



All-Party Parliamentary Taxation Group

PAYE at the Crossroads

By Jamie Black

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Foreword by Ian Liddell-Grainger MP

Dear Colleagues and Friends,

The All-Party Parliamentary Taxation Group (APPTG) has vocally advocated the case for modernising the Pay-As-You-Earn (PAYE) system since our establishment. We are delighted that HMRC began the process of bringing PAYE into the 21st Century over the last few years of the Labour Government, and that this has continued under the Coalition.

Progress has been made with the introduction of the National Insurance and PAYE Computer Service and will continue with Real Time Information (RTI) reporting. RTI is undoubtedly the biggest change to PAYE since its introduction back in 1944, but it should be regarded as a stepping-stone, not the final destination. HMRC both can and should go a lot further with the modernisation of PAYE.

RTI is also significant because it practically demonstrates the importance of the PAYE system for policy delivery across government. It is well reported that the Government's welfare reform programme – Universal Credit – is reliant on RTI for real time PAYE data. This is absolutely true and Universal Credit should also be regarded as the beginning, not the end for sharing real time PAYE data and using the PAYE system across government.

The APPTG's role in all of this is to contribute to the discussion and facilitate debate in Westminster. We are objective, serve no partisan agenda and believe that modernising PAYE is a cross-party issue. Over the past three years we have produced two reports on PAYE, making our latest report 'PAYE at the Crossroads' the third in a series. 'PAYE at the Crossroads' is the result of months of research, performed by our independent researcher – Jamie Black. I would like to thank Jamie, along with all the organisations and individuals who contributed to the research.

Throughout this research project, HMRC has provided the APPTG with the closest access we have ever received and for this I would like to thank David Gauke MP, Exchequer Secretary to the Treasury and Stephen Banyard, Director of Personal Taxation at HMRC. I hope that the APPTG and HMRC can continue our constructive relationship into the future.

Stephen Banyard will be shortly stepping down from his position and retiring. He leaves behind him a legacy of modernisation and the APPTG wish him well in his retirement. We hope his successor will be able to continue along the path that Stephen has laid out.

Kind Regards,



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

About the All-Party Parliamentary Taxation Group

Ian Liddell-Grainger MP founded the APPTG in 2006 and continues to serve as its Chairman. It is made up of 20 parliamentarians with the purpose of looking at and understanding tax policy at all levels, and particularly tax administration. The APPTG has produced a series of papers and reports on tax administration and hosted a number of private and public events on a wide range of taxation issues. It has strong links with a broad spectrum of organisations and individuals across the tax space in the UK and internationally. The Chartered Institute of Taxation (CIOT) acts as the APPTG's Secretariat.

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Publications

APPTG (2012), PAYE at the Crossroads.
 APPTG (2011), PAYE Review and Recommendations.
 APPTG (2010), Improving PAYE: How information is collected and managed in the administration of Income Tax.
 APPTG (2009), Pre-populated Returns.
 APPTG (2009), European Online Filing.
 APPTG (2008), The Future of Income Tax Administration in the UK.
 APPTG (2007), The Future of Income Tax Administration in the UK: Preliminary Findings.

About Jamie Black – Author of ‘PAYE at the Crossroads’

Jamie Black has led the APPTG's research project on the PAYE system culminating in the report 'PAYE at the Crossroads'. Previously, he has worked for the Foundation for Defense of Democracies in Washington DC and the Conservative Party. Jamie graduated with an MPhil in Management from the University of Cambridge (2010-11), having previously graduated with a First-class BA Honours degree in Politics from the University of Nottingham (2007-10).

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Her Majesty's Revenue and Customs

Inland Revenue electronic exchange Network

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Purely Payroll

Sage

Student Loans Company

TaxAssist Accountants

United Kingdom Border Agency

United States House of Representatives Ways and Means Committee

United States Inland Revenue Service

United States Senate Finance Committee

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The Chartered Institute of Taxation

The Payroll Practice

The Pension Regulator

VocaLink

The APPTG would like to especially thank TaxAssist Accountants for designing, building and running a joint survey for micro-business on RTI.

Executive Summary

1. 'PAYE at the Crossroads' is the third report in a series on the operation of PAYE. It is the result of working closely with HMRC and months of stakeholder research across government, business and professional bodies. Our objective in this report is four-fold:
 - To make the case for the modernisation of PAYE;
 - To provide a vision for a new model for PAYE;
 - To assess the current modernisation of PAYE through Real Time Information (RTI) reporting; and
 - Provide recommendation to these ends.
2. Our PAYE system was introduced in 1944 and its fundamental operation has not changed to this day. As a result, PAYE is problematic for the following reasons:
 - Administrative burden on business;
 - Additional administrative burden on small business;
 - Inaccurate calculation of PAYE for millions of taxpayers;
 - Disengagement of taxpayers from their own tax affairs;
 - Administrative burden on HMRC; and
 - Restraint on policy delivery across government.
3. The APPTG lays out a vision for a new model for PAYE – Centralised Deductions. Under Centralised Deductions, employers would pay their employees in gross and have the PAYE calculation performed by a centralised calculator within the payments system. HMRC formally introduced Centralised Deductions into the public arena in July 2010 and its implementation would remove most of, if not all of, PAYE's negative dimensions.
4. Moreover, Centralised Deductions could transform government policy delivery and revolutionise the way that citizens interact with the state. Our research extensively details areas of existing and new policy that could be delivered more effectively and efficiently as a result. This is because of Centralised Deduction's two core features:
 - Central feed of real time income and PAYE data; and
 - Automatic reconciliation between deducted PAYE and benefit entitlement;
5. HMRC introduced Centralised Deductions along with another proposal that could achieve the first of its core features – RTI. This was taken forward to consultation and is currently being implemented by HMRC. Under RTI, employers will submit payroll data to HMRC via their payroll software at-or-before the point they pay an employee. RTI will be used to facilitate the introduction of Universal Credit in October 2013 with the earnings information it requires to calculate benefits.
6. The APPTG supports the concept of RTI, which is to integrate PAYE reporting with payroll practice. We proposed RTI back in March 2010 because it could address several of the problems with PAYE, including:
 - Administrative burden on business;
 - Inaccurate calculation of PAYE; and
 - Restraint on policy delivery across government.
7. However, the APPTG is concerned that RTI's policy driven timetable could undermine the concept at the heart of the operation of RTI – integration of PAYE reporting with payroll practice – and cause

additional administrative cost to business as a result. We are concerned that the speed at which RTI is being delivered potentially threatens every business and benefit claimant in the UK, as Universal Credit is reliant on RTI for benefit calculation.

8. Moreover, our stakeholder research indicates HMRC's has overstated its business case through:
 - Underestimation of the cost required for RTI investment;
 - Underestimation of employer migration cost;
 - No estimation of employer software cost;
 - No estimation of software development cost;
 - Underestimation of the additional administrative burden under RTI; and
 - Failure to account for the differences between the Interim Solution and the Strategic Solution, particularly in relation to the deliver of Universal Credit.
9. We argue that the benefits of RTI will not be recognised in full initially because HMRC is delivering RTI through its Interim Solution and are concerned about the effect this will have on the accuracy of Universal Credit. Under the Interim Solution, HMRC will only be able to check, not guarantee, that employers submit information at-or-before the point they pay an employee. On the other hand, the submission channel originally planned, the payments infrastructure (known as the Strategic Solution), guarantees real time accurate information by attaching the payroll data to a payment instruction. HMRC are officially committed to delivering RTI through the Strategic Solution from after April 2016, but we are concerned that in practice there is little evidence to suggest this will occur.
10. This report asserts that the modernisation of PAYE is at the crossroads. In its effort to bring PAYE into the 21st Century, HMRC is currently investing through its Interim Solution in a legacy IT system due for retirement in April 2016 – the Electronic Data Interchange (EDI). We do not view the Interim Solution as sustainable, because the at-or-before principle that is fundamental to the concept of RTI will not be guaranteed and RTI will not be fully integrated with payroll from the start. To this end, the Government has two viable choices:
 - **Implement the Strategic Solution:** Guarantee the flow of real time data to government through using the payments infrastructure. This will also progress towards our vision of Centralised Deductions; or
 - **Scale back to RTI-light:** Implement a form of periodic or monthly filing, as in other OECD countries, and remove the complications associated with at-or-before. The Interim Solution would become the permanent submission channel. However, at that point, Universal Credit ceases to be dynamic.
11. RTI's planned facilitation of Universal Credit illustrates our point in our new model for PAYE - that PAYE reform should be considered a cross-governmental issue. This is because other departments could all be beneficiaries of the PAYE system and/or PAYE data. In order to achieve the PAYE model that can deliver effective and efficient policy across government, we feel the appropriate governance structures must be place. A single government department should not be expected to consider the full cross-governmental implications of its strategy and to this end, the most important recommendation of this report is for the Cabinet Office to establish a working group, endorsed by HMRC, to fully explore the importance of the PAYE system and PAYE data across government and the benefits of the Strategic Solution and Centralised Deductions.

Introduction

12. The APPTG has previously reported how problems with the operation of the PAYE system have led to the miscalculation of income tax for millions of people. It is unfortunate, yet expected, that these problems have persisted. In May 2012, HMRC announced that they would be reconciling under and overpayments for 5.1 million taxpayers for the 2011-12 tax year, accounting for 13% of people in the PAYE system. As with previous HMRC announcements of this nature, the PAYE system was thrown into the spotlight of the national media.
13. However, much of the media reporting is misguided in several respects: usually devoid of basic understanding about how the PAYE system works; unable to explain why the PAYE system breaks down; and providing little to no exposure of HMRC's modernisation of PAYE – past, present or future. In doing so, the public and policymakers are not properly informed, and HMRC is unnecessarily demoralised.
14. This is especially unfortunate because the modernisation of PAYE is under way. The foundations of a 21st Century PAYE system were built with the introduction of the National Insurance and PAYE Computer Service (NPS), which integrated twelve regional PAYE systems organised by employer into a single system organised around the taxpayer. With the taxpayer at the heart of the PAYE system, HMRC published a discussion document in July 2010 entitled 'Improving the Operation of PAYE'. It 'intended to start a discussion about the collection of RTI for PAYE and to introduce the Centralised Deductions option.'¹
15. Whilst Centralised Deductions was put on hold, HMRC took RTI forward to consultation in December 2010 and it is currently being piloted with employers. By October 2013, it will be mandatory for all employers to be compliant with RTI. The timescale intentionally coincides with the planned introduction of the Government's welfare reform programme – Universal Credit. DWP are planning to deliver Universal Credit using RTI and will receive a feed of real time earnings data from HMRC, which should facilitate the accurate calculation of an employed claimant's (or household's) monthly credit.
16. The delivery of Universal Credit demonstrates the importance of the PAYE system across government. There are many other current areas of policy across other government departments (OGDs) that could be delivered more effectively and efficiently with real time data, and equally for several emerging areas of policy. However, the underlying assumption in this is that the PAYE system under RTI will be able to deliver accurate and timely real time PAYE data.
17. The previous two APPTG reports on PAYE have sought to explain how the PAYE system works; why it breaks down; and made the case for its modernisation. Both reports have concluded that the PAYE system should be fundamentally reformed for the better and we have provided ideas and policy recommendations for government and HMRC to this end, including RTI. Several of the core arguments and themes from the previous two reports are incorporated into 'PAYE at the Crossroads'.
18. In the first chapter 'PAYE Explained', we provide an introduction to income tax collection and look at international variation within tax withholding regimes. The operation of the UK PAYE system is explained through outlining the role played by each of the three stakeholders - HMRC, employers and

¹ HMRC (July 2010), Improving the Operation of PAYE, p. 4.

employees. Finally, we explain the operation of HMRC's PAYE computer system (NPS), which is key to understanding HMRC's administration of the PAYE system.

19. The second chapter – 'The PAYE Problem' - is the first half of our case for the modernisation of the PAYE system, with following chapter – 'A PAYE System for the 21st Century' – forming the second half. 'The PAYE Problem' addresses PAYE's foremost negative dimensions across its three stakeholders and government. It amalgamates our core arguments from the previous two reports in this series on PAYE and also raises fresh concerns.
20. 'A PAYE System for the 21st Century' outlines the APPTG's long-term vision for the PAYE system – Centralised Deductions. It details the changing roles of PAYE's three stakeholders and highlights the big cross-governmental prize that this new model of PAYE would offer for policy delivery across government. We outline genuine issues of consideration and respond to what we consider are concerns born out of misunderstanding about how Centralised Deductions would work. Both parts of our case use the current (pre-RTI) PAYE system as the basis of comparison. However, RTI, and its effect on our case for modernisation are developed later on.
21. In the fourth chapter - 'Real Time Information' - HMRC's ongoing RTI project is looked at in detail. It explains what RTI is; how it will work; and how it will affect PAYE's three stakeholders – employers, employees and HMRC. We look at the submission channel through which HMRC will receive RTI data and the role that RTI will play in delivering Universal Credit. HMRC's business case for RTI is also outlined in full.
22. In the fifth chapter – 'Real Time Information Assessed' we look at the delivery of RTI, particularly the timetable, and how this will affect the migration of employers onto RTI, and the integration of RTI and payroll. We scrutinise HMRC's business case, with reference to HMRC's investment cost, employer migration cost and the additional administrative burden on business. We also look at the how RTI under the Interim Solution will affect Universal Credit and HMRC's immediate post-RTI delivery strategy.
23. Following the completion of our case for modernisation and assessment of RTI, we make nine recommendations to the Government in relation to RTI migration, immediate post-RTI strategy and the wider reform agenda. Our conclusion - 'PAYE at the Crossroads' – considers the strategic direction in which HMRC are heading with the modernisation of PAYE.

Chapter 1: PAYE Explained

24. One of PAYE's intentional design features is to minimise contact with taxpayers. A downside of this is that the taxpayer becomes altogether disengaged from their tax affairs and the operation of the PAYE system is not widely understood. 'PAYE Explained' attempts to address this issue through setting the PAYE system within the context of international tax withholding regimes and explaining the role of its three stakeholders – employers, employees and HMRC.² Given the context of RTI, the role of employer payroll vis-à-vis PAYE is touched on. Readers with a thorough knowledge of PAYE may wish to move directly to the first half of our case for modernisation - 'The PAYE Problem'.

Tax Withholding

25. According to the OECD '[w]ithholding at source arrangements are generally regarded as the cornerstone of an effective income tax system.'³ All thirty-four OECD countries apart from two (France and Switzerland) use withholding arrangements for the collection of income tax.⁴ Withholding can be defined as a method of tax collection whereby the payer of income deducts tax from the gross payment due to a payee and then submits the deducted money to the taxing authority for credit to the account of the payee.
26. Tax withholding at the source of earnings has several inherent advantages over other methods of tax collection:
- Near elimination of the ability to understate income for tax purposes;
 - Reduction in both voluntary and involuntary tax evasion;
 - Reduction in the cost of tax administration by reducing the number of interactions (i.e. there are less employers than employees); and
 - Improvement in government cash flow and budgetary management.
27. Withholding arrangements can be either cumulative or non-cumulative. Twenty OECD countries use a cumulative system, while twelve use a non-cumulative system.⁵ The fundamental differences between the design objectives of these two systems are two-fold:
- Accurate collection at source (cumulative) v rough estimation of collection at source (non-cumulative); and
 - Employer compliance costs (cumulative) v taxpayer compliance costs (non-cumulative).
28. In a cumulative system such as the UK, the employer attempts to withhold the correct amount of tax at source. Therefore, the system allows for the tax withheld each pay-period to adjust to events as and when they happen. Taxing correctly at source requires the flow of information between employers, employees and the revenue collector, and some kind of in-year reporting system. As the system is designed to tax correctly, employees are often freed from the burden of filing a tax return.

² The term 'employer' will be used to denote all forms of withholding agents throughout. In the UK, the other major withholding agents are pension providers. The terms 'taxpayer' and 'employee' will be used interchangeably to represent individuals within the PAYE system.

³ OECD (March 2011), Tax Administration in OECD and Selected Non- OECD Countries: Comparative Information Series, p. 215.

⁴ Ibid.

⁵ Ibid, p. 224-225.

29. By contrast, in a non-cumulative system such as the United States, the objective is to ensure that roughly the right amount of tax is withheld in the knowledge that the correct amount will be deduced through the filing of individual tax returns at the end of the tax year. The average taxpayer in the United States is predictably over-withheld by 15-20% and anticipates a refund.⁶ The employer does not adjust to events (hence the non-cumulative nature) and tends to withhold periodically using general bands applied to salary levels and circumstances.
30. Even among cumulative and non-cumulative withholding systems there is great variation. This is because each country's tax regime, and business and political environment is unique. However, in all tax withholding systems there are three stakeholders:
- Employers;
 - Employees; and
 - The revenue collector (e.g. HMRC, IRS etc...).

The difficulty in income tax administration policy is to simultaneously consider both the overall system and each of its individual stakeholders.

The UK PAYE System

31. PAYE is the withholding system used by employers to deduct income tax and national insurance contributions (NICs).⁷ It is also increasingly used to collect and distribute payments for other areas of policy to employers and employees, including: the collection of student loans on behalf of the Department for Business, Innovation and Skills (BIS); the payment statutory payments to employers on behalf of BIS and DWP; the payment of working tax credits; and the collection of attachment of earnings on behalf of HM Courts and Tribunal Service (HMCTS).
32. PAYE is a cumulative withholding system designed to collect the correct amount of deductions at source. It was introduced in 1944 to help the Treasury with the financial strains of the Second World War and its foundations have remained largely unchanged to this day. In 2010-11, PAYE accounted for 55% of the Government's revenue, collecting £132bn in income tax and £97bn in NICs making it the Government's largest revenue single source of revenue by far.

