



GOVERNMENT SERVICES

Administrative Burdens – HMRC Measurement Project

Report by Tax Area

Part 24: Tax Credits

20 March 2006
Restricted – Commercial

TAX



HMRC

**Administrative Burdens -
HMRC Measurement Project
Report by Tax Area
Part 24: Tax Credits**

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KPMG LLP
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1 **How to use this report**

This report should be read in conjunction with the main report on the Administrative Burdens - HMRC Measurement project. Both reports seek to give an overview of the model that has been built to measure the tax administrative burden for UK business. The reports give examples of some early analysis of areas of high burden, outline how the model was built and the size and format of the resulting data framework.

Like the UK tax system the model is large and complex. Thus the reports can only give a flavour of the model's full potential. The detailed analysis looking at specific pieces of tax regulation, the setting of the baseline and targets, how to link the administrative burden to the full range of impact assessments and wider policy initiatives will be done by HMRC as it takes the model forward, using the data framework.

For ease of reference, the main report is hereafter referred to as Volume 1 and this report, by tax area, is hereafter referred to as Volume 2.

1.1 **Volume 1**

Volume 1 is a good starting point for an overview of the model and the dynamics of the tax administration burden for UK business. The main body of Volume 1 provides a brief description of the background to the model, how the model was built, some examples of early analysis at a total level and a summary of the overall themes arising from business interviews. This report uses, from time to time, technical terms set out in the Standard Cost Model. The Glossary to Volume 1 seeks to give a practical explanation of each term.

There are a series of Annexes to Volume 1:

- **Annex A** is a detailed description of the methodology and how the model was applied in practice
- **Annex B** provides an example of the guide used to interview businesses
- **Annex C** provides a summary of the overall themes arising from interviews with businesses. The focus is on issues that do not relate to one specific tax but were raised in the context of interviews on many different subjects
- **Annex D** addresses demarcation issues: what regulation is included in the model and what is not

1.2 **Volume 2**

Volume 2 should be read in conjunction with Volume 1 for details of key terms used in the model and early analysis.

Volume 2 is in 28 Parts, one for each of the tax areas, described in further detail below. Volume 2 gives an overview of the administrative burden, early analysis and business

feedback for each tax area. Volume 2 can only give a flavour of the model's potential. It is already clear that the early analysis may prompt further questions. The further detailed analysis looking at specific pieces of tax regulation will be done by HMRC as it takes the model forward, using the data framework.

The tax areas are:

Part 1	Aggregates Levy	Part 15	Inheritance Tax
Part 2	Air Passenger Duty	Part 16	Insurance Premium Tax
Part 3	Capital Allowances	Part 17	Intrastat
Part 4	Capital Gains Tax	Part 18	Landfill Tax
Part 5	Climate Change Levy	Part 19	Pensions
Part 6	Construction Industry Scheme	Part 20	Petroleum Revenue Tax
Part 7	Corporation Tax	Part 21	Stamp Duty
Part 8	Customs	Part 22	Stamp Duty Land Tax
Part 9	Double Tax Treaties	Part 23	Stamp Duty Reserve Tax
Part 10	EC Sales List	Part 24	Tax Credits
Part 11	Employer Taxes	Part 25	Tax Management Provisions
Part 12	Excise Duties	Part 26	Tonnage Tax
Part 13	Gaming Duties	Part 27	Value Added Tax
Part 14	Income Tax for Businesses	Part 28	Withholding Tax

1.3 **Table conventions**

The early analysis in the reports is based on tables of monetary amounts and percentages derived from the data framework. These tables look at the administrative burden in a number of ways, at different levels of detail and for different areas of tax (some large, some small), to give examples of how the model can be used. This means that different measurement units are used for the monetary amounts and percentages, depending on which aspect of the model is being looked at. For example, some tables show monetary amounts to the nearest £ million and percentages in whole numbers. Other tables use different conventions. The overarching aim is that a monetary amount or percentage is shown and that the tables are as helpful as possible.

The underlying data held in the data framework is extremely detailed and has been rounded up to prepare the tables. Due to complex roundings not all the tables, as presented, will add up to the total shown on the table.

A dash '-' in the tables indicates a genuine zero value. By contrast, the figure '0' indicates a negligible number in the context of that table.

2 Executive summary

The administrative burden of Working Tax Credit is £12m, 0.23% of the total burden placed on business.

The burden is made up as follows:

	£000	%
Internal costs	9,777	83.72%
Acquisition costs	79	0.67%
External costs	1,823	15.61%
Total burden	11,679	100.00%

Most of the Working Tax Credit burden relates to internal costs. This is because, even if the payroll is outsourced, payment of Working Tax Credit by employers to employees, which is the key burden in this area, would only be done by the business, and not by its external advisors. Nonetheless, businesses may seek external advice on particularly technical aspects of the Working Tax Credit rules, such as applying for funding.

