



## Mandatory e-filing

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In the 2002 Budget the Government announced that it would be “implementing a three-stage move towards universal electronic filing of employer PAYE returns, with financial incentives to encourage small employers to make greater use of IT.”<sup>1</sup> This measure had been recommended in a review of payroll services<sup>2</sup> – the ‘Carter Report’ – published at the time of the *Pre-Budget Report* in November 2001, which argued that “better and more consistent use of information technology is the key to enabling businesses to deal with the complexity of payroll.”<sup>3</sup> Provision to introduce mandatory e-filing was included in the *Finance Act 2002* (specifically sections 135-6). Guidance for employers is published on the Inland Revenue’s internet site.<sup>4</sup> This note discusses the background to this proposal and its impact on businesses, before looking at the introduction of incentives for small employers to file online.

### Contents

A.	The ‘Carter Report’ on payroll services	1
B.	Proposals in the 2002 Budget	5
C.	Incentives to file online	12

### A. The ‘Carter Report’ on payroll services

At the time of the March 2000 Budget a number of measures were announced to support businesses paying tax, including a £30 million package for small businesses running a payroll. In addition two research projects were announced to look at the costs faced by businesses in meeting their responsibilities in paying tax:

#### Joint research programme

Inland Revenue and Customs and Excise have embarked on a 4 year programme of research to understand business compliance costs. This will cover the costs to business of dealing with VAT, Income Tax Self Assessment and Corporation Tax

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<sup>1</sup> Inland Revenue/HM Customs & Excise Budget press notice REV/C&E 2, *Supporting small business and entrepreneurs*, 17 April 2002

<sup>2</sup> Inland Revenue, *Review of payroll services: chaired by Patrick Carter*, November 2001 [Dep 02/126]. The report is on the Revenue’s internet site at: [http://www.inlandrevenue.gov.uk/pbr2001/carter\\_review.pdf](http://www.inlandrevenue.gov.uk/pbr2001/carter_review.pdf)

<sup>3</sup> HM Treasury, *Pre-Budget Report*, Cm 5318 November 2001 para 3.38

<sup>4</sup> At: <http://www.inlandrevenue.gov.uk/employers/ppip/index.htm>. A summary of the new rules is given in, Inland Revenue, *Working Together*, issue 12, February 2003 pp 4-5.

Self Assessment. The results of this research will help identify those areas of the tax system that are most burdensome to business and enable the Revenue Departments to look for ways of making improvements in those areas.<sup>5</sup>

### **Payroll responsibilities**

The Revenue, with the support of the DTI, has commissioned KPMG to undertake a major piece of research on the practical problems experienced by new and small employers. This innovative study will look at 200 employers at different stages of the annual payroll cycle. The aim of the research is to report in detail on what exactly employers find to be the main stumbling blocks, and what is preventing them from complying with their responsibilities accurately and on time. The results are expected in October and will be used to set in train a programme of work for the Revenue, aimed at providing employers with better information and guidance at the right time, and where practicable, simplified procedures.<sup>6</sup>

In the latter case, in June 2001 the Government announced that it had appointed Patrick Carter, a member of the Government's Public Services Productivity Panel, to review the market for payroll services to small enterprises in the UK and to report by 30 September 2001.<sup>7</sup> The Chancellor Gordon Brown announced the publication of this report in his Pre-Budget statement on 27 November, acknowledging that there was a "strong case ... for cash help for small firms to bring their payroll and tax systems online", and that the Government would consult on the review's recommendations.<sup>8</sup>

The report argued that "an electronic strategy would be the right way to cut through the difficulties faced by small employers in coping with the complexity of payroll," although "the benefits of electronic technology have not been enough to persuade many employers to move away from paper." It recommended employers should be required to file electronically, either directly themselves or through intermediaries (that is, accountants):

There are cultural and financial barriers to be overcome. To demonstrate its commitment to new technology the government should set a date, several years ahead, by which all employers will have to transact electronically with the Inland Revenue. To persuade small employers to make the change early the Inland Revenue should offer cash incentives for 5 years to those employers who send in their end-of-year returns electronically ...

