Teams are a welcome initiative and seem to work well and effectively at a local level, the Small Business Service however does not seem to have been very visible or effective.

AM
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