



Improving PAYE

How information is collected and managed
in the administration of Income Tax

By Jonathan Graham

Executive Summary

A Report for the All-Party Parliamentary Taxation Group
Chairman Ian Liddell-Grainger, MP

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All-Party Parliamentary Taxation Group

Chairman Ian Liddell-Grainger MP

House of Commons

London

SW1A 0AA

E-mail: liddelli@parliament.uk

To contact the author of this report, e-mail grahamj@parliament.uk.

Foreword

Taxation and taxation administration are areas that are too-often ignored in the public sphere, and yet they play a vital role in the daily lives of every taxpayer and business in the country. It is important that we not lose sight of how important our tax policy is to determining our economic wellbeing and the ability of our government services to function.

The All-Party Parliamentary Taxation Group's new study is the result of months of research and interviews, performed by an independent researcher, to better understand how PAYE functions and what action should be taken to improve it. The All-Party Parliamentary Taxation Group serves no partisan agenda, but is interested in promoting discussion and education on taxation policy in the United Kingdom.

This report is the first part of the All-Party Parliamentary Taxation Group's ongoing investigation in improving the collection of tax revenue in the UK. We hope this study will open the door to a wider public debate about how UK taxation operates, allowing for new ideas to come forward to address old problems.

I would like to thank Financial Secretary to the Treasury Stephen Timms, HM Revenue & Customs officials and a wide range of organizations and companies for their help in providing thoughts and comments to strengthen this report's findings. I encourage you to contact the All-Party Parliamentary Group after reading the report to share your thoughts and remain involved.



Ian Liddell-Grainger MP
Chairman, All-Party Parliamentary Taxation Group

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Executive Summary

Income Tax and National Insurance Contributions (NICs) make up nearly 60 per cent of UK Government revenue, and most of that revenue is collected through the Pay-As-You-Earn (PAYE) system. Employers operate PAYE to withhold the correct amount of tax from an employee's pay, and pay that withheld tax to HM Revenue & Customs (HMRC). Because this withholding system is cumulative, employees do not need to fill in annual tax returns but HMRC needs to ensure it is always withholding the right tax.

Collecting Information From Withholders

Changing demographics in the labour market, such as more volatile employment patterns and more simultaneous income sources, are causing the PAYE system to breakdown. These failures are directly responsible for recent increases in backlogged open cases, which then are held until the manpower is available to manually check the information. There were more than 16 million open cases last year, and a backlog of 20 million, leading to tax debts going unnoticed, increasing administrative costs, lags in processing time and increased error rates. HMRC's new PAYE computer system, NPS, will help with this issue by putting the taxpayer at the centre of the PAYE system for the first time, but there will still be at least 4.5 million open cases annually, 12 per cent of all PAYE cases.

The reason for these open cases are that information about employees does not arrive quick enough in-year and the current taxpayer identifiers are not sufficiently robust. The only major in-year process, the P45 form, is not given to employers immediately in 70 per cent of cases, which leads to the system having to play catch

up to understand who the employee is and what should be withheld from their pay for Income Tax. There are at least 1 million temporary identifiers added each year, used when the key link for PAYE — the National Insurance Number — fails.

More in-year reporting would help PAYE better validate information as it enters employers payroll and better follow taxpayers as they move from employment to employment. But an increase in reporting must both maintain employer compliance costs in operating the PAYE system and maintain HMRC's administrative costs in processing employer information. On the employer side, costs can be maintained through the use of xml or XBRL links with employer payrolls so that their reporting follows business-as-usual practice. For HMRC, it must create systems which limit the amount of clerical action necessary to process employer information, through more robust identifiers and more efficient IT infrastructure.

HMRC has examined utilising the infrastructure of the Bacs Service, taking advantage of its ability to calculate high volumes of transactions while also adding a new taxpayer identifier key, the bank account, improving matching accuracy without increasing compliance costs. As part of that project, HMRC also examined tying the calculation of income tax with the Bacs Service. Bacs processes 20 million transactions daily and is already used by employers each payroll day, offering a ready-made infrastructure on which PAYE improvements can piggyback.

