TAXREP 54/11

ICAEW TAX REPRESENTATION

TAX/NIC OPERATIONAL INTEGRATION

Comments submitted on 19 September 2011 by ICAEW Tax Faculty in response to HM Treasury and HM Revenue & Customs' call for evidence *Integrating the operation of income tax and national insurance contributions* published on 11 July 2011

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TAX/NIC OPERATIONAL INTEGRATION

INTRODUCTION

1. ICAEW welcomes the opportunity to respond to the call for evidence - Integrating the operation of income tax and national insurance contributions published on 11 July 2011 by HM Treasury and HM Revenue & Customs at http://www.hm-treasury.gov.uk/consult_income_tax_national_insurance_contributions.htm

2. We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

3. Information about the Tax Faculty and ICAEW is given below. We have also set out, in Appendix 1, the Tax Faculty's Ten Tenets for a Better Tax System by which we benchmark proposals to change the tax system.

WHO WE ARE

4. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

5. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

6. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including TAXline, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

KEY POINT SUMMARY

7. Misaligment of tax and NICs causes burdens on business because employers have to interpret two sets of rules.

8. Whatever the outcome of this review, there are tax/NIC alignments which would simplify life for everyone, namely:
   - align NIC primary and secondary thresholds with one another and with the income tax personal allowance,
   - align tax and NIC charging rules so only cash payments which are charged to income tax via the payroll are subject to Class 1 NIC, and benefits-in-kind and expenses which are reported via P11D are subject to Class 1A NIC, and
   - align the NIC residence rules with those for tax.

   We think that these 'quick wins' should be undertaken as soon as possible, after consultation on detail.

9. Looking to the longer term, as part of this review we feel that consideration needs to be given to making more major changes such as:

- cumulation of NIC and aggregation of jobs,
- abolishing the many rates of NIC including the reduced rate for married women,
- making Class 1 NIC an employee-only impost, and
- whether NIC should be credited rather than paid to qualify for benefits.

10. Such radical changes would have far reaching effects as they would impact on, inter alia benefit entitlement, the calcuation of the employer charge and who pays how much, and the international aspects would need to be taken into account. These more radical changes should be considered as part of any major review but need more detailed thought and consultation than the 'quick wins', and this consultation process may, indeed, show that the benefits of alignment are outweigned by the disadvantages.

11. In particular, businesses have frequently complained about the burden of dealing with the rate of change – these changes would be far-reaching and apply to every employer in the country. Clear benefits must be shown in order to outweigh the very significant disadvantages of changing the status quo, even though elements of it are clearly eclectic.

12. If there is to be major change, we suggest that it would be better to wait until the very signficiant changes to the HMRC computer systems have bedded in, so that any changes can be dovetailed with that system, rather than reforming both the IT system and the technical rules at the same time.

MAJOR POINTS

13. As a general point the non-integration of the operation of income tax and national insurance contributions (NIC) creates a considerable burden for employers. Every item of earnings and expenses has to be considered in the light of both the tax and NIC rules which contain different definitions. The 'disguised remuneration' rules add further complexity, especially for employers of international assignees who are normally liable only to income tax or UK NIC but not both, by requiring the employer to identify benefits and expenses which contain an element of 'recognition or reward', even if they qualify for exemption from the normal PAYE/NIC charges. Employers are presently liable to a penalty if PAYE tax and NIC is paid late, further 'tax on tax' charges under s.222 ITEPA 2003 and interest charges. The increased uncertainty and cost in penalties and interest at punitive rates for getting it wrong highlight the need to not only harmonise but also simplify tax and NIC rules.

14. We recommend the following quick wins which we consider would result in a more transparent and simpler system more in line with our Ten Tenets for a Better Tax System summarised in Appendix 1:
    - align the primary and secondary NIC thresholds with one another and this combined NIC threshold (formerly known as the earnings threshold (ET)) with the income tax personal allowance, and
    - align the liability to income tax and NIC, and therefore the reporting requirements, of employment earnings including benefits-in-kind and expenses and other deductions, so that only cash payments that are subjected to income tax via the payroll are chargeable to Class 1 NIC and benefits-in-kind and expenses which are returned via form P11D for income tax are chargeable to Class 1A NIC.

15. Another quick win would be to align the NIC definition of residence with that for income tax. We are disappointed that this was specifically excluded from the proposals for a statutory residence test for tax.

16. As part of the more substantive review, we suggest giving consideration to how NIC could be made annual and/or cumulative taking into account how it would impact the incidence of employer contributions and cross-border liabilities, and whether different employments should continue to be dealt with in isolation.

17. With NIC rebates being withdrawn from April 2012 for all but salary-related schemes we feel that consideration should be given to eliminating non-standard NIC rates such as the reduced rate for married women. This would simplify compliance for employers and simplify checking by HMRC.

18. As more far reaching points we suggest consideration of:
    - whether employment NIC should be paid wholly by employees rather than partly by employees and partly by employers, and
    - the need for qualifying periods to be based on monetary contributions and whether a period should be treated as qualifying for pensions/benefit purposes simply from the fact that someone is employed or self employed in that period.

19. However, the present system, whilst not what would have been designed if one were starting again, is embedded in the minds of employers, and radical changes would necessitate every employer and adviser and HMRC in having to relearn new rules. Adjusting to changes to rules is said to be more stressful than living with and where necessary working around current rules. Familiarity with the rules is a great help for the busy employer; this is the case even where the rules are complex if they are carried out automatically by a payroll system or by payroll experts. There is also the question of who (employers, employees, the exchequer) will win and who will lose from changes. Further, given the current financial position, we recognise that major changes in this area could lead to significant risks to existing revenue streams. For all these reasons we recommend caution before making changes to the employee/employer tax and NIC regimes beyond the 'quick wins' set out above.

