



Improving the operation of Pay As You Earn (PAYE)

Publication date:

27th July 2010

Closing date for comments:

23rd September 2010

Subject of this document:	The business processes behind PAYE have remained unchanged for 66 years. This document explores whether there are alternative ways of collecting information that would reduce administration costs and provide a foundation for further change.
Scope of this document:	This document explores the option to move to a system that collects information on PAYE deductions at the time employers pay individuals (Real Time Information) and, if it is, how processes might be changed further to exploit this.
Who should read this:	Those running PAYE schemes, providers of payroll software, providers of payroll services, employers and pension schemes
Duration:	27th July 2010 to 23rd September 2010
Enquiries and how to respond:	HM Revenue and Customs, PAYE Consultation, Room 1/40, 100 Parliament Street, London, SW1A 2BQ Telephone: 020 7147 0842 (from a Text Phone prefix this number with 18001) e-mail: paye.consultation@hmrc.gsi.gov.uk
Additional ways to become involved:	HMRC will be running a series of seminars for employers and software providers. If you would like to attend one of these or to host one please phone 01274 539666 if you are a software developer or 0845 6032691 if you are an employer.
What next:	If it is decided to proceed with the collection of real time information on PAYE deductions, it is expected that the next stage of consultation will begin in the Autumn.

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On request this document can be produced in alternative languages and formats including large print, audio formats and Braille

1. The Process

How to respond

This document is intended to start a discussion about the future of PAYE by gathering evidence from as wide a range of employers and software providers as possible. This process is being conducted in line with the principles outlined in the document [“Tax policy making - a new approach”](#) published alongside the Budget which sets out three stages for policy development:

- stage 1 - set out objectives and identify options
- stage 2 - determine the best option and develop a framework for implementation, including detailed policy design
- stage 3 - draft legislation to effect the proposed change.

This document is being issued during stage 1 of the process. The purpose of the consultation is to seek views on the policy design and any suitable possible alternatives, before consulting later on a specific proposal for reform.

How to respond

A summary of the views sought in this document is included at chapter 7.

Responses should be sent by 23 September 2010,

e-mail: paye.consultation@hmrc.gsi.gov.uk

post : HM Revenue and Customs, Room 1/40, 100 Parliament Street, London, SW1A 2BQ

Fax: 020 7147 2531

Telephone : 020 7147 0842 (from a Text Phone prefix this number with 18001)

Paper copies of this document or copies in alternative languages and formats may be obtained free of charge from the above address. This document can also be accessed from the HMRC Internet site at <http://www.hmrc.gov.uk/consultations>. All responses will be acknowledged,

but it will not be possible to give substantive replies to individual representations.

When responding please say if you are a business, individual or representative body. In the case of representative bodies please provide information on the number and nature of people you represent.

Confidentiality

Information provided in response to this document, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you want the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Revenue and Customs (HMRC).

HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

2. Executive Summary

Improving the operation of Pay As You Earn (PAYE)

- 2.1** The Government is committed to improving the competitiveness of the UK's tax system. The PAYE system is a fundamental part of that system and the Government wishes to explore how its administration could be improved.
- 2.2** In considering changes to PAYE, the Government's objectives are, to reduce costs both for employers and for HMRC by making the system easier to administer; to improve service levels for individual customers; and to ensure accurate tax deductions.
- 2.3** The June 2010 Budget announced that the Government intended to consult employers and payroll providers on mechanisms that could support more frequent or Real Time Information collection.
- 2.4** PAYE has successfully collected tax in the UK for 66 years. In the tax year 2009/10 it brought in £249 billion in tax and National Insurance Contributions (NIC) and £1.1 billion in student loan repayments. It cost HMRC less than one penny for each pound of tax collected.
- 2.5** PAYE works well for the majority of people, particularly those with stable circumstances, but because the processes remain fundamentally unchanged since they were introduced in 1944 there are some limitations. For example, where people have more than one concurrent job or pension, or have volatile employment patterns this can mean that people may not pay the correct tax during the year and intervention from HMRC after the end of the tax year may be necessary in some cases to correct this. Some of these limitations have been demonstrated in the levels of overpayments and underpayments over recent years.
- 2.6** PAYE requires employers¹ to calculate and deduct tax and national insurance from the payments they make to their employees². The