Many small employers already use IT in their businesses and, where they do not do so already, could switch relatively easily to using IT for payroll and transactions with the Inland Revenue. Other small employers will not want to buy hardware and software

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<sup>5</sup> [In November 2001 the Paymaster General, Dawn Primarolo, confirmed these studies were ongoing and that Ministers would "consider the results at the completion of each" (HC Deb 26 November 2001 c 630W). The issue is examined in detail in Treasury Committee, *Seventh report: the administrative costs of tax compliance*, 4 June 2004 HC 269 2003-04; see, in particular, the revenue departments' evidence: Ev 85-6.]

<sup>6</sup> Inland Revenue Budget press notice REV10, 21 March 2000

<sup>7</sup> HM Treasury press notice 67/01, *Enterprise for all: the challenge for the next Parliament*, 18 June 2001

<sup>8</sup> HC Deb 27 November 2001 c 831

solely to do payroll and will prefer to go to a specialist intermediary, such as a payroll bureau. The incentive should therefore be paid to intermediaries who take on small employers and file electronically on their behalf. Increased volumes of business for the intermediaries should mean they keep the cost of their services to a minimum. To underpin this strategy the Inland Revenue would need to improve the support it offers small employers.<sup>9</sup>

A longer extract from the report's examination of electronic filing is reproduced below:

Electronic business services are already available from the Inland Revenue to support employers in meeting their payroll obligations and there have been small incentive payments from government to encourage employers to take them up. The employer EDI service has been in operation for 2 years. Some 5000 employers generating over 5 million individual employee end-of-year returns and many other in-year forms have signed up to the service. Feedback from electronic data interchange (EDI) customers indicates that they are most attracted to it for in-year forms. They see that aspect as supporting and making easier their day to day business by contrast with the end-of-year return which they see as government driven. The Filing By Internet (FBI) service went live only in April 2001 on a restricted basis and will be supported for the first time by the commercial payroll software companies in April 2002. So it is too early to judge likely take up.

However, the difficulties in achieving a rapid take up of electronic filing are illustrated by the experience with the filing by internet service of the tax return for individuals. The service itself has experienced some teething problems but they do not fully explain why so far only 160,000 individuals have registered to file their returns over the internet.

By contrast, in the US, some 35 million out of 128 million tax returns in the year 2000 were filed electronically. These figures give a flavour of the cultural barriers which have to be overcome in the UK. These include well publicised problems with commercial websites –security breaches and failed internet transactions - which put UK employers off even though they have nothing directly to do with the Inland Revenue service. But there are also incentives built into the US system: the great majority of people receive a significant refund at the end of the year and get it much quicker if they file electronically. In addition, most individuals in the US file via an intermediary and it is the intermediary who files electronically not the individual. Finally, UK employers are reluctant to pay for the initial costs of hardware and the regular cost of software upgrades.

The review nevertheless thinks that an electronic strategy - along with a robust intermediary system - is the right way forward. But because of the barriers government would need to take a much more proactive approach than it has in the past if it is to increase significantly the number of employers who adopt electronic solutions.

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<sup>9</sup> *Review of payroll services*, November 2001 p 6

The review recommends the following electronic strategy to help employers with payroll:

### **Large Employers**

- It should be mandatory for all large employers to file electronically, preferably for 2004. Large should be defined as employers with 50 or more employees: fewer than 10 per cent of all employers.
- This would include having to make their end-of-year returns for PAYE by EDI or FBI (not magnetic media).
- There should be defined quality thresholds for making such a return. Currently even some of the largest employers file paper end-of-year returns. The majority file by magnetic media often of dubious quality.

### **Smaller Employers**

- Businesses with fewer than 50 employees (over 90 per cent of the total number of employers) should be encouraged to file electronically by offering incentives over a 5 year period. The incentive should be front loaded starting at, say, £250 and scaling down to, say, £75. To qualify for the incentive the return would have to meet the quality threshold. An employer who switched to electronic filing would not be able to revert to paper.
- In the longer term consideration should be given to making it compulsory for these employers to file electronically (by, say, 2007).

