



## ICAEW TAX FACULTY REPRESENTATION

### TAXREP 36/10

### IMPROVING THE OPERATION OF PAY AS YOU EARN (PAYE)

*Comments submitted on 23 September 2010 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales in response to the consultation document issued on 27 July 2010 by HM Revenue & Customs.*

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# IMPROVING THE OPERATION OF PAY AS YOU EARN (PAYE)

## INTRODUCTION

1. In this document we present the response of the Tax Faculty of the Institute of Chartered Accountants in England and Wales (ICAEW) to the above-named consultation document (condoc) published by HM Revenue & Customs (HMRC) on 27 July 2010 at [http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?\\_nfpb=true&\\_pageLabel=pageLibrary\\_ConsultationDocuments&propertyType=document&columns=1&id=HMCE\\_PROD1\\_030623](http://customs.hmrc.gov.uk/channelsPortalWebApp/channelsPortalWebApp.portal?_nfpb=true&_pageLabel=pageLibrary_ConsultationDocuments&propertyType=document&columns=1&id=HMCE_PROD1_030623).
2. We are pleased to have the opportunity to respond to this consultation. 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 the 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. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the Institute provides leadership and practical support to over 134,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 775,000 members worldwide.
5. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The ICAEW ensures these skills are constantly developed, recognised and valued.
6. The Tax Faculty is the focus for tax within the ICAEW. It is responsible for technical tax submissions on behalf of the ICAEW 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, and a free weekly newswire.

## MAIN POINTS

7. We welcome the opportunity to comment on the proposals in the condoc, although we believe that this important issue warranted a longer consultation period.
8. We think that this consultation has to be taken on two different levels, first as blue sky thinking and secondly on the basis of what is practical in the world as it is.
9. We believe that HMRC should consider how it can improve the tax system generally and the operation of the PAYE system particularly. As blue sky thinking, the ideas in the condoc are in our view worth considering as part of trying to help PAYE better to do its job of getting tax and NIC calculations more or less right in year.
10. However, in the real world and given recent events, we have serious concerns about the ability of HMRC currently to deliver even on its existing commitments, let alone on what is proposed in the condoc. We believe that the department should concentrate on rectifying existing problems and

ensuring that systems work properly, with minimal error rates, before introducing further radical changes.

11. We can see the attraction of Real Time Information (RTI) to government as it would provide information that would enable HMRC to monitor on an ongoing basis whether the correct PAYE/NIC has been paid on time, whether the national minimum wage has been paid and any changes in hours worked by tax credit claimants. There are also potentially positive implications for reducing fraud and error across the tax and benefit systems.
12. We can see some potential advantages in the administration of the tax credits and benefits systems of RTI, but only if these currently separate IT systems are linked. That of course poses the question of cost and would also require the integration of these systems, a process that would require considerable care and resource.
13. Assuming that the Government decides to proceed with a full roll out of the National Employment Savings Trust (NEST), we can see administrative savings for employers whose employees will be in NEST if they could, at the same time as providing payroll information, give HMRC details of NEST contributions and, at the same time as paying over the tax and NIC, remit the NEST contributions to HMRC for passing over to NEST for investing in employees' NEST accounts. HMRC offering a one-stop shop on behalf of NEST would be a good example of joined-up government.
14. We think that the costs of implementing RTI would be high for both employers and HMRC, as would be the ongoing costs to employers of making, and to HMRC of processing, up to 53 returns per year for 60 million employees (employee in this response covers anyone paid via a payroll, eg employees, company officers, pensioners and annuitants) and, we assume, reconciling them each time new information is received. The burden would be greater for those employers with weekly-paid employees or employees who are not paid via BACS (eg working overseas or paid cash) and employers who do not have computerised payrolls and so will be expected to transcribe the information into electronic format for RTI transmission. Providing details of hours worked would be an additional burden for employers and in many cases a significant one. We wonder what the associated Impact Assessment would have estimated these costs to be?
15. It should be borne in mind that RTI will be merely a means of getting information from employers to HMRC; it is HMRC's NIC and PAYE Service ('NPS') that is the 'engine house' of PAYE and which stores and processes the information.
16. If it were decided to proceed with RTI, its introduction should not happen until:
  - HMRC has got NPS to work properly and has cleansed and reconciled all the data it holds and it can consistently produce accurate code numbers and timeous year-end reconciliations;
  - online filing of forms can be done easily by all employers and all data on forms submitted by employers, eg forms P45, P46, P14/P35 and P11D, is processed quickly and accurately by HMRC

and then only on the basis of RTI complying with the recommendations in Lord Carter's reports published in November 2001 '*Review of payroll services*' and March 2006 '*Review of HMRC online services*', in particular having been successfully capacity tested at least a year before implementation, and RTI being a two way street, that is to say, providing correct code numbers in real time to employers, employees and agents.

