

APPG on Taxation: PAYE Review and Recommendations

By Adam Marks

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

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Any enquiries relating to the copyright in this document should be sent to:

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 marksa@parliament.uk.

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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 second 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 Exchequer Secretary to the Treasury David Gauke, 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.

A handwritten signature in black ink, consisting of a large 'I' followed by a series of loops and a final flourish.

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

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The APPG on Taxation would also like to acknowledge the helpful feedback and evidence provided by the Treasury, the Low Incomes Tax Reform Group, the Chartered Institute of Payroll Professionals, and the Institute of Chartered Accountants in England and Wales on a pre-final draft of this report. Where appropriate, the responses received regarding evidence and statistics have been incorporated in the body of this final version.

All Party Parliamentary Group (APPG) on Taxation: PAYE Review and Recommendations

March 2011

Purpose

1. This paper considers the UK's Pay As You Earn (PAYE) taxation system. It reviews a number of current operational issues; considers their underlying causes; and makes a series of evidence-based recommendations intended to help Her Majesty's Revenue and Customs (HMRC) improve the operational efficiency and quality of PAYE.

Introduction

2. PAYE was introduced over 65 years ago in 1944 in order for the government to collect increased tax revenues¹. It brought many employees and employers into contact with the tax system for the first time. In place of annual or twice-yearly collections, tax was deducted by employers from wages on a weekly or monthly basis. An employee leaving an employer was given a P45 recording his or her code number, pay to date and tax paid to date to pass on to a subsequent employer².
3. The last All Party Parliamentary Group (APPG) on Taxation's report³ on reforming PAYE was published in the summer of 2010. Since that time

¹ <http://www.hmrc.gov.uk/history/taxhis6.htm>

² For more information on the history of PAYE please consult the previous APPG on Taxation report which can be found at <http://www.appgtaxation.org/>.

³ Go to <http://www.appgtaxation.org/> for a full copy of the first report

HMRC has rarely been out of the headlines as a consequence of widely reported problems with the PAYE system. These issues have resulted in the identification of a large number of open cases; increased the amount of citizen interactions with the Department; raised questions about data quality and the Department's approach to information management; and seen a notable decline in public confidence amongst citizens and businesses that HMRC is operating at appropriate levels of quality and efficiency⁴.

Background to this Report

4. According to HMRC there are 30.3 million PAYE taxpayers in the UK today⁵, so any problems affecting PAYE have the potential to impact upon a large number of taxpayers. The Treasury however believes the correct number to be 38m PAYE taxpayers, taking into account those who do not have any tax liability because their earnings are below the personal allowance⁶. Many of the affected taxpayers are understood to be those who have multiple sources of PAYE income and/or frequent changes in employment – typically lower income pensioners and employees. In light of the issues mentioned above, the APPG on Taxation believes that this is an opportune moment to review both the underlying causes and to consider how PAYE could become better adapted to the twenty-first century.

⁴ From written evidence and oral evidence given to the Treasury Sub Committee enquiry into HMRC

⁵ http://www.hmrc.gov.uk/stats/income_tax/liabilities-january2011.pdf

⁶ Email to the APPG's researcher from HM Treasury on a pre-final draft of this report

5. HMRC faces several challenges, including the need to:

- **optimise tax revenues:** this is HMRC's core remit, although last year the tax gap was £42 billion⁷ of which £3.2 billion arose from employers sending in inaccurate PAYE returns⁸
- **identify internal operational savings:** totalling 15% over the next five years⁹
- **implement more efficient and improved processes:** to enable PAYE to operate in a more efficient and automated manner more appropriate to the twenty-first century

6. Over the last few months the APPG on Taxation has engaged with numerous UK experts and other witnesses, and considered best practice from around the world. The identification and analysis of existing problems, and the recommendations to address them contained in this report, arise directly from those discussions.

7. This report explores how to address a range of underlying problems with PAYE in order to enable it to meet twenty-first century needs. The report therefore:

- reviews developments since the last report by the APPG on Taxation;

⁷ <http://www.bbc.co.uk/news/business-11342237>

⁸ <http://www.bbc.co.uk/news/business-11342237>

⁹ http://cdn.hm-treasury.gov.uk/sr2010_pressnotices.pdf

- examines the causes behind the current problems being experienced with the operation of the PAYE system;
- makes some recommendations intended to help resolve existing PAYE and HMRC operational issues

Developments since the last APPG report

8. The last six months have seen considerable changes within HMRC to the systems and processes used to administer PAYE. The most notable is that the National Insurance and PAYE Service (NPS)¹⁰ has started to be used for the purposes of automatically reconciling individuals' tax records for both 2008/09 and 2009/10.
9. NPS allows HMRC to combine the information previously held on various separate internal systems, such as those relating to an individual's employment and pension income, into a single record. The purpose is to enable HMRC to make a more accurate assessment of an individual's overall tax situation and hence reduce the likelihood of over- or under-payments of tax. The consolidation of information should also mean that the Department can deal with taxpayers' enquiries at the first point of contact, and manage and prioritise its PAYE workload nationally, rather than by region¹¹. However, the implementation of NPS has contributed to the identification of

