



Tax Faculty

## **TAXREP 14/05**

### **PENALTIES FOR EMPLOYERS WHO FILE P35/P14 ON PAPER**

*Memorandum submitted in March 2005 by the Tax Faculty of the Institute of Chartered Accountants in England and Wales to the Revenue*

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## PENALTIES FOR EMPLOYERS WHO FILE P35/P14 ON PAPER

### INTRODUCTION

1. We are concerned that many well-intentioned and otherwise-compliant employers will unwittingly incur late-filing penalties as new requirements set out on page 2 of Employers Help Book E10(2005): 'Finishing the tax year up to 5 April 2005' (on Revenue website at <http://www.inlandrevenue.gov.uk/helpsheets/2005/e10.pdf>) have been neither well publicised nor well explained.
2. We believe that the Revenue can and should help employers get it right, by streamlining existing and unnecessary burdens, issuing guidance that explains exactly and simply what employers should do and taking steps to ensure that changes to the law and/or Revenue requirements are drawn to the attention of employers in such a way that they cannot help but be aware of them.

### KEY POINT SUMMARY

3. The quality requirements listed in E10(2005) in column 2 of page 2 are new. If employers are going to be subject to penalties on forms submitted, say on 10 May, that are sent back to them for correction, say on 1 June (so that the forms clearly cannot be returned so as to avoid a late-filing penalty), then the fact that the Revenue is going to charge penalties in those wider circumstances this year for the first time needs to be recognised as meriting proper communication.
4. One of the biggest issues in the tax profession and businesses is not when the law changes, because all can see clearly when it does so, but when government departments start applying existing law differently and the first that people know about it is when they are in trouble.
5. Our main concerns are that:
  - Changes in quality standards in E10(2005) have not been given adequate prominence to ensure that employers, especially those who think they know what they should be doing, will be aware of changes. The information about the quality standards should be better signposted so that employers cannot help but read it.
  - The information should be highlighted with tinting or sidelines, so that it is clear that it is different from last year, as well as being important.
  - Quality checks guidance should be complete and self-explanatory, so that employers do not have to look elsewhere to obtain an explanation what the points mean.

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- The consultation on the guidance in E10(2005) was illusory. The invitation to comment was circulated late on Friday 26 November 2004 with a deadline for comment the following Monday. We would have welcomed an opportunity to comment on the draft guidance on a considered basis in order to help improve the wording and presentation.
- Quality standards guidelines should be consistent. The guidance in booklet E10(2005) is different from that in February 2005 Employers Bulletin and both are different again from the covering note that comes with paper forms P14 ordered from the Employers Orderline.
- As employers have only six weeks to lodge perfect returns (a deadline that we have previously suggested should be extended) we believe that, unless the Revenue sends back forms containing errors within thirty days of submission it should be prepared to mitigate the late filing penalties that would otherwise be imposed.
- We also consider that employers should have 14 days to correct forms that are returned to them as not meeting quality checks without incurring a late-filing penalty where the form was submitted by the filing deadline.
- We would welcome confirmation that Extra-statutory Concession B46 dated 14 September 1994 relating to automatic penalties still applies.
- Whilst not relevant to paper filers (except such filers who were supposed to efile) we are also concerned about how the default surcharge will operate at a compliance review where appropriate interest and penalty charges are already in point.

## WHO WE ARE

6. The Institute of Chartered Accountants in England and Wales ('ICAEW') is the largest accountancy body in Europe, with more than 128,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.
7. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry through the Accountancy Foundation. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy, including taxation.
8. The Tax Faculty is the focus for tax within the Institute. It is responsible for tax representations on behalf of the Institute as a whole and it also provides various tax services including the monthly newsletter 'TAXline' to more than 11,000 members of the ICAEW who pay an additional subscription.