Working Tax Credit is an income-related payment to low-income workers. Employers pay Working Tax Credit to eligible employees with their wages and fund this from the PAYE tax and National Insurance Contributions that they are due to pay to HMRC.

This area is relevant to all businesses with employees.

Many businesses made adverse comments about the system, although many of these arise from the fact that this regime was only recently introduced. The difficulties include lack of guidance from HMRC and erroneous notices. This then causes an additional burden (not measured as part of this project) in terms of having to handle queries from employees and having to explain to them the adjustments being made. One business did comment that the initial difficulties seemed to have been largely resolved, which suggests that some of the perceived burden in this area was simply due to both business and HMRC adapting to the change.

The business burden in this area will be addressed by the phasing out of the payment of Working Tax Credit by employers, which began on 7 November 2005 and is due to be complete by 31 March 2006.

3 Introduction

3.1 Background

See Volume 1 Section 3.1.

3.2 Overview of regulation affecting the private sector

3.2.1 Description of the scope and objectives of tax area

Working Tax Credit is an income-related payment to low-income workers. The regime, which is assessed and administered by HMRC, requires employers to pay Working Tax Credit to eligible employees with their wages. Employers fund Working Tax Credit from the PAYE tax and National Insurance Contributions they would otherwise be due to pay to HMRC.

The model is based on 600,000 employees being paid Working Tax Credit.

However, payment of Working Tax Credit by the employer via employees' wages is being phased out between 7 November 2005 and 31 March 2006.

The regulations governing Working Tax Credit are UK domestic legislation.

3.2.2 Summary statistics relating to the regulations included within the scope of the measurement exercise

Table 1: Number of Regulations, HMRC Forms, Information Obligations and Data Requirements by Tax Area

Tax Area	Number of sources of regulations	Number of forms	Number of Information Obligations	Number of Data Requirements
Tax Credits	1	1	15	20
HMRC Total		279	2,692	6,614

Child Tax Credit is not included in the report as it is not paid with wages and so does not impact on business.

General payroll tax related matters (discussed under the Employer Taxes area – see Part 11 of Volume 2) may also be relevant to Working Tax Credit.

3.3 Approach and methodology

3.3.1 Overall methodology

See Volume 1 Section 3.2 and Annex A.

3.3.2 Major methodological issues specific to tax area

Frequency issues are important to Working Tax Credit. As discussed at 4.2 and 4.5 below, the key burden relates to the payment of Working Tax Credit by employers to employees, advised via their payslips. As employees may be weekly or monthly paid, so the frequency could be either 52 or 12, an average frequency of 30 was used.

4 Administrative burden on business

4.1 Overview

4.1.1 Summary of the administrative burden results

Table 2: Administrative burden – overview

Tax Area	Total administrative burden	
	£m	Share of HMRC total
Tax Credits	12	0%
HMRC Total	5,100	100%

Working Tax Credit IOs are only 0.23% of the total administrative burden placed on business.

4.2 Administrative burden by type of Information Obligation

Table 3 shows the number of IOs analysed by type of IO and the administrative burden for each type of IO. As set out in Volume 1 Section 3.2.2, the model uses 13 IO types, each of which represent a particular process. They are thus very helpful in seeing the overall dynamics in the tax system.

Table 3 uses the terminology in the SCM; please refer to Volume 1 – Glossary for a practical explanation of each term.

Table 3: Burden by Information Obligation type

Information Obligation type	Admin burden £000	Share of total admin burden for tax area	Number of IOs	Share of total IOs for tax area
Providing statutory information for third parties	8,810	75.43%	3	20.00%
Notification of activities/registration	1,806	15.46%	6	40.00%
Keeping commercial emergency plans and programmes updated, etc ...	620	5.31%	1	6.67%
Applications for subsidies, grants, allowances or credits for ...	405	3.47%	3	20.00%
Cooperating with audits/inspections of ...	36	0.31%	1	6.67%
Framing complaints and appeals	2	0.02%	1	6.67%
Statutory labelling for third parties	-	-	-	-
Carrying out inspections of ...	-	-	-	-
Entry in a register	-	-	-	-
Returns and reports	-	-	-	-
Applications for authorisation	-	-	-	-
Applications for permission for or exemption from	-	-	-	-
Application for Guidance	-	-	-	-
Total	11,679	100.00%	15	100.00%

HMRC total	5,100,094		2,692	
Share of HMRC total	0.23%		0.56%	

The largest burden by far is providing information to third parties, which is 75% of the total burden in this area, although it represents only 20% of the total number of IOs. This relates to the obligation for employers to enter the Working Tax Credit on employees' payslips. This is not in itself a particularly burdensome activity – the reason this appears as a high burden is simply because of the number of entries to payslips required.