¹⁰ <http://www.hmrc.gov.uk/agents/news-payeservice.htm>

¹¹ Public Accounts Committee Report into HMRC found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/502/50202.htm>

a significant number of over- and under-payments. This situation arose in part because as the new single central system was introduced a large number of duplicate records were identified across the previously separate databases¹²

10. Progress has also taken place with plans to modernise aspects of PAYE. On 27th July 2010 HMRC published the first consultation looking into two key proposals for PAYE reform. Firstly, the adoption of a real time information (RTI) system for the calculation of PAYE. Secondly, a revised process whereby PAYE deductions would be calculated centrally by an HMRC system instead of within local employers' systems. The consultation received over 400 responses of which over three quarters were in favour of moving to RTI^{13,14}. Following the feedback received during the initial consultation, HMRC subsequently launched a second consultation which included the first detailed plans of the proposed implementation, including potential dates¹⁵.
11. The move towards a real time information system is particularly significant for the introduction of the Universal Credit. The success of this programme will depend largely upon how well the move to a real time information system is designed and delivered.

¹² Public Accounts Committee Report into HMRC found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/502/50202.htm>

¹³ Improving the operation of PAYE which can be found at <http://www.hmrc.gov.uk/news/improve-payee.htm>

¹⁴ More information regarding these results can be found at <http://www.hmrc.gov.uk/news/improve-payee.htm>

¹⁵ Details of the second consultation can be found at <http://www.hmrc.gov.uk/news/improve-payee.htm>

Current Issues with PAYE

12. PAYE is intended to ensure that the correct amount of tax is deducted directly from an employee's pay packet each payday so that at the end of the tax year, for the majority of basic rate taxpayers, there will be no further action required by either HMRC or the employee. PAYE stills works well for the majority of Taxpayers¹⁶.

13. For some PAYE taxpayers however the current system leaves them either owing or being owed money at the end of the financial year. Last year alone some 5.7 million people received letters from HMRC indicating that they had either under- or over-paid tax in 2008/2009 and 2009/2010¹⁷. This represents 18% of all PAYE taxpayers, based on HMRC's figures.

14. When mismatches occur in PAYE records they result in an "open case". An open case is created at the end of the tax year when the taxpayer's account cannot be reconciled automatically. This does not necessarily mean, however, that they have paid an incorrect amount of tax. It merely flags that the account will require manual clerical review before it can be closed for the year. The taxpayer's account concerned cannot therefore be "closed" for the year in question and the case remains "open" until either the situation is satisfactorily resolved or, eventually, the case times out and becomes closed by default through the statutory time limit of four years. The four year limit

¹⁶ Improving the operation of PAYE which can be found at <http://www.hmrc.gov.uk/news/improve-payee.htm>

¹⁷ <http://www.bbc.co.uk/news/uk-11186397>

was introduced in the Finance Act of 2008¹⁸ which reduced the limit from six years to four in all cases. Older cases can now only be pursued if fraud is suspected.

15. HMRC was created on 18th April 2005 and since that time the number of open cases has grown significantly. The table below shows the rise in the number of open cases over the last five years¹⁹.

| Tax Year Ending 5th April | Open Cases in Millions | % of Total PAYE taxpayers²⁰ (1) |
|---|-----------------------------------|---|
| 2005 | 7.00 | 23% |
| 2006 | 12.20 | 39% |
| 2007 | 13.00 | 40% |
| 2008 | 16.20 | 49% |
| 2009 | 20.00 | 63% |

Table 1: Total Number of Open Cases

- (1) The percentages are not 100% accurate due to the fact that if a taxpayer’s account becomes an open case and it’s not solved that tax year for each subsequent tax year the account will remain open but show up as a new open case.
16. Whilst cases remain open there is no reliable way to calculate accurately their overall value. The Treasury estimates that the current backlog of open cases could be worth around £3 billion²¹. It takes time – up to three months – for the Department to establish an enforceable debt once it has contacted

18 A copy of the Finance Bill 2008 can be found here <http://www.hmrc.gov.uk/budget/fa08.pdf>

19 Primarolo Dawn. Hansard HC Deb 25th June 2007, Column 288W and Freedom of Information Act request 1114/10 made to HMRC

20 Based on figures contained in Income Tax Liabilities Statistics which can be found at http://www.hmrc.gov.uk/stats/income_tax/liabilities-january2011.pdf

21 Gauke, David. Hansard HC Deb 19th October 2010, Column 679W

the taxpayer with an income tax calculation²². Some open cases may not return any revenue once the consolidation has been completed since no money may be due.