Compelling all employers to file electronically is a sensitive issue but ultimately it may be the only realistic option if large numbers are to switch and so obtain the longer term benefits which the new technology has to offer. The incentive should not only persuade small employers to switch early but also ease the transition to the new way of working.<sup>10</sup>

The Government's response to the report was given in the *Pre-Budget Report*:

The Government accepts the review's conclusion that better and more consistent use of information technology is the key to enabling businesses to deal with the complexity of payroll. To advance the use of IT, the review recommends that smaller employers should receive cash incentives for electronic filing of end-of-year returns with the Inland Revenue for a period of five years. Electronic filing would become mandatory during this period for larger employers (over 50 employees), and at the end of it for all employers ... The Government recognises, however, that the proposals raise issues that would benefit from wider debate before final decisions are taken. It therefore invites comments on the detail of the review's recommendations by 31 January 2002.<sup>11</sup>

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<sup>10</sup> *Review of payroll services*, November 2001 pp 18-19

<sup>11</sup> *Pre-Budget Report*, Cm 5318 November 2001 paras 3.38-3.39

## B. Proposals in the 2002 Budget

The Government received over 50 responses to the recommendations made in the ‘Carter Report’ from a wide range of interested parties, including most of the main bodies representing employers.<sup>12</sup> In light of them, the Government proposed in the 2002 Budget that although it would introduce mandatory e-filing, the lead-in time for small businesses would be extended:

While the consultation revealed general support for making greater use of IT, many respondents regarded the adoption of universal e-filing by 2007 as too ambitious, particularly for smaller employers. Although the Government believes that all employers should in due course file returns electronically, it recognises that achieving this by 2007 will be difficult for the smallest employers. The Government therefore proposes to implement a three stage move towards universal e-filing:

- the largest employers, with 250 or more employees, will be required to file electronically for the year 2004-05 onwards;
- employers with 50 or more employees will be required to file electronically from the year 2005-06; and
- incentive payments to encourage smaller employers, with fewer than 50 employees, to file electronically will commence for 2004-05, at a level of £250, tapering to £75 by 2008-09. The Government proposes that electronic filing of employer returns should become a universal requirement from 2010, for the filing of 2009-10 returns.

To help business in dealing with payroll issues generally and, in particular, to encourage firms to realise the advantages and cost savings of greater use of IT, the Inland Revenue will also make improvements in the support services it offers to employers.<sup>13</sup>

The Government’s choice of 2010 as the date for making e-filing mandatory for employer returns is to ensure that ‘clean data’ is provided by those making returns. The Paymaster General, Dawn Primarolo, explained the problem when the relevant provisions in the *Finance Bill* were scrutinised in Committee:

One problem for small businesses and their representative bodies, mentioned in many representations made during the debates on this Finance Bill, is that there are many reasons why correct information is not provided—paper floating around, returns sent to the wrong place, returns not sent in on time—which can lead to incorrect data being stored by the Inland Revenue.

What happens then is that inquiries can occur that need not have been made, causing more compliance costs and pressure on a business; or service to the business can be delayed while there are endless investigations to piece all the data together, or a completely wrong assessment may be made.

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<sup>12</sup> HC Deb 26 February 2002 c 1208W

<sup>13</sup> *Budget 2002* HC 592 April 2002 para 3.35-3.36

Small businesses were widely consulted, on this matter specifically ... and concluded that they wanted effective, quick and accurate service from the Inland Revenue on their PAYE. They wanted to ensure that they could attempt to reduce their compliance costs and they welcomed the opportunity to develop their business through e-commerce ... What they want is clean data. The way to ensure that is to have the data transmitted to the Inland Revenue on time in forms that are acceptable ... It is a burden to ask for information that we do not require—we often receive such information—and businesses want to be able to develop.<sup>14</sup>

In its analysis of the benefits of e-filing, the ‘Carter Report’ commented on the variation in the standards of employer returns, and the ‘rework’ cost incurred by the Revenue correcting employers’ errors:

The review is surprised at the poor quality of some of the end-of-year returns submitted by employers. It is aware of instances where empty tapes or previous year’s returns have been filed in order to meet the filing deadline. The review is also aware that the Inland Revenue takes on responsibility for correcting the majority of submission errors. This is expensive compared with validating the data before it is captured by the computer system. It is also unfair on the majority of taxpayers who make every effort to comply.<sup>15</sup>

At the time of the 2002 Budget the Revenue issued a partial regulatory impact assessment which made the following comments on the potential costs of this measure to employers:

*22. Costs to small employers*

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

*23. Costs to large employers:*

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

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<sup>14</sup> SC Deb (F) 25 June 2002 c 539

