TAX CREDITS ACT 1999 AND ACCOMPANYING REGULATIONS

REGULATORY IMPACT ASSESSMENT

Revised December 1999

CONTENTS

I. Introduction

1. In his November 1997 Pre-Budget Report the Chancellor of the Exchequer committed the Government to a co-ordinated strategy of tax and benefit reform. The Working Families' Tax Credit (WFTC) and Disabled Person's Tax Credit (DPTC), which the Chancellor announced in his March 1998 Budget, are central elements in that reform programme. The proposals for the WFTC, which were informed by Martin Taylor's report[*] on work incentives, are designed to help make work pay for families; while the DPTC helps people with disabilities who want to work to do so.

2. A draft RIA was issued in February 1999. Subsequently the March 1999 Budget increased the tax credit rates payable, thus increasing the number of people eligible to apply. This uprating affects the number of employers who will pay tax credits through the payroll. This final RIA updates the February 1999 version to take account of the changes announced in the Budget as well as changes to certain aspects and costs of the scheme which have emerged during consultation.

3. The new tax credits were introduced in October 1999 and are assessed and administered by the Inland Revenue. They have replaced Family Credit (FC) and Disability Working Allowance (DWA) respectively, two benefits formerly administered by the Department of Social Security.

4. From April 2000 the tax credits will be payable to employees through the pay packet except where a couple elect for the tax credit to go to a self-employed or non-working partner. This is a crucial feature of the scheme - and the one which will demonstrate most clearly that the tax credits are a reward for work. The new tax credits are therefore a vital element in the Government's overall strategy of encouraging people to move from unemployment into work. The Government is committed to working with employers to minimise the administrative costs of the tax credits and is also acting where it can to reduce administrative, tax and National Insurance Contributions (NICs) burdens on employers.

5. Employer organisations have welcomed in particular the simplification of the administrative burdens on business as a result of the transfer of the Contributions Agency to the Inland Revenue and the transfer of national insurance policy to the Revenue, which will make it easier to achieve the gradual alignment of tax and NICs rules. Dealing with one organisation rather than two should help to bring about a reduction in employers' costs. Business has also welcomed the Government's proposal to bring national insurance matters into the appeals system that already covers tax.

6. In line with Martin Taylor's recommendations, the Chancellor announced in his March 1998 Budget that the system of NICs for employers would be reformed to abolish the "entry fee" and "steps" up to the main rate of employer NICs in order to help remove the barriers to employment for the lower paid and their employers. These changes came into force in April 1999. The changes will significantly reduce the NICs burden on many small employers, especially those who employ lower-paid workers.

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[*] The Modernisation of Britain's Tax and Benefit System (No.2) "Work Incentives: A Report by Martin Taylor".

7. The Inland Revenue has also continued to improve the service that it provides to employers by, in particular, establishing an employers' helpline, issuing new guidance material and placing new business advisers in local tax offices.

8. In addition, the abolition of Advance Corporation Tax from April 1999 will bring a £1 billion cash flow advantage to smaller companies, as well as reducing their administrative burden. Also from April 1999, the small companies' tax rate has been reduced to 20 per cent. This follows the reduction of two per cent in the Government's first Budget in July 1997, and is the UK's lowest rate ever, making the UK`s tax regime for small companies the most generous combination in Europe of a low rate and high profit limit. All small and medium-sized enterprises have been in a position to benefit from enhanced capital allowances which have been in place since July 1997.

9. In the year 2000/01, WFTC will provide help to about 1.4 million working families, giving some £1.4 billion more in-work support than FC, and benefiting more than 500,000 more families. The DPTC will provide about £40 million more in-work support than DWA and will benefit around 8,000 more disabled people.

II. Purpose of WFTC

10. The WFTC will make work pay for families, by tackling the main obstacles to work: the unemployment trap, the poverty trap and lack of affordable childcare. It

- guarantees working families a minimum income, above and beyond the level of the minimum wage;
- reduces the net tax burden on families;
- as a tax credit rather than a welfare benefit, reduces the stigma associated with claiming in-work support, and so helps encourage higher take-up. Its clear link with employment should demonstrate the rewards of work over welfare and help reinforce the link between the receipt of credit and the rewards of work;
- substantially increases the support available for childcare by including a new childcare tax credit in place of the childcare disregard in FC;
- improves work incentives through a withdrawal rate much lower than that of FC, resulting in lower marginal tax and benefit withdrawal rates for 500,000 families previously in receipt of FC; and
- reduces the wasteful overlap between the tax and social security systems. Almost 400,000 families paid income tax to the Inland Revenue while receiving FC from the DSS: the net effect of WFTC is to take 99 per cent of them out of tax. (This represents an important step towards greater integration of the tax and benefit system.)