Information and Individual Taxpayers

Stakeholders view HMRC's efforts to reduce HMRC's administrative costs to have resulted in a lessening in service quality, which is the wrong direction for the

organization. As tax systems become more computerised and more distant, it is more vital than ever that taxpayers have as much access and information as possible about how their tax administration functions.

Tax codes are the primary way for PAYE taxpayers to understand their income and how much tax they pay. However, these codes, especially if a taxpayer has more than one income source, are confusing and unclear. With the implementation of NPS, there should be an opportunity to immediately begin sending taxpayers an annual or monthly statement of their account so they might have a better opportunity to both understand their tax obligations and spot small errors before they have a chance to grow into something larger.

Most other OECD countries have made the decision to allow their taxpayers to access their tax information online, trading some elements of security with the need for taxpayers to remain informed. Letting taxpayers see their information online and make adjustments to their details could reduce contact costs by giving taxpayers more day-to-day oversight, and improve accuracy. There must, however, be a secure regime in place to ensure taxpayer security when they access their financial information and it would be best if this log-in were linked to current individual processes, saving taxpayers the difficulty of remembering a number of different user log in for different Government sites. There are significant IT challenges to developing this sort of system which still need to be addressed.

Managing Information

PAYE sits at the centre of much of HMRC's and Government's individual services, providing information which is necessary, for example, to calculate Tax Credits and Benefits. But the information is currently hard to access across Government and basic individual information available to HMRC is not available to DWP and vice versa. Even within HMRC, PAYE information is often unavailable except with difficulty. HMRC has set goals to achieve improvement, but does not appear to have a detailed long-term plan — such as over the next decade — in how it expects to be able to link information and services together in a way that will affect the lives of its individual users.

By better linking up information within HMRC and within Government, it will help meet stakeholder desires for individuals to be able to access a joined-up Government, rather than have to juggle between a Benefits system, a Tax Credits system and an Income Tax system. This was a vision expressed by the Government's Varney Review, but stakeholders are not seeing much progress. The success of programmes like the In-and-Out of Work scheme show there is support both administratively and among service users for more joined-up service, and HMRC should be participating in all such programmes, while it appears that is not the case.

Recommendations

1. HMRC should view NPS as a beginning rather than an end and continue to drive out improvements which are now available with the switch from an employer-based, regional database to an employee-based national one.

2. Utilise payroll-date reporting to cover the shortfalls in in-year reporting from PAYE. However, these increases must include methods of reducing employer compliance burdens by allowing them to increasingly report on a business-as-usual approach, something offered by xml and XBRL software.
3. Improve taxpayer identifiers to decrease the number of PAYE cases which fail to automatically match and require clerical action. HMRC could adapt to a UK-wide, robust identifier if one is implemented, but a better medium-term solution is to utilise bank accounts as an extra identifying piece, while simultaneously limiting employer compliance.
4. Ensure HMRC processing infrastructure can handle the higher volume created by more in-year reporting, either through further improvements to NPS or by utilising the existing Bacs Service infrastructure.
5. Participate in a public discussion of what was previously an internal HMRC discussion about the advantages and disadvantages of performing PAYE calculations through the Bacs Service.
6. Protect support and contact services which taxpayers need to ensure HMRC staff are able to make informed decisions about their tax.
7. Make it a Department goal to provide PAYE taxpayers with their tax information in a readable, understandable form, so that those with multiple incomes and more volatile work patterns can better follow HMRC's tax calculations, as taxpayers would read their bank statements. It would be best if these statements were to be sent out monthly.
8. Create the infrastructure necessary to allow taxpayers to access their tax information online, as occurs in many other countries. If Government Gateway is unable to perform this task, begin planning for an alternative method.

9. The information collected through PAYE must be made better available to HMRC, DWP and the rest of Government. This could potentially be through the creation by a specialised database IT firm of an umbrella database link, allowing for information to be better linked across Government, or through another method, but political will must be placed in this area. There are security concerns to this kind of project which will need to be addressed that this report does not investigate.
10. By allowing PAYE to link to other areas of Government, it will ensure Government services have a wider reach and are more user-friendly. Joining-up data should not be viewed as an end in itself, but focused on the creation of better Government services for taxpayers, many of whom already interact with the PAYE system.