Employers

33. The PAYE system is operated by employers and consists of five major procedures:
- Calculation of deductions – including determination of what is taxable;
 - Determination and reporting of benefits-in-kind;
 - Payment of PAYE to HMRC (19th or 22nd day of the following month or quarterly in some cases);
 - Reporting when an employee leaves and joins (P45 & P46 forms); and
 - End-of-year reporting (P14 & P35 forms to HMRC and P60 form to employees no later than 6 weeks after the end of the tax year).

⁶ Lerman, Allen (Economist, Office of Tax Analysis, U.S. Department of Treasury), *Interview*, 23.03.12.

⁷ Income tax, NICs and other deductions may be collectively referred to as PAYE in the context of deductions.

34. In order to calculate deductions, employers require a tax code for each employee indicating an employee's tax-free pay. Tax codes are calculated by HMRC and are unique to each employee taking into account four components: income allowances, employee benefits, expenses and deductions.
35. Several other areas of policy have been brought into the PAYE system, adding additional responsibilities onto employers. These include:
- Student loan repayment: additional employee deduction;
 - Statutory payments:⁸ entitlements for employers in certain cases. Employers are responsible for calculating and deducting these payments from the pot of employee PAYE due to HMRC;
 - Payment of working tax credit: reduction in employee deduction; and
 - Attachment of earnings (court fine collection): additional employee deduction.

Employees

36. The PAYE system is designed to minimise contact with employees, but their obligations include:
- Reporting certain changes in income or circumstances to HMRC that may affect their amount of payable income tax;
 - Providing new employers with a P45 or P46 forms;
 - Completing or checking forms; and
 - Ensuring payment of the correct amount of tax.
37. Over 90% of employees in the PAYE system do not need to file a tax return, but some people's tax affairs are too complicated to be handled under PAYE and they are required to self-assess. This may be because these individuals need to report all of their income and/or capital gains.

HMRC

38. HMRC have outsourced most of the operation of PAYE to employers, but have the following responsibilities:
- Calculation and issuance of tax codes by processing information received from employees and employers;
 - Annual reconciling a taxpayer's income and deductions. HMRC match monthly deductions with monthly payments and reconciling the difference for each individual employment, and then look at a taxpayer's entire income and deductions across all employments.
 - Making necessary reconciliations and issuing revised tax codes;
 - Enforcing compliance with the PAYE legislation (i.e. penalty regime);
 - Interacting with other government departments on policy areas within the PAYE system; and
 - General oversight of the PAYE system.

Employer Payroll

39. RTT's design objective to integrate PAYE reporting with payroll. Given this context, it is worth reflecting on the role of payroll within an employer company. There are four core functions of payroll:

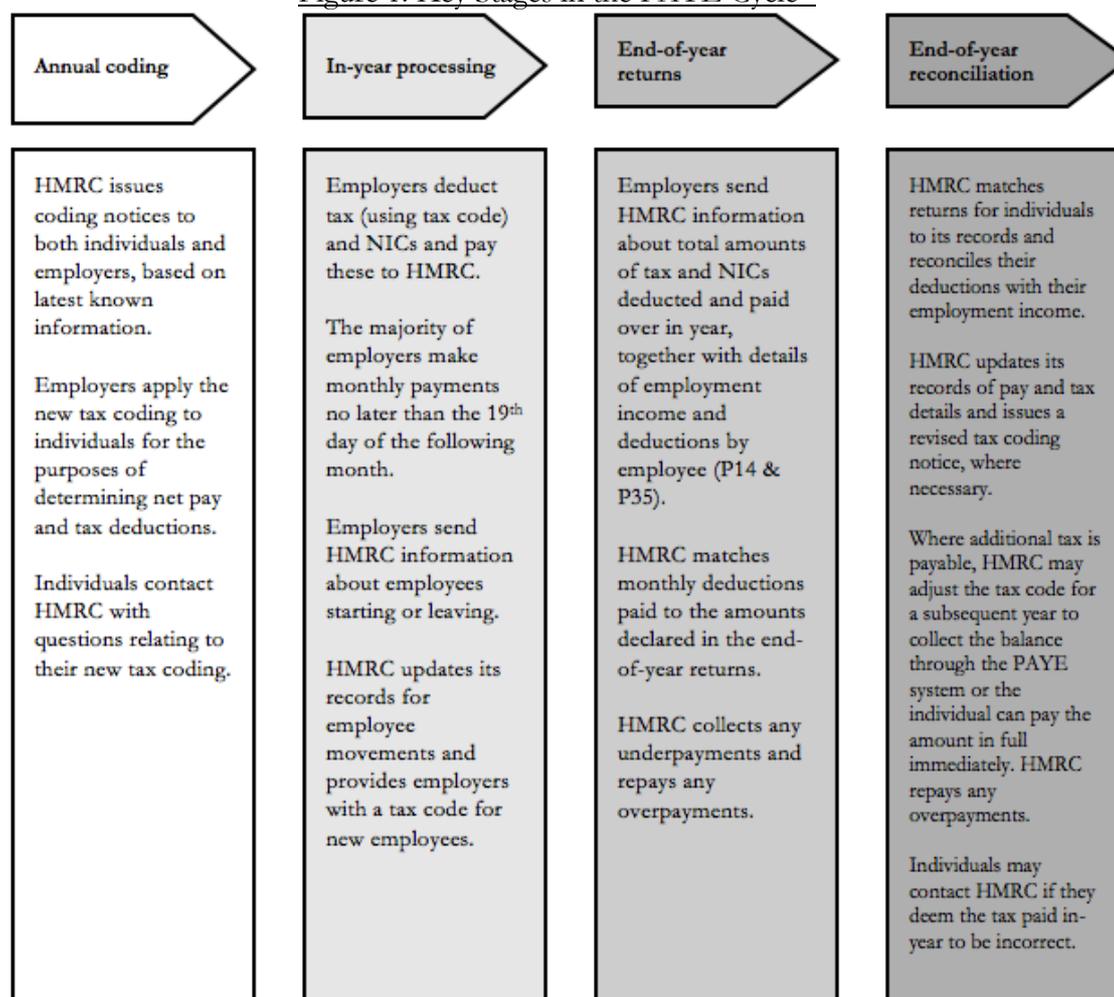
⁸ Statutory payments include: statutory adoption pay, statutory maternity pay, ordinary statutory paternity pay, additional statutory paternity pay, and statutory sick pay.

- Paying employees on time and accurately;
- Providing financial information;
- Compliance and statutory obligations; and
- Liaising with HMRC.

It is important to note that whilst PAYE forms a large part of payroll’s functions, two of its four core functions would still exist if there were no PAYE requirements. Payroll would still need to pay employees and keep track of an employee’s gross pay-to-date, annual pay and expenses. PAYE is an administrative burden imposed on employers (and their payroll) and should be considered separately from payroll – something that all employers have to do.

40. Organisational payroll arrangements vary enormously. They may be in-house, outsourced (i.e. accountant, payroll professional etc...) or a mixture. Large employers may have a dedicated payroll staff or a department; whereas for micro-business, a general employee or business owner is more commonly responsible for managing the payroll. According to HMRC, 77% of employers (or their agents) use commercial payroll software.⁹ Some employers may have fully integrated payroll, HR and expenses systems, whereas for others each function may be separated.

Figure 1: Key Stages in the PAYE Cycle¹⁰



⁹ Gauke, David (Exchequer Secretary to the Treasury), Hansard, HC Deb, 25.06.12, c78W.

¹⁰ NAO (July 2011), HM Revenue & Customs 2010 Accounts: Report by the Comptroller and Auditor General, p. 32.

The National Insurance and PAYE Computer Service

41. The NPS is HMRC's PAYE records computer system, which it uses to carry out its business of administering the PAYE system. It was fully introduced in 2010 and holds information by a single taxpayer account. NPS is a significant improvement from the old COP system (Computerisation of PAYE), which had been built in the 1980s and consisted of 12 separate regional databases organised by employer. NPS has several major benefits:
- Organises the administration of the PAYE system around the taxpayer;
 - Increases HMRC's ability to complete its end-of-year reconciliation of taxpayers' records automatically;
 - Improves the effectiveness and efficiency of manual processing; and
 - Increases the number of taxpayers starting the year with the correct tax code.
42. The end-of-year reconciliation under the old PAYE computer system was a manual process that 'required considerable manpower'.¹¹ With the new single taxpayer account under the NPS, reconciliations are much more computerised. Stephen Banyard, Director of Personal Taxation illustrated this point to the Committee of Public Accounts:¹²
- 'Under the old pay-as-you-earn system we had to manually reconcile 16 million or 17 million records a year; under the new one, we expect to have to reconcile 3 million to 4 million a year, so there is a huge reduction in the amount of manual work we have to do.'
43. Unfortunately the introduction of the NPS was highly problematic and had to be delayed for a year. We reported back in March 2010, that there were 'significant teething problems with the system' caused by poor data quality, which resulted in the issuance of incorrect coding notices.¹³ This led to the deferral of the 2008-09 end-of-year reconciliations until September 2010. NPS is now fully functional.

¹¹ House of Commons Treasury Committee (July 2011), Administration and Effectiveness of HM Revenue and Customs, Sixteenth Report of Session 2010-12, HC 731, p. 26.

¹² House of Commons Committee of Public Accounts (November 2011), HM Revenue & Customs: PAYE, tax credit debt and cost reduction, Fifty-eighth Report of Session 2010-12, HC 1565, Ev. 22.

¹³ APPTG (2010), Improving PAYE: How information is collected and managed in the administration of Income Tax, p. 22.

Chapter 2: The PAYE Problem

44. The PAYE system was introduced in 1944. It was designed and implemented in nine months and did not apply to all employees. Today, PAYE applies to all employees earning above the NIC threshold, and also the working environment has changed dramatically. However, the fundamental operation of PAYE remains unchanged, albeit delivered via and administered by a more computerised version. The APPTG has called for the PAYE system to be fundamentally reformed since our establishment, particularly in our last two reports on the operation of PAYE.
45. This chapter assesses the negative dimensions of PAYE mostly covering old ground through amalgamating our core argument from past reports; and the next chapter lays out our vision for a PAYE system fit for the 21st Century. Both chapters form our case for the modernisation of PAYE. The basis of our case is three-fold:
- The PAYE system has several negative dimensions across its three stakeholders, which also acts as a restraint on policy delivery across government;
 - The Government has the capability to remove most of (if not all) PAYE's negative dimensions through implementing Centralised Deductions; and
 - The benefits of Centralised Deductions far outweigh the costs and therefore the Government should bring PAYE into the 21st Century.

Employers

46. The UK is one of only three OECD countries where businesses cited personal income tax as the most administratively challenging tax they deal with.¹⁴ In the 2006 KPMG report 'Administrative Burdens – HMRC measurement project' it was observed that:¹⁵

'Employer taxes are a common area for business complaint. This in part reflects the burden – even though the process can be managed, possibly with the assistance of outsourcers or software, there is still a considerable burden in complying with the tax obligations... Many businesses resent being treated as an "unpaid tax collector" and then made to feel that they are "automatically ... in the wrong" if there is an error.'

Moreover, the administrative burden is regressive and disproportionately expensive for small business.

Administrative Burden on Business¹⁶

47. There have been two major studies on administrative cost of PAYE to business in the past twenty years – the Bath Report (1996)¹⁷ and KPMG (2006).¹⁸¹⁹ The total cost of PAYE on business according to Bath is £2bn, whereas KPMG is £901m. The differences between these figures are more

¹⁴ OECD (2008), Programs to Reduce the Administrative Burden of Tax Regulations in Selected Countries.

¹⁵ KPMG (March 2006), Administrative Burdens – HMRC Measurement Project, Report by Tax Area: Part 11: Employer Taxes pp. 4-5.

¹⁶ All figures in this chapter are adjusted for inflation.

¹⁷ Centre for Fiscal Studies University of Bath (October 1998), The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995-96.

¹⁸ KPMG (March 2006), Administrative Burdens – HMRC Measurement Project.

¹⁹ According to the Treasury Select Committee, HMRC is currently updating the KPMG study: Treasury Select Committee, *op cit*, p. 10.

attributable to variations in methodology, rather than a reduction in the cost of administering PAYE. KPMG identify three distinct costs of PAYE for business:²⁰

Table 1: Administrative Burden on Business

Type of Cost	Cost (£m)
Internal	374
Acquisition	248
External	279

48. Form-filling accounts for the majority of PAYE's administrative burden on business, costing £734m, which accounts for 81% of the total administrative burden. The end-of-year process is the most significant contributor to the burden of form-filling, with the P14 & P35 forms costing £249m (28%) and the P11D form for expenses and benefits-in-kind costing £156m (17%). Since KPMG, HMRC has computerised more of PAYE through the greater use of online channels. But, as there is no authoritative study since KPMG, it is unclear whether this has reduced the administrative burden. HMRC have, however, recently estimated the cost to business of administering the P14 & P35 forms at £300m, which suggests the burden is at least as great as before.²¹
49. The complexity of the tax system and additional areas of policy in the PAYE system also increase the administrative burden on business, particularly in terms of understanding compliance obligations. Various international studies demonstrate the relationship between the complexity of the tax system and the cost of tax administration (for the all three stakeholders).²² The APPTG supports the wider tax simplification agenda, although the focus of our report is on the operation of PAYE. However, John Whiting (Office of Tax Simplification) has noted that the PAYE system also 'constrains tax policy'.²³
50. It is important to note that employers receive a cash-flow benefit from operating the PAYE system. PAYE represents a free short-term loan from the government. For example, an employer paying staff monthly on the 28th day of the month will receive roughly a three-week cash-flow advantage before having to pay HMRC the withheld PAYE on the 19th or 22nd day of the following month. PAYE is especially advantageous for the cash-flow of employers who pay quarterly.
51. At present HMRC has no data to ensure that employers pay over the correct amount of PAYE month-to-month, as the reporting process occurs after the end of the tax year. Numerous stakeholders have suggested that it is not uncommon for businesses to pay less than the full amount of PAYE over to HMRC on month-to-month basis, which disadvantages compliant businesses.

Additional Burden on Small Business

52. The administrative burden of PAYE is highly regressive and therefore falls disproportionately on small businesses. PAYE compliance costs disadvantage small business over large business. Figure 2, from KPMG's study, illustrates this as 86% of the administrative burden of PAYE falls onto micro and

²⁰ An internal cost is the cost of activities that business undertakes in order to be compliant; an acquisition cost is the non-time costs incurred by business (i.e. payroll software); and an external cost is the cost of working with intermediaries (i.e. payroll agent – such as accountant or payroll professional).

²¹ HMRC (December 2010), Impact Assessment of Improving the operation of Pay As You Earn (PAYE): Real Time Information.

²² See for example: Cordes, J. & Holen, A. (September 2010), Should the Government Prepare Individual Income Tax Returns? September 2010 or Laffer, A., Winegaren, W. & Childs, J. (April 2011), The Economic Burden Caused by Tax Code Complexity.

²³ Whiting, J. (2003), 'Employment taxes: Where are we going?', Economic Affairs, Vol. 23, No. 1, p. 11.

small business, with micro business accounting for 69% of the total burden. Moreover, Figure 3, taken from the Bath Report further illustrates the highly regressive nature of PAYE in terms of compliance cost per employee. The highly regressive nature of PAYE's administrative burden reflects the economies of scale associated with its operation. These economies are additionally derived from the learning costs of PAYE's complex compliance obligations.

Table 2: Share of the PAYE Administrative Burden

No of employees	Total administrative burden (£m)	Share
1-9	621	69%
10-49	155	17%
50-249	56	6%
250+	70	8%
Total	901	100%

Table 3: PAYE Compliance Cost per Employee

No. of employees	Compliance cost per employee (£)
1-4	449
5-9	223
10-49	139
50-99	90
100-499	70
500-999	45
1,000 - 4,999	45
5,000+	8

Employees

53. Due to changes in the work environment, the PAYE system is no longer able to accurately calculate withholding at source for a significant minority of taxpayers. This causes a host of negative consequences and increases employee compliance costs. Moreover, employees find the PAYE system difficult to understand and the nature of its design disengages them from their own tax affairs.

PAYE Breakdown

54. The PAYE system is no longer able to perform the principal design function of a cumulative withholding system - collecting the correct amount of tax at source. HMRC notes that '[w]hilst PAYE works well for a large majority of people, there is a significant minority ... for whom PAYE works less well'.²⁴ For the last tax year, there were under or overpayments for 5.1 million people.
55. Reconciliations are usually unexpected by taxpayers and can create a range of negative financial and emotional consequences, especially in cases where a large bill for underpayment is presented by surprise and unbudgeted. The APPTG has accumulated correspondence with distraught taxpayers in this position since our establishment and we have found that the negative ramifications are commonly exacerbated by HMRC's troublesome record on customer contact and service. For example, in 2010-

²⁴ HMRC (July 2010), *op cit*, p. 11.

11 only 48% of calls were answered and 36.8% of post was handled within 15 working days.²⁵ Furthermore, stakeholders from our previous research have informed us that payroll departments are often expected for resolving PAYE breakdown, increasing their costs.

Why does the PAYE system breakdown?

56. There are a variety of reasons across PAYE's three stakeholders why miscalculation at source may occur.²⁶ Several of these are not related to the PAYE system itself and may result from the complexity of tax system and/or compliance requirements. Miscalculation may also be the result of human error. However, there are two primary and interrelated reasons for PAYE breakdown:

- Over-reliance on an inadequate system of in-year reporting; and
- Poor data quality.

57. The PAYE system is predicated on HMRC knowing when an employee starts working for their employer; when the employee stops working for them; and the employee's total pay to date. At the time when PAYE was introduced in 1944, the labour market was more rigid than it is today and many employees had one job for life and this helped to ensure that the tax code system worked effectively. But, the labour market today is significantly more complex and the modern worker is more flexible and mobile. For example:²⁷

- Higher amount of taxpayers hold multiple sources of income (the number of second jobs increased by 68% between 1984 and 2001);
- Casual employment is more common;
- Average job time is shorter (20% last less than one year and 5% less than 3 months); and
- People move job more frequently (13 million people moved job in 2006).