<sup>15</sup> *Review of payroll services*, November 2001 p 22

- Some familiarisation and first year training costs.<sup>16</sup>

At the time there was strong criticism of this proposal by, among others, the Law Society<sup>17</sup>, the Tax Faculty of the Institute for Chartered Accountants<sup>18</sup> and the Chartered Institute of Taxation (CIOT); an extract from the latter's response to the Finance Bill is given below:

We feel strongly that the attempt to make an e filing regime compulsory is the wrong approach. Whilst supporting the moves towards e-filing we believe the incentives should be by way of carrot, not stick. There are considerable administrative efficiencies to be gained from electronic communications but many of these benefits will accrue to the Revenue. The costs savings need to be shared. It is not fair to impose further costs on the taxpayer and businesses.

We find these particular clauses onerous and un-deregulatory and are most concerned that general empowering clauses, with so little substance, have been placed in a Finance Bill. If compulsory e-filing in specified circumstances is deemed necessary (for employers, following Carter for instance) then proposals of substance should be brought before Parliament for proper debate. Statutory Instruments should only be used to fill in or change minor details. They should not be used to contain the whole legislation.

We are concerned that whilst benefits to Government may arise from compulsory e-filing, there is little in these clauses to reduce burdens for taxpayers. Even the matter of incentives has been left to other regulation making powers. We note for instance that the new clauses require or impose:

- persons to prepare and keep records of information delivered electronically
- persons to produce the contents of records kept in accordance with the regulations
- conditions that must be complied with in connection with the use of electronic communications
- information to be treated as not delivered where conditions as to delivery not satisfied
- a process for authenticating electronic records and persons delivering electronic information
- a penalty of £3,000 for failure to comply
- quality standards to be set
- taxpayers having to appeal against a notice that they are "within a category of persons" required to submit electronically.

We are concerned that these clauses impose a burden on all taxpayers not just those identified by the Carter review and we believe that there should be let-outs for taxpayers who either cannot afford or choose not to use electronic communication.

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<sup>16</sup> Inland Revenue, *Partial regulatory impact assessment (RIA): Payroll Services*, 17 April 2002 p 5. This document is on the Revenue's site at: [http://www.inlandrevenue.gov.uk/ria/payroll\\_services.pdf](http://www.inlandrevenue.gov.uk/ria/payroll_services.pdf)

<sup>17</sup> Law Society, *Finance Bill 2002: a memorandum by the Tax Law Committee*, May 2002 pp 27-28

<sup>18</sup> ICAEW, *Finance Bill 2002 TAXREP 17/02*, 21 May 2002 pp 30-31

We also would argue that a system of providing information that helps the Government process that information should be enabling to the taxpayer and not burdensome. The cost savings that the Government make on receiving information electronically should be passed over to the taxpayer.<sup>19</sup>

These provisions were the subject of a long debate at the Committee stage of the Bill, before being agreed to without amendment.<sup>20</sup> The Paymaster General, Dawn Primarolo, rejected an amendment put forward by the Conservatives to remove the provision to charge penalties where an employer failed to file electronically, making the case for this measure as follows:

The Government's objectives are to listen to businesses, to provide incentives to use an intermediary—an accountant—who files on the internet, to try to reduce the compliance costs for businesses and to make the change in a way that enables them to develop the technology so that they can grow. Those principles underpinned the review and that is what we are delivering in these provisions...

Regulations cannot be effective without some form of sanction for those who fail to comply. That is the experience of this Government and Treasury Ministers; the Conservative Government reached the same conclusion. Employers have the choice of sending their returns electronically themselves or using an intermediary, such as a payroll bureau, so no-one should have to pay a penalty ... we are paying a fee to encourage employers to make that transition.

Where a non-electronic or substandard return is submitted, the clause will allow the Inland Revenue to provide in the regulations either to treat the return as not made or to charge a fixed penalty. The amount of any fixed penalty will be linked to the employer's size, which is normal procedure. The clause sets an upper limit of £3,000 for penalties and, in line with normal practice, only the most serious failures would attract the maximum penalty. The actual amounts of the penalty for each category of employer size will be specified in the regulations; the practice is well known ...