11. The design of the WFTC has been informed by the work of Martin Taylor's task force, by the consultations which have been taking place since the 1997 Pre-Budget Statement and by international experience. The Earned Income Tax Credit (EITC) in the United States and the Working Income Supplement (WIS) in Canada have provided important lessons. But the WFTC has been designed to reflect British circumstances, building on the successful elements and the experience of FC.

III. Structure of WFTC

12. The WFTC is assessed and paid over a 26-week period, on the basis of an initial assessment of household income.

13. Families on low incomes where the main earner works more than 16 hours are entitled to a tax credit of £52.30 in respect of the adults (or adult) in the household, and a tax credit ranging from £19.85 to £25.95 a week, depending on age, in respect of each child.

14. The tax credit begins to be withdrawn when the family's net income, before adding the WFTC, exceeds £90 a week. The withdrawal rate for each additional pound of net earnings is 55 per cent. The lower taper, compared to one of 70 per cent in FC, combined with the more generous threshold and the retention of the additional credit of £11.05 where the main earner works for more than 30 hours a week, will encourage low earners to move from part-time to full-time work, and onwards up the earnings ladder.

15. For many families, especially lone parents, the cost of childcare is a major obstacle to work. The WFTC therefore includes a childcare tax credit designed to make support for childcare through the tax system more generous and more transparent. Any lone parent working 16 hours a week or more, and paying for eligible childcare, can receive the childcare tax credit. Couples can also receive it where both parents are working 16 hours or more a week.

16. The childcare tax credit provides support over and above the basic adult, child and 30 hour credits. It is worth 70 per cent of eligible childcare costs of up to £100 a week for one child and £150 a week for two or more children. These limits broadly reflect the average cost of quality childcare, while providing a 'shopping incentive' to find good value. They mean that the maximum childcare support available through the WFTC and DPTC is £70 a week for a family with one child and £105 for a family with two or more children.

IV. Purpose and structure of DPTC

17. The DPTC is one of a package of measures to help people who have an illness or disability which puts them at a disadvantage in getting a job. These measures represent a new and inclusive approach to helping the one million disabled people who are not in work and say they would like to work.

18. The DPTC is more generous than DWA. It ensures that people are better off in work than out of work through

- higher earnings thresholds - £90 per week for couples (compared with £80.65 in DWA) and £70 per week for single people (£60.50 in DWA) before the tax credit begins to be withdrawn;

- a lower taper of 55 per cent (down from 70 per cent in DWA) for withdrawing the tax credit where income exceeds the threshold;

- a childcare tax credit which gives help with childcare costs.

19. The DPTC is available to disabled people on low incomes who work at least 16 hours per week and have one of a number of qualifying benefits for disability, or have received one up to six months (increased from the 56 days allowed in DWA) prior to an application for DPTC. The basic tax credit is £54.30 for a single person or £83.55 for a couple, with a further £11.05 credit where the applicant works at least 30 hours per week. There are child tax credits ranging from £19.85 to £25.95, depending on the child's age, and an additional disabled child's tax credit of £21.90.

20. Like WFTC, the DPTC includes a childcare tax credit worth up to 70 per cent of eligible childcare costs up to £100 for one child (maximum award £70) and up to £150 for two or more children (maximum award £105).

V. Payment of tax credits by employers through the pay packet

21. From April 2000 employees will normally receive their tax credits with their pay, but couples will be able to choose to have the credits paid direct by the Inland Revenue to the self-employed or non-earning partner. The Government believes that employer payment of the tax credits is of crucial importance in helping to reinforce - and demonstrate - the link between receipt of the tax credits and the rewards of work.

22. The Inland Revenue has been consulting representatives of employers and payroll software providers on this aspect of the scheme since May 1998 with the aim of keeping to a minimum any burdens on employers. Consultations are continuing. The representative bodies have provided invaluable insight into the implications of the scheme for employers and they have contributed extensively to its design. The arrangements for employers to pay tax credits through the pay-packet are described in paragraphs 23 - 29 below and are set out in regulations under Section 6 of the Tax Credits Act.

