

# PARTIAL REGULATORY IMPACT ASSESSMENT (RIA)

## Payroll Services

### Introduction/Purpose and intended effect

#### *Background*

1. On 18<sup>th</sup> June 2001, the Chancellor, Gordon Brown announced that he had asked businessman Patrick Carter to undertake a review of payroll services to identify ways of reducing the cost to business and the economy of payroll obligations. The terms of reference of the review are at Appendix A
2. The review was published at the Pre Budget Report of November 2001 when the Government welcomed its proposals and announced a consultation on the detail of its recommendations. The consultation closed on 31st January 2002.
3. The principal finding of the review was that an electronic strategy would be the best way to help small employers with payroll - but that the benefits of electronic technology have not been clear enough on their own to persuade many small employers to move away from paper.
4. The review put forward a package of proposals:
  - compulsion and incentives for employers to move to e-business methods for payroll
  - wider support measures for employers, and
  - some minor policy changes.
5. The Government aims to make the UK the best environment in the world for e-commerce. It has set targets for all government services to be available electronically by 2005 . The Carter proposals will assist these objectives.
6. Those proposals requiring legislation will be implemented by both primary and secondary legislation.

### The Proposals

#### *COMPULSION AND INCENTIVES*

7. The Carter report considered that the best way to encourage use of new technology was a mixture of compulsion and incentives as follows: -

- Employers with 50 or more employees to be required to transact with the Inland Revenue electronically from 2004.
- Employers with less than 50 employees to be required to transact electronically from 2007.
- At the same time incentives to be introduced to encourage smaller employers to switch to new technology.
- Intermediaries should be encouraged to offer payroll services to small employers which incorporate electronic filing. In return they should be entitled to receive the incentive payments for each of the employers for whom they file an end-of-year return.

### *SUPPORT*

8. The Carter Report recommended that the Inland Revenue support for employers should be increased to encourage greater use of new technology. Specifically:
  - Extending the service Business Support Teams provide to encourage employers to take advantage of new technologies.
  - Expanding helpline services for employers
  - Making the Inland Revenue Website more accessible.
  - Focusing employer compliance more towards assisting employers get things right for the future.

### *POLICY CHANGES*

9. The Carter review suggested a number of small policy changes to ease the task of employers in dealing with payroll.

### *APPROACH*

10. Following the period of consultation the Inland Revenue considered a number of ways forward, taking account of the views of respondents.

#### *Implement the report in full*

11. The risks with this approach were that many small employers would not be ready for compulsory electronic filing as early as 2007 nor medium sized companies (between 50 and 250 employees) by 2004. During the consultation period a number of respondents expressed concerns over the practicalities of meeting this timetable.

#### *Implement only the support aspects of the report*

12. The recommendations of the review were a comprehensive package of measures to encourage and support employers to use new technology as

a way both of helping their business generally and of helping them meet their payroll obligations. The risk in implementing only the support recommendations was that, by themselves, they would not significantly encourage this move.

*Implement the recommendations to a different timescale*

13. This is the preferred approach. It addresses the concerns expressed in the consultation by giving employers more time to prepare for electronic business and ensuring that the necessary support mechanisms are in place. The revised approach and timetable for compulsion and incentives are as follows:

- Employers with 250 or more employees to be required to transact with the Inland Revenue electronically for the 2004/05 tax year;
- Employers with 50 or more employees, but fewer than 250, to be required to transact electronically for the 2005/06 tax year;
- At the same time a programme of incentives to be introduced to encourage smaller employers to increase their use of new technology.
- Incentives to be paid to employers with fewer than 50 employees starting for 2004/05 at a level of £250 and tapering to £75 by 2008/09.
- Small employers to be required to file electronically for the 2009/10 tax year.

14. In addition the Inland Revenue will look at ways to make it easier for employers to verify National Insurance numbers and how it can further improve its relationship with software developers.

**Risks**

15. The risks associated with not implementing the package as proposed are:

- The opportunity to promote the benefits of new technology for employers will be missed.
- The Governmental strategy on electronic services will not be promoted.
- Small businesses will not receive the increase in support.

**Sectors Affected**

16. Implementation of the package as proposed will affect:

- Medium and Large Employers (50 or more employees)
- Small employers (less than 50 employees)

- Intermediaries (such as payroll bureaux)
- Software Developers

## **Summary of benefits**

### *17. Benefits for small employers:*

- The value of incentives in helping reduce the cost of work undertaken in meeting payroll obligations; or, alternatively,
- The value of time released by passing payroll work to an intermediary;
- More support from BSTs and Helplines which will provide a service to business, and help employers make fewer mistakes in completing their returns;
- The opportunity to complete returns online (which provides certainty and convenience )
- Secondary benefits in helping employers improve their organisation , eg, better payroll system management;
- Some gains from competition in the market for payroll services.