The clause provides for the same provisions to apply for electronic transmission as for the current paper submissions that can be made by employers ... [The Opposition want] employers to be able to choose whether to file electronically for PAYE, whereas the Government wish all employers to do so, after a period of time and investment. To remove the penalties would render the clause useless—which is the [Opposition's] intention in moving the amendment. The Government reject it and ask the Committee to do so.<sup>21</sup>

The Minister also responded to the concern that the provision of incentives would not be covered in the regulations made under these provisions, an issue touched on in the CIOT's response reproduced above:

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<sup>19</sup> Chartered Institute of Taxation, *Finance Bill 2002*, 20 May 2002 pp 21-22

<sup>20</sup> SC Deb (F) 25 June 2002 cc 523-561

<sup>21</sup> SC Deb (F) 25 June 2002 cc 539-540, cc 543-4



The Government propose that payments start at £250 for 2004–05. We do not need to include that in the Bill, because we already have the power to pay the incentives. The payment is not for equipment but for the intermediary's bill. It is intended to facilitate the use of the intermediary by way of a direct subsidy to those who use it, so it reduces their costs, because they still have to do tax returns and pay an accountant if they use one. The payment tapers off during the five years to a final payment of £75 in 2008–09.<sup>22</sup>

Speaking for the Conservatives John Bercow supported the encouragement of e-filing but opposed the use of enforcement:

The Conservative party supports measures to encourage electronic communication, but we strongly believe that this provision is totally unreasonable ... [We] propose a permissive rather than a prescriptive approach. In other words, by contrast with the Government, we are saying that if people wish to file their tax returns electronically, now or by 2010, they should be permitted to do so. We are the party of choice. On the other hand, people should be under no obligation to do so if they do not wish to.<sup>23</sup>

Members also raised concerns about the security of electronic transmission, the number of businesses that might not be connected to the internet,<sup>24</sup> and the fact that many of those submitting PAYE returns would not be large businesses.<sup>25</sup> In responding to the last of these points Ms Primarolo underlined the role of intermediaries in making PAYE returns:

People have two options. They can file their returns personally using the software on the Inland Revenue website that has been available for some time. If they do that, they will still receive a payment from the Inland Revenue over the five-year period, which they will be able to use to invest further in their software to improve their business. If people do not want to do that, we now provide an intermediary for them to use, which many people already do. Again, there will be a direct payment to assist in the transfer to using the intermediary. The software can be very simple, and will speed up, not slow down, the processes that businesses must undertake on PAYE ... The intermediary provisions, which allow returns to be made on an employer's behalf, are no different from the current arrangements. Intermediaries already file information electronically, and we want to move to a situation in which all the information arrives in that way.<sup>26</sup>

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<sup>22</sup> SC Deb (F) 25 June 2002 cc 540-1. The introduction of incentives for small employers is discussed below.

<sup>23</sup> SC Deb (F) 25 June 2002 cc 523-4

<sup>24</sup> In response the Minister cited a recent DTI report on internet access - *Business in the information age: international benchmarking report*, 2001 [URN 01/147] - showing the number of UK businesses connected to the internet in 2001 was 94% for all businesses and 62% for micro businesses (*op.cit.* c 539).

<sup>25</sup> In their response to the Bill the ICAEW noted, "it needs to be appreciated that the obligation to apply PAYE is not limited to businesses. Many individuals engage nannies, gardeners and other helpers and have an obligation to deduct PAYE from the salaries of such people" (ICAEW, *Finance Bill 2002 TAXREP 17/02*, 21 May 2002 p 30).

<sup>26</sup> SC Deb (F) 25 June 2002 cc 545-6

Regulations setting out the rules for online filing were introduced in September 2003, and came into force on 20 October that year.<sup>27</sup> The Revenue issued a full RIA at this time; its summary is reproduced below:

This impact appraisal addresses specific regulations and Board's Directions about mandatory e-filing. The costs and benefits - whether to employers, payroll intermediaries or the Inland Revenue - of these regulations are difficult to separate from the much wider set of process improvements.<sup>28</sup> In isolation, a simplistic cost-benefit analysis of the regulations shows no return in purely financial terms. But the regulations put the Inland Revenue into a position to undertake wider process and organisational change.

For the largest employers the benefits of these specific regulations may be small when taken in isolation, but the longer term benefits from wider use of new technologies in the round will be easier to achieve from the economies of scale and investment both during the financial year as well as at the year end. The medium sized employer with 50 to 250 (and possibly higher) is likely to see overall benefits fairly quickly from the quality standard and internet transmission, especially those who switch to an up-to-date integrated software package. For employers of less than 50 employees, these regulations do not impose mandatory e-filing. Instead, they make available some £420 million of public funds for voluntary e-filing.

