

TAXREP 6/02

REVIEW OF PAYROLL SERVICES

Comments submitted in February 2002 to an Inland Revenue report dated September 2001 and published on 27 November 2001

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REVIEW OF PAYROLL SERVICES.

Summary

1. We welcome the continuing open debate on the future of payroll reporting and filing.
2. Whilst the future of efficient payroll management, both for employers and for the Inland Revenue lies in an electronic solution, we are concerned at the unrealistic time scales which have been proposed and the element of compulsion suggested. This is particularly so for large businesses.
3. Problems within the current electronic solutions need to be resolved before consideration of whether electronic filing should be made compulsory. Such a decision should only be reached after further debate in the light of experience of the current electronic filing methods.
4. Simplification of the current tax system should take priority over all administrative proposals.

General comments

5. The overall conclusions of the review are not surprising. In principle we support the general move towards using technology, provided that it is implemented in a manner which is both practical and which does not place an even greater burden on the employer. We are worried, however, by the proposal to compel certain businesses to file payroll data electronically.
6. Certain of the suggestions in the document are excellent and we support them wholeheartedly. These include the removal of the £1,000 charge for software accreditation, extending the employer's helpline and the Business Support Team service, and looking again at dispensations.
7. No consideration seems to have been given to pay as you earn settlement agreements. This is a vital complementary facility to dispensation. However, there are significant differences between practices followed by different Inland Revenue offices and in their approach in terms of materiality, degree and interpretation. This needs to be addressed at an early stage.
8. Although an accepted responsibility, it remains a problem that many employers resent being asked to act as the government's unpaid tax administrators, particularly where they are then penalised for making mistakes, frequently caused by a misunderstanding of the rules. This burden falls disproportionately on the very small employer.
9. Whilst incentive payments have been suggested for a five year period, there is no help available for new employers beginning after that period. The costs of computer hardware and software are likely to be a significant expense where

payroll is very small. What is really needed for such employers, is a much simpler payroll system.

10. The Government's strategy appears to rather assume that everyone can afford to buy a computer. This is not always the case: we know that many businesses function at a very low profit level. Grants towards the cost of hardware would help solve this problem.

Specific comments

Simplification

11. The report acknowledges that many of the employers and employer representatives who responded to the review called for radical simplification of the tax system.
12. We welcome the list of recommended changes in paragraph 5.3. However, we cannot agree with the statement in paragraph 5.5 that 'as long as the government has to tax people fairly the tax system will always be more complex than anyone would like'. We agree that this is one factor which causes complexity in the tax system, but it is by no means the only factor. Many of the complexities in the present system have arisen because of piecemeal policy changes made over many years. We appreciate that radical change may cause the Government political problems, but fundamentally we think that many of the problems are not overtly political. Given time and thought, it should be possible to achieve a broad consensus in favour of change. Our solution is to establish an apolitical tax law review committee charged with simplifying tax law.
13. The treatment of casual workers and the alignment of PAYE and national insurance, are referred to in paragraph 5.4. Whilst it is true that the Inland Revenue has done extensive work with employers' representatives in these areas, there has been little progress towards a solution, particularly in relation to casual employees.

Paragraph 5.2

14. The report refers to a vast majority of employees who do not need to contact the Inland Revenue. In many cases, the reason why employees do not contact the Inland Revenue is that their employer is providing the necessary tax advice. In other cases we suspect that many employees do not know how to contact the correct office of the Inland Revenue and therefore do not do so even though they have a problem.
15. Many employees do still need to be able to contact the Inland Revenue to understand their coding notice. It is becoming increasingly common to code out underpayments of tax in a previous year, together with, for example, tax credits. This means that more employees now need to contact the Inland Revenue. In this respect, we think that the approach of the telephone call centres needs to be improved if they are to provide an effective way of resolving taxpayers' problems.

The experience of many of our members is that call centre staff usually cannot resolve queries or put answers in plain English which taxpayers will understand. An important illustration is the explanation of an adjustment to a coding notice to collect an underpayment of tax. This suggests that call centre staff need more thorough training, but the root cause of the problem is a deep seated complexity which mere training alone is unlikely to address.

Electronic strategy

16. Many accountancy practices (and other financial businesses) provide a small payroll bureau service for their clients. However many practices see this as part of providing a service to the client rather than a profitable area of business in its own right. If practices are to be encouraged to offer such services, it needs to provide a satisfactory return on the level of investment required. In many cases, volumes of processing would have to increase substantially in order to achieve any economies of scale and thus increased profitability. There is a risk that an increased volume of work may merely lead to more processing staff being taken on, with associated costs, but with no benefits of scale.
17. Inland Revenue accredited software must be available to bureau processors and employers at economic rates if electronic interchange is to become compulsory. The Inland Revenue may find that it is impractical to deal with more than a limited number of software houses. Indeed, given the frequency and number of changes to payroll and PAYE systems it is possible that there will in fact be only a limited number of software houses in the market. Whilst this may make the Inland Revenue's task easier, it also leads to the possibility of the payroll software market becoming an oligopoly, with increased prices charged to employers who seek to use accredited software.