58. As employers only report PAYE at the end of the tax year, the PAYE's key in-year reporting mechanism (P45 form) is called into action considerably more often. This is problematic because the PAYE system was not designed to be overly reliant on its in-year reporting system and also because of another change since 1944 - a move from weekly to monthly payroll. Denis Madden, a former HMRC official who volunteers with Tax Help For Older People told the APPTG in 2009:

“The chances of you getting a P45 on the day you leave is pretty remote, and yet the whole PAYE system was designed around a P45 being given and that P45 being given to the new employer on your first day.”²⁸

As a result, the PAYE system often finds itself left behind.

59. The Treasury Select Committee commented that '[d]ata quality has been a key weakness in the PAYE system to date'.²⁹ Approximately 80% of matching problems³⁰ are caused by incorrect data about an employee's name, NINO or date of birth. As noted in Chapter 1, the NPS's introduction was plagued by problems with data quality following the transfer from the old system. However, there has been an improvement in data quality as of late, as the NAO recently reported that only 1 million items were

²⁵ NAO (June 2012), HM Revenue & Customs 2011-12 Accounts: Report by the Comptroller and Auditor General, p. 23; and for more information on HMRC's customer service see: APPTG (2011), PAYE Review and Recommendations.

²⁶ See: LITRG (May 2012), 5.1 million reconciliations – not errors.

²⁷ Madden, Dennis (Tax Help for Older People), Telephone Interview, 11.12.09.

²⁸ Ibid, p. 27.

²⁹ HC 731, *op cit*, p. 29.

³⁰ When HMRC matches returns for individuals to its records.

placed at risk of inaccurate coding this year, compared with 11 million last year.³¹ HMRC estimates 97.2% accuracy for 2012-13 tax codes.³²

Taxpayer Disengagement

60. As noted in Chapter 1, the PAYE system is designed to minimise the role of taxpayers. Reductions in compliance costs for taxpayers are desirable, whereas its effect - disengagement from the tax system - is a problematic feature. Angela Williams (ICAEW) noted that the PAYE system has created an ‘ostrich approach’,³³ where taxpayers assume they do not have any responsibilities in the operation of the PAYE system. This problem can lead directly to the miscalculation of PAYE in cases where taxpayers have not provided HMRC with all the information they need to calculate their tax code or when a taxpayer fails to spot an error made by their employer or HMRC.
61. The widespread lack of understanding about the PAYE system makes the task of both HMRC and the employer more difficult. This has become more problematic as the amount of contact between taxpayers and HMRC, and taxpayers and employers (on PAYE issues) has increased significantly since the introduction of PAYE. HMRC note that they take approximately 8.6 million telephone calls in relation to PAYE, most of which are ‘from customers seeking help in completing forms, ascertaining whether tax codes are correct or asking about a repayment of tax’.³⁴
62. An additional dimension of disengagement of a different nature is that between the citizen and the state. The taxpayer does not receive any statement from HMRC showing the total amount of tax they have paid for the year; an employee only receives a P60 form from their employer after the end of the tax year detailing their pay and PAYE deductions for that specific employment income. Whilst paying tax is a fundamental commitment made by the citizen to the state, it is symptomatic of the current PAYE system that the citizen is not informed at any point of the amount they contribute.

HMRC

63. The PAYE system is expensive to administer and has been identified by the 2010 Spending Review as an area for cost reduction. It also results in lost revenue. HMRC spends over £1bn annually administering the PAYE system accounting for approximately one third of their total budget. The figures are detailed in Table 4 below. The precise figures for the end-of-year reconciliation spend are not available,³⁵ although this has clearly increased as a result of PAYE breakdown and the backlog of open cases, which HMRC are still clearing.

Table 4: HMRC Administration Cost³⁶

	2006-07	2007-08	2008-09	2009-10	2010-11
Income tax PAYE (£m)	944	949	952	860	839
NIC (£m)	338	374	371	351	305
Total (£m)	1,283	1,323	1,322	1,211	1,144

³¹ NAO (2012), *op cit*, p. 22.

³² Ibid.

³³ Williams, Angela (ICAEW), *Interview*, 18.11.09.

³⁴ HMRC (December 2010), *Improving the Operation of Pay As You Earn (PAYE): Collecting Real Time Information: Consultation Document*, p. 10.

³⁵ Gauke, David (Exchequer Secretary to the Treasury), Hansard, HC Deb, 27.06.12, c307W.

³⁶ Gauke, David (Exchequer Secretary to the Treasury), Hansard, HC Deb, 22.05.12, c581W.

64. PAYE breakdown increases HMRC's administration costs. When a miscalculation or suspected miscalculation cannot be reconciled automatically it creates an open case requiring manual clarification. As noted in Chapter 1, the introduction of the NPS in 2010 has increased automation and made manual clarification more efficient. However, the sheer volume of miscalculations (many of which pre-date the NPS) has caused an enormous backlog of open cases. In 2010, the backlog of pre-NPS open cases stood at 17.9 million, many of which dated back as far as 2003-04. HMRC forecasted it would cost £57.3m to clear the backlog, including the recruitment of 2,500 temporary staff, who last year manually reconciled 6.7 million cases. At present, there is still a pre-NPS backlog of 5.1 million open cases.³⁷
65. In the first in this series on the operation of PAYE, the APPTG recognised the significance of the NPS, but also its limitations:³⁸
- ‘Although NPS is an important step forward, it only solves one problem with PAYE: HMRC’s ability to link up and see an individual’s multiple income sources on its database. But it will not improve the quality of the information arriving at HMRC or the speed with which that information arrives, which will lead to continuing failures in the PAYE calculation and reconciliation process.’
66. The 2010 Spending Review found the area of Personal Taxation (the area within HMRC that administers the PAYE system) as being too costly to administer, despite a reduction of £111m between 2008-09 and 2009-10. In order to meet the Spending Review targets by 2015, the Personal Taxation section will have to reduce its costs by £209m, including a reduction in its headcount from 24,900 to 16,000 people. The Department has both a short-term process management strategy and a long-term process-improvement strategy. However, according to the NAO both strategies are fairly presumptuous and ‘the Department does not have a contingency plan should these workload reductions not materialise’.³⁹
67. PAYE breakdown also incurs costs through lost revenue. This is because the Finance Act (2008) limits tax collection to four years and given the scale of the backlog, there is not enough time to work through all the open cases before they expire. Furthermore, small amounts of owed tax are considered inefficient to pursue. According to the NAO, £150m in underpaid tax from 2004-05 and 2005-06 was written off, along with £500m from 2006-07.⁴⁰ Last year, HMRC wrote off £756m in income tax, most of which resulted from a decision to temporarily increase the amount which underpayment is not pursued from £50 to £300 as part of their strategy to stabilise PAYE by March 2013.⁴¹

Government

68. As already noted, employers report employee income and deductions after the end of the tax year. Therefore, the government does not have access to live earnings data in-year, which is problematic for policy delivery given the recalibration of welfare entitlement since the 1980s. In the modern welfare state, eligibility criteria for entitlement or services are increasingly based on means. This is clearly the

³⁷ NAO (2012), *op cit*, pp. 17-23.

³⁸ APPTG (2010), *op cit*, p. 23.

³⁹ NAO (2011), *op cit*, pp. 24-25.

⁴⁰ *Ibid*, p. 37; and note that a proportion of £500m in lost revenue was attributable to incorrect coding notices as a result of the faulty introduction of NPS, rather than the operation of the PAYE system per say.

⁴¹ Note: Under a stabilised PAYE system there would be no more than three open tax years that would be dealt with at any point.

case for DWP, but also for several other government departments. For example, the NHS means tests for prescriptions and the Department for Education (DfE) means tests for free school means.

69. However, the PAYE system only provides the government with information on income for means testing once a year, by which time it is already out of date. Personal Tax Credits are also calculated on the previous year's income and therefore are always out of date. The lack of accurate data also results in a system riddled with error and fraud. For example, in 2010-11 error and fraud within the Personal Tax Credits System alone was estimated at £2.46bn, accounting for 8.6% of the total amount, and £290m in credits were not paid to claimants because of error.⁴² It's also high inefficient to administer, with a process involving:
- HMRC using the NPS to put together a household's income, deductions and allowances;
 - Sending out two copies by post;
 - The household checking and if necessary amending the information before sending it back; and
 - HMRC processing the paperwork.
70. As the PAYE system does not deliver in-year earnings data, many government departments independently rely on in-year self-reporting as their basis for means testing. This involves mass duplication and a high risk of error and fraud. As Anne Begg, Chair of the DWP Select Committee commented, 'the benefits system currently relies on trust'.⁴³
71. As noted in Chapter 1, several other areas of policy have been incorporated into the PAYE system. Statutory payments are entitlements for employers, whereas tax credits, student loans and attachment of earnings are deductions and payments for employees. These additional requirements increase both the chance of PAYE breakdown and level of miscalculation. Moreover, they suffer from high levels of inaccuracy, which also causes an additional administration. For example, deductions for student loans will continue to be made in-year following full repayment, as repayment cannot be deduced until information is provided to HMRC after the end of the tax year.
72. Whilst in Chapter 1 we have described three stakeholders in the operation of PAYE – employers, employees and HMRC - every government department has an interest or potential interest in using PAYE data and/or the PAYE system. As means testing for entitlements and services continues to increase, the lack of in-year accurate earnings data becomes more problematic for government departments. Moreover, there are further uses for in-year PAYE data beyond means testing, such as work related policy or analysis.

⁴² NAO (2012), *op cit*, p. 38.

⁴³ Begg, Anne (Chair, DWP Select Committee), *Interview*, 12.01.12.

Chapter 3: A PAYE System for the 21st Century⁴⁴

73. Since HMRC published their discussion document ‘Improving the Operation of PAYE’ in July 2010, there has been a lot of debate about the PAYE system and the question of reform. Whilst the previous chapter outlined a number of PAYE’s negative dimensions, we reject suggestions that the PAYE system is ‘broken’ and that its reformation is a matter of urgency. However, our vision for a new PAYE system – Centralised Deductions – is a fundamental change to the model of PAYE and would require the necessary time for implementation and adaptation.
74. The benefits of Centralised Deductions to employers, employees, HMRC and across government would be substantial. Under Centralised Deductions, employers would interact almost entirely with the payments systems. It is an entirely new model for PAYE. The APPTG first introduced the idea of Centralised Deductions into the public arena in March 2010. We reported that HMRC and VocaLink, who operate the Bacs and Faster Payment payments systems, had discussed:⁴⁵
- ‘[A] project [that] would have employers pay their employee gross pay and have the Bacs Service perform the income tax and NIC calculation... [and that] HMRC has a business case’.
75. HMRC outlined the Centralised Deductions option in their July 2010 discussion document, along with RTI. This followed several years of development and preparation, as a team within HMRC - the PAYE Improvement Group - had been looking at the concept of Centralised Deductions since 2005. Stephen Timms MP, former Financial Secretary to the Treasury (responsible for HMRC at the time) recalls interacting with the group, commenting that he found Centralised Deductions “very attractive” and “asked advice from officials on [its] implementation.”⁴⁶ Timms notes that he “never got as far as phasing it in” as “Leslie Strathie [HMRC Permanent Secretary at the time] was opposed”.⁴⁷
76. Centralised Deductions is a radical idea and as such, opinion was divided following its formal introduction by HMRC. HMRC reported that around a fifth of those who expressed a view were in favour, whereas ‘the majority of respondents expressed significant concerns’.⁴⁸ In our discussions with stakeholders, Centralised Deductions was referred to as a ‘crazy idea’, ‘a dream’ and ‘a fantasy’.
77. We take the idea of Centralised Deductions and the benefits it would bring seriously. However, it is not merely an idea, as HMRC have built a fully functioning proof of concept model. The technological capability exists and the Government can deliver the following advantages should it choose:⁴⁹
- One off revenues reduction of employer PAYE float (up to £18bn depending on how much the float is reduced);
 - Increased tax revenues through the collection of the correct tax (up to £1bn per annum);
 - Reduction of HMRC staff required for collecting and correcting tax forms (estimated at 6,000 people);
 - Reduction in tax credits error and fraud (up to £4bn per annum);
 - Removal of up to 100 million pieces of HMRC paper along with a reduction in the complexity of the system and costs for business (up to £500m per annum);

⁴⁴ As with the previous chapter, the current (pre-RTI) PAYE system forms the unit of comparison. Centralised Deductions and RTI are juxtaposed in Chapter 5.

⁴⁵ APPTG (2011), *op cit*, pp. 42-43.

⁴⁶ Timms MP, Stephen (Shadow Minister for Employment), *Interview*, 14.06.12.

⁴⁷ *Ibid*.

⁴⁸ HMRC (December 2010), *Consultation*, p. 12.

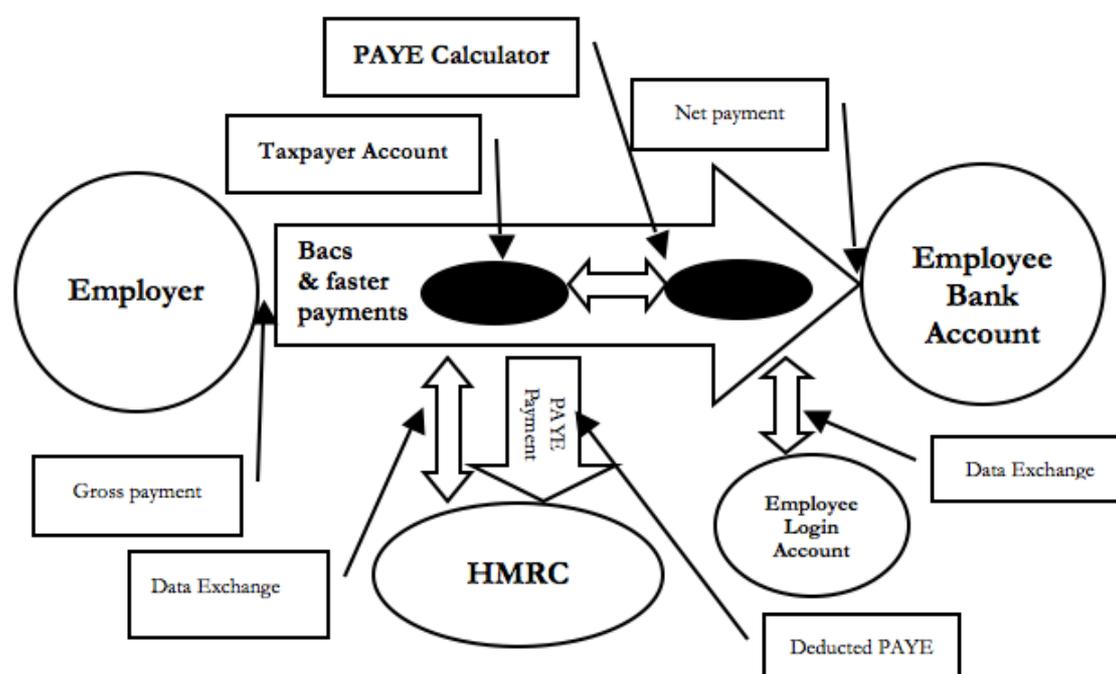
⁴⁹ Seymour, Peter (Head of Government and Public Sector, VocaLink), *Interview*, 26.01.10.

- Moves to electronic (where possible) delivery of payslips and tax account records; and
- The ability to make changes to tax rates & allowances in near real time.

A New Model for PAYE

78. Centralised Deductions would utilise the existing Bacs and Faster Payments infrastructure through which 96% of employees are currently paid. This payment infrastructure is part of the UK's critical national infrastructure and is regulated by government.⁵⁰ Under Centralised Deductions, employers would no longer be responsible for the calculation of PAYE deductions and would simply pay their employees in gross. Once in the payments system, the payment instruction would interact with both a taxpayer's personal account and a centralised calculator.
79. A taxpayer's personal account would contain personal tax allowances and other reliefs, as well payment and deduction information. Interacting with the taxpayer's account, the payment instruction is fed through a centralised calculator, which would calculate the relevant PAYE deductions. The net payment would be sent directly to the employee's bank account, and the deduction would be sent to HMRC at some point. This process is shown in Figure 2 below.

Figure 2: Centralised Deductions PAYE System



Employers

80. 'The PAYE Problem' highlighted the administrative burden that PAYE places on business, particularly small business. Centralised Deductions would fundamentally change the role that employers play in the PAYE system, as they would no longer have any reporting obligations or need to calculate and make deductions or operate tax codes. PAYE would be considerably less regressive and would create a more level playing field between large and small business.

⁵⁰ The Bacs and Faster Payment services are currently operated by VocaLink, a private company collectively owned by the UK's banking sector.

81. Through removing red tape and disintermediation, Centralised Deductions is estimated to save business £500m annually. Employers would still have to comply with PAYE under Centralised Deductions, but under a greatly reduced and simplified regime. Employers would be responsible for:⁵¹
- Determining pay liable for tax; and
 - Determining taxable expenses and payments.⁵²
82. Employer payroll as an industry would be much leaner under Centralised Deductions, focusing on value added practices, rather than compliance with government regulation. These include:
- Ensuring that employees are paid timely and accurately; and
 - Providing financial information.
83. Centralised Deductions represents a new model of tax withholding, as it would be both cumulative (i.e. accurate) and place minimal compliance costs on employers. It would make the UK a more attractive destination for business; and domestic business would benefit by means of international comparative advantage.

Employees

84. In the previous chapter, we outlined two problems that taxpayers face as a result of the PAYE system:
- PAYE breakdown; and
 - Taxpayer disengagement.

Under Centralised Deductions both of these issues would be removed from the PAYE system and it would also revolutionise government transparency the way that citizens interact with the state.