23. From April 2000 applications for the tax credits will continue to be made to the Inland Revenue who will assess entitlement and notify the amount payable to both the applicant and his/her employer. Where an employee is to receive the tax credits through the pay packet, the Inland Revenue will make the initial payments in an award period direct to the employee in order to ensure that no employer is asked to start payments without having adequate time in which to adjust the payroll. The notice period will be 14 days for weekly paid employees and 42 days in all other cases, and no employer will be asked to take over responsibility for payment unless he expects to be able to make at least three consecutive tax credit payments to the employee.

24. When employers are notified of an award to one of their employees they will be told when to start paying, how much to pay and when to stop[1]. The start notification will include the daily rate of the award and a table showing 1-31 multiples of the daily rate to assist the employer in calculating the amount due in each pay period. Once employer payments begin, the employer will need to show the tax credit on the employee's payslip and continue to pay the tax credits with pay until the end of the award period unless notified by the Inland Revenue to stop paying sooner, or in certain other circumstances. If the award is renewed the Inland Revenue will again make initial payments before notifying the employer to start paying.

25. If a tax credit recipient changes jobs or leaves employment altogether the employer will stop tax credit payments and issue a Certificate of Payments showing tax credits paid by the employer up to the date the employee leaves, and the period they cover. The employee will have to send this to the Inland Revenue as evidence that employer payments have ceased. The Inland Revenue will then make direct payments to the recipient, up to the end of the award or until a new employer starts to make payments.

26. As a compliance-reducing change brought forward during the consultation period, employers will have a choice for leavers as to whether they pay tax credits up to the date of leaving employment or pay tax credits up to the end of the pay period which includes the date of leaving, and supply a Certificate of Payment within seven days of the end of that pay period. Some employers, especially those with several pay sites, will benefit from the increased flexibility which this choice will now give them.

27. Certificates of Payments will also have to be provided if the employer stops payment of tax credits in certain other circumstances: if the employee dies or is involved in a trade dispute lasting for the whole of a pay period or longer, or if there is a pay period in which the employer will not be making any other payment to the employee. When informed of any of these situations the Inland Revenue will take over direct payment of the tax credits.

28. Employers will set off the amounts of tax credit they pay against their PAYE and NIC liabilities and against any student loan repayments deducted from their employees' pay. If the tax credits due are expected to exceed these amounts, employers will be able to apply to the Inland Revenue for funding. An application form will be provided for this purpose.

29. At the end of the month or quarter employers will have to show on the relevant Inland Revenue form (P32) the total tax, NICs and student loan repayments deducted from all their employees' pay (reduced by the amount of tax credits paid to employees), and remit to the Inland Revenue only the net tax, NICs and student loan repayment amounts. At the end of the tax year employers will complete new entries on the relevant revised forms (P14, P35 and P60) showing the total amount of tax credit paid to each employee

[1] The option of delivering tax credits through the PAYE coding system was considered, but was rejected on the grounds that PAYE codes could not deliver the necessary accuracy and reliability. Nor would they provide transparency for employees. Transparency for employees is also the main reason for the requirement in the draft regulations for the tax credit to be shown on the employee's payslip as an addition to net pay.

and the amount by which payments of tax, NICs and student loan repayments have been reduced by the tax credits.

VI. Compliance costs for business

Employers

30. The consultations with employer representatives were aimed at keeping any extra work to a minimum. Additional work for employers is likely to arise in four main areas:

- providing information in relation to their employees' applications (para 31);
- making the necessary changes to their payroll - whether computerised or manual - systems to enable tax credits to be paid and to undertake various related tasks (para 32);
- applying for funding from the Revenue where they do not expect to have enough PAYE, NIC and student loan liabilities to cover the credits they have to pay (para 33); and
- a reduction in the cash flow benefit they get from having use, until the monthly or quarterly payment dates, of PAYE/NIC and student loan deductions (para 34).

31. Employers whose employees apply for WFTC or DPTC will continue to have a role, as they did with FC, in verifying their employees' wages and hours worked. Although this is not new work, its volume is expected to increase as the number of people applying for tax credits grows.