## DETAILED COMMENTS

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## **Reasonableness of the quality checks guidelines**

9. Some of the guidance is manifestly unreasonable. For example, to place an employer in jeopardy of incurring a penalty of a minimum of £100 but potentially as much as £6,000 (£100 x 12 months x 5 lots of 50 employees – section 98A Taxes Management Act 1970) for failing to remove the sprockets from the form P14 is absurdly harsh.
10. Other guidance is not sufficiently precise to enable employers to be sure of avoiding penalties. We give some examples below.
11. It is stated that ‘the font size of the print should not be too small’. Whilst what the Revenue considers ‘too small’ is explained for those using computers or machines in column 2 on page 8 of E10(2005) under ‘Some dos and don'ts’, there is no cross reference to this from column 2 on page 2. As to handwritten end-of-year returns, is some subjective judgement going to be made about the size and/or quality of individuals’ handwriting?
12. Explanation of ‘the National Insurance contributions boxes on the forms P14 are not fully completed’ will be necessary for some employers. It is also quite possible for an employer who has taken on a new employee towards the close of the year to be legitimately unaware of the National Insurance number, which he may have requested (again perfectly legitimately) from the Revenue itself.
13. On the same point, the phrase ‘the forms P14 do not have a valid entry in ... the National Insurance Number box’ is not helpful without the explanation that the ‘TN’ numbers used are no longer acceptable or a cross-reference to full details elsewhere in the same booklet. Also essential in next year’s guidance booklet is a re-listing of the other national insurance number prefixes that will not be accepted.
14. Given the lack of clear guidance given to employers on NI numbers we consider that it is unreasonable to expect employers filing on paper to rectify this matter in particular at this stage of the year. The year end processing is an additional burden on employers running manual or half computerised systems which puts extreme pressure on them to cope with both the payroll process, running the year end and correcting data that has been accepted in the past but has now been designated as unacceptable.

## **Bringing changes to employers’ attention**

15. Quality checks guidance should be complete and self-explanatory, so that employers do not have to look elsewhere in order to interpret it.
16. Changes in quality standards in E10(2005) have not been given adequate prominence to ensure that employers, especially those who think they know what they should be doing, will be aware of changes. The information about the quality standards should be better

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signposted (eg by way of sidelines or tinting) so clearly demonstrating that column 2 on page 2 is new this year, as well as emphasising its importance.

17. Further, whilst there is some reference to quality checks in booklet E1(2005): 'What's New – Key points for employers', E1(2005) refers only to 'mistakes'. 'Mistakes' implies a reference to content rather than presentation. We consider that most people are unlikely to consider the items listed in column 2 of page 2 in E10(2005) to be 'mistakes' (which covers matters like ensuring that the figures are correct).
18. We consider that employers are entitled to expect that instructions such as these, which if not followed may cost them money, are conveyed honestly and openly.

## **Consistency and accessibility**

19. Quality standards guidelines should be consistent. Those in booklet E10(2005) are different from those given in February 2005 Employers Bulletin and the covering note that comes with forms P35 and P14 ordered from the Employers Orderline.

## **Supplementary forms P35**

20. We understand from Computer Users Notes (which are for developers of software, not individual employer paper filers) that any supplementary P35 submitted for 2004/05 will be taken to signify that the first return was negligently incorrect/incomplete and will be penalised accordingly. We would welcome confirmation of whether this understanding is correct. If it does apply to returns filed on paper, then we should be grateful to be advised where in booklets E10-E13 this is stated.
21. The use of a supplementary P35 by those who are going to continue to file wholly on paper is a widespread and nationally-accepted practice, and if the Revenue intend to withdraw this facility then this change in policy should be clearly notified to affected employers.