85. HMRC note that Centralised Deductions would '[r]esult in correct PAYE calculations in almost all situations'.⁵³ This includes the significant minority of taxpayers for whom the current PAYE system doesn't work so well, which are particularly those with highly flexible and/or mobile working patterns. Taxpayers would still have to report information to HMRC in order to ensure that PAYE is accurate calculated, although they could do this themselves directly through a self-service online account showing their personal allowances and reliefs.
86. A personal account would also include up-to-date and fully accurate information on their income and deductions. It would transform the way the citizens interact with their own tax affairs. The account should also include a breakdown of public spending and show how much a citizen has personally contributed to each government department and policy area. Moreover, citizens would be able to elect whether to have this information sent to them and how frequently; for example, it would be possible for it to be included on a bank statement.
87. Under Centralised Deductions, the operation of the PAYE system would be greatly simplified (no forms or tax codes) and therefore a lot easier for taxpayers to understand. Moreover, with the removal of forms and the accurate calculation of PAYE many of the reasons why taxpayers contact HMRC at present would not exist. The PAYE system would be designed to encourage taxpayers to use their self-service login and engage more with their contribution, and also how the government spends their income.

⁵¹ HMRC (July 2010), *op cit*, p. 26.

⁵² Note: Employers would not need to calculate statutory payments.

⁵³ *Ibid*, p. 22.

HMRC

88. ‘The PAYE Problem’ showed how the current PAYE system is overly expensive for HMRC to administer (increased by PAYE breakdown) and results in lost revenue. Under Centralised Deductions, PAYE would be considerably cheaper to administer and not result in any lost revenue. HMRC would have far less interaction with employers, as they would be interacting entirely with the payments system; and there would be inherently less interaction with taxpayers for the reasons noted above. According to HMRC, the administrative savings would result from: ⁵⁴

- Correct PAYE deductions and therefore much less need to adjust tax after the year end;
- Removing the requirement to annually reconcile;
- Removing a significant of paperwork; and
- Improved data quality.

89. HMRC’s role in the PAYE system would be greatly reduced under Centralised Deductions and it would enable them to make efficiencies far beyond its 2010 Spending Review settlements, including the near wholesale removal of various areas, such as collecting and correcting tax forms. It would be able to focus its resources more on compliance and enforcement, and more pressing issues of public concern, such as tax simplification and the tax avoidance regime. In terms of revenue, Centralised Deductions would result in up to an £18bn one off payment, as the PAYE float would no longer be required and approximately £1bn additional revenue annually through the collection of accurate PAYE at source.

The Big Cross-Governmental Prize

90. Centralised Deductions would not only improve existing policy delivery, but also opens the door for a new generation of policy, held back by the current PAYE system, and also the way that businesses and citizens communicate information with government. Government, citizens and businesses would receive significant gains as a result of Centralised Deductions. The big cross-governmental prize is derived from two features of Centralised Deductions:

- Central feed of real time PAYE data; and
- Automatic reconciliation between deducted PAYE and benefit entitlement;

91. The availability of real time PAYE data from a central feed to government departments would take government policy delivery to an unprecedented level of accuracy, removing systematic fraud and error and allowing considerably more effective and efficient targeting of benefits and services. It would allow for considerable areas of bureaucracy across the public sector to be removed overnight and eliminate substantial amounts of duplication and inefficiency across government. Furthermore, in-year data would improve earnings and work related analysis and forecasts.

92. Under Centralised Deductions, the payment of benefits could be merged with PAYE deductions. Rather than taking income away from employees and paying it back to them through benefits, the two could be automatically reconciled. Information about benefit entitlement would be included in the taxpayer’s personal account within the payments system and would be taken into account by the centralised calculator. Benefit entitlement would be paid through a reduction in PAYE entitlement. If

⁵⁴ HMRC (July 2010), *op cit*, p. 26.

benefit entitlement exceeds PAYE deduction, then the system would facilitate the payment of additional benefits directly into an employee's bank account in a real time and accurate manner.

93. As noted above, a citizen would have full transparency over their contribution in income to the state, and also receipt in benefits from the state. Citizens would be able to login through their self-service account and see an itemised view of their debits and credits to the state. In essence it would be like a bank account. Moreover, as every benefit would be automatically reconciled through the same channel, the government would have a bird's eye of the entire benefits system and would be able to consider the benefits system in its entirety. In effect, a Universal Credit plus.
94. The APPTG has engaged with a number of government departments directly as part of our research into the benefits of Centralised Deductions across government. Table 5 below outlines policy areas that could theoretically be improved and/or facilitated under Centralised Deductions. Centralised Deductions also has the capability to act as the single two-way communications channel between employer and government, as employers could attach information to payments; and also between citizen and government, through the self-service login, removing much of the need for paper-based communications.

Table 5: The Big Prize

<p>Attachment of earnings (HMCTS, MoJ):⁵⁵ At present, employees can elect to have court fines collected through the PAYE system (if approved). HMCTS are reliant on employees telling them whom they work for and on employers for confirmation. This is inefficient and an invasion of employee privacy. Centralised Deductions would reduce administration for government and business through automatic reconciliation within the payments system, making collection wholly accurate and protecting the privacy of employees. Furthermore, at present, HMCTS also spends significant time tracking people down who owe fines. Through a central feed of data facilitated by Centralised Deductions, HMCTS could significantly enhance this function and reduce administration. It could even be carried out automatically where appropriate.</p>
<p>Business Surveys (ONS):⁵⁶ The ONS currently conduct around 80 surveys of business and local authorities in the UK, issuing around 1.7 million questionnaires to about 290,000 businesses. The data involved with a number of these surveys could be provided directly by Centralised Deductions and the channel would allow for other surveys to be conducted electronically, removing paperwork and bureaucracy. It would significantly reduce administration for the ONS and business, and allow the ONS to carry out better analysis.</p>
<p>Child benefit (HMRC): The Government's proposed changes to child benefit were problematic from a delivery perspective, adding a high degree of complexity to the system. Centralised Deductions has the capacity to deliver means tested child benefit through automatic reconciliation through the payments system.</p>
<p>Council tax: Under Centralised Deductions, council tax could be reconciled automatically if taxpayer's provided the relevant information through their self-service login, or the government decided that information would be automatically entered into the taxpayer's account within the payments system. This would reduce administration and improve accuracy for every council across the UK.</p>

⁵⁵ Morris, Grant (Head of Criminal Enforcement Team, Her Majesty's Courts and Tribunals Service), *Email*, 16.05.12.

⁵⁶ ONS, General information about business surveys.

<p>Flexible maternity and paternity leave (BIS):⁵⁷ The BIS paper 'Modern Workplaces' includes proposals for changing the maternity and paternity leave arrangements. The idea is that following eighteen weeks of maternity leave, the next thirty-four could be shared by drawing down from a joint account of leave, in segments if preferred. However, in order to deliver this policy idea, BIS requires accurate and real time information on how much leave partners are taking. Centralised Deductions could facilitate this policy at negligible administrative cost to business and government, and ensure compliance.</p>
<p>Health and wellbeing (DWP): Employees who become sick for an extended period often become unemployed subsequently. Centralised Deductions could provide information on an employee's Statutory Sick Pay, allowing for DWP to write to them offering support services and potentially intervening to help individuals recover and move back into work more easily.</p>
<p>HMT:⁵⁸ The availability of real time and accurate income information offers greater tax policy flexibility and improved management information for HMT. Under Centralised Deductions, HMT could make changes to tax rates and allowances in real time at a negligible additional cost.</p>
<p>Illegal working (UKBA, Home Office):⁵⁹ The information provided by real time earnings data can help establish identity and illegal working. It could also help establish the authenticity of potential sponsors.</p>
<p>Local authority allowances: There are a number of means tested local allowances, such as adoption allowances and personal budgets. These could be reconciled automatically under Centralised Deductions, reducing local administration and improving the effectiveness of targeting.</p>
<p>NHS Care and Prescriptions: The NHS offers a variety of means tested services. Through a central feed, the NHS could deduce earnings at a negligible administrative cost and target these services more effectively and efficiently.</p>
<p>Pensions credit (DWP): This is a means tested credit for increasing the state pension. Currently, this credit only has a 2/3rd take up rate, as its administration involves asking pensioners about their income and many do not respond. Under Centralised Deductions it could be paid automatically to all pensioners who qualify.</p>
<p>Personal and working tax credits (DWP): These are means tested in-work credits for low earners, which as mentioned in Chapter 2, suffer from high levels of error and fraud. Under Centralised Deductions, these could be deduced and reconciled automatically.</p>
<p>Personal independence payment (DWP): This payment will replace the disability living allowance. An element of it may be means tested, which could be automatically reconciled under Centralised Deductions and allow for efficient and effective targeting.</p>
<p>Statutory payments (BIS and DWP): Employers are currently responsible for calculating a number of statutory payments, which are subsequently deducted from the collective employee PAYE paid over to HMRC.⁶⁰ This procedure is burdensome and highly regressive, disadvantaging small business. Under Centralised Deductions, the calculation of statutory payments could be carried out centrally and reconciled automatically, entirely removing this burden on business.</p>
<p>School meals (DoE): These are means tested benefits for children from low-earning households. Under</p>

⁵⁷ Death, Andrew (Employment Relations, Department of Business, Innovation and Skills), *Telephone Interview*, 20.06.12.

⁵⁸ Kelly, Dympna (RTI Policy Advisor), *Email*, 01.03.12; and note: this point was made in relation to RTI.

⁵⁹ *Ibid.*

⁶⁰ See Chapter 1.

Centralised Deductions, the DfE could deduce household earnings at a negligible administrative cost through a central feed, allowing more effective and efficient targeting.
Student loans (Student Loans Company, BIS): Student loans are collected through the PAYE system. At present, they are deducted at a fixed rate of 9% above a threshold of £15,000 until the loan is fully repaid. However, under the higher education reforms to university funding, student loans will be repaid in a more dynamic manner, with the interest rate related to earnings. Under Centralised Deductions, student loans could be reconciled automatically at a negligible administrative cost to government and at no administrative cost to business or individual's with outstanding student loans.
Travel (Department of Transport): Free travel is age related and not currently means tested. Under Centralised Deductions, the Department of Transport could deduce earnings at a negligible administrative cost through the central feed allowing for effective and efficient targeting if they wish to do so.
Universal Credit (DWP): ⁶¹ The Government's welfare reform programme - Universal Credit – could be reconciled automatically under Centralised Deductions.
Winter fuel allowance (DWP): Winter fuel allowances are provided to pensioners and are not currently means tested. Under Centralised Deductions, winter fuel allowances could be reconciled automatically with pension earnings and means tested at a negligible administrative cost should DWP wish to do so.

95. The APPTG is cross-party group and we are not arguing on the merits of the various policies above. Our point is that Centralised Deductions would considerably improve the government of the day's capability to deliver the policy of choosing effectively and efficiently. In addition, we also consider the benefits to employees and employers, and the affect on citizenship to be an issue of cross-party consensus. Moreover, the idea of Centralised Deductions was developed under the last Labour Government and formally introduced by a Coalition consisting of the Conservatives and Liberal Democrats. It has support across the UK's three major political parties.
96. Table 5 illustrates our point that whilst the operation of PAYE has three stakeholders – employers, employees and HMRC – most government departments could benefit from the model of PAYE that we envisage.

Concerns and Considerations

97. Following HMRC's formal introduction of Centralised Deductions in July 2010, there were a number of concerns raised by various parties. The reaction was to be expected given the radical nature of Centralised Deductions and also because of the age of the current PAYE system it was proposed to replace. Most people are used to it and don't usually consider given its design objective. Moreover, some of the benefits to employers, employees, HMRC and across government come at the cost of several stakeholders currently involved the PAYE system (i.e. producer v consumer interest). The most common points of concern included:
- Data security; privacy and government transparency;
 - Employer and employee control over payments;
 - Employer loss of PAYE cash-flow advantage; and
 - Cost of implementation.

⁶¹ For more information on Universal Credit see Chapter 4.

98. Before addressing each of these concerns, it is important to note that the precise way in which Centralised Deductions would work was not decided in July 2010 and therefore our argument is only restrained by what is theoretically possible. Moreover, a number of these areas clearly require consideration and future planning should Centralised Deductions go ahead.
99. Several observers raised concerns over the risk posed the concentration of resources and by the security of data in relation to the threat of hacking. However, the Bacs service has been a secure transmission channel for over 40 years and the newer Faster Payments service for 4 years. They are the national payments infrastructure and are inherently trusted channels. Today, Bacs processes up to 90 million payments on a peak day and Faster Payments has now processed over 1 billion payments under government regulator security and resilience oversight.⁶² Moreover, it is also worth considering that there would be a significant reduction in data exchange and contact (e.g. tax codes, forms etc.) between employers and employees with HMRC, reducing risk and increasing security. There would need to be additional governance in relation to the infrastructure as a result of this change.
100. The data items under Centralised Deductions are not new, but they are shared in a different way, especially with the options for policy delivery outlined in Table 5. Each new data exchange requires legislation and the government would need to devise a data management plan. The objectives should be to minimise risk and protect privacy. At all times, only relevant data should be shared.
101. Centralised Deductions would significantly increase government transparency, particularly given the functionality we described with a self-service login account. However, some observers though argued that Centralised Deductions would reduce government transparency. There were also concerns about the security of an employee login account and this is a legitimate consideration. However, there are many security technologies available to ensure the system is secure, such as the security procedures used for online banking. We've previously reported that many other countries already have such a system, such as Canada, where citizens can login to their own account and pay their taxes or register for benefits. DWP will be launching a similar system for Universal Credit in October 2013.
102. A further area of concern regarded the control of payments and deductions. HMRC clearly stated that at no point would HMRC take control of employee's pay and that 'the money would, at all times, stay within the electronic banking system and would not be transferred to HMRC'.⁶³ The employer is interacting with the payments system, not HMRC.
103. A few objectors believe it is an employer's right to calculate and make deductions and were wary of the state interfering. We reject this thesis entirely. PAYE is an operation that exists solely because of the government and is thus an area of the state, albeit an outsourced one to employers. Unlike other policy where the government regulates a pre-existing activity, such as insisting that car owners purchase insurance, PAYE would not exist within government. On the other hand, cars would still exist without the government requirement to own car insurance.
104. A genuine area of consideration regards the propensity for errors. This involves both employer payroll error and any error that could arise as a result of the central calculator and/or the taxpayer account within the payments system. Future planning for Centralised Deductions would involve creating processes to accommodate both.

⁶² VocaLink, Infrastructure: Bacs and VocaLink, Infrastructure: Faster Payments.

⁶³ HMRC (December 2010), *op cit*, p. 14.

105. As noted in ‘The PAYE Problem’, employers gain a cash-flow advantage from PAYE before paying it over to HMRC on the 19th or 22nd day of the following month, with some employers enjoying a quarterly cash-flow advantage. The loss of this advantage was a point of concern raised by respondents to the July 2010 discussion document. However, HMRC responded:

‘Centralised Deductions makes no presumption about bringing forward the date deductions will have to be paid over to HMRC. If it were decided at a future point to move forward on Centralised Deductions the cash flow effect on employers would be a key part of the consultation.’⁶⁴

106. Under Centralised Deductions it is possible to retain the cash-flow advantage and even enhance it. Following the calculation of a deduction by the central calculator and the payment of an employee, the deducted PAYE could remain in the employer’s bank account until an agreed date where it would be transferred automatically to HMRC. Under Centralised Deductions, HMT would have enhanced information and HMRC would have greater security of payment. These new benefits could be used to look at extending the cash-flow advantage, aiding business with additional free borrowing time.

107. Several observers raised concerns over the cost of Centralised Deductions. However, the actual cost of implementation would be considerably lower than one might initially think. This is because Centralised Deductions uses existing national infrastructure. The upfront cost is estimated at £200, consisting of £100m for building the central calculator and £100m for government IT;⁶⁵ with an annual running cost estimated at £75m. Taking into the account the benefits, the costs are not significant. Moreover, there are a number of substantial IT projects planned within HMRC and DWP that would not need to take place. Centralised Deductions would incur an implementation cost on business, through acquisition of new software and change in business process, but when compared to the annual benefits and the one off payment of up to £18bn these would be inconsequential.

108. HMRC clearly stated in the discussion document that moving to a Centralised Deductions system of PAYE would require careful change management. All stakeholders would need to fully understand how the system would work and their changing roles and responsibilities. Given adequate time and resource, we envisage that such a change could be effectively managed through a phased transition. The first transition phase to Centralised Deductions is RTI. Centralised Deductions was presented by HMRC as ‘[a]n option for exploiting RTI’, which ‘could build on RTI and deliver further benefits for individuals, employers and HMRC’.⁶⁶ HMRC note that:⁶⁷

‘Once employers were sending information about income and deductions along with their payment instructions, the next step could be to use that information as the basis for centralising the calculation and deduction of tax, NIC and student loan repayments, moving the responsibility for doing the calculation away from employers’.

⁶⁴ Ibid.

⁶⁵ Note: A proportion of IT now built for RTI can be used for Centralised Deduction and represents a sunk cost. Therefore, the cost will now be less than £100m.

⁶⁶ HMRC (July 2010), *op cit*, p. 22.

⁶⁷ Ibid.