32. The Inland Revenue (not employers) will calculate the amount of tax credit due to an employee. Employers will have to be able to:

- calculate the tax credits for the pay period from a daily rate and add the tax credit amount to net pay;
- enter this amount on the employee's payslip and record the total tax credits paid in a tax year;
- enter the total tax credits in the year for the employee on the P14 and P60;
- enter the total tax credits for all employees in the year on the P35, together with the total amount of Inland Revenue funding in that year; and
- produce Certificates of Payments for leavers.

Employers who contract out their payroll work will need to ensure that the payroll system they use can cope with these tasks.

33. It is difficult to estimate with confidence the likely incidence of businesses (mainly small firms) applying for Revenue funding where the amount of PAYE/NIC/student loan repayments they expect to deduct from their employees' pay falls short of the tax credits they must pay. We have assumed, for the purposes of this RIA, that all employers who expect such a shortfall do approach the Revenue to be put in funds.

34. The loss of cash flow advantage is valued at 10 per cent per year in line with the Bath study - whether the PAYE/NIC/student loan deductions would otherwise have earned interest for the employer or have been used to reduce the need for other credit lines.

Business sectors affected

35. It is estimated that there are nearly 1.2 million employers who are currently on the Revenue's PAYE/NIC database and employ (or have employed in the past year) one or more persons. The size distribution of these employers is given in Table 1 below. Compliance costs for business are based on, and derived from, the following size distribution for number of employers on the Inland Revenue's database plus adjustments for other cases. The Government has decided to exclude those very small employers who do not operate PAYE/NICs schemes because all their employees are below the NICs threshold - they are therefore not included in the table below.

Table 1: Numbers of employers by size (Inland Revenue COP basis)[2]

Employer Size	**Number of cases end 1998**
Small (1 to 4)	670,000
Small (5 to 9)	155,000
Small (10 to 99)	175,000
Medium (100 to 499)	16,000
Large (500 to 999)	2,000
Large (1000 to 4999)	1,800
Large (5000+)	300
Government (all sizes)	3,000
Other (miscellaneous, no employees at survey date, some not active)	150,000
Total (rounded)	**1,170,000**

36. The move to pay tax credits though the payroll will not affect all employers every pay period. The extent to which they are affected depends on

[2] (i) 'Other', miscellaneous, those with no employees at survey date, could be seasonal employers, other employers who are not active currently (though they could be later), or a business that is 'dead'. Those operating Q codes for nannies, some 25,000 employers, are specifically excluded from paying tax credits.
(ii) Table entries are counted on Inland Revenue COP basis, ie some employers may have more than one entry, as they run two or more separate payrolls.

- whether they do in fact have an employee receiving tax credits in any given pay period; and

- the number of such employees on their payroll; and

- the degree to which their payroll systems have to be adapted to cater for such employees just in case the need arises.

37. We estimate that slightly more than 1 in 20 of all employees will receive WFTC awards (approximately 1 in a 1,000 for DPTC). But not all of these will get WFTC with their pay because couples will be able to opt for a non-working or self-employed partner to receive the credit direct from the Inland Revenue; and small sums (not exceeding £4.05 per week) will be paid as a lump sum direct to the applicant. Those operating a simplified PAYE scheme for domestic staff (Q codes) are also excluded

38. Direct payments to partners further reduce the chance that a micro/small employer would employ someone with an award to be paid through the pay packet. On the other hand some sectors of employment with low wages and high part-time working are considerably more likely to be affected by WFTC. This tends to apply strongly to both small employers (perhaps by up to a factor of 2) and other large employers with considerable numbers of part-time workers. After adjustments[3] about 1 in 10 small employers are expected to pay WFTC through the payroll, and effectively all large employers are expected to have at least one WFTC employee paid through the payroll.

39. In all some 240,000 to 260,000 employers are projected to have at least one employee with a WFTC award. This is an increase, since the first announcement, of around 10,000 employers due to the March 1999 Budget which increased the generosity of the awards consequently bringing in more individuals and so more employers. This number is reduced to about190,000 to 230,000 as some employers drop out from the requirement to pay the award to one or more of their employees because the election to have payment direct to a self-employed or non-working partner or the £4.05 per week threshold removes *all* their employees from payment. Other behavioural effects here are particularly uncertain and may alter the range for employers affected. Table 2 below shows WFTC individuals paid by employer, according to employer size.

