

# THE PAYE FURORE – WILL THINGS EVER BE THE SAME AGAIN?

Frank Haskeew considers the wider implications for HMRC

*TAXline* readers could not have failed to notice the furore in the national press about the letters which HMRC is sending to taxpayers who have paid too much or too little tax under PAYE. It has made front page news in several papers, many tax pundits have spoken about it on radio and TV (including our very own Anita Monteith) and senior HMRC staff have been hauled in front of the Treasury Committee to be grilled about the whole affair.

As is usually the case when such stories become whipped up in a media storm, problems tend to spiral out of control. It is not always easy to disentangle fact from fiction, particularly when the media want someone to fall on their sword even if it was hardly their fault. Nevertheless, the furore has opened up some very serious issues that need to be confronted if lessons are to be learnt and such problems avoided in the future.

What about the facts? The PAYE system has come in for much criticism, with suggestions that it is broken beyond repair and in need of wholesale reform. The Tax Faculty does not think that it is. The principle of PAYE is to match tax payments in-year with the ultimate tax due at the end of the year in a way that is fair to taxpayers. The successful operation of the UK PAYE system means that the number of employees who need to complete a tax return at the year end is far lower than it would be if all taxpayers had to complete one, thereby reducing costs both for HMRC and for many taxpayers.

When PAYE started in 1944 people tended to stay in their jobs for life. There were few benefits in kind and few people had multiple occupations. Life has changed and it is more difficult to operate PAYE successfully, but that does not mean that the principles underlying the PAYE system are no longer sound. PAYE needs to evolve to meet changed conditions and HMRC also recognises this.

Although the PAYE system will usually produce the right results, by its very nature it will not always produce the right answer. Under- and overpayments arise from a variety of circumstances which include: taxpayers being subject to tapered personal allowances; taking taxpayers out of self assessment and instead coding out estimated investment income; the mismatching of benefit information; changes in employment circumstances; and commencing state and pension benefits. It is therefore important to ensure that taxpayers appreciate that the PAYE system will not necessarily produce the correct result every time.

HMRC's new PAYE computer system replaces 12 older systems. This is a big step forward and the automated year-end reconciliation within the system has to be an improvement and an important management control. The trouble is not with the new system. Rather, it has highlighted that HMRC has not been following through these reconciliations in recent years because it required extensive manual intervention and therefore resources which they no longer appear to have. The Comptroller and Auditor General's report on HMRC's 2009/10 accounts states that there are 18.2m unreconciled accounts for 2007/08 and earlier years that could take four years to clear. Given that those who may have to pay more tax will always shout the loudest, this problem will haunt HMRC for years unless a way is found to resolve it quickly and give those who owe tax some certainty. Also, it cannot be right that HMRC keeps sitting on repayments that have been identified, not least as many of those affected will have no idea they have overpaid.

Alternative systems such as the US tax deduction system do not appear to offer any significant benefits. The US system leads to overdeductions and universal tax returns with many taxpayers seeking to reclaim overpaid tax, often with government funding to help lower paid taxpayers to file tax returns. That doesn't sound like a recipe that would go down well with UK taxpayers, let alone with HM Treasury and HMRC. The only viable option appears to be to improve the PAYE system. It would also help if the tax system were simplified, something that the current Government is keen to do through its Office of Tax Simplification.

The problem, therefore, is not about whether HMRC's PAYE system is up to the job as, given time and development, there is no reason to think it should not be. Rather, the PAYE problems have exposed a much bigger and more serious problem, namely whether HMRC has the resources needed to plan and manage such large scale change?

Over the past five years HMRC has changed its business model from one based on local processing and contact to one based on centralised processing. The Change Programme that began in 2004 has resulted in budget cuts totalling about 28% and a similar reduction in headcount. Many of the more experienced staff have left. No doubt there was considerable scope for efficiency savings at HMRC, but we would have expected that many of the real savings would only have been achieved following investment in improved IT systems that allowed manual processes to be automated (assuming of course that such systems work properly).



In 2007 the Treasury Committee cautioned that underpinning the Change Programme was 'the notion that efficiency gains can be achieved without an adverse effect on quality of service, and that monetary savings will therefore not be reported as efficiency savings unless quality of service is maintained'. The Committee was clearly concerned that efficiency savings should not lead to a reduction in the quality of services delivered or products provided.

On the evidence we have seen, the concerns of the Treasury Committee were well founded. The Auditor General's recent report on HMRC's 2009/10 accounts highlights several specific areas of concern and the need to redeploy significant numbers of staff to fire-fight problems. This highlights what we all suspect to be the case: namely that staff have been cut in anticipation of efficiencies through, for example, e-filing, but in advance of those efficiencies actually being delivered.

On the evidence we see, we are not convinced that HMRC does have the necessary resources and management capability to see the change to its business model through to a successful conclusion. This is not intended as a criticism of HMRC's staff, most of whom are doing the best they can in difficult circumstances

and who, if the staff surveys are anything to go by, are probably just as frustrated as we are with current levels of service standards.

We think that there is now a need for a thorough review of HMRC's reorganisation plans and current operational capabilities in the light of its available resources and what taxpayers have a right to expect. The new Charter sets out specific obligations on the part of HMRC but there is a need for this to be backed up by a set of robust and reliable service standards that HMRC must meet. In the meantime, any further reorganisation should be put on hold.

The highly damaging media comments have also highlighted the need for HMRC to improve its public image. The old saying that 'it's not what you say that matters, it's the way you say it' has never appeared more apposite. HMRC needs to adopt a better 'tone' that is both more conciliatory and coupled with a realistic appraisal of where things are going wrong and a clear determination to put them right. HMRC has a right to expect high standards from taxpayers and their agents but in return has a responsibility to demonstrate similar values.

In conclusion, the PAYE problems were an accident waiting to happen. Although the media frenzy that has followed blew this specific problem out of proportion, it has served an important purpose by identifying the more serious underlying problems – namely HMRC's resources and management capabilities. Until now, these problems have escaped close media scrutiny but, for better or worse, the cat is now out of the bag. There needs to be a frank and open discussion about how HMRC should be organised and operated so that it can deliver the sort of service that taxpayers have a right to expect in the most efficient and cost-effective way. For our part we need to work with HMRC to learn the lessons and help the department and its hard-working staff to bring about real improvements in service standards.



Frank Haskew is Head of the Tax Faculty.