Chapter 4: Real Time Information

109. RTI is a priority Government programme aimed at improving the operation of PAYE and supporting DWP's introduction of Universal Credit. HMRC were allocated £108m in the 2010 Spending Review for investment in RTI and began a phased introduction in April 2012. According to the legislation, all employers must be fully migrated onto RTI by October 2013. It is undoubtedly the biggest change to the PAYE system since its introduction in 1944.
110. RTI is a change in the way that employers report PAYE information to HMRC. Under RTI, every employer will be required to report information about employee income and deductions to HMRC at-or-before the point of payment. At-or-before is absolutely fundamental to the concept of RTI. This is radical shift from the current reporting obligations for employee income and deductions, which occurs six weeks after the end of the tax year. HMRC intend for RTI to be integrated with an employer's regular payroll practice. RTI files will be submitted to HMRC via payroll software.
111. The stated objective of RTI is to bring PAYE into the 21st Century. HMRC argues that RTI will:⁶⁸
- Reduce administrative costs of PAYE for employers and HMRC;
 - Enable reductions in fraud, error and overpayments in the current benefits and tax credits system;
 - Increase the number of individuals taxed correctly through PAYE; and
 - Support DWP's introduction of Universal Credit.
112. RTI is groundbreaking internationally in terms of employer withholding reporting obligations. Of the OECD countries with cumulative withholding systems, twelve report annually, seven report monthly and one reports quarterly. For the countries with monthly reporting, the obligation to file ranges between the fifth and final day of the following month.⁶⁹ The most real time withholding reporting we are aware of is Bulgaria, where the employer is obligated to report no later than the day following payment for the respective month.⁷⁰
113. There is interest internationally in HMRC's RTI project, particularly in the United States. In December 2011, IRS Commissioner Douglas Shuman called for the development of a real time tax filing system.⁷¹ The APPTG met with a delegation from the IRS, who were interested in the concept of RTI.⁷² However, there were concerns from the Ways and Means Committee about increasing employer compliance costs.⁷³ There has been a lot of debate in the United States about their withholding system, although the real time tax proposal is not at an advanced stage.

RTI Official Policy Development

114. The Conservative Party had been considering ideas for improving the PAYE system before the formation of the Coalition Government following the inconclusive outcome of the 2010 General

⁶⁸ HMRC (December 2010), *Impact Assessment*.

⁶⁹ Appendix 2.

⁷⁰ Ibid.

⁷¹ Bloomberg (December 2011), IRS Commissioner Calls for Real time U.S. Tax Filing System.

⁷² Davis, Jonathan (Chief of Staff, IRS), Stevens, Thomas (Manager - International Meetings, Travel, and Visitors Programs, IRS), Tackney, Stephen (General Counsel, IRS) and Ligeia Donis (General Counsel, IRS), *Interview*, 27.03.12.

⁷³ Armstrong, Chris (Oversight Counsel, United States House of Representatives Ways and Means Committee), *Interview*, 23.03.12.

Election. The Coalition announced in the June 2010 Emergency Budget that they intended to consider the PAYE system:

‘The Pay As You Earn system is a fundamental part of the UK tax system. The Government wishes to explore how it could be improved in order to reduce costs and make the system easier for employers and HMRC to administer. As an initial step, the Government intends to consult with employers and payroll providers on mechanisms that could support more frequent or real time PAYE data.’⁷⁴

115. Shortly afterwards in July 2010, HMRC published a discussion document entitled ‘Improving the Operation of PAYE’. It outlined a next step for improving PAYE and a longer-term proposal:⁷⁵

- RTI; and
- Centralised Deductions.

116. The discussion document received over 400 responses with the majority in favour of RTI, but opinion was more divided on Centralised Deductions. In December 2010, HMRC brought RTI forward to full consultation stage – publishing a consultation document and an impact assessment. The consultation document included a timetable for the implementation of RTI. In relation to Centralised Deductions, HMRC stated that ‘[c]onsideration will only be given to further developments of PAYE once RTI has bedded in and been evaluated’.⁷⁶

117. The consultation ended in February 2011, receiving 187 formal responses mostly from software developers and employers.⁷⁷ HMRC received a great deal of detailed feedback from the consultation and began to focus on the delivery of RTI. Table 6 below shows RTI’s development to date.

Table 6: RTI Development

July 2010	HMRC publish a discussion document on improving PAYE
December 2010	RTI taken to full consultation
May 2011	HMRC announce that RTI will be delivered through the Interim Solution and publish a technical guide for software developers
November 2011	HMRC publish draft legislative changes relating to PAYE
April 2012	HMRC begin piloting RTI
May 2012	HMRC consult on RTI compliance principles

Changes for Employers

118. RTI will be a fundamental change to the way that employers report PAYE to HMRC. HMRC has been working closely with payroll software developers and the RTI Customer User Group (CUG) to attempt to fully integrate RTI with an employer’s current payroll process. The objective is to remove the current administrative burden of PAYE reporting. By fully integrating payroll with PAYE reporting, HMRC will receive real time PAYE data through the click of a button on an employer’s payroll software at no additional administrative burden to employers.

119. Employers will make RTI submissions to HMRC using their commercial payroll software. Micro-employers qualify for the use of HMRC’s free Basic PAYE Tool (BPT) if they wish to do so. RTI’s regular reporting mechanism is the Full Payment Submission (FPS), which must be submitted at-or-before the point of payment to an employee.

⁷⁴ HMT (June 2010), Budget, p. 46.

⁷⁵ HMRC (July 2010), *op cit.*

⁷⁶ HMRC (December 2010), *Consultation*, p. 4.

⁷⁷ HMRC (September 2011), *Improving the Operation of Pay As You Earn (PAYE): Collecting Real Time Information: Summary of Responses*, p. 7.

120. An FPS contains over 100 data item fields, many of which will not be required on a regular basis, but it will always provide HMRC with information to identify the employer, employee, payment and deduction. It also includes the new starters and leavers process and additional data items to assist DWP and BIS, in relation to working patterns, some other types of payments or benefits, and details of a partner's personal information in relation to Additional Statutory Paternity Pay.

121. There are two further submission types under RTI:

- Employer Payment Summary (EPS): Used to notify HMRC of a change in an employer's PAYE liability that cannot be accounted for on the FPS, such as a statutory payment; and
- NINO Verification Request: Allows employers to request or validate a NINO.

122. Employers will also be able to receive messages from HMRC. These include: the existing messages - tax codes and student loan instructions; NINO verification response messages; and response messages to the FPS. The last point is particularly important because the validating requirements for the FPS are very high and HMRC will reject an entire FPS file if there is a single error, even if the file contains the information on a large number of employees.

123. Under RTI, employers will not need to file an end-of-year return (P14 & P35) or send starters or leavers forms (P45 & P46) to HMRC. However, the operation of PAYE system through calculating deductions using tax codes, and withholding and transferring PAYE to HMRC remain in place. Table 7 below shows what will and wont change under RTI.

Table 7: Employer Reporting Changes under RTI⁷⁸

<u>What changes under RTI?</u>	<u>What doesn't change under RTI?</u>
PAYE reporting	Fundamental operation of PAYE
An FPS must be sent to HMRC at-or-before the point of payment of an employee.	Calculation of PAYE using tax codes and national tax bands.
An EPS will be sent when, (a) no monthly payment is due, (b) monthly payment of PAYE to HMRC offset by Statutory Payments, and (c) monthly payment offset by Construction Industry Scheme deductions.	Payment date of PAYE to HMRC on the 19 th or 22 nd day of the following month or quarterly equivalent.
End-of-year returns (P35, P14 & P38a forms) are no longer required.	Requirement to provide employees with an End-of-year Certificate (P60 form).
Starters and leavers (P45 & P46 forms) do not need to be sent to HMRC.	Annual reporting of Benefits-in-kind and Expenses (P11D form).

Migrating Employers onto RTI

124. Migrating onto RTI is a business challenge for employers. Every will employer will need to take the following steps in migrating onto RTI:

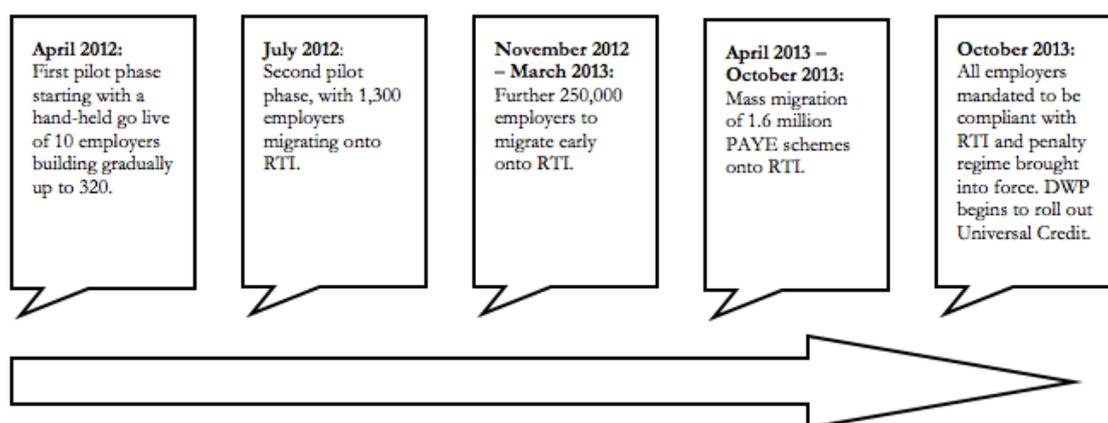
- Understanding RTI and the business challenge;
- Ensuring their payroll software is RTI compliant (able to submit RTI files directly to HMRC) and that their other internal systems support RTI;

⁷⁸ HMRC (February 2012), RTI Programme Presentation.

- Overhauling of businesses processes involving payroll, HR, finance and IT; and
- Data cleansing employee's personal information (e.g. full name, NINO etc...).

125. It will be mandatory for all employers to be compliant with RTI by October 2013. This timetable, shown in Figure 3, is designed to facilitate DWP's planned introduction of Universal Credit. HMRC began piloting RTI in April 2012 offering hand-held assistance for employers in migration. Assistance available to employers will be gradually reduced as the pilot progresses.

Figure 3: Implementation Timetable



126. Employers with more than 250 staff will be required to submit a one off Employer Alignment Submission (EAS) in advance of migrating onto RTI. This is a data cleansing exercise for HMRC, which will allow them to update their PAYE records on the NPS. The EAS will include personal details (e.g. name, date of birth etc...) about all employees on a PAYE reference, including leavers.

127. Employers with less than 250 staff are not required to complete an EAS, but may elect to do so. However, every employer will have to include information on all of their current year employees (including leavers) on their first Full Payment Submission. Businesses of all sizes will have to ensure their data meets HMRC's validation criteria, through conducting a comprehensive data checking and collection exercise.

Changes for HMRC

128. RTI will not change information that HMRC receives, but the frequency at which it is received. Rather than receiving information on employee income and deductions after the end of the tax year, it will be received at-or-before the point an employee is paid. Although it is unclear yet how HMRC will handle and process this information, RTI provides HMRC four significant new capabilities:

- Ability to adjust tax codes in-year using up-to-date information;
- Check an employer is paying HMRC the correct amount of PAYE;
- Fully automated and faster processing of starters and leavers; and
- Control over data quality.

129. The first three capabilities are a result of receiving information in real time, whereas the final point is a result of the way in which HMRC will receive information. For the first time, HMRC will be able to control what it receives and employ its own validation standards. The initial migration onto RTI, especially through the EAS, will allow HMRC to cleanse its own data. Moreover, HMRC is providing additional assistance to the 1,000 employers with poorest data quality. As Stephen Banyard (Director

of Personal Taxation, HMRC) noted, 'we are focused on getting data quality built in from the start'.⁷⁹ HMRC will also be able to regulate data quality throughout by rejecting an FPS that contains an error.

130. RTI will change the way that HMRC operates as an organisation. This will reflect the changing demands in administering PAYE due the fundamental change in the reporting of PAYE, which RTI represents. This is important given HMRC's tough settlement in the 2010 Spending Review, although the change will not be fully understood until RTI is fully implemented and bedded down.

Changes for Employees

131. Employees will be affected by RTI as it a significant change to PAYE. RTI should make the PAYE system more accurate and reduce the number of employees requiring reconciliation, both through the frequency of information and the improvement in data quality. As noted in Chapter 2, much of the contact between employees and HMRC concerns the repayment of tax and therefore RTI should reduce employee costs by reducing the amount of contact between employees and HMRC.

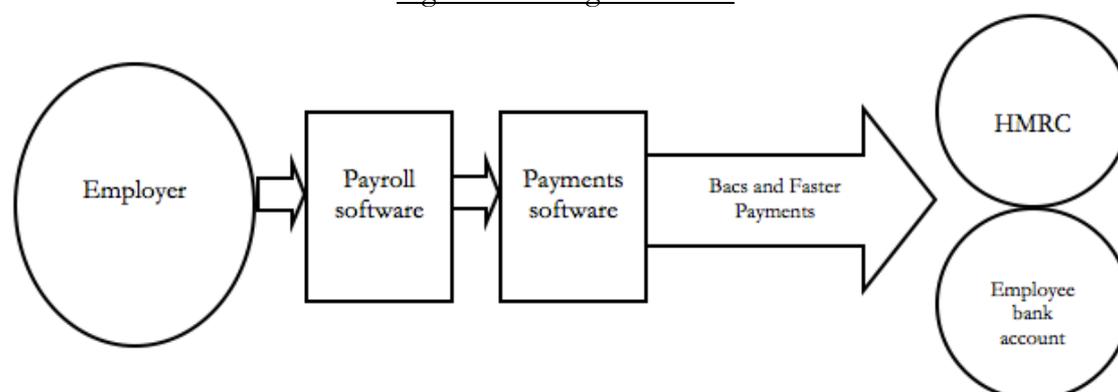
132. However, RTI does not change an employee's responsibilities in the operation of PAYE. HMRC initially proposed to abolish the P45 form and have employers issue employees with a leavers statement instead, but this decision was reversed. Moreover, it wouldn't have represented a change for the employee, other than the type of form they would present to a new employer. Employees are involved in the migration onto RTI, as they will need to assist in their employer's data checking and collection process

Submission Channel

133. Employers will send RTI files to HMRC via their commercial payroll software or HMRC's BPT. HMRC intend to eventually receive RTI files through both the Bacs and Faster Payments channels (known as the Strategic Solution) shown in Figure 4 below. HMRC stated the following advantages of using the Bacs channel:⁸⁰

- Information about a payment is corroborated by the amount of the payment to which it is attached
- Bacs 'signing' PKI infrastructure covers the linked RTI data as well as the payment
- Employers use a single channel for payment instructions and PAYE information

Figure 4: Strategic Solution



⁷⁹ Committee of Public Accounts, *op cit*, Ev. 23.

⁸⁰ HMRC (December 2010), *Consultation*, p. 21.

134. In May 2011 HMRC announced that the Strategic Solution would be delayed until at least April 2014 due to concerns in relation to RTI's implementation timetable. This decision was reached following a series of meetings with representatives from the software industry.⁸¹ It rested primarily on two points:

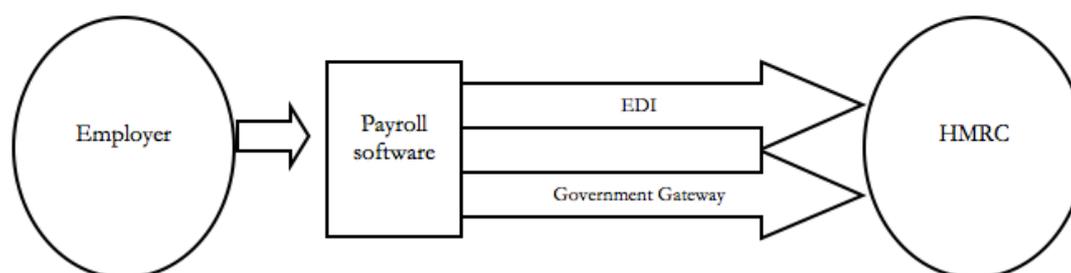
- The current banking payment standard (Standard 18) lacks sufficient data fields to accommodate an FPS and required an upgrade, which could not be facilitated within the timescales; and
- The software industry argued that it lacked the development capacity to rewrite the way their software communicates with the payments software within the suggested time period and there would be a risk of market failure where employees would not get paid.

135. At no point have HMRC ruled out the viability of the Strategic Solution, only the viability to implement it in accordance with RTI's timetable. HMRC will initially receive RTI files using an interim solution; and to this end, the Electronic Data Interchange (EDI), was extended, having been previously planned for retirement under RTI. In May 2012 HMRC announced that the Interim Solution using the EDI would be extended until at least April 2016. Officially, the Strategic Solution remains HMRC's preferred solution and they intend to move to it from April 2016.

136. Under the Interim Solution, HMRC will receive RTI files using two channels:

- EDI – a private channel between HMRC and larger businesses; and
- Internet – either through the Government Gateway or using HMRC BPT.

Figure 5: Interim Solution



137. Unlike the Strategic Solution, under the Interim Solution RTI files cannot be attached to a payment instruction. However, HMRC considers the attachment of information about employee PAYE deductions to an employee's Bacs payment instruction as 'fundamental to the RTI concept.'⁸² Tying the two together ensures that HMRC receives accurate and timely information. Therefore, in an attempt to replicate the Strategic Solution, HMRC and representatives from the payroll software industry devised a cross-reference between an FPS and a Bacs payment instruction to link the two back at the HMRC end. The cross-reference applies to employers (or their agents) who submit Bacs⁸³ directly and consists of two parts:

- A hash included in the FPS to HMRC; and
- A random value inserted in the Bacs payment instruction.

