



OFFICE OF TAX SIMPLIFICATION EVALUATION PAPER ON IMPROVEMENTS TO THE OPERATION OF THE PAYE SYSTEM

Issued 5 May 2022

ICAEW welcomes the opportunity to comment on the Office of Tax Simplification (OTS) evaluation paper on improvements to the operation of the PAYE system published on 24 February 2022, a copy of which is available from this [link](#).

For questions on this response please contact our Tax Faculty at taxfac@icaew.com quoting REP 35/22.

We agree with the OTS report which includes numerous recommendations that we consider should be pursued.

In this paper we summarise the most prevalent specific problems which we believe need resolving, most of which we have previously raised with government / HMRC.

This response of 5 May 2022 has been prepared by the ICAEW Tax Faculty. Internationally recognised as a source of expertise, the ICAEW Tax Faculty is a leading authority on taxation and is the voice of tax for ICAEW. It is responsible for making all submissions to the tax authorities on behalf of ICAEW, drawing upon the knowledge and experience of ICAEW's membership. The Tax Faculty's work is directly supported by over 130 active members, many of them well-known names in the tax world, who work across the complete spectrum of tax, both in practice and in business. ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark the tax system and changes to it, are summarised in Appendix 1.

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COMMENTS

1. We agree with the points made by OTS in its evaluation published on 24 February 2022. Ten years on since PAYE RTI (real time information) was launched on 6 April 2012, and over four years since HMRC's [PAYE RTI post-implementation review](#) was published on 7 December 2017, the example in the OTS paper at para 2.24 (reproducing official guidance in which civil servants transferring between government Departments are advised to do so only on the 1st of the month otherwise they run the risk of duplicate records being created in HMRC's database) epitomises the current inadequacy of the government's PAYE systems, which do not comply with our *Ten Tenets for a Better Tax System* (summarised in Appendix 1) by which we benchmark the tax system and changes to it.
2. The OTS paper includes recommendations that we consider should be pursued. We would add the following more specific recommendations, most of which we have raised with HMRC and/or ministers in the past (our representations referred to below are the most recent, but we and other representative bodies raised a number of the problems cited whilst PAYE RTI was being designed).
3. To create and maintain successfully a digital tax system, policy development and legislation-making needs to consider the mechanics of implementation and practical issues, including software updates, from the start, rather than, as seemingly happens currently, as an afterthought. HMRC's IT specifications provided to payroll software developers are frequently limited to describing a field but not when the field should be completed and do not consider other HMRC developments such as reporting of benefits-in-kind nor HMRC making tax digital (MTD) tax estimates. They are not sufficiently detailed to allow consistent development. Software needs early consideration for these reasons and because software developers need eighteen months to design, build, test and install software, supply clients and train users. We raised this in a letter to HMRC dated 19 July 2017 (reproduced as an Appendix to our letter dated 30 September 2021 to the Financial Secretary to the Treasury (FST), published as [ICAEW REP 95/21](#)).
4. New methods of calculating PAYE/NIC and thresholds, allowances, rates, repayment percentages, etc need to be announced at least six months before the start of the tax year, not a matter of a few weeks in advance when it is almost too late to update payroll software before payrolls have to be run. For example, HMRC issued guidance in December 2021 to software developers which specified a new way of calculating Class 1 NIC (ie incorporating the freeports upper secondary threshold in all calculations) that differed from HMRC's other guidance (we raised this in letters to HMRC dated 23 December 2021 to 8 March 2022 supplemented by a spreadsheet on 16 March 2022). The late announcements of student loan thresholds and repayment rates (28 January 2022), auto-enrolment thresholds ([8 February 2022](#)) and Welsh attachments of earnings orders for unpaid council tax ([9 February 2022](#)) are other examples.
5. The starter checklist needs to be revamped so it provides employers – and deemed employers/ fee payers under the off-payroll working regime – with all necessary information. We made recommendations relating to mandation of completion, wording of the form, interaction with HMRC's processes of the data submitted from completed forms, etc.in a paper submitted to HMRC on 17 July 2020 (reproduced in Appendix 2).
6. The form P45 needs to include additional information, for example on student loans.
7. HMRC's liabilities and payments records should agree with those of employers. There are too many examples where HMRC's database contains submissions and payments recorded as having been made by employers and payroll agents which do not agree with submissions and payments actually made by employers and agents. HMRC asks employers to pay