¹ 'Employer' includes pension providers and DWP throughout the document unless a specific reference is made to the contrary.

tax and NIC is paid over to HMRC shortly afterwards. But the employer only reports the details of the payments and deductions to HMRC once a year. This paper outlines an option, “Real Time Information”, for employers to report the payments and deductions more frequently – at the time of each payment.

2.7 HMRC believe that Real Time Information would significantly improve the tax and welfare systems by:

- making it easier to ensure individuals pay the right tax after a change of job and possibly removing the need for the P45/P46 procedure
- offering the prospect of simplifying the PAYE end of year reconciliation process for employers, HMRC and individuals
- allowing more accurate payment of benefits and reducing the costs of administration and
- reducing the uncertainty for individuals and HMRC around the levels of employment income on which tax credits awards are based that can lead to errors in claims.

2.8 Real Time Information could provide a foundation for further changes to PAYE. In the longer term PAYE could be improved for all parties concerned if calculations could be made more accurately. This paper outlines an option to achieve this and HMRC is interested in views on this or other ideas with similar potential to meet the Government’s objectives.

What’s Next?

2.9 This document is intended to start a discussion about the collection of Real Time Information for PAYE and to introduce the Centralised Deductions option while inviting any alternative proposals for achieving the stated objectives.

² ‘Employees’ includes employees, pensioners or recipients of state pension, contributions based job seekers allowance or contributions based employment support allowance.

- 2.10** This discussion document will gather information and views. Interested parties will have 8 weeks in which to comment to inform further consultation.
- 2.11** To help ensure that interested parties are able to fully contribute HMRC will also be holding a series of seminars. HMRC will use these seminars to establish the level of support for Real Time Information and to discuss how it might be used to simplify the PAYE process for all involved. HMRC will also be seeking any issues stakeholders feel should be taken into account in developing Real Time Information and their help in starting the process of arriving at solutions to address these issues. If the Government decides to proceed with Real Time Information, employers and software developers will be given early notification of the changes to be made.
- 2.12** Throughout this process, HMRC will consider the responses it receives and the outcomes of the seminars.
- 2.13** This first stage will inform decisions about what happens next and when. If the responses are positive this may lead to a second stage of consultation commencing in the autumn.
- 2.14** This document sets out a general approach to acquiring real time information. Further work is required on the options for PAYE improvements based on the opportunities provided by real time information. Responses to this document will provide details of potential costs, benefits and other impacts. An Impact Assessment will then be prepared and published – once options for reform have been developed in further detail.
- 2.15** A second stage of consultation would also provide an opportunity to develop further any proposals for longer-term changes.

3. PAYE Today

- 3.1** PAYE is operated by employers who calculate and report deductions using tax codes and rules provided by HMRC. It collects tax, NIC and student loan repayments³ from income. It is designed so that individuals should not need to contact HMRC after the end of the tax year to claim a repayment or settle a bill. As a result, the great majority of individuals do not need to submit a self assessment return because PAYE should have collected the right tax during the year.

Why change PAYE?

- 3.2** PAYE is tried and tested. Since its introduction, it has successfully collected deductions from individuals with little burden to them and at a relatively low cost. However, each year:
- operating PAYE costs private sector employers and pension providers £0.7bn
 - HMRC spends around £1 billion on PAYE administration
 - around five million people receive a repayment or a bill for previous years because PAYE had not collected the right tax in the previous year
 - student loans deductions can continue to be made after the loan has been repaid
 - individuals with more than one job can pay more NIC than is due requiring a repayment after the year-end.

A number of factors that lead to these shortcomings.