138. Payroll software will automatically generate the hash and insert a random value in the Bacs payment instruction. VocaLink, who operate the Bacs system, will pass the reference numbers from the Bacs

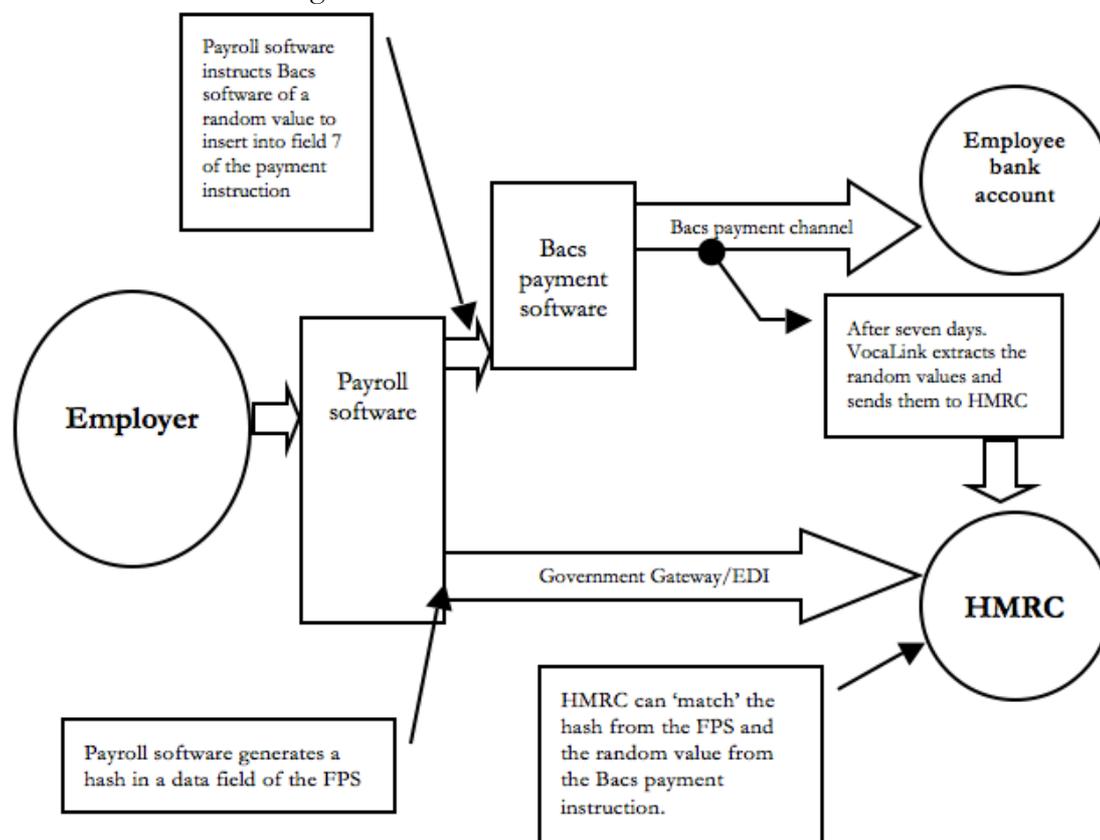
⁸¹ Business Application Software Developers Association (November 2011), Journal 2011/2012.

⁸² Consultation, p. 9.

⁸³ Direct submitters of Bacs will have a Bacs Service User Number (SUN).

payment instructions over to HMRC around seven days after the payment to the employee is made. This will allow HMRC to ‘match’ the cross-references together and check that the information provided in the FPS is both timely and accurate. The process is shown in Figure 6 below.

Figure 6: Interim Solution Cross-reference



RTI and Universal Credit

139. The Government’s primary objective with Universal Credit is to incentivise work. To this end, ‘the key mechanisms for making work pay will be a single taper to withdraw support as earnings rise’.⁸⁴ Universal Credit will be paid monthly, although the precise day of receipt will depend on the day of the month that a claimant registers. Household benefits will be capped to ensure that families do not receive more in welfare than the median after-tax earnings for working households. Universal Credit will integrate the following benefits:

- Income Support;
- Income based Job Seeker’s Allowance;
- Housing Benefit;
- Child Tax Credit; and
- Working Tax Credit.

140. According to HMRC, ‘RTI is a key component in the DWP’s plans for the introduction of Universal Credits from 2013. DWP will use RTI to award and adjust Universal Credit to take account of

⁸⁴ DWP (November 2010), Universal Credit: Welfare that Works, p. 14

employment and pension income'.⁸⁵ HMRC will pass on RTI data for claimants (including households) to DWP through a feed. Universal Credit's alternative method to RTI is monthly self-reporting, which will be used by the self-employed. Employed claimants will be asked to temporarily self-report if their employer experiences problems with RTI. In effect, employers have taken on an additional responsibility under RTI - to ensure their employees' (including household) benefits are accurate.

HMRC's RTI Business Case

141. HMRC's was allocated £108m for the Spending Review period by HMT to RTI. HMRC's business case for RTI is shown in Table 8 below. It is derived from HMRC documentation, prioritising the most up-to-date analysis.⁸⁶

Table 8: HMRC's RTI Business Case

	Benefits	Costs
HMRC	-Better Debt Management and Banking: RTI data expected to create opportunities to improve enforcement and compliance (<i>not quantified</i>); and -Expected savings from fraud, error and overpayments in tax credits of £355m in 2014-15 and £330m in 2015-16.	• £108m allocation from the spending review for development of IT and business processes to implement RTI.
Employers	- £330m annual savings through abolition of reporting requirements to HMRC (starters and leavers forms P45 & P46 and the end-of-year forms P35, P14 & P38a); and -NINO service will support employers in setting up employees correctly on their system (<i>not quantified</i>).	-Migration cost: checking and amending data estimated at £35m (£20 per PAYE scheme) -Migration cost: training and familiarising staff with the new processes estimated at £85m (£50 per PAYE scheme); -Migration cost: Total software costs not estimated; - £30m new ongoing administrative burden; and -Additional cost of reporting for all employees, as currently employees under the NIC earnings limit are exempt from PAYE reporting (<i>not quantified</i>).
Taxpayers	-Longer term increased accuracy of PAYE for some employees (<i>not quantified</i>); and -Improved customer service through greater availability of information (<i>not quantified</i>).	-Negligible.
Software Industry	-Not applicable.	-Software development costs (<i>not quantified</i>).

⁸⁵ HMRC (December 2010), *Consultation*, p. 5.

⁸⁶ HMRC (April 2012), Tax Information and Impact Note: Real Time Information (RTI): Improving the operation of Pay As You Earn; HMRC (November 2011), Legislative changes relating to the introduction of Real Time Information: Draft legislation for comment; and HMRC (December 2010), *Impact Assessment*.

Chapter 5: Real Time Information Assessed

142. The APPTG welcomes the introduction of RTI, having recommended in our first report in this series on the operation of PAYE in March 2010 that HMRC '[u]tilise payroll-date reporting to cover the shortfalls in in-year reporting from PAYE.'⁸⁷ RTI should address several of the problems with PAYE outlined in Chapter 2. These include:

- Reducing business administration – through the removal of the end-of-year reporting (P14 & P35 forms) and starters and leavers forms (P45 & P46) to HMRC;
- PAYE breakdown – through significant improvements in HMRC's data quality and access to real time PAYE data; and
- Real time PAYE data – improving and facilitating other areas of government policy delivery.

143. RTI is the first logical step towards our vision for PAYE – Centralised Deductions. Under RTI, HMRC, software developers and business will make changes that move them in this direction. Yet, we are concerned by the lack of any longer term strategy for PAYE and its relation to RTI under the Interim Solution, but this will be discussed in our conclusion 'PAYE at the Crossroads'.

144. As HMRC stated that '[c]onsideration will only be given to further developments of PAYE once RTI has bedded in and been evaluated', this chapter will assess RTI in its own right.⁸⁸ In addition to HMRC's strategic direction, we also have a number of concerns with delivery of RTI and its business case. These are a result of wide ranging stakeholder research conducted predominantly since January 2012. We have openly discussed our concerns with HMRC and where appropriate include their response. Our concerns about the implementation of RTI predominantly fall into two areas:

- Implementation timetable: we are concerned that it is potentially undeliverable and could reduce the level of RTI's integration with payroll practice;
- HMRC's business case: we are concerned that HMRC has underestimated RTI's costs and overestimated its benefits;

145. We have two further concerns regarding the design of Interim RTI, of which the first will be addressed in this chapter and the second in conclusion. These are:

- The Interim Solution cannot guarantee real time accurate data and will not deliver Universal Credit the way the Government want it to work; and
- Investment in a legacy system and standard makes genuine modernisation more difficult.

146. HMRC's immediate post-RTI approach on a number of areas, such as the compliance regime and information management, is yet to be decided. These issues will be discussed in this chapter, and followed by a series of nine recommendations in the next chapter on RTI migration, immediate post-RTI strategy and the wider reform agenda.

Implementation Timetable

147. RTI's implementation timetable is driven by the policy requirement to facilitate the introduction of Universal Credit by October 2013 and ensure it has been widely rolled out before the 2015 General Election. The policy driven timetable for business change has been the major issue of concern across

⁸⁷ APPTG 2010

⁸⁸ HMRC (December 2010), *Consultation*, p. 4.

all the stakeholders we have interviewed. In fact, there has been widespread scepticism over the viability of RTI's timetable since it was first announced in December 2010:

- Between December 2010 and February 2011, 75% of respondents to the RTI consultation deemed it 'unachievable';⁸⁹
- In July 2011, the Treasury Select Committee regarded the timetable as 'ambitious';⁹⁰ and
- In June 2012, the National Audit Office stated it was 'challenging'.⁹¹

148. HMRC's pilot is progressing well and recently moved into the second phase, but it is limited and is not indicative of the timetable for mass migration onto RTI, as we will address. Moreover, the APPTG is concerned that the current RTI timetable for mass migration is too tight. Our concerns are two-fold:

- Successful full employer migration by October 2013; and
- Integration of RTI with payroll practice within the timetable.

Migrating Employers onto RTI

149. At present, DWP are rolling out the workplace pension reform programme – auto-enrolment. Many of the business processes involved in migration onto auto-enrolment, such as internal system evaluation, are similar to processes we have described for migration onto RTI. As such, it is worth comparing their respective implementation timetables:

Table 9: RTI v Auto-enrolment Implementation Timetables

RTI		Auto-enrolment	
April 2012 – October 2012	Migration of 2,000 PAYE schemes through a two-phased pilot	October 2012 – February 2014	Migration of PAYE schemes with 250 more members
November 2012 – March 2013	Migration of approximately 250,000 PAYE schemes	April 2014 – April 2015	Migration of PAYE schemes with 50 to 249 members
April 2013 – October 2013	Mass migration of remaining 1.6 million PAYE schemes	August 2015 – October 2015	Migration of PAYE schemes with 30 to 49 members
		January 2016 – April 2017	Migration of PAYE schemes with less than 30 members

150. As Table 9 demonstrates, employers with PAYE schemes are being migrated onto auto-enrolment in phases over five and a half, whereas employers are being migrated onto RTI over eighteen months, although the significant majority will migrate over six months. In fact, the timetable for auto-enrolment above is a revised timetable, following a decision to delay auto-enrolment in January 2012. Andrew Fleming, an Industry Liaison Manager at The Pensions Regulator, noted that the delay was a result of pressure from industry, which felt the timetable was too tight, and because of the burden of migration in relation to the current economic climate.⁹² It is anticipated that the timetable for auto-enrolment will be further delayed to facilitate a smoother migration.

151. As noted in the previous chapter, migrating onto RTI is a significant business challenge. In a recent PwC survey, 80% of respondents identified RTI as one of their top three business challenges over the

⁸⁹ HMRC (September 2011), *op cit*, p. 9.

⁹⁰ Treasury Select Committee, *op cit*, p. 30.

⁹¹ NAO (2012), *op cit*, p. 7

⁹² Fleming, Andrew (Industry Liaison Manager, Workplace Pension Reform, The Pension Regulator), *Telephone Interview*, 03.07.12.

next 12 months.⁹³ Respondents viewed: the system changes and interface as the most significant challenge (38%), followed by data collection, storage and transmission (26%), followed by resource constraints (22%) and lastly, transparency of information and risk of HMRC enquiries (14%).⁹⁴

152. RTI migration is a business challenge that requires an extended period of time to overcome, particularly the data aspect; refining each employee's personal data (such name, date of birth, NINO etc.), much of which had previously been regarded as surplus to requirements and is therefore missing or inaccurate. For example, Ian Whytside of the Chartered Institute for Payroll Professionals (CIPP) noted that a company in Thames Valley with over 13,000 employees were missing the full-names of around 5,000 employees.⁹⁵ Moreover, one of the first employers to migrate onto RTI – the Golden Gates Housing Trust – required six months of preparation, despite employing only 340 staff, and reportedly having well organised data and new systems, as well as hand-held support from HMRC.⁹⁶
153. RTI requires a single FPS containing all of the relevant data items. As a result, businesses need to conduct an audit of their existing internal systems, particularly in reference to where data items are held and how they link up. The same process is required for business process, as RTI requires much faster information flows within companies. For example, in a large company with a high frequency hiring pattern data must flow almost instantaneously onto key internal systems after recruiting a new employee. This is because an employee could be hired on a pay day and therefore his/her information would be required for the FPS. Another example includes the flow of information in relation to statutory payments, which are predominantly handled by HR. Under RTI, an FPS must contain details of statutory payments and a separate EPS will be required. New business processes, supported by internal systems, are a necessity to avoid unnecessary administration and costly administration.
154. Our stakeholder research indicates that many larger sized businesses are leaving planning for RTI dangerously late. This is supported by survey evidence:
- March 2012 KPMG survey⁹⁷ - over two-thirds of respondents had not begun preparation for RTI;
 - May 2012 PwC survey⁹⁸ – 69% of respondents have not compared the data reporting obligations under RTI with the information held on their existing payroll or other systems; and
 - May 2012 PwC survey⁹⁹ - 87% of respondents have not yet conducted a payroll data cleanse.
155. The data and systems migration challenge for SMEs is smaller. However, RTI still presents a challenge, but it is of different nature. Our research suggests that the challenge for smaller businesses will be to understand both how RTI works and their new PAYE obligations, and be able to explain these to their employees. Every employer must have compliant RTI software; otherwise they will not be able to send RTI submissions to HMRC. This challenge is even greater for the digitally excluded, particularly those with poor computer literacy, who may find it easier to outsource their payroll function, if they don't

⁹³ PwC (May 2012), Real Time Information Pulse Survey Results.

⁹⁴ Ibid.

⁹⁵ Whytside, Ian (NED, CIPP), *CIPP RTI Training Course*, 15.0.5.12.

⁹⁶ Payroll World (April 2012), Payroll history made as housing trust submits first live RTI data.

⁹⁷ KPMG (March 2012), RTI Survey.

⁹⁸ PwC, *op cit*.

⁹⁹ Ibid.

already do so, which will incur a cost. The level of assistance offered by HMRC at the time of mass-migration is not decided yet, as HMRC are using the pilot for guidance. Although given HMRC's resources, small businesses should not expect the hand-held assistance offered in the pilot.

156. Stakeholder research points out general lack of awareness of RTI, even among members of the HR community in both SMEs and large organisations. Only 34% of respondents to the APPTG/TaxAssist survey had heard of RTI.¹⁰⁰ As part of our research, we audited HMRC's communications as of April 2012 and found it to be well targeted in terms of coverage and volume. However, HMRC are yet to launch a major marketing campaign capable of reaching all businesses. Crucially, HMRC do not have an RTI migration page linked on their website, even though they have built a beta site. General comments from stakeholders in relation to the current RTI page, 'employer FAQs',¹⁰¹ included 'confusing' and 'difficult to find'. Whilst HMRC's communications effort is commendable (website aside), the scale of the task of informing every employer in the UK is substantial.
157. HMRC are yet do announce the precise stage in dates for RTI and businesses are mostly unaware of the mandatory migration date for RTI. 72% of respondents to the APPTG/TaxAssist survey either did not know or incorrectly guessed the mandatory date for submitting RTI.¹⁰² Furthermore, our research indicates that there is a further lack of clarity and understanding in relation to RTI's initial and long-term requirements. A senior CIPP official commented that 'the problem with RTI is that by the end of the day it will all have changed again'.¹⁰³ At a Purely Payroll event in February 2012, a member of the RTI CUG disagreed on the panel with a member of HMRC's RTI team over the formatting of a name required under RTI.¹⁰⁴ Furthermore, at an Albany Software event in June 2012, two members of the expert panel disagreed over the treatment of nil payment due to long-term sickness in the FPS.¹⁰⁵ Whilst these issues may sound trivial, RTI has high validation requirement and the onus is on employers to get them right first time around. Failure to achieve this may result in vulnerable individuals experiencing personal financial hardship with a reduction in their benefit calculation.
158. In part, this lack of clarity is a result of several ongoing issues since HMRC began planning RTI's implementation. Many of these have now been resolved, which include: the reversal of the decision, to replace the P45 with a leavers statement; a change in way that working hours are reported; and the inclusion of number of specific data items, such as an accounts office reference number. However, as noted, the precise migration dates have not yet been established and the key issue with RTI that will most affect business process is still unresolved – the requirement to submit an FPS at-or-before the point of payment; which presents a challenge to many businesses operating dynamic, demand driven or ad hoc working practices. Furthermore, it is still unclear how notional payments will function under RTI, as well as complex arrangements such as share schemes and expats.
159. HMRC maintain that the pilot is progressing well for 1.7 million individuals. However, the current state of the pilot does not validate the timetable for mass migration for the following reasons:

¹⁰⁰ APPTG/TaxAssist, *op cit*.

¹⁰¹ HMRC, Real Time Information: an introduction for employers.

¹⁰² APPTG/TaxAssist, *op cit*.

¹⁰³ Anonymous senior CIPP official.

¹⁰⁴ Anderson, Maggie (RTI Policy Advisor, HMRC), Ball, Susan (Director, Employment Tax & Advisory Services, Crowe Clark Whitehill LLP), Leybourne, Georgia (Sales & Marketing Director at Albany Software, Albany Software), Thompson, Bill (Payroll Legislation Manager, Northgate Arinso), Upcraft, Kate (Independent Payroll Expert), *Panel Discussion (Purely Payroll)*, 23.02.12.

¹⁰⁵ Albany Software (June 2012), Clarification on question raised on nil pay.

- Complex PAYE schemes are absent;
- Exemptions from several of the complexities involved with at-or-before;
- 1.35m of the individuals are Prudential annuitants;
- Significantly more assistance than will be available for mass-migration; and
- HMRC unable to check accuracy through cross-referencing for the significant majority.