17. Based on Parliamentary Questions and evidence given during the Treasury Select Committee and Public Accountants Committee hearings, the table below shows the number of open cases that remained to be cleared before the 2010 Finance Bill removed tax years 04/05 and 05/06.

| | Open Cases in Millions | | | |
|-----------------|-------------------------------|---------------------|---------------------|-----------------------|
| Tax Year | Y/E March 07 | Y/E March 08 | Y/E March 09 | Y/E March 2010 |
| 2007-08 | - | (1) | 9.52 | 7.92 |
| 2006-07 | (1) | 8.93 | 6.01 | 5.37 |
| 2005-06 | 8.45 | 4.29 | 3.17 | 2.42 |
| 2004-05 | 3.90 | 2.70 | 2.15 | 1.66 |
| 2003-04 | 0.81 | 0.52 | All Cleared | All Cleared |
| 2002-03 | 0.21 | All Cleared | All Cleared | All Cleared |

Table 2: Number of Open Cases waiting to be cleared

(1) The number of open cases can only be determined after the end of the tax year.

18. The table shows that as a consequence of the 2008 Finance Act, HMRC are unable to collect tax from more than 4.08 million cases (since the Act prevents them doing so). At the Public Accounts Committee hearing on 16th November 2010, HMRC Chief Executive and Permanent Secretary Dame

²² Public Account Committee report into HMRC which can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/502/50202.htm>

Lesley Strathie confirmed that HMRC were writing off 5.37 million open cases from 06/07²³. Dame Lesley Strathie agreed with the Chair of the Public Accounts Committee that a figure of around £650 million would not be an unreasonable assessment of the amount of revenue that had not been collected²⁴.

19. HMRC has announced that it will be writing off any taxes due from earlier open cases, but will ensure that every taxpayer who has overpaid will still receive a refund²⁵. This means that HMRC's workload remains little changed since it will still be necessary to work through the majority of open cases in order to determine those taxpayers entitled to a refund. This approach was questioned at the Public Account Committee hearing on 16th November 2010 where Ian Swales MP asked why HMRC didn't send out letters to those who owe tax, saying "it would only take a letter how difficult can it be?"²⁶. HMRC claimed however that it was not that simple and these cases were very difficult to work through.

20. The APPG on Taxation believes that taxpayers have the right to question HMRC's assertion that it is unable to recover taxes due in a more timely, efficient and effective manner. These open cases are relatively recent and

²³ Public Accounts Committee hearing on Tuesday 16th November 2010 minutes can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/uc502-ii/uc50201.htm>

²⁴ Public Accounts Committee hearing on Tuesday 16th November 2010 minutes can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/uc502-ii/uc50201.htm>

²⁵ Public Accounts Committee hearing on Tuesday 16th November 2010 minutes can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/uc502-ii/uc50201.htm>

²⁶ Public Accounts Committee hearing on Tuesday 16th November 2010 minutes can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmpubacc/uc502-ii/uc50201.htm>

therefore the majority of people who owe money should still be in the system somewhere and able to be tracked down. It is likely that most other organisations would, at the very least, send out a letter to see if they could contact customers who owed them money. The APPG on Taxation therefore has concerns that either HMRC may be setting the bar too low, or that their computer systems are in such disarray it is not possible to identify and contact the appropriate people.

Reasons for the rise in Open Cases

21. There are several reasons for the rise in open cases. Over recent years the UK tax system has drawn many more people into the higher rate tax threshold. In consequence, far more people are now higher rate taxpayers, complicating their tax affairs. A study by the think tank the Institute for Fiscal Studies (IFS) concluded that an extra 750,000 people will start paying the higher rate tax rate this year²⁷. This is because the threshold at which the higher rate tax starts will be £35,001, down from £37,400 the previous financial year²⁸.

22. Another cause is that the PAYE system works in arrears, with an annual twelve month cycle and peak in submissions. It can therefore be some time before HMRC becomes aware of changes in a taxpayer's circumstances. If they start receiving a different salary package, one that includes a company

²⁷ <http://www.ifs.org.uk/publications/5451>

²⁸ <http://www.bbc.co.uk/news/business-12321524>

car for example, their tax code may need to be altered, but under the current PAYE system this may not happen in the current tax year, leaving the person open to either an over or underpayment at the end of year.

23. The twelve month cycle with its annual peak also means that the majority of open cases all arise in a very short period of time, presenting HMRC with resourcing issues in successfully tackling those cases in a timely and efficient manner. This twelve monthly cycle of arrears is in part a legacy of a paper-based system, when there was a need to minimise the number and frequency of transactions due to the high manual overheads involved with their processing. However, in the digital age, where such transactions can be automated, the frequency and number of transactions matters less, meaning that PAYE could be adapted to work on a timelier basis.
24. HMRC already permits many larger companies to transfer PAYE data directly to the HMRC computer systems. From April 2011 all employers, except those who are exempt, are mandated to submit information to HMRC electronically. This approach reduces bureaucracy and increases timeliness, but relies on such third parties ensuring that data quality is high in their own computer systems. Under current processes, any errors in such third party data are automatically accepted into the HMRC system without

correction²⁹. Poor quality data admitted to the system as part of this process can cause consequential problems further downstream in the process.