³ All loans advanced since August 1998 are income-contingent Student Loans (referred to as Student Loans in this document)

Employers report information annually

- 3.3** Under PAYE employers are only required to provide full information on individuals' deductions annually, after the tax year has ended. This has two effects on the operation of PAYE. Firstly, checks that correct deductions have been made can only be carried out after the tax year has ended. Secondly, in-year adjustments to tax codes have to be based on estimated income. This can be an imprecise process as circumstances can turn out differently from those predicted when the estimate was made.
- 3.4** There is an additional consequence where HMRC takes on collection for another Department. For example, HMRC collects student loans on behalf of the Department for Business, Innovation and Skills and passes information about repayments to the Student Loan Company (SLC). HMRC is unable to provide information about individual repayments until after the end of the tax year. This can mean that in some instances deductions continue after the loan has been fully repaid, requiring a refund from SLC.

Payroll changes

- 3.5** Changes in the labour market and payroll operation have also affected the operation of PAYE. The labour market into which PAYE was introduced in 1944 was very different from that of today. Most people only had one job – often for life. In addition, most employers ran a weekly payroll, so people leaving for another job received their P45 at the end of the week that they left, together with their final payment.
- 3.6** The general move to monthly and computerised payroll systems has meant that today the issue of a P45 can be delayed until some time after an individual leaves a job. This can prevent the new employer from deducting the correct amount of tax with the result that the individual may have over or under paid tax by the end of the tax year.

Working pattern changes

- 3.7** The complexity of the workforce has also increased. The number of employees with multiple sources of income doubled between 1984 and 2000. 600,000 pensioners have more than one pension and the proportion of pensioners over the state pension age who are also working has risen to 10 per cent. With the advent of new pension rules that facilitate flexible retirement, this figure is likely to increase further. Term-time working by students is also increasing as is the sporadic nature of student work patterns.
- 3.8** People in these situations may require several tax codes so it is harder to ensure the correct amounts of tax are deducted from each payment.
- 3.9** All of this impacts on the correct deduction of tax for those within PAYE. Whilst PAYE works well for a large majority of people, there is a significant minority, usually those with less stable or more complex employment patterns, for whom PAYE works less well. For these people further intervention is required by employers, HMRC or both to ensure that the correct amount of tax has been deducted during the year. Nor is this a stable minority. Its make-up changes from year to year and can potentially include an individual each time they change jobs or move into retirement – situations where the risk of an inaccuracy in the tax code can lead to the incorrect deduction of tax and an unsatisfactory customer experience at a time which may already be stressful.

Tax Codes

- 3.10** Employers and pension providers are responsible for applying the tax code when calculating tax. They should make this calculation by reference to HMRC procedures and any P45, P46 or coding notice from HMRC in their possession. Where employers hold incorrect details or have not received a coding notice or a P45/P46 form on time it is possible that the tax calculation for an individual will be incorrect and will need HMRC intervention to correct it.

- 3.11** Similarly it is likely that those employed by agencies, those with more than one job at the same time or with multiple pensions will have tax deducted from one or more of those sources of income using a code based on an HMRC estimate of their total income for the year. This, too, can lead to incorrect deductions and the need for end of year intervention by HMRC.

Payment

- 3.12** Finally, when PAYE was introduced, almost everyone was paid in cash, but nowadays, around 96 per cent of payments taxable under PAYE are made electronically via the Direct Credit system (BACS). Employers also use other payment channels in use, e.g. Faster Payments Service and the Clearing House Automatic Payments System (CHAPS).

Additional requirements of PAYE

- 3.13** Over the years, PAYE has been adapted to collect and report further deductions and payments made by an employer such as student loan repayments and statutory payments e.g. statutory sick, maternity and paternity pay.

Technology

- 3.14** Advances in technology offer opportunities to increase the efficiency of tax collection and administration. Most employers now use computerised payroll systems. Most employees are paid through electronic banking. Internet and telephone banking are increasingly common and it is now possible for internet banking customers to view and pay their bills from within the secure surroundings of their online bank. Information is now exchanged, processed and checked in fractions of a second, using technologies that were not available a few years ago. The Government wants to make use of these to deliver efficiencies and improve services.