Integrating RTI with Payroll Practice

160. The objective of RTI is to integrate PAYE reporting with payroll practice, enabling HMRC to receive tax relevant information at no additional administrative cost to business. However, there are a number of scenarios where HMRC are finding this challenging and we are concerned that the policy driven timetable does not provide adequate time to resolve them. The RTI CUG produced a circular document in April 2012 containing over twenty such scenarios and continues to work through these with HMRC to seek solutions. HMRC are prepared to amend the legislation mandating at-or-before, but only in cases where it is absolutely necessary to avoid creating unnecessary loopholes, as RTI would not be real time without at-or-before. The finalised RTI at-or-before regime is not being piloted at present, because it has not been figured out.

161. At-or-before will be further explored in relation to administrative burden in the next section regarding HMRC's business case, but its uncertainty is problematic in relation to RTI's timetable, in respect of business processes and payroll software. Integration of RTI with payroll practice is reliant on integration with the software that supports that payroll practice. However, HMRC has effectively deferred the at-or-before issue from pilot, because of its uncertainty. In the pilot, ad-hoc payments are permitted, without the requirement to submit an FPS at-or-before. This will not be the case under RTI proper as ad-hoc payments constitute payments subject to PAYE and therefore require an FPS. As a result:

- HMRC risk insufficient understanding of what RTI means;
- Software developers are unable to test their systems; and
- Businesses are unable to understand the change in business processes.

The lack of available time to finalise and pilot at-or-before could result in a less integrated RTI than that originally intended and one that is achievable.

162. RTI requires a significant amount of software development. Payroll software is currently coded for P14s in arrears, RTI. HMRC have not estimated the cost of RTI to the payroll software industry, although a senior official of one of the UK's largest software companies has roughly estimated the total development cost at £100m.¹⁰⁶ Software developers have pointed out to us that they are operating at a level close to capacity and highlighted that whilst they are confident in the majority of products up to a point, there is concern over the functionality of several products. We are concerned that the timetable does not allow sufficient time for product development.

163. Furthermore, Kevin Hart, Chairman of the Business Application Software Developers Association (BASDA), pointed out that there is little time between the second phase of the pilot beginning in July 2012 until the migration of 250,000 employers in November in order for software developers to learn

¹⁰⁶ Anonymous senior official at a major software company; and this estimation is based on the number of development hours per product, multiplied by the cost per hour and the total number of software products.

from the pilot and adapt their products accordingly.¹⁰⁷ Economies of learning are particularly important in relation to software.

164. Moreover, HMRC has induced a lack of certainty in the payroll software market as a result of move from the Strategic Solution to the Interim Solution, and general uncertainty over RTI more widely, particularly the timetable. Carolyn Parmeter, of HMRC's RTI team, commented that they HMRC had extended the EDI channel until at least April 2016 in order to improve certainty within the market.¹⁰⁸ However, this announcement was made as late as May 2012 and we are concerned that uncertainty in the market may reduce the initial functionality of several payroll products on the market. Prior to this announcement, a senior official at a major software company pointed out to us that they had been holding back on the development of a number of products on the basis of uncertainty over RTI.¹⁰⁹ We are aware of dialogue between software developers and HMRC officials as late as February 2012 in relation to relegating RTI to P14 once a period - the preferred option for a number of software companies. The timetable is considered so unrealistic by some software developers, that there is still a cloud hanging over RTI. Moreover, HMRC's inconsistency over the Strategic Solution, which we will address later on, adds further uncertainty into the market.
165. Due to these factors, a number of payroll software providers are unable to provide larger businesses with any certainty in relation to the functionality or cost of RTI compliant products, particularly those requiring bespoke products. As a result, businesses are hindered in their preparation for RTI migration, particularly in relation to how software will facilitate the new business processes that underpin RTI. This is particularly important in relation to staff training and familiarisation of new processes.

Policy Driven Timetable

166. The difference between the timetable for RTI and auto-enrolment is that the prior is driven by policy, whereas the latter is driven by business needs. The Treasury Select Committee noted that '[t]he history of large IT projects subject to policy driven timescales has been littered with failure'.¹¹⁰ However, RTI is not only an IT project, it's a fundamental change to PAYE reporting for every employer in the UK. This in turn is a precursor to the biggest change in the relationship between state and citizen in terms of the delivery of benefits via Universal Credit. HMRC recognise RTI as 'the biggest change to PAYE in its history'.¹¹¹ The Treasury Select Committee note that 'a common theme in the evidence from professional bodies was the need to introduce reform slowly'.¹¹² We are concerned that feedback from stakeholders and survey evidence suggest the timetable for migration is unrealistic. This not only endangers every business potentially, but also every benefit claimant.
167. HMRC assert that their standards for approving payroll software as RTI compliant are high, but there is 'no legal requirement to press a button once [under RTI]'. Fundamentally, RTI is an additional piece of compliance every time an employer pays an employee, with the potential to be fully integrated and unnoticeable. In practice market forces should make RTI no more of a burden than the press of a

¹⁰⁷ Hart, Kevin (Chairman, BASDA), *Interview*, 03.05.12.

¹⁰⁸ Parmeter, Carolyn (Personal Tax Product and Process - RTI team, HMRC), *Interview*, 18.06.12.

¹⁰⁹ Anonymous senior official at a major software company.

¹¹⁰ Treasury Select Committee, *op cit*, p. 30.

¹¹¹ HMRC (June 2012), *Securing Compliance with Real Time Information – Late Filing and Late Payment Penalties*, p. 7.

¹¹² Treasury Select Committee, *op cit*, p. 29.

button. However, through prematurely introducing RTI, there is a threat of unnecessarily increasing the administrative burden of RTI when it is initially rolled out. We find this particularly troublesome given the current economic climate, although eventually we will anticipate the market to integrate RTI and payroll processes as much as possible.

HMRC' RTI Business Case

168. The APPTG are concerned that HMRC's business case for RTI, outlined in the previous chapter, underestimates the cost of RTI to HMRC, the migration cost to employers and the additional administrative burden of RTI on employers. RTI has a business, albeit a weaker one that initially thought by HMRC, for the following reasons:

- Underestimation of the cost required for RTI investment;
- Underestimation of employer migration cost;
- No estimation of employer software cost;
- No estimation of software development cost;
- Underestimation of the additional administrative burden under RTI; and
- Failure to account for the differences between the Interim Solution and the Strategic Solution, particularly in relation to the deliver of Universal Credit.

HMRC Cost

169. HMRC was allocated £108m by the Treasury in the 2010 Spending Review for investment in RTI and £16m to cover depreciation. The Treasury Select Committee stakeholder research included 'scepticism as to whether the project would be delivered within the £100m budget set by the Government.¹¹³ In the course of our research, the APPTG has uncovered internal HMRC documentation, which indicates the forecasted cost of RTI is significantly greater than the allocated £108m, although this is disputed by HMRC. The figures from the RTI Programme Finance Board's April 2012 report are shown below.

Table 10: HMRC SR10 RTI Costs¹¹⁴

Year	Forecast (£m)
2011-12	47.64 ¹¹⁵
2012-13	59.76
2013-14	61.65
2014-15	32.36
Total	201.41m

170. The SR10 forecast indicates an overspend of £93m. Moreover, according to the RTI Finance Board document, this figure does not include the following costs:

- Paybill funded by business as usual (i.e. allocated costs);
- Depreciation (£16m); and
- Cost of Capital.

¹¹³ Ibid.

¹¹⁴ HMRC (May 2012), RTI Programme Board, Change Program Programme Finance Report.

¹¹⁵ Note: This figure represents the actual spend for 2011-12.

171. The Government Major Projects Portfolio forecasted in December 2011 that RTI's total lifecycle costs would be £195m, of which £136m would fall in the SR10 period. Three observations can be drawn from this:

- The forecasted cost of RTI may have increased by nearly 50% in four months (between December 2011 & April 2012);
- The post SR10 cost of RTI was last estimated at £57m; and
- The total investment cost for RTI may be greater than £274.1m.

172. The RTI Programme Finance Board April 2012 forecasts are contested by HMRC who claim:¹¹⁶

'The figures ... represented a high level forecast for the total cost of the programme during the SR period at that point in time... [and] these forecast were based on a number of high level business cost assumptions... Following receipt of those assumptions we have done significant work with the affected business areas and we now understand the costs associated with RTI to be significantly lower than this forecast... [A]t this stage we do not expect to be too far away from the £108m allocation.'

However, in order to reach the £108m allocation, the RTI Finance Board forecast would need to be reduced by 60%, given that £47.64m has already been spent.

Employer Migration Cost

173. HMRC estimate the migration cost of RTI at £85m (£50 per PAYE scheme), which includes £35m on checking and amending data estimated and £50m on training and familiarising staff with the new processes. However, HMRC have not included the key component in its estimation – software costs. All employers will be required to ensure their software is RTI compliant and many employers will be required to purchase payroll software for the first time and the appropriate ongoing support and maintenance package. As according to the APPTG/TaxAssist survey, 23% of micro-businesses do not use any form of payroll software.¹¹⁷ HMRC have not attempted to quantify the software costs in any impact assessment and as of June 25th 2012, these costs have still not yet been estimated.¹¹⁸ HMRC offers a free software solution for micro-business – the BPT. However, it has intentionally limited functionality and cannot for example produce a payslip, which is a requirement for PAYE compliance. This is because HMRC do not wish to interfere in the payroll market.

174. We believe the cost of migration is significantly higher than the HMRC estimate. We are aware of examples where businesses will be spending in excess of £1m on RTI migration, although invariably this cost will be split across RTI and auto-enrolment. Furthermore, Hays, the recruitment agents, reported a rise in payroll staff hiring as a result of RTI.¹¹⁹ It is likely that the software industry will pass on the estimated £100m development cost and we are aware of one major software company, which intends to increase the price of a payslip by approximately 20%. Moreover, HMRC's estimated migration cost does not take the additional cost of RTI migration for the digitally excluded into account, particularly those with low levels of computer literacy.

Additional Administrative Burden on Employers under RTI

175. In HMRC's business case, the additional burden caused by RTI was estimated at £30m per year, approximately £17 per PAYE scheme – assuming near enough full integration. However, the

¹¹⁶ Holden, Mark (Programme Director, RTI, HMRC), *Email*, 06.07.12.

¹¹⁷ APPTG/TaxAssist Accountants (July 2012), RTI Survey.

¹¹⁸ *Ibid*, c77W.

¹¹⁹ Recruiter (May 2012), Hays sees rise in payroll staff as RTI draws near.

integration of PAYE reporting with payroll is proving a lot more challenging than expected, but HMRC has not revised its figures. Many of the stakeholders we interviewed believe that HMRC did not fully understand the complexities of payroll practice in the UK.

176. As noted in the previous section, most of these issues arise out of the at-or-before requirement, which is fundamental to the concept of RTI. The RTI CUG put together a document containing over twenty scenarios where at-or-before was problematic. Several of these scenarios involved high pay frequency, timing issues, digital exclusion, advance, the process for correcting payroll errors and notional payments. Karen Thomson, Associate Director of Policy, Research, and Strategic Visibility at the CIPP highlighted one such situation:¹²⁰

‘A company pays its employees in cash every week. However, the bureau processing the payroll only processes it monthly and, at this time, takes into consideration any monies that the employer has paid its staff.

The resultant extra money appears on the payslip, which the employer pays to them (in cash).’

177. HMRC maintain that the at-or-before requirement is nothing new in PAYE, as the current legislation mandates for PAYE calculation before payment. However, it is apparent from our stakeholder research that the legislative requirement is not a true reflection of payroll practice in the market. As such, HMRC’s assumptions are inaccurate.

178. A further additional burden of RTI is that it brings many new employees into the PAYE system. At present, employees earning below the NICs threshold do not need to be included in a PAYE scheme. However, under RTI, any PAYE scheme with one or more employees earning above the NIC threshold must include all employees on the FPS, irrespective of whether they earn above the NIC threshold. Again, HMRC has not attempted to estimate these costs in any of its three impact assessments.

179. The hospitality and leisure sector will be particularly affected by a combination of bringing employees earning under the NIC threshold and the requirement to submit at-or-before. As part of our stakeholder research we interviewed Dave Mountford, a publican and GMB member, who highlighted the highly flexible nature of working patterns within the pub industry. He told us that RTI would be a significant administrative burden, as he would be required to submit an FPS every night before paying his staff at the end of the night.¹²¹ Several of the stakeholders we interviewed believed that a combination of RTI and auto-enrolment would lead to increase in self-employment. Others suggested that it would to increase in non-compliance with PAYE and the cash economy.

180. HMRC’s estimation of the additional burden of RTI does not take into account the difficulty that a number of micro-businesses, particularly those with digital exclusion issues will face under RTI. The position of Sue Cave, of the FSB, is that micro business should be exempt from RTI.¹²² According to the APPTG/TaxAssist survey 76% of respondents thought that RTI would either increase or significantly increase their payroll administration, with 3% believing RTI will either reduce or significantly reduce their workload. We are concerned that HMRC has no wider strategy on how these employers will be accommodated by RTI and will lead to an increase in one of PAYE’s worst negative

¹²⁰ Thomson, Karen (Associate Director of Policy, Research, and Strategic Visibility, CIPP), *Email*, 31.05.12.

¹²¹ Mountford, Dave (GMB member and Publican), *Interview*, 12.05.12.

¹²² Cave, Sue (Regional Vice-Chair and Finance Spokeswoman, Cornwall, FSB), *Interview*, 23.04.12.

dimensions – its highly regressive nature and disproportionate burden on small business. The Low Incomes Tax Reform Group offer such a scenario:¹²³

‘A key illustrative example is the farming industry for which frequency and practicality of RTI reporting will be a significant issue given the greater prevalence of digital exclusion amongst farmers (the majority of farmers are older people - the average farm holder is now 59 years of age and geographical remoteness is a significant issue). A recent survey by the National Farmers Union in relation to VAT online filing requirements for businesses with turnover of less than £100,000 has revealed that 6.5% of respondents would be unable to file their VAT return online or didn't know how they would do it. 27% of respondents had to outsource the online filing aspect of their VAT returns³. These problems will be magnified under RTI.’

181. We are concerned that HMRC's promotion of its BPT will inadvertently increase the burden on micro-business. Martyn Faulkner, a member of the RTI CUG, commented:¹²⁴

‘The downside to the BPT is that it is not a payroll (e.g. it doesn't produce a true net figure, there is nowhere voluntary deductions can be included, etc) and because HMRC do not want to cause problems with the payroll software companies, it never will be, which is a shame because if your company is a micro employer (less than 10 employees) like mine, you will be able to use the BPT to submit the FPS to HMRC but additionally you will still need to process your payroll separately (we use an Excel spreadsheet) before you load the information on to the BPT, so in essence your workload could double when you move onto RTI.’

One stakeholder pointed out that smaller businesses often forget to price time costs and that the additional time cost of the BPT will significantly exceed the upfront and maintenance cost of commercial payroll software.

RTI and Universal Credit

182. Universal Credit requires a flow of real time accurate earnings data, and anything short will reduce its dynamic nature and the resultant incentive to work. Peter Hopkins, an Assistant Director of Universal Credit at DWP explains:¹²⁵

‘Imagine someone on UC considering short-term employment in a world where PAYE information is sent in with the payment to HMRC. The work is for a month and payment is made on 19th May. PAYE for May is submitted on 19th June and UC assessed on 2nd June. In the UC period to June the claimant has received full UC (no PAYE reported) and a month's earnings. In July the UC payment will be reduced to reflect the RTI received and in that month, in which the claimant is unemployed, the UC will go down. This is not the policy intent.’

183. Moreover, inaccurate or late reported earnings data could result in lost benefits for a claimant given the way that that Universal Credit's disregard function will operate. Peter Hopkins further explains:¹²⁶

‘If Universal Credit is being built with a disregard (D) where earnings below D will be ignored when awarding UC; and a taper (T) which removes £x of UC for every pound of earnings above D then the timing of information is key. So if RTI for a claimant earning £D a month is submitted on time the claimant will get the right UC. If, however, the RTI returns for UC assessment period 1 and period 2 are submitted in period 2 the claimant gets the right UC in period 1 and sees a reduction of xD in the second period. This effect will apply to anyone earning regularly in the range D/2 to D and T/2 to T.’

184. However, under the Interim Solution, there is no guarantee that RTI will be either real time or accurate. This is because the Interim Solution separates the payment instruction and the FPS. Although in most cases HMRC will be able to cross-reference the hash in the FPS with the random

¹²³ LITRG (April 2012), Real Time Information (RTI): Improving the operation of PAYE Tax Information and Impact Note: Comments from the Low Incomes Tax Reform Group (‘LITRG’), p. 2.

¹²⁴ Faulkner, Martyn (Project IHR Limited), *Email*, 01.07.12.

¹²⁵ Hopkins, Peter (Assistant Director, Universal Credit, DWP), *Interview*, 15.02.12.

¹²⁶ *Ibid.*

value in payment instruction, this can only take place at a minimum of seven days later and is only a checking process – not a guarantee. Given the complexities associated with at-or-before, we find this problematic. Furthermore, earnings data under the Interim Solution does not flow directly to DWP, as it is fed through HMRC. This additional link in the chain slows down the flow of data to DWP.

185. A further problem with the Interim Solution is complexity, both for the employer and HMRC. Employers are additionally responsible for ensuring both parts of the cross-reference, where appropriate; and HMRC are additionally responsible for matching these up. HMRC are currently experiencing a 'glitch in ... [their] automatic management information system'¹²⁷ and have only made 87,798 matches since the pilot began.¹²⁸ According to our estimation based on the numbers of employees in the pilot, HMRC should have made over 1 million matches to date. We anticipate that these issues will be overcome, but they demonstrate the complexity of the Interim Solution.
186. A senior source within DWP has informed us that there are parties with great discomfort over the Interim Solution inside DWP, as they do not consider it accurate enough for the purposes of Universal Credit.¹²⁹ Their preferred option is a full self-reporting regime that would be supported by RTI for checking purposes only. However, this is not the policy of DWP, who plan to deliver Universal Credit using RTI in October 2013.