17. The optimal solution may rest simply in ensuring that the present system works properly as described in the two bullets in the previous paragraph and HMRC better encouraging employers and employees promptly to complete and submit in-year leavers and joiners forms P45 and P46.
18. Turning to Centralised Deductions (CD), we cannot see this as a practical proposition.

19. CD would involve HMRC itself running payrolls for in the region of 60 million employees. Employers would have to send information and money (we should welcome clarification of how and when secondary NIC would be accounted for) to HMRC well before present deadlines which would impose a cash flow disadvantage on employers – but would grant an equal and opposite cash flow advantage to the exchequer, so we can appreciate the superficial attraction of CD to government.
20. Leaving aside the cost to HMRC of setting up CD, including writing and capacity testing the software, buying and running the computers, and, once it is up and running, doing the calculations, distributing pay and payslips to employees by their normal paydays and reports to employers accounting for the monies that they have remitted, having adequate staff to enable speedy manual intervention where necessary and answer queries from employees which would formerly have been handled by employers, we think that the implications of systems error or failure on a computer database catering for 60 million taxpayers is a risk that the government should not countenance.
21. In the light of the foregoing and as the private sector has been administering payrolls without serious error or failure for the most part since before PAYE was introduced, we cannot see any case for changing the arrangement whereby employers, or on their behalf payroll bureaux and/or advisers, undertake this work. We therefore think that CD should not be considered further in the foreseeable future, unless HMRC can explain how the system could be operated and run without the risks identified in paragraph 20. On the information provided, we cannot see that this is possible.

## **COMMENTS AND ANSWERS TO SPECIFIC QUESTIONS**

### ***Chapter 2 Executive Summary***

22. Paras 2.1 and 2.2 say that the Government's objectives in considering changes to PAYE are to:
  - improve competitiveness;
  - reduce costs;
  - improve service levels; and
  - ensure accurate tax deductions.
23. We support these objectives but they can only be achieved;
  - when the new NIC and PAYE Service (NPS) is working as intended;
  - if the data received from employers and inputted is all 'clean';
  - if the data can all be matched up to the right taxpayer and employer on NPS;
  - if data received from employers is processed quickly by HMRC; and
  - if the data is processed using defaults appropriate to the individual taxpayer.
24. On the basis of recent events and bearing in mind the fact that employer-provided information in some cases is not able to be input without amendment, we are not confident that employers being obliged to get information to HMRC earlier under the real time information proposals will on its own achieve these objectives, and even less convinced that that an HMRC-run centralised deduction system would be sufficiently robust, and therefore in accordance with principles laid down by Lord Carter in his reports of November 2001 and March 2006, not to expose the Government to the risk of a national payroll failure.
25. However, we do believe that RTI could have advantages for HMRC and for taxpayers as a whole, as it would enable HMRC better to ascertain whether employers have paid PAYE/NIC on time and employers having to state the number of hours worked will enable HMRC better to monitor national

minimum wage (NMW) and whether the hours worked by tax credit claimants breaches a threshold. There are also positive implications for reducing fraud and error across the tax and benefit systems.