Modernising PAYE

3.15 HMRC has recently invested in a new National Insurance and PAYE Computer Service (NPS) which will significantly improve certain aspects of PAYE by creating a single tax account for each employee and pensioner which will contain their:

- employment history
- historic earnings
- National Insurance record.

3.16 Previously, the HMRC system held details at employer level, so if an individual had more than one job, the record for each would be held separately. Details were not brought together until all the sources of an individual's income were consolidated at the year end. The new service provides:

- a joined up view of an individual's employment and pension income
- a complete contact history in which all information about an individual's contact with HMRC is attached to their tax account.

3.17 This enables an HMRC officer dealing with an individual to see all their previous contacts with HMRC, whichever office they contacted.

Further Modernisation

3.18 HMRC has explored building on NPS to improve other aspects of the operation of PAYE. HMRC now seek views on a concept for further enhancement, Real Time Information, which could simplify and improve the operation of PAYE especially around job changes and end of year reporting; reduce errors in the Tax Credits system and allow benefits and welfare payments to better reflect the individual's current circumstances.

- 3.19** HMRC is also interested in views on a longer-term option, which would build on Real Time Information and offer further enhancements. This is outlined in Chapter 5 and is described as “Centralised Deductions”. It is an option that offers considerable reductions in the employer burden and HMRC costs while enabling PAYE to get tax deductions right in even the most complex cases.
- 3.20** This document seeks views on this further option and how Real Time Information could best be implemented.

4: A possible next stage in the evolution of PAYE

Real time information

- 4.1 The previous chapter outlined the advantages to PAYE brought by NPS which provides a comprehensive, single view of an individual's employment income. This is a significant improvement, which addresses one of the shortfalls of the previous PAYE arrangements under which HMRC held this information on twelve separate databases.
- 4.2 Most PAYE arrangements remain the same, however, and in particular the data relating to amounts of tax and NIC collected during the year are still only sent by employers to HMRC once a year, after the tax year end.
- 4.3 HMRC has developed an option – Real Time Information – to obtain the information on deductions from employers on a real time basis. This would enable the PAYE system to cope much better with the work patterns of today which involve many more changes of jobs and rates of pay than in the past. It would also reduce the number of people needing an adjustment to their tax position at the end of the year.
- 4.4 The more frequent flow of information could improve the accuracy of tax credit and benefit payments and limit the extent to which claimants need to report changes of income.
- 4.5 Responsibility for the calculation of the amounts of tax, NIC and student loan repayments and their deduction would remain with employers.

How it could work

- 4.6 Most employers now use computerised payroll systems which calculate deductions from an employee's pay and the great majority of employees are now paid electronically.
- 4.7 With Real Time Information, employers paying electronically would send HMRC details of an employee's pay; the deductions of tax, NIC and student loan repayments; together with information about the payee's identity as part of making the payment to the employee. This would be for all employees, including those from whose wages the employer is not required to deduct any tax, NIC etc.
- 4.8 The information would be produced automatically by the computerised payroll system at the point of making the payment and would be sent to HMRC via the electronic payments system as part of the payment instructions.
- 4.9 A few small employers do not currently use electronic payments. For them, HMRC already produces software which includes a facility to record payments, calculate tax deductions and send the details to HMRC at the year end. Under Real Time Information, this facility might be enhanced to supply HMRC with the information at the time of payment.

What improvements could Real Time Information make?

- 4.10 Applying the Real Time Information approach to earnings and tax deductions could make significant improvements to the systems for tax, tax credits and welfare and benefit administration.
- 4.11 In the **tax system**, Real Time Information could provide the opportunity radically to simplify the processes when people change jobs (P45/P46). If employers tell HMRC whom they are paying each payday, HMRC could identify those who have just joined that employer and issue correct tax codes – without the need for the employer or employee to complete and submit a form.