25. Evidence provided to the APPG on Taxation suggests that the rise in open cases, and the slow speed of their resolution, may also have been contributed to by issues affecting staffing and skills. For example, the APPG has heard evidence from the Public and Commercial Services Union (PCS) that HMRC has disbanded its specialist open case teams³⁰. The Treasury has indicated however that this is not correct³¹. PCS further claimed that there has been a loss of specialist knowledge from HMRC.

26. The APPG on Taxation has taken evidence from a large number of different interest groups (including the Low Incomes Tax Reform Group and the Chartered Institute of Payroll Professionals³²) regarding a perceived drop in the level of service that HMRC provides. Coupled with this drop in service, the trade unions that represent HMRC workers have talked about an increase in contact with citizens. In a submission made to the Treasury subcommittee, the group Tax Aid stated “that HMRC skills of front-line staff are probably about the same, or possibly a bit worse, than 5 years ago - and

²⁹ Personal interview by Adam Marks with Anonymous, former HM Revenue & Customs official, , 15 November 2010

³⁰ Interview with Peter Lockhart Public and Commercial Services Union conducted by Adam Marks on 11 November 2010

³¹ Email to the APPG’s researcher from HM Treasury stating: “The Minister has checked this and been advised that this is not correct. This work was built into normal operating plans but co-ordinated by a project team which still exists.”

³² Now the Chartered Institute of Payroll Professionals

definitely worse than 10-15 years ago when staff facing the public had much more hands on knowledge and experience of tax”³³.

27. Problems with communication have also been identified as a contributory cause to some of the current operational problems of PAYE. HMRC remains largely reliant on two traditional and resource-intensive forms of communication – letters and the use of call centres – with some adoption of online services over recent years.

28. The APPG on Taxation has heard from a variety of different sources that a large number of letters are lost in the post³⁴. However the APPG has been unable to obtain definitive figures.

29. If it is substantiated that a large number of letters are going missing, this may be indicative of problems with data quality: in particular, out of date or inaccurate address records (which in turn could be arising from the annual cycle that forms a key part of the existing PAYE processes).

30. The problem with post doesn’t just affect outgoing mail. The Treasury Sub Committee heard evidence about the delays in HMRC responding to letters from agents. Paul Aplin from ICAEW said “it will take up to six weeks, or

³³ Tax Aids submission to the Treasury Sub Committee investigation into HMRC which can be found at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/sub-committee-hmrc/>

³⁴ From submission made to the Treasury Sub Committee investigation into HMRC which can be found at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/sub-committee-hmrc>

even longer than that, sometimes a matter of months, before a letter is dealt with.”³⁵

31. Call centres also play a key role for HMRC and the majority of calls received are from citizens seeking help in completing forms, ascertaining whether tax codes are correct, or asking about a repayment of tax³⁶. On top of the usual run-rate of phone calls from citizens requiring assistance it was revealed during a meeting of the Treasury Select Committee that 40% of people who receive letters from HMRC then call HMRC regardless of what the letter says³⁷. HMRC takes approximately 8.6 million telephone calls a year relating to PAYE³⁸. The APPG on Taxation has also heard evidence that local tax offices with knowledgeable employees have been replaced by call centre staff who lack a detailed training in, and understanding of, the tax system³⁹.
32. The PCS union has also stated that due to staff shortages call centre staff are encouraged to get through as many calls as possible⁴⁰. Although this is usual practice for a normal call centre it may prove a less satisfactory policy when dealing with complicated issues of taxation. Approximately 2,700 people have left, or will leave, the call centres during 2009/10 and 2010/11. This

35 Paul Aplin, Chairman of the Tax Faculty Technical Committee at the Institute of Chartered Accountants England and Wales in evidence given at the Treasury Sub Committee hearing on Tuesday 8th February 2010, which can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/uc731-ii/uc73101.htm>

36 <http://www.hmrc.gov.uk/ria/ia-improve-payee.pdf>

37 Treasury Select Committee hearing on Wednesday 15 September 2010 which can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/479/10091501.htm>

38 <http://www.hmrc.gov.uk/ria/ia-improve-payee.pdf>

39 Personal Interview by Adam Marks with Robin Williamson from Low Income Tax Reform Group on 14 August 2010

40 The Public Commercial Services Union submission to the Treasury Sub Committee which can be found at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/sub-committee-hmrc/>

equates to approximately 25%-30% of the staff within the directorate⁴¹.

While staff numbers are being reduced, the number of callers increased by 20% from 2009/10 to 2010/11 and the number of people who received an engaged or busy tone increased from 7 million to 39 million⁴².

33. When people do get through to a call centre many complain that they are often given conflicting advice⁴³. The Institute of Payroll Professionals has suggested that the advice given to its members lacks consistency and this in turn leads to employers carrying out their obligations in different ways, all apparently approved by HMRC⁴⁴.

