



Xafinity response to the consultation on improving the operation of Pay As You Earn (PAYE)

September 2010

About Xafinity

Xafinity is one of the UK's leading specialist providers of pension, employee benefit and payment services.

Xafinity Paymaster provides outsourced pension, payroll and annuity administration to over 130 major public and private sector organisations, performing administration for more than 750 pension schemes. 2.2 million pensioners, annuitants and their dependants rely on Xafinity Paymaster to make payments of more than £11 billion every year in over 180 countries worldwide.

Xafinity Claybrook provides market leading software and services for pensions administration, payroll and actuarial valuations, and was recognised in 2010 as "Pensions Systems Provider of the Year" for the fifth time in six years. Xafinity Claybrook has developed an international base of clients, representing nearly ten million pension scheme members and delivers products and services to group schemes, consultants, insurers and third-party administrators.

This consultation response is being submitted jointly by Xafinity Paymaster and Xafinity Claybrook.

Introduction

As a major provider of pension payroll administration software and services, we welcome the opportunity to comment on the Government's proposals to improve the operation of PAYE.

Improvements such as a reduction of year-end tax adjustments and more accurate payment of social security benefits are commendable aims and would benefit tax payers significantly. In this context, we broadly welcome the concept of Real Time information, subject to various issues being addressed.

We believe there are significant challenges with the concept of centralised deductions, but are willing to work with the Government to explore the concept further.

Pension payroll services and software may be considered a sub set of employer payroll, without complications such as national insurance deductions, statutory sick pay, statutory maternity pay etc. However they do present particular challenges and we regret that the consultation paper has not adequately considered these.

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Overall Summary of Views

- We welcome:
 - Improved accuracy and timeliness of tax code notification and deduction
 - A reduction in year-end tax adjustments
 - More accurate social security benefits
 - A reduction in social security fraud
- We believe the concept of Real Time information has merit and whilst we recognise that a centralised deduction system may lead to improved accuracy and visibility, we have identified a number of issues and challenges which need to be considered.
- The practical implications of providing Real Time information on a daily basis should be recognised. Daily reporting to HMRC would increase the reconciliation requirement and impose an added element of time-pressure.
- The Government may wish to consider monthly reporting of all transactional events linked with monthly payroll runs as an alternative. This would achieve many of the desired improvements whilst minimising the impact on workloads and operating costs.
- The size and complexity of a centralised deduction system and its necessary interfaces creates the potential for large scale data security and payment failures. Given the risk of a large number of employees across the country going without pay for a time, the benefits need to be balanced against the potential costs and risks.
- A system of centralised deductions will create a “vacuum” between employers, paying organisations and the individuals to whom payments are made. Current paying organisations (employers, payroll bureaux, pensions payroll organisations, insurance companies handling annuity payments etc.) would be left without the information to resolve queries from employees and pensioners about the timing or value of payments. Any delay in providing payments or related information generates increased volumes of enquiries and complaints and should not be underestimated. The size of any support structure to handle payee requests and queries is likely to be significant if it is to provide a reasonable service.

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Responses to Specific Consultation Questions

Chapter 4 Questions

- I. Views on concept of Real Time information and issues that would need to be addressed:

Xafinity supports the concept of providing more frequent payment information, however there are a number of issues which would need to be taken into account in developing a solution. Some would be avoided if a monthly reporting process was adopted rather than the proposed Real Time reporting. We believe a monthly reporting process linked with the current monthly pay-over would provide many of the benefits of the proposed Real Time reporting with a much lower overhead cost.

The current proposals would require co-ordinating the introduction of changes to three of the major information handling systems in the UK: HMRC's PAYE system, the BACS payments system and the employer base of payroll systems (including all the third-party software suppliers). The costs and risks associated with such an exercise should not be underestimated.

With a daily reporting process directly linked to payroll processing, there is a considerable volume of additional reconciliation and reporting which must be performed. This is over and above current monthly pay-over and annual reporting.

Much of the value of the proposal is based upon the achievement of an accurate Real Time picture of an individual's tax position at any given time rather than at the year-end. Other aspects of taxation also need to be considered such as bank interest, employee benefits, share dividends etc. HMRC would still be required to undertake a reconciliation exercise at the end of a tax year for each individual.