amounts that are not due, and, owing to misallocations of liabilities and payments in HMRC's database and consequential interest charges on apparent underpayments along with duplicated employment records (which can be created for example when an employee changes job (as referred to above) or an employer changes payroll software), neither party can easily, if at all, reconcile their records to the other's. The stencil that HMRC provides to facilitate reconciliations does not contain all the necessary fields. As noted above, HMRC published the results of its [PAYE RTI post implementation review](#) (to which we gave evidence) in 2017, but the review's March 2019 action plan, which included an undertaking to address this, remains unfulfilled. The inability to reconcile HMRC's with employer records is probably why the imposition of RTI late filing and late payment penalties continue to be risk assessed under a three-day easement every year. Please see our letter dated 30 September 2021 to the FST (published as [ICAEW REP 95/21](#)).

8. The form P11D and associated processes need to be made fit for purpose. It should not be left unreformed in the hope that employers will start payrolling benefits-in-kind. If the government intends to abolish the form P11D for most employers (it will still be needed for employers who are exempt from online filing) then the rules for taxing beneficial loans and employer-provided accommodation need to be simplified to enable these benefits-in-kind to be payrolled in real time. Amendments to P11Ds must be made on paper which can lead to errors when HMRC inputs the data onto its computers. Please see our letter dated 30 September 2021 to the FST (published as [ICAEW REP 95/21](#)). The type of difficulties that HMRC has with calculating correct code numbers due to the problems with the form P11D and the RTI bonus issue described below will be repeated in MTD tax estimates.
9. As noted by OTS, code numbers are frequently incorrect. This can be because they do not agree with returns submitted. An example of where such errors occur is where an employee receives a bonus – HMRC's system treats the bonus as being payable monthly rather than as a one-off payment, and the consequential adjustment to estimated annual income can cause the personal allowance to be withdrawn and other incorrect changes to code numbers.
10. Another reason for incorrect code numbers is that HMRC's long-established internal rules for determining code numbers can allocate a code number which gives rise to an over- or underpayment rather than collect the right amount of tax. Below are three more examples where changing the rules for allocating code numbers etc would result in a more accurate amount of tax being paid via PAYE.
11. First, week 1/month 1, ie, non-cumulative, codes are issued in the first half of the tax year where known income values (eg, pensions) should mean that cumulative codes are issued. Please see our letter dated September 2021 to the FST; published as [ICAEW REP 95/21](#).
12. Secondly, where an employee with another job returns a duly completed starter checklist to their new employer, HMRC instructions tell the employer to apply code BR. If the employee is a higher rate taxpayer, deducting tax only at basic rate leads to an underpayment of tax. A better code would be OT, which is the code that employers must use if the starter checklist is not returned by the employee to the employer, and which deducts tax at all relevant rates of tax and gives no allowances. We raised this in a letter to HMRC dated 17 July 2020.
13. Thirdly, if an employee is paid weekly, fortnightly or four-weekly, there can be 53, 27 or 14 paydays in the year respectively (where this happens, the extra payday is known as week 53, 54 or 56 respectively). However, HMRC instructions say that the personal allowance must be divided by 52, 26 or 13 respectively rather than by the actual number of paydays in the year. This means that a weekly paid employee is allocated 1/52nd of their personal allowance on each payday even if there are 53 paydays (and similarly *pari passu* fortnightly and four-weekly paid employees), so are given too much personal allowance over the year, which leads to underpayments. If the rule were changed so that personal allowances were

divided by the number of paydays in the year, ie, 53, 27 or 14 in years with week 53, 54 or 56 paydays, the tax deducted under PAYE would be correct. We raised this in a letter to HMRC dated 19 November 2019.