RESPONSES TO SPECIFIC QUESTIONS ON WHICH EVIDENCE SOUGHT

Section 1: General Interest

1 The Government believes that integrating the operation of income tax and NICs may hav the potential to remove distortions, reduce burdens on business and improve fairness. Do you have any comments on these objectives?

20. We support wholeheartedly the Government's objectives of removing distortions, reducing burdens of business and improving fairness. These objectives align with our Ten Tenets for a Better Tax System by which we benchmark tax and NIC, summarised in Appendix 1.

21. Over recent decades we have been involved in numerous, mainly government-sponsored, initiatives to merge, harmonise, work more closely on, etc, etc, income tax and national insurance contributions (NIC) for both employees/employers and the self employed. However, the practical outcome has been that, whilst some of the rules have moved towards harmonisation and the Government departments responsible for tax and NIC have merged, none of the reviews has made any fundamental difference to the burden on employers and the self employed arising from having to apply two different sets of rules to the same earnings.

22. We think that this is largely because it has always been assumed that a merger of tax and NIC means that NIC would no longer be payable and therefore income tax rates would have to rise or some other impost would have to be imposed which would not be popular amongst the 'losers'.

23. In the context of the current review we note also the Government's commitment to the contributory principle and its undertaking not to extend NIC to individuals above state pension age or to pensions, savings and dividends, which restrict still further the Government's room for manoeuvre. During a similar consultation exercise in the early 1990s some work was done on the significance of the contributory principle. This revealed that '£500 not allocated to an earner's NI account reduces his state pension on average by 12 pence a week currently and 4 pence a week by 2026/27'. We suggest further work be undertaken by reference to current rates of contributions and benefits to determine just how valuable are the rights generated by

NIC at the margins, compared with the potential benefits available from restricting the principle.

24. As they are still largely applicable, we reiterate the comments we made in our response dated 25 August 2000 (published as TAXREP 28/00) to a technical discussion document 'Simplifying NICs for employers' published by the Inland Revenue in June 2000 (and repeated in our submission dated 30 November 2001 (published as TAXREP 33/01) commenting on the Revenue's summary of comments and response document published in July 2001):

    3. '…Whilst the busy businessman is indeed concerned about whether he has understood sufficiently the inconsistent and labyrinthine rules that he has to master in order to ensure that he pays his employees and the Collector of Taxes the correct amounts and will not be caught out at a later date by a PAYE/national insurance contributions ('NIC') auditor, this is simply because when he is computing the payroll or completing forms P11D this is his immediate and pressing objective.

    4. 'In the longer term he would rather the Government provided him with a simple system, so that he does not need to do two different sets of calculations for each item of pay and complete up to eight columns in the NIC section of each employee's deductions workings sheet, rather than initiatives which tinker at the edges such as this exercise or, worse, which use the tax/NIC system to try to influence peoples' behaviour and result in endless changes which are no clearer and are probably more burdensome and expensive than what is replaced.

    5. 'Real simplification and harmonisation of tax and NICs would involve aligning the inconsistent rules not only for those items which are not only the most common but which employers find the most complex, namely cash payments, credit cards, vouchers and pecuniary liability, but also 'sacred cows' such as charitable giving and pension contributions. As to the latter two items, we agree with the Government that charitable giving and self-provision of pensions should be encouraged, which suggests that both should be deductible for NIC.

    6. 'In short, if an item is subject to/deductible for PAYE income tax, then it should be subject to/deductible for Class 1 NIC and vice versa, and (given that Government policy is that benefits-in-kind are subject to Class 1A NIC) if an item is a taxable benefit-in-kind which goes on the P11D, then it is subject to Class 1A NIC. Whilst common rules might result in a loss to the Exchequer, overall a revenue-neutral outcome could be achieved by adjusting tax or NIC rates.

    7. 'In the longer term, although NIC is not officially acknowledged to be a tax, the underlying structure of NIC (and social security generally) needs to be critically examined in the light of our ten tenets towards a better tax system [summarised in Appendix 1]. In addition, section [336, Income Tax (Earnings & Pensions) Act 2003] and the NIC equivalent should be amended so that the criterion is commercial need. Whilst we note that acknowledgement is given to important policy questions which are listed under "Tax/NICs alignment", we are disappointed that the technical discussion document does not include a commitment to any long-term strategic review of the contributory principle, the unquestioning acceptance of which has over the years hampered any meaningful discussion which might otherwise have resulted in progress. We consider that the collection of taxes to fund social security should be by way of a more straightforward and streamlined system to which the contributory system is then applied, rather than, as at present, the contributory principle tying the authorities' hands and preventing helpful change.

    8. 'Only if such radical proposals are addressed and implemented can meaningful simplification ever be achieved…'.

2 Of the differences between income tax and NICs listed in Table 1.A (or any others that yo consider important) which do you see as the most significant in terms of their impact on:
a economic distortions;
b burdens on employers;
c fairness?

and

3 What do you think are the most important steps that could be taken to reduce the effect on:
a economic distortions;
b burdens on employers;
c fairness?

