Looking back to the future

Employment Tax | Management of taxes



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Key Points

What is the issue?
In recent years, HMRC has increased its reliance on employers to ensure compliance, keep abreast of the relevant changes in tax legislation and through their use of technology tools.

What does it mean for me?

By actively considering employment tax trends, businesses can be more proactive and try to guard against potential surprises.

What can I take away?

Upskilling, both in terms of employment tax developments and technological capabilities, will be key to keep up and even remain one step ahead.

Tax is a constantly evolving area. Many changes have followed trends, such as the increased use of technology, which have continued regardless of the political party that holds office. With the onset of Covid-19 and corresponding increases in public debt as a result of this unprecedented extraneous event, it seems likely that we might see yet further legislation introduced to try to make up gaps in revenue. The government has increasingly looked at employment taxes as an efficient method of raising revenue, unsurprising given that income tax and National Insurance Contributions (NICs) make up about 45% of the UK tax take.

In this article, we look at a number of key employment tax and technological trends observed during recent years. By actively considering such trends, businesses can undertake early risk management, be more proactive in their decision making, and try to guard against any potential surprises.

The evolution of self-compliance

Historically, HMRC had limited oversight of employment tax information, typically relying on the end of year employer submissions. There are several advantages for

HMRC where submissions are made during (rather than at the end of) the tax year. These include reducing the time spent on one-to-one discussions with individual taxpayers, enabling better management of debts by checking payments near to the time of payment rather than at/after year end and freeing officer time for more proactive customer engagement and other matters.

Successive governments have introduced legislation requiring businesses to provide greater transparency of their tax affairs to HMRC. Some of the key milestone legislation for this can be found below.

Disclosure of Tax Avoidance Schemes (DOTAS)

Introduced in 2004, where an arrangement meets certain conditions, the scheme promoter, often the adviser (or scheme user in prescribed circumstances) must disclose certain information about it to HMRC. HMRC hopes to obtain early information about certain tax saving arrangements and how widespread their usage might be. This provides HMRC with an early opportunity to counteract these arrangements.

Senior Accounting Officer (SAO)

This regime was introduced in 2009 and requires a designated responsible senior employee, the SAO, to certify that the business has appropriate financial accounting arrangements in place. Where the company considers that it did not have appropriate tax accounting arrangements in place, including in relation to employment taxes, the SAO may have to use this process to make HMRC aware.

Real Time Information (RTI)

Introduced from the 2012/13 tax year, this requires employers to provide details of salary and other payments made to their employees on or before the payment is made via electronic reporting, thereby providing HMRC with information promptly.

Intermediary reporting

Since the 2015/16 tax year, where an intermediary places a worker with an end client and that worker’s income is not subject to PAYE, the intermediary is required to provide certain details on the worker, engagement and rationale as to why PAYE was not operated.

Voluntary payrolling of benefits

Formally introduced from the 2016/17 tax year, employers are able to opt to report certain taxable employer provided benefits through the payroll. Where all eligible benefits are payrolled (and no other benefits are provided), the requirement to submit a Form P11D to HMRC after the tax year is removed (although the employer P11D(b) reporting requirement remains).

Tax Strategy publication

Large businesses, namely those caught by the SAO regime and multinationals with a turnover exceeding €750 million, are required to publish a tax strategy which includes their approach to tax planning, risk management and governance.

Self-compliance: looking ahead

Will this trend continue? If so, what steps should employers take to try to future proof their employment and remuneration arrangements?

This trend of more timely reporting shows no signs of abating. In fact, within HMRC's 2020 'Building a trusted, modern tax administration system' strategy, HMRC explores changes to the timing and frequency for the payment of different taxes and the technology infrastructure needed to support it. This will likely result in more information in relation to payments needing to be reported as near as possible in real time.

Building on this, the government is also consulting around requiring large businesses to disclose planning where there is an uncertain tax treatment and where individually or together there's more than £1 million at stake in the financial year. The onus of proof rests with the business; however, it remains to be seen how this might be implemented. Although postponed until 2022, this regime is expected to cover income tax but not NICs.

Businesses should review their existing employment tax processes to ensure that they support accurate reporting and payment of tax. Practically, this might involve mapping out the relevant existing end to end process, determining the purpose of each step and considering whether any alterations are needed to reduce the risk of tax reporting errors.

