



***Research report***

# ***Real Time Information: Compliance Research***

A research project to inform HMRC understanding on employer attitudes to RTI compliance and penalties

**TNS BMRB**

**7<sup>th</sup> August 2012**

## RTI - Compliance Research

Personal Tax Customer & Strategy works with colleagues in Personal Tax and across HMRC to help develop our approach to implementing the customer centric business strategy. We use customer insight to help PT design, deliver and operate services for individual customers which

- improve customer experience
- maximise tax yield
- ensure that those who need help get the support they need, when they need it

PT C&S also has a corporate role, to manage the relationship with the voluntary and community sector on behalf of HMRC

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### *Research requirement (background to the project)*

From April 2013, the current PAYE system will be replaced by Real Time Information (RTI). Under RTI, employers will report details of staffs' salaries each payday, rather than at the end of the year. It is important for Her Majesty's Revenue and Customs (HMRC) to understand the likely impact of RTI on businesses and their employees in order to address these when launching the new system.

The project had three objectives:

1. Examine the impact that RTI will have on employers' compliance with PAYE;
2. Identify the most effective levers to encourage employers to file and pay in full and on time in the short and long term; and
3. Identify the principles that will lead to the most effective communications and penalties strategy.

### *When the research took place*

Fieldwork took place between 23<sup>rd</sup> April and 15<sup>th</sup> May 2012.

### *Who did the work (research agency)*

HMRC commissioned TNS BMRB to conduct qualitative research to inform the development of a compliance strategy for RTI.

### *Method, Data and Tools used, Sample*

A three stage qualitative approach was used. Stage 1 comprised 16 depth interviews with employers who were likely to be non-compliant, to explore the attitudes, pressures, drivers and knowledge that lead to non-compliance with a range of employers. In stage 2, 7 focus groups with the same profile of employers were used to develop prototype compliance regimes. In stage 3, these ideas were tested in 4 depth interviews and 5 focus groups with a range of compliant employers and large businesses to ensure there were no adverse consequences for these groups.

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### *Main Findings*

#### *Current Situation*

##### **Influence of the economic climate**

The current economic situation has a profound impact on employers' behaviours and attitudes. Smaller businesses in particular feel under greater pressure due to declining revenue, the reluctance of banks to lend or extend overdrafts, and less reliability among clients and suppliers. Many employers also felt that HMRC does not understand the pressure small businesses are under or offer sufficient flexibility in payment options, and those who were generally compliant often felt they were treated with undue suspicion. Many reported taking advantage of what they saw as flexibility in the current PAYE system to manage their business.

##### **PAYE and RTI priorities**

PAYE is not currently a major concern for employers but rather a routine, familiar process. The burden is in gathering information, not running the payroll. Likewise, PAYE compliance is important to many employers, but not the top priority. While employers recognise HMRC's authority and ability to penalise, HMRC is more remote than suppliers and staff who are seen as a higher priority for payment in-year.

##### **Four reasons for non-compliant behaviour**

Businesses' identified four broad drivers for behaviour that could be interpreted as non-compliant, all of which were seen as compliant by at least some of the respondents:

1. Cash flow
2. Staff payments
3. Lacking capability
4. Business Advantage

In general, some reasons for non-compliance under PAYE are more 'acceptable' and understandable to employers than others. Occasional non-compliance for reasons outside the individual's control was broadly more acceptable than repeated and deliberately chosen non-compliance intended to maximise profit. On this basis, cash flow and the prioritisation of staff payments received more sympathy than a chronic lack of capability or non-compliance for business advantage.

##### **1. Cash Flow**

Fluctuating revenues led to payments that were on time, but incomplete or nominal. Businesses affected by fluctuating revenues, such as those with seasonal trade, construction and recruitment agencies, sometimes found they lacked the cash during 'low' periods to pay

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HMRC. In other cases, staff were paid at month end, but revenue from invoices was received at a later date, leading to insufficient cash to pay HMRC as well as staff. In the current financial climate, temporary cash flow problems were also expected to affect other, less typically fluctuating businesses.

### **2. Staff Payments**

Businesses who pay staff irregularly or incorrectly fill in their PAYE submissions, typically correct this the next month or at year end. This affects small manual or service contractors, companies with sales staff, businesses with low paid, irregular staff, and businesses that have recently moved from weekly to monthly payroll. An error in PAYE submission could be caused by expenses claims, late submission of timesheets, or paying staff part of their wages in advance to tide them over. Other reasons could be performance related – e.g. a plumbing job later found inadequate would lead to deductions in pay. Employers respond by giving advances against net wages and complete inaccurate submissions; they then aim to correct the submissions at the subsequent payroll or at year end.