25. Using the headings in Table 1A, we consider that the following need to be addressed as priorities to achieve the three objectives of reducing economic distortions and burdens on employers and increasing fairness.

What is it paid on?

26. There is an absence of logic in the way the law subjects items to PAYE, income tax, Class 1 NIC, Class 1A NIC or some or none of these. Employers are also obliged to apply PAYE income tax and/or Class 1 NIC to some items which are not paid via the payroll. We recommend aligning the tax and NIC treatment of as many items as possible, so that if the current tax law says that something is to be put through the payroll for income tax then it should be subject to Class 1 NIC and if something is reported on form P11D for income tax then it should be subject to Class 1A NIC.

27. Differences between the income tax and NIC treatments and reporting requirements are highlighted in the Tables in Chapter 5 of CWG 2 http://www.hmrc.gov.uk/guidance/cwg2.pdf and in Chapter 5 of CWG2 http://www.hmrc.gov.uk/guidance/cwg5.pdf. Both tables are helpful in highlighting the many differences with which employers have to contend .

28. As explained in TAXREP 28/00, common items for which differences arise are cash payments, credit card payments, vouchers (pecuniary and other) and pecuniary liabilities generally, for example telephones, where there is a different NIC treatment depending on whether the liability is that of the employee or employer. Basing the liability on the nature of the expense would be more logical.

29. We consider that pecuniary liability payments, purchases via company credit card where 'the litany' (explained in answer to Question 9) is either inapplicable or is not used and non-cash vouchers not exempt from tax or NIC, all of which are currently subject to Class 1 NIC, should instead be subject to Class 1A NIC because there is no cash from which tax or NIC can be collected: it is for this reason that the PAYE Regulations were framed to subject such items to reporting on P11D (see in Appendix 2 our letter dated 2 October 2008 to HMRC). If the loss to the exchequer of the primary element of Class 1 and the cash flow disadvantage arising from Class 1A being payable later, ie on 19 July after the year end, is not acceptable, then we suggest that the rate of Class 1A NIC should be reviewed so that it no longer automatically tracks the main Class 1 rate.

30. Other common items which need review because the law creates distortions and barriers include the travelling and entertaining/subsistence rules (see in Appendix 3 our letter dated 3 December 2008 to HMRC).

31. For readily convertible assets, 90 days is not enough time for an employer to get the PAYE calculations right and raise/collect the tax. This is especially so for overseas and smaller employers who do not appreciate that they have shares within this regime. The effect of s.222 ITEPA 2003 in these circumstances is to impose an automatic, non-appealable penalty for

what most would regard as innocent error, of up to 50% depending on the employee's marginal tax rate. In this regard, the NIC rules work more satisfactorily than those for income tax.

32. All changes to the rules need to take account of other initiatives – see also our reply to Question 14 (Real Time Information and payrolling of benefits-in-kind) – and international obligations including treaties.

Period of assessment and Cumulative or non-cumulative collection

33. We consider that earnings periods and cumulation, including the question of whether NIC should or should not ignore multiple employments, should be considered for review. On the face of it, if NIC were annual and cumulative, this would not only enable closer alignment with income tax but give rise to other benefits such as reducing the amount of NIC legislation, for example special rules for directors, non-standard pay periods, deferment and earnings exception, directives (Regs 3(2A), 30 and 31), and payments after termination would have a default earnings period for NIC of more than one week (which might actually raise revenue).

34. This would also reinforce the government's desire to retain the contributory principle; for example, it would enable individuals on lower and/or variable wages to earn qualifying years and open up the possibility of finding a means of enabling those in multiple employments below the NIC lower earnings limit (but with total employment income above the lower earnings limit) to aggregate their earnings and earn a qualifying year.

35. However, for employees with multiple employments, cumulation without keeping the earnings from different jobs separate would create its own questions as to which employer is responsible for which bit of the secondary liability, which would be compounded if any of the employments were contracted out. This area needs careful consideration.

36. We would refer you to the leading article in Tolley's Practical NIC (TPN) for December 2007 commenting on the report 'Tax and NIC alignment – an evidence-based assessment' published on 9 October 2007 at Pre-Budget Report. Inter alia, the article highlights that a single earnings threshold across all jobs is not a given for annual earnings period/cumulation. The number of NIC earnings thresholds is a separate issue to be considered and, if necessary, solved separately.

Structure of charge

37. The thresholds for NIC are chaotic owing to continued failures in the past to anticipate the impact of changes to income tax personal allowances and rates, and because of the way in which NIC thresholds are linked to each other, state pensions, income tax rates and allowances, etc. We recommend alignment of NIC thresholds with income tax allowances/thresholds.

38. Specifically, the NIC primary and secondary earnings thresholds should be the same as one another and the same as the income tax personal allowance. Ideally, the legislation should be changed so that it is not possible in future for the primary and secondary thresholds to be different from one another (conceptually, this should only have been applicable to the introductory years 1999/2000 and 2000/01). This would result in a charge to NIC arising for employers and employees at the same figure at which for most employees a basic rate charge arises for income tax, which would be logical and intuitively acceptable. For similar reasons, the NIC upper earnings limit should remain the same as the income tax higher rate threshold plus the personal allowance.

39. Standing back, we recommend that the radical approach adopted by the Dutch be considered, under which all employer NIC liabilities were made the liability of employees and employers were obliged to give a compensatory pay rise to employees. This provides greater transparency and makes employees realise the true cost of funding any benefits to which they may be entitled.