It is expected that by looking across the range of employers, with 50 or more employees, the compliance benefits are broadly in balance with the compliance costs estimated for the first seven years.<sup>29</sup>

The regulations also introduced new rules requiring large employers to make payments electronically from 2004/05 – a measure announced at the time of the 2003 Budget:

Employers can currently pay the Inland Revenue by a variety of methods including cheques, BACS (Banker's Automated Credit Service) and CHAPS (Clearing House Automated Payments System). Cheque payment is less secure than electronic methods and cheques sent through the post are vulnerable to postal delays. Cheque payments are treated, in law, as made on the day that the cheque is received. However, the funds don't pass to the recipient until the cheque has cleared, usually two or three days later. A small minority of large employers exploit the cheque payment rules by paying with cheques drawn on overseas bank accounts which take longer to clear.

Regulations will be made that will require electronic payment from employers with 250 or more employees with effect from 6 April 2004. Employers will be able to

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<sup>27</sup> SI 2003/2494. These provisions are consolidated in the *Income Tax (PAYE) Regulations* SI 2003/2682.

<sup>28</sup> [This is a reference to the Revenue's 'Modernisation of PAYE processes for customers' (MPPC) programme, cited in its *Spring Departmental Report*: Cm 6225, May 2004 p 20.]

<sup>29</sup> Inland Revenue, *RIA: payroll services (electronic end of year filing of employer returns)*, September 2003 p 19. At: <http://www.inlandrevenue.gov.uk/ria/payroll-services.pdf>

choose between paying by BACS or CHAPS. At the same time the Inland Revenue will introduce a later due date for electronic payments made by all employers. This will compensate for the loss of the cash flow advantage offered by cheque payment. The funds represented by electronic payments pass to the recipient on the same day as the payment is received. The regulations will include provision for a surcharge that will apply, after a number of warnings, where the Exchequer receives the funds represented by the payment after the due date. This will ensure that payments are made on time as well as electronically.<sup>30</sup>

Detailed guidance for employers on online filing and electronic payment was published by the Revenue in June 2004.<sup>31</sup>

When the legislation to introduce mandatory e-filing was debated in Standing Committee, one other important issue arose. Speaking for the Conservatives John Bercow moved an amendment, to make it clear that any regulations on mandatory e-filing might include an exemption for those who objected to the use of the internet on religious grounds. Concerns had been expressed by the Brethren, a religious society, whose members do not use computers, either at home or at business. In response the Paymaster General confirmed that the Government already intended to consult on this issue to answer these concerns, and as a consequence the amendment was withdrawn.<sup>32</sup>

The outcome of these consultations was set out in the RIA:

During the Committee stage debate into section 135 *Finance Act 2002* the Government agreed that the Inland Revenue, when producing the final regulations, should look to accommodate the concerns of some 1,400 employers whose religious beliefs are incompatible with the use of electronic communications whether directly or indirectly via an intermediary. To leave these employers within the framework for a mandatory electronic return would have left them the choice of penalties or acting against their beliefs. Inland Revenue have met representatives of these employers and their concerns have been recognised in these regulations.

These employers will be able to continue to make their return on paper.

An employer who decides to use Electronic Data Interchange as the means of electronic communications, is likely to incur higher one-off setting up costs to put the infrastructure in place. However the decision to make the extra outlay will have been based upon the wider business benefits greater use of electronic communications will bring them.

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<sup>30</sup> Inland Revenue Budget Notice REV BN35, 15 April 2003. Provision was made under ss 204-5 of the *Finance Act 2003*. A full RIA was published when this Order was laid: *RIA: mandatory electronic payment for large employers*, September 2003. At: <http://www.inlandrevenue.gov.uk/ria/large-employers.pdf>

<sup>31</sup> Inland Revenue, *Tax Bulletin*, issue 71, June 2004 p 1124. This publication - *Do it online: Online filing and Electronic Payment Handbook* - is at: <http://www.inlandrevenue.gov.uk/employers/doitonline.pdf>