These are seen as ‘process’ issues rather than non-compliances, as it is possible within the current regime and payment is rarely withheld for long.

### **3. Lacking Capability**

Inadequate bookkeeping and/or IT capability was a common reason for in-year filing and payment errors, typically for those lacking the finances to regularly employ an accountant for the whole year and lacking competencies in accounting themselves. This is often the case for unconfident users of payroll software, employers that are currently paper managing or transitioning to electronic methods, employers making multiple adjustments to salaries, and micro companies reliant on one person for PAYE. Occasional errors are considered acceptable, but frequent mistakes and ‘incompetence’ did not get broad sympathy.

### **4. Business advantage**

A few employers were deliberately taking advantage of the PAYE system for business reasons. They believed that any fines ‘pay for themselves’ through profits from the use of capital, keeping money back for investment, buy more stock or pay off immediate debts – and that flexible use of PAYE is often not penalised anyway. This group routinely underpaid in-year, with the intention of paying in full at year end, and saw no incentive to do so in the absence of a fine. This was seen as ‘good business sense’, while maximising turnover was also considered in HMRC’s interest.

This was rarely seen as acceptable by those who did not do it, as it was ‘fiddling the system’ by choice for profit rather than being compelled to do so for business survival.

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### **Ambiguities around compliance**

Employers had one of two broad views about where the boundary between compliance and non-compliance lies.

At one end of the spectrum, non-compliance was seen as anything that is against the rules. These employers never did anything that might 'cheat the tax man' due to the principle that tax is not their money and a fear or assumption of getting caught. Often, there was little awareness of how to 'bend' the system. This view cut across all types of employer, but was more common among larger businesses with more sophisticated systems and auditing.

At the other end of the spectrum, non-compliance was seen as 'anything you get caught for'. These employers knew that late/non payment is picked up, but underpayments are not. Few saw in-year underpayments as 'non compliant' if they paid in full by year end, partly because of the view that HMRC tacitly allows and is aware of this. Instead, non-compliance was defined as late or non payment at year end. A range of underpayment activities was seen as 'acceptable' by people who held this view, strengthened in conditions of economic pressure for small businesses. There was no particular view on late filing, as this would attract penalties and, since filing is not currently directly linked to payment, there was no financial reason to do it deliberately.

Most employers were clear in their own minds about what constitutes compliance, but across the sample the picture was confused and blurred. Employers tended to be convinced of their own position on compliance, and not to understand others. There was little agreement as to what HMRC permits, what is 'ethically' acceptable, and what justifies behaviour. Few employers were consciously non-compliant, but many saw nothing wrong with taking advantage of 'flexibility' in the system.

### ***Impacts of RTI***

#### **Loss of the grey area around what constitutes compliance**

Non-compliance regarding payment of PAYE is currently a grey area for many, but RTI makes compliance black and white: it leaves no ambiguity over whether payment and filing behaviour is compliant or not. All employers understood that HMRC will know quickly about in-year filing and payment discrepancies; this removes the ambiguity caused by view that 'compliance = not getting caught'. This crystallisation is likely to polarise behaviour.

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### Segmentation and Compliance with RTI

RTI has the potential to affect employers in different ways, creating 'segments' which need different handling. On the basis of this research, these employer 'segments' are:

1. RTI Willing and Able
2. RTI Potential/Occasional deferrers
3. RTI Deferrers/Rule Breakers

Within these three RTI segments, the general view of the effect that RTI would have varied greatly:

**Cash Flow:** RTI Willing and Able would manage their accounts effectively, either continuing current practices or being 'forced' into better practice. RTI Potential/Occasional Deferrers believe that employers need time to adjust, and/or they will remain vulnerable to occasional cash shortfalls. RTI Deferrers/Rule Breakers believe that struggling businesses and those with fluctuating revenues will be 'forced' into non-compliance, regardless of the higher risk of being penalised.

**Staff Payments:** RTI Willing and Able would not make irregular payments anyway. RTI Potential/Occasional Deferrers understand that RTI will force a more stringent approach to staff payments, and will comply to the detriment of employees but face pressure to revert to their old practices. RTI Deferrers and Rule Breakers would retain advances by classifying them as 'loans' or may push the payments off books.

**Lacking Capabilities:** RTI Willing and Able who are currently less capable would see RTI as a reason to update systems and shift from paper management. RTI Potential/Occasional Deferrers see glitches in system and/or absence of key staff as creating higher admin burdens and/or 'accidental' non-compliance.

**Business Advantage:** RTI Willing and Able will avoid bad practice, either because they currently do, or because they do not believe it will be worth it to continue in the face of certain penalties. RTI Potential/Occasional Deferrers would cease bad practice, but continue to be tempted to revert. RTI Deferrers and Rule Breakers who continue consistently to seek a business advantage are likely to be few in number since costs of this practice will be higher.

Overall, it seems likely that in-year underpayment would continue to be the predominant form of deliberate non-compliance under RTI, because the external pressures which currently lead to this will still be present, encouraging reversion to current behaviour despite penalties.

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### *Levers to secure compliance*

**RTI Willing and Able** employers will carry on as before, or adapt to the new reality with few problems, meaning that the levers required from HMRC to secure compliance will be restricted to education about RTI, clarity about any link between long-term compliance and leniency, and positive reinforcement through thank you letters.

More encouragement and support will be needed for **RTI Potential/Occasional Deferrers**. Practices they currently see as compliant will become clearly non-compliant under RTI, but the external pressures that cause them will not change. Given the view that HMRC does not understand these business pressures, being penalised for something they are currently 'allowed' to do is likely to engender ill-feeling, and they are likely to need support to prevent them bowing to those pressures and becoming non-compliant. It is likely that they will seek permission from HMRC for flexibility around payments, and their compliance is likely to be unstable; they could easily move between compliance and non-compliance depending on how RTI is applied and the external pressures they face. Education and clarity about the rules and penalties will be vital. Discretion over the application of penalties, with reassurance and understanding from HMRC, time to adapt to RTI, positive reinforcement, advice and assistance from HMRC are likely to be needed.

**RTI Deferrers/Rule Breakers** will continue to think of ways around RTI rules. They are likely to defer payment to retain flexibility or become involved in 'extra-RTI' behaviour, perhaps by underreporting wages and thus underpaying PAYE. They will remain non-compliant, determined to continue as before. Like RTI Potential/Occasional Deferrers, education and clarity about the rules and penalties will be needed, alongside a swift reaction to non-compliance, with progressive penalties based on their long-term profile involving stages of action such as visits, audits and court action.

### *Principles of a Compliance regime*

Two key features make RTI different from the current system: a **rigidity** that can be tempered by the ability to respond with discretion, made possible by a **fast response** to non-compliance and building company profiles in the long-term. Many believe these should combine as principles of a compliance regime.

Flowing from this, the following principles for the introduction of RTI were suggested.

#### **Education and initial communications:**

There was broad agreement that there needs to be an **up-front** education/communication programme that runs for a number of months before RTI launch. The RTI 'interface' was perceived as being straightforward and light-touch – integrated into payroll software – so most



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employers did not feel they would need much instruction about using it. Ex-paper managers have mostly adapted well to electronic filing (principles are the same) but felt that if anything causes problems, it will be the move to electronic management, not RTI itself. The real need for clarity is around what constitutes compliance, what will happen to those who are non-compliant, what employers should do if they know they will be non-compliant etc.

### ***A soft landing (combination of hidden and broadcast leniency):***

Employers called for early leniency for two reasons:

- a. RTI is a new system – seems straightforward, but early **technical/practical problems** are inevitable
- b. drivers of current non-compliance **will not change**, so employers might be ‘forced’ into non-compliance

There was broad agreement over length of soft landing: 6 months from employer’s start date seemed suitable to many, but 12 months was preferred by some as this allows for a full year cycle. A hybrid of broadcast and hidden leniency was deemed most appropriate: HMRC should give the message to employers that RTI is live, and the regime will apply, but that they are there to help; while in reality warnings, not penalties, would be applied for the first 6 months.

### ***Day-to-day***

Quick responses to non-compliance were expected to help deter non-compliance, determine causes of it, and to improve employer relations. Many employers believed these responses should start with a general enquiry about the situation, and escalate to penalties if the circumstances made this appropriate. Warnings and penalties would be given for those who are non-compliant for ‘unacceptable’ reasons, while discretion would be applied for ‘acceptable’ reasons.

### ***Long-term***

The concept of ‘**earned recognition**’ was strongly supported as a means of encouraging compliance in the long term. RTI could allow HMRC to build ‘reflexive profiles’ of businesses:

- The typically compliant get a ‘good rating’ – rewarded with greater discretion/flexibility if circumstances push them to occasional non-compliance
- The typically non-compliant get a ‘poor rating’ – regime applied more rigidly when they are non-compliant
- Reflexive profiles encourage compliance – incentive for compliant to maintain ‘good rating’ and non-compliant to earn a better rating

Positive reinforcement of compliant behaviour was also thought likely to help maintain that compliance. The suggested form of this would be the encouragement of long-term compliance with a ‘thank you’ letter that both reinforces positive behaviour and in itself implies

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that HMRC will know about non-compliance. There was expected to be a possible danger of such a letter 'patronising' the compliant, so the tone would need to be carefully handled.

**The 'on or before' rule seemed likely to affect a small proportion of employers, but its impact on them could be significant.** Currently there are two main reasons to paying staff before running the payroll. The first is ***routine***: the staff are paid regularly, with the amounts recorded each time, and the accountant does the books (including PAYE) less frequently. This is generally due to an employer's lack of financial capability, and/or unwillingness to use an accountant frequently. Under RTI they will need to change their routines, acquire new skills and/or pay accountants more frequently. The second reason is ***occasional***: staff are given advances against their wages, which are deducted from the net wage when payroll is run. This occurs because of employers' 'compassion' for staff; under RTI they will want to retain the ability to look after their staff, and will look for ways around the OOB rule, e.g. classing advances as 'loans'.

These types of employer are both likely to be RTI Potential/Occasional Deferrers, but levers towards RTI Willing and Able differ. For 'routine' employers, a simple explanation of the 'on or before' rule, time to adjust, and advice and assistance from HMRC is likely to be sufficient. For 'occasional' employers, clarity about what is allowed and flexibility from HMRC to allow them to help their staff occasionally will be needed.

### *Towards a penalty regime*

In these employers' eyes, penalties/warnings need to recognise the variety of reasons for non-compliance, the continuing pressures that cause it, and (initially at least) the fact that what is currently seen as compliant will become non-compliant. In this sense, the regime needs to cater for and differentiate between the three groups of employers.

***RTI Willing and Able:*** HMRC should recognise their history of compliance if they do slip up, and should not treat them the same as the frequently non-compliant.

***RTI Potential/Occasional Deferrers:*** pushed into compliance by RTI but are under the same pressures as before so at risk of reverting. HMRC needs to retain some flexibility in the penalties system to recognise this, and prevent ill-feeling.

***RTI Deferrers/Rule Breakers:*** pushed into greater non-compliance to retain their flexibility under RTI. HMRC should focus on deterring deliberate non-compliance.

Employers' ideas about the acceptability of non-compliance under RTI came down to two filter questions: *Is the non-compliance occasional or regular?* and *Is the non-compliance planned or not?* Regular non-compliance implied a systemic issue; planned suggested it was deliberate; occasional and unplanned was more acceptable.

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Employers felt that the speed with which non-compliance could be identified under RTI would allow a quick and initially benign enquiry from HMRC. This would have a number of benefits: creating a channel through which HMRC could distinguish between more and less 'acceptable' forms of non-compliance and act accordingly; helping to deter 'unacceptable' behaviour by making a clear connection between behaviour and sanctions; and allowing a benign first contact which would escalate if necessary but avoid occasionally non-compliant employers from feeling harshly treated.

Reflecting the above, there was a widespread view that penalties should be proportionate and progressive, and that RTI's responsiveness should allow HMRC to bear in mind a non-compliant employer's immediate behaviour and long-term profile. Many felt that there should be no penalty for initial accidental non-compliance as the first stage is maintaining or encouraging complaint behaviour and habits. Warning of rising fines, repeated to help employers avoid unknown repetitions, would be vital, and employers wanted to see penalties linked to their long-term profile, giving them an incentive to 'clean their record' through consistent compliance.

The 'costs' of penalties need to outweigh the 'benefits' of non-compliance for all businesses. Currently the fixed penalty of £100 seemed low to employers (especially for larger businesses and serial non-compliers). 5% of the amount owed was considered a good level, rising for 'serious' offenders with poor history. Many respondents also wanted interest charged on the amount owed for payment penalties. Conversely, lower penalties for employers with better profiles were suggested. Beyond this, many employers felt that HMRC should identify 'off books' non-compliance through visits, spot checks and investigations, and hold company directors individually accountable.