REGULATORY IMPACT ASSESSMENT (RIA)

Mandatory Electronic Payment for Large Employers

The Income Tax (Employments) (Amendment) Regulations 2003

Purpose and intended effect

1. Regulations have been made that will require electronic payment from employers with 250 or more employees with effect from April 2004. The purpose of this measure is to ensure prompt and secure payment from the largest employers.

2. At the same time the Inland Revenue will introduce a later due date for electronic payments made by all employers. This will compensate for the loss of the cash flow advantage offered by cheque payment. It will also encourage smaller employers to adopt electronic payment voluntarily.

3. The regulations named above provide for tax to be paid electronically. Additional regulations will be made by April 2004 to replicate that requirement, and the later due date for electronic payments, for National Insurance contributions, Constructions Industry Scheme deductions and Student Loan repayments. This regulatory impact assessment addresses the impact of the changes in all these areas.

Risks

4. Cheque payment is less secure than electronic payment and the funds take longer to pass to the recipient. The majority of cheque payments made to the Inland Revenue are sent through the post to their Accounts Offices. This means that the transfer of funds, represented by those payments, is also vulnerable to postal delays.

5. Most large employers pay promptly but approximately one third still pay by cheque. There is no interest charge for late payments made by employers during the year[1]. A minority of employers take advantage of this and regularly make their monthly payments a few days late. And a few employers exploit the cheque payment rules[2] by paying with cheques drawn on overseas bank accounts which take longer to clear.

6. This measure will ensure secure and prompt payment by the 10,000 (approx.) largest employers. The payments made by this category of

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[1] Interest is charged on PAYE and NICs paid after 19 April following the end of the tax year to which the payment relates.

[2] In law a cheque payment is treated as made when the cheque is received. Value passes to the recipient when the cheque clears through his bank, at least two days later.

employers represent around two thirds of the total PAYE and NIC yield. It will remove the unfair competitive advantage currently enjoyed by the minority of large employers that pay late or exploit the cheque payment rules. It will also build on the Carter measures[3], promote the use of modern electronic communications methods throughout the employer's businesses and improve the efficiency of the administration of the tax system.

Options

Option 1 –Do nothing

7. Doing nothing would permit some large employers to continue to use an outmoded and less secure payment method. And it would mean that the minority of large employers that deliberately pay late or exploit the cheque payment rules would continue to have a competitive advantage over compliant employers and at the expense of the Exchequer.

Option 2 – introduce an in year interest charge for employer payments

8. This option would encourage prompt payment but would not do anything to move employers from cheque payment to the more secure electronic payment methods. And it wouldn't prevent exploitation of the cheque payment rules. An effective interest regime would need more detailed information from employers about the amounts due for each month, perhaps involving monthly returns. That would involve fairly wide ranging changes to the PAYE system which would be high risk and burdensome at a time when employers are gearing up for mandatory electronic filing.

Option 3 – require electronic payment from all employers

9. The Government is committed to encouraging all employers to make greater use of new technology in operating payroll and running their businesses. However, it recognises that there are cultural and financial barriers to be overcome and that the adoption of electronic strategies will be more gradual for smaller employers. There are economies of scale in operating payroll and it is proportionally more expensive for small and medium sized employers than for large employers. The particular needs of these employers need to be borne in mind in evaluating options.

[3] Patrick Carter undertook a Review of Payroll Services in 2001 for the Chancellor. His principle finding was that an electronic strategy was the best way for employers to deal with their payroll obligations and that the Inland Revenue should encourage employers to make greater use of technology in their businesses generally. The Chancellor announced a package of measures in Budget 2002, based on Patrick Carter's recommendations. These include mandatory electronic filing for large employers from 2004/05.

Option 4 – require electronic payment from employers with 250 or more employees.

10. This option would require electronic payment from the same category of employers that will be required, under the Carter provisions, to send their returns electronically from 2004/5[4]. It would ensure that a large proportion of PAYE and NICs funds were transferred securely and promptly to the Exchequer and it would affect less than 1% of employers. Approximately two thirds of the total yield of PAYE and NICs is received from the 10000 largest employers. Restricting the requirement to pay electronically to large employers therefore strikes a balance between ensuring the prompt and secure flow of funds to the Exchequer and imposing additional regulatory requirements on the majority of employers.