Table 2: WFTC individuals paid by employer - according to employer size

Employer Size	**WFTC Individuals (paid by**

[3] Employers do not have to pay small sums of WFTC with wages where an employee's entitlement is £4.05 per week or less, as in FC, The Revenue will pay the award as a lump sum direct to the applicant. This affects some 10,000 to 20,000 employees. If there are not three consecutive pay periods following the start date of the employer's period of responsibility , then employers will not be responsible for paying the award. Both will reduce burdens on employers. These are taken as further factors affecting the split between those paid direct and those paid by the employer .

	employer)
Small (1 to 4)	75,000
Small (5 to 9)	35,000
Small (10 to 99)	110,000
Medium (100 to 499)	100,000
Large (500 to 999)	60,000
Large (1,000 to 4,999)	140,000
Large (5,000+)	150,000
Government (all sizes)	170,000
Totals	**840,000**

Compliance costs estimates

40. Compliance costs are, as usual, divided into non-recurrent set-up costs and costs which occur year on year. The general approach to the assessment of such costs for the purposes of this RIA has followed the broad principles adopted for the Bath University report entitled "The Tax Compliance Costs for Employers of PAYE and National Insurance 1995-96". The figures in that also form the basis for some of the estimates used for this study. And the Revenue also consulted a number of individual employers, payroll representatives, software houses and payroll experts. Small employers were covered by discussions with the Federation of Small Businesses (FSB) and by software suppliers. The Revenue are very grateful for the valuable contributions made by all those participants and also by representatives serving on the employer consultative group.

41. Further details of how costs were derived for typical businesses in each size group are given in Appendix A.

42. Large employers were assumed to have their own in-house payroll department (or in some cases to use a bureau), whereas those of medium size were assumed to need software fixes to their own bespoke payroll software which required specialist programming. Small employers were assigned to one of three typical payroll systems: manual (essentially the proprietor), advisers (could be high street accountants or part-time bookkeeper) or software (essentially a bottom-end PC package). The costs are time costs of the proprietor, which are valued at £20 per hour and costs of advisers and payroll software, plus some overheads. More details are given in Appendix B.

Overall compliance costs

43. Table 3 summarises estimates of the total recurrent and non-recurrent compliance costs and gives a breakdown of each by conventional employer size band.

44. In round terms total recurrent costs are estimated to be about £100 million, and total non-recurrent costs about £40 million which are incurred to get the new system up and running for April 2000.

45. Estimates of costs to this degree of disaggregation should be treated as no more than indicative of the broad scale effects. These are revised upwards since February 1999 to account for the increase in awards announced in the March Budget. Generally the effect brings more WFTC employees into employers with existing WFTC awards, and so the recurrent compliance cost does not rise pro rata to number of awards, because of the scale effect within an existing employer. However, at the bottom end more employers of sizes (1 to 4) and (5 to 9) are brought in nearly pro rata. The change to the period of notice for the production of the certificate of payments will impact generally in favour of the medium to large employers, and strongly so for the 5000+ employers, to reduce their compliance costs. The overall effect of the increase in number of awards taken with the less onerous certificate of payments regime increases the net recurrent compliance costs by some £2 million to £105 million which is rounded to £100 million. The overall one-off cost rises by £1 million to £44 million for similar reasons to the recurrent.

Table 3: WFTC cost to employers by size £ million[4]

Employer Size	**Recurrent**	**Non-Recurrent**
Small (1 to 4)	25	1
Small (5 to 9)	12	1
Small (10 to 99)	15	12
Medium (100 to 499)	12	10
Large (500 to 999)	9	4
Large (1,000 to 4,999)	17	7
Large (5,000+)	8	3
Government (all sizes)	7	6
Totals	**105**	**44**

Other costs not included in Table 3

46. The figures in Table 3 do not include any estimates for the additional costs arising

- from the DPTC - where the numbers involved are about 2.5% of the WFTC caseload. The DPTC costs are likely to be about 1% to 2% of WFTC - assuming that the DPTC regime is seen as largely additional to WFTC ;
- from employment tribunals;
- for the childcare industry from having to deal with the verification of claims to childcare tax credit; or

[4] (i) Recurrent costs are in 1998/99 prices and include interest costs of cash-flow effects.
(ii) WFTC costs are in respect of employees only. The self-employed are excluded. Some 1,200,000 employees hold awards, of which 840,000 are expected to receive their payments through the payroll.

- for software houses bearing costs they may be unable to recoup from customers in the short term.

These items are particularly difficult to estimate - they might fairly be represented by about 5% of both recurrent and non-recurrent costs.