26. However, RTI will not solve the problems that face HMRC as it is simply a means of getting employers to provide more information to HMRC more quickly than at present, tied to when employees (including pensioners) are paid, whether it be annually, half-yearly, quarterly, monthly, four-weekly, fortnightly, weekly or ad hoc. NPS is the 'engine house' of PAYE which processes the information and it is essential to get NPS working as intended before resources are diverted to setting up a yet another new computer system to increase inflows of information to a system that seems unable to cope with the present flows.
27. Para 2.7 proposes four advantages arising from RTI. Regarding the first proposition that the P45/P46 procedure could be removed, we question this as the P45 and P46 have additional functions aimed at leavers and new employees, for example on both forms boxes for student loans and on P45 the code number and on P46 the questions relating to 'your present circumstances' which enable the new employer to determine what code number to use in the absence of a P45. If it is intended that the code number for employers to use for new employees should be a standard code number, or if P45 is abolished one of the answers arrived at by using the same questions as on P46 which will presumably be in a checklist that employers will be expected to follow in the absence of form P46, then the tax deduction for the first pay period – is always likely to be wrong which will render inaccurate the tax calculations for those who change jobs frequently.
28. The fourth bullet in para 2.7 says that uncertainty will be reduced for tax credit claimants. We acknowledge that RTI will provide information on hours worked which should enable HMRC to monitor when tax credit claimants breach one of the 16 or 30 hours worked thresholds, but should welcome clarification of how uncertainty can be reduced to any great extent in practice given that tax credits seem to be administered in isolation from the income tax side, added to which awards are based on total income not just earnings subject to PAYE and are governed by rules specific to tax credits, and deductions allowable for tax credit purposes, such as gift aid, are not reflected in payrolls.
29. Para 2.8 says rightly that 'in the longer term PAYE could be improved ... if calculations could be made more accurately'. This is the crux of the matter. Many inaccuracies are not the fault of PAYE per se but are caused by external factors or administrative inefficiencies including dirty data having been brought forward from the previous databases. Also, tax law does not always enable PAYE correctly to calculate in-year the tax due, for example tapered age allowance and personal allowance for those earning just over £100,000: in order to improve PAYE accuracy such rules would need to be removed from the statute book. Also, code numbers may be wrong because they are based on inappropriate defaults for individual taxpayers; for example some taxpayers like non-PAYE income coded out whereas others prefer to pay the tax as a lump sum, or benefits-in-kind information, such as in forms P11D, has not been processed.

### **Chapter 3 PAYE today**

30. We note para 3.3 which says that checks that correct deductions have been made can only be carried out annually and in-year adjustments to codes have to be based on estimated income. We should welcome clarification of how RTI will remedy the second of these shortcomings given that RTI will provide details only of employment earnings, not other income and deductions for business expenses and other allowable outgoings such as gift aid, and certain tax rules, for example tapered personal allowances, mean that the tax liability can be determined only after the tax year has ended. If this proposal is to be considered further, simplification of the tax and NICs system would be required.
31. We note para 3.4 and understand that the Student Loans Company offers a facility to those who are expected to repay their student loans within a couple of years to repay by direct debit

instalments rather than through PAYE. This facility was introduced so that over-repayments of loans could be prevented. If this facility is taken up, there is minimal risk of student loan over-repayments. Furthermore, it should be noted that for the proposed PAYE changes to prevent overpayments, HMRC would need to notify the Student Loans Company promptly about payments received from borrowers. The Student Loans Company would then have to provide information to HMRC about borrowings and interest charges. There is currently no mechanism for doing this and new legislation and systems would need to be introduced to deal with such arrangements.

32. Working Pattern Changes in paras 3.7-3.9: it is our understanding that NPS was intended to deal with changes in working patterns provided employers comply with regulations requiring them to submit forms P45 and P46 and provided HMRC processes such information correctly. As RTI is only a means of passing information, we fail to see how RTI will change this.
33. In para 3.9, we agree with the statement that ‘...PAYE works well for a large majority of people...’. We therefore question the need for wholesale change for the majority to cater for the minority of cases where PAYE does not work so well. Where there are problems caused by pensioners with multiple sources of income and by student work patterns (para 3.7), or agency workers (para 3.11), then we suggest that HMRC should work on making PAYE work for these groups, perhaps having flat-rate tax codes with a mini tax return at the year end (in saying this we are not advocating universal self assessment). We appreciate that this would involve the employer identifying that a person did have more than one source of income in the tax year, and this has its own difficulties. Many problems with pensioners (and those earning just over £100,000) are caused by the tapered age (and personal) allowances. Removal of tapering would should help to improve the accuracy of PAYE processing in those circumstances, although multiple/part-time employments etc would remain problem areas.
34. Para 3.14 says that ‘information is ... processed ... in fractions of a second...’. We would note only that the P14/P35 statistics that we have been provided with by HMRC show that since 2004/05 an average of around half a percent have not been processed. This may appear a small number but, in a population of 60 million P14s, it represents 300,000 people whose income tax position has not been reconciled and whose state pension contributions may be deficient. Quicker and more frequent provision of information will not improve the PAYE system unless processing times are improved.