- 4.12** *Individuals changing jobs* in year would be much more likely to pay the right amount of tax during the year and avoid the need for end of year adjustments.
- 4.13** For many **employers**, the current arrangements for people joining and leaving them are a considerable burden. Under Real Time Information, the arrangements would be radically simplified and streamlined. HMRC would also benefit from the simplified arrangements.
- 4.14** Real Time Information offers a further potential prize for employers and HMRC in enabling the simplification and streamlining of the end of year reporting and reconciliation process. This currently involves considerable work both for employers and for HMRC. If the employer is providing information during the year which is continuously reconciled by HMRC on receipt, the burden of end of the year could be substantially reduced.

Tax Credits and DWP Benefits

- 4.15** Access to real time earnings data would also offer opportunities significantly to improve the **benefits and tax credits system**, through streamlined administration and reductions in fraud, error and overpayment.

Reduced fraud, error and overpayments

- 4.16** The most recently available figures, 2008/9 show that error and fraud in the **Tax Credits system** amounted to some £2.1bn, affecting some 1.2m households' claims. A significant proportion of that Exchequer loss resulted from mistakes made by customers in the calculation of the income that needs to be taken into account in fixing their awards. This is particularly so when tax credit claimants have had changes in their employment or rates of pay during the tax year. The plan to give HMRC access to real time income information would enable HMRC to help customers get their calculations right when changes in income and employment affect entitlement – and

so significantly reduce the numbers of errors and overpayments. Reducing overpayments would also mean that fewer claimants would get an unexpected bill for repayment.

- 4.17** Real time earnings data could have a similar effect on fraud and error in the working age benefits system, particularly on those benefits paid in and out of work, such as Housing Benefit and Council Tax Benefit, which are sensitive to changes in income. Income-related fraud and error amounts to around £400m in the benefits system and a further £305m in tax credits. Real time earnings data could substantially reduce this and help to ensure that benefits are paid in the right amount to the right people.

Improved Administration

- 4.18** Access to real time data would remove the need for benefits and tax credits claimants to notify changes of income, reducing the administrative burden on both the claimant and the Government. In the current system, changes in income may have to be notified to at least three different parts of central and local Government to ensure benefit payments remain correct.
- 4.19** Real Time Information could provide accurate annual income figures for tax credit claimants immediately after the end of the tax year. This would reduce the risk of overpayments arising whilst the award is finalised. It could also enable more claims to be renewed automatically. The process for making new tax credit claims could also be made simpler for claimants as the up-to-date information on income from employment would already be held by HMRC (although details of self-employed income and relevant expenses would still be needed).
- 4.20** HMRC could also use real time income information to contact individuals who might benefit from tax credits at the point their level of income reduced and entitled them to an award.
- 4.21** In addition to the benefits to claimants, the streamlining of tax credits administration in this way could offer substantial savings to HMRC by

removing many of the sources of error which currently require interventions on claims. If Real Time Information were adopted and used to improve the benefits and welfare systems, it would not change the existing safeguards and protocols which regulate how HMRC shares information with other Government Departments.

Enabling Future reforms

4.22 As well as improving the current benefits and tax credits system, real time earnings information would enable Department for Work and Pensions more easily to introduce further reforms to reduce complexity, improve work incentives and smooth the transition between different benefits and between unemployment and work.

4.23 There may also be benefits for borrowers repaying student loans

What could it mean for employers?

4.24 The simplification of the arrangements for individuals leaving and joining an employer and of the end of year reporting and reconciliation processes could be simplified to offer a significant reduction in the burden on employers.

4.25 Computerised payroll systems used by employers would need to be changed. Arrangements would need to be made for those employers not operating computerised payroll, possibly, for example, through enhancements to the software provided to small employers by HMRC.

4.26 Real Time Information may also offer opportunities to change how employers pay the money they have deducted and how this is checked by HMRC.

What could it mean for payroll software

4.27 Payroll software would need to be enhanced to extract the relevant information from employers' systems at the time a payment was made.

- 4.28** If the information was transmitted to HMRC using the same mechanism employers use to make electronic payments, there would also need to be enhancements in that system to carry the additional information.