Entitlements provided

40. We note that the contributory principle is to be retained (paras 1.8-1.9). This is presumably to keep the United Kingdom NIC/social security regime in line with other countries with whom there are reciprocal arrangements under which contributions in one country are recognised in another when assessing the benefits to which a contributor is entitled.

41. However, we see no reason in principle why benefit contribution records need to be built up wholly or mainly from monetary contributions paid in – a principle which already applies to employees earning £102-136 per week (2011/12 figures). It would be far simpler if a qualifying week could arise simply from the fact that someone is employed or self employed in that week. This would obviate the need to ascertain the quantum of earnings or profits on which NICs need to be paid and calculate how much NIC is payable. This would also be the same as happens at present whereby a week in which an individual receives jobseeker's allowance or child benefit is treated as a qualifying week. (If it were felt that a de minimis amount of earnings were needed for a period to qualify then this could be accommodated in such a regime and need not require a complex calculation.)

42. Leaving aside the international question, in the UK the contributory principle – and the rationale underlying the Categorisation Regulations that certain occupations should be treated as employments for NIC to enable certain contributors within certain trades, such as actors and many behind the scenes in the entertainment industry, lecturers, etc, to claim contributory benefits when out of work – is undermined by the way in which certain benefits are calculated and for how long benefits are payable. For example, the quantum of maternity benefit is linked to earnings not NI contributions and payment of jobseekers allowance and incapacity benefit is time limited.

Section 2: Employers and Payroll Professionals

General

4 Under the current system, how much staff time and/or other resource is required to carr out income tax and NICs processes? Please give a score on a scale from 1 to 5 where 1 is only a small amount of time/resource and 5 is a great deal of time/resource for each of the following:

a) Familiarisation: understanding HMRC's requirements, legislation and guidance.

b) Retrieval of information: obtaining the information required to run a PAYE payroll.

c) Record keeping: maintaining the records needed for income and NICs purposes e.g. keeping copies of returns/letters where necessary.

d) Calculation: calculating and checking income tax and NICs due (including in-year and end of year processes).

e) Provision of information to HMRC: reporting of information to HMRC e.g. P45s for new employees.

f) Provision of information to employees: reporting and providing information to employee e.g. year end P60s.

g) Payment of liabilities: paying income tax and NICs to HMRC.

43. Given that employers are subject to penalties and end-of-year interest for late payment of PAYE income tax and NIC, and will shortly also be liable to in-year interest on late payments, and the complexity of the income tax and NIC rules (as well as the other payroll rules that employers have to apply such as on student loan repayments, statutory payments, national minimum wage, working time), employers have to ensure that they allocate a great deal of time/resource to ensure that no mistakes are made and that payment deadlines are met. The score in each case is therefore 5.

5 Which aspects of the current income tax and NICs process work well for your business?

44. The fact that for NIC each employment is separate and, save for where there are associated employments, unaffected by whether the employee has another employment or any self

employment simplifies compliance by employers. The employer can calculate the NIC without reference to other factors. This in conjunction with the earnings thresholds means that employers who have on their payroll employees earning below the lower of the primary and secondary earnings thresholds do not have to make any payment of NIC in respect of those employees even if aware that the employee has other employment or is also self employed. Also the fact that each pay period is discrete. This contrasts with income tax where the employer has to have regard to previous pay periods and employments (forms P45 or P46) and other circumstances (via code number). But these advantages need to be considered in the light of our comments under Questions 2-3 Period of assessment and Cumulative or non-cumulative.

6 Do you carry out income tax and NICs obligations together? Are there any elements you carry out separately?

45. Tax and NIC obligations are carried out as far as possible at the same time but unless using a computer not simultaneously by the same individual.

7 What effect do differences between income tax and NICs have on wider payroll processe such as expenses and benefits, statutory payments and student loans deductions?

46. The differences mean that each item of earnings including benefits and expenses has to be worked on twice, once using the income tax rules and again using the NIC rules. This means many things take twice as long as they would if one set of rules applied for both imposts – and even where the treatment is the same, the fact that these are contained in two different statutory codes means that both have to be considered separately. Even where a computer is used, the data has to be input twice, once into the income tax field and again into the NIC field. If the computer does this automatically with the different treatments being resolved by the software, the software designer will have had to have had regard to both the tax and NIC rules so he will have had to spend twice as long or perhaps more writing the software, the cost of which will be reflected in the cost of the payroll package and borne by the end user, ie the employer.

8 Which of the differences between income tax and NICs are dealt with largely automatica by payroll software and which require significant manual working? Where manual working is required how straight forward is this?

47. The answer to this question depends on what the software is capable of. It may depend on whether the information has reached the payroll department in time to be processed as part of the normal run or whether it has arrived too late and has to be worked manually because the software does not have the features to accommodate retrospective adjustments, or whether, quite simply, the payroll is sufficiently sophisticated to deal correctly with an unusual situation or complex rule.

Issues and Errors

9 Are there particular issues that occur in the calculation of income tax and NICs?

48. One issue is that it can take a long time for data to reach the payroll department. It may arrive after the deadline for starting the payroll processing has passed, so it will be too late to be input into the payroll for the right pay period so the payroll will not be able to reflect all the appropriate data in the correct pay period. This is especially so for large departmentalised employers and those who are geographically dispersed whether nationally or internationally. Delays will mean that large employers will almost invariably be subject to a late payment penalty and is why HMRC's NIC easement (originally in CWG2 but revised on 24 June 2010 and published at http://www.hmrc.gov.uk/paye/payroll/day-to-day/pay-marginal.pdf) explaining when a marginal item of pay can be included in an earnings period later than the one in which it was paid, or treated as paid, is so important. Given that the issue is particularly acute for share

related payments and is unavoidable, it would be helpful if this situation could be included in the easement.