#### ***Chapter 4 A possible next stage in the evolution of PAYE***

35. Para 4.3 says that ‘HMRC has developed an option’. On the basis of the condoc, it seems to us that this is more a concept for discussion than any developed plan, and it seems to us that it needs extensive work before it can be turned into reality. We welcome the fact that HMRC has exposed this option for comment at this early stage.
36. Para 4.3 suggest that suggests that RTI will enable the PAYE system to cope better and reduce the number of people needing an adjustment to their tax position at the year end. Please clarify how simply getting information to HMRC earlier will achieve this. The main information that HMRC needs relates to leavers and joiners – who are covered by forms P45/P46 which should be submitted around the final/first payday for leavers/joiners respectively. If they are not, then HMRC should enforce deadlines for submission. Sometimes it is difficult to get employees to sign the P46 and perhaps there is scope here for HMRC to incentivise employees to return the form quickly. Getting NPS to work as intended is the best way to enable PAYE to cope better – and this requires the data on the system to be clean and information submitted by employers to be processed quickly by HMRC. Also, and as referred to earlier, eliminating tax rules that require income to be estimated, for example tapered age and personal allowances, would also enable the PAYE system to cope better, and make the tax system more understandable for everyone.
37. Paras 4.6-4.9 cover ‘How it could work’. As HMRC’s systems currently fail to cope with some of the demands of a paper-based reporting system, it is difficult to see how the RTI will be practicable. For example, the proposed system includes a requirement to provide information with every

payment about the payee's identity as well as pay and deductions. This will require a unique employee identifier, which is currently the employee's NI number (NINO). HMRC's own experience, and the experience of its predecessor Contributions Agency, should suggest that using NINOs causes problems. There are millions of non-matching items in NPS because employee NINOs are missing or incorrect.

38. Where an employee who does not have a NINO starts a new employment, the employer currently submits a NINO trace application to HMRC, which can take weeks to process. Where employers operate a weekly payroll, or a daily payroll for casual workers, for this process to work in will need to be permanently available and instantaneous in operation. The employer needs to be able to access the NINO (or other future employee identifier) while the new employee is present, in case of queries or the need for extra identifying information.
39. In the case of a newly-arrived foreign worker, the system breaks down completely, because it takes weeks or months for a NINO to be issued by HMRC. Legitimate HMRC concerns about personal data security, and the correct identification of the worker before issuing the key to accessing the UK social security system, will stand in the way of any speedy resolution of this problem. In the case of foreign casual workers, the worker might have worked for a dozen or more different employers by the time the NINO is even issued.
40. HMRC will also need to find a solution to personal data security constraints. A contact centre employee will not talk to anyone but the employee concerned about his or her tax affairs unless a 64-8 authority has been received and logged on the system. These take weeks to process initially and frequently go astray, either in the CAAT office or on the computer system. Against that background, we should welcome clarification of how HMRC proposes to deal with employer queries about employees' tax affairs in real-time without creating a big security loophole.
41. Two employee types that are likely to cause greatest difficulties are expatriates and casuals.
42. Many workers sent overseas remain subject to PAYE, because they do not necessarily cease to be resident while working overseas for long periods, but they are paid by credit to a foreign bank account and not necessarily in sterling. The new system will need to be able to cope with e-payment to a non-UK account.
43. It will also need to be able to cope with the possibility that the expatriate is also subject to payroll deductions in the host country, with or without a double tax credit, and the additional or alternative possibility that the employee becomes liable to a foreign social security regime. If that regime is within the EEA, it may have to be able to cope with accounting for foreign employer contributions, and remitting the same to the relevant competent EEA authority.
44. Similar considerations will apply to inbound expatriates who fall within the UK tax and/or NIC rules, some of whom will have no obligation to apply for a UK NINO or have a UK bank account. This situation can be handled at the moment because nothing is required to happen in real-time, and the flexibility exists to fix anything that is broken when the paper returns are prepared.
45. Casual workers are usually paid in cash at the end of a shift. We cannot see how the proposed system will cope let alone offer the same flexibility currently afforded by the P38A process, which offers is a pragmatic solution to a practical problem.
46. Para 4.9 deals with those who do not pay employees electronically. This is all very helpful, but being able successfully to transmit electronically the required information on a regular basis does depend on reliable electricity and broadband supplies which are not guaranteed, especially in rural areas. It is not clear how the required information will be able to be transmitted to HMRC when failures occur for reasons beyond the control of the employer and this would need to be taken into account when framing the rules.