<sup>32</sup> SC Deb (F) 25 June 2002 c 556

Medium sized employer (50+ employees) who use the Inland Revenue PAYE Online for Employers Services to meet the mandatory submission of the Employer Annual Return requirements, without any appreciable outlay, would achieve few of the other benefits of doing business with Inland Revenue electronically. They would also not achieve any of the benefits that wider use of new technologies bring. Within the requirements and timetable of mandatory e-filing, employers will have choice over which areas of business to conduct electronically, and if so, how. Within that flexibility, employers may want to undertake some cost/benefit analysis to determine which is the most business efficient way forward for them.<sup>33</sup>

### **C. Incentives to file online**

As noted above, when the Government announced the introduction of mandatory e-filing in the 2002 Budget, it stated that it would also provide “financial incentives to encourage small employers to make greater use of IT.”<sup>34</sup> An Order to empower the Revenue to make these incentive payments were laid in September 2003 along with the regulations relating to online filing.<sup>35</sup> In fact, the statutory authority to make these particular regulations concerning incentive payments already existed – under the *Finance Act 2000*.<sup>36</sup> When this provision was debated at the Committee stage of the Bill in June 2000, the then Financial Secretary, Stephen Timms, set out its purpose:

The clause and schedule 38 make provision for incentives to encourage the use of electronic services for communicating with the tax authorities or making payments. The Finance Act 1999 enabled the Inland Revenue and Customs and Excise to develop new electronic services for taxpayers as an alternative to traditional paper-based communication. Over the next 12 months the Inland Revenue and Customs and Excise will introduce services that will allow taxpayers to send their income tax self-assessment, PAYE and VAT returns to the tax authorities over the internet. They are planning to introduce further electronic services later. The clause will enable the tax authorities to offer incentives in the form of discounts to encourage people to take up the new services.

As a first step, one-off discounts will be offered to people who use the internet for income tax self-assessment, PAYE and VAT returns. We have announced a £10 discount for people who complete their income tax self-assessment return in that way, with £50 discount for PAYE, £50 for VAT and a further £50 for those who submit tax credit returns using the internet ... The proposals that we have announced relate to the next two years. We have not announced what we intend to do beyond that, but we

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<sup>33</sup> *RIA: payroll services (electronic end of year filing of employer returns)*, September 2003 p 14. Similar concerns were raised when mandatory electronic payment was debated the following year: SC Deb (B) 17 June 2003 c 633.

<sup>34</sup> Inland Revenue/HM Customs & Excise Budget press notice REV/C&E 2, *Supporting small business and entrepreneurs*, 17 April 2002

<sup>35</sup> SI 2003/2495, which came into force on 20 October 2003.

<sup>36</sup> under section 143(1) and schedule 38 of the *Finance Act 2000*.

shall look carefully at what happens as a result of the incentives that we have announced and decide what to do in the light of our experience of them.<sup>37</sup>

The Paymaster General, Dawn Primarolo, confirmed that this Order making power would be used to provide incentives for small employers during the scrutiny of the Finance Bill in June 2002,<sup>38</sup> and the Minister noted that the appropriate Order had been approved by the House in answer to a PQ in January 2004:

**Brian Cotter:** To ask the Chancellor of the Exchequer if he will make a statement on his Department's plan to bring forward regulations for the introduction of mandatory electronic filing of employers' end of year returns.

**Dawn Primarolo:** Following consultation two Statutory Instruments (SI 2003/2494 and SI 2003/2495) were laid on 29 September 2003 and came into force on 20 October. The first of these requires the e-filing of an employer's end of year PAYE return from May 2005 where the employer has 250 or more employees, and from May 2006 where the employer has between 50 and 249 employees. The second makes e-filing incentives available to employers with fewer than 50 employees over the five years from the 2004-05 tax year. In accordance with these regulations, the Inland Revenue has sent a letter to every employer on their database setting out the employer size band for 2004-05 and giving guidance about e-filing options.<sup>39</sup>

The size of these incentive payments – and the conditions for receiving them – are set out in a guide for small employers published on the Revenue's site:

#### **Up to £825 tax - free for small employers**

You can get up to £825 tax-free from us over five years if you file your end of year returns online:

- file online for 2004-05 (return due by 19 May 2005) and get **£250**
- file online for 2005-06 (return due by 19 May 2006) and get **£250**
- file online for 2006-07 (return due by 19 May 2007) and get **£150**
- file online for 2007-08 (return due by 19 May 2008) and get **£100**
- file online for 2008-09 (return due by 19 May 2009) and get **£75**

**Total £825**

The tax-free payments are not available for any other tax years.