14. Since employment allowance has been limited to smaller employers, the state aid rules have applied. The state aid rules were supposed to be replaced by subsidy control rules on 1 January 2021. We acknowledge that the subsidy control legislation has not yet been passed by Parliament, but the guidance on gov.uk telling employers how to claim employment allowance has not been updated to explain whether and if so how subsidy control should be taken into account in the meantime. We raised this in a letter to HMRC dated 18 March 2022, dispatched on 21 March 2022.
15. Given that all employers (unless exempt) must submit payroll returns online it is surprising that there are still many instances where employers and HMRC have to communicate by post. Examples include amendments to forms P11D (already mentioned above), confirmation of employment allowance claims, and applications for 2021/22 refunds of NIC for veterans.
16. There are long delays in HMRC replying to correspondence. Specific examples include HMRC not agreeing applications for NIC deferments, determinations under s690 ITEPA 2003 which, once agreed, enable employers to not account for PAYE on employment earnings that are not liable to UK tax, and NT (no tax) codes. In some cases a year has passed without a response from HMRC. To ease administration burdens for employers and reduce calls to HMRC we suggest that the law be changed so employers can operate PAYE as requested in their application if HMRC has not replied substantively within 30 days. This point is included in our letter dated September 2021 to the FST; published as [ICAEW REP 95/21](#).
17. HMRC's [check employment status for tax](#) (CEST) tool does not cover all the tests that a court would use to determine employment status. In particular it disregards what is known as specific mutuality of obligation (MOO) (ie whether there is an obligation on the worker to work and an obligation on the other party to pay the worker and to continue to make work available during the time of the contract) and being in business on one's own account. HMRC revamped CEST in 2019 but in around 20% of cases it does not make a determination.
18. The tax tribunals and courts need to be given specific authority to rule on all tax-related matters, including PAYE and NIC as well as judicial reviews of HMRC decisions. In the recent case [Stephen Hoey v HMRC \[2021\] UT 0082](#) the FTT and the UT agreed that neither had jurisdiction over certain questions that relate to how much tax someone has to pay – the UT held that the matter is one of debt collection so needed to be taken to the county court. We question why the county court, which is non-specialist, should have to consider complex PAYE regulations to establish whether or not a debt is due. We recommend that the law is redrafted so it is clear that an assessment not only determines liability but also the amount due after credit so that jurisdiction over the full range of PAYE credits can be given to the FTT and UT and higher courts.
19. Resolving the foregoing issues would reduce the need for customers to contact HMRC and also help the UK employment tax regime better to comply with our *Ten Tenets for a Better Tax System* (see Appendix 1), especially Tenet 4: Easy to collect and calculate and Tenet 9: Fair and reasonable.

APPENDIX 1

ICAEW TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <https://goo.gl/x6UjJ5>).

APPENDIX 2

STARTER CHECKLIST AND RTI SCHEMA FOR NEW EMPLOYEES AND OFF-PAYROLL DEEMED EMPLOYEES: ICAEW SUGGESTIONS TO IMPROVE THE OPERATION OF PAYE

Paper submitted to HMRC on 17 July 2020

1. We set out in this memorandum some suggestions which are intended to improve the efficiency of PAYE for new employees (starters) and for deemed employees under the off-payroll working rules.
2. We think difficulties arise because:
 - A. completing the starter checklist (SC) and declaration is not mandatory and HMRC's guidance *Tell HMRC about a new employee: Get employee information*, is wrong where it explains when an SC should be completed,
 - B. the SC itself, and
 - C. the RTI schema (see HMRC's *Guidance on RTI Data Items from April 2020*) are insufficient to cover all the requirements placed on the PAYE system, and
 - D. HMRC takes a piecemeal approach to updating the SC. It does not consider all the requirements that are now placed on the PAYE system but looks at each change independently. For example, ignoring off-payrolling when looking at student loans.An all over review, covering tax, student loans, etc and changes to the legislation, is required to make the SC fit for purpose.