The other types of IO, mainly around notifying HMRC, record keeping and applying for funding, have a much smaller proportion of the total administrative burden, reflecting the fact that these tend to be more ad hoc in nature.

4.3 Administrative burden by origin of Information Obligation

All the legislation affecting Working Tax Credit is domestic in origin.

4.4 Administrative burden by business size

Table 4 shows the administrative burden broken down by business size.

Table 4: Burden by business size

Tax Area	Total administrative burden					
	Nano £m	Micro £m	Small £m	Medium £m	Large £m	Total £m
Tax Credits	-	3	2	1	5	12
HMRC total	1,216	1,952	925	364	642	5,100

How the table is derived from the model

As outlined in Volume 1 Section 3.2.3.2, the administrative burden is a function of price and quantity. Thus, the burden shown in a particular size segment is driven by the number of business affected by the IOs in that size segment as much as by the price for that size segment.

As outlined in Volume 1 Section 3.2.3.1, considerable efforts have been made to ensure the population numbers are not unreasonable at a total level. As outlined in Volume 1 Section 3.2.3.1 and Section 3.3, the allocation of total population to segment populations has been done using a generic model. This means that the segment population in the model may be out of line with the segment population in practice. This means that Table 4, the analysis of the burden by size segment, needs to be interpreted with care.

Interpreting the table

Some burdens apply on a 'by business' basis, while others apply on a 'per employee' basis. For example, the application for funding to pay Working Tax Credits would be on a per business basis, whereas the obligation to enter the Working Tax Credit on payslips will be on a per employee basis.

Where the obligation on business is on a per employee basis the administrative burden is weighted towards the large businesses that have more employees. However where the burden is measured on a per business basis the weighting is towards micro businesses because there are significantly more micro and small businesses than there are medium and large. This explains the high burden in micro and large businesses, with a lower burden in the intermediate size categories.

4.5 Administrative burden by most burdensome Information Obligations

Table 5: Top 8 obligations by total administrative burden

Information Obligation	Total administrative burden	Internal cost	External cost	Acquisition cost
	£000	£000	£000	£000
Employer pays Working Tax Credit and enters this on payslip	5,157	5,157	-	-
Employer pays Working Tax Credit to employee on amendment notice	2,193	2,193	-	-
Employer pays Working Tax Credit to employee on start notice	1,460	1,460	-	-
Report that Working Tax Credit is not paid	996	132	848	15
Retention of Working Tax Credit documents	620	573	-	47
Application for funding to pay Working Tax Credit	353	96	257	-
Report that Working Tax Credit is not paid on receipt of start notice	218	26	188	3
Working Tax Credit paid after employee has left the employment	215	23	188	3
Total	11,212	9,661	1,482	69
Share of total for tax area	96.00%	98.80%	81.32%	87.56%

Total for tax area	11,679	9,777	1,823	79
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The most burdensome IO is the obligation to pay the Working Tax Credit and enter this on the payslip, which has a burden of £5.2m. This is effectively the burden to the business to administer the scheme on an ongoing basis.

The next two highest IOs are the burdens to make an amendment to the Working Tax Credit to be paid to an employee (£2.2m) and to set up a new employee to receive the Credit (£1.5m). As these are not ongoing IOs, but only apply if there is a change in employee circumstances or a new employee is taken on, they are likely to have a higher unit cost than the routine process. However, as these IOs arise infrequently, the total burden is lower than for the ongoing obligation to pay the credit and enter this on payslips.

Most of the burden with regard to Working Tax Credit relates to internal costs. This is because, even if the payroll is outsourced, payment of Working Tax Credit by employers to employees, which underlies the key burden in this area, would only be done by the



business, and not by its external advisors. Nonetheless, businesses may seek external advice on particularly technical aspects of the Working Tax Credit rules, such as applying for funding.

The external costs in relation to notifying HMRC that, for example, Working Tax Credit is not paid, are linked to where businesses outsource their payroll functions. The outsourcer would carry out these notifications for an additional charge over and above their normal payroll processing functions. Overall, however, Working Tax Credit costs reflect a very small proportion of the total external costs for outsourcing payroll.

Where businesses deal with the administration of Working Tax Credit in house, the software used is the software already purchased for payroll tax matters generally. There is therefore limited acquisition cost attributable to Working Tax Credit.