34. Another complaint levelled at the call centres is the use of 0845 numbers. A quote from the Low Incomes Tax Reform Group sums up the problem *“Research has shown that many of HMRC’s lowest income customers use mobile phones rather than landlines. Yet most of the time, HMRC force their customers to use 0845 numbers to make contact with them. This is not discretionary contact; HMRC rules mean that you have to ring these numbers if you are to avoid significant financial penalties. Costs from some mobile phones to an 0845 number can be up to 40p a minute. Even if you*

41 The Public Commercial Services Union submission to the Treasury Sub Committee which can be found at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/sub-committee-hmrc/>

42 The Public Commercial Services Union submission to the Treasury Sub Committee which can be found at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/sub-committee-hmrc/>

43 Chas Roy –Chowdhury, Head of Taxation Association of Chartered and Certified Accountants at the Treasury Sub Committee hearing on 8th February 2010 a copy of the transcript can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/uc731-ii/uc73101.htm>

44 The Institute of Payroll Professionals submission to the Treasury Sub Committee which can be found at <http://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/inquiries1/sub-committee-hmrc/>

have a landline, the 0845 number is effectively levying another tax when a cost free 0800 alternative is available.”⁴⁵“Bearing in mind how HMRC are driving its customers into using the telephone for contact and requiring more and more information to be notified in this way one would hope that they were providing the very cheapest arrangements for their customers.

35. This reliance on letters and call centres contrasts with HMRC’s early adoption of online services around ten years ago. HMRC was amongst the first Departments to move to the provision of services online over the internet, notably with its Self Assessment service which enables taxpayers to complete and submit their tax return online. This was one of the first services provided directly to the public when the UK Government Gateway went live in 2001⁴⁶. HMRC has however been slow to enable two-way electronic communication with citizens and businesses. The Department initially used the Government Gateway to pilot a secure online two-way messaging service of a similar kind to those operated by online banks for secure communication with their customers, although it appears this is no longer in use.

36. The APPG on Taxation believes that HMRC should adopt improved communication tools such as secure online two-way messaging as an alternative option to post and call centres. Doing so will have the potential to

⁴⁵ <http://www.litrg.org.uk/News/2011/telephone-call-charges%E2%80%93time-for-hmrc-to-act>, January 2011

⁴⁶ The Government Gateway provides a secure means for citizens and businesses to authenticate to Government Departments and to transact with them and their services online. See <http://www.gateway.gov.uk>

increase efficiency and save costs for agents, citizens, employers and HMRC. It also has the potential to cut down on the amount of fraud and lost post and should enable HMRC to maintain more accurate data. The APPG on Taxation is unclear why a secure means of two-way electronic communication between citizens and HMRC is not in place. Such services are well proven in banking and e-commerce. The APPG on Taxation would strongly urge HMRC to adopt a secure means of two-way electronic communication to reduce its continuing dependency on the insecure and expensive use of paper-based documentation and the postal service.

Recommendation

- *Implement secure online two-way communication between citizens and organisations, and HMRC*

Data Quality

37. The most significant contributory factor to the current issues with PAYE appears to be that of poor data quality. Problems with data quality arise from a variety of factors including the increasing number of people being drawn into more complex PAYE arrangements; the periodicity of the PAYE process, operating some 12 months in arrears; and the quality of data received by and maintained on HMRC systems. If HMRC were able to improve the quality of data, it would help reduce these existing problems.

38. Like most Government Departments, HMRC is primarily involved with the acquisition, management and effective utilisation of information. In HMRC's specific case, that information relates to the tax affairs of

individuals and organisations. HMRC depends upon underlying information management that is accurate, consistent and reliable. HMRC's success relies upon it correctly identifying the data it needs access to in order to determine (in an accurate and timely manner) the correct tax situation for each individual and organisation in the UK.

39. Ensuring access to timely and accurate information also needs to take into account the way in which most tax collection in the UK is now outsourced, both to employers (for collection of PAYE) and to retailers and others (for taxes such as VAT). Under the current system employers send through consolidated PAYE information only at the end of the year. This means by the time HMRC receives the data they are already up to 12 months old. Therefore there is more of a chance that there has been a change in a citizen's circumstances and that the data are no longer correct, or indeed that there is a mistake in the data and the person can no longer be traced.
40. A more efficient data management model would enable information to flow from those collecting tax, such as employers, to HMRC in a much more timely fashion. This could happen on a more frequent and regular basis than under the current PAYE processes. However HMRC would need to ensure it has appropriate automated mechanisms in place for verifying and validating the information it receives and handles. Maintaining data on a more regular basis would enable HMRC to ensure information is less likely to become out-dated, or to remain inaccurate, than at present.

41. In addition, citizens and organisations cannot easily maintain and update their information. PAYE would benefit from citizens and organisations playing a more active role in reviewing and updating their own information. Companies such as Amazon and eBay shift the responsibility of keeping customers' account details up to date onto the customer. After all, customers are best placed to know their own personal details and to keep them up to date on a timely basis. The APPG on Taxation believe HMRC should follow this model, build on its initial work on online services and open up the data it has on a citizen to that citizen so that they are able to check that the data held on them is correct. This already happens in Canada where citizens have access to a secure online Government Gateway. The system allows Canadian taxpayers to pay their taxes online and also register for a number of state benefits. This one stop shop also allows them to keep their details up to date.
42. The APPG on Taxation believes that the proposed real-time information (RTI) system provides the ideal opportunity to tackle both of these issues, and to enable PAYE to become better adapted to the needs of the twenty-first century.