A. Mandating the SC and guidance on when to complete it

3. We understand from past discussions with HMRC that not all employers provide their new employees with a starter checklist. It is clear from the regulations (*in Chapter 2 of Part 3 of the PAYE Regulations 2003*) that it is not mandatory for employers to submit an SC to HMRC. This is understandable because the employee may not complete and return the SC to their employer. The regulations are unfortunately out of date in that they are based on the premise that a P45 is sufficient for the PAYE system to operated efficiently. This is no longer true as highlighted by the issues this causes for student loans.
4. We suggest that it should be made mandatory for employers to issue an SC to new employees and to ask them to complete and return it. We feel that this would increase the number of completed starter declarations and the resulting code numbers would make the collection of PAYE from new employees more accurate more quickly. We believe the same rule should apply to fee payers and contractors who are deemed employees under the off-payroll working (OPW) rules.
5. HMRC's guidance *Tell HMRC about a new employee: Get employee information*, is wrong where it says that an SC should be completed if the employee does not provide form P45. An SC is needed for all employees because form P45 does not contain details about student loans. We suggest that this longstanding error in the guidance be rectified.

B. The design of the starter checklist

Generally

6. We welcome the fact that a number of the questions have been combined but it has lost some of the information that helped employees, and also some information that would assist employers who have to use the form after it has been completed.

Student loans

7. The current form dated March 2020 contains some explanation on the student loan side (which applies to undergraduates) about part-time maintenance loans, advanced learner loans and postgraduate healthcare loans being classed as Plan 2 which was a very useful piece of information. That has now disappeared in the explanation boxes on the new form.
8. Question 10 should flow such that after the employee has completed it says to go to the Declaration as it does in question 9, otherwise in question 10 the employee is left hanging.
9. We suggest that the section that says 'please note' should make it clearer that this is an instruction not to complete questions 9 and 10 at all if any of these things apply. We think this box is confusing because it implies that employees don't pay back an undergraduate loan until they have completed their postgraduate loan which is not true. They are entirely separate: in fact an employee could be paying back an existing undergraduate loan whilst studying for a second that is not yet repayable.
10. The form is very much geared to the employee now rather than the employer and we feel that there should also be some information to assist employers that was included in the previous form (there was a hyperlink to guidance on gov.uk). For example, if the individual ticks plan 1, 2 and 4, which is entirely possible, our understanding is that the employer is supposed to combine all three instructions and set them up as just a plan 1 because it is not possible to have more than one undergraduate plan in repayment at once. The only two plans that can coexist for repayment are an undergraduate plan and a postgraduate plan, so the current instruction is: If you have more than one undergraduate plan everything is deducted as plan 1 and the student loan company splits the available monies between the various undergraduate plans on receipt.

Employee Statement

11. The RTI message in *Guidance on RTI Data Items from April 2020* data item 24A confirms whether the employee has ticked Box A, B or C. We suggest that the SC should have an additional box, Box D: "Starter declaration not completed by employee/deemed employee."

Deemed employees under the off payroll working rules

12. We recommend that the SC should be used by fee payers when they start paying new deemed employees under the off-payroll working rules as well as employers taking on new starters. This would necessitate making some changes to the SC.
13. On page 1 of the SC:
 - add "and fee payers" after "Instructions to employers" and
 - add "and deemed employees under the off-payroll working rules" after "and fee payers" after "Instructions to employers".Also amend the text of the instructions and wording throughout the form similarly to the above to make it clear that the SC applies equally to fee payers and deemed employees under the off-payroll working rules.
14. Box 5: Address: we suggest that this box be augmented to provide HMRC with sufficient detail accurately to determine whether the employee is an English/Northern Irish or Welsh or Scottish taxpayer.
15. Box 7: Employment Start Date: insert "or deemed employment" after "Employment".
16. Add a new Box 8 with the following instructions:

"Off-payroll worker: Tick this box if you are a contractor who is a deemed employee under the off-payroll working (IR35) rules."