Benefits

Doing nothing

11. Doing nothing would benefit the minority of large employers that pay late or exploit the cheque payment rules at the expense of the Exchequer. These employers would also continue to enjoy an unfair advantage over compliant employers.

In year interest charge for employer payments

12. An in year interest charge would benefit the Exchequer but it would involve changes to the information required in returns from employers, and the number and regularity of employers returns. Such changes would be high risk and burdensome at a time when both employers and the Inland Revenue are gearing up for mandatory electronic filing.

Mandatory electronic payment for all employers

13. Introducing mandatory electronic payment for all employers would benefit the Exchequer as it would ensure that all employer payments were received securely and promptly. However, it would involve the imposition of a further statutory requirement on all employers and the Government has decided that this should not be imposed on small and medium sized employers.

Mandatory electronic payment for large employers

14. Requiring electronic payment from large employers will ensure that the majority of PAYE and NICs funds are received securely and promptly whilst not imposing costs upon smaller employers. It will also benefit large

[4] The Income Tax (Employments) (Amendment) Regulations – Payroll services (Electronic End of Year Filing of Employer Returns) RIA.

employers that are already paying electronically and on time by removing the unfair competitive advantage non-compliant employers currently enjoy.

Policy Costs

15. Employers that currently pay on time by cheque should, on switching to electronic payment, be broadly in the same cash flow position. The later due date for electronic payments will mean that the value of an electronic payment, made on time, will leave their bank account at approximately the same time as a timely cheque payment would have cleared under the old arrangements.

16. Employers that currently pay electronically will, potentially, gain a couple of days' interest on the funds as a result of the new later due date for electronic payments.

17. The cashflow cost of this to the Exchequer (i.e. a transfer) is given in Table 1

Table 1 Cash flow cost to Government

Year	03/04	04/05	05/06	06/07	07/08
£million	0	0	-5	0	0

18. There are two main effects which very nearly balance out. The later due date for electronic payments causes a delay to receipts of payments made by electronic means as compliant employers avail themselves of the extra time. Cheque payers receive no advantage. The surcharges result in earlier payment by the bulk of large employers who currently pay late. The balance arises because the two effects which rise to as much as plus and minus £30 million in the period are largely offsetting.

19. Cash flow benefit to employers is not the exact mirror image of cash flow cost to Government because the interest rate applicable to employers is their individual cost of funds rate, which by considerations of risk is always higher than the rate applicable to Government. However this higher rate boosts both cost and benefit in the period, again in a largely offsetting manner for these employers as a whole. Overall the expectation is for a cash flow benefit to employers which is marginally greater (but of the opposite sign) than to Government

Implementation costs

20. There will be a small transitional cost for large employers that currently pay by cheque representing the cost of changing their internal procedures and arranging for their bank to make electronic payments.

21. The costs of making an electronic payment compared with a cheque payment will depend on the individual employer's banking arrangements and their choice of electronic payment method. Some employers may find electronic payment cheaper overall as many payroll software products include functionality for initiating electronic payments.

22. The latest information from BACS (Press release 5/8/2003) reports that direct credit volumes are expected to grow in the next decade at the rate of 7% per year for business to business. Furthermore BACS research estimated that each direct payment costs at least £1 less than cheque and stated that many businesses are not aware of these advantages.

23. The BACS information suggests very clearly that the implementation costs of employers moving from cheques could well not be a cost all, that is small cost saving for these 250+ employers. In fact there are likely to be some small benefits when the value of the added functionality in the software of direct payment is considered.

24. The overall compliance cost of electronic payment is comprised of the cost of switching (para 23) and the cash flow effects (para 18) plus some overall costs of learning the new rules. For the largest employers the net effect is assessed to be negligible. This excludes the effect of any surcharges which are deemed to be not proper for implementation costs since they will not be incurred by those employers who make timely payment.

25. Some large employers may upgrade internal procedures to be sure of avoiding surcharges after the initial warnings. There may be costs for compliant and non-compliant employers in discussing reasonable excuse claims with Inland Revenue staff.