49. One particular matter which has for many years created difficulties is where employees using their own cars pay for petrol using a company credit or charge card (eg an All Star card). In such circumstances, if the NIC charge is to be Class 1A instead of Class 1, the employee has to indulge in what is colloquially termed 'forecourt foreplay' in which before putting petrol in his car he is expected to cite 'the litany', ie inform the cashier that he is acting as agent for his employer in this transaction and thereby varying the contract between the card supplier, employer and garage. Whilst this is the effect of the Overdrive case, we suspect that this ritual is honoured more in the breach than in the observance and we recommend that the requirement should be withdrawn.

50. Looking ahead we foresee real problems following the introduction of the disguised remuneration regime. Employers will have to understand not only whether they are in the regime but if so also apply the income tax and NIC rules.

10 How often is it necessary to correct income tax or NICs calculations and which are the most time consuming to correct?

51. Any error is time consuming to correct.

Software

11 Do you have any comments about difficulties in designing or using software resulting from the differences identified in Table 1.A (or any others that you consider important)?

52. As there are two regimes and two sets of rules, software designers have understand both sets of rules and design software to suit each set, which we would imagine takes twice as long as it would if there was only one set of rules.

International

12 What do you see as the main differences between income tax and NICs in relation to employees you have who work internationally?

and

13 Which of the differences outlined in question 12 are dealt with largely automatically by payroll software and which require significant manual working? Where manual working is required how straightforward is this?

53. When an employee is assigned to the UK from overseas, then he is normally liable to UK income tax but may not be liable for UK NIC depending on the length of stay and/or the terms of the NIC/social security cross border agreement. When an employee is assigned overseas, then he will normally not be liable to UK income tax but probably remains liable to UK NIC, again depending on the length of stay and/or the terms of the NIC/social security cross border agreement.

54. Difficulties arise with overseas pension funds and these will be compounded by the disguised remuneration rules. Overseas pension funds are generally unapproved. Employees who are assigned to the UK may be members of an overseas pension scheme. If the UK employer pays contributions to the scheme, then, once the employee leaves, the now ex-employer will need to track the ex-employee for life, because once the ex-employee draws a pension from the overseas scheme, then unless the ex-employee is covered by a double tax treaty and/or NIC agreement respectively, he is chargeable to tax and/or NIC on the element of his pension relating to the UK assignment if the employee was chargeable to UK income tax and/or NIC on his earnings when in the UK. The ex-employer is responsible for discharging the liability. We

anticipate that this issue will become more common under the disguised remuneration regime. Similar comments apply to share schemes.

55. The situations above normally have to be dealt with manually, for various reasons. No two cases are exactly the same so will need bespoke processing. The complications (which may mean that the payroll computer cannot cope with the circumstances of the case) coupled with the time taken to collate the data (which may be held overseas) and the confidential nature thereof (especially when it relates to senior personnel) will normally mean that it is processed by specialist personnel separately from the main payroll run.

Interaction with other reforms

14 Do you have any views on how the introduction of Real Time Information (RTI) may affe the cost and benefits of income tax and NICs integration?

56. We do not see how reporting information in real time will of itself affect the costs and benefits of integrating the operation of tax and NIC. However, RTI may resurrect the feeling in some quarters that all benefits-in-kind should be payrolled and in this regard we would draw attention to the table in our response dated 4 September 2008 (published as TAXREP 69/08 http://www.icaew.com/en/technical/tax/tax-faculty/tax-faculty-representations/~/media/Files/Techn faculty/TAXREPs/2008/taxrep-69-08-tax-faculty-hmrc-s.ashx) to HMRC's consultation on simplifications needed for benefits-in-kind to payroll successfully in which we suggest modifications to the income tax charging rules for some specific commonly-provided benefit-in-kind/expenses to make it possible to calculate the tax in real time.

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19.9.11

APPENDIX 1

THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.

2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.

3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.

4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.

5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.

6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.

7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.

8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.

9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.

10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see http://www.icaew.com/~/media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguid towards-a-better-tax-system.ashx)

APPENDIX 2
Para 23

PROPOSED TAX/NIC ALIGNMENT OF THREE ISSUES

Text of letter dated 2 October 2008 to HMRC

1. Thank you for your invitation dated 26 September to let us have your views by 2 October on the proposal to align the tax treatment with the NICs treatment by payrolling:
   (i) Pecuniary liability payments, e.g. home telephone and utility bills,
   (ii) Purchases or payment for provision of services by employee using company credit cards where the 'litany' is neither applicable nor used, and
   (iii) Non-cash vouchers not exempt from tax or NICs.

   We welcome the opportunity to comment.

2. At present these are all reported for income tax on form P11D and are supposed to be payrolled to collect the Class 1 NIC in the pay period in which the expense is incurred, save for the second item in cases where the employee is authorised to make purchases on behalf of his employer and the 'litany' is used, in which case Class 1A NIC applies and the tax and NIC are reported on form P11D and P11D(b).

3. In our view, there is a very good reason why these three items are not being payrolled for income tax already – which is that that they give rise to no cash in the hands of the employee from which income tax can be deducted, particularly in the case of non-cash vouchers and payments to a third party. The PAYE regulations generally do not apply where a payment of cash earnings is not made directly to the earner for this very pragmatic reason. They have worked like this since their inception because the architects of PAYE understood this practical point.