VII. Compliance costs for a "typical" business

47. The figures in Table 3 give aggregates for each size class. Particular care has been taken to cover each employer size class.

48. It is also useful to look at the position of the "typical" employer paying tax credits. There is, of course, a question about what is meant by a typical employer. As far as employers in general are concerned, a typical business is a small employer with 1 to 4 employees. These are the majority in terms of number of employers, but in terms of employees they account for a little over 5% of all employees. However, ‘typical’ in terms of employees is a large employer with 5,000+ employees and a significant number of part-timers. Both examples are considered below.

49. A general point to make at the outset is that the pattern of costs is not as regressive as that underlying PAYE/NICs. The small(1 to 4) employers face recurrent costs of around £25 million, whereas the largest employers face £8 million costs but cover around 2.5 times as many individuals as small employers. But when allowance is made for non-recurrent costs, the distribution is more progressive.

Employers with 1 to 4 employees

50. There are around 670,000 employers (size 1 to 4) with on average around 2.2 employees per employer. Overall, nearly 5% of all employees are estimated to be recipients of WFTC awards, but at the disaggregated level more than twice as many are likely to work for a small (size 1 to 4) employer than on average. We calculate that more than 10% of these employers could have a WFTC case per year. Movements in-year would tend to boost the number of employers affected, but direct payments by the Inland Revenue in some cases reduces the number of employers involved to nearly 10% of all small employers, say about 75,000 employers in round terms.

51. Employers of this size use manual systems in 37.5% of cases, advisers in 37.5% of cases and PC software in 25% of cases. The estimated costs are set out below, and shown with a WFTC case, or without. The systems costs are built up from detailed considerations of time spent and/or software (including support) costs. The detailed analysis of the recurrent costs by system type is given in Table 4. The assumptions for the basic systems used and for other costs are in Appendix B.

Table 4: WFTC recurrent payroll system costs per employer (1 to 4) £/year

System Type	Produce	Overheads	Total

with/without WFTC case			**Certificate**		
Manual	with	60	9	15	84
	without	0		15	15
Adviser	with	50	9	10	69
	without	25		10	35
Software	with	60	9	10	79
	without	20		10	30
Total mean weighted cost					**31**

52. We have also assumed that employers will in a proportion of cases help their employees to complete the WFTC forms, mainly by helping to establish their pay and hours worked. In Family Credit (FC) compliance costs are incurred by both employee and employer in completing the current FC forms, but there will be more people eligible for WFTC. An extra 20,000 to 25,000 or so small employers are likely to be involved in such work as compared to FC. (This increase in employer numbers is calculated pro rata to the increase from about 800,000 FC awards to about 1.4 million WFTC awards for 2000/01, and apportioned to the employers of 1 to 4 employees.)

53. Costs of assistance and answering queries could be perhaps £20 to £60 per case per year. Employers with employees already in FC will see no increase in unit costs for WFTC because this is work they already do, although more of their employees may be covered.

54. The process of applying to be put in funds has been estimated to cost around £30 - £80 per year, to cover the range of factors listed at paragraph 28.

55. After taking account of small employers who are put in funds, the rest see their cash flow benefit for handling PAYE/NIC reduced. At a 10% interest rate for 34 days for each period that monthly payment is made to the Revenue, the cost to small employers is roughly £1 million per year.

Summary compliance costs for a typical small business

56. All the above categories of compliance cost are summarised in Table 5. Only 10% of all small employers in this group are likely to pay WFTC through the payroll during the year. Actual costs in any particular case will depend on which payroll system is used. The worst case is a proprietor operating a manual system for one WFTC case - this could typically amount to 5 hours per year plus £35 overheads. This is likely to affect less than 4% of all employers with 1 to 4 employees. Overall, the total recurrent compliance cost is estimated to be some £24 million per year for all such employers - when averaged over 670,000 employers this is the equivalent of £37 per employer of size (1 to 4) per year, and this is defined as the typical recurrent compliance cost. And, as the Chancellor announced in his Budget Report in helping business to succeed, many of these employers will benefit from the Inland Revenue, on a nationwide basis, offering them help with their payroll systems.

