TAXREP 9/02

PAYE PRIMARY LEGISLATION

Memorandum submitted in March 2002 to the Revenue by the Tax Faculty of the Institute of Chartered Accountants in England and Wales in response to an invitation to comment issued in February 2002

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PAYE PRIMARY LEGISLATION

GENERAL COMMENTS

1. We welcome the opportunity to comment on the proposed PAYE primary legislation, the objective of which is to improve the section 203, Income and Corporation Taxes Act 1988 powers, set out in Tax Law Rewrite note CC/SC(02)01 issued in February 2002 by the Revenue (www.inlandrevenue.gov.uk/rewrite/index.htm).

2. In principle, we support extending the PAYE primary legislation to clarify the powers of the Revenue and to confirm existing practice as this will enable the Revenue to do things that they are currently reluctant to do which would be beneficial to taxpayers, for example adjust tax codes to collect the right amount of tax from starting rate taxpayers who have tax deducted from savings income at 20%. However, what is of concern is that the proposed widening of the powers of and use of discretion by the Revenue make it easier for them to collect tax from the softer option of the employee rather than the employer, and the rights of appeal of the employee are not being extended.

QUESTIONS ON THE DRAFT CLAUSE (paragraph 1.2)

(a) Would it help to make the existing PAYE legislation (including the regulations) clearer and more manageable?

3. We doubt that the draft clause will of itself make the rewritten legislation clearer and more manageable. Why should it? Its purpose is to ensure that parts of the existing Regulations are not ultra vires. Whilst this is a laudable aim we would not expect it to have any impact on the clarity of the regulations.

(b) Should the changes be made in the Finance Bill rather than in the rewrite Bill later in 2002?

4. We agree that the changes should be made in the Finance Bill. The changes appear to impinge adversely on the rights of taxpayers (even if these are rights no one realises that they have) and thus increase taxes. That is something that ought to be reserved to Parliament. We also consider that some of the proposed changes are undesirable. Accordingly, Parliament ought to have the opportunity to debate them. The Rewrite Bill procedure does not give that opportunity.

(c) Do you agree the changes should be deemed always to have had effect, given that the intention is only to make clear that what is being done in practice can be done, and the complications if it is not?

5. We do not agree that the changes should be deemed always to have had effect. We believe that it is wrong in principle that legislation should be enacted retrospectively, let alone for 50 years.

6. We consider also that the transitional problems are exaggerated. Neither past agreed Schedule E assessments nor self-assessment cases where the return has become final can now be re-opened, because section 33(2A) Taxes Management Act 1970 says that

taxpayers who did not challenge the Regulations are stuck with them. For cases outside the scope of self-assessment it is now too late to ask for assessments to be issued under section 205(4) Income and Corporation Tax 1988 for years before 1996/97. Accordingly, we doubt that there is much tax at risk.

7. Anyone who has already challenged the validity of the PAYE Regulations ought to retain the benefit of that challenge. Subject to that, if the Revenue are really worried, we would not object to the change applying for 1996/97 and later years, as that would only involve five years' retrospection.

DETAILED COMMENTS ON THE DRAFT CLAUSE

Clause 1(1)

8. We are concerned about this provision unless there is a specific right of appeal for the taxpayer. For example, suppose in 2001/02 Mr X has £150,000 of income from employment A and £20,000 income from employment B. His income from employment A is high because he has been sacked and it is mainly a termination payment. When the Revenue issue a notice of coding for 2002/03 for employment A in January 2002 they may well 'reasonably assume' that Mr X will be a higher rate taxpayer for 2002/03 as, until he submits his 2001/02 tax return, they will not necessarily know that Mr X's 'income' from employment A is a termination payment. It is not reasonable for the new clause to force Mr X to be taxed at 40% on his entire £20,000 earnings when the reality is that it is his only income for 2002/03 so his average tax rate should be around 15%.