### *18. Benefits for large employers:*

- Secure and quick transmission of end of year forms;
- More systematic software controls on internal data and other gains from cleaner data;
- Faster transmission of information when an employee changes job;
- Savings from reductions in paper-handling, postage, printing and storage;
- Second order improvements in organisation, eg better integration to payments systems and BACS.

### *19. Benefits for Inland Revenue:*

As list for large employers, with additionally

- Reduction in keying in information from paper returns at Inland Revenue National Insurance Contributions Office (NICO), better data reconciliation, with substantial potential for savings;
- Reductions in paper storage and forms/stationery usage;
- Potentially fewer errors in the end to end process of handling information with consequent savings at NICO and elsewhere.

20. *Benefits for intermediaries (payroll bureaux) and software providers:*

- New opportunities for business to take on work previously done manually;
- After some internal investment in new software, a likely boost to profits from taking on more payroll work.;
- New opportunities for software houses to sell payroll software to replace manual processes and/or similar gains from providing bespoke software for the larger employers.

21. The list is not exhaustive but picks up the main effects. It does not imply that the benefits accrue to all employers or intermediaries, of whatever size, in every year.

### **Compliance/Administration Costs**

22. *Costs to small employers*

- With the Internet Service for PAYE, the incremental cost of the extra software feature is negligible, provided that a standard PC with modem and line is already available to the employer;
- Transmission cost of end of year information is tiny.
- Incremental software - cost of internet for employers already using payroll software is negligible. For employers previously using a manual system, an entry level software package may be bought; alternatively
- Intermediaries' fees - a market for checking the end of year forms may open up. The final cost would be determined by the extent of the work shifting from manual to electronic processing and local competition from agents;
- There may be an initial extra cost if employers have to spend more time on help lines or with BSTs;

23. *Costs to large employers:*

- One-off kit costs and the related installation and testing for Electronic Data Interchange (EDI), as appropriate, plus charges related to the size of transmission in EDI, plus a first year testing cost;
- Where bureaux/large service providers are used costs passed on to employers may vary with their service level agreement with the provider;
- Some familiarisation and first year training costs;

#### 24. *Costs to Inland Revenue*

- Investment to accommodate the IT systems, NIRS2 startup costs, Helpline IT, validations and testing service;
- Incentive costs borne by IR, dependent on take up pattern plus administrative costs of making and checking incentive payments;
- The extra cost of BST support staff and helplines;
- Marketing/publicity costs;
- Miscellaneous staff costs from familiarisation with new rules;

#### 25. *Costs to Intermediaries / software bureaux*

- An expanded market for intermediaries – new business start up/expansion costs, some initial learning and software costs to be recouped from the new business attracted;
- Software development costs.
- Possible marketing costs.

26. The time profile is particularly important, as there are considerable uncertainties about the annual take-up rates in the first five years, which in turn drive the incentive costs. The systems and support costs fall heavily in the early years.

27. After the end of the period of incentive payments 100% electronic filing of data produced from payroll standard software would be expected to produce significant net benefits to Government and to employers.

#### **Consultation**

28. Patrick Carter sought the views of different government and non government organisations whilst carrying out his review. The full report was published for consultation. This later consultation was closed on the 31<sup>st</sup> Jan 2002 . However, the Inland Revenue has accepted comments beyond the closing date - and is still considering some of these in detail.

29. Workshops with small employers were held, organised by the Small Business Service.

30. The majority of respondents supported the recommendations on support and policy simplification. On compulsion, whilst there was broad acceptance of requiring large employers to transact with the Inland Revenue electronically there was much less support for requiring small employers to do the same.

31. The responses to the consultation will be taken into account when detailed regulations are drawn up. Further consultation will take place with employers, intermediaries and software providers about the implementation of the proposals.
32. The Inland Revenue will produce a final Impact Assessment in due course. In the meantime **comments would be welcome on how the costs and benefits put forward in this assessment might flow to businesses. General comments on the detail of the proposals are also invited.**

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## Appendix A

### Terms of Reference of Review of Payroll Services (Carter Review)

To review the market for payroll services to small enterprises in the UK, to identify ways of reducing the total costs to business and the economy of compliance with payroll obligations.

In particular, the review should:

- Examine the supply side:
  - The services available to and used by small enterprises to meet their obligations for running payroll, how these are evolving to reflect new technology, what more might be done to drive the quality, reduce the cost and increase the accessibility of the services available, particularly to very small firms.
- Examine the demand side:
  - The relationship between firms' internal information needs and the costs of complying with their obligations as employers, the barriers to small firms using the most efficient means of performing the payroll task, the impact of existing government intervention such as Business Support Teams and the help provided through the SBS, and what more might be done to help firms meet their obligations more efficiently within existing policies for the structure of the tax system.

The review should make recommendations to meet the goal set out above, and identify the likely resource implications, by 30 September 2001.