This will tell the payroll administrator to set the off-payroll worker marker in the payroll software for appropriate individuals when setting up such individuals on payroll.
17. On page 2, at the top of the student loan/postgraduate loan section, insert:

“If you are a deemed employee under the off-payroll working rules, and your deemed employer has ticked Box [8] above, ignore this section and go straight to the Declaration.”.

C. The RTI schema

Starter information submitted later than in the first full payment submission for a new starter (applies equally to actual employees and deemed employees)

18. When the SC is returned to payroll too late for the data to be included in the first payroll run and the employer subsequently includes the information on an RTI full payment submission (FPS) which is not the first submission for the employment, it needs to be possible for the employer to flag the RTI submission as not being the first in connection with the employment, so that HMRC’s normal starter processes are overridden. For example, in connection with the employment start date data item on PAYE RTI returns (*Guidance on RTI Data Items from April 2020* data item 24), HMRC’s software needs to be changed to ensure that employers can submit a corrected start date via RTI to HMRC without HMRC’s systems processing the submission as a new employment which creates a duplicate employment.

Statutory payments

19. A deemed employee under the off-payroll working (OPW) rules is not entitled to statutory payments by virtue of their deemed employment. **ESM10030** says:
“For a [deemed employee who is an off-payroll] worker to claim statutory payments they must do so through their intermediary [ie their personal service company (PSC)]. To be eligible to claim statutory payments the worker must be paid salary through their intermediary... . Therefore, they will need to pay a salary through [the intermediary’s] payroll and report it on a FPS [as a non-taxable and non-NICable payment] using box 58A.”.
20. Currently, data item 58A is used to report other amounts too, such as season ticket loan advances, travel and subsistence costs, flexibly accessed pensions, and termination awards and sporting testimonial payments on which Class 1A NIC is payable.
21. In order to keep OPW payments separate from other payments and enable entitlement to statutory payments to be ascertained, we recommend that tax and NIC-free OPW salary paid by a PSC should be reported under a separate data item, say 58AA.
22. Given that the OPW salary payments made to the contractor via the PSC are NIC-free, we would welcome clarification of the legislative vires for enabling statutory payments to be claimed by the contractor via the PSC.

Statements B and C outcomes

23. Statement C is appropriate for someone who is claiming (and continues to be entitled to and claims) a taxable state benefit such as ESA or IB and starts an employment doing ‘permitted work’, but the form does not cover this scenario. We accept that the SC cannot cover every situation but this does result in unfortunate underpayments for vulnerable individuals (admittedly fewer now that the PA has increased).

Statement C declared and undeclared outcomes

24. The result of ticking Statement C, ie code BR, creates underpayments for higher rate taxpayers. In most cases code OT, which is allocated when the form is not returned by the employee, provides a more accurate outcome than BR. We appreciate that this could lead to over payments but it is better for taxpayers to overpay and receive a repayment of tax later on than be faced with an unexpected tax bill even if it is collected by way of coding adjustments in subsequent years.

D. HMRC's piecemeal approach

25. The introduction of the off-payrolling legislation should be grasped as the opportunity to review the whole operation of the SC and the requirements that need to be covered. The form, the guidance and the legislation should be reviewed so that we can have a new form with the legislation, the guidance and payroll software fully aligned. Piecemeal changes are not working and the benefits that RTI promised are still not being realised. HMRC should urgently set up a review team so that a new form supported by legislative changes can be rolled out for April 2022 and the efficiency of the PAYE system improved.

ICAEW Tax Faculty