4. The NIC rule can be made to work at present only because employees who receive these benefits have other pay from which the primary Class 1 NIC can be deducted – provided the information is available at the right time.

5. Putting non-cash pay through a computerised payroll involves entering, each month or week, notional gross pay equal to the value of the benefit provided in that period, and deducting that same notional amount from net pay. This generates a NIC liability at the relevant rate, affecting net pay by the amount of any primary NIC deduction and generating a secondary NIC figure for payment by the employer. Two manual and variable adjustments are needed in each pay period for each affected employee, to collect a peripheral amount of NIC. The extra work involved if PAYE were to be applied to these peripheral items can hardly be justified as 'revenue protection'.

6. To achieve genuine simplification and harmonisation, we consider that the reporting requirements for all three should indeed be harmonised, but in such a way that all are reported via forms P11D and P11D(b) for NIC as well as tax, and the applicable charge to NIC should be Class 1A.

7. We make this recommendation because it is technically impossible to comply with the Class 1 NIC law owing to timing and process issues. This same issue brought NIC policy into disrepute after policy changes in the new NI269 Green Book in 1989.

8. To explain: in theory, the payment of earnings takes place when the third party bill is paid, the employee uses the company credit card or the voucher is handed over. In small businesses, it may be possible to ensure that the relevant data are made available for payroll purposes within the correct earnings period, in time for processing, but in medium and large businesses it is often impossible, particularly in the case of transactions on company credit cards that can take many weeks to process. As HMRC well knows (eg comments at the 23 September 2008 Benefits & Expenses Employer Consultation Forum Sub-group meeting), the statutorily correct, but impracticable, procedure is widely ignored, and employers simply do their best by deducting and accounting for NICs in a later period. This is pragmatic but may not strictly be permissible, since

only errors made 'in good faith' may be corrected in this way, and deliberate flouting of the rules as described in this paragraph would not seem to fall into that category.

9. Dealing with the exception to the second item, namely where the employee is authorised to make purchases on behalf of the employer and the 'litany' is used, in which case Class 1A NIC applies, we see no logic in payrolling this for income tax and reporting via P11D for NIC, and recommend that the reporting of this item continues to be dealt with via form P11D for both income tax and NIC. On a wider policy issue, it would simplify work for employers if both item (ii) and the exception to it were subject to the same class of NIC, ie Class 1A.

10. In putting forward the proposal to harmonise the tax treatment of these three items with the NIC treatment, HMRC seems to be working on the theory that employers being obliged to put them through the payroll for income tax should not face any more difficulties than they currently face in payrolling for Class 1 NIC. Whilst this is a correct assumption, it is in practice an absurdity.

11. We would reiterate that the primary NIC liability for these three items should technically be discharged in the pay period in which the money relating to the expense is paid out (which includes presenting the employer's credit card to meet a personal expense). Deducting Class 1 NIC in the correct pay period for all three of these items (save for the 'litany' exception to the second item) is currently not possible in many instances.

12. This is because of the practical difficulty, and in many cases impossibility, for example when the expense is incurred in the tax month but after the payroll has been closed and run, of getting the information to the payroll department in time to put through employees' payrolls in the correct pay period.

13. What happens in practice is that the amount chargeable to income tax is picked up when completing forms P11D and possibly Class 1A NIC accounted for. Class 1 NIC is generally put through payroll for Class 1 in a subsequent pay period, although some is inevitably overlooked by less knowledgeable or less conscientious employers.

14. Without wishing to labour the point, we suggest that putting it through payroll to deduct Class 1 NIC in a subsequent pay period is incorrect. The NIC liability cannot technically be discharged in a different pay period from that in which the money was paid out in respect of any of the three items (because there has been no error made in good faith) and it will not even 'come right' on an annual basis as NIC is not cumulative (and the option of cumulating was ruled out in the evidence-based report on tax/NICs alignment published on 9 October 2007 by HM Treasury). For most employees (over 85% of employees are in larger organisations), by the time the information is processed through the payroll, the net pay from which the deduction should have been made has already been paid.

15. We acknowledge that there is an easement in leaflet CWG2 under which employers are allowed to account for Class 1 NIC on non-cash items in a later pay period provided they do so immediately the information comes to light, but this easement is itself illegal as there is no care and management provision in NIC law.

16. The legal framework of the NIC system should be designed so that it is in practice workable by employers and HMRC, in other words, the law should ensure that these three types of 'earnings' are subject to a liability and collection system which is workable in practice.

17. The bullets in the note explaining the proposal say that alignment on the lines suggested 'would bring real benefits to both employers, employees and HMRC'. We would comment as follows:
    - 'Reduction in number of items being reported on forms P11D' – as noted in our previous representations on payrolling benefits in kind and expenses (eg TAXREP 25/08 http://www.icaew.com/index.cfm?route=155793), the proposals potentially replace an annual reporting obligation with up to twelve operations, which on any basis is increasing, not decreasing, employer burdens;

- 'Reduction in coding – no need for coding as PAYE income tax collected in-year' – the P11D only has to be processed once and correct processing of P11Ds and P46(car) forms should mean only one or two code number changes per year per typical employee, rather than, for example, the 20,000 coding notices per year for 4,800 employees as in Karen Thomson's anonymous employer case study presented on 23 September at the Payrolling Stakeholders' Focus Group meeting;
- 'Employer knows that where PAYE income tax is due Class 1 NICs are due' – we suggest rather that the employer needs to know that where PAYE not is due neither is Class 1 NIC and that both may be dealt with correctly through the P11D process; and
- 'In year collection of income tax rather than through coding' – we see these proposals as a means of advancing the collection date for the tax rather than protecting revenue.