What could it mean for payroll bureaux?

- 4.29** Payroll bureaux operate PAYE on behalf of some employers. Their role should be unchanged under Real Time Information beyond the changes already described for employers.

What could it mean for HMRC

- 4.30** HMRC's operating costs would reduce following streamlining of the processes for people leaving and joining jobs.
- 4.31** There is also the potential for:
- reducing operating costs from streamlining the end of year reconciliation processes
 - cleansing and matching the records it holds against those held by employers in real time as changes to employments occur
 - enhancing compliance with tax laws by using real time information to assist in tackling late or under payment of the deductions some employers make
 - tackling error and fraud.
- 4.32** Money deducted under PAYE is due on the 19th day of the month following its deduction (if paying by cash or cheque) or the 22nd of the month (if paying electronically). HMRC analysis shows that many employers pay this money late and the average amount owed at any given time is £3.5bn. Moreover, HMRC does not get full information on the amounts that should have been paid until the end of the tax year, and is therefore limited in the action it can take to collect this debt at the point it is incurred. Real Time Information would enable HMRC to calculate the PAYE tax owed by an employer at any point

in the tax year and to take effective action to collect the debt at that time.

Views sought

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

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

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

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

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

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

5: An option for exploiting Real Time Information

“Centralised Deductions”

- 5.1** Chapter 4 outlines how Real Time Information could improve the tax and welfare systems. This chapter outlines one possible longer-term proposal which could build on Real Time Information and deliver significant further benefits for individuals, employers and HMRC. This would result in correct PAYE calculations in almost all situations and would significantly reduce error and confusion caused by tax codes. While this option is one way to make the improvements looked for, HMRC would be interested in hearing views on any other ways in which a similar outcome could be achieved.
- 5.2** NPS and Real Time Information concept would together address a number of the current issues with PAYE and would make it better able to deal with the challenges of the modern world of work. But they would not fully address the issues faced by those people for whom the PAYE system currently works less well – for example pensioners, agency workers, and those with several jobs. Nor would they enable employers and HMRC to dispense fully with the existing processes for people changing employer and end of year reconciliation.
- 5.3** HMRC has considered a further, more radical, option which would build on Real Time Information. 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 and placing it fully with HMRC. We have called this “Centralised Deductions”.

How it could work

- 5.4** Under Real Time Information employers would already be sending information about income and deductions to HMRC with each payment to an employee. HMRC would hold this information in a consolidated real time tax account for each individual. Under Centralised Deductions, it would expand this real time tax account to include details of the individual's personal tax allowances and other reliefs that may be due.
- 5.5** HMRC would also construct a central calculator to work out the correct deductions of tax, NIC and student loan repayments from an individual's pay.
- 5.6** Today, the majority of employer payrolls are connected to the electronic payment infrastructure. Under Centralised Deductions the employer would send the gross payment through the electronic payment system to a central calculator where the deductions calculated by HMRC would be made automatically. The resulting net payment would then be sent to the individual's bank account and the deductions would be paid directly to the Government.
- 5.7** Where the employer pays the individual by cheque or cash, HMRC could calculate and notify the employer of the deductions to be made and request their payment separately to HMRC.
- 5.8** As employers would no longer be responsible for calculating tax, NIC (both primary and secondary) and student loan deductions, they would not need to operate tax codes or need a separate procedure for people starting and leaving work.
- 5.9** Employers would however remain responsible for making statutory payments and third party deductions (such as Trade Union subscriptions) and for identifying whether a payment should be taxed.
- 5.10** At no stage would HMRC or its agents have direct access to any money or information contained in the recipient's bank account or indeed the bank account itself. The tax calculation would be made between the employer's payment transmission and the receipt of that

instruction by the employers and employees banks. The system would adhere to the high standards of taxpayer confidentiality that characterise the existing system.

What improvements could Centralised Deductions bring?