To qualify for the tax-free payments:

- you must have fewer than 50 employees
- send your P14 and P35 data online
- and the return must meet the Inland Revenue Quality Standard. ...

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<sup>37</sup> SC Deb (H) 27 June 2000 cc 956-8

<sup>38</sup> SC Deb (F) 25 June 2002 cc 540-1

<sup>39</sup> HC Deb 14 January 2004 c 815W

If you use the simplified PAYE arrangements and send us your P37 and P12 data online you will also qualify for the tax-free payments.

You will not qualify if any part of your end of year return is sent to us on paper or using magnetic media ...

The tax-free payment becomes available after you successfully file your return online. We will credit it to your payment record and you can offset it against future payments you make to us. Or you can claim it back and get a cheque from us.<sup>40</sup>

In the RIA on these changes, the Revenue discussed the range of options facing the Government – including taking no action at all, and, simply relying on incentive payments made to small employers; two extracts are reproduced below:

### **Option 1 - Do Nothing Option**

Inland Revenue already provide an electronic service which employers can use at both the in-year stage and for the submission of their end of year returns. These services have been available since 1999 (EDI) and 2001 (Internet). Voluntary take up has been slow with some 23,000 employers from a total of 1.2m submitting their 2002/03 end of year return electronically. This represented 11.58% of the employee returns.

Date	Percentage of total submitters (1.2m total employers)	Percentage of total employee reports (55.2m total employees)
April 2001	0.73%	8.56%
April 2002	0.8%	11.41%
April 2003	1.61%	11.58%

Without legislative support the current take-up rates would take an indefinite period to achieve universal electronic submission. In the meantime Inland Revenue would continue to incur costs, currently running at £9.3m pa to capture the receipt, logging, storage and retrieval of paper end of year returns and the costs to capture data from the magnetic media submissions. Inland Revenue would also forgo the reduced costs of rework<sup>41</sup> ... and employers would miss the 'right first time' savings which are a high priority for them.

A continued low take-up would significantly reduce the potential for growth in the payroll bureau and intermediary market, with the added cost of this market being unable to capitalise upon the economies of scale that an increased customer base provides. There is the risk that the opportunity to promote the benefits of new technology to employers may be missed with the consequential loss to their business of the potential to capitalise on the benefits of e-commerce. This will be of particular

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<sup>40</sup> *Small Employers: Online Filing* At: <http://www.inlandrevenue.gov.uk/employers/smallemp.htm>

<sup>41</sup> [ie, the costs incurred in correcting errors in employer returns – see, *Review of payroll services*, November 2001 p 22.]

relevance to the small employer where the burden of payroll is disproportionately expensive.<sup>42</sup> The benefits missed could extend beyond payroll to those that would be obtained from a more extensive use of new technologies in their business generally...

**Option 3 . The payment of incentives to small employers.**

The initial Ministerial announcement in April 2002 highlighted the payment of an incentive to assist and encourage smaller employers to make greater use of IT. 1.16m employers with fewer than 50 employees will be able to take advantage of the payment if they send their end of year returns electronically. The payment of the incentive will help the small employer to defray their costs of purchasing a computer or payroll software; or the costs of arranging for a payroll bureau or intermediary to handle payroll on their behalf.

There is a risk that the number of small employers taking up the incentives will be low, so that the opportunities for small businesses to realise the benefits of new technology at an early date are missed. But the Inland Revenue is taking, and will continue to take, steps to raise awareness of the incentives and the benefits of switching to technology ... the conclusion drawn is that the payment of incentives at an affordable level to small employers would, on its own, be insufficient to bring about the behavioural change of greater use of electronic transmission routes that the Carter review recommended.<sup>43</sup>

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<sup>42</sup> *The Tax Compliance Costs for Employers of PAYE and National Insurance in 1995/96* which can be found at <http://www.inlandrevenue.gov.uk/pdfs/bathv1.pdf>

<sup>43</sup> *RIA: payroll services (electronic end of year filing of employer returns)*, September 2003 pp 4, 5-6