Real Time Information (RTI)

43. Under the proposals for real time information (RTI) instead of information only being sent to HMRC at year-end it will eventually be provided automatically whenever employers run their regular payroll process for their employees. Employers will provide details about employer-level payments at the same time as they pay over to HMRC tax, NIC and Student Loan

repayments. Once the full system is up and running it is possible that employers will also no longer need to submit P14/P35 forms at the end of the year and P45/P46 forms when people move or join their company. This information will instead flow automatically between employers' systems and HMRC.

44. Using RTI, the information currently sent in at the end of year via a P14 will be sent to HMRC every time a payroll is completed. If HMRC's data matching is not improved, given the total number of open cases produced on an annual basis at present, the Department will have to work through millions of open cases on a monthly basis instead since what is currently the NPS annual peak will be spread across the year, potentially overloading the system. In a world of electronic commerce, HMRC needs to move away from manually intensive ways of running the UK tax system. The majority of PAYE submissions, data matching and case resolution should happen electronically, with only the complex exception flagged for specialist manual intervention.

45. As well as reducing the occurrence of future open cases, the APPG on Taxation believes that HMRC needs to invest in a more efficient and quicker way to process those open cases that are created. HMRC should consider using an automated matching system, adopting a similar approach to that used in the banking industry, which can help automatically match and identify records, reducing the high levels of manual intervention currently required. The APPG on Taxation therefore recommends that HMRC should

explore the implementation of an automated process which would facilitate faster reconciliation, allowing HMRC to recover taxation revenue in a more timely fashion.

46. As HMRC moves to adopt RTI, it also needs to undertake a detailed review of its overall approach to information management and governance. It is not clear at present that HMRC has an effective approach to information management, nor that it has reviewed its options on how best to access and use information necessary for the efficient administration of taxation. In particular, it should re-examine what information it needs access to and where that information needs to be held and maintained. As with the banks, for example, it may make sense for HMRC to utilise information already held by existing third parties rather than to build and operate its own in-house infrastructure. Banks do not hold all data themselves, but rely upon others, such as credit reference agencies, to provide services such as checking whether an individual lives where they claim. The APPG on Taxation sees no reason why if such a model can be used by banks and other major organisations that HMRC should not find some benefit from doing likewise.

47. HMRC has already announced that PAYE will move to an RTI system with roll-out of a pilot starting in the spring of 2012. With this imminent change, it is now even more important for HMRC to improve their data quality. Opening up the personal taxation data HMRC hold for self-management would revolutionise the way HMRC manages data. It would help reduce the

number of phone calls that HMRC receives, with many people able to login directly to their accounts instead of phoning or writing to update their details. It would also mean people can check their own tax status online, helping cut down the number of people calling HMRC to ask about their tax position. This change would also see an improvement in security with up-to-date addresses meaning letters, where they are required, are less likely to go missing⁴⁷.

48. HMRC's main argument against introducing such a model to the UK appears to be one of security. The APPG on Taxation believes that providing citizens with self-service access to their own data via a secure online login, such as the banks use for internet banking, is probably more secure than the current model where letters are sent out with potentially out-dated addresses. Some of the security arguments also appear tenuous since the Government Gateway already provides a secure way for users to authenticate to HMRC's Self-Assessment system. It is unclear why HMRC should regard this system as secure enough for entering and submitting self-assessment tax returns but not for users to update and submit other personal details.

⁴⁷ In an email to the APPG's researcher from HM Treasury it is stated that "HMRC have, on the Minister's request, set up a dedicated project to clean the data and ensure they have sustainable automated processes they keep it [sic] clean"

49. These changes in process and information management would help reduce the costs and inefficiencies that HMRC is presently encountering in its current approach to the administration of PAYE.

Recommendations

- *Increase the use of automated matching for open cases;*
- *Extend the use of the current secure online login system to enable citizens to view and keep their own personal details up to date;*
- *Review and update the end-to-end data and information management requirements as part of the move to RTI, identifying who needs to hold what data for what purposes;*
- *Continue the changes that will enable citizens to view all of their dealings with HMRC in one place or document*

Conclusion

50. The APPG on Taxation believes that making the right changes could enable PAYE to once again become a very successful and efficient way to collect tax. However HMRC needs to fundamentally overhaul the way it treats and uses data. It should adopt processes already widely deployed in the commercial sector, including automated data matching, the use of existing third-party services and empowering the citizen to enable them to keep their own personal details up to date. Without improvements to HMRC's overall information management and data quality the benefits of NPS and RTI will be largely wasted since their full potential will never be realised and the problems around open cases and rising citizen and organisation complaints will continue.