9. Whilst it can be argued that a 'reasonable assumption' under clause 1(1) is a 'decision' under clause 1(2)(f) so that there is a right of appeal, the Appeal Commissioners may well take a different view. We consider that an assumption is different from a decision. We would be content with clause 1(1) if it were clarified by adding words on the lines of 'such assumptions are to be treated as decisions for the purpose of section 1(2)(f)'.

Clause 1(2)(a)

10. We are in sympathy with the spirit of the provision. However, we are unfamiliar with the phrase 'unless the employee objects'. We would welcome clarification of what the phrase means, how it is intended that the employee is to object and the implications if the Revenue dismiss his objection. Can the taxpayer object in part? What action will the Revenue take where a taxpayer telephones them and says, for example, that they have deducted £500 for interest received but as interest rates are falling rapidly, the interest will be only £50 this year so please deduct only £50. Will this be acceptable without more?

11. Notices of coding and other relevant literature should contain details about the taxpayer's right of appeal and the procedure. This would be of assistance to non-represented taxpayers, many of whom presently are unlikely to realise that they have a right of appeal, and would carry the spirit of intelligible and self-explanatory legislation and enablement onto the forms that employees encounter.

Clause 1(2)(c)

12. We accept that there are circumstances where it is impracticable for the employer to deduct tax and that other arrangements will need to be made in such circumstances. In most such cases we think that the most sensible other arrangement is by direct collection, rather than under PAYE. Accordingly all that is needed is to provide that tax does not need to be collected under PAYE where it appears to the Revenue that it is impracticable to do so. That would leave the Revenue free to issue a tax return to the employee. Alternatively, we would welcome clarification of the circumstances where it is better to require the employee to apply PAYE himself.

Clause 1(2)(d)

13. We are particularly concerned about this provision because it moves an obligation to pay tax from the employer to the employee. Existing regulations 42 and 49, Income Tax (Employments) Regulations 1993 (SI 1993/744) do this too. Both regulations are unfair insofar as the employee has no right to be told that the Revenue are considering applying the provision when the effect of it is to impose upon him a tax liability - in many cases relating to an earlier year - which he believes to have been settled under PAYE. Regulation 42 is worse, as there is no right of appeal. We would welcome clarification of why, if an employer makes an error, should the fact that this was made 'in good faith' enable the Revenue to impose a tax charge on a third party who has equally acted throughout in good faith.

14. We are opposed to this one-sided procedure being extended. Indeed, the rewrite should be regarded as giving an opportunity to correct this patent unfairness. If a liability is to be shifted from employer to employee the employee ought to have a right to make representations to the Revenue before they consider making a decision and both employer and employee should have a right of appeal to the Commissioners against the decision.

Clause 1(2)(f)

15. We accept that clause 1(2)(f) purports to give a right of appeal. However, we consider that such a right will prove illusory as the taxpayer would need to show that the Revenue's exercise of their discretion was 'Wednesbury unreasonable', which is virtually impossible to do.

Clause 1(4)

16. We are concerned about this clause despite the Revenue's commentary which says that 'subsection (4) goes with subsection 2(c)'. We consider that sub-clause 1(4) is inconsistent with sub-clause (2)(c). Sub-clause (2)(c) refers to deduction being 'impracticable'. That is far more restrictive than the conditions in sub-clause (4), namely 'as may be agreed by … the employer', or 'not necessary', or 'not appropriate'. All of these terms seem to enable a Revenue officer to say to an employer 'Don't worry if you don't want to apply PAYE. I am happy in your circumstances to take away this burden that Parliament has put on you and instead impose it on the employee'. It is not acceptable that the Revenue should be given a

wide discretion to do this, particularly where there is a perception that there are unwritten rules that favour certain types of employer.

Clause 1(5)

17. The definition of 'Inland Revenue' is cited as meaning the Board or an officer of the Board, which means that in the context of the draft clause the two are interchangeable for all purposes. As noted in para 4.18 of the Revenue commentary, there are some Regulations that provide specifically for Board approval. We would not like to see this distinction dispensed with.

14-13-36
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6.3.02