18. Finally, turning to practical issues, we should welcome clarification of how it is envisaged that employers quantify for the payroll and deduct PAYE from the following payments:
    (a) Home telephone payments, home utility bills, payments using company credit cards and payments via non-cash vouchers, eg a company cheque (which is a non-cash voucher) given to the firm's handyman to buy some paint. Currently, businesses make such payments when they consider that there is a business element and the employee is assessed to income tax on the private element, ie the gross bill less his s.336 claim. For NIC, the business element is disregarded. If these are to be payrolled for income tax, we would welcome clarification of whether the employer will be able to take account of the s.336 claim, preferably by way of an automatic employer self-certified blanket dispensation for all business expenses, or is it envisaged that the employee pays tax via the payroll on the gross amount (including the handyman who used a company cheque to buy the paint) and then claims a tax deduction in his tax return after the tax year has ended?
    (b) Post-termination payments to third parties: bills must still be paid under contractual obligations after the employee has left and the P45 has been issued, but there is no cash pay from which to deduct – will employers face a section 144A/222 situation with extra deemed benefits for not reimbursing within 90 days? and
    (c) women who continue to receive all their benefits in kind during additional maternity leave, when there is no cash pay, or only £117 of SMP, from which to deduct PAYE and NIC liabilities.

19. In summary, we consider that these proposals which are being put forward as a simplification and alignment measure to reduce burdens for employers will achieve neither objective and are misconceived.

20. They will not only be unworkable in practice without extra-statutory easements but also increase the number of opportunities for employers to make mistakes and therefore potentially be liable to penalties and interest, especially if proposals to charge interest on late paid in-year PAYE payments are enacted (unless the rules are in line with the proposal made by employer representatives at the in-year PAYE penalties and interest workshop on 22 September that if interest is charged on in-year payments, it be charged only on the PAYE originally paid over, not as finally recomputed).

21. Instead, we recommend harmonisation by making these three items liable to Class 1A NIC. The tax and NIC liabilities could be reported via forms P11D and P11D(b) and the absurdity of the 'litany' would be eliminated. Harmonising the NIC with the tax treatment would meet the twin aims of simplification and reducing employer burdens. As an incidental benefit to the Exchequer, it would also probably increase tax yield (as income tax and Class 1A NIC would be collected in all cases instead of only income tax in some).

APPENDIX 3
Para 24

THE MAIN OBSTACLES THAT PREVENT CUSTOMERS FROM GETTING IT RIGHT

Text of letter dated 2 December 2008 to HMRC

1. Further to your invitation at the ECF meeting on 17 September for which we thank you and your email dated 3 November we welcome the opportunity to set out some issues which make things difficult for clients to comply and some suggested solutions.

2. We have grouped these into two areas, the first technical and the second operational.

Technical

Apparent lack of logic in the way the law subjects items to PAYE, to NI, to Class 1A or none of these

3. One only has to look at the tables in Chapter 5 of CWG2 (both the P11 (PAYE/NI) chart and the P9D/ P11D chart) to see just how complicated and confusing the various rules are. Simplification of the law would make compliance easier. The simplest way forward would seem to be to have all cash items of remuneration attract Class 1 NI and PAYE. You may be aware that the NI scheme was designed to levy NICs only on cash pay for the very practical reason that employers could not deduct from benefits in kind, and we feel it is well past time to sort out the muddle caused by multiple anti-avoidance measures introduced in seemingly uncoordinated steps since Chancellor Lawson removed the cap on employer NICs in 1985. Class 1A was created to raise money from NIC on benefits, so why not use it properly? Items for which payrolling is impractical should all be moved from the PAYE system to the P11D system, so that tax and NI are collected after the tax year end rather than trying to collect in-year. We appreciate that there may be winners and losers as a result.

Need to apply PAYE/NI to items which are not normally paid through payroll

4. Having to apply PAYE or NI to items which are not normally paid through payroll (such as expenses eg home phone bills reclaimed through expenses) is very difficult in practice, let alone on a timely basis. Some of these items may have been settled by a different department in the company which is unaware of the payroll implications. A similar issue probably arises in larger companies in respect of share-related items. We would suggest removing these items from PAYE and transferring them to the P11D.

Travel rules

5. Most clients are not aware of the detailed rules for tax-allowable travel and many deal with these on the basis of what seems reasonable or logical, resulting in mistakes. Small and medium sized businesses do not have anyone on the staff who knows and understands all the rules and can check all the claims, and employees do not have the time to familiarise themselves with the content of Booklet 490 either. The simple answer is to make the rules more accessible to ordinary businesspeople and employees. Any ordinary person faced with Booklet 490 probably gives up before the end of the first page of the overview, even though there are useful examples on page 4. Too much detail discourages the normal employer from reading the guidance because so little seems relevant.