Table 5: Summary of Small Employer Recurrent Compliance Costs

	£ million
Recurrent costs from the system	21
Putting in funds	2
Assistance with forms	1
Cash flow loss	1
Total	**25**

Note: at 1998/99 prices

Summary of Non-Recurrent Costs for a typical small business

57. Non-recurrent costs are probably very small. The approach here has been to handle them as largely learning costs in the first year, since by the nature of the small business the bulk of the costs are covered by software costs or advisers - which are treated as recurrent. It is only the manual cases where we assume that only one in three (1 in 10 overall) employers spends £10 on either a manual or a book about WFTC and a further £10 in time costs in reading, so that the non-recurrent cost would be around £1 million. This is the equivalent of approximately £2 on average for one-off learning/educational costs for a typical small employer.

Typical large employer

58. The largest non-Government employers (5000+ employees) are estimated to incur recurrent costs of typically £25,000 to £30,000 per year and a £10,000 non-recurrent cost. This represents a significant saving to the largest employers compared with the estimate in the February 1999 draft RIA. This is because employers will have a choice of when to complete the certificate of payments for leavers.

59. These largest non-Government employers typically buy in a large employer payroll software product and then incur further costs in making the software bespoke to the individual system and for testing the adapted system plus associated education costs. Also there are further one-off learning costs in the payroll office to cover wider aspects of WFTC. The software related costs are likely to be partly covered under the terms of the software licence/contract (in which case the development costs fall to the software houses) but other significant costs are likely to be required to make the system changes ready for April 2000. Other large employers may do relatively more work in-house and so purchase less from outside suppliers. Overall these system costs are deemed to be one-off capital costs, which are estimated to be about £3 million in total or around £10,000 per employer (5000+). Similar considerations apply to other large employers with more than 500 employees, though the balance between non-recurrent and recurrent shifts with employer size.

60. The largest employers will face an increased recurrent cost burden. Handling the WFTC notices of awards, entering them into their system, handling employees' queries, dealing with Revenue queries and preparing certificates for leavers are likely to involve manual intervention. Costs may also be incurred in dealing with other contracts, such as term-time contracts. Overall the largest category of employer is estimated to incur some £8

million of recurrent costs, or around £27,500 per year per employer[5]. On the basis of some typical employers with 5,000 to 15,000 employees, we estimate that some 300 to 1,000 of their employees might claim WFTC - possibly more in some cases with a concentration of part-time workers. After allowance for the election for direct payment to partners we estimate that employers in this size class might have some 200 to 700 people with tax credits paid through the employers' payroll.

VIII. Small business 'litmus test'

61. Since a typical employer for WFTC is a small employer with 1 to 4 employees, the small business litmus test is covered by the above analysis. That is, a typical small employer faces an average £37 per year increase in recurrent compliance costs and an average £2 one-off cost.

62. The Bath Report estimated that the total PAYE/NICs compliance costs are on average around £800 per year (uprated to 1999 prices) for a small employer (1 to 4 employees). Thus, the £37 average increase due to WFTC is under 5 per cent of the total annual average compliance cost.

IX. Additional costs to individuals

63. Individuals incur compliance costs arising from the time costs of applying for the WFTC awards: filling in forms, getting help from the employer with past payslips, other queries to the employer and similar queries about eligible child care costs to nurseries or registered childminders, and there are likely to be queries to the Revenue's helplines. Leavers will also have to supply evidence to the Revenue of when employer payments have ceased. There may also be some other largely non-time costs, eg for correspondence or telephone calls, professional advice and transaction costs. The self-employed will also have their own forms and incur similar costs. As some of these costs are already occurring in the FC scheme, it is only those costs above the present FC baseline which should be considered as arising from WFTC - typically arising from the extra individuals or from more take-up on the childcare.

X. Administrative costs

64. The additional administrative cost of setting up the new tax credit system over and above that of Family Credit, transferring existing staff from the DSS Family Credit Unit (and Family Credit Branch in Belfast), handling claims and providing new IT systems has been revised since the draft RIA published in February 1999. The cost is now estimated to be:

- £5.9 million in 1998/99,
- £67.5 million in 1999/00,

[5] Unlike for small employers it is in probability terms virtually certain that all large employers will have a WFTC employee to be paid through the payroll, and so the £27,500average per employer is fairly typical of an employer with around 12,000 employees.

- £ 57.8 million in 2000/01, and

- £47 million in 2001/02.

The increases have been caused by the need for improved compliance audit, greater advertising coverage, improved investment in IT and telephone systems to support a better service and higher than initially forecast application volumes following the March 1999 Budget. During the above periods the Inland Revenue expects to identify efficiencies in the operation of the new system which it hopes will offset some of the cost in the longer term.