There are a number of issues specifically relating to pensions payroll which will need to be considered in the design of any new Real Time operational model. Many of these relate to death, the return of payments and the recalculation of payments due up to death:

- Pension payroll starters and leavers (deaths) must be reported as they occur and this introduces complexities which can cause significant delay and cross tax-year boundaries. For example, if a payment has been issued to a pensioner who has died during a payment period, the payment is normally required to be returned by the pensioner's bank or by those handling their estate. The payment entitlement must then be re-calculated at the date of death, with any residual payment being subject to PAYE, and re-issued once evidence of death, proof of estate or probate has been received. This approach will need to be accommodated in any new operational model.
- Payments are reversed or cancelled due mainly to late notification of the death of the pensioner or annuitant. Current monthly processing takes these negative payments into account and would therefore need to be reflected in a Real Time approach linked to daily payroll payments.

- Many pension payment returns come back via a different banking route than the one from which they were originally issued. It is unclear how these would be handled under a Real Time solution.
- Reversed or cancelled pension payments frequently result in an adjustment to a previous tax period or even a previous tax year. This requirement should be taken into account with any new reporting system, especially the need to adjust previous tax years which is currently a complex process.
- The implementation of more frequent tax reporting will allow HMRC to quickly assess whether an employer or scheme sponsor is applying the correct tax code. However the timing of the application of tax code changes needs to take into account the natural delays inherent in pension payroll cycle lead times and the frequency of payment. A tax code revision may take a considerable time to implement due to the pension or annuity payment cycle.

2. HMRC's engagement with affected groups:

We would welcome the opportunity to work with HMRC to develop the concept of Real Time information further and to identify the likely issues, benefits and cost implications. As one of the UK's largest providers of pension payroll services, we are in a good position to support HMRC in this work.

3. How the system might be constructed to simplify the process for employers:

The stability and accuracy of HMRC's new NPS system would be a pre-requisite.

For all but the smallest employers, there will be a requirement to transfer data files to HMRC in a secure, efficient and cost effective manner. Data encryption and an xml or variable data format would be preferable to the fixed text format currently used for the end-of-year returns.

Smaller employers could post information directly to HMRC's website but this is likely to be impractical for anyone with more than a handful of taxpayers to report. Such data transfer systems would need to be high speed and robust in order to cope with the peak end-of-month reporting required.

The move to using the same mechanism as is used to make electronic payments, as suggested in the consultation paper, should consider the significant number of payments still made by cheque.

In addition within pension payrolls, payment adjustments are made which take the form of negative payments. These are not included as part of any electronic payroll but still need to be reported to HMRC. The Real Time reporting model will need to accommodate this situation.

The current systems for extracting payment and tax information to complete the end-of-year returns could offer a better base on which to build more frequent reporting. HMRC's existing EDI and internet systems are capable of receiving pay and tax information directly from payroll and the annual P14 and P35 submissions. These could be extended to provide information against each pay period and enable Real Time submissions without involving a third-party mechanism such as BACS or CHAPS.

The design of any new system should include a positive feedback mechanism so payroll operations receive confirmation of receipt and validity. This would provide some assurance about the risk of mis-routing a submission or overlooking the need for a re-submission. Nil returns could enable HMRC to identify missing submissions and allow them to follow up with payroll operations in order to minimise late filing and pay-over.

The submission of Real Time information via a third-party system such as the BACS processing system or the CHAPS payment system raises issues of data confidentiality and this needs to be adequately addressed in the design of any new Real Time reporting model. A third party would have no reason to receive information about an individual's gross pay or tax liability other than passing it on to HMRC.

However, on a positive note Real Time reporting would significantly ease the strain currently placed upon employers and pension scheme sponsors and administrators to handle end-of-year reconciliation and reporting. The improvement of data and matching of records between HMRC and employers arising by more frequent interaction will also have a positive impact on the volume of tax code rejections currently experienced.

4. Whether Real Time information would offer a more cost-effective means of collecting the tax and NIC deducted by employers:

With adequate automation, collecting tax and NICs would become more cost effective for individuals with more complex tax affairs such as those having multiple employments. For such individuals, the improved accuracy would lead to fewer queries and rework, and the end-of-year reconciliations would be greatly simplified.

5. How easy it would be to transmit the required information:

It should be possible to extract most information listed in Annex A of the consultation paper from existing systems. The definition of gross and taxable pay needs to be clarified in order to exclude payments not subject to PAYE, such as purchased life annuities and pension contributions made to scheme trustees.

It should be noted that there is currently no requirement for pension payroll providers to make P11D returns.