51. The APPG on Taxation therefore submits the following recommendations for HMRC's consideration to help bring PAYE up-to-date:
- a) *Implement secure online two-way communication between citizens and organisations, and HMRC;*
 - b) *Increase the use of automated matching for open cases;*
 - c) *Extend the use of the current secure online login system to enable citizens to view and keep their own personal details up to date;*
 - d) *Review and update the end-to-end data and information management requirements as part of the move to real time information (RTI), identifying who needs to hold what data for what purposes;*
 - e) *Continue the changes that will enable citizens to view all of their dealings with HMRC in one place or document.*

Annex 1: A Brief History of HMRC

52. HMRC was formed on 18th April 2005 as a result of the merger of the former two Government Departments of Inland Revenue and Her Majesty's Customs and Excise. The merger was announced by the then Chancellor of the Exchequer, Gordon Brown, in his Budget of 17th March 2004. The "*Commissioners for Revenue and Customs Bill*"⁴⁸, was subsequently introduced into the House of Commons on 24th September 2004 and received Royal Assent on 7th April 2005 as the "*Commissioners for Revenue and Customs Act 2005*".

53. This Act resulted in two very different organisations merging their diverse policy functions, IT services and staff practices whilst still continuing to carry out all of the various functions undertaken pre-merger. This period exposed a number of weaknesses in the newly formed organisation including, for example, a significant rise in the number of open cases.

⁴⁸ A full copy of the Act can be found at <http://www.legislation.gov.uk/ukpga/2005/11/contents>

54. The table below shows the different areas in which HMRC operates.

| Administer | Type | Amount of Tax Collected Y/E 08/09 |
|------------------------|-----------------------------------|---|
| Direct Taxes | Capital Gains Tax. | £2.7 Billion |
| | Corporation Tax. | £41.8 Billion |
| | Income Tax. | £248.6 Billion |
| | Inheritance Tax. | £2.5 Billion |
| | National Insurance Contributions. | Part of the £248.6 Billion income tax, not shown separately |
| Indirect Taxes | | |
| | Excise duties. | £2.2 Billion |
| | Insurance Premium Tax. | £2.3 Billion |
| | Petroleum Revenue Tax. | £2.5 Billion |
| | Stamp Duty. | £6.1 Billion |
| | Stamp Duty Land Tax. | £4.4 Billion |
| | Stamp Duty Reserve Tax. | £2.9 Billion |
| | VAT. | £6.4 Billion |
| | | |
| Enforce and Administer | | |
| | Border and frontier protection | N/A |
| | Environmental taxes | £1.8 billion |
| | National Minimum Wage enforcement | N/A |
| | Recovery of student loans. | N/A |

Table 3: HMRC’s responsibilities⁴⁹

55. The table above shows how HMRC has two main roles: to administer tax collected (the majority of tax collection itself is effectively outsourced to employers and other organisations), as well as being an enforcer of tax. They currently also pay out tax credits.

56. The former Inland Revenue was principally a tax administration and enforcement organisation until 2001 when the Labour Government

⁴⁹ Sources: <http://www.hmrc.gov.uk/menus/aboutmenu.htm> and <http://www.hmrc.gov.uk/about/hmrc-accs-0809.pdf>

introduced Tax Credits. The then Chancellor, Gordon Brown, gave the Inland Revenue responsibility for administering new Tax Credits. Integration between Tax Credits and traditional tax administration proved a complex task for management. It has been widely acknowledged that the Tax Credit system has not worked well and has been a major distraction for both the then Inland Revenue and subsequently HMRC.

57. In October 2010 the new coalition Government announced that the Tax Credit system would be overhauled and replaced by a Universal Credit. The new Universal Credit will be administered by the Department of Work and Pensions (DWP).

Annex 2: The Staffing and Structure of HMRC

58. HMRC is unique within Government since it is neither a direct Government Department nor a quango. It operates as a non-ministerial Department run by Commissioners appointed by Her Majesty the Queen. Currently there are six Commissioners⁵⁰. This special arrangement exists to ensure that Ministers cannot have any involvement in taxpayers' cases. The APPG on Taxation has spoken with a number of different interest groups regarding this idea and does not see any need for change. After the recent problems experienced by HMRC, however, some are now calling for more Ministerial oversight – something that should be debated by the public.

59. Since it was created in 2005 HMRC has been re-organising and reducing staff numbers. When HMRC was created it employed 104,000 people⁵¹. After the 2005 and 2007 spending reviews the workforce was reduced by around 35,000 people to around 75,000⁵². In the 2010 Spending Review another 13,000 jobs were identified to be cut. Jonathan Baume, General Secretary of the Civil Service Union FDA said the threat of job losses has given *“Senior Managers a particularly difficult task in seeking to maintain the morale and motivation of the teams they manage”*⁵³.