47. Paras 4.11 seems to be putting the cart before the horse. Currently, form P45 is needed so that the new employer can apply the correct code. In the absence of P45, the employer has to complete and ask the new employee to sign a form P46 which contains questions about the employee's current circumstances the answers to which are used to determine a suitable temporary code. Either way, the object of these forms is to provide a code that the employer can apply to the new employee's pay.
48. Many employers, particularly of part-time workers, do not issue a P45 to those who leave at the point when they leave, because they may expect the workers to come again in due course looking for more casual or part-time work (pub and restaurant chains are examples where P45s are not always used). However, there is a practical problem for HMRC with this kind of worker, namely, from which employer's wages will the deductions be made? If the system is to offer any advantage over the current regime, it must be able to feed back instantaneously the correct code to each employer of the casual worker.
49. We should welcome clarification of how, if the worker's employers change but no P45 is issued, how will HMRC propose to allocate the correct code without knowing that the worker has left the employment to which the last code was allocated? Unless it is intended that employers will always use a standard code such as BR (or D0 if the employee's pay takes him into higher rate) for new joiners pending receipt of a proper code, employers will always need to ascertain, before calculating the new employee's first pay, the answer to the questions on form P46, or, preferably, be notified of the code number applied in the employee's previous job. If the employer cannot deduct correctly first time, we are no better off than under the current regime, where retrospective corrective action is needed.
50. Para 4.14 suggests that year-end reporting could be substantially reduced. We question whether HMRC will in fact reconcile information continuously on receipt given its resource constraints. Under the present tax system year-end reporting will always be needed because, owing to the time that it sometimes takes for information to reach the payroll department, there are often adjustments that are made in 'Month 13/Week 53' in time for the final payment of tax and NIC for the year on 19 April. This means that the year-end figures may be different from those submitted on the last payday before 6 April.
51. Para 4.16 – We have no direct experience in the area of benefit fraud. While we agree that RTI would allow government to know whether or not a benefit claimant was in work, this depends on accurate identity codes being in existence (see our point about NINOs above), and on the system being able to work effectively for casual workers such as pub and restaurant staff. Of course, RTI would also not deal with ID theft or evasion, such as payment in cash which neither the employer nor the employee plan to disclose.
52. The idea of keeping up to date earnings information for the compliant claimant population, sharing it across relevant departments and adjusting benefit entitlements accordingly is very attractive. If the new system could be made to work as envisaged, it would certainly simplify and speed up the adjustments needed for changes in employment earnings. However, adjustments would still be made in arrears and could even become more frequent, which we suspect is likely to require more HMRC or DWP staff time than the current regime, and the gains would be limited to employment income notification, which is only part of the benefit adjustment requirement.
53. Paras 4.16 to 4.21 assume that the benefits and PAYE systems interact with one another. At present they do not, either in concept, ie their rules, or administratively, eg having linked computer systems. The government has said that it intends radically to reform the benefits system. As an aspiration, being able to obtain information about claimants' means on a more current basis should enable benefits to be targeted where they are needed. However, claimants do need to be able to budget for their outgoings, and benefits that change on, say, a weekly or monthly basis depending on income figures for a previous week or month have the potential to create much hardship.