Given HMRC’s increased ability to monitor submissions in real time and impose significant penalties automatically, quality data which is complete and auditable is key to enable accurate reporting. HMRC departments are also increasingly joined up, so a default in one tax can lead to further scrutiny in another.

Employers should also consider whether they can move towards an automated input and output process which, when coupled with appropriate controls, can also drive efficiency and demonstrate good governance. Employee training should also be supported and invested in so that businesses can ensure this can be carried out from a practical perspective.

The evolution of labour supply chains

HMRC perceives that significant tax losses can arise throughout supply chains. They are often complex with multiple different layers, making them time consuming for HMRC to scrutinise and police on an individual basis. It is logical then that HMRC has sought to shift greater responsibility of monitoring supply chains onto end clients (i.e. the highest entity in the contractual chain). Several pieces of legislation have been introduced which either impose a responsibility to deduct tax, transfer a tax liability or supply information downstream. The key legislation has been summarised below.

Construction Industry Scheme (CIS)

Contractors are required to validate whether the subcontractors they are paying have gross payment status. If not, contractors must withhold a fixed percentage of the invoice labour element and remit to HMRC.

Agency rules

The end clients are required to validate whether workers are under their ‘supervision, direction or control’, with the potential for greater reporting if so.

Managed Service Company (MSC) rules

Where an MSC is involved in the contractual chain, a transfer of debt can result in a liability for the end client.

Off payroll worker legislation (IR35)

Amending the current approach applicable to public bodies and introducing it to the private sector from April 2021, end clients (who are not small) will be responsible for assessing the employment status of contractors engaged via intermediaries, typically personal service companies (PSCs), and providing a status determination statement downstream. In addition, if the end client also pays the intermediary, they will be responsible for reporting and withholding.

Corporate Criminal Offence (CCO)

Whilst not solely related to employment tax, UK businesses have a responsibility to prevent the facilitation of tax evasion. This requires businesses to ensure that their customers and supply chains are tax compliant.

The evolution of labour supply chains: looking ahead

Will this trend continue? If so, what steps should employers take to try to future proof their employment and remuneration arrangements?

Whilst the legislation that underpins the above requirements might be complex when taken together, it removes some of the burden on HMRC by transferring the compliance responsibility. HMRC has introduced several further requirements that increases the responsibilities for end clients.

For instance, some of the suggestions made within HMRC's 2020 'Tackling abuse within the Construction Industry Scheme' consultation would require the main contractor to be responsible for the identification of potential fraud within the supply chain. HMRC would then encourage these businesses to identify the perpetrator and remove them from the chain or to ensure CIS deductions are applied retrospectively to payments those entities have received. Whilst these suggestions have not yet translated into the draft legislation, it supports the trajectory of travel HMRC is taking.

In addition, within the 2020 'Call For Evidence: tackling disguised remuneration tax avoidance', HMRC is looking at requiring engagers to assure themselves of the tax compliance of their flexible workforce. It is suggested that, as a matter of course, contracts with third parties are reviewed to ensure that they appropriately manage business risk and, to the extent they do not, amendments are made. This may include, as an example, including clauses that restrict the ability of suppliers to subcontract their work.

Whilst there is a requirement under the CCO to undertake due diligence of supply chains, this is best practice for all businesses. This would typically involve key considerations such as understanding whether any entities in the supply chains are based offshore, have a history of non-compliance and have withheld PAYE where they are obliged to do so.

Finally, with the development of the IR35 legislation, as well as the wider risks around off-payroll workers, businesses should ensure that their processes are suitably robust. This would include ensuring that data held by businesses on workers is accurate, there is strategic oversight over the numbers of contingent workers within the business, and there are appropriate on-boarding processes, as well as periodic review.

The robots taking over

Technology and automation potentially makes it easier to pay tax, as well as to enforce the payment of it. Whilst businesses are increasingly seeing how they can best utilise technology to do things like increase efficiency, automate tasks and obtain data driven insights, HMRC is also catching up with its adoption of technology.

The challenges of ‘Big Data’ are often the source of discussion, and HMRC is using tools to drive deeper analysis. Making Tax Digital has also been a longstanding project across a number of taxes. It is already being introduced for VAT and is currently being consulted upon for corporation tax. There are some notable examples of where HMRC has already enhanced its technological capabilities.