4.6 Administrative burden by administrative activity and forms

Table 6 analyses the administrative burden into the three component price parts (internal costs, external costs and acquisition costs). It also analyses internal costs across the 16 administrative activities set out in the SCM. Table 6 uses the description of administrative activities in the SCM. A practical interpretation of those activities is given in Volume 1 – Glossary.

The first part of the table analyses internal costs. The second part of the table analyses the total burden into the three component parts of price.

Table 6: Summary of burden by standard activity type

Activity	Form-filling related		Non form-filling related		Total	
	£000	%	£000	%	£000	%
Familiarisation with the information obligation	29	0.29%	182	1.86%	211	2.16%
Information retrieval	16	0.16%	83	0.85%	99	1.01%
Assessment	27	0.27%	259	2.65%	286	2.92%
Calculation	5	0.05%	2,366	24.20%	2,371	24.25%
Presentation of figures	-	-	5,833	59.65%	5,833	59.65%
Checking	10	0.10%	207	2.12%	216	2.21%
Correction	-	-	-	-	-	-
Description	-	-	15	0.15%	15	0.15%
Settlement/payment	-	-	-	-	-	-
Internal meetings	-	-	-	-	-	-
External meetings	-	-	-	-	-	-
Inspection by public authorities	-	-	34	0.34%	34	0.34%
Correction resulting from inspection by public authorities	-	-	-	-	-	-
Training	-	-	-	-	-	-
Copying, distribution, filing, etc.	6	0.06%	631	6.45%	637	6.51%
Reporting/submitting information	5	0.05%	72	0.74%	77	0.79%
Internal total	96	0.98%	9,681	99.02%	9,777	100.00%

		Share of total burden %		Share of total burden %		Share of total burden %
Internal total	96	0.82%	9,681	82.90%	9,777	83.72%
Acquisition costs	-	-	79	0.67%	79	0.67%
External costs	257	2.20%	1,566	13.41%	1,823	15.61%
Total burden	353	3.02%	11,326	96.98%	11,679	100.00%

As discussed, the key burdens relate to the payment of Working Tax Credit by employers to employees. This involves employers calculating (following instructions from HMRC) the amount of Working Tax Credit to be paid to employees and then entering this data on payslips. The calculation (24%) and presentation (60%) of figures are therefore the most burdensome activities.

Form-filling accounts for just 3% of the burden in this area, as the only form is the application for funding to pay Working Tax Credit.

4.7 **Administrative burden by Information Obligations to third parties**

Table 7: Breakdown of administrative burden of obligations to third parties

Tax Area	Total administrative burden			
	Obligations to third parties	Share of HMRC total	All other obligations	Share of HMRC total
	£m		£m	
Tax Credits	9	0%	3	0%
HMRC Total	892	17%	4,208	83%

The Working Tax Credit obligations to third parties comprise 75% of the total because, as described in detail above, the key burdens relate to employers' obligations towards employees, rather than obligations directly to HMRC.

5 Other findings

This section summarises the feedback recorded from businesses interviewed as part of the project work. It therefore represents those businesses' views rather than the views of HMRC or KPMG.

5.1 Irritations

A number of businesses expressed dissatisfaction with the Working Tax Credit regime. The examples they gave in support of this view include the following:

- employees who applied for Working Tax Credit (sometimes not expecting to get it) being told they qualify and then at a later date being told a mistake was made and they must pay it back
- the Working Tax Credit section of the HMRC website being down for a week after the ability to file online was withdrawn due to 'fraud'
- "we can't often get through to HMRC if we have an issue or query regarding Working Tax Credit"
- "the helpline is NOT helpful, they don't take ownership of the issue you're ringing about"

However, other businesses said they had no difficulties with the "quite straightforward" Working Tax Credit regime, also describing it as "not at all onerous, [the guidance is] very easy to read and never a problem."

Another business said that, overall, the Working Tax Credit system has got a lot better. They stated that at one time they received a lot of very late retrospective stop notices, for example, two months after the event which did cause some issues, mainly for the recipient as amendments needed to be made. This business also said that they often received a start notice where dates did not match up and so time had to be spent sorting this out, although they confirmed that this has now stopped happening.

5.2 Simplifications

It was suggested that if HMRC included an employee's payroll number on the notice that is sent to the business, this would save the business time.

Businesses also said that a simpler solution would be for HMRC to pay Working Tax Credit direct to employees, rather than requiring employers to pay Working Tax Credit to employees with their wages.

5.3 Examples of best practice

One business gave the example of a mistake they made in relation to Working Tax Credit which was partly due to their miscalculations and partly due to their unfamiliarity with



this area, and stated that HMRC, via the employer helpline, was very helpful in resolving it.

The comment was also made that Working Tax Credit forms are now easier to read and have a better layout.

