



Improving the operation of PAYE

Improving the operation of Pay As You Earn (PAYE), HMRC discussion document published 27 July 2010 Response from the Institute of Directors

14 September 2010

1. We welcome the initiative to seek improvements in PAYE. The system has experienced difficulties recently. Furthermore, as the resources available to HMRC are reduced, it will become ever more important for the PAYE system to collect the right amount of tax from as many taxpayers as possible, rather than to collect amounts that are approximately right, with corrections to be made after the year-end.

Real-time information

2. We agree that there could be significant benefits from introducing real-time information, and we have no objection in principle to doing so. We are however concerned about the potential costs to employers and to payroll bureaux of making changes to computer systems, even though the long-term result may be a reduction in costs. In order to minimise the costs of making changes, it will be essential to give several years' notice of the change, to define the interface precisely when the change is announced, and not to make any changes to that specification in the run-up to the introduction of real-time information. If that happens to limit the tax policy options that are available to Ministers in the run-up to introduction, so be it.
3. One risk is that the increased freedom to reform policy, for example the benefits and tax credits system, will lead to reforms that will impose additional data collection requirements on employers. Any such temptation should be resisted. We do strongly support reform of the benefits and tax credits system, and real-time information could greatly facilitate that reform, but there is no need to impose additional data-collection requirements on employers in order to achieve this.
4. Quite separately from the question of reform, it will be worth reviewing the long list of items in Annex A to see whether any can be dropped, particularly the ones that are not currently included in a P11. Is pay frequency really needed? Can employers be expected to know about all third-party payments, or to know about any of them within the timescale that real-time information would require? Do strike/holiday pay/period really matter for tax purposes?
5. Finally, hours worked would be a considerable nuisance for employers to record, when the hours were not already recorded for some good business reason. We assume that the thought is that tax credits may continue to depend on hours worked. If so, we should first debate whether hours should have that role in the tax credits system. In any case, it would be very helpful if all of the reasons why HMRC might be interested in hours worked could be spelt out in the next round of consultation.
6. Benefits in kind are mentioned. How they fit into the process will of course depend on how much progress is made in payrolling benefits.

Centralised computation

7. The discussion document groups together two things in chapter 5: having computations performed centrally, and having funds flow from employers to a central calculator and then to employees, rather than directly from employers to employees.
8. Centralised computation could take place without centralised deduction. That is, an employer could send data to a centralised calculator, and could receive back a file that would include all of the details that currently appear

on payslips. The employer could then use this file to pay employees, and to pay the appropriate total of deductions to HMRC. Given that there are very strong objections to centralised deduction (the flow of funds via a central calculator), we think that this option of centralised computation without centralised deduction should be seriously considered.

9. In this section of our response, we set out our thoughts on centralised computation. In the next section, we set out our thoughts on the flow of funds.
10. Central calculation could have considerable advantages. As with real-time information, it will be important to define the interface with employers well in advance and to stick to the definition. However, there should be a lower risk of constraining policy options, because changes to policy that changed only the amounts of figures, rather than their presence or absence, would only affect the central calculator, and would not affect employers.
11. We do regard it as essential for employees to continue to have access to all the data they currently have on pay and deductions, and this can most easily be done by providing payslips (perhaps in electronic form, as was introduced for HMRC employees five or six years ago). The views expressed in paragraphs 5.15, 5.17 and 5.18 suggest that employees might not be too bothered, and that they might be happy to rely on HMRC to provide confirmation that everything was correct. This is too complacent. Employees care about their pay, and they will not, and should not, trust HMRC to check that everything is in order. They must have all the facilities they need to make their own checks, entirely independently of HMRC.
12. It is also vital that people see, every payday, just how much of their pay is taken away from them before they even get it. They need to be aware of the burden of taxation.
13. There would have to be an easy fall-back procedure for employers if the data did not arrive from the central calculator on time, or if the file was corrupted. Such a procedure might, for example, involve making the same deductions as in the previous month, subject to safeguards which ensured that deductions were not inappropriately high.

The flow of funds to a central calculator

14. We are implacably opposed to the suggestion that money might flow via a central calculator, instead of flowing directly from employers to employees. The advantages of central computation are available without having funds flow to a central calculator, as noted above. The reasons for our opposition follow.
15. Sooner or later, there would be a slip-up or a systemic problem which would lead to money being paid over by employers, but not reaching employees in full on the due day. The track record of large IT projects shows this. Any claim that special precautions would remove this risk is plainly groundless.
16. When that happened, it would be viewed as theft by the Crown. That might not be an accurate legal characterisation, but that is how it would be seen. The only option would be for the problem to be rectified the very next day, whether or not a business day, even if that meant taking banknotes round to the homes of the affected employees. And there would be entirely justified calls for the immediate dismissal of the Chief Executive of HMRC – the error would be at least as grave as the loss of data discs in 2007. We do not believe that the Government, or HMRC, would wish to get into such an embarrassing position. We cannot emphasise strongly enough that this is not a risk that could be managed away. A failure to pay someone correctly *would happen*, sooner or later.
17. Furthermore, such an incident would not be on a par with a failure to ensure the arrival of tax credits, or a loan to a university student. In those cases, the money involved is to be paid on account of a Government policy decision. With wages in the private sector, the Crown has no involvement in the decision to pay someone, or how much to pay him or her. Any problem would be the result of the Crown's unnecessarily involving itself in a flow of money that was not its business to start with.
18. Lastly, such incidents would greatly damage relations between employers and employees. If an employee is not properly paid, he or she will blame the employer. We do not need damage to employee relations that result from failures in public sector systems.
19. Moving on from failures to pay the right amounts, on time, we have several other objections to the proposal to send funds to a central calculator. We list these in the remaining paragraphs of this response.
20. There is no clarity about the legal status of the central calculator. Would it be a trustee, and if so, for whom (the employer, the employee, HMRC), in respect of which funds, at which times?

21. There is no clarity about how insolvency of the central calculator, while holding funds, would be handled. No doubt steps would be taken to minimise the risk, but we doubt that the risk could be eliminated entirely.
22. A flow of funds to the central calculator would put money under the control of an agent of the Crown before there was any tax liability. A liability only arises once an employee has been paid. Until that point, the Crown and its agents should have no contact with the money.
23. The current cash-flow advantage to employers of not having to pay HMRC until a fortnight after the end of the tax month would be lost. The central calculator could of course pay interest, but at what rate? Some employers use the money to reduce overdraft costs, and would expect a much higher return than those who put the money on deposit. Furthermore, the central calculator could only earn a decent rate of return by putting the money at risk. That risk might not be borne by the employer, but it would increase the risk of insolvency in the central calculator. We appreciate that HMRC may not like the fact that PAYE deductions are currently at risk in employers' businesses until they are paid over, but that is the current deal. And businesses do find real uses for money. Few have idle funds sitting around. This is not to say that a deal to compensate employers for a loss of the benefit to them of the current timing of flows of cash could not be reached. But we must not suppose that this would be a secondary detail, to be sorted out once a policy that would change the flows of cash had been selected.
24. Finally, it may be worth developing thoughts around the idea of having, not a central deduction system but an individual tax-imposing gateway on each person's bank account, that would know about allowances and amounts already received, would detect taxable amounts coming in directly from employers or from payers of interest or dividends (because they would be tagged as such) and would withhold some money. That would address some, but not all, of the concerns that are noted above.

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