Entertaining / staff entertaining / subsistence

6. These are a major headache for clients and there is no useful help on the HMRC website or in their booklets on issues which frequently arise in practice. The real world cannot be compartmentalised in the way envisaged by tax legislation. The dividing line between entertaining, staff entertaining and subsistence can often be very blurred. For example:
   a. Three furniture company salesmen travel abroad for a business exhibition. They run their employer's stand and, at the end of the show, offer to take the last customer to dinner. How should the company deal with this? Can they apportion the cost and treat the customer's

meal as entertaining? Is it all entertaining? Or all subsistence (the customer comes from the UK so is also away from his normal workplace)?

b. The MD of a firm wants a quiet chat with an employee, away from the company premises and in a relaxed environment. He takes the employee to a local pub. Why is this a taxable benefit? If they had both been on the company premises, they could have gone to a staff canteen (or had sandwiches which are brought in for all staff) tax-free. If it is a taxable benefit, whose P11D should it go on or should it be split between them?

c. Treatment of alcoholic beverages - it seems wine etc with meal is seen as part of the meal (not a taxable benefit) but alcohol without a meal, eg in the departure lounge of an airport, is seen as a taxable benefit, although water and soft drinks are not. Why? On whose P11D should the amount go when one employee picks up a bill for many - can costs be apportioned to avoid unfairness to the person paying?

d. Working lunches - these are 'subsistence' when working at a temporary place of business but staff entertaining and a taxable benefit on the employer's own premises. The taxable benefit to staff is considered unjust (after all, staff are working through their lunch break and a modest lunch is not unreasonable in the circumstances). The difficulty of identifying all involved and getting the reporting right is onerous and the PSA route almost doubles the cost. There is a strong possibility of mis-recording in client books when the tax effect is known. If there can be exemptions in the legislation for late-night travel (albeit these are awkward to deal with) surely legislation can be introduced to exempt working lunches on employer premises from being a taxable benefit.

e. Employees working late on an important project are taken out to a restaurant afterwards as the boss considers that it is too late to ask them to go home and cook for themselves. Employers see this as a proper business expense and do not understand why it is a taxable benefit on staff. If the late project was away from usual business premises, this might be non-taxable subsistence, although as far as the employer is concerned the principle is identical. As for working lunches - if late-night taxis can be exempt, cannot late meals also be exempt? This would also alleviate the reporting issues and allocation of costs, lack of information after the event etc, which all contribute to incorrect application of rules.

Notification of car changes (P46(car))

7. In larger organisations there are probably set procedures in place to ensure that cars provided to staff are notified to payroll departments. In smaller organisations, the people who organise and pay for vehicles may have no idea that there are any notification requirements. It is a lot to expect of small businesses to remember to provide the information. The car will still need reporting on the P11D by the employer but this has more chance of happening due to how the P11Ds are prepared in small organisations, ie by the external accountant when he prepares the accounts. We would suggest that

a the P46 and P45 should include a prominent reminder of the need for a P46(car) if a company car is provided for a new employee, and

b. that the submission of a P46(car) should be acted upon by HMRC issuing an updated and accurate PAYE code within a maximum of a month.

Credit card payments

8. The need for the 'litany' ie to have employees state that they are buying on behalf of the business (and have the vendor business accept this) is very difficult and impractical (impossible?) to deal with in practice, and it is even more difficult to prove what has happened. Removal of this obligation would mean that employers can be much more certain that they are accurately completing forms P11 and P11D. The tax system would be better respected by employers and employees if this type of hair-splitting were abolished in favour of a practical and reasonable system that all could understand and operate.

Operational

9. The main issue here is the time that deficiencies in HMRC's processes waste for employers, individual taxpayers and agents. This is evidenced by two areas in particular.

Efiling

10. HMRC has failed to deliver Lord Carter's vision. The unreliable systems and problems in efiling (not confined to employment taxes) result in false penalties, and the failure to process data timeously leads to, for example, wrong coding notices and incorrect deficiency notices, all of which must then be corrected. We were delighted that HMRC followed our suggestion and wrote to each employer to confirm that the recent wrongly-issued P11D(b) late filing penalties would be cancelled, and apologised, and we hope that by doing this HMRC will have regained the respect of affected employers, but we should not have had to suggest such an obvious remedy.

11. Incidentally, has the cause of the P11D(b) penalty problem now been ascertained and put right?

12. The strategic solutions here are in recommendation 23 of Lord Carter's report of 22 March 2006: '…Each of the services should be capacity tested at least a year before our recommendations are implemented, and if any tests are not successful the measures relating to that service should be deferred' and in recommendation 2: '… HMRC should benchmark customer satisfaction with its online services against commercial online services and seek to learn from best practice'. Every new IT development has teething trouble, and this was recognised in the Carter report, but extra work is still caused each year for employers and their advisers because the stress testing is being done with the live system as each year progresses.

Notices of coding

13. It would save time all round if the number of coding changes that HMRC has to make and employers have to process was reduced. Has HMRC considered whether the changes from SA return, P11D, P46(car) submission and mid-year unexpected policy changes could be reduced, perhaps by imposing a de minimis level for any change to be processed in-year rather than in the following year? One particular problem about which we have received complaints from members is where a taxpayer has asked in the SA return that non-PAYE income not be coded out. HMRC abides by that request only until the next coding change, when HMRC seems to ignore the earlier request and reinstates the non-PAYE income recovery. This makes it necessary for the taxpayer/agent again to ask HMRC to not code out that non-PAYE income and issue yet another coding notice.

Technical guidance

14. Much of the technical content of the old DSS Contributions Code and Field Operations Manual was lost when the NI Manual was put on the web. It would help our members understand the system more easily if the rest of the technical guidance was made available again.