- 5.11** The Centralised Deductions concept offers significant further benefits for individuals with income subject to PAYE. Most would pay the right amount of tax in year including those with multiple employments, short term employments, students and pensioners and so few would need any end of year adjustment.
- 5.12** Individuals would no longer need to understand tax codes, which are a means of hiding an individual's personal circumstances from the employer. As employers would no longer be deducting tax, codes would no longer be needed. Individuals would be able to see a simple calculation showing the personal allowances and reliefs due to them.
- 5.13** HMRC would be responsible for ensuring deductions were correct and would be responsible for ensuring individuals had access to timely information about them.
- 5.14** Information about deductions might no longer appear on an employer generated payslip. To compensate, one option would be to give individuals access to their consolidated tax account which would show how deductions had been calculated. This information could be made available in a number of ways – many would want to view it online but others might prefer alternative means.
- 5.15** HMRC would, at any time in the year, be able to confirm what deductions had been made and that they were correct or make necessary adjustments.
- 5.16** There would also be potential to simplify tax for those who have to complete a self-assessment tax return. HMRC would be able to send them self-assessment returns pre-populated with information about employment income and pensions, reducing the time needed to complete the return.

- 5.17** Recent research by HMRC⁴ suggests 66 per cent of individuals use their bank when checking whether and how much they have been paid. They would not notice any change under Centralised Deductions.
- 5.18** Nevertheless, such a reform would require individuals to get used to a new means of dealing with pay issues. They would continue to deal with their employer on questions about amounts and timing of gross payments, statutory payments and third party deductions, but questions about tax and NIC deductions would be the responsibility of HMRC. The handling of cases where the individual had a query about the deductions will be considered very carefully as part of this consultation exercise. Much of the information wanted by individuals in this situation could be provided through self-service, online or elsewhere. But there is potential to add to the administrative burden for both individuals and HMRC if people are unclear about who to contact with a question. This would require careful design to avoid significant additional cost to HMRC or employers.

What does this mean for employers

- 5.19** We estimate the potential savings to employers from the introduction of the combined Real Time Information and Centralised Deductions concept to be about £500m. This would follow from their no longer having to:
- receive information about individuals, calculate and make deductions from payments to them
 - operate tax codes on 55m employments
 - make monthly payments of deductions to HMRC
 - process forms for people starting or leaving work
 - reconcile payments across the year and make annual returns to HMRC
 - provide employees with an end of year return (P60).

⁴ HMRC Survey October 2009

5.20 Employers would still remain responsible for some activities such as:

- determining pay subject to tax and NIC
- determining taxable expenses and payments
- some statutory payments (for example statutory sick pay)
- third party deductions (such as trade union subscriptions).

What could this mean for payroll software providers and payroll bureaux?

5.21 The scope of the service offered by payroll software providers could change under Centralised Deductions as responsibility for calculating and deducting PAYE, NIC and student loan repayments would shift to HMRC. Equally, the service offered by payroll bureaux would narrow in scope, but their functions might evolve with a reduced emphasis on carrying out processes and a greater emphasis on providing advice and guidance.

What could it mean for HMRC?

5.22 Centralised Deduction offers a number of benefits including:

- correct tax deductions and therefore much less need to adjust individuals' tax after the year end
- abolition of the separate processes for dealing with people starting and leaving employments
- end of the need for an annual reconciliation process with employers as payments and information would flow together
- less paper information to be transmitted, for example coding notices to individuals
- improved data quality.

But, as noted above, there is a risk of it increasing avoidable contact with HMRC, increasing costs for HMRC and employers if their respective areas of responsibility are not made clear to individual PAYE taxpayers.

- 5.23** This new system would identify data errors immediately and both employers and employees would have greater incentives for ensuring that they provide the correct details in order to ensure that the correct tax treatment was applied.

Views sought

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

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

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

6: Data and Security

- 6.1 The concepts explored in this consultative document would fundamentally change the operation of PAYE. A number of issues, such as data security and system resilience would need to be addressed before any such changes could be implemented.

