

Summary: Intervention & Options

Department /Agency:

HMRC

Title:

Impact Assessment of Improving the operation of Pay As You Earn (PAYE): Real Time Information

Stage: Consultation

Version: Final

Date: 3 December 2010

Related Publications: HM Revenue & Customs' discussion paper 'Improving the operation of Pay As You Earn (PAYE)' published on 23 July 2010

Available to view or download at:

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

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What is the problem under consideration? Why is government intervention necessary?

Although improvements have been made to PAYE in recent years, the underlying structure and processes remain much the same today as when introduced in 1944.

The Government's view is that a structural change is desirable and is looking to improve PAYE to:

- Support the Government's wider tax and welfare agenda;
- Reduce costs borne by employers, individuals and HMRC;
- Increase the number of individuals who are subject to the right deductions; and
- Reduce fraud and error in the credits and benefits systems.

What are the policy objectives and the intended effects?

Real Time Information (RTI) will collect information from employers about the deductions they make under PAYE at the time at which they pay their employees. Obtaining this information at the time payment is made, instead of annually, will allow improvements to be made to PAYE, reducing the administrative costs of PAYE for employers and HMRC. It will enable reductions in fraud, error and overpayments in the current benefits and tax credits system. It will also increase the number of individuals who are taxed correctly through PAYE. RTI will also support DWP's introduction of the Universal Credit.

What policy options have been considered? Please justify any preferred option.

An earlier discussion document, 'Improving the operation of Pay As You Earn (PAYE)', was published on 23 July 2010. It set out a concept for improving the operation of PAYE by the collection of RTI, which was broadly welcomed by respondents.

Having analysed the responses to the discussion document, Ministers have decided to go forward with the modernisation of PAYE by moving towards the collection of PAYE information in real time.

When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?

RTI will be subject to HMRC's post implementation review procedures. The review will take place once all employers have been migrated on to RTI and the system has bedded in. This could be in 2014/15.

Ministerial Sign-off For consultation stage Impact Assessments:

I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.

Signed by the responsible Minister:



Date: 02/12/10

Summary: Analysis & Evidence

Policy Option: Real Time Information (RTI)	Description: RTI will collect information from employers about the deductions they make under PAYE at the time payment is made.
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COSTS	ANNUAL COSTS	Description and scale of key monetised costs by 'main affected groups' There will be significant one-off costs associated with the project for HMRC, including the cost of the infrastructure required (estimated as £100m). Software providers will have to implement new standards for exchange of information. Employers will have to review payroll processes.
	One-off (Transition) Yrs	
	£ to be quantified	
	Average Annual Cost (excluding one-off)	
£ to be quantified	Total Cost (PV)	£ to be quantified
Other key non-monetised costs by 'main affected groups'		

BENEFITS	ANNUAL BENEFITS	Description and scale of key monetised benefits by 'main affected groups' The PAYE process will be simplified for employers, reducing costs by an estimated £360m per year in 2010 prices.
	One-off Yrs	
	£ n/a	
	Average Annual Benefit (excluding one-off)	
£ 360m	Total Benefit (PV)	£ Up to £1bn
Other key non-monetised benefits by 'main affected groups' PAYE will be accurate for more customers. As in-year tax becomes more accurate, fewer individuals will need to contact HMRC, benefiting HMRC and its customers. More accurate information will reduce Tax Credits error, fraud and overpayments by £350-400m annually, based on the current tax credits population.		

Key Assumptions/Sensitivities/Risks Figures shown above and below are benefits to employers. A table in the evidence base shows when we have assumed the admin burden savings will be realised. RTI will also reduce tax credits error & fraud and overpayments by £350m-£400m annually. These benefits will be shared across different regimes when the migration to Universal Credit starts.