Post-RTI Approach

187. Once employers are migrated onto RTI, HMRC will be in regular receipt of significant quantities of PAYE data. However, this will not automatically remove PAYE breakdown. In order to reconcile employee deductions with income, HMRC would need to feed the PAYE data into the NPS and issue revised tax coding notices. There is a cost associated with feeding data through the NPS and issuing revised coding notices and moreover, HMRC are still stabilising the NPS. At present, HMRC is planning to do this once a year, which will not increase the accuracy of PAYE from today, but intends to do this more in the future. HMRC assert that before they draw up a management information strategy they need to look at the data once RTI is up and running and cannot do it before.¹³⁰
188. We concur with HMRC that they require RTI data in order to maximise bang-for-buck with RTI. However, HMRC should be able to establish its objectives prior to its management information strategy. RTI data will also include information of how much PAYE employers have paid over against what they should have paid over. In HMRC's business case, employer compliance with accurate PAYE payment, and improved accuracy of PAYE of taxpayers were included as benefits. HMRC's management information strategy objectives will include where its resources are focused.
189. HMRC will also require a compliance regime, which they are currently consulting on. We echo HMRC's objectives, which are: to be fair; influence behaviour; and be effective.¹³¹ It is especially important given the influence of RTI on Universal Credit calculations that employers comply with

¹²⁷ Holden, Mark (Programme Director, RTI, HMRC), *Email*, 06.07.12.

¹²⁸ Gauke, David (Exchequer Secretary to the Treasury), *Hansard*, HC Deb, 27.06.12, c306W.

¹²⁹ Anonymous senior DWP official.

¹³⁰ Banyard, Stephen (Director, Personal Tax, HMRC), Holden, Mark (Programme Director, RTI, HMRC), Parmeter, Carolyn (Personal Tax Product and Process - RTI team, HMRC) and Kelly, Dympna (RTI Policy Advisor, HMRC), *Interview*, 18.06.12.

¹³¹ HMRC (June 2012), *op cit*, p. 11.

RTI. HMRC have spoken to us about a ‘two-tiered’ penalty regime, taking into account the learning curve associated with RTI, an approach that we also concur with.¹³²

190. Through our research across OGDs, we are aware of a number of RTI related dialogues, some more recent than others. Several of the policy areas listed under ‘The Big Cross-Governmental Prize’ in Chapter 3 would benefit from the availability of RTI data in and of itself, without automatic reconciliation. Several OGDs will be requesting RTI data once it is bedded in.

¹³² Banyard, Holden, Parmeter, and Kelly, *op cit*, 18.06.12.

Recommendations

191. **Recommendation 1:** The APPTG recommends that business needs should be prioritised over the policy deadline for Universal Credit in RTI's migration timetable. We note that the majority of tax credits will not be migrated into Universal Credit until mid-2015 and should HMRC delay the migration of RTI up until this point, the effect on Universal Credit will not be substantial, due to the relatively low number of claimants, all of whom will be able to self report.
192. **Recommendation 2:** The APPTG recommends the following criteria prior to RTI migration:
- The migration cost and additional administrative cost of RTI are fully understood;
 - A strategy for micro-business and the digitally excluded are executed;
 - Representatives from the software industry are content with the functionality of payroll products on the market;
 - All outstanding payroll issues are resolved and there is absolute clarity about how RTI will work and this has been fully tested by piloting; and
 - The timeline for the Strategic Solution is fully understood and role of the Interim Solution is fully understood, functional and properly tested.
193. **Recommendation 3:** The APPTG recommends that HMRC set up an independent website for RTI migration as soon as possible. This should include a downloadable form for taxpayers, explaining their role within the PAYE system, RTI and providing fields for their personal information for the purposes of data migration.
194. **Recommendation 4:** The APPTG supports LITRG's recommendation that micro-business should be provided with a free RTI hotline for the purposes of migration onto RTI.
195. **Recommendation 5:** Given the lack of clarity over the SR10 forecast for RTI, the APPTG supports the Treasury Select Committee's recommendation for external audit and arrangements are in place for the external auditors to report regularly to the appropriate parliamentary committees.
196. **Recommendation 6:** The APPTG recommends that HMRC prioritise resource in its information management strategy for PAYE accuracy over employer compliance in relation to timely payment of PAYE. Investment in PAYE should deliver for the taxpayer.
197. **Recommendation 7:** The APPTG recommends that RTI under the Interim Solution is not extended across government, because there is no guarantee of accurate real-time data and this could also create further switching costs for moving towards HMRC's preferred Strategic Solution, which does guarantee accurate real-time data.
198. **Recommendation 8:** HMRC should include the creation a self-service account linked to NPS as part of its business case to HMT in relation to the Strategic Solution.
199. **Recommendation 9:** The APPTG recommends the establishment of a working group within the Cabinet Office, endorsed by HMRC, to look at the benefits of both the Strategic Solution and Centralised Deductions across government, to think creatively, and include a cross-governmental business case in the Strategic Solution's business case for HMT.

Conclusion: PAYE at the Crossroads

200. RTI is a step in the right direction, but it is also a step in the wrong direction. By delivering RTI through the Interim Solution, HMRC has created switching costs for moving to its preferred Strategic Solution. PAYE will not be brought into the 21st Century through investment in EDI, a legacy system due for retirement and built for the 20th Century.

201. Whilst RTI in its current form addresses some of PAYE's problems in Chapter 2, it does not resolve or fully resolve:

- PAYE breakdown;
- Taxpayer disengagement;
- Administrative burden of PAYE;
- Regressive nature of PAYE; and
- Restraint on policy delivery across government.

202. RTI has a business case in and of itself, albeit a weaker one than HMRC believes, as we argued in Chapter 5:

- Underestimation of the cost required for RTI investment;
- Underestimation of employer migration cost;
- No estimation of employer software cost;
- No estimation of software development cost;
- Underestimation of the additional administrative burden under RTI; and
- Failure to account for the differences between the Interim Solution and the Strategic Solution, particularly in relation to the deliver of Universal Credit.

RTI's business case would be a lot stronger under the Strategic Solution, particularly if it were to be focused on policy deliver across government, not just focused on primarily one department.

203. The PAYE system should not be considered as 21st Century under RTI, because it is still fundamentally 1944, albeit a more computerised version with much more frequent reporting obligations. RTI should be viewed as the next logical phase in a transition towards a new model for PAYE in the 21st Century, which negates all of PAYE's problems and delivers the big cross-governmental prize – Centralised Deductions.

204. The next step towards true modernisation is to introduce the Strategic Solution and begin to utilise the Bacs payment channel and wider payments infrastructure. In March 2012, David Gauke MP's outlined HMRC's current position on the Strategic Solution in a letter to Bernard Jenkin MP, Chairman of the Public Administration Select Committee:¹³³

‘Our long-term goal remains to introduce the Strategic Solution and we have continued to develop our thinking in this area in close-cooperation with the banking industry. As one of HMT's conditions regarding the approval of the RTI business case, we plan to work up a full business case for the Strategic Solution. We have agreed an approach and timeline with DWP, HMT and Cabinet Office to look at the feasibility of the Strategic Solution and work will be commencing on initial requirements gathering this month.’

205. There is however, little evidence to suggest a move to the Strategic Solution, but importance evidence indicating to the contrary. Subsequently to this letter, as noted in Chapter 4, HMRC extended the Interim Solution by a further two years. Moreover, at present, there is no agreed budget for the

¹³³ Gauke, David (Exchequer Secretary to the Treasury), Letter to Bernard Jenkin (Chairman, Public Administration Select Committee), 07.03.12.

Strategic Solution¹³⁴ and given the indication of an overspend we highlighted in Chapter 5; we are concerned that HMT will lack appetite. Furthermore, the HMRC RTI Working Group at the Payments Council, whom are necessary for upgrading the banking standard required for the Strategic Solution, are being disbanded.¹³⁵ Fundamentally, HMRC has not formulated a business case for the Strategic Solution and therefore, it cannot actually know whether it is its long-term goal or not. HMRC's position on the Strategic Solution is thoroughly inconsistent and inherently contradictory. Moreover, its lack of a long-term strategy or vision is not only worrying in and of itself; it has also induced uncertainty in the payroll software market.

206. We believe that HMRC has lost its momentum and its modernising zeal. At present it is narrowly focused on delivering the Interim Solution by October 2013 and ensuring that the Government has rolled out Universal Credit sufficiently in time for the 2015 General Election. As noted in Chapter 5, the speed at which RTI is being delivered threatens potentially every business and benefit claimant in the UK. Moreover, the Interim Solution was never HMRC's original intention in July 2010. In fact, it planned to retire the very channel – EDI – that it will be relying on. Stephen Timms MP, the former Minister responsible for HMRC, left office on May 11th 2010, having never discussed or even heard of RTI.¹³⁶

207. HMRC's first proposal in the July 2010 discussion document – RTI – was intentionally set up to as the first half of Centralised Deductions through utilising the payments infrastructure, as noted by Peter Hopkins, an Assistant Director of Universal Credit at DWP, formerly part of the PAYE Improvement Group:¹³⁷

'Prior to the discussion document, the objective of the PAYE Improvement Group was to consider radical change to improve the system. The model we came up with was Centralised Deductions which would remove the need for distributed tax codes and calculations and the need to manage employments. We then looked at the whole proposition and split it into two with the advantages attaching to both halves with one leading logically to other. Reuse of the payments infrastructure was always at the heart this.'

208. The first half, RTI, was designed to have an independent business case and critically, to support introduction of Universal Credit. A senior member of the CIPP noted that the July 2010 discussion document was a 'result of electioneering'.¹³⁸ This was because the dynamic benefit idea was not going anywhere until the Conservatives heard about Centralised Deductions, because of PAYE's restraint on policy delivery across government. We reported in March 2010 that Centralised Deductions was put on hold as 'shortfalls in Government revenue made it a difficult time to make large capital investments'. Universal Credit provided the political will to modernise PAYE. The situation we are now is the worst of both worlds and a result of the Government trying to push change too fast for political means. HMRC are focused on implementing a delivery channel because of Universal Credit that is inherently less suitable for Universal Credit.

209. Moreover, the result of a policy driven timetable – the Interim Solution - threatens to throw the genuine modernisation of PAYE off course entirely. Stephen Banyard, Director of Personal Taxation

¹³⁴ Holden, *op cit.*

¹³⁵ Payments Council HMRC RTI Working Group (July 2012), Agenda and Minutes.

¹³⁶ Timms, *op cit.*

¹³⁷ Hopkins, *op cit.*

¹³⁸ Anonymous senior CIPP official.

of HMRC, commented ‘we would have delivered the Strategic [Solution] given another year’.¹³⁹ However, there is a further element to the adoption of the Interim Solution that requires recognition if actual reform is to be achieved. As noted in Chapter 3, the Strategic Solution was deferred following close consultation by representatives from the software industry. Whilst many of their concerns were clearly legitimate given the policy driven timetable, we have evidence that commercial interest was also at play. One of the representatives openly told us that ‘my CEO has instructed me to kill it’.¹⁴⁰

210. The role of the software industry in PAYE reform is absolutely crucial and whilst industry may be apprehensive of regulatory change, the modernisation of PAYE cannot occur without their support. Inducing market failure in the payroll industry would have disastrous consequences. The issue though is that changing the model of PAYE will require significant development cost and will be accompanied by perceived reduction in the size of the market will be opposed. This is an economically rational position, but one that prevents the greater good and the two must be reconciled somehow.
211. HMRC had developed the idea of using the payments infrastructure to improve PAYE much earlier to its formal introduction, but failed to engage in the necessary dialogues with the banks or the software industry over the time it would take. Only once the consultation period was nearing its end did HMRC fully engage with these parties. Therefore, HMRC is also partially responsible for the realisation of the Interim Solution and the current situation.
212. PAYE is at the crossroads. We do not believe that RTI under the Interim Solution is sustainable, as it cannot guarantee real-time accuracy and RTI will not be fully integrated with payroll from start – particularly from a Universal Credit perspective. The Government has two viable options:
- **Implement the Strategic Solution:** Guarantee the flow of real time data to government through using the payments infrastructure. This will also progress towards our vision of Centralised Deductions; or
 - **Scale back to RTI-light:** Implement a form of periodic or monthly filing, as in other OECD countries, and remove the complications associated with at-or-before. The Interim Solution would become the permanent submission channel.
213. From a purely HMRC perspective, there is a case for RTI-light and this is the preferred option of most software developers. It removes many of the complexities from at-or-before and would be easier to enforce. However, at that point, Universal Credit would cease to be dynamic. And this is the crux of the issue. HMRC is not the only stakeholder in PAYE; every government department is a potential beneficiary in the operation of PAYE and PAYE data. HMRC’s stakeholders, the software developers, are pushing for the Interim Solution to be more than just interim.
214. The model for PAYE should reflect the interest of government, not a single government department. By its very nature, a government department will be concerned with its own requirements and tied to its own stakeholders. If we are to ever achieve a new model for PAYE that delivers the benefits we have described to government, citizens and business alike, we need a new structure to facilitate its introduction. This is why the most important recommendation of this report is for the Cabinet Office to establish a working group, endorsed by HMRC, to fully explore the benefits of the Strategic Solution and Centralised Deductions across all of government.

¹³⁹ Banyard, Stephen (Director, Personal Tax, HMRC), Interview, 18.06.12.

¹⁴⁰ Anonymous software industry representative involved in meetings with HMRC about the Strategic Solution in April 2011.

Appendix 1: Methodology

215. 'PAYE at the Crossroads' is the culmination of a research project that was launched on December 14th 2011 at an event in Parliament. It is produced on behalf of the APPTG, which is dedicated to look at and understand tax policy and taxation at all levels; to understand VAT and PAYE in the UK; to contact and talk to accountants and Revenue officials; to look at European tax affairs and international taxation.
216. The APPTG's mandate for the author of this report – Jamie Black - was to consider the modernisation of the PAYE system and to build on the research from the past two APPTG reports in this series. The mandate also includes assessing the delivery of RTI.
217. The research methodology for this study involved a range interviews and meetings with organisations and people involved with the modernisation of the PAYE system and the delivery of RTI, all of which are listed in Appendix 4 under 'Interviews and Written Correspondence'. This includes but is not limited to HMRC officials within Personal Taxation; members of the RTI team within HMRC; DWP officials involved with Universal Credit; OGDs; members of the RTI Customer User Group; payroll software companies; industry representatives; tax advisors and accountants; and businesses and individual taxpayers.
218. Information was also obtained through Parliamentary Questions asked by the APPTG's Chairman Ian Liddell-Grainger, MP and through a Freedom of Information Request to view responses to HMRC's consultations on the 'Improvement of the Operation of PAYE.'
219. In conjunction with TaxAssist Accounts, the APPTG surveyed 340 micro-businesses about payroll practice and RTI.
220. The research methodology includes a range primary as well as secondary sources. These include but are not limited to past APPTG reports; government reports; select committee reports on tax, welfare and IT; answers to parliamentary questions on RTI; responses HMRC's consultation on the 'Improvement of the Operation of PAYE'; and academic papers on tax withholding.

Appendix 2: International Comparison of Employer Reporting¹⁴¹

OECD Countries with a cumulative withholding system			
Country	Employers' withholding reporting obligations		
	Period	Date	Special rules prescribed small (s) or large (l) employers, if any
Austria	Annually	End of February in the following year	NA
Chile	Annually	23rd of March after end of tax year	By 23rd March. If e-reporting by 20th March
Czech Republic	Annually	20th February after end of income year	NA
Denmark	Annually	20th January after end of income year	NA
Estonia	Monthly	10th day of following month	NA
Germany	Monthly	10th day after the end of every wages tax reporting period	See note 1
Ireland	Annually	15th February of following year	NA
Israel	Annually	31st March of following year	NA
Italy	Annually	End of February of following year	NA
Japan	Monthly	10th day of following month	Semi annually (s) - by 10th day after liability period
Korea	Monthly	10th day of following month	Semi annually - by 10th day of following month (approved small companies)
Luxembourg	Annually	Not available	Not available
Mexico	Annually	15th February after end of income year	NA
Netherlands	Monthly	Last day of the following month	NA
New Zealand	Monthly	5th of the next month	NA
Poland	Annually	End of January	Not available
Slovak Rep.	Quarterly	30th of next month after every quarter	
Spain	Annually	31st January after end of income year	Annually - by 20th January If the pre-printed form is used
Turkey	Monthly	23rd day of following month	Quarterly (for small) - on 23rd day of January, April, July and October (note 1)
UK	Annually	19th May of following year	NA
Selected non-OECD Countries with a cumulative withholding system			
Argentina	Monthly	10th day of following month	NA
Bulgaria	Monthly	Not later than the day following the day of paying the income for the respective month	NA
China	Monthly	7th day of following month	NA
Cyprus	Annually	End of April after income year	NA
Latvia	Monthly	Date set by the Revenue body	Quarterly - by 15th day following end of the quarter for businesses subject to micro-business tax
South Africa	Annually	Reconciliation return is due at end of May (note 1)	NA

Note1

Germany- The wages tax reporting period is the calendar quarter if the wages tax to be paid over for the previous calendar year amounted to more than Euro 1000, but less than Euro 4000; the wages tax reporting period is the calendar year if the wages tax to be paid over for the previous calendar year amounted to no more than Euro 1000. If the permanent establishment was not in existence during the whole of the previous calendar year, then the wages tax to be paid over for the previous calendar year shall be converted to an annual amount for the purposes of determining the wages tax reporting period. If the permanent establishment was not yet in existence in the previous calendar year, the determination shall be based on the wages tax to be paid over for the first full calendar month after the opening of the permanent establishment, converted to an annual amount.

¹⁴¹ OECD (03.03.11), Tax Administration in OECD and Selected Non- OECD Countries: Comparative Information Series.

Appendix 3: Sources

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