Data

- 6.2 Under these options (Real Time Information and Centralised Deductions), HMRC would only hold data which it already holds today or is currently held by employers. All the data would belong to HMRC and it would therefore continue to be subject to the legal safeguards applying to personal data held by HMRC. This can only be shared with other agencies where there is a legal gateway. Neither option requires any new data to be captured in order to work.
- 6.3 However, real-time data would be combined more often and more quickly than previously and this could create potential risks of data misuse. HMRC would need to ensure there are sufficient safeguards to mitigate these.
- 6.4 On the other hand under Centralised Deductions, some current data exchanges would no longer be needed – for example, HMRC would no longer issue 25m notices of a tax code to individuals. So some existing data exchange risks would disappear.
- 6.5 If an electronic payment channel were used in realising the concepts – for instance the current BACS system- HMRC would be using a tested secure electronic channel with a record of 40 years' successful handling of secure transmissions.
- 6.6 HMRC is particularly aware there would be concerns around data issues but believes these options could be developed to provide a more secure method for handling and processing data. A data management plan showing the steps to be taken to ensure data security and integrity would be developed if these options were pursued.

Resilience and availability

- 6.7** The systems created under the options in this document would be a crucial piece of infrastructure. If the electronic payment system were used for data transmission, the linked PAYE systems would need to meet the resilience and security standards applying to it.
- 6.8** Any new PAYE systems under these options would need to be available at all times, aligned with the systems they interacted with.

Views sought

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

7: Summary of Views Sought

Chapter 4

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

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

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

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

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

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

Chapter 5

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

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

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

Chapter 6

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

Annex A: Data requirements of 'Real-Time Information' and 'Centralised Deductions'

All references in brackets are to entries on a P11

Employer data:*

- Company name (Box A)
- Employer Reference (Box B)

Employee data:*

- Name (Boxes C & D)
- Gender (Box H)
- Pay Frequency e.g. weekly, monthly
- NI number (Box E)
- Date of birth (Box F)
- Works number (if used) (Box G)
- New starter date (Box I)
- Leaver date (Box J)

Pay Data:

- Value of the gross pay*
- Value of Statutory Sick Pay* (Box 1g)
- Value of Statutory Maternity Pay* (Box 1h)
- Value of Statutory Paternity Pay* (Box 1i)
- Value of Statutory Adoption Pay* (Box 1j)
- Value of taxable pay (Box 2)*
- Employee pension contributions*
- Payroll giving*
- Pension scheme(s) Contracted out number*
- Third party payments*

- Strike/Holiday pay/period
- Hours worked*
- Value of tax deducted from this payment (Box 7)*
- Tax code operated (Box L or M)*
- The date the code was operated from (in the case of a code in Box M)*
- Value of tax deducted in the year to date excluding the amount from this payment (previous period Box 6)*
- Value of student loan repayment recovered in period* (Box 1k)
- Value of Primary class 1 national insurance contribution collected in this period* (Box 1f)
- Value of Secondary Class 1 national insurance contribution collected in this period* (Box 1e - Box 1f)
- Value of earnings at the Lower Earnings Limit (LEL) in this period* (Box 1a)
- Value of earnings above the LEL but at or below Earnings Threshold (ET)* (Box 1b)
- Value of earnings above the ET but at or below Upper Accrual Point (UAP)* (Box 1c)
- Value of earnings above the UAP but at or below Upper Earnings Point (UEP)* (Box 1d)
- Value of net pay*
- Assumed earnings from K code* (Box 4b)
- Tax not deducted because of regulatory limit* (Box 8)

* Required for Real Time Information stage, remaining items would be required for the Centralised Deduction stage.

Most of the information requested is currently held on the P11 or equivalent. Some of the extra information pension contributions, payroll giving and third party payments will be held on the employer's system.

The one item where HMRC think there might be particular interest is hours worked. HMRC would be interested in how this figure might be obtained most easily.

Benefits in Kind

This document assumes that Benefits in Kind would continue to be returned annually in arrears using form P11d as now. HMRC would be interested in hearing suggestions for simplification of the benefits in kind process using real time information.