## **Time limits**

22. We would welcome confirmation that Extra-statutory Concession ('ESC') B46 issued on 14 September 1995 remains in force, despite the note in Employers Bulletin 19 of February 2005 announcing a change in Revenue 'process' and stating that the employer's annual return is due by 19 May and if it is received late a penalty '**will**' be applied. (Our representative on the employers umbrella group consultative committee has already contacted you in this regard.)
23. As to returns that the Revenue considers to be incomplete, we recommend that the Revenue adopts the same procedure as that for personal tax returns, whereby if the Revenue believes that the return is incomplete, it is sent back to the taxpayer who then has 14 days to rectify it without a penalty being imposed where it was submitted by the deadline for filing, ie as extended by ESC B46. This would be reasonable, given that personal tax returns have a longer completion period and are not subjected to such rigorous checks.

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24. There is a view that, once the filing deadline has passed, the Inland Revenue has every incentive to delay the return of unacceptable P35s since the late-filing penalty is monthly-gear for 12 months. It is unacceptable to impose a penalty that is in part calculated by reference to the Revenue's delay in processing the return, regardless of when it is submitted.
25. We would therefore welcome an undertaking from the Revenue that it will send back to employers for correction without undue delay after filing returns that do not meet the Quality Checks in E10 or requirements listed in other Revenue publications. We suggest that a time limit of thirty days is appropriate for the Revenue to check forms and send them back to employers for correction, with any time-gear penalty being mitigated or completely eliminated appropriately if the time limit is not met by the Revenue. Thirty days is a standard time limit with which the Revenue is familiar, and in conjunction with the fourteen-day time limit recommended above, gives employers a chance to return completed forms in time to avoid or mitigate a penalty.
26. The final paragraph in column 2 of page 2 of E10 suggests that returns will be checked for acceptability at two separate stages. This implies that there are two opportunities for the Revenue to reject a return. We believe that the first check should be conclusive for penalty purposes and any later supposed faults should be dealt with in-house by the Revenue without the employer being at risk of any penalty arising solely from the discovery of those faults.

## **Imposition of penalties**

27. As a corollary of the above point, we would welcome clarification of the way in which the Revenue's handling of paper returns which do not meet the Quality Checks will impact on the imposition of penalties. E10(2005) is silent on the point.
28. For example, if a numerically-correct P14 with its full complement of, say, three P14s is submitted on 13 April 2005, but one P14 carries a 'TN' National Insurance number, will this be returned by, say, the end of April so that there is reasonable chance that the employer may have the opportunity to resubmit it in time to avoid a late filing penalty? Or will it be held back either by pressure of work in a particular local office or official procedures so that it is received by the employer at such a date, possibly after the filing deadline, by which time a late filing penalty is inevitable?
29. As another example, if a P35 and its full set of P14s which does not meet the Quality Checks, Dos and Don'ts and other requirements listed in E10(2005) is submitted on 12 May, what steps will the Revenue take to enable the employer to avoid a late filing penalty?
30. We would also welcome confirmation of whether a default surcharge will be levied where items that should be on form P11 are returned on form P11D and vice versa.

## **Proportionality of penalty**

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31. We question whether it is proportional to impose a penalty running into hundreds of pounds if not more because on one form the figures have strayed outside of the box, are too faint or too small.

## **Consultation with employer representatives**

32. We consider that it was unhelpful that the timeframe of the consultation with employers' representatives concerning E10(2005), some of the information in which will be new to employers and is not explained clearly enough to ensure that employers who do try to comply know exactly what they are required to do, was so short as to make the exercise illusory. The invitation to comment on draft E10(2005) was emailed to employer representatives on Friday 26 November 2004 timed at 17.25hrs with the deadline for comment the following Monday 29 November. Even taking into account that it was not a formal consultation, it was well outside the standards of the Cabinet Office code of practice.
33. Whilst we acknowledge that even meaningful consultation may not have resulted in any changes to the requirements themselves, it would have provided more time for consideration to be given to how the Quality Check guidance might best be drawn to the attention of employers.