26. The implementation costs of upgrading the Inland Revenue Receivables Management systems, to handle the surcharge element of securing compliance, are provisionally estimated as follows. For the current proposed solution the central estimate is a one-off cost of £1.4m in the first year. On going support costs would be in the region of £150,000 per year. For the period 2003/04 to 2009/10 the sum of the discounted (NPV) system costs is approximately £2m in 2003/04 prices.

27. The Inland Revenue Receivables Management staff will continue the work, started by their Joint Employment Remittance Initiative (JERI), dedicated to educating large employers about their obligations and getting them to pay on time. The cost attributable to educating large employers about the new arrangements is estimated at £3m for the period 2003/4 to 2009/10.

Securing Compliance

28. The value of an electronic payment passes to the recipient on the same day that it is received. The regulations include provision for a surcharge which will be applied, after a number of warnings, where the value of a payment is received by the Exchequer after the relevant due date. (Cheque

payments that are made early so that value passes to the Exchequer by the due date for cheques payments will be disregarded for the purposes of calculating the surcharge, despite the employer's failure to comply with the requirement to pay electronically.)

29. The surcharge has been modelled, in part, on the VAT default surcharge. The regulations provide for employers to receive two warnings before they start to incur surcharge. The surcharge will be calculated at the end of the year and based on the total amount due for the year. There is a progressive scale of surcharge rates for each payment made in default. The maximum surcharge rate for a default payment will be 0.83% of the total amount due for the year. This is equivalent to 10% of the employer's average monthly payment. The maximum rate will only be reached where the employer has failed to make prompt payment for twelve months. An employer's position on the scale of surcharge rates will not automatically start from scratch each year, but will incorporate a backward look at the previous year. Full details of the surcharge rates are set out in the regulations which are available at http://www.inlandrevenue.gov.uk/si/index.htm .

30. The yield from the surcharge depends on a number of behavioural assumptions about how large employers will react to the new timetable for their electronic payments. It is likely that a small number of employers will after warnings still incur a surcharge by reason of one or more further default payments. A provisional estimate of the level of surcharge is put at £10 million per year after the scheme has settled down by the third year.

Impact on Small Business

31. The requirement to pay electronically will only apply to large employers. (Large employer will be defined in terms of having 250 or more employees.) Small and medium sized employers will be unaffected, but the later due date for electronic payments will encourage them to adopt electronic payment methods voluntarily.

Consultation

32. The Inland Revenue published draft regulations in June 2003 and a 12 week period of consultation followed. The measures were also presented to employers' groups and an article was provided to PayAdvice magazine. Several of the comments received were drafting points and most of these have been addressed in the final regulations. In response to representations we have also excluded quarterly payments[5] from the requirement to pay electronically, provided for an earlier date on which the employer's size will be measured each year and set deadlines for the issue of notices telling large employers that they must pay electronically and for the issue of surcharge notices.

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[5] Under regulation 41 SI1993/744 employers whose average monthly payment is expected to be less £1500, may make their payment to the Inland Revenue quarterly instead of monthly.

Competition Assessment

33. There is no expectation of a significant detrimental effect on competition (in banking markets) by requiring electronic payment in place of cheque. Rather the measure is competition enhancing between large employers, because it encourages all large employers to pay on the same monthly date and removes the gain from non-compliance.

Monitoring and Evaluation

34. The Inland Revenue will monitor the rates of adoption of electronic payment by all sizes of employer, the percentages of large employers paying electronically, the rates of timely payment, the levels of default by large employers and the amounts of surcharge incurred. This information will be analysed over the first two years of the new arrangements and the need for further changes assessed.

Summary

35. The requirement for large employers to pay electronically is not a significant imposition. This was acknowledged by consultees. The extended due date for electronic payments will leave current cheque payers in broadly the same cash flow position on switching to electronic payment. Employers that are currently paying electronically and on time will have a cash flow gain.

36. The costs for the Exchequer are balanced by the benefit of ensuring that the majority of PAYE and NICs funds are received securely and promptly.

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ANNEX F

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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:

Dawn Primarolo

Dawn Primarolo

Paymaster General

Date

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