XI. Summary of costs and benefits

65. The table below summarises the costs and benefits of the proposals.

Table 6: Summary of costs and benefits

	Expected costs	Expected benefits
Business	(i) Around £100 million a year of payroll compliance costs to employers (ii) One-off costs of about £40 million	(i) Likely to reduce staff turnover by improving work incentives for lower paid and by boosting rewards of work (ii) Remove obstacles to work or return to work of suitable employees through improved childcare support (iii) Improve labour supply through better in-work support.
Citizens	(i) Time costs of filling in tax credit application forms and time spent on queries plus telephone and other correspondence costs (ii) Other time costs for childcare forms and forms for the self-employed	(i) Improve work incentives by lower withdrawal rate and higher income threshold for withdrawal and more generous childcare support (ii) Ease poverty trap by reducing marginal tax rates for over 500,000 families (iii) Help women in particular with new childcare tax credit (iv) Guarantee minimum income for working families of £200 per week(99/00) (v) Remove stigma attached to claiming in-work support and so encourage take-up (vi) Emphasise rewards of work through payment in the wage packet
Government	See Section X. Administrative costs	(i) Reduce wasteful overlap between tax and social security systems (ii) Is an important step towards greater integration of tax and benefit systems

NB Charities, as generally small employers, are included under Business costs and benefits.

XII. Monitoring and review

66. The Inland Revenue will be monitoring and evaluating the implementation and impact of the tax credits following introduction.

XIII. Conclusion

67. In designing the scheme the Government has demonstrated its commitment to working with employers to minimise extra costs. The Working Families' Tax Credit:

- removes obstacles to work or return to work with improved childcare support;
- improves work incentives and emphasise the rewards of work through payment in the pay packet;
- eases the poverty trap; and
- reduces the wasteful overlap between the tax and social security systems.

And, of course, employer compliance costs as a result of the introduction of the WFTC must be seen in the overall context of the reform of the National Insurance Contributions system - and its organisation - and the company tax system described in the introduction which will bring benefits to employers generally, and small employers in particular.

Contact point

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APPENDIX A

Sources for the estimates of total recurrent costs (paragraph 41)

Table 7: Source of assumptions - identified by employer size

Small (1 to 4)	as detailed in text, also FSB outline estimate of £100 per case for small FSB employer
Small (5 to 9)	extrapolation from 1 to 4
Small (10 to 99)	assumed all PC with proprietary software
Medium (100 to 499)	assumed own software/some bureau
Large (500 to 999)	extrapolation from other large
Large (1,000 to 4,999)	major educational consortium
Large (5,000+)	major retailers / banks /supermarkets / large industry
Government	based on a range of sizes with lower than average costs
Software Houses (including dealers/resellers)	discussions with major computer groups for leading payroll software plus extrapolation to the rest of industry. Plus some costs in dealers/resellers

APPENDIX B

Assumptions for basic systems used (paragraph 42)

We assume :

- manual system, operated by sole proprietor with 52 pay days per year (strictly 48, since maximum is only 48 because IR has responsibility for 2 weeks every 26 weeks), requiring an extra 2 minutes for writing pay slip, counting cash if applicable and writing down record, equivalent to £35 per year; other time costs for end of year and contact with Revenue for queries (say 1 hour) £20; and miscellaneous costs £5, total £60 per year per WFTC case;
- adviser used, dependent on negotiated price, likely to be in line with underlying work in manual, say £50 with, and £25 without a WFTC case; overheads still incurred by proprietor;
- software system, operated by sole proprietor with entry level package plus licence and annual support apportioned to be £20. This assumes an 8 to 10 per cent increase in baseline costs (typically between £200 and £250) to cover licence/support for WFTC enhancement. Extra costs with WFTC case include time costs of data entry plus queries to helpline etc, say a further £40, making £60 in total per year.

Assumptions for other costs (paragraph 42)

We assume:

- extra work for leaver's certificate is effectively always manual in all systems and takes on average 30 minutes (including queries), say at £20 per hour, £10;
- contact with Inland Revenue, say £8 for extras including telephone calls;
- total £18 per case, say ½ leaver case per year, £9 on average;
- overheads are time costs of reading about WFTC plus miscellaneous non-time costs incurred by all systems, mainly proprietor's time - say £10 per year, or £15 if manual.