## **The scale of potential problems**

34. Approximately one million PAYE Schemes, ie one million forms P35 (c.80% of all forms P35), for which forms will be filed other than electronically will be affected by the above. We understand that the e-filing gateway will not be live and available for testing outside the Revenue before 6 April. There is the possibility that the failure of the Revenue's online self-assessment IT system around the 31 January 2005 filing deadline will replicate itself in the employers' end-of-year return IT system around 19 May. Employers are aware of this, which means that the number of employers who might have efiled voluntarily in order to receive the financial incentive is likely to be less than it might otherwise have been, in which case the number of Schemes which will be filed on paper may be higher than the one million that we have so far estimated.
35. It would be helpful if the Revenue would accept responsibility for the continued availability and efficacy of the IT system which taxpayers are required to use, and that any failure of that system which prevents employers from meeting the time limits imposed by law will be recognised by a waiver or mitigation of any penalties arising, and confirm that the incentive will be paid to those who have registered to efile but are unable to do so owing to failure of the Revenue's IT system.

## **Default surcharge**

36. We are also concerned about the e-payment default surcharge generally in the light of the item on page 9 of the February 2005 Employers Bulletin (although the only paper filers affected will of course have incurred a penalty for failing to efile in any event, as they will have been notified of their obligation to efile).



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37. It is well known by employers, advisers and the Revenue that the prospect of a PAYE Scheme with 250 or more employees receiving a compliance visit where the Revenue auditor does not find an underpayment of PAYE/NIC arising is virtually nil. This is due to the complexities of the system imposed upon employers, with which even the most compliant have difficulty in understanding fully.
38. When the default surcharge was introduced the emphasis was very much on payment 'in time' rather than 'in full'. The Employers Bulletin article acknowledges that small late payments will not trigger a default surcharge. However, it says nothing about what is a small payment nor how relatively minor defaults, for example in respect of reimbursements, will be treated if in fact reported on form P11D (not unknown in practice).
39. Nor does it say anything about how, if a default is identified on Revenue review, the default surcharge will be applied in the context of any other penalty.
40. The implication of the Employers Bulletin article is that where an underpayment arises of a kind that is an accumulation of the same error in every month over six years, there will be (once the default surcharge has been in force long-term) an instant surcharge on the employer for most of the six-year period, as well as the existing interest charge at punitive rates and 100% penalty. The default surcharge alone could reach 53.87% and eventually 59.76% (Table 8, Regulation 203, Income Tax (PAYE) Regulations 2003, SI 2003/2682). Whilst both penalties are mitigable, one is referable to the underpayment while the surcharge is referable to the net liability for the year and could be a very significant percentage.
41. We would be glad to receive your confirmation that the Revenue does not intend to apply the default surcharge to standard compliance work that is subject to a contract settlement following a compliance review.

## The wider picture

42. More fundamentally, the requirements set out in this year's E10 raise worrying concerns about the merger on 1 April 1999 between the Revenue and the Contributions Agency and do not bode well for the merger with Customs. The reasons for the Revenue/Contributions Agency merger were stated to be to:
- reduce the burdens on businesses and people;
  - share experience, knowledge and skills in combating avoidance and make better use of resources;
  - enable a more joined-up approach to customer service; and
  - achieve a gradual alignment of the tax and NIC rules.
43. In six years, any advantages of the merger accruing to employers have been nugatory. For example, we continue to believe, and have made representations several times accordingly, that the National Insurance boxes 1b and 1c could easily be combined into one. By creating an extra box, there is more for employers to get wrong, and thereby more chance of the Revenue retuning a form after the deadline so that a late filing penalty may be incurred.



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44. Another requirement that unnecessarily continues post-Contributions Agency/Revenue merger is the need for employers to submit two copies of P14. Pre-merger, when there were two Departments, it was perhaps not unreasonable to expect employers to submit one P14 for the then Contributions Agency in respect of NIC and another for the Revenue for tax. For the past six years both tax and NIC have been dealt with by a single organisation but still employers are obliged to submit two forms P14 (and incur penalties if not submitted in the 'right' way). We would welcome clarification of why two copies of form P14 are still required, when only one copy of form P46 is now needed owing to the combining of tax and NIC processes.

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