Enterprise Tax Management Platform (ETMP)

HMRC is moving towards a single domain where tax management and financial accounting processes are hosted. A byproduct of this will be that there is more information readily accessible to HMRC on particular taxpayers, including RTI submissions which are currently housed within it.

Specialist data analytics teams with bespoke tools

One of the main analytics tools used and developed by HMRC is known as ‘Connect’. This houses a wide array of HMRC data (in 2017, this amounted to 22 billion lines of data and 500 million documents) and identifies and links data related to

individuals and businesses.

Recently, HMRC has been using this data to create maps of underpayments which can identify businesses down to street and property level. As at 2019 (the most recently available reporting for the tool), HMRC states that the use of Connect has alerted it to more than 500,000 cases for enquiry per year.

Provision of automatic penalties

HMRC uses large-scale automated processes to carry out routine tasks such as issuing statutory penalties. This is because making individual decisions on individual cases would be impractical and resource intensive.

Whilst the use of automated penalties was previously challenged in the courts on the basis that it was not supported by legislation, Finance Bill 2020 expressly authorises HMRC to use computerised decision making for such tasks.

Use of robots and AI

In early 2018, HMRC passed the landmark of processing 10 million transactions by robots. In this context, robots are programmed pieces of software that transact work items in the same way as humans and are typically used for routine tasks. This has helped to increase the time officers spend proactively speaking to businesses directly.

Further expansion is expected with HMRC looking to enhance the use of artificial intelligence (AI) and machine learning for contact handling, casework and effective self-service, again with the view to decrease officer time spent on repetitive and administrative tasks.

Technology and automation: looking ahead

Will this trend continue? If so, what steps should employers take to try to future proof their employment and remuneration arrangements?

We are seeing and often benefiting from the development of technology in almost every sphere.

We take the use of email for granted and its use by HMRC is rising, as well as the use of AI chatbots and web interfaces for document upload. Most recently, we have

seen this in the design and rollout of the Covid-19 Job Retention Scheme portal and calculator. In addition, those who have been preparing for the change in the rules around IR35 will have become more familiar with HMRC's Check Employment Status for Tax (CEST) tool and it seems likely that the development and utilisation of such online tools will continue.

Data quality is key. Historically, tax functions utilise a significant amount of their time in manually collecting, manipulating and validating their data. Ensuring that it is correct and auditable back to the primary source is also important. Going forwards, given HMRC's continual advancement in data gathering and analytics, businesses should ensure that they have appropriate data analytics processes in place. This may include creating their own internal data solutions or purchasing tools from third parties.

In addition, businesses should seek to upskill tax professionals in the use of technology. This would include ensuring that employees are comfortable utilising the tools made available to them, as well as understanding any functional limitations and inherent risks.

The use of technology that is either not understood or without the required checks and balances could mean that businesses lose oversight of their tax obligations; for instance, with tax being calculated automatically, validated and then paid over to HMRC. Risks could arise if taxpayer activity falls outside of an established technological process, while businesses may lose out if they do not fully understand their obligations or do not possess the knowledge to challenge any automated tax assessment made by HMRC.

A growing number of businesses have sought to draw down on and utilise the Apprenticeship Levy funding for taxation related apprenticeships and qualifying specialised training programmes.

Appropriately taxing?

Whilst changes to the tax legislation often happen incrementally and in different spheres, taking a step back to consider the trends makes it clear that the tax system is being modernised or at least evolved with employers at its core and underpinned by technology.
Whether we will see a bold statement to take things significantly further in the future remains to be seen. In any case, the burden will likely continue to rest with

employers to ensure compliance and keep abreast of the relevant changes in tax legislation and use of technology tools.

Whilst fears have been raised about the onset of robots, the responsible use of AI and other developments has its place in tax enforcement as well as collection. However, as tax professionals, our jobs should be safe – not just to translate the practical implications by keeping one step ahead, but also by providing leadership and vision. In doing so, we might help, at least in part, to bring about a tax system fit for the future and one that is ‘appropriately taxing’ rather than ‘mind boggling’ or simply ‘exasperating’.