Office of
Tax Simplification

Taxation and Life Events:
Simplifying tax for individuals

October 2019

Contents

Foreword

In this report, the Office of Tax Simplification (OTS) identifies and makes recommendations about a number of key areas in which individuals' experience of engaging with the tax system could be simplified and improved.

The work has been approached by considering a wide range of 'life events', such as having children, entering work, changing jobs, saving for or drawing a pension, and supporting others who are less able to take care of their own affairs.

The aim has been to identify issues which cause the greatest or most frequent sources of complexity or difficulty to taxpayers, agents or HMRC. Such issues are likely to be those which cause the most error or inadvertent non-compliance, resulting in additional costs for all concerned.

The OTS hopes that this report will promote a constructive dialogue between government and stakeholders about the issues identified.

The recommendations are focused on areas identified as causing the most concern to stakeholders, which mainly related to income tax, in particular:

- the High Income Child Benefit Charge
- the operation of PAYE, as people start work or first receive a pension
- the workings of pension reliefs and charges
- the ability for people to assist others who may have lesser capacity
- the potential for better information and education about tax

The OTS would like to thank Andrew Parrock, who led the review, supported by Simon Jackson, Sylvia Otieno, Eileen Rafferty and Robin Williamson MBE, guided by OTS Head of Office David Halsey. We are also very grateful to our HM Treasury and HM Revenue & Customs colleagues and all those who have willingly given time, ideas, challenge and support.

Kathryn Cearns OBE - OTS Chair

Bill Dodwell – OTS Tax Director

Executive summary

Introduction

The Office of Tax Simplification (OTS) is the independent adviser to government on simplifying the UK tax system. The work of the OTS is rooted in improving the experience of all who interact with tax. The OTS aims to improve the administrative process – which is what people actually encounter in practice – as well as simplifying the rules. These are often of equal importance to taxpayers and HM Revenue & Customs (HMRC).

In this review the OTS has explored individuals' experience of engaging with tax in relation to a wide range of life events, such as having a child, entering work, changing jobs, saving for or drawing a pension, and supporting others who are less able to take care of their own affairs.

> "Death, taxes and childbirth! There's never any convenient time for any of them."[1]

Income tax and National Insurance Contributions are the two taxes that directly affect the largest number of individuals.

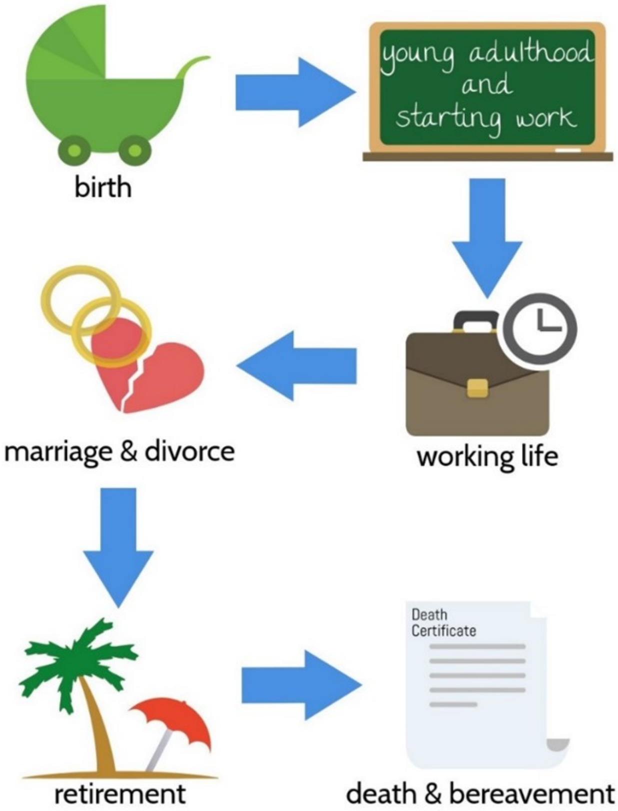
This report focuses on complexity or difficulty encountered by individuals in relation to these two taxes, including the operation of Pay As You Earn (PAYE) and, where relevant, the interaction with benefits.

The OTS has looked separately at inheritance tax[2] and there may be scope in future work to consider two other taxes which are paid directly by individuals: Capital Gains Tax and Stamp Duty Land Tax.

[1] Scarlett O'Hara in *Gone with the Wind* by Margaret Mitchell.

[2] In its reviews published in November 2018 and July 2019: https://www.gov.uk/government/publications/ots-inheritance-tax-review-simplifying-the-design-of-the-tax

Chart A: Overview of Life Events



Source: OTS

Background and context

In mid-2017, the UK's population was 66 million.[3] 47.3 million made use of their personal allowance[4] in 2018-19 and 31.7 million were income tax payers.[5]

Income tax and National Insurance Contributions paid by individuals raised £256 billion in 2018-19, mostly paid by employed people through PAYE.[6]

This represents 34.7% of national accounts taxes which are forecasted to be £737 billion in 2018-19,[7] and 41.3% of the £619 billion of taxes collected by HMRC.[8]

[3] https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationestimates/articles/overviewoftheukpopulation/november2018

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/805191/Jan19_Principal_Reliefs _Final_Revised_for_Marriage_allowance.pdf

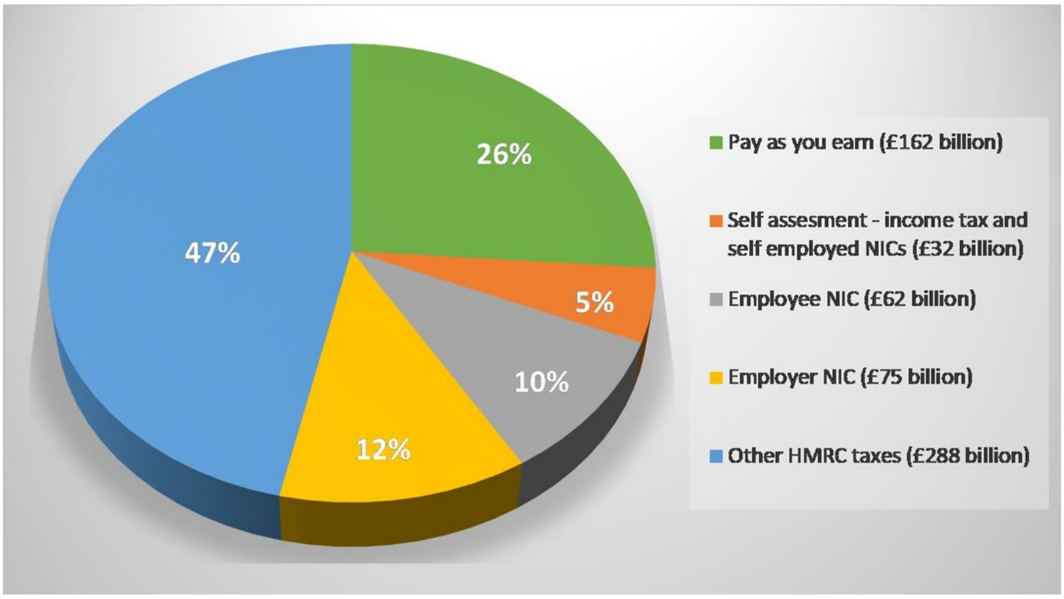
[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/812844/Income_Tax_Liabilities_Statistics_June_2019.pdf - Table 2.1.

[6] PAYE of £162 billion, Self assessment income tax (including self-employed NICs) of £32 billion https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk#history%20August%202019_Receipts – forecast Employee NIC of £62 billion – see footnote 9.

[7] https://cdn.obr.uk/March-2019_EFO_Web-Accessible.pdf - Page 76

[8] https://www.gov.uk/government/statistics/hmrc-tax-and-nics-receipts-for-the-uk#history%20August%202019_Receipts

Chart B: HMRC tax receipts for 2018-19



Source: OBR[9]

For most people, income tax and National Insurance Contributions (NICs) are the taxes they are most likely to think about. Most income tax is paid through PAYE, so it is the operation of that system which affects the largest number of income tax payers.

Most of the time the taxpayer will not need to think about how their tax is calculated and paid through PAYE, but there are times when they will.

The main occasions on which people come into contact with the tax system, in a way that causes them to ask questions, are at particular points in their lives when something changes, or when they have to make a decision with long-lasting effects.

Such life events include

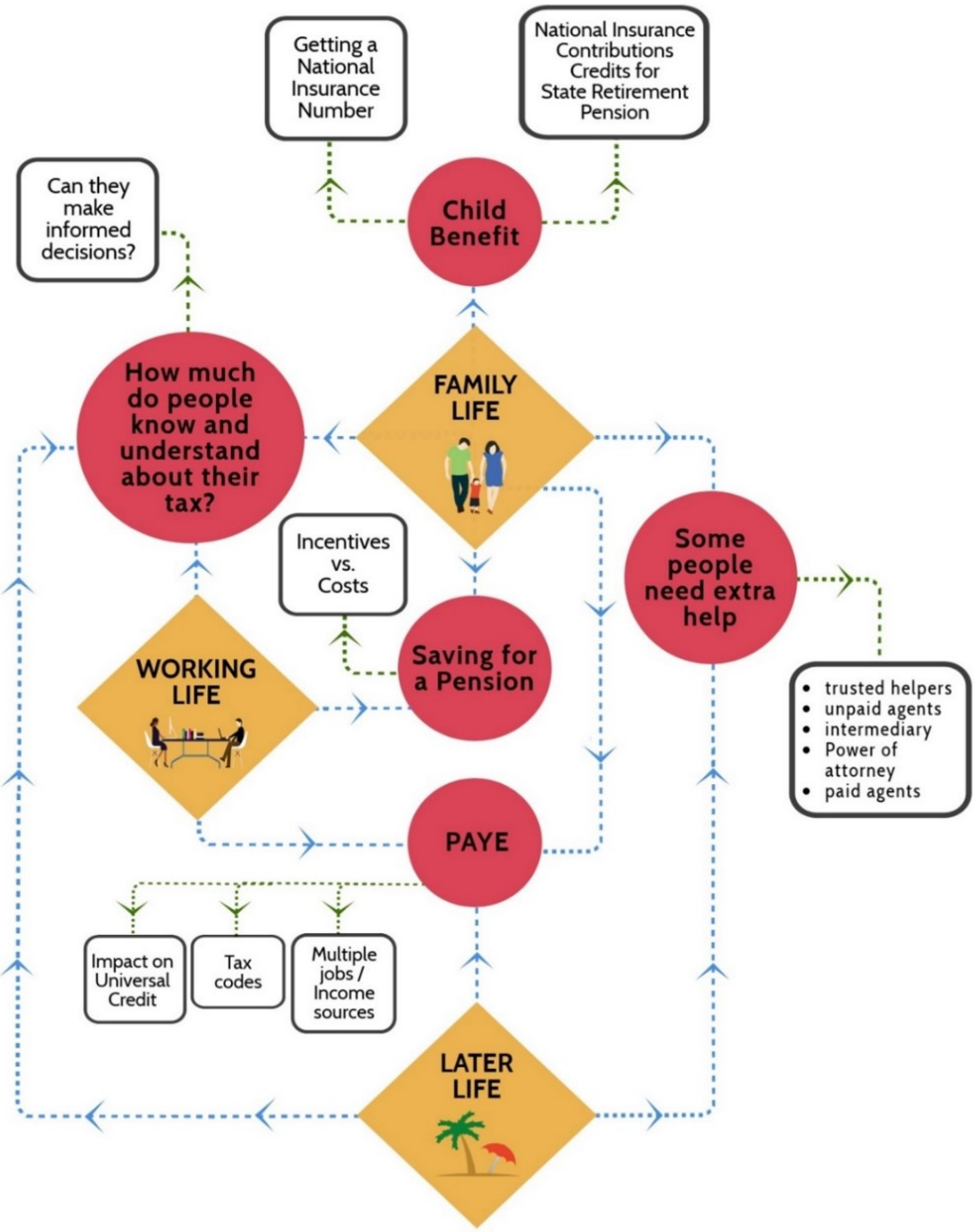
- having a child – and becoming entitled to child benefit
- starting work – and becoming liable to pay income tax and national insurance contributions
- starting to save for a pension
- starting to draw a pension in retirement
- when others need support and help, for example following bereavement

[9] PAYE £162 billion, Self assessment income tax including self-employed NICs £32 billion – see footnote 6;

Employee NIC (forecast) £62 billion, Employer NIC (forecast) £75 billion - https://obr.uk/download/march-2019-economic-and-fiscal-outlook-supplementary-fiscal-tables-receipts-and-other/ - Table 2.4

(Other HMRC taxes of £288 billion is total HMRC taxes of £619 billion less £256 billion less £75 billion.)

Chart C: Relationship between life events and tax issues explored in this report



Source: OTS

The questions people have, in particular about income tax or NICs, may cause them to seek help. If people cannot easily find an answer online, they may call HMRC.

At such times it is especially desirable that what people need to do to handle their tax affairs, and how that is to be done, is as simple and clear as possible. If the taxpayer has a seamless experience it will make it really easy for them to comply with the rules, however complicated they may be.[10] Underlying this, individuals are legally required to ensure that they pay the right amount of tax.[11]

More widely, the extent of formal education on financial literacy varies considerably as it is a matter for local decision by individual schools. This is one factor in

[10] See the OTS report on HMRC *Guidance for taxpayers* at https://www.gov.uk/government/publications/guidance-for-taxpayers HMRC has an active programme working on this report's recommendations.

[11] HMRC annual report and accounts: 2018-19 - Page R24 paragraph 2.6.

explaining why many taxpayers are not well informed about how to manage their money, or about how the tax system works and might apply to them.

Child benefit and the High Income Child Benefit Charge

> In 2017-18 there were about 7.3 million recipients of Child Benefit,[12] of whom 809,000[13] (around 11% of total claimants) had either opted out or who were paying the High Income Child Benefit Charge.

Child Benefit, as a universal benefit, was introduced in the 1970's and has become an integral part of parents' understanding of the benefits system. However, the introduction of the High Income Child Benefit Charge (HICBC), from 7 January 2013, has complicated this picture.

This tax charge applies where an individual or their partner receives child benefit, and either of them has income of more than £50,000. The charge claws back an equivalent sum to all the child benefit paid if that person's income is above £60,000 and a tapered proportion of it if the person's income is between £50,000 and £60,000.

The difficulty is that those affected have various options about what to do, and the consequences of these options are not obvious. The options are to:

- not claim the benefit at all
- claim the benefit, but not to receive payment of it
- receive the benefit but, in effect, pay some or all of it back through the HICBC tax charge

Registering a claim for child benefit but then opting not to receive it is the only way to avoid paying the HICBC charge and its associated administration, while preserving national insurance entitlements.

It is not always appreciated that, as well as providing financial support to families with children, child benefit has important links with the wider national insurance system by

- being the main way children are issued a National Insurance number (NINO) as they turn 16
- providing the child benefit claimant with national insurance credits until the child is 12, which can help fill gaps in their national insurance record for State Pension if they are not working[14]

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12 ONS child benefit statistics, August 2018 - https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/782370/ChB_18_commentary_pdf.pdf

13 FOI release, High Income Child Benefit Charge, June 2019 -

https://www.gov.uk/government/publications/high-income-child-benefit-charge-data/high-income-child-benefit-charge

14 If a person who claims child benefit is not working and paying national insurance contributions through their work, they are entitled to be credited with Class 3 national insurance until the child is 12, whether or not they actually receive the benefit (see https://www.gov.uk/national-insurance/what-national-insurance-is-for).

The consequences of not claiming the benefit at all (perhaps to avoid needing to pay the HICBC charge on child benefit and to register for self assessment) are that:

- the child will have to take an additional step to prove their identity to get their NINO
- one of the parents (very often the mother) may lose out on State Pension, to which a more complete national insurance record would entitle them

The information about this has recently been improved (from May 2019),[15] but it is unreasonable that the way the linkages in the system work mean that people can easily disadvantage themselves, especially if they cannot correct this later.

Future implications for the Department of Work and Pensions' administrative workload of an increasing number of children without a NINO could also be considerable. Alternatively, consideration could be given to the possibility of enabling a NINO to be issued automatically even if there has not been a child benefit claim.

Recommendations 1 to 3 (Chapter 1)

1. The government should review the administrative arrangements linked to the operation of Child Benefit, making clear the consequences of not claiming the benefit, with a view to ensuring that people cannot lose out on national insurance entitlements.
2. The government should consider the potential for enabling national insurance credits to be restored to those people who have lost out through not claiming Child Benefit.
3. The government should consider how to ease the process of enabling children of those who have not claimed Child Benefit to receive their National Insurance number.

The operation of PAYE

The Pay As You Earn system is an efficient way to collect a lot of tax (£162 billion in the year 2018-19) which, together with self assessment income tax and employees' and self employed NICs of £94 billion, makes up 41.3% of all tax collected by HMRC, as noted on page 4. However, it is far from perfect. In 2017-18, there were just over 6 million PAYE overpayments and just under 2.9 million underpayments.[16]

HMRC is expanding the range of information provided through the Personal Tax Account, to improve individuals' understanding of their tax position. For example, you can see what your tax code is, although it is not always clear how each element has been calculated. 19 million taxpayers have opened up their personal tax account since they were launched in late 2015.[17]

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[15] An improved form, specifying the consequences of not claiming, was introduced in May 2019.

[16] *HMRC annual report and accounts: 2018 to 2019* - Page R33 - Figure 15. https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2018-to-2019

[17] HMRC annual report and accounts: 2018 to 2019 Page R33 - Figure 15 - https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2018-to-2019

However, the current system does not handle the fluidity of the modern workplace very well, especially where individuals hold multiple jobs or have concurrent employment and self-employment, as noted in the OTS's report on 'Simplifying everyday tax for smaller businesses'.[18]

That report, which focused on the position of employers, recommended that

- a strategic focus on the PAYE system should be an HMRC priority to ensure effective implementation of improvements and system changes
- a fresh review of areas where the PAYE/Real Time Information system should be improved should be carried out, possibly by the OTS

Many of the underlying issues also of course have a direct impact on individuals.

The OTS notes that trying to understand how PAYE operates can be a source of confusion and stress for individuals, as tax codes and the workings of the system are not always clearly explained.

As the population ages and the number of people with multiple pensions increases (because many fewer people are holding one job through their entire working life), the PAYE system's processes will come under even greater pressure.

Issues arise where someone first starts work, or takes on a second job and, in particular (in terms of the numbers of people affected) when the state pension is first received. This reflects previous OTS work which found people were confused about how their personal allowance had been allocated between multiple pension sources.[19]

OTS also heard that interactions between the tax (PAYE) and benefits (Universal Credit) systems cause administrative difficulties, particularly around the quality and accuracy of information provided to the Department of Work and Pensions (DWP), on which the calculation of Universal Credit depends.

Families that seek help in caring for their children or elderly relatives may find, if they engage someone directly, that they themselves have become a (non-commercial) employer.

In nearly all these areas, the answers lie in continued improvements to the existing guidance, processes and technology, as noted in the OTS report referred to above.

Clearer information on tax coding notices and greater access to information through the personal tax account will help, together with continued improvements to the PAYE/Real Time Information systems, and greater implementation of dynamic coding. This will enable information about new income sources to be more quickly included into PAYE codes, which take overall account of the individual's income, and for multiple sources of income to be handled accurately as soon as possible.

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[18] https://www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses – page 6

[19] OTS 2013 Review of pensioners' taxation.

Recommendations 4, 5, 10 and 11 (Chapters 1, 2 and 4)

4 HMRC should work with the Government Digital Service to improve the visibility of guidance for non-commercial employers and maintain the Basic PAYE Tools to meet their needs.

5 HMRC should incorporate consideration of practical issues arising in connection with starting work, changing jobs, taking on additional jobs and claiming expenses into its ongoing work to improve the operation of the PAYE system.

10 HMRC should improve the explanatory notes provided with tax coding notices issued when people first receive the state pension, or another pension.

11 HMRC should explore the potential for developing automated checks or other tools for 'designing out' errors such as the allocation of 'K-codes' to smaller PAYE sources.

Saving for a pension

The pensions savings landscape is complex in itself, not least because of the different types of schemes available and the range of specific variations there can be. To an extent, it is inevitable that the tax issues arising will reflect that inherent complexity. However, there are also some very specific tax rules which significantly add to this complexity.

Occupational pensions saving schemes are of two main types:

- Defined Benefit (DB), where the savings buy entitlement to a defined pension, based upon, for example, a person's final salary or a career average salary. DB schemes are common in the public sector, but most private sector DB schemes have now closed
- Defined Contribution (DC), where the savings accumulate over time and can either be used to buy an annuity, or 'draw down' as and when needed, including in lump sums. With DC schemes, the amount available depends on the amount there is in the fund, which depends on the level of contribution and investment returns and values

Before 2006 there were eight separate tax regimes covering individual and occupational pensions. The pension reforms in 2006 changed the rules to create a simpler framework and added the Lifetime Allowance and Annual Allowance rules.

However, changes to the level of annual and lifetime allowances since then, and the addition of a money purchase annual allowance, have increased the number of people affected by these complications.

Employed and self-employed people can save as much of their earnings as they like into a personal pension and get tax relief, subject to these rules. However, some of the interaction between the tax rules and pension scheme rules lead to outcomes which are hard to predict.

Minor differences in circumstances can produce very different outcomes, both in any tax charges that occur and the effect that the payment of these charges through the pension scheme can have on the final pension.

This creates uncertainty in people's minds, which can distort behaviour or lead to unanticipated outcomes which are perceived as unfair, with wider knock-on effects elsewhere in society.

Net pay and relief at source arrangements

Employers have a choice between what are known as 'net pay' or 'relief at source' (RAS) arrangements when providing pensions for their employees.[20] This choice affects the operation of income tax but makes no difference in relation to national insurance contributions.

For employees with income below the personal allowance, the different ways these arrangements operate mean that someone in a RAS arrangement effectively pays less for their pension than someone in a net pay arrangement, even though they each end up with the same amount in their pension scheme. This anomaly arises from the interaction between the mechanics of the tax relief and the personal allowance.

Many employers operating automatic enrolment occupational pension schemes tend to choose net pay schemes, since the administration is much easier: The pension scheme does not have to make a claim from HMRC, and taxpaying employees do not have to do anything to secure the tax relief to which they are entitled.

The latest figures available, for 2016-17, show that 1.1 million individuals are affected by this issue, out of the 2.4 million workplace pension savers who have income less than the personal allowance.[21]

Annual allowance, lifetime allowance and money purchase annual allowance

The Exchequer cost of pension tax relief is substantial. In 2016-17, pension tax and NICs relief cost £36.7 billion.[22] As part of the reforms, overall limits were placed on annual and lifetime pension saving through the Annual Allowance and Lifetime Allowance rules.

The workings of the Annual Allowance charge can be disproportionate for some higher paid workers in 'defined benefit' pension schemes, in that it can produce an effective marginal rate of tax, such that it may no longer be in their financial interest to do additional work.

The OTS has been told that some employers can respond to this by changing the way their employees are remunerated, choosing to pay them more instead of contributing to the employees' pension.

Other employers have not given themselves this flexibility, so some of their employees have to pay an Annual Allowance charge (either personally, or by requesting that the pension scheme bears the charge, which reduces the pension

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[20] Sections 192 and 193, Finance Act 2004.

[21] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/798812/April_2019_Pensions_Publication.pdf - Table PEN3 and HMRC data

[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/833841/Personal_Pensions_and_Pensions_Relief_Statistics.pdf

entitlement). The calculations are complex, and it is difficult to predict whether the annual allowance will be exceeded.

On 7 August 2019, the government announced a consultation about the ways the National Health Service (NHS) pension scheme works, proposing full flexibility over the amount senior clinicians put into their pension pots, and for employers to be able to recycle their unused contribution back into the clinician's salary. Alongside this, HM Treasury will review how the tapered annual allowance supports the delivery of public services such as the NHS.[23]

In relation to the lifetime allowance charge, those in 'defined contribution' schemes face uncertainty about whether and when the charge will apply as it depends on the value of funds invested in the market, which is inherently unpredictable.

People with both types of pension can find themselves in both of these situations.

The money purchase allowance was introduced alongside pension freedom changes in 2015 to prevent people inappropriately taking monies out of one pension only to put it back into another, securing double relief. However, in some cases the rules go further than simply preventing double relief and can work disproportionately.

The reduction in the level of the money-purchase annual allowance in 2017 has increased concern that those withdrawing small amounts, perhaps from a small pension savings scheme they have, can unwittingly and disproportionately limit their capacity to maintain their main pension saving through another scheme.

Recommendations 6 to 9 (Chapter 3)

6. The government should consider the potential for reducing or removing the differences in outcomes between net pay and relief at source schemes for people whose income is below the personal allowance, without making it more complicated for those affected.

7. HMRC should play a full part in helping to ensure that guidance on the tax consequences of particular pension arrangements and choices is available and clear to all concerned.

8. The government should continue to review the annual allowance and lifetime allowances and how, in combination, they deliver against their policy objectives, taking account of the distortions (such as those affecting the National Health Service) they sometimes produce.

9. The government should review the operation of the Money Purchase Annual Allowance, gathering better evidence, considering whether it meets its policy objectives, is set at the right level and is sufficiently understood, given the present potential for disproportionate outcomes.

Helping others

There are times when people find that they cannot manage their financial affairs, including tax. This change can be gradual or sudden as health or personal circumstances bring about unexpected and unwanted changes.

[23] https://www.gov.uk/government/news/nhs-pensions-for-senior-clinicians-new-changes-announced-to-improve-care

When this happens, people may well need additional help to deal with their finances and their tax. A sudden change, such as the death of partner, necessarily means that the survivor (or their helper) has to engage with HMRC's processes. Gradual change may mean that the individual will gradually need more help, and increasingly on a more formal basis.

HMRC have a 'trusted helper' scheme where a taxpayer can have someone help them with their tax. This involves gaining access to aspects of HMRC's online systems on behalf of the taxpayer.

In practice becoming a trusted helper involves a number of steps, one of which requires verification of the helper's identity, which has a success rate of less than 50%.[24] This deters many from completing the process and drives them down the simpler route of circumventing that process. Only 1,212 people became trusted helpers between 2017 and July 2019.[25]

Some people turn to tax charities to help them navigate HMRC's processes,[26] and the charity may become their unpaid agent. This can work well when speaking to HMRC's teams dedicated to dealing with people who need extra support,[27] which have built up a successful working relationship with the charities.

People also turn to more formal representation, through 'intermediaries': people given formal 'power of attorney', unpaid helpers (such as friends and family) and paid agents (such as accountants or lawyers). The degree to which HMRC will accept these and the processes by which the status of the representative is verified by HMRC vary and are sometimes unclear, adding to the difficulty some intermediaries may have.

The complications following someone's death faced by their representatives have, in many parts of the country, been addressed by the 'Tell Us Once' process. But finalising the tax affairs of the deceased is still far from simple, with HMRC's processes sometimes asking for the same information more than once. HMRC's dedicated bereavement teams approach the situation with empathy but can do little to change the processes.

Recommendations 12 and 13 (Chapters 4 and 5)

12 HMRC should review the current series of forms issued once a death has been notified through 'Tell Us Once' and consider how they could work more effectively with personal representatives to gain a complete view of the tax affairs of the deceased person, and the survivor, rapidly and sensitively.

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[24] National Audit Office report *'Investigation into Verify'*, March 2019, para 4 on page 4: by February 2019, 3.6 million people had signed up through Verify as against a target of 25 million by 2020. As of February 2019, 48% of users were successful in having their identity confirmed by the system as against a 2015 target of 90%.

[25] HMRC data.

[26] For example, the Low Incomes Tax Reform Group website had nearly 5 million visits in 2018 (LITRG personal communication). Tax Aid helped 5,188 clients in 19,123 tax advice sessions, and Tax Help for Older people helped 11,753 people in 22,015 tax advice sessions in the year to 31 March 2019.

[27] https://www.gov.uk/government/publications/hmrc-issue-briefing-support-for-customers-who-need-extra-help/hmrc-issue-briefing-support-for-customers-who-need-extra-help

13 HMRC should integrate and improve its various sources of guidance for those helping others, including agents and those with powers of attorney, to help make it easier for suitable people (whether paid or not) to take on such roles.

Improving tax education and awareness

A common theme across all the areas covered in this report is taxpayers' lack of awareness of various issues concerning their own tax affairs. This ranges from not knowing the basics, to specific instances where lack of knowledge can have a significant impact.

Clearly not everyone can have a comprehensive knowledge of a complex system. However, despite the range of accessible and engaging 'Tax Facts'[28] material HMRC has produced for schools, and HMRC deterrence campaigns, it seems that the level of knowledge and awareness about tax matters is lower than it is widely felt would be desirable. This is for example reflected in a recent YouGov survey commissioned by Deloitte on the Tax Education Gap.[29]

Tax knowledge is important, as tax affects so many economic and family choices. Without knowledge people may not understand the implications of particular decisions.

Tax knowledge also has an impact on the tax gap (the difference between the amount of tax that should be paid, and what is actually paid). Addressing this wider issue could give HMRC greater ability to tackle evasion and avoidance and reduce the level of unintended error.

Recommendations 14 and 15 (Chapter 6)

14 HMRC should collaborate more with relevant external bodies, including schools and in further and higher education, seeking to improve the public's understanding of tax and finance, when seeking to extend the reach of its own tax education materials.

15 HMRC should extend its collaboration with academic researchers to quantify the effect of HMRC's tax education programme and explore the potential for a cost/benefit measure to allow HMRC to prioritise and target its tax education resources.

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28 https://www.tes.com/teaching-resource/hmrc-tax-facts-12109552

https://www.youtube.com/watch?v=O3dDaEkykto

29 https://www2.deloitte.com/uk/en/pages/tax/articles/tax-education-gap.html

Summary of recommendations

Family life

1. The government should review the administrative arrangements linked to the operation of Child Benefit, making clear the consequences of not claiming the benefit, with a view to ensuring that people cannot lose out on national insurance entitlements.
2. The government should consider the potential for enabling national insurance credits to be restored to those people who have lost out through not claiming Child Benefit.
3. The government should consider how to ease the process of enabling children of those who have not claimed Child Benefit to receive their National Insurance number.
4. HMRC should work with the Government Digital Service to improve the visibility of guidance for non-commercial employers and maintain the Basic PAYE Tools to meet their needs.

Being in work

5. HMRC should incorporate consideration of practical issues arising in connection with starting work, changing jobs, taking on additional jobs and claiming expenses into its ongoing work to improve the operation of the PAYE system.

Saving for a pension

6. The government should consider the potential for reducing or removing the differences in outcomes between net pay and relief at source schemes for people whose income is below the personal allowance, without making it more complicated for those affected.
7. HMRC should play a full part in helping to ensure that guidance on the tax consequences of particular pension arrangements and choices is available and clear to all concerned.
8. The government should continue to review the annual allowance and lifetime allowances and how, in combination, they deliver against their policy objectives, taking account of the distortions (such as those affecting the National Health Service) they sometimes produce.
9. The government should review the operation of the Money Purchase Annual Allowance, gathering better evidence, considering whether it meets its policy objectives, is set at the right level and is sufficiently understood, given the present potential for disproportionate outcomes.

Later life

10 HMRC should improve the explanatory notes provided with tax coding notices issued when people first receive the state pension, or another pension.

11 HMRC should explore the potential for developing automated checks or other tools for 'designing out' errors such as the allocation of 'K-codes' to smaller PAYE sources.

12 HMRC should review the current series of forms issued once a death has been notified through 'Tell Us Once' and consider how they could work more effectively with personal representatives to gain a complete view of the tax affairs of the deceased person, and the survivor, rapidly and sensitively.

Helping others

13 HMRC should integrate and improve its various sources of guidance for those helping others, including agents and those with powers of attorney, to help make it easier for suitable people (whether paid or not) to take on such roles.

Tax education and awareness

14 HMRC should collaborate more with relevant external bodies, including schools and in further and higher education, seeking to improve the public's understanding of tax and finance, when seeking to extend the reach of its own tax education materials.

15 HMRC should extend its collaboration with academic researchers to quantify the effect of HMRC's tax education programme and explore the potential for a cost/benefit measure to allow HMRC to prioritise and target its tax education resources.

Chapter 1
Family life

1.1 Families face a number of tax issues around life events such as childbirth, marriage and divorce, and the care of children and of elderly or incapacitated family members. This chapter examines income tax and National Insurance issues which may be associated with these events.

Child benefit and the High Income Child Benefit Charge

Introduction

1.2 Child benefit is available to those living in the UK who are responsible for a child under 16 (or under 20 if they stay in approved education or training). There is a single entitlement for each child (rather than for each parent) and it is paid to around 7.33 million families, in relation to about 12.75 million children, at a cost to the exchequer of around £11.5 billion a year.[1]

1.3 In the UK in 2018 there were 657,076 live births.[2] When a baby is born in hospital, new parents are soon offered a 'Bounty Pack'[3] of vouchers, health advice and a Child Benefit form.[4]

1.4 This form is used not only to claim child benefit, but also to ensure that:

- the claimant receives national insurance credits[5] towards their state pension entitlement,[6] which they may not otherwise get if they are not working
- the child receives a letter, when they are 16, with their National Insurance number (NINO)

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1 Data from HMRC child benefit statistics (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/782370/ChB_18_commentary_pdf.pdf) and HMRC *annual report and accounts: 2018 to 2019* (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/821378/HMRC_Annual_Report_and_Accounts_2018_to_2019.pdf).

2 https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/livebirths/bulletins/birthsummarytablesenglandandwales/2018

3 http://www.bounty.com/about-bounty/about-us/your-questions-answered

4 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/792053/CH2_online.pdf

5 If a person who claims child benefit is not working and paying national insurance contributions through their work, they are entitled to be credited with Class 3 national insurance until the child is 12, whether or not they actually receive the benefit (see https://www.gov.uk/national-insurance/what-national-insurance-is-for).

6 See https://www.gov.uk/child-benefit/what-youll-get

1.5 The NINO is the most significant and enduring number relating to tax and benefits an individual will ever have. It is their key to the national insurance system for the rest of their lives, including access to the state pension.

1.6 This wider significance, both for the child and the parents, of making a child benefit claim may not be immediately obvious. Given that benefits and tax are unlikely to be the first thing on new parents' minds, it is unclear whether this message is successful in grabbing their attention.

1.7 The information about this has recently been improved (a revised form introduced in May 2019 specifies the consequences of not claiming), but it is unreasonable that the way the linkages in the system work mean people can easily disadvantage themselves, especially if they cannot correct this later.

1.8 Since 2013, the High Income Child Benefit Charge (HICBC) has applied where an individual or their partner receives child benefit for any week in the tax year, and either of them has income of more than £50,000 in that year. This tax charge collects an equivalent sum to all the child benefit paid if that person's income is above £60,000 and a tapered proportion of it where the person's income is between £50,000 and £60,000.

1.9 The HICBC charge does not affect the underlying entitlement to the benefit. It is a separate income tax charge, but its close relationship to child benefit has caused confusion.

1.10 It can mean a person has to submit a self-assessment income tax return, though the charge can be collected through PAYE if the tax return is made before the December after the tax year in which the charge arose. In particular, this affects some people who have not made a self-assessment tax return before (for example, if all their earnings are within PAYE).

1.11 The introduction of the HICBC has made the processes involved in the administration of child benefit, and the smooth operation of its related national insurance implications, more difficult. This particularly affects the many parents who wish to save themselves the trouble of having to pay the charge, or of interacting with HMRC, by not receiving the child benefit.

1.12 The key point here is that rather than achieving this by not claiming the benefit at all, there is also the option of registering a claim for it but then opting not to receive it. This avoids the HICBC charge and related administration, but preserves national insurance entitlements.

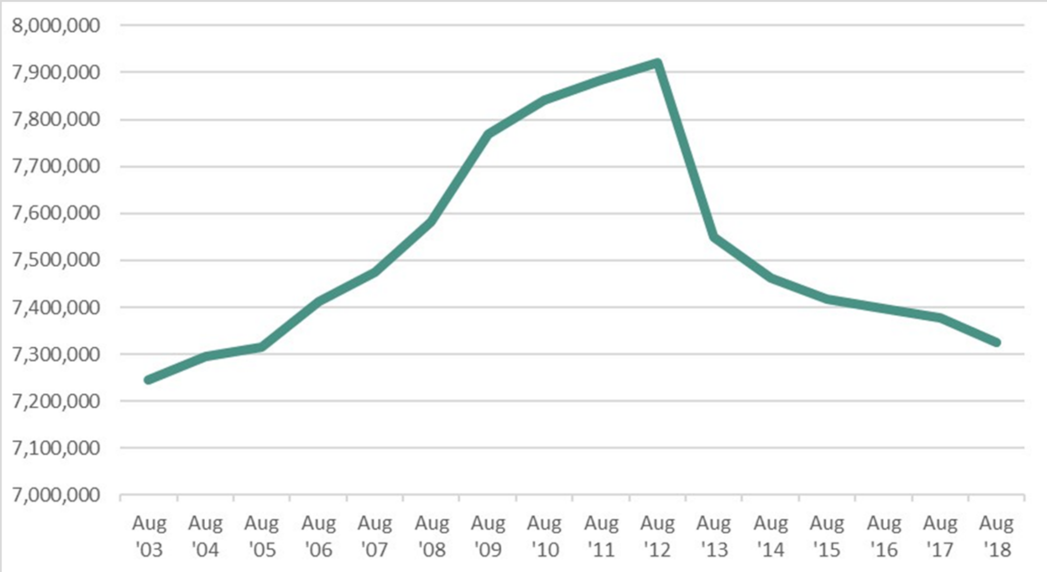
The impact of the High Income Child Benefit Charge

1.13 In advance of its introduction, HMRC published a Tax Information and Impact Note setting out an impact assessment of the policy.[7] HMRC estimated that up to 500,000 additional tax self-assessment returns would be completed and over a five-year period, its introduction would cost around £25 million per year in additional staff costs, systems changes and so on.

[7] https://webarchive.nationalarchives.gov.uk/20141007023213/http:/www.hmrc.gov.uk/budget2012/tiin-0620.pdf

1.14 HMRC statistics show that across the whole of the UK the number of families receiving child benefit declined from some 7.9 million in 2012 (the year before the introduction of the charge) to about 7.3 million in August 2018.[8]

Chart 1.A: Numbers of families in receipt of child benefit



Source: HMRC data[9]

1.15 Between 2012 and 2013, 370,000 fewer families received child benefit (equating to over 650,000 fewer children) or just less than 5 per cent of total recipients (2013 seeing the introduction of the HICBC). This is by far the most significant change in the numbers receiving child benefit since 2003.

1.16 The increase in the numbers opting out of child benefit due to the HICBC may also be explained by more people becoming liable to the charge due to earnings growth in the economy, as the earnings thresholds in HICBC have remained the same since its introduction (£50,000 and £60,000) in 2013.

Table 1.A: Child benefit claimant data

	2013-2014	2014-2015	2015-2016	2016-2017	2017-2018
Number of people paying the High Income Child Benefit Charge	366,000	319,000	296,000	290,000	293,000
Families opting out of receiving Child Benefit payment at August of each year	397,000	476,000	492,000	504,000	516,000

Source: HMRC data[10]

[8] https://www.gov.uk/government/statistics/child-benefit-statistics-geographical-analysis-august-2018

[9] HMRC Child Benefit statistics geographical analysis - August 2018

[10] https://www.gov.uk/government/publications/high-income-child-benefit-charge-data/high-income-child-benefit-charge

Child benefit and HICBC administration

1.17 The child benefit claim form is lengthy, with 7 pages containing 78 questions.

1.18 The form begins with who should fill it in, then goes on to explain the High Income Child Benefit Charge. In the middle of this tax section, with a prominent diagram that explains how the charge works, it says:

> "You may decide not to get Child Benefit payments, in which case the tax charge will not apply. It's still important that you fill in this form to protect your State Pension (you'll get National Insurance credits until your child turns 12) and help your child get their National Insurance number automatically at 16."

1.19 This option has seen an increasing take up by new parents, with the number of opt out claims for child benefit exceeding 500,000 in 2017 (up from just below 400,000 in 2013).

1.20 An important consideration for parents, whether or not opting out of receiving the benefit, is who actually claims the child benefit.

1.21 For example, where one parent stays at home to bring up the child, and the other works full time and earns over £50,000 (and pays the HICBC), it is important that the non-working parent claims child benefit so that they will have their national insurance contributions credited (until the child reaches 12 years old). These NIC credits can be important in building up entitlement to any future claims for state retirement pension.

1.22 All this can easily be confusing for parents, and there have been numerous complaints about the process, and comments in the national media. One reason for this is that the process appears illogical. It could be more helpful (both in the claim form and the guidance on GOV.UK)[11] to explain the benefits of making a claim before going on to cover the option not to receive payments, if the claimant wishes to ensure there will not be a HICBC.

1.23 Another concern is that some people can face an unexpected charge at the end of the year that they have not been able to anticipate (especially if their earnings have changed during the year).

1.24 An individual's income may fluctuate because, for example, they are self-employed or a seasonal worker; a bonus or promotion mid-year might result in their income being greater than anticipated at the beginning of the year.

1.25 HMRC are aware that people may not realise they are liable to the charge if their income changes during the year and are planning more targeted publicity to increase awareness.

[11] https://www.gov.uk/child-benefit

1.26 More widely, HMRC's research[12] has shown that some people were confused about the relationship between Child Benefit and the HICBC: they thought that being liable to the HICBC meant they could not claim Child Benefit. They were also unaware of the consequences of not claiming - on their NI Credits and automatic notification of their child's NINO.

1.27 Another cause for concern highlighted by parents is where the HICBC has applied to a number of years without parents knowing. This has sometimes led to the imposition of penalty charges by HMRC on monies owed, even though it appears many parents were unwittingly caught out. HMRC have responded to concerns raised in this respect by tempering their approach to penalties where tax arrears have arisen as a result of the HICBC.

Illustrative case study 1.A: The Greens

Helen and George Green's first child, Ben, is born at Midshire Hospital.

Helen is an IT consultant earning £87,000 a year and is in line for a promotion and considerable salary increase in the near future.

George is also an IT professional but does not want to continue in IT. He wants to explore other options, including local community support and environmental engagement. The couple agree that George will give up his work to be the primary carer for Ben and their planned second child.

Because Helen earns over £60,000 a year she is liable to the full HICBC charge, equal to the whole of the child benefit George could claim. If Helen earned between £50,000 and £60,000, she would be liable to pay a sliding proportion of the child benefit received.

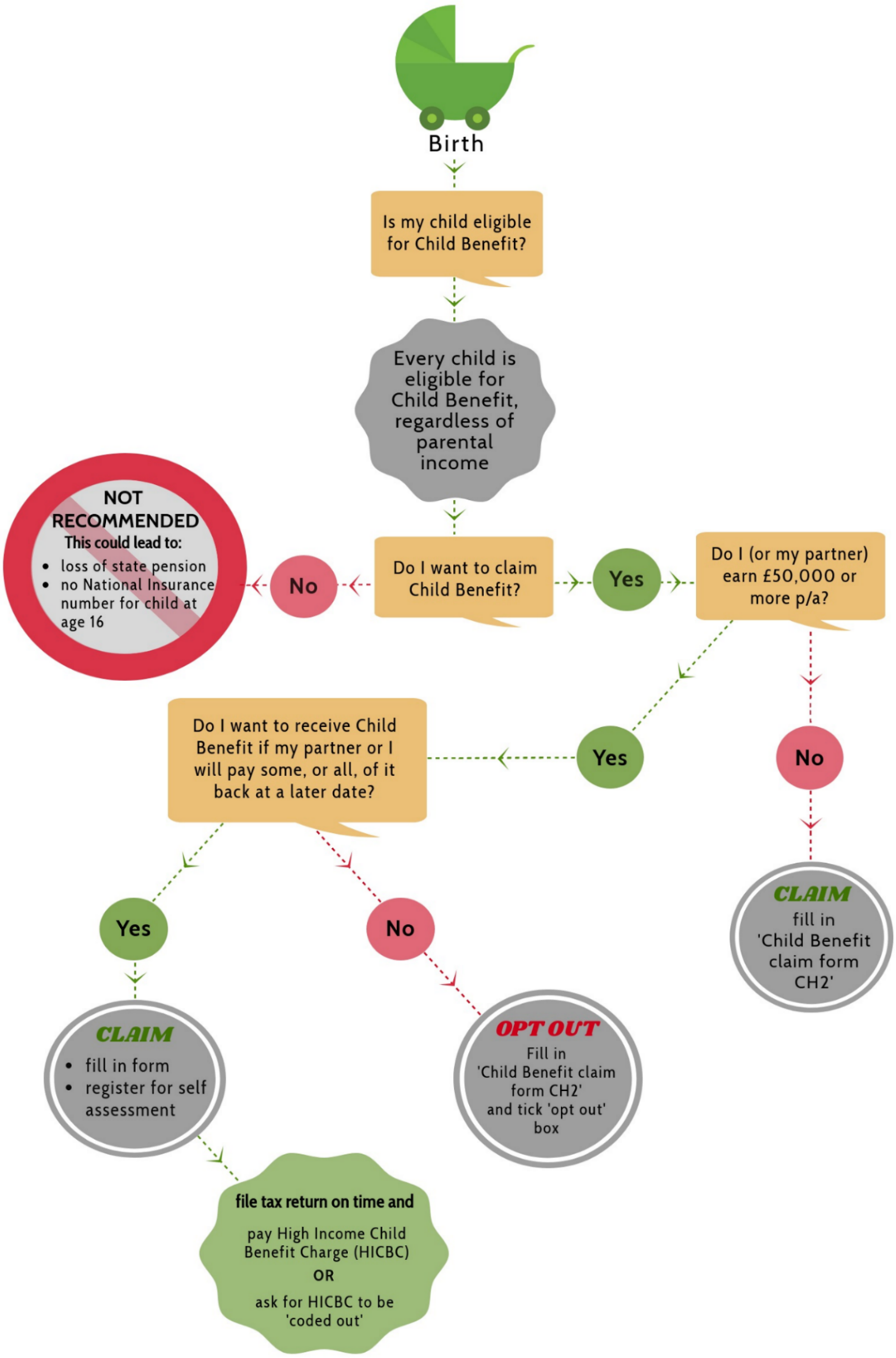
They have seen articles about the High Income Child Benefit Charge. They think that because of Helen's earnings they are not entitled to child benefit and, to avoid any potential problems with HMRC, they decide not to claim it. They receive a form to make the claim in their bounty pack. They glance at it, but it seems irrelevant to them and is quite long, so they discard it.

Helen and George have two more children over the next five years. George remains the primary carer until the youngest child starts school. He then retrains as a horticulturalist, taking a three-year degree. He starts working as a self-employed gardener when he leaves college, and after one year his business is sufficiently established that tax and National Insurance are payable.

Because the Greens have never registered for Child Benefit, their children will not receive their National Insurance numbers automatically when they are 16, as this process is linked to Child Benefit claims. George has also had many years during which he has lost out on accruing entitlement to State Pension.

[12] https://www.gov.uk/government/publications/high-income-child-benefit-charge-awareness-understanding-and-decision-making-processes

Chart 1.B: Child benefit claim decision-making process



Source: OTS

National Insurance credits

1.28 For working parents, there may be little incentive to claim child benefit if the level of their earnings means the HICBC applies, and both earn over the national insurance lower earnings limit (currently £118 a week or £6,136 per year) and therefore pay national insurance contributions already.

1.29 However, although there is information about the option to claim child benefit then opt out of receiving it (see paragraph 1.18) on the Child Benefit claim form and on GOV.UK,[13] it is difficult to judge how well it is understood, given the significant fall in claims for child benefit being made.

1.30 A letter from HMRC to the Treasury Select Committee in January 2019[14] set out that around 3 per cent of those eligible to child benefit (over 200,000 people) may be missing out on national insurance credits because the recipient of child benefit is the working parent, rather than the non-working parent. However, HMRC has not been able to establish the total scale of any reduction in the number of parents who are entitled to, but do not receive, national insurance credits.

Issuing National Insurance numbers

1.31 The other issue that arises if neither parent claims child benefit is that their son or daughter will not automatically receive a national insurance number at age 16.

1.32 Under current arrangements, the child will then have to actively contact the relevant department to receive one. This can involve a face to face interview with a DWP official.

1.33 It is likely that the changes in child benefit will lead to an increase in the numbers of children not automatically receiving a NINO, resulting in an increase in DWP's workload.

1.34 The OTS considers the government should consider how to mitigate the impact of these pressures on the system, to enable children who do not receive a NINO automatically to be allocated one without the need for further intervention from DWP.

Recommendation 1

The government should review the administrative arrangements linked to the operation of Child Benefit, making clear the consequences of not claiming the benefit, with a view to ensuring that people cannot lose out on national insurance entitlements.

Recommendation 2

The government should consider the potential for enabling national insurance credits to be restored to those people who have lost out through not claiming Child Benefit.

Recommendation 3

The government should consider how to ease the process of enabling children of those who have not claimed Child Benefit to receive their National Insurance number.

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[13] https://www.gov.uk/child-benefit/what-youll-get

[14] https://www.parliament.uk/business/committees/committees-a-z/commons-select/treasury-committee/news-parliament-2017/chairs-comments-parents-could-be-missing-out-on-state-pension-17-19/

Non-commercial employers

1.35 Individuals and families may hire additional help for a variety of reasons at different times. This may be a nanny for childcare, or a carer to look after a disabled or elderly relative. They might go to an agency, but some hire someone direct using either their own money, or funding received from a body such as a local authority or the NHS.

1.36 If the nature of the arrangement amounts to direct employment, the individual or family will need to operate a PAYE scheme. This can be complicated, although HMRC's free Basic PAYE Tools software is very useful for many people who have to operate PAYE in simple circumstances.

1.37 Typically, reporting on or before each payday and monthly payment is required, but where an employer needs to pay less than £1,500 a month overall, they can pay quarterly, rather than monthly.[15]

1.38 As an employer, even though not in business themselves, they will also be responsible for paying at least the national minimum wage, for auto-enrolling the employee into an appropriate pension scheme, and other aspects of employment law compliance.

1.39 The majority of people who employ people in this way use local authority funding to do so, and their numbers are estimated to have doubled between 2008 and 2017 to around 70,000.[16]

1.40 For most people, including elderly or otherwise vulnerable individuals, or their relatives, setting up a payroll is a challenge,[17] particularly as the individual may never have expected to be in this position (hence the occasionally used term 'accidental employers'). But there may be ways in which the burdens for the individual non-commercial employer can be lessened or simplified.

1.41 For example, some local authorities offering specific grants to such care and support employers also offer a payroll service alongside. There are sources of information from both official[18] [19] and third sector organisations such as Skills for Care[20] and the Low Incomes Tax Reform Group[21] (the latter offers a

[15] https://www.gov.uk/paye-for-employers

[16] Skills for Care, a charity, estimated that 70,000 people in receipt of direct payments in 2017 were directly employing personal assistants, up from 35,000 in 2008 (https://www.skillsforcare.org.uk/NMDS-SC-intelligence/Workforce-intelligence/documents/2Individual-employers-and-personal-assistants-2017.pdf).

[17] https://www.gov.uk/au-pairs-employment-law

[18] https://www.gov.uk/paye-for-employers

[19] https://www.moneyadviceservice.org.uk/en/articles/using-a-personal-assistant-to-provide-your-care

[20] https://www.skillsforcare.org.uk/Recruitment-retention/Employing-your-own-care-and-support/Employing-your-own-care-and-support.aspx

[21] https://www.disabilitytaxguide.org.uk

free payroll tool[22] enabling the user to set up a simple payroll by linking with the functionality of HMRC's Basic PAYE Tools).[23] Some nanny agencies also offer tax calculators, which are especially useful where the nanny is employed on a net salary (which then needs to be grossed up for tax and national insurance).

1.42 There is a wealth of material, yet the GOV.UK material appears not have anything specific about employing carers. The page on 'employing someone to work in your own home' is under 'childcare and parenting'. This does not link to the page on Basic PAYE tools. Better linkage and sign-posting should allow people to gain access to the material more rapidly.

Recommendation 4

HMRC should work with the Government Digital Service to improve the visibility of guidance for non-commercial employers and maintain the Basic PAYE Tools to meet their needs.

Marriage and divorce

1.43 In 2016, the latest year for which there are statistics, there were 249,793 marriages (opposite-sex and same-sex). The marriage rate remains low by historical comparison, despite a small increase in the number of people who got married in 2016.[24]

1.44 In 2017, the latest year for which there are statistics, there were 102,007 divorces (opposite-sex and same-sex), about 8.4 divorces per 1000 marriages, the lowest divorce rate since 1973.[25]

1.45 For married people, there are two reliefs: Marriage Allowance and Married Couples' Allowance.[26]

1.46 Married Couples' Allowance can be claimed only if one of the couple was born before 6th April 1935.

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22 https://disabilitytaxguide.org.uk/paying-wages/reporting-paye-in-real-time/rti-software/hmrc-basic-paye-tools/payslip-tool/

23 https://www.gov.uk/basic-paye-tools

24 https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/marriagecohabitationandcivilpartnerships/bulletins/marriagesinenglandandwalesprovisional/2016

25 https://www.ons.gov.uk/peoplepopulationandcommunity/birthsdeathsandmarriages/divorce/bulletins/divorcesinenglandandwales/201

26 The estimated number of claimants of marriage allowance for 2018-19, subject to self-assessment returns for that year being finalised, is 1,780,000 (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/804774/Reliefs_Bulletin_Final__January_2019_-_Marriage_allowance_estimates_only_updated_in_May_2019_.pdf). The numbers of married couples and civil partners eligible for marriage allowance were estimated at 4 million in February 2015 (HMRC Issue Briefing https://www.gov.uk/government/publications/issue-briefing-marriage-allowance/issue-briefing-marriage-allowance). An estimated 270,000 were in receipt of the married couple's allowance in 2018-19 (https://www.gov.uk/government/statistics/main-tax-expenditures-and-structural-reliefs, and Written Answer 27 March 2019 'Married People: Tax Allowances').

1.47 If both were born on or after 6th April 1935, then the transferable Marriage Allowance can be claimed, under which 10% (currently £1,250) of unused Personal Allowances can be transferred from one partner to the other, provided that neither partner pays tax at a rate higher than the basic rate during the tax year in question.

1.48 The OTS has heard that it is sometimes claimed in cases where the transferee is, or becomes, a higher rate taxpayer for the year of claim. This is understandable as not everyone would know whether they are going to be liable at a higher rate until after the end of the year.

1.49 Secondly, lack of knowledge of the Marriage Allowance among the public has provided an opportunity for high-volume repayment agents (HVRAs), many of which operate exclusively online, are not affiliated with any professional body, and which take a high proportion for recovering relatively small refunds from HMRC.

1.50 Concern has been expressed to the OTS that some HVRAs do not do sufficient work to establish properly whether marriage allowance is due and will put in a claim for Marriage Allowance that is not legally due, for example because one of the partners is a higher rate taxpayer. In due course, the couple is obliged to repay the amount of the allowance to HMRC while having already paid a fee to the agent, which may be hard to recover.

1.51 The transferable Marriage Allowance is sometimes confused with the Married Couple's Allowance, leading some who are eligible for the latter, more generous, allowance to claim the former. HMRC's guidance is clear, yet the OTS has heard that older people still confuse the two.[27] Some try to claim the Marriage Allowance instead of, or as well as, the Married Couple's Allowance, not understanding the difference between them.

1.52 The OTS has heard that HMRC sometimes give insufficient credit for the Married Couple's Allowance in the year of bereavement. This is considered in Chapter 3.

1.53 For divorce, one issue highlighted to the OTS relates to way pensions are treated if shared after divorce. The recipient may discover they have breached their pensions Lifetime Allowance following the transfer from their former partner and so face a tax charge that was not anticipated during the negotiation of the divorce. This is a matter of ensuring awareness of the issue; it is likely that the number of people affected by this issue is small.

1.54 There may also be Capital Gains Tax consequences if it is not possible to complete the transfer of chargeable assets from one spouse to another in the year of separation.

[27] From Tax Help for Older People and HMRC's 'Needs Extra Support' customer facing team.

Chapter 2
Being in work

Introduction

2.1 Whether starting to work, or well established in a job, a variety of deductions will be made from an employee's pay through their employer's operation of PAYE, including income tax and National Insurance Contributions, student loan repayments and saving for a pension.

Starting work: The importance of the National Insurance number

2.2 The PAYE process involves HMRC telling the employer how much tax to deduct from an employee's pay. To maintain the confidentiality of the employee's tax affairs, this is done through a 'tax code' that reflects the personal allowance (helpfully described by HMRC as the tax-free amount) and any other circumstances that affect the employee's tax liability.

2.3 The process is designed to ensure that, by and large, the right amount has been deducted over the course of a tax year, so employees can use the income they get with confidence and do not have to fill in a tax return. PAYE does a good job of collecting the right amount of tax from the majority of taxpayers and people generally rely on the system to be correct and so don't check the end result.

2.4 If one of a child's parents or carers have been registered for child benefit, then when that child reaches the age of 16, around their birthday, their National Insurance number (NINO) will arrive. However, its significance may well be missed.

Box 2.A: Quote from OTS interviewee

"My national insurance number came to me in the post on a piece of paper. I read it and was not really sure what it was, and I don't remember it indicating that it would be as important as it is. I only kept it as my Dad told me to when he noticed it. It didn't seem very significant when it arrived, and I wasn't even aware it was going to be important in the future."

2.5 It is probably when someone first secures a job that they consciously encounter the tax system for the first time (VAT on the things they have bought going largely unnoticed).

2.6 The first thing they should get as a new employee is a 'Starter checklist' to complete.[1] This will allow their employer to deduct the correct amount of tax or national insurance, if any.

2.7 The fact that income tax and National Insurance Contributions (NICs) are deducted 'at source' by the employer, might be expected in principle. However, their payslip, showing how much tax and NICs have been deducted, will not explain how those amounts have been calculated, though such information is available elsewhere.[2]

2.8 The new worker may well have had no formal education about the tax system, either at school or in higher education. Financial education is part of the National Curriculum but it is not inspected; only a minority of secondary schools provide some teaching about this, including tax. One university told OTS that if a student asked them about tax, it pointed them towards the Money and Pensions Service or to Citizens Advice. Another provides basic classes in personal taxation and finance. Chapter 6 explores this area further.

2.9 If someone has lost track of their NINO, the employer will still deduct NICs, but they may experience a delay in having them credited to their national insurance record until a NINO is obtained. The employer's payroll software might have a feature that allows them to find the missing NINO for their employee. If not, the new employee will have to engage with HMRC to confirm their NINO.

2.10 A new employee's income tax is sometimes calculated using what is known as an 'emergency code',[3] if this is not their first job or if a mistake is made in completing the starter checklist.

2.11 Such a code allocates the personal allowance (and a share of lower tax rate bands) for a fixed pay period (week or month) but does not capture accumulated but unused allowances and rate bands. As a result, too much tax may be paid overall because this type of code does not take full account of their personal allowance. The new employee, if they know little or nothing about tax, may not realise this. The employer must use the emergency code for the rest of the tax year, unless HMRC issues a new tax code.

2.12 HMRC's annual 'catching up' process (the 'P800 reconciliation') will usually identify the overpayment and pay it back, some months after the end of the tax year on 5th April. Alternatively, the taxpayer can contact HMRC to claim their refund earlier.

Illustrative case study 2.A: Ben starts work

Ben Green is approaching the end of his first A level year and wants to go on a school trip, working and then travelling in Africa over the summer. His

1 https://www.gov.uk/government/publications/paye-starter-checklist

2 https://www.moneyadviceservice.org.uk/en/articles/understanding-your-payslip

3 https://www.gov.uk/tax-codes/emergency-tax-codes and https://taxaid.org.uk/guides/information/issues-for-employees/employee/form-p46

parents are supportive, but are not able to fund the whole trip, so they encourage Ben to get part-time summer work.

Ben gets work in his local garden centre: working 10 hours a week at £10 an hour. They ask him for his national insurance number (NINO). Ben doesn't know his NINO: he does not remember receiving one at 16. Ben looks online, and calls HMRC to get his number.

(In 2017-18 HMRC sent out 680,000 NINO letters to people approaching their 16th birthday. That year, 450,000 calls were received from those under 25 about lost NINOs or requesting confirmation of a NINO, which was 78% of all calls HMRC had about NINOs in that year, with 52% of those calls being from 16 to 17 year olds.)[4]

It's a few weeks after Ben starts work that he gets his number; in the meantime, as a result of some confusion about how to complete the starter checklist, his employer mistakenly deducts tax at the emergency rate.

Once his employer has Ben's NINO his tax position will then take weeks or months to regularise (depending on how frequently he is paid).

2.13 This sort of situation can also arise in relation to students or others who work for only part of a year, particularly in multiple jobs.

Box 2.B: Quote from OTS interviewee

I turned 16 in 2012, the year after HMRC stopped sending out National Insurance cards. This was also the year I got my first 'real job'. As I have had many part-time jobs in shops/restaurants/bars, I know my NINO off by heart, but otherwise wouldn't know how to locate it. As a student, I worked 10 to 20 hours per week most of the year, but for about three months every summer would work 40+ hours per week, usually in two different jobs. For these summer months I earned significantly more and was receiving pay slips from 2 companies, and my tax code was wrong.

The approach I took for five years was that it was easier to have the wrong tax code, be taxed too much, and receive a tax rebate than try and go through the effort of trying to change my tax code. As a teenager, I did not have the knowledge or confidence to contact HMRC to try to fix the issue.

Among my peers, it was also quite normal to be incorrectly taxed on part-time/summer wages; we all knew that we would receive the money back. There was a stereotype that you would get the rebate you were owed, but only after waiting hours in a phone queue. As far as I was aware, there was no online alternative. I have gotten tax rebates of over £1,000, a considerable amount for a part-time working student.

[4] HMRC data.

Changing jobs

2.14 When an employee moves jobs, there can be a problem in transferring their PAYE record from one employer to the next. This is not automated and relies upon the individual providing their new employer with relevant information on one of several HMRC forms.

2.15 Problems can arise even when the forms are completed on time. For example, a change of job mid-month,[5] can lead to under or over payments of tax and NICs.

2.16 If this occurs towards the end of the tax year, the employee has three options:

- to wait for the 'end-of-year' reconciliation process to check what should have been paid against what has been paid
- to complete a self-assessment income tax return
- to contact HMRC directly

2.17 For the first option, underpayments can be 'coded in'. The individual's tax code is changed to collect the underpayment over the course of the following year. For the second, some employers' pay sections have advised completing a tax return if the employee wishes to speed the process up.

2.18 Where there is a delay in the information provided being reflected in the employee's tax code or in the relatively new 'dynamic coding' process,[6] the employer is required to apply an emergency tax code. This can also be the case when no information is available (see paragraph 2.10). This may give rise to an over or underpayment of tax, depending on whether too much or too little tax-free allowance is given.

2.19 For an individual to check that they are paying the right amount of tax, they would need to understand the way income tax works, including their tax code, which is something many people have told the OTS they find difficult.

2.20 This is because although coding notices and the online personal tax account do provide some explanation, this is not always easy to understand and depends on a greater level of general awareness of the system than most people wish or need to have.

2.21 There is no easy means for taxpayers to correct information (there is a facility in the Personal Tax Account, but the range of options is limited and there is no plain text field for a taxpayer to give an explanation). This can have a significant impact, given the tendency for the system to bring forward figures from the previous tax year and assume the same amount will be relevant in the current tax year, until new information is received.

[5] See the OTS's May 2019 report, "Simplifying everyday tax for smaller businesses" para 6.6

[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/635408/Changes_to_PAYE_in_2017-Employer_information_and_support_pack.pdf

Multiple sources of income

2.22 As the labour market changes, more people are taking on more than one job or self-employment, either as a matter of choice or because that is how they are best able to make ends meet. This, as with the example of the student above, sometimes gives rise to problems with the correct allocation of the individual's personal allowance.

2.23 If someone takes on a new job, but has not left their other employment, they will not have a form P45 (the form which shows income and tax paid under the employment which has ended) to give the new employer. They will instead have to complete the 'new starter checklist' form mentioned earlier and tick box C to make clear they have another job or pension.[7]

2.24 If someone ticks box A or B instead, the new employer will operate an 'emergency code'[8] which allocates a tax-free amount equivalent to the personal allowance, on either a cumulative basis (box A) or a non-cumulative basis (box B). This is likely to lead to multiple allowances being given, as the personal allowance will almost certainly be already being given in the tax code for the other job, which will result in the individual underpaying tax.

2.25 A similar problem can affect pensioners who have more than one pension, and bereaved spouses or civil partners who inherit a pension (see paragraphs 4.46 in Chapter 4.

2.26 The OTS has not identified any underlying cause of these problems. Processes are there to prevent them but are by no means always followed, as evidenced by the 300,000 or so duplicated employment records that are in the system.[9] The wider challenge is to enable HMRC systems to integrate multiple sources of information closer to real time.

2.27 Responsibility for reporting job changes must lie with the individual, helped or prompted by the employer. But, given the planned integration of HMRC's various databases to aid its compliance activities, if an employer has the minimum of information about their new employee (NINO, name and address), a higher proportion of these people could be picked up.

2.28 Their PAYE records could then be automatically cross-checked in real time to ensure that only a single personal allowance was given, adjusting the tax code as appropriate using 'dynamic coding', mitigating the issues and reducing the numbers affected.

Interactions between PAYE reporting and Universal Credit

2.29 The operation of Universal Credit (UC) depends on the information passed to DWP from HMRC's PAYE systems.

2.30 The employer is required to report to HMRC the amount and date of each payment of salary or wages through the PAYE system 'on or before' the date of payment.

[7] https://www.gov.uk/government/publications/paye-starter-checklist

[8] https://www.gov.uk/tax-codes/emergency-tax-codes

[9] See the OTS's May 2019 report, "Simplifying everyday tax for smaller businesses" para 6.6.

2.31 If the employee is claiming UC, that information is passed to DWP. DWP use the date they receive that information as the basis for apportioning the payment to a UC assessment period (which is the period of one month beginning with the date of claim, and successive months).

2.32 Usually the date on which the payment of wages is sent to DWP is the same as the date on which it is reported to HMRC, but sometimes the two dates can differ.

2.33 Such mismatches can lead to financial loss for the individual if it results in DWP systems allocating the payment to a different assessment period from the one to which it relates.

2.34 If, for example, two payments of wages are allocated to the same assessment period, the UC system can treat this as an increase in pay for the month of receipt and reduce or cancel the UC payment as a result.

2.35 The UC will then be increased for the following assessment period when there is no pay. However, that will be at least one month away, and the individual may lose an allowance which they would otherwise have received (this is not just a question of cashflow). If the misallocation of pay results in their pay being high enough for their UC to be cancelled for an assessment period, the claimant may have to reclaim UC subsequently.

2.36 A common situation where this could be an issue is where a normal payday falls on a non-banking day, and so payment is made on the nearest working day before or after the normal payday. In such cases, HMRC instruct employers to report the normal payday rather than the date when payment is actually made,[10] which prevents the problem arising.

2.37 However, if employers do not act according to those instructions, DWP systems will allocate the payment to the date notified to them, so the payment may be allocated to the wrong assessment period and the employee/claimant loses out.

2.38 It seems this still happens, so it could be useful for HMRC to issue a reminder to employers. In that context it could be helpful if the instructions were to make clear the potential impact on the individuals concerned.

Illustrative case study 2.B: Molly - payment dates interaction

Molly is 24. She has a three-year-old son, Paul. Paul's father left her before Paul was born and does not contribute to childcare or family expenses. Molly's parents look after Paul three days per week, allowing her to work part-time.

Molly receives Universal Credit (UC) to top up her income so she can pay the rent and bills on her one-bedroomed flat and buy food and other necessities. She tries to save but it is very difficult: when Paul is able to go to school, she hopes to get more hours so she can find a flat where he will have his own

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[10] CWG2 Further Guide to PAYE and National Insurance Contributions (https://www.gov.uk/government/publications/cwg2-further-guide-to-paye-and-national-insurance-contributions/2017-to-2018-employer-further-guide-to-paye-and-nics#sec1 – para 1.8)

room, improve their living standards and put some money aside. In the meantime, she gets through from month to month with little to spare.

In January her UC payment does not come through. When she speaks on the telephone to an adviser, she is told that her claim for that month was stopped because her income increased. However, her income hadn't increased so this doesn't make sense to her.

Eventually it emerges that last month two of her monthly payments from her employer were made in the same month (because one of the payment dates was on a weekend, so the payment was made on the nearest working day), even though one was for November and one for December. Molly is told that her employer sends information to HMRC every month when she is paid. HMRC then sends this to DWP.

(Clearly Molly's employer reported to HMRC the date she was paid rather than the date on which payment was due. So, although these payments are for different months, the UC system treated them as an increase in pay for the month of receipt and cancelled the UC payment. Her UC is increased the following month when there is no pay.)

Molly can't afford to pay her rent without the UC payment and has to borrow money from her parents and a payday loan company to get through, incurring a large interest charge.

If Molly's employer had followed HMRC's instructions and reported the date on which the second payment was due rather than the actual date of payment, the DWP would have allocated it to the right assessment period and the problem would not have arisen.

2.39 The other main situation in which this issue arises is where an employer reports a payment to HMRC after 9pm on the payment date; this means DWP will both receive the information and allocate it to an assessment period on the following day. It can also occur if an employer is late notifying HMRC of a payment to the employee (that is, the employer reports the payment a day or more after it is paid). At present there is no official guidance on how best to handle such situations.

Work-related expenses

2.40 There is evidence that among the 5 million or so people[11] entitled to tax relief on work-related expenses, which their employers do not reimburse, that low-paid workers[12] and others not submitting self-assessment returns[13]

[11] https://www.gov.uk/government/publications/qualitative-research-on-employees-non-reimbursed-expenses-tax-relief para 2.1

[12] https://www.litrg.org.uk/sites/default/files/180502-Carers-report-May2018.pdf - Chapter 5, The knock-on effects - tax

[13] https://www.gov.uk/government/publications/qualitative-research-on-employees-non-reimbursed-expenses-tax-relief

have limited awareness of the reliefs available and how they work, or experience difficulties with the process of making claims for the relief.

2.41 Such deductions are limited in scope, but there are some that can be claimed by many taxpayers, such as the cost of cleaning a work uniform, subscriptions to professional bodies and some trades unions. For example, care workers, who may travel between appointments at their own expense and are sometimes not reimbursed their costs.[14]

2.42 The process typically involves registering online to claim these expenses as a tax deduction using form P87. This must be completed online in stages, so it is impossible to see at the outset all the information which will be required. There is a 'print and post' version of the form, but this still has to be completed online, before being printed off and posted.[15]

2.43 HMRC have begun to provide decision-based guidance[16] to steer people to the most appropriate answers on the most often asked questions about employment expenses and how to claim them. This work should continue because it should help many people who are not presently benefitting from the full amount of the tax refund due to them.

2.44 HMRC is taking active steps to improve the process for claiming tax relief for around 70 to 80% of expenses claimed (Fixed Rate Expenses and Professional fees).

2.45 In practice, many still respond to marketing from tax refund agencies (so called 'high volume repayment agencies') who will take a large proportion of any refund in fees.

Illustrative case study 2.C: Sam's expense claims

Sam is a hospital porter at Midshire hospital: his wife Betty works for the hospital in the supplies unit. Sam has been working there for 25 years and enjoys his job. It is not very well-paid, but he and Betty can manage on their income from the hospital.

Sam sees a post on social media telling him that NHS workers can claim tax back on uniform cleaning costs. Sam wears a uniform but has never made a claim. The link tells him that he is entitled to £125 every year for the cost of cleaning his uniform. This can be backdated for four years.

Sam clicks the link to make a claim, fills in the form and waits for his repayment. He gets £60 for the four years. He is pleased to get the money.

[14] The number of adult social care jobs in England in 2018 is estimated at 1.62 million. https://www.skillsforcare.org.uk/adult-social-care-workforce-data/Workforce-intelligence/documents/Size-of-the-adult-social-care-sector/Size-and-Structure-2019.pdf

[15] https://www.gov.uk/guidance/claim-income-tax-relief-for-your-employment-expenses-p87

[16] For example: https://www.tax.service.gov.uk/claim-tax-relief-expenses/who-claiming-for

However, he knows that he was entitled to £100 (20% of £500): the difference balance is the agents' charge for making the claim.

Sam is unhappy that the agents took so much of the claim. He searches online and finds that he can make the claim himself next time.[17]

He also discovers that HMRC has improved its guidance[18] with a tool that takes him through the process[19] as an alternative to commercial websites.

2.46 The OTS understand that HMRC introduced the present online process to make the process easier and to minimise the risk of errors being made as forms were completed. It would be helpful, however, if it were possible for the claimant to see information they need to collect before they start the process. It would also make it accessible for digitally disadvantaged people if it were possible to print a hard copy form, to complete post back.

2.47 In addition, the OTS has heard that some workers whose income is less than the personal allowance do not understand that they cannot claim their unreimbursed expenses against tax. It would help if the guidance with the form made that clear.

Conclusions

2.48 In nearly all the areas explored in this chapter, the answers lie in continued improvements to the existing guidance, processes and technology.

2.49 Clearer information on tax coding notices and greater access to information through the personal tax account will help, together with continued improvements to the PAYE/Real Time Information systems, and dynamic coding. This will enable information about new income sources to be more quickly included into PAYE codes, which take overall account of the individual's income, and for multiple sources of income to be handled accurately as soon as possible.

2.50 The OTS has recently called for a renewed and continuing focus in this area, recommending that 'a strategic focus on the PAYE system should be an HMRC priority to ensure effective implementation of improvements and system changes'.[20] This is equally relevant to people in work (as discussed here) and to people receiving pensions (see paragraphs 4.29 and 4.49).

Recommendation 5

HMRC should incorporate consideration of practical issues arising in connection with starting work, changing jobs, taking on additional jobs and claiming expenses into its ongoing work to improve the operation of the PAYE system.

[17] https://www.moneysavingexpert.com/reclaim/uniform-tax-refund/

[18] https://www.gov.uk/hmrc-internal-manuals/employment-income-manual/eim32712

[19] https://www.gov.uk/guidance/job-expenses-for-uniforms-work-clothing-and-tools

[20] See the OTS's May 2019 report on 'Simplifying everyday tax for smaller businesses', recommendation 2 https://www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses

Chapter 3

Saving for a pension

Introduction

3.1 The pensions savings landscape is complex, not least because of the different types of schemes available and the range of specific variations there can be. To an extent, it is inevitable that the tax issues arising will reflect that inherent complexity. However, there are also some very specific tax rules which significantly add to this complexity.

3.2 The government introduced the first 'old age' pension in 1908 for men over 70. Then, in 1921, tax relief on pension contributions was introduced. A universal state pension was introduced in 1948. As the number of pension savers and providers grew, the area attracted more regulation to promote greater fairness across the population and to protect savers from misappropriation of their pension savings.

3.3 Occupational pensions saving schemes (schemes provided by employers) are now of two main types:

- Defined Contribution (DC), where the savings accumulate over time so that when the individual retires, they can either buy an investment (known as an annuity) which will pay out a defined amount each year, or keep the investment and 'draw down' amounts as and when needed, including in lump sums. The amount of potential pension depends on the size of the accumulated fund
- Defined Benefit (DB), where the savings secure the right to a pension equal to a specified amount, based upon, for example, their final salary or a career average. DB schemes are common in the public sector, but most private sector DB schemes have now closed (at least to new entrants)

3.4 There are also cash balance, or hybrid, plans, which are essentially defined contribution plans with a minimum pension value guaranteed by the sponsoring employer.

3.5 Individuals may also have a personal pension, which will operate on a DC basis. This is the only type of pension available to a self-employed individual. Someone enrolled in an occupational scheme may also contribute to a personal pension.

3.6 Before 2006 there were eight separate tax regimes covering individual and occupational pensions. In 2006 a comprehensive reform of pensions and taxation (the 'A-Day reforms') took effect to rationalise the UK tax system as it applied to pensions. A key objective was to reduce administrative barriers to saving for a pension, in response to criticism that the tax regime for pension saving had become so complex that it was discouraging saving.[1]

3.7 The outcome was one income tax regime across all individual and occupational pensions. Individuals with existing pension savings had the option to opt out entirely from the new regime or to go into it with some protection for funds over the new limits.

3.8 As part of the 2006 reforms, limits were placed on annual and lifetime pension saving through the mechanism of Annual Allowance and Lifetime Allowances, as indicated in the box below. The Exchequer cost of pension tax relief remains substantial. In 2016-17, pension tax and NICs relief cost £36.7 billion.[2]

Box 3.A: Key developments[3] in pensions taxation since the 2006 reforms

- 2006: The A-Day reforms rationalised the UK tax system for pensions. Introduction of lifetime allowance (LTA) of £1.5 million and annual allowance (AA) of £215,000. The LTA increased in steps to £1.8 million in 2010-11 and the AA increased in steps to £255,000 in 2010-11. Some LTA protection for existing pensions was provided.
- 2010: AA reduced to £50,000 for 2011-12, LTA to £1.5 million from 2012-13. The AA Defined Benefit conversion rate changed from x10 to x16.
- 2012: Employer pension scheme auto-enrolment starts to roll out.
- 2014: AA reduced to £40,000 and LTA to £1.25 million for 2014-15. Some LTA protection for existing pensions was provided.
- 2015: Pensions freedom introduced, enabling individuals with DC pensions to draw amounts, including lump sums, from pensions from age 55, as they wished, and removing the need to buy an annuity
- 2015: Money-purchase annual allowance (MPAA) introduced to limit future relief for contributions where the individual had previously flexibly accessed their pension in certain circumstances, including having taken a taxable lump sum from a pension. The MPAA was initially set at £10,000 a year, later reduced to £4,000 a year from 6 April 2017.
- 2016: LTA reduced to £1 million and the AA taper introduced for 2016-17 which can reduce the AA on a sliding scale to a minimum

1 https://webarchive.nationalarchives.gov.uk/20100407203659/http://www.hm-treasury.gov.uk/d/bud09_completereport_2520.pdf Paragraph 5.90

2 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/833841/Personal_Pensions_and_Pensions_Relief_Statistics.pdf

3 https://www.professionalpensions.com/professional-pensions/analysis/2316994/pension-tax-relief-cuts-a-brief-history and https://www.pensionsadvisoryservice.org.uk/about-pensions/saving-into-a-pension/pensions-and-tax/the-annual-allowance

of £10,000 a year once a threshold of £150,000 is exceeded, depending on the individual's level of income and pension saving. Some protection for existing pensions was provided. Pension savings periods were aligned in 2015-16, so this year was a complex transitional year for AA.

- **2018**: Introduction of annual increase of LTA by CPI from 6 April 2018

3.9 Pension savings and related income tax issues have become increasingly complex for many since 2006 as a result of the changes in the allowances and their interactions.

3.10 The existing interactions with National Insurance, which have their own complexities, have however remained unchanged.

3.11 National Insurance Contributions (NICs) are paid by employees and by employers, based on the employee's salary. Employees' pension contributions do not affect the amount of NICs they pay, although they do reduce the income on which they pay income tax. But any employer contributions to employees' pensions are not included in the base on which NICs are calculated.

3.12 This misalignment has a high exchequer cost (£16.5 billion in 2017-18).[4] The OTS's March 2016 report on the closer alignment of income tax and national insurance pointed out that:

"As a result of this misalignment …. some employers and employees enter into salary sacrifice arrangements: usually this means that the employee reduces their gross salary and the employer increases their pension contribution. There is a NICs gain for both the employee and the employer which is sometimes used to increase the amount saved into the pension." [5]

3.13 The overall effect of the income tax changes has been to create a range of complexities and anomalies, resulting in uncertainty and confusion.

3.14 For employees with income below the personal allowance, the different ways these arrangements operate produce an anomaly, as someone in a 'relief at source' arrangement effectively pays less for their pension than someone in a 'net pay' arrangement, even though they each end up with the same amount in their pension scheme.

3.15 For some people on higher incomes, the limitations on annual pension savings have created complexities that can be difficult to understand or comply with without specialised professional advice.

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4 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/797895/PEN6__2012-13_to_2017-18___for_publication.pdf

5 https://www.gov.uk/government/publications/closer-alignment-of-income-tax-and-national-insurance-contributions - see paragraph 4.22 and Box 4C

Net pay and relief at source arrangements

3.16 Employers have a choice between what are known as 'net pay' or 'relief at source' (RAS) arrangements when providing pensions for their employees.[6] This choice affects the operation of income tax but makes no difference in relation to national insurance contributions.

3.17 For employees whose total income is less than the personal allowance, this choice makes a difference to their net pay after tax, national insurance and pension savings are taken into account. This is because RAS arrangements enable the pension savings to be boosted by 'tax relief' (effectively a top-up), even where the individual does not pay income tax.

3.18 Under RAS arrangements, an employee's pension contribution is deducted from their pay after income tax has been deducted, with the scheme then claiming back 20% tax relief from HMRC (and any higher rate relief being claimed by the individual). This 20% tax relief is paid to the scheme regardless of the level of the individual's income or their tax position.

3.19 (The pension savings are supported by a top-up to the pension, equivalent to tax relief at the basic rate (20%) on the gross contribution, even if the beneficiary has no earnings when the top-up is limited to £720. This may seem anomalous, but it is notable that 'stakeholder pensions'[7] allow non-taxpayers to benefit from a top-up equivalent to basic rate tax relief; for example, a parent can contribute to a child's stakeholder pension.)

3.20 Under net pay arrangements, the pension contribution is deducted before tax on the employee's earnings is calculated. This means that the full income tax relief is taken into account when calculating the tax to be deducted under PAYE. The employee does not have to claim any tax relief separately if they pay tax at higher rates, and the pension scheme does not need to reclaim basic rate tax on net pay contributions from HMRC.

3.21 This is administratively easier, not least for employers, but means that if the individual has insufficient income to pay income tax, they will not gain any benefit from the tax relief that would have been available, had their employer chosen to use a RAS scheme.

Illustrative case study 3.A: Elizabeth and Susan[8]

Elizabeth works for United Widgets Ltd earning £12,500a year in 2019-20. Under auto enrolment United Widgets operates a net pay scheme, to which Elizabeth's contribution is £318.20, all of which is deducted from her pay.

6 Sections 192 and 193 of Finance Act 2004.

7 https://www.pensionsadvisoryservice.org.uk/about-pensions/pensions-basics/contract-based-schemes/stakeholder-pension-schemes

8 The amounts of pension contribution and tax relief cited in this example are those that would actually be paid and received under auto-enrolment by a person earning £12,500 p/a – that is, 5% of earnings above the lower earnings limit (£6,136 in 2019-20). The Money Advice Service provides a workplace pensions calculator at https://www.moneyadviceservice.org.uk/en/tools/workplace-pension-contribution-calculator - From January 2019 MAS was replaced by the Money and Pensions Service, MAPS.

However, because her income is already wholly covered by her personal allowance, she receives no benefit from the tax relief available on her contribution.

Elizabeth's friend Susan works for Bandwidth Solutions Ltd which operates a relief at source scheme. She earns exactly the same amount as Elizabeth: £12,500 a. Instead of paying £318.20 of her qualifying earnings into the scheme, she pays a net contribution of £318.20 less 20%, or £254.56, and the scheme recovers that 20% from HMRC, amounting to £63.64, regardless of the level of her income.

As a result, Susan is £63.84 a year better-off than Elizabeth, as a result of her employer choosing to operate a relief at source scheme, rather than a net pay scheme.

3.22 The overall effect is that when gross pay is at or below the Personal Allowance, people saving the same amount into their pension end up in different positions. For those in net pay schemes, they have to fund it all, whereas those in RAS schemes gain from the relief from the exchequer. As a result, the person in a net pay scheme has less take-home pay, as in the case study above. See Annex B for more details.

3.23 There is another difference in the position of net pay and RAS contributors which affects Scottish taxpayers who pay income tax at rates set by the Scottish Parliament.

3.24 Employees who are liable to tax at 19% and who contribute to net pay schemes receive tax relief at 19%, but if they contribute to RAS schemes, they receive tax relief at the basic rate of 20%. HMRC do not recover the 1% difference. If the taxpayer is liable to income tax at 21%, 41% or 46%, they get tax relief on pensions contributions at 20% at source and can recover the difference through self assessment or by contacting HMRC.

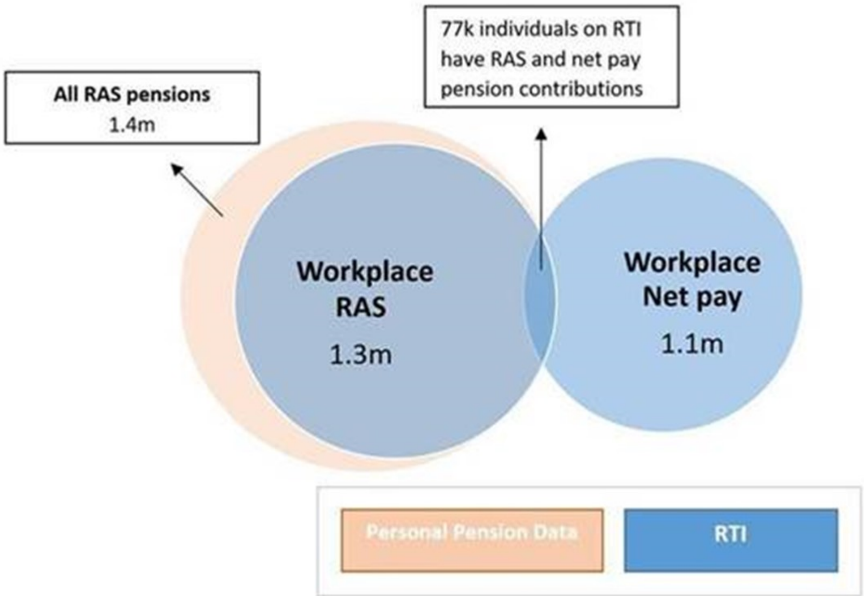
3.25 One reason employers operating automatic enrolment occupational pension schemes choose net pay schemes is that the administration is much easier – the pension scheme does not have to make a claim from HMRC and the employee does not have to do anything in order to secure the tax relief to which they are entitled.

3.26 However, it is anomalous that for some people, whether they get the benefit of tax relief, depends not on their tax status, but on what scheme is chosen by their employer.

3.27 The latest figures available to OTS, for 2016-17, show that 1.1 million individuals are affected by this issue, out of the 2.4 million workplace pension savers who have income less than the personal allowance.[9] This will grow if the personal allowance continues to increase year by year.

[9] HMRC data using information on personal pensions and from the PAYE 'Real Time Information (RTI) system.

Chart 3.A: Numbers of people in pension schemes with income under the personal allowance in 2016-17



Source: HMRC data using information on personal pensions and from the PAYE 'Real Time Information (RTI) system

3.28 One method of resolving the anomaly[10] would involve using RTI data to capture pension contributions and incorporate them into the PAYE process, so that in relation to net pay schemes, tax relief could be given as part of the end-of-year reconciliation process (P800), potentially resulting in a refund to the individual or the scheme.

3.29 Another possibility would be to extend the work already being done to identify Scottish taxpayers who pay income tax at the 21% rate, and to use that mechanism to identify those taxpayers not receiving the 20% top-up under net pay arrangements.[11]

3.30 However, the amount of money that would be needed to ensure low-paid workers in net pay schemes do not lose out is around £100 million and such a process would cost about £10 million to administer.[12] Also, if the contributor was a universal credit claimant, it would reduce their universal credit in the assessment period in which the tax repayment is received, as repayments of income tax count as income for universal credit purposes.

Recommendation 6

The government should consider the potential for reducing or removing the differences in outcomes between net pay and relief at source schemes for people

[10] Suggested by LITRG.

[11] Letter to Chancellor of the Exchequer dated 4 October 2018, see https://www.litrg.org.uk/latest-news/news/181005-press-release-campaigners-press-government-action-pension-tax-relief

[12] Oral evidence by Economic Secretary to the Treasury John Glen MP to the Work and Pensions Select Committee Inquiry on Pension Costs and Transparency, 3 April 2019, Q333. http://data.parliament.uk/writtenevidence/committeeevidence.svc/evidencedocument/work-and-pensions-committee/pension-costs-and-transparency/oral/99411.html

whose income is below the personal allowance, without making it more complicated for those affected.

Pensions Annual Allowance and Lifetime Allowance

3.31 Two restrictions are intended to limit the amount of pensions tax relief available to any one individual. These are the Annual Allowance and the Lifetime Allowance.

3.32 The Annual Allowance (AA) sets an upper limit on how much an individual's pension savings can grow each year with the individual continuing to benefit from full income tax relief.

3.33 How this 'growth' is defined differs between DB and DC schemes because the way they work is different. Growth for DB is how much the pension entitlement has changed. For DC it is the amount saved into the pension fund - it does not include investment growth of the fund.

3.34 If this growth limit is exceeded, a free-standing income tax charge is triggered at the taxpayer's highest rate of income tax. An individual can save more into their DB or DC pension scheme in a year than their AA, but they will pay a charge if they do so (called the Annual Allowance Charge). Any unused AA can be carried forward for up to three later years.

3.35 There is no limit to how much can be saved by an individual into their pension over their lifetime. But if the value of their pension exceeds the Lifetime Allowance, again a stand-alone income tax charge will be incurred. This is called the Lifetime Allowance Charge (LTA charge).

3.36 It is difficult for taxpayers both to know they are liable for a charge at all, and to calculate it. As importantly, depending on the type of scheme and its rules, they may wish to adjust contributions or take other action to avoid incurring a charge, which requires being able to predict likely charges in advance.

3.37 How the tax on any charge is collected is also complicated. An LTA charge is paid by the pension scheme, with the individual receiving a smaller pension all other things being equal. An Annual Allowance charge (AA charge) can be paid by the taxpayer or, sometimes, through the pension scheme - depending on the size of the charge and the taxpayer's wishes.

Annual allowance charges

3.38 The Annual Allowance charge affected 18,500 individuals in the 2016-17 tax year.[13]

3.39 Knowing that an AA charge exists is not obvious. The rules are complex and widely misunderstood. HMRC's guidance is unclear and open to interpretation. At one point it recommends that taxpayers go to a financial adviser specialising in tax and pensions.[14]

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[13] https://www.gov.uk/government/statistics/personal-pensions-pensions-annual-allowance-statistics – Table 7

[14] https://www.gov.uk/guidance/pension-schemes-work-out-your-tapered-annual-allowance

3.40 An individual must be warned by their pension provider by 6 October if their contributions into a particular scheme have exceeded the AA for the previous tax year. They may also be warned that they are in danger of incurring an AA charge in some other circumstances. However, in general no warning will be received if the person has more than one pension scheme, though some public sector scheme administrators give members a statement for each of their schemes that a member is in, if they exceed the AA when looking across those schemes.

3.41 The calculation is different depending on whether the scheme is a Defined Benefit or Defined Contribution scheme. Guidance on GOV.UK is comprehensive and includes a calculator,[15] but is difficult to navigate and the distinction between the different calculation methods for Defined Benefit and Defined Contribution pensions is not made clear. It lacks examples to illustrate the various terms. A flow chart to guide people through the calculation is essential.

3.42 Annex C shows how the AA charge arises and how it is calculated, providing an indicative flowchart, a narrative explanation and some examples.

3.43 Once calculated, the AA charge can be paid in two ways; direct to HMRC through self-assessment or through the pension scheme by a process called 'Scheme Pays'. Scheme Pays is always voluntary for the taxpayer, but if asked for, it is mandatory so far as the scheme is concerned if certain conditions are met.

3.44 'Scheme Pays' necessarily reduces one's entitlement to future pension as some of the value of the fund is being used to pay the charge. Each scheme has different rules, so different transactions will result. For example, the NHS pension scheme does this by treating the AA charge as a loan, with interest, repaid as pension is paid.[16] The Local Government scheme does this by an actuarial reduction to the pension.

3.45 It is not possible to provide useful generic examples because of the combination of factors including the tax rules for calculating the charge, pension scheme rules for accruing pension and paying the charge, and the highly varied personal circumstances of different people. What is outlined here are two indicative examples, to illustrate the effects and show how those affected perceive their situation.

3.46 First, consider a doctor, Anne, aged 40, who has preserved benefits in the old NHS final salary scheme and is a current member of the new career-average scheme. Her pension growth will generate an AA charge every year. Paying the charge every year out of income may not be a practical option. If Scheme Pays is used, it has been explained to the OTS that this can lead to an accumulated loan of a six-figure sum that will be taken from the pension at an actuarially determined rate, based on repayment over many years. This

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[15] https://www.tax.service.gov.uk/pension-annual-allowance-calculator

[16] The NHS pension scheme uses CPI plus the government's SCAPE (Superannuation Contributions Adjusted for Past Experience methodology) discount rate which is currently around 5% (https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/190119/consult_discount_rate_summary_responses.pdf)

will affect the final pension to a significant extent, not least due to the interest charges on the loan.

3.47 Second, consider a civil servant, Tracey, aged 55, with 30 years' service, who gets a promotion and a resulting pay rise which triggers an annual allowance tax charge (See Annex D). Subsequent pension growth may well not be enough to result in a recurring AA charge. She may therefore be able to pay this charge from taxed income. If she chooses Scheme Pays and retires at 60, this will reduce her pension, but it is still likely to be higher than would have been expected before the promotion. Nevertheless, the AA charge can easily be more than twice the amount of tax relief on her personal pension contributions, for the one year when an AA charge arises.

3.48 The timing can also have a big impact. For the year ending 5 April 2019, the pension benefits statement will arrive in July or August 2019. There will have been a growing expectation of what the final salary will be based upon previous years statements. Any letter from the pension scheme notifying a potential AA charge will arrive by 6 October 2019.

3.49 There is no quick and easy way to calculate the size of the charge or the effect of paying directly, compared to using Scheme Pays. Either way the effect will not have been anticipated. The individual will be left feeling that they have lost part of their pension, and that advance warning, perhaps through readily available calculators, could potentially have prevented it.

3.50 A paper by Royal London provides a perspective from within the industry:

> "Liability to pay a tax charge may be unforeseen. This is particularly true for members of defined benefit schemes where calculation of pension input is complex. For this reason, realistically members of DB schemes are unlikely to be able to forward plan for payment of a tax charge.
>
> In many cases affected individuals are unlikely to be aware of their liability to a charge until a pension savings statement (PSS) is received from the scheme administrator. As the deadline for PSS is 6th October following the end of the relevant tax year, a PSS received close to the regulatory deadline will leave the individual less than 4 months to work out if a charge is due and if so, to pay it."[17]

3.51 The OTS has been told that some employers can respond to this by changing the way their employees are remunerated, choosing to pay them more instead of contributing to the employees' pension. Other employers have not chosen to give themselves this flexibility or are prevented from doing so by law. This means that some of their employees are forced into paying an AA charge (either personally, or by requesting that the pension scheme bears the charge and recoups it from the pension entitlement), whose calculation is complex and which has results which are difficult to predict.

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[17] https://adviser.royallondon.com/globalassets/docs/adviser/misc/1901-annual-lifetime-allowance-guide.pdf

3.52 These effects are not restricted to any one particular sector of the economy.

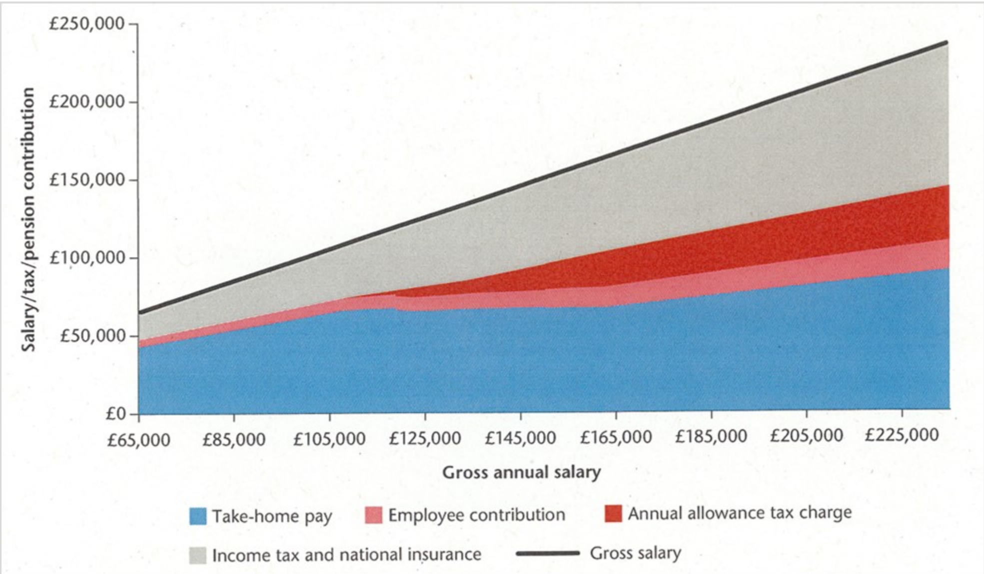
3.53 In relation to the NHS, there has been increasing concern that the AA charge can produce an effective marginal rate of tax, such that it is no longer in some doctors' interests to do additional work.

3.54 In response to this, on 7 August 2019, the government announced a consultation about the ways NHS pension scheme works, proposing full flexibility over the amount senior clinicians put into their pension pots, and for employers to be able to recycle their unused contribution back into the clinician's salary.

3.55 Alongside this, HM Treasury will 'review how the tapered annual allowance supports the delivery of public services such as the NHS'.[18] The OTS awaits the outcome of the review of the tapered annual allowance and stands ready to assist with any further work in this area.

3.56 The Senior Civil Service pay review has made a similar, if less well known, claim,[19] as have many of the public services such as police, fire and local government. Chart 3.B, taken from the Senior Civil Service pay review, demonstrates the impact on take-home pay of senior civil servants, represented by the blue area.

Chart 3.B: Effect of annual allowance charge on senior civil servants' take-home pay



Source: Fortieth Annual Report on Senior Civil Service Salaries 2018[20]

[18] https://www.gov.uk/government/news/nhs-pensions-for-senior-clinicians-new-changes-announced-to-improve-care

[19] https://www.gov.uk/government/publications/senior-salaries-review-body-report-2018 Appendix G

[20] https://www.gov.uk/government/publications/senior-salaries-review-body-report-2018 Figure G.3

3.57 As the legislation produces distortions[21] in behaviour that have negative effects such as those in the NHS, it seems sensible this legislation should be reviewed with a clear focus on its wider impact. It is encouraging that the 7 August 2019 announcement referred to above also stated that the Treasury will review the operation of the Annual Allowance tapering rules.[22]

Lifetime Allowance (LTA) and the LTA Charge

3.58 Having varied since its introduction, as noted above, the Lifetime Allowance is £1,055,000 for the 2019-20 tax year, for most people, and is set to increase with CPI inflation.

3.59 This amount applies to the total value of all pensions from registered schemes that an individual has, whether they are Defined Contribution (DC) or Defined Benefits (DB) schemes. It does not include their State Pension.

3.60 How the total value of an individual's pensions is calculated depends upon the type of pension.

- Defined Contribution pensions: it is the value of funds saved and accumulated by investment growth, up to the point when one of the specified events occurs
- Defined Benefit Pensions: the value is calculated by multiplying the annual pension by 20 and adding any additional cash lump sum

3.61 For DB pensions, savers usually get an annual statement showing the value of their pension. The growing value is easily calculated for LTA purposes (although this will vary in practice because of decisions such as commuting pension for lump sum and early retirement) and the possibility of exceeding one's LTA can easily be seen. The statement may also show whether the savings in the scheme, taken by itself, are likely to exceed the current LTA.

3.62 By