Paragraph 6.3

18. A number of our members have criticised the employer EDI service. Some have expressed surprise that the Inland Revenue would wish to expand a service before the existing problems have been solved. In particular, there is widespread concern that this filing system could be made mandatory as early as 2004. In our view, this is both unwelcome and unrealistic.

Paragraph 6.6

19. A distinction has been drawn between large employers and small employers. Paragraph 3.5 gives the following statistics:

Employers with 50 or more employees	50,000
Employers with between 5 and 49 employees	450,000
Employers with between 1 and 4 employees	1 million

20. The purpose of the Review of Payroll Services is to find ways to help small employers. It is unfortunate that the report has made its recommendations as though all employers of less than 50 employees face the same types of problem. There are significant differences between micro employers (less than 5

employees) and others. This was recognised during the work done by the Bath study, which modified its approach in recognition of this.

21. Appendix 3 suggests that because 50 employees is used to define a small company by the Companies Act, it is a suitable cut off point for these payroll suggestions. The fact that it is not directly relevant to many businesses appears to have been ignored. For example, many employers of this size may not be incorporated. Indeed, it would appear that the main reason for using 50 employees as a cut off is because of the practicalities of identifying the number of employers moving into and out of the 4-5 range. Thus, the approach adopted appears to be one of changing the problem to fit the solution rather than finding a solution to the problem.
22. The proposals must be flexible enough to take account of multiple payrolls. Very many businesses run two or more payrolls. For example, a bureau is used for the main payroll, whilst separate payrolls may be operated by the employer company itself for directors or casual staff. The incentive payments systems must be able to accommodate this.

Paragraphs 6.6 and 6.7

23. One of the difficulties the Review does not seem to address is the distinction between a 'business' and an 'employer'. A family engaging the services of a nanny is an employer. It should not be assumed that all small employers, husband and wife businesses, initial sole traderships etc will have unfettered access to appropriate hardware and software. This once again suggests that it would be better to look at a micro category of very small employers employing less than 5 staff. In particular, employers of domestic staff are denied tax relief for their employment costs. To require that they should now incur costs associated with filing their payroll details electronically for which they will not receive tax relief appears particularly unjustified.
24. It is inevitable that the Inland Revenue would have to improve the support offered to small employers significantly to make these proposals viable.

Paragraph 6.9

25. The review recommends paying intermediaries incentive awards as a means of helping them market their services to small employers. Whilst this may have the desired effect, it is likely to take longer than the suggested time scale to become properly effective.

Paragraph 6.14

26. An accurate NI NO tracing system is an essential pre-requisite to electronic filing.
27. The NI NO verification service must therefore provide information on an immediate turnaround basis. Even a 24 hour delay could be prejudicial given the rigid and tight time limits for monthly payroll processing and reporting.

Paragraph 6.15

- 28.** The costs quoted may be understated. Smaller intermediaries are likely to charge more. Moreover, much depends on whether the payroll is relatively static. For example, are most employees on fixed salaries with few adjustments for overtime, bonuses etc? Where most of the payroll consists of weekly paid employees with many adjustments required, the costs of running the weekly payroll will be much higher. No account appears to have been taken of this.

Paragraph 6.23

- 29.** Whilst it is relatively easy to require end of year electronic filing, the possibility of mandatory filing for other forms eg P45, P46 should be 'desirable' rather than 'mandatory'. Depending on staff turnover and economic conditions, mandatory filing of such forms may or may not be an imposition for a struggling payroll operator.

Paragraph 6.25

- 30.** The report states that it is not the role of the Inland Revenue to provide free calculation software. It is however, a fact that it provides virtually all that is needed to operate a manual system. Imposition of a task with a cost attached will not help a growing business nor will it encourage potential employers to take on that first employee and do things properly.
- 31.** A solution would be for the Inland Revenue to supply basic PAYE software at no cost to the employer, in the same way that they supply all of the forms and paperwork needed to run a manual system. To a small businessman, time is not usually the determining factor, it is the cash flow of the business which is critical to its success or failure and this involves keeping expenses to a minimum. If that business can be given a software package that makes the process simple, then the switch away from manual systems becomes more likely to be achieved.
- 32.** If the Inland Revenue offered payroll software on their website free of charge more people would use it.

Support

- 33.** We welcome the increased emphasis placed on support for employers. This could be complemented by payroll seminars for new and growing employers, either run by the Inland Revenue alone, or in conjunction with software manufacturers. These seminars would be used to explain payroll procedures and how to achieve the filing of clean data.

Assistance

Paragraph 8.2

- 34.** We welcome the comments relating to educating employees and future employees about the calculation of tax that they pay. This would be helped considerably by simplifying the payroll system.

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8 February 2002