

# **REGULATORY IMPACT ASSESSMENT (RIA)**

## **Tax Law Rewrite Project: rewrite of PAYE Regulations**

### **The Income Tax (Pay As You Earn) Regulations 2003 S.I. 2003/2682**

#### **Introduction**

1. The Tax Law Rewrite project ("the project") aims to rewrite all of the UK's primary direct tax legislation so that it is clearer and easier to use, without changing or making less certain its general effect. While it is not within the project's general remit to rewrite secondary legislation, as an exception, the PAYE Regulations ("the Regulations") have been rewritten by the project in response to requests by users and representative bodies such as the CBI. It was seen as important that the Regulations reflect the changes in language and terminology known to be coming in the project's second rewrite Bill so that the whole of the legislative base for employment and pension income forms a cohesive whole. The rewrite of the Regulations also has the support of our Better Regulation Consultative Committee.
2. This assessment considers the risks of not rewriting the Regulations and the costs and benefits of rewriting them.
3. This is the third batch of legislation to be rewritten by the project. The first was the Capital Allowances Act 2001. The second was the Income Tax (Earnings and Pensions) Act 2003 (ITEPA for short). ITEPA contains the primary legislation relating to the Regulations and so it is appropriate that it is followed by a rewrite of the Regulations themselves.

#### **Purpose and intended effect**

4. Tax legislation has grown enormously in the last 25 years. In general, this is not because new taxes have been introduced, but because existing taxes have become more elaborate. In addition, some of the existing language and terminology is outdated or conceptually difficult and cannot be adapted easily to reflect modern usage.
5. The Tax Law Rewrite project was set up in 1996 in response to such concerns.
6. The key objectives and characteristics of the project are clearer, more user-friendly tax legislation incorporating:
  - A new, more logical, structure for the rewritten legislation.
  - Use of modern language - as long as this can be done without changing the law or making its effect less certain.

- Shorter sentences and better use of definitions.
- Better signposts and similar rules grouped together, to make the rules easier to find.
- No change in underlying tax policy. But, where possible, minor changes if these would further improve the rewritten legislation.

7. A key feature of the project is full consultation with interested parties throughout the life of the project.

### *The PAYE Regulations*

8. The Regulations were first made in 1944. Since then, the way the PAYE system operates has essentially remained unchanged. PAYE is the primary means of collecting income tax on PAYE income: broadly employment income, most pension income and some social security income. PAYE is the biggest part of the income tax system and for many taxpayers is their only contact with income tax. As at April 2002 there were around 1.6 million PAYE schemes operated by employers, pensions providers and others dealing with employments, offices, pensions and other payments. In the tax year 2001-2002 of the total net income tax receipts of around £103 billion, £92 billion (around 89%) was collected through the PAYE system. A further £60 billion of National Insurance Contributions were collected through PAYE.

9. In 1996 an important study into compliance costs for PAYE and National Insurance was carried out for the government by the Centre for Fiscal Studies, University of Bath. Amongst its many recommendations was that the literature received from the Inland Revenue should be simpler and more comprehensible and a direct reference was made in that report to the newly formed project and how it had demonstrated that even complex legislation was capable of being rewritten in more comprehensible form.

10. The Regulations deal with the rights and obligations of

- employers, pension payers, departments and others who make payments of PAYE income (“employers” for short)
- employees, pensioners, claimants and others who receive PAYE income (“employees” for short)
- the Inland Revenue

11. The Regulations mainly require:

- the Inland Revenue to set PAYE codes for employees which take account of their income and entitlement to allowances, and of underpayments from earlier years.

- employers to deduct tax in accordance with the employee's PAYE code when making payments, to pay the tax over to the Inland Revenue monthly or quarterly, and to give information to employees and the Inland Revenue when employees change jobs or at the end of the year.
- employees to give employers information when starting jobs.

12. The objective of all this, as set out in ITEPA, is that so far as possible the right amount of income tax for the year is deducted during the year.

13. Work has been progressing on rewriting the Regulations since 2001. Progress reports exposing drafts of the rewritten Regulations have been made available on the internet, inviting comments on both substance and approach.

1st Progress Report	October 2001	approach and timetable
2nd Progress Report	April 2002	Regulations 3 - 39 of SI 1993/744
3rd Progress Report	July 2002	Regulations 40 - 55
4th Progress Report	October 2002	Regulations 80A to 80N
5th Progress Report	November 2002	Regulations 81 - 98H
6th Progress Report	December 2002	Regulations 99 - 108
7th Progress Report	January 2003	Regulations 56 - 80

## **Risks**

14. There are two main areas of risk in not rewriting the Regulations. The first is that users will spend more time on the legislation and/or misconstrue it. Following the rewrite of the Schedule E legislation in ITEPA, it is logical for the Regulations to adopt the new terminology that is used in ITEPA and to refer to sections in ITEPA since the two pieces of legislation work together. If the Regulations are unchanged they will refer to sections of the Income and Corporation Taxes Act 1988 which have been repealed, and use outdated language (such as "Schedule E"). Confusion could easily follow from those mismatches between ITEPA on the one hand and the Regulations on the other – especially for new readers.

15. The second is that all the reasons for rewriting the UK primary tax legislation can equally be applied to the rewrite of the Regulations, many of which are summarised in the introduction to this document.

16. The costs/benefits analysis below demonstrates that there are no known positive risks in rewriting the Regulations – i.e. it will not impose any significant extra costs either in terms of implementation or compliance.

17. The other point to be made, in the context of assessing risk, is that most people who operate, or who are pay tax through, the PAYE system will not see any change as a result of the Regulations being rewritten. This is because only a minority of people need to refer to the Regulations themselves, and that only occasionally – for example in a particularly unusual situation which is not covered by the explanatory literature from the Inland Revenue and others. The impact of the rewrite on users will therefore be low.

### **Options**

18. The available options were to rewrite the PAYE Regulations or do nothing. The possibility of a much wider exercise to rewrite as a whole the PAYE regulations *and* all the other regulations which employers may need to have regard to was raised in the course of consultation but was not practicable with the resources available to the project and would not have been practicable with additional expenditure.

### **Benefits**

19. It is generally agreed that the benefits of the rewritten Regulations, and the rewrite project as a whole, can become clear only when a particular block of rewritten legislation has been in force for some time.

20. The Project carried out a stocktake in late 1998, sending a questionnaire to some 200 people involved in our consultative process. It asked them about the likely costs and benefits of the project. All agreed that it would be difficult to quantify most of the costs in advance, and impossible to arrive at any objective measure of the benefits. But users still firmly believe that any costs will be more than outweighed by the benefits flowing from the project.

21. The Capital Allowances Act 2001 was well received both outside and within the Inland Revenue. Initial experience with it has not diminished that welcome. A leading practitioner wrote in 2002 in an updated text:

"For those learning about capital allowances for the first time, the Capital Allowances Act 2001 is an unqualified blessing. Besides consolidating the old law into one Act, the new legislation is much more clearly laid out than the patchwork of legislation which it replaced."

*(Whitehouse: Revenue Law, 20<sup>th</sup> ed)*

22. Further work to explore what users see as the costs and benefits of the Capital Allowances Act 2001 is planned for the coming year.

23. ITEPA has been equally well-received. For example the Institute of Chartered Accountants in England and Wales described the draft Bill as

“another major step forward in improving the intelligibility of UK tax legislation in areas of the law that affect the majority of taxpayers”

24. However, specifically in the context of the Regulations, for the same reasons that the risk element involved in rewriting them is low, the great majority of users will not see any significant change and therefore no significant benefits from the rewritten Regulations. This is simply because those people who have in place a well established PAYE operation rarely, if at all, need to look at the Regulations themselves. There will however be some benefits, at the margins, which are elaborated further below.

25. The benefits are best further analysed by looking at each of the interest groups in turn:

- employers and other PAYE operators;
- tax practitioners;
- employees;
- Inland Revenue.

#### *Employers*

26. While many will barely notice the rewrite, there will be improvements for those who have to look at the legislative changes and, at the margins, where there are disagreements. There may also be benefits in reduced costs if they or their advisors are able, as a result of the rewrite, to analyse and solve problems more swiftly.

#### *Tax practitioners*

27. These are people who use tax legislation in the course of their work. They include:

- tax advisers: these may be advisers within the legal or accountancy professions or tax managers working in house for companies and organisations; many large organisations will employ staff specifically to deal with payroll matters.
- legal and accountancy publishers, both in the context of printed material and software.

28. One indication of the impact of the project is that these users' representatives continue both to support the project and to contribute to it substantially by commenting on successive drafts of the legislation.

29. The benefits to this broad group of users will come from the clarification of existing law and the clearer expression of future changes to that law. They potentially include:

- less time construing legislation and fewer errors caused by misunderstanding of the law;
- fewer issues on which time needs to be spent on obtaining specialist advice;
- less resource expended on interpretation type queries;
- fewer disputes with the Inland Revenue about the meaning of legislation;

### *Taxpayers*

30. In the context of the Regulations, this group will comprise employees, pensioners and those in receipt of taxable social security benefits.

31. Only a tiny minority of employees, pensioners and so on consult the Regulations themselves in order to resolve questions about their own tax liability. If they do have queries they are likely to be answered by one of the Inland Revenue's leaflets; by contacting an Inland Revenue employee on one of the many help lines available or locally; or by a third party – often the employer, pension payer or the department paying benefits.

32. There will be some indirect benefit to this group, derived from the greater ease of use for their advisers (which should result in lower fees for advice). And clearer legislation should also mean fewer disputes and resultant litigation.

### *The Inland Revenue*

33. Inland Revenue staff are in a similar position to other 'tax practitioners'.

### **Policy Costs**

34. Policy costs represent the essential costs of meeting policy objectives. Because the rewrite of the Regulations does not involve changes in the law, apart from some minor ones, policy costs arising from the rewrite will be minimal. Businesses and advisors will have to invest in updated versions of the legislation, but since they would need to update their tax legislation on an annual basis in any event, it is unlikely that any significant extra costs will be incurred.

### **Implementation costs**

35. While some implementation costs for employers and tax practitioners may be incurred to enable them to become familiar with the new structure, paragraph numbers and language used in the Regulations these should be minimal. It should be emphasised that the leaflets, other Inland Revenue

explanatory material and the forms themselves will remain the same save for some tiny changes where (as is very much the exception) they refer to the Regulations or quote from them.

36. The rewritten Regulations will mean that commercial publishers and software suppliers will need to make changes to their products, but since these are generally updated on an annual basis in any event, the level of extra costs which would be passed on to the end user should be minimal.

37. It is not anticipated that employers and employees (whether or not they use tax advisors) will incur anything other than minimal extra costs, and those only in selective circumstances, in adjusting to minor changes to the new legislation.

38. This is a change from the partial regulatory impact assessment on which views were sought in April 2003. Then the draft Regulations extended the requirement for employers to give employees in their employment at the end of the tax year a certificate (Form P60) of payments made and tax deducted. Employers were to be required to do so if they had been required to prepare a deductions working sheet for the employee, whether or not they had deducted tax. In the light of responses that change will not now be made in the Regulations.

### **Other costs/impacts**

39. The cost to the Inland Revenue in producing the PAYE Regulations will be approximately £1.3 million spread over a period of 3 years (2001 - 2004). These costs can in part be offset by the costs that would have expended on the consolidation of the Regulations that would have been needed but for the work of the project.

40. There will also be a small cost to the Inland Revenue in updating the relevant parts of the guidance manuals and internal training material, but in the context of PAYE this is done on an annual basis in any event.

41. Inevitably costs in terms of time expended have fallen on the tax professionals and representative bodies in respect of the time and resources they have expended in taking part in the consultation process. However, those same professionals and representative bodies urge us to maintain full and open consultation.

### **Securing Compliance**

42. Since, as explained above, the law is not materially being changed, securing compliance is not an issue.

## **Impact on Small Business**

43. While it was recognised by the Bath Report, referred to in paragraph 9 of this document, that the costs per employee in administering PAYE were higher for small businesses than larger ones, the rewrite of the Regulations will not have any impact on those costs that will significantly affect that differential, either in terms of reducing it or increasing it. This is because, except in some marginal cases, the demands put upon employers by the Regulations are not changing. There will be some instances where the Regulations will be rewritten so as to align more closely with practice, which will be advantageous, but for the vast majority of employers - small and large alike - there will be minimal noticeable change. The forms/software will remain the same subject to the usual annual updates and it is seldom necessary for a PAYE operator to have to look behind the forms and at the Regulations themselves.

## **Competition Assessment**

44. The legislation concerns the assessment and collection of taxes relating to the employment, pensions and social security income of individuals so there is no direct affect on markets. It is true that at present the cost per employee of administering PAYE is higher for smaller businesses than large ones. The impact of the rewritten Regulations will do nothing to change those relative costs and therefore will not affect the relevant markets (see paragraph 41 above). Nor will new entrants to the employment market be put at any special disadvantage to those already administering PAYE schemes that does not otherwise exist. No other concerns were identified in the comments on plans for the rewrite of the Regulations or earlier drafts of them so there was no known need to carry out a detailed competition assessment.

## **Consultation**

45. Full consultation with interested parties has been a feature of the project. The draft Regulations published for consultation in April 2003 were better for the comments and suggestions from users on early drafts. Substantial further improvements have been made as a result of that further consultation. Experience with the two rewrite Bills shows that this iterative process of consultation and revised draft legislation improves the final product. It has continued after the end of the consultation period.

## **Monitoring and Evaluation**

46. The effectiveness of the rewritten Regulations will be monitored and evaluated but this task cannot be undertaken until they have been in force for a number of years. It is likely that such an evaluation will be carried out as part of evaluation of the effectiveness of ITEPA and of the Inland Revenue's other initiatives to enable and help employers and employees to understand

their obligations and their rights - eg the employer programme which is giving employers clearer and more accessible guidance (see paragraph 9 above).

## **Summary**

47. The consultation process – including consultation on a partial RIA published in April 2003 – has given rise to no doubts about the low regulatory impact and costs to employers flowing from the rewrite of the PAYE Regulations

### **Contact Point:**

Basil Rajamanie  
Tax Law Rewrite Project  
Inland Revenue  
Room 826  
Bush House, South West Wing  
Strand  
London WC2B 4RD

## **REGULATORY IMPACT ASSESSMENT**

### **The Income Tax (Pay As You Earn) Regulations 2003**

#### **Statement of Ministerial Approval**

I have read the regulatory impact assessment and I am satisfied that the benefits justify the costs.

Signed by the responsible Minister:

A handwritten signature in black ink, appearing to read "Dawn Primarolo". The signature is fluid and cursive, with a large initial 'D' and a long, sweeping tail.

Dawn Primarolo

Paymaster General

Date 21 October 2003