54. In para 4.23 the use of current information to trigger the issue of a stop notice for those who have repaid their student loans is very attractive, but the problem could be addressed much more simply by moving those graduates who have repaid 80% or 90% of their loan via payroll at the tax year-end onto a direct debit regime operated by the SLC for the balance. As noted above in our comment on para 3.4, a suitable arrangement is already in place and we suggest it be more widely publicised.
55. Para 4.24 suggests that leaving and joiner arrangements will be able to be streamlined. We are not convinced that this would be the case – please see our comments on para 4.11.
56. Para 4.25 refers to employers who are not using computerised payroll. As noted above, they would have to spend time transcribing payroll information onto RTI input.
57. Para 4.26 refers to employers changing how they pay over the money that they have deducted. We should welcome confirmation that this does not imply that employers will have pay over the deductions on the relevant paydays but simply refers to the fact that with RTI, HMRC would be able to ensure that employees have paid over all tax, NIC and student loan repayments, as reduced by statutory payments, by the due dates of 19<sup>th</sup> or 22<sup>nd</sup> of the month. We should mention that paydays can be weekly, fortnightly, monthly, quarterly, bi-annually, yearly, or even ad hoc, and having to pay over the deductions earlier than at present would have adverse cash flow implications for employers (with an equal and opposite cash flow impact on the exchequer). Also, would HMRC be able to reconcile in real time what is paid to what is supposed to have been paid?
58. Paras 4.27 and 4.28 refer to the need to enhance payroll software and BACS. This will incur costs which together with the impact on the various affected parties, eg HMRC, employers, etc, need to be quantified, at least by way of estimates.
59. Para 4.30 refers to HMRC's operating costs reducing following streamlining of the processes for people leaving and joining jobs. Our understanding is that compulsory online filing of forms P45 and P46 is intended to achieve this end – we assume that such online filed forms are processed automatically onto NPS – and we should welcome clarification, or otherwise, that our understanding is correct.
60. Similarly para 4.31 also suggests that there is potential for streamlining the end-of-year reconciliation process. Again we had understood that NPS is supposed to streamline these reconciliations so, leaving aside the fact that information will arrive much earlier with RTI, we should would welcome clarification as to how RTI will streamline end-of-year reconciliations.
61. In the third bullet of 4.31 and in para 4.32, we welcome the fact that slow-paying employers will be able to be spotted by HMRC, but this alone is not sufficient to justify RTI.

*HMRC would welcome views on the concept of Real Time Information, whether it would support the collection of tax through the PAYE system and the issues that would need to be addressed in putting it into effect.*

62. RTI is unlikely to be realisable without a very significant increase in investment in systems and staff. NPS needs to be allowed to work properly first and HMRC needs to process promptly and accurately information submitted to it (see elsewhere in this document). Employers currently make an annual return of pay and an annual return of benefits, and it takes HMRC an unnecessarily long time process the information provided, despite its already having been submitted electronically for 90%-plus of the workforce and pensioner population for the past few years.
63. Requiring period returns of pay and tax every pay period would increase that workload manifold. We would have thought that an annual return will still be needed to include Month 13/Week 53 adjustments.

64. RTI does not address elements that cause the problem of incorrect deductions, such as varying P11D benefits and varying estimated amounts of non-employment income that are currently coded out. These will continue to lead to under- and over-payments, however sophisticated the proposed IT systems.
65. RTI will not solve the problem of excessive NIC deductions for those in multiple employments. That would require wholesale reform of the NIC rules away from an earnings-period basis to a cumulative annual basis, which would in turn suggest a wholesale reform of the allocation of the Class 1 earnings threshold between employers, the abolition of contracting out, and a fundamental reform of the contributory benefits regime.
66. Making per pay period returns instead of a single annual return increases the number of opportunities for employers – and HMRC – to make mistakes that require manual intervention and corrective action. Employers will inevitably make some mistakes during the year, but these will get corrected before the submission of the annual return. RTI could increase the time and costs incurred in correcting mistakes which would have been rectified by the employer without the need for HMRC to become involved.
67. There will always be recalcitrant and poorly organised employers, whatever level of penalty for non-compliance may be set. HMRC currently does not appear to have the resources to police such employers once a year, so we do not see how they could police up to 53 late or incorrect returns without considerable extra resources to effect a fundamental change to the way it conducts its compliance operations.
68. Despite e-filing having been part of the tax system for a number of years by now, online submission of data does not guarantee simplicity, freedom from error or even confidence that the data has been processed. Returns filed online on time this year have been promptly e-acknowledged by HMRC's system, only to be followed by the issue of penalty notices for late filing of those same returns. The year-end reconciliation forms 800 recently issued show that some underpayments which arise from employer P11D data have not been processed. Until HMRC's systems, electronic and clerical, are robust, RTI is more likely to generate more work and reduce efficiency, thereby damaging the relations between employers, their agents and HMRC.
69. Making the current e-filing system and NPS operate efficiently, with no digital problems and an acceptable clerical error rate, is in our opinion a prerequisite for any further development towards RTI. One of the major problems identified in the condoc (para 3.10) is the incorrect or delayed use of P45 and P46 information, but employers of 50 or more employees started to file these online on a mandatory basis only in 2010, and small employers will be compelled to do so from 2011. Assuming adequate HMRC resource is allocated to dealing with the improved and prompt information flow, the scale of the PAYE problems stemming from the leavers and joiners should reduce. The current system, for now, needs stability and resource, and time to work, not fundamental reform.
70. RTI is in principle a desirable goal. If and when the current systems have been demonstrated to work, HMRC might wish to develop RTI. However, any move to RTI will need to be done incrementally and over an extended period to allow time for the systems to be properly developed, thoroughly tested and any teething problems fixed in accordance with the Carter principles.