50 <http://www.hmrc.gov.uk/governance/commissioners.htm>

51 Written evidence presented to the Treasury Select Committee by Public and Commercial Services Union

52 Written evidence presented to the Treasury Select Committee by Public and Commercial Services Union

53 Curtis Polly, Guardian 20 October 2010

60. Data from publicly available staff surveys show that HMRC staff morale has been declining for a number of years. In 2005, just after HMRC was created, 35% of people questioned said they would recommend a job at HMRC⁵⁴. By 2010 this figure had fallen to just 14%⁵⁵.
61. In the 2010 survey, one of the biggest concerns identified by staff related to their management, with just 12% of staff indicating that they believe HMRC is well managed (as of February 2010⁵⁶).
62. HMRC has an atypical management structure. The management of Government Departments is usually led by one Permanent Secretary, who steers the Department and reports to the elected Minister in overall charge. HMRC however has two Permanent Secretaries as well as a part-time Chairman who works a 3 day week. With two Permanent Secretaries and a Chairman it is possible for ambiguities to arise about who has overall responsibility for the day to day running of HMRC, and who is in overall charge – and accountable – when something goes wrong.
63. The Coalition Government recently released figures for top earners across Government, detailing everyone in the Civil Service who earns over £150,000 a year excluding pension contributions. These figures show that there are currently nine senior HMRC staff earning more than the Prime

⁵⁴ http://www.hmrc.gov.uk/research/results_may_06.pdf retrieved on 4/11/2010

⁵⁵ http://www.kenfrost.com/PeopleSurvey2010_HMRC_results_final20102.pdf retrieved on 4/11/2010

⁵⁶ http://www.kenfrost.com/PeopleSurvey2010_HMRC_results_final20102.pdf

Minister (£142,500), with one – the Director General of Benefits and Credits – earning over £200,000 a year as the 19th highest earner in the Civil Service⁵⁷, despite not even being the Chief Executive⁵⁸.

64. A number of stakeholders have also drawn attention to the lack of tax experts at the top of the Department⁵⁹. This point is supported by the comments made in the submission to the Treasury Sub Committee hearing by the Tax Help for Older people. They said: *“In addition, many senior and experienced staff were encouraged to retire early and almost everyone in the top management of the Department has come from elsewhere – either from another Government Department or from outside the Civil Service.”*⁶⁰

65. When compared with the remainder of Whitehall, HMRC’s rating amongst its own staff is poor. HMRC’s average position in the rankings was 87th, and it came 96th out of 96th on seven questions⁶¹. HMRC’s highest position out of the 96 Government Departments surveyed was 56th on one question. This included asking whether staff would recommend HMRC as a place of employment and whether they would tell people they worked at HMRC.

⁵⁷ http://www.direct.gov.uk/en/N11/Newsroom/DG_188114

⁵⁸ <http://sheet.zoho.com/view.do?url=http://www.hmrc.gov.uk/transparency/senior-salaries-sept2010.csv>

⁵⁹ From written and oral evidence given to the Treasury Sub Committee

⁶⁰ Tax Help for Older People’s submission to the Treasury Sub Committee investigation which can be found at <http://www.publications.parliament.uk/pa/cm201011/cmselect/cmtreasy/memo/hmrc/contents.htm>

⁶¹ http://www.kenfrost.com/PeopleSurvey2010_HMRC_results_final20102.pdf

Appendix 1: Methodology and Sources

66. The report was produced on behalf of the All Party Parliamentary Group (APPG) on Taxation, which is dedicated to looking at and understanding tax policy and taxation at all levels; to understand VAT and PAYE in the UK; to contact and talk to accountants and Revenue officials and Payroll Professionals; and to look at European tax affairs and international taxation.
67. The APPG on Taxation's mandate for the author of this report was to examine issues and concerns around the PAYE system and to offer constructive methods to improve the system.
68. The research methodology for this study included a range of interviews over several months with current and former HMRC officials, industry representatives, individual taxpayers, accountants, and businesses. This outreach included a roundtable discussion held in Westminster with Members of Parliament and stakeholders. Information was also obtained through Parliamentary Questions tabled by the APPG on Taxation Group's Chairman, Ian Liddell-Grainger MP, along with Freedom of Information requests.

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- Treasury Sub Committee hearing on **The Effectiveness of HMRC** held on Tuesday 8 February 2010
- Public Accounts Committee hearing on **HMRC Account** held on Tuesday 16 November 2010
- Public Accounts Committee hearing on **HMRC Accounts 2009-10** on Tuesday 12 October 2010

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Appendix 2: HMRC Response

The challenge for HMRC has been to deal with the build up of work while making sure it carefully stabilises the new NPS system. In recent months HMRC has put significant effort into stabilising PAYE. The Department has almost completed the end of year reconciliation for both years 2008/9 and 2009/10, for the cases for which it holds all the relevant information. Being so far forward for 2009/10 – the last full tax year - is an encouraging result. HMRC has also been issuing tax codes for next year and all the signs are that the rigorous preparation they made for this exercise has resulted in a big improvement. Looking forward, electronically filed end of year returns from employers together with the new NPS system will allow HMRC to reconcile 2010/11 cases much sooner than has been possible in recent times, moving the PAYE system to a more up to date position. The next step is RTI.⁶²

⁶² This assessment was given to the APPG on Taxation following a meeting the Chairman held with Stephen Banyard on the 15/03/2011. Stephen is acting director general of personal tax at HMRC.