6. Views on which processes should be simplified first:

An initial focus on reducing the use of temporary tax codes would be of significant benefit as there would be an immediate improvement in accuracy and a reduction in the need for retrospective adjustments.

This includes:

- The use of Month 1 tax codes and retrospective re-assessment after the end of year tax returns which leads to incorrect tax deductions and the need for retrospective recovery of under-collections. The use of more frequent reporting and in year code adjustments should enable the application of Month 1 codes to be kept to a minimum.
- The application of temporary codes for new pensioners which leads to the under-collection of tax because of the application of additional incorrect tax allowances. Tax over-collection could be minimised and under-collection eliminated if a different initial tax code is set for new pensions and a quicker overall tax reassessment is available using the new system.

From a pensions perspective, another area of initial focus which would bring a significant benefit would be simplifying the process for adjusting past tax years due to payment reversals. When pensioners die it is common for payments previously issued to be recalled and cancelled. Often it is the failure of a payment that is the first indication that a pensioner has died. In the early months of any tax year there are a number of failed or reversed payments relating to the previous tax year requiring an adjustment to the P14 figures and the prior year's tax pay-over.

Chapter 5 Questions

I. Views on concept of centralised deductions, assumptions about benefits and issues that would need to be addressed:

We recognise that a centralised deduction system may lead to improved accuracy, simplicity and visibility. Xafinity would like to draw attention to a number of issues that will need to be considered. These have implications for payroll service and software providers as well as pension schemes and third-party administrators and others with responsibility for making salary type payments:

Payee Related Issues

- Employees' payslips provide an important and established point of reference for checking pay, tax and other deductions. Any replacement model needs to recognise the importance of this document.
- Delays in providing payments or related information tend to generate high volumes of enquiries and complaints. Any replacement model should recognise the need for an efficient and highly reactive response mechanism for queries.

- Payees are likely to perceive employers and payroll providers as being responsible for any errors or delays in payment. The replacement model needs to encompass clear payee communication channels to which employers or providers can direct payees. Alternatively, the payers need to have access to the appropriate information to enable them to address payee concerns. However, this latter approach will transfer a cost to employers and payroll providers which they may be reluctant to take on without any control.
- Payments in respect of multiple sources of income for a period will require processing in the sequence that payment files are received. This may not be a consistent sequence from one month to another. Allowances applied to one source of income in one month and another source the next could lead to inconsistent levels of net pay from each employment. This is likely to lead to payee queries. As detailed above, the replacement model needs a mechanism for handling these queries.

System Challenges

- Replacing proven and reliable employer and third-party payroll software solutions with a new and all embracing external system is a major undertaking.
- The replacement system will need to have significant throughput capacity in order to accept the number of incoming payment files, process all payments, calculate tax, update the tax account history, and output a payment.
- The size of the system will in itself present a challenge in identifying when something has not been processed and worked as expected.
- The system will need to handle the significant peaks in payment volumes that occur at the end of pay periods and the tax year.
- The contingency or risk mitigation required to prevent or minimise any payment failures will be significant.

Processing Considerations

- Extending the current BACS processing cycle will have an impact on the topicality of payments and banking data.
- The centralised deduction proposals appear to require BACS and banking systems to handle even more personal information than the Real Time information proposals.
- As with the Real Time information concept, consideration must be given to the processing of reversed and cancelled payments (see comments under the Chapter 4 questions).
- Supplementary payments to individuals can arise in significant volume.
- Certain payroll payments are not subject to PAYE. Consideration must be given to how best to process these and provide information to payees.
- A process for notifying and processing changes to bank account details will be needed.
- Employers deduct employees' contributions to occupational pension schemes from gross pay. Consideration must be given to how these will be processed and how best to provide employees with access to information.

Pension Administration and Payroll

Many of the above issues will apply to both to employers and their payroll functions and pensioner payroll operations. The following issues are unique to pension administration services and payroll operations:

- Trivial pensions paid as a one off cash sum in accordance with Paragraphs 7-9, Schedule 29, of Finance Act 2004 (as amended) and Statutory Instrument 2009/1171 are taxable under PAYE and will need to be accommodated by a system of centralised deductions.
- Payment processing must recognise that a statutory deadline applies to employers paying pension contributions deducted from employees' pay to pension scheme trustees.
- Pension schemes usually seek recovery of payments that would create an unauthorised payment under Finance Act 2004 (as amended). This will have an impact on the volume of payment reversals.
- Payments to pensioners who reside overseas are frequently made via a centralised account with an overseas payment handling bank. When payments are returned, the reason is transmitted directly to the payroll organisation for investigation and resolution. Consideration should be given to how best to provide this information under a centralised deduction approach.
- A change to the tax code or rate applying to pension income subject to an earmarking order would require the entitlement of both recipients to be re-calculated.
- Some pension payroll payments are paid to third parties. This includes, for example, the payment of death benefits to legal personal representatives. Again, consideration must be given to how these will be processed and how best to provide payment recipients with access to information.
- Tax codes enable pension payroll providers to do manual tax calculations and get urgent payments to new pensioners who may not have any other source of income. The time lag between retirement and first payment is commonly one to three months. Any replacement system should reflect the need to make immediate payments in order to avoid financial hardship.
- Processing delays and related complaints would have an impact on statutory internal dispute resolution and complaint procedures, the Pension Advisory Service, the Pensions Ombudsman and Financial Services Ombudsman. A robust mechanism for resolving enquiries will ensure that these procedures and organisations are not overloaded.

Other Considerations and Comments

- Tax codes currently provide a means for flexible benefit selection systems to show employees the impact of salary sacrifice on their earnings and tax position so they can make an informed decision. There will be a need for employers to develop an alternative solution.
- A target end date of at least eight to ten years should be allowed for implementing centralised deductions and would allow payroll organisations sufficient time to prepare for this momentous change.
- Preceding implementation with a national awareness programme would help to prepare the public for the changes and aid its understanding of how to access information and where to direct enquiries.
- The proposals would place a disproportionate financial burden on providers of third-party pension administration, payroll and software services where contracts require them to absorb the cost of legislative changes.

2. Alternative proposals that could deliver a similar or better outcome:

Many of the issues highlighted with the current PAYE system may be overcome using the information provided by the more frequent reporting processes. Using EDI to transmit tax code changes and improved data matching to ensure that they are applied to the correct tax payer, would provide most of the benefits required and outlined in the consultation paper without the proposed centralised deduction system. The proposal in Paragraph 5.16 to pre populate individual self assessment returns with payment and taxation information could also be achieved in this manner.

3. HMRC's engagement with affected groups:

We would welcome the opportunity to help HMRC explore the concept further, especially around centralised deductions. We have particular experience in the area of pension and annuity payments and would be pleased to "bring this to the table".

Chapter 6 Questions

I. Views on data, resilience and availability issues:

A key success factor of any improved tax reporting is the accuracy of data matching between HMRC and payroll operators. Poor data matching processes (NI Numbers on multiple payrolls, mis-spelling of surnames, out of date or incorrect works numbers) would lead to a large volume of queries and have an adverse effect on system accuracy and availability.

The matching of data on NI number and surname can be ineffective when an individual receives payments from a number of payrolls within the same organisation. It may also be an issue for any employer who runs both pensioner and employee payrolls. The concern is how to determine to which pension, annuity or employee payroll a tax code should be applied. The recognised way to achieve this is to have separate tax prefixes for each payroll. This may be unreliable as a pensioner may receive a widow or widower's pension and a member's pension from the pension scheme at the same time but paid separately on different days. Annuitants may also receive separate payments from more than one policy with the same insurance provider on different days or at different frequencies.

The use of accurate work numbers is key to correct identification but the mechanism for synchronising works numbers between HMRC and payroll operators is currently not highly effective. For improved reporting and tax assessment, it is essential referencing between HMRC and employers is as accurate as possible and that automated processes are in place for the future.

The suggested data transmission method is to utilise the existing BACS system (or something similar), which is considered to be secure, reliable and well established. This channel is however specifically designed to handle payment transaction data, not personal details. To use this for transferring data to HMRC would require additional safeguards to ensure that there is no possibility of data being diverted to an incorrect recipient.

System availability, resilience and performance are crucial to the concept of a centralised deduction system. The failure to pay vast numbers of employees or pensioners on time through the failure of a centralised system would result in a serious public response.

The existing BACS system offers reliability but is a transaction routing system with payees' records held by the sending party and by the recipient bank rather than within the BACS system itself. The proposed centralised deduction system would need to access taxpayers' records as well as input data in order to be able to calculate the required deductions.

System availability would also be paramount to a centralised deduction system. Payments could be transmitted any time during any 24 hour period. There would be peaks at the end of pay periods and at the month end. Any system solution should take into account the need to avoid impacting on payroll cycles and the timing of payments.

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