*HMRC would like to engage with employers, payroll software providers and payroll bureaux to discuss how it would affect them and the likely costs to them and benefits that it might bring.*

71. If it is decided to continue with RTI then we are happy to engage and be involved in further consultations as how the system might be made to work.

*HMRC would particularly like to understand how the system might be constructed to simplify the process for employers.*

72. Again if RTI is to be developed we should be happy to help HMRC with this.

*HMRC is interested to understand whether Real Time Information would offer a more cost effective means of collecting the tax and NIC deducted by employers.*

73. Our understanding of RTI is that it is a means of transmitting information to HMRC rather than a means of payment, so we do not see how it could be more cost effective unless the suggestion is that employers should pay over the tax and NIC on the employees' payday rather than on 19<sup>th</sup>/22<sup>nd</sup> as presently. If so, this would have cash flow implications that have not been addressed. We would welcome clarification.

*Annex A sets out the information that HMRC would need to be transmitted with each payment to an individual. HMRC would be interested in views as to how easy it would be to provide this information.*

74. Most of the information is already on payrolls or we anticipate should be able to be ascertained without too much difficulty once employers put in place procedures to collect the data.
75. Employee pension scheme contributions may cause difficulties. It will be necessary to distinguish between contributions paid gross and net. We assume that this is not intended to include pension contributions not paid to the employers' schemes, about which employers will have no information.
76. We should welcome clarification of what is meant by 'Third party payments' – if they are payments made by third parties, we are unsure how the employer will get to know about them, unless they are by arrangement with the employer (PAYE Regs, reg 86(1)(b) and (4)).

*Following the introduction of Real Time Information HMRC would look to simplify processes in a measured fashion to ensure that employers and HMRC's systems were not overloaded. HMRC would be interested in employers views on which processes should be simplified first.*

77. There needs to be a means whereby employers can liaise easily with HMRC when an employee's code is incorrect. At present, HMRC cite security as a reason to make it almost impossible for an employer to get HMRC to correct an employee's code even if it is obviously wrong. An easier way needs to be found.
78. As has been noted in other forums, completing P11D is an acknowledged burden on employers. This is because the rules governing tax and NIC on benefits-in-kind are not always simple and may not be consistent between tax and NIC. Simplification of those rules would simplify this end-of-year P11D process.

### **Chapter 5 An option for exploiting Real Time Information**

*HMRC would welcome views on the "Centralised Deduction" concept, the assumptions made about its benefits to all parties involved in the operation of PAYE and the issues it would raise and how they might be addressed.*

79. In our view, CD should not be pursued further. We think that the potential for error or failure on the part of HMRC's systems makes it too risky for government via HMRC to take on the processing of 60,000,000 employees. Employees are the responsibility of employers, and payroll is an integral part of the business and must be 100% robust. HMRC's employer IT record and customer service levels in recent years do not provide the level of confidence that business needs to entrust payroll to HMRC.
80. The processes proposed for a centralised deductions regime are not entirely clear from the document, but in any event it seems clear that the process envisaged will not be trusted by employers or employees, as payroll is a business-critical process that cannot afford to go wrong.

81. Payroll operation is not simply a matter of inputting numbers into a computer once a week or once a month and watching the computer generate payslips and remittances. If payroll were that simple, we would not have seen the development of a payroll profession.
82. We doubt that HMRC could cope with the proposed system. All the evidence suggests that HMRC is struggling to handle its current information flows to an acceptable timescale. It is essential that payroll processing is accurate and timely. It may be possible in time to manage basic operation of CD to an acceptable quality level, but exceptions have to be handled by people who understand the employees and the business, as well as the tax and NIC rules, and the people in payroll departments across the country have direct personal responsibility for getting things right, an ownership that would be lost in the proposed HMRC model. We respectfully suggest that HMRC is not set up to be a payroll bureau and instead should concentrate on collecting tax and NIC at the right times and in the correct amounts.
83. Given the number of HMRC processing errors experienced by employers, employees and advisers over the last few years, it is doubtful, without evidence of significant improvement in quality of service, whether they would trust HMRC to get such an important process right every time.
84. The proposal outlined in para 5.6 fits the 'plain vanilla' payroll model, but takes no account of the numerous issues that complicate real payroll. For example:
- How would the CD system cope with employees who have no bank account?
  - Or who are paid in cash after each shift?
  - Or payments to employees outside the UK?
  - Or payments to employees from abroad who are on a foreign payroll (and are paid overseas) but subject to UK PAYE?
  - Or employees who change their bank account in mid-month?
  - Or payments made in error by HMRC to the wrong account?
  - If employers are still responsible for SSP, SMP, etc, who will deal with recovery under the small employer relief or percentage threshold scheme rules?
85. How would the proposed system cope with employers' NI contributions? HMRC seem to want employers to send the data and the money and leave HMRC to account for the deductions.
86. How would the system handle employee pension contributions, which might be deducted from pre-tax pay in DB or DC schemes, or from post-tax pay in other DC schemes?
87. The same concerns outlined earlier in relation to real-time information also arise with CD:
- How will the system cope when an employee has a missing or incorrect NINO that takes months to resolve?
  - Where a taxpayer has more than one source, and there is a query on one of those sources, how will the system handle the calculation of the deductions for the other sources in the appropriate timescale?
  - What happens when a worker from the EEA is waiting months for a Form A1 (former E101) from an overseas social security authority to provide evidence of exemption from UK NIC?
  - How would HMRC deal with queries given the current security arrangements for personal data? The 64-8 process does not work well – forms go missing and agent details sometimes disappear unexpectedly. Call centre staff cannot discuss an employee's personal affairs with the employer, so an employee would have to grant some kind of authorisation to every employer for whom he worked, and response times would need to be such that the system would be open to abuse because there would be inadequate time for full security checks on callers. As noted in para 5.18, there is considerable scope for extra, unnecessary work and confusion as to responsibility.

*HMRC is interested in hearing proposals that could deliver a similar or better outcome through a different means to those outlined in this chapter.*

88. Employers have been doing payroll either themselves or outsourcing it to bureaux and advisers since before PAYE was invented without major failure or errors for the most part. We see no case to change something which is not broken.

*HMRC would like to engage with all groups of people who could be affected by this concept to discuss the practical advantages and issues to be addressed.*

89. See above.

### **Chapter 6 Data and Security**

*HMRC would like to hear views on data, resilience and availability issues raised in chapter 6.*

90. Para 6.2 – HMRC would need to hold extra data to be able to operate CD. It currently does not see pension contribution data, but it would need to know about this to calculate PAYE and NICs correctly, since they are dealt with differently in the gross-to-net calculation (and different types of contribution are dealt with differently).
91. Para 6.5 – BACS only works within the UK. Thought needs to be given to how payments are to be made to overseas accounts. Has HMRC consulted the banking industry on the changes potentially needed to BACS to make the plan work, and whether the necessary changes to BACS are compatible with other banking systems that are not related to the UK fiscal system, such as SWIFT?

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23 September 2010

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## 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/index.cfm?route=128518>).

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