Price Base Year 2010	Time Period Years 7	Net Benefit Range (NPV) £	NET BENEFIT (NPV Best estimate) £ Up to £1bn
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What is the geographic coverage of the policy/option?	UK				
On what date will the policy be implemented?	2012/13				
Which organisation(s) will enforce the policy?	HMRC				
What is the total annual cost of enforcement for these organisations?	£ Absorbed				
Does enforcement comply with Hampton principles?	Yes/No				
Will implementation go beyond minimum EU requirements?	N/A				
What is the value of the proposed offsetting measure per year?	£ N/A				
What is the value of changes in greenhouse gas emissions?	£ negligible				
Will the proposal have a significant impact on competition?	No				
Annual cost (£-£) per organisation (excluding one-off)	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; border: 1px solid black;">Micro tbc</td> <td style="width: 25%; border: 1px solid black;">Small tbc</td> <td style="width: 25%; border: 1px solid black;">Medium tbc</td> <td style="width: 25%; border: 1px solid black;">Large tbc</td> </tr> </table>	Micro tbc	Small tbc	Medium tbc	Large tbc
Micro tbc	Small tbc	Medium tbc	Large tbc		
Are any of these organisations exempt?	<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 25%; border: 1px solid black; text-align: center;">No</td> <td style="width: 25%; border: 1px solid black; text-align: center;">No</td> <td style="width: 25%; border: 1px solid black; text-align: center;">N/A</td> <td style="width: 25%; border: 1px solid black; text-align: center;">N/A</td> </tr> </table>	No	No	N/A	N/A
No	No	N/A	N/A		

Impact on Admin Burdens Baseline (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £ 310m	Net Impact £ 310m decrease

Key: Annual costs and benefits: Constant Prices (Net) Present Value

Evidence Base (for summary sheets)

The Issue

Current PAYE

PAYE has successfully collected income tax in the UK since 1944. In the tax year 2009-10 it brought in around £225 billion in tax, National Insurance contributions (NIC) and student loan repayments. This cost in the region of £2 billion to collect (£1.2 billion for HMRC and £0.7 billion for businesses).

Employers apply the tax code and other rules for each employee¹ as notified by HMRC. These enable the employer to calculate the tax, national insurance and student loan repayments due on each wage or salary payment.

The PAYE process is made up of six distinct procedures and processes:

- **calculation** of deductions – including determining whether something is or is not taxable;
- determination and reporting of **benefits** in kind;
- **payment** of tax etc to HMRC monthly;
- reporting when an employee **leaves**;
- reporting when an employee **joins**; and
- **end of year** reporting.

Administrative Burden of PAYE Processes

£m (rounded to the nearest £m)

Employer Size	Calculation	Benefits	Joiner	Leaver	Payment	End of Year	Grand Total
Large	38	2	14	15	0	21	90
Medium	11	6	4	5	2	22	50
Small	42	130	17	21	153	193	556
Total	90	138	36	41	155	237	696

HMRC is subject to quantified targets to reduce one aspect of compliance costs in particular: the admin burden on business of disclosing information to HMRC or to third parties. This burden is assessed through the 'Standard Cost Model' (SCM), an activity-based costing model which identifies what activities a business has to do to comply with HMRC's obligations. The SCM estimates the cost of these activities, including agent fees and software costs. The employer costs in the table above are expressed in 2005 values, based on HMRC's SCM.

Policy Objectives and Intended Effects

The objective of RTI is to improve the accuracy and efficiency of PAYE processes. It should ensure that more individuals have the correct amount of tax deducted throughout the year, and will reduce the administrative burden of operating PAYE for employers. RTI will also reduce income related error and fraud in the Tax Credits system and support the DWP's introduction of the Universal Credit.

¹ 'Employees' includes employees, pensioners or recipients of state pension, contributions based job seekers allowance or contributions based employment support allowance.

RTI Proposal

For RTI to work, employers will need to make some changes to their current payroll processes. Employers would be required (by a change to the PAYE regulations) to provide information about the payments they make to individuals when they do a regular pay run for their employees, rather than annually. Employers would also provide details about employer level payments at the time they pay HMRC the tax etc. deducted. We envisage that the due date for payments to HMRC would remain unchanged.

By embedding the new reporting processes into the regular pay run, when deductions are calculated and recorded, the additional time that the employer needs to spend on reporting to HMRC should be marginal. This would be particularly so where payroll software is used and the software deals with reporting as an integral part of the payroll run.

Once the RTI system has bedded in, and employers have successfully switched to the new system, they would no longer have to submit P14/P35 end of year returns to HMRC and the procedures for joiners and leavers would be simplified. P11Ds (Benefits in Kind) would remain.

RTI Structure

- Most employers would be required by regulation to use the Bacs system to transmit RTI information with payment instructions.
- A common end-to-end standard will be applied to the transmission of RTI data. The standard will be incorporated within payroll software, banking interfaces and Bacs submission software.
- Smaller employers (fewer than 50 employees) who do not pay their employees via Bacs but make payments based on information calculated by:
 - manual working,
 - payroll software,
 - a payroll bureau not affiliated to Bacs, or
 - another type of agent (e.g. accountant or bookkeeper) unaffiliated to Bacs,will initially be able to submit RTI through the Government Gateway.
- HMRC will bear the costs of gathering information using the Bacs channel.

Benefits in kind are not included in the proposals, meaning that employers will still be required to submit forms P9D and P11D at the end of the tax year.

In initial consultation, representations were made suggesting that the Electronic Data Interchange channel (EDI) should be an RTI channel. But, as this channel would not link earnings paid and the reporting function, the advantages of using the Bacs channel would be lost. EDI will therefore not be taken forward as an RTI option.

Costs Associated with RTI

Costs to HMRC

There will be significant costs associated with RTI which will be borne by HMRC, including the cost of collecting the information from the Bacs channel. £100m was allocated to HMRC in the Spending Review for RTI.

Costs to Software Developers

To achieve the common standard mentioned above, most payroll software providers will have to re-write the parts of their software that submit payment instructions.

At this stage, the cost to software developers has not been quantified, but our early discussions with developers suggest that they may be able to absorb the costs within their normal development budgets to cover legislative change.

Costs to Employers

HMRC will meet the cost of the transmission of extra information by those employers already using the Bacs infrastructure. The need to ensure that this is done to the approved standard may entail some reorganisation of their payroll processes.

A. Employers who write their own software in-house

At this stage, the cost of this re-organisation to in-house software developers is unknown.

B. Employers who use payroll software

These employers pay an annual service charge to their software provider which includes updating the software to meet legislative requirements. The software providers will bear the cost of updating software in time for the Spring 2012 release.

C. Smaller Employers using HMRC's CD-ROM

Many smaller employers use HMRC's CD-ROM (soon to be replaced by a web-based "Basic PAYE Tools"). HMRC will provide a channel for these employers to file RTI each time they update the P11 on the CD-ROM / Basic PAYE tools, at no extra cost to them.

D. Paper based employers using an agent to file electronically

Some very small employers engage an agent to file electronically on their behalf, relying on them to submit their records at the end of the year. For these employers it might be appropriate to let these arrangements continue until the software industry or agency can make the necessary changes to allow integration of the payment instruction and RTI. We propose this relaxation should be available to employers with fewer than 50 employees where the following conditions apply:

- the employer is not a direct submitter to Bacs;
- the payment instruction is not made electronically at some point in the process – i.e. the software or agent passes information back to the employer who then phones, faxes, sends on paper or re-keys the data into internet banking software;

These employers (or their agents) will initially be able to file RTI across the Government Gateway and will not be mandated to use the Bacs channel. Where the relaxation applies the employer (or their agent) will still be required to submit real time information at or before the time of payment.

E. Employers who are not currently required to file online

There are some very small groups of employers who are not currently required to file online. These include certain "care and support employers" – individuals who employ a carer in their home to look after an elderly or disabled person. The employee carer could be disadvantaged if their information is not included in the RTI system (because their PAYE deductions may not be as accurate and they could encounter difficulties when making a Universal Credit claim). We will be considering further how best to deal with these employers and their employees under RTI. Some Local Authorities already

contract payroll bureaux to provide free payroll services to these employers and we will explore whether this approach could be rolled out more widely as part of the next consultation.

Benefits of RTI

Benefits for Employers

1. *Reduced Administration*

Under PAYE today employers have to:

- issue a P45 to all employees who leave employment;
- notify HMRC about employees who join and determine a tax code by requiring the employee to complete a P46; and
- make an end of year return to HMRC.

These processes will be removed or simplified on the successful introduction of RTI, reducing significantly the administrative burden placed on employers.

At this stage, we are not certain at what point the employers would be able to make the associated savings. However, to allow us to estimate the reduction in admin burden over 7 years, we have used the following cautious assumptions about when the savings to employers will accrue:

Assumed time profile of Admin Burden Savings

Savings Profile	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17
End of Year Obligations	0%	0%	0%	0%	100%	100%	100%
Movements	0%	0%	10%	100%	100%	100%	100%

When the administration relating to both End of Year and Movements has been removed, there should be a saving of around £360m annually, in 2010 values. This gives a Net Present Value saving of up to £1bn over 7 years.

2. *Administrative Burden*

The annual cost of the administrative burden associated with the above processes was identified in 2005 through the Standard Cost Model as being:

- £76.6m relating to in year movements (when an employee leaves or joins);
- and £236.8m relating to end of year activity.

Over time, RTI would completely remove these processes and the administrative cost.

RTI Admin Burden Benefits £m (rounded to nearest £m, based on SCM 2005 prices)

Employer Size	Calculation	Benefits in Kind	Joiner	Leaver	Payment	End of Year	Grand Total
Large	-	-	14	15	-	21	50
Medium	-	-	4	5	-	22	31
Small	-	-	17	21	-	193	231
Total	-	-	36	41	-	237	313

3. *Other benefits*

As part of the joining process it is hoped to offer employers an electronic NINO trace service so that they can check whether the details given by a new employee match HMRC's records. This could help make employers' pre-employment checks easier and reduce the updating that they need to make to their records later.

RTI could also potentially help HMRC to improve its targeting of employer compliance activities, reducing the burden of employer compliance checks on compliant businesses.

Benefits for Individuals

1. *Fewer Overpayments and Underpayments*

Currently, HMRC can only check that an individual has paid the correct tax and national insurance at the end of the tax year once full information on individuals' income and deductions has been received from employers.

For most people PAYE collects the correct amount of tax during the year and the end of year check simply confirms this. However, those with complex working patterns or multiple sources of income have an increased chance of under- or overpaying because their tax code has to include a potentially inaccurate estimate of income from each source of income. RTI will enable HMRC to adjust codes in-year to take account of actual earnings and reduce the number of people who under- or overpay.

RTI will also benefit individuals who join or leave employment. When people move jobs, delays in getting information to HMRC can cause the wrong tax to be deducted. This can be compounded when the new job is a second job. RTI will get information on those joining and leaving employment to HMRC more quickly by allowing the date of leaving to be sent before final earnings information is available.

2. *Improved customer service*

HMRC takes approximately 8.6 million telephone calls a year relating to PAYE. Most of these are from customers seeking help in completing forms, ascertaining whether tax codes are correct or asking about a repayment of tax. Many of these calls are from employees who have sporadic or multiple employments or pensioners who can find it difficult to calculate the correct tax on their pensions.

HMRC believes that RTI will help to reduce the causes of this customer contact because more people will be taxed correctly in-year. It will also be easier and quicker for HMRC staff to answer the questions that arise because they will have access to in-year information about income.

Benefits for HMRC

1. *Reduction in Tax Credits Error and Fraud*

Working Tax Credits awards, both provisional and final, are often dependent on household composition and income. Income changes in-year can affect the current award, and the provisional and final amounts of the next year's award.

RTI will provide income details directly to the Tax Credits system reducing reliance on the customer to tell us about the income details we need, and thus error in calculating their award. We estimate that this will reduce overpayments and error by between £350m and £400m a year based on the current tax credit population.

2. *Better Debt Management and Banking*

The direct linkage of payment and reporting under RTI will mean that HMRC can verify that an employer has paid over the correct amount on a monthly basis instead of having to wait for amounts to be reconciled at the year-end.

Impact Tests

Disability Equality

There may be an impact on PAYE employers who are disabled: in particular, those 45,000* disabled customers who currently receive Direct Payments from their Local Authority and use that money to employ carers and who have to operate PAYE.

The vast majority of these customers use a payroll bureau to handle their employer-related responsibilities (PAYE, NI, National Minimum Wage, etc). There are, however, about 900* of these recipients who operate the payroll themselves and their numbers could grow significantly if the policy of Individual Budgets is extended.

There will be an alternative channel provided for those employers who do not currently use electronic payment systems. And HMRC's "Basic PAYE Tools" would provide functionality for filing RTI through this channel.

We will be considering further how best to deal with these employers and their employees under RTI. Some local authorities already contract payroll bureaux to provide free payroll services to these employers. We will explore whether this approach could be rolled out more widely as part of the consultation.

Small Firms Impact Test

The modernisation proposals within this consultation are designed to reduce administrative burdens on the average compliant business. It is therefore appropriate to encompass all small firms to ensure that they can also access the cost savings.

The Bath Report <http://www.hmrc.gov.uk/pdfs/bathv1.pdf> found that the cost of the PAYE process falls most heavily on smaller employers. The removal of certain PAYE processes for employers may therefore particularly benefit small employers.

As explained above in the employer benefits section, certain small employers (or their agents) will initially be able to file RTI through the Government Gateway and will not be mandated to use the Bacs channel.

Some small employers use HMRC's CD-ROM (soon to be replaced by a web-based "Basic PAYE Tools") to file their returns. HMRC will provide a channel for these employers to file RTI each time they update the P11 on the CD-ROM / Basic PAYE Tools, and so these employers will not incur any extra cost.

We will be seeking views about any disproportionate impact on small employers during this round of consultation.

* 2009 Figures

Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	Yes	No
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	Yes	No
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

Impact Tests

Competition Test

RTI should significantly reduce the administrative burden associated with PAYE. HMRC does not anticipate any major effects on competition or competitiveness, however, there will be a different effect on businesses who carry out their payroll function in different ways, e.g. those who use in-house designed payroll software will need to ensure it meets the new standard.

The proposals apply across the board to all businesses and do not affect any particular markets.

There have been no issues raised regarding competition and competitiveness in response to the discussion document.

Legal Aid Test

These proposals do not have a legal aid impact.

Sustainable Development

No sustainable development impacts have been identified and none were raised in response to the discussion document.

Environmental Impact Tests

Carbon – the proposals have no significant carbon emissions impact.

Other Environmental – the proposals have no significant environmental impacts.

Health Impact

Using the Health Departments three stage screening questions it can be seen that the proposals have no significant impact on health or well-being, and therefore a complete health impact assessment does not need to be completed.

Rural Proofing

There are no indications that these proposals will impact differently in rural areas.

Equality Impact Tests

Equality Impacts have been considered as part of the consultation process for these proposals. Responses to our discussion document have not highlighted any:

- race equality impacts; or
- gender equality impacts.

Human Rights

The potential impact on human rights of these proposals has been considered as part of the development of these options, and no impacts have been identified.

HMRC Standard Cost Model

The 'Standard Cost Model' (SCM) has been used to derive an estimate of the costs to business of complying with HMRC obligations to disclose information to HMRC or to third parties. The SCM considers which activities a business has to do to comply with an HMRC obligation, how many businesses have to comply, and how often they need to comply. The SCM considers the burdens applying to different sizes of business.

The SCM estimates the costs of using agents; the costs of undertaking work in-house; and the costs of actually transmitting the information. The SCM does not consider one-off costs or transitional costs. The SCM does not consider costs which a business would have incurred anyway had the relevant HMRC obligation not existed. It considers the costs which apply to a normally efficient business and the costs to businesses which comply. The SCM does not consider wider compliance cost issues, such as the costs of business uncertainty, cash flow costs, or the costs of deciding whether or not to do something.

The Impact Assessment template requires SCM figures to be presented in May 2005 prices, as admin burden reduction targets relate to a May 2005 baseline. The Impact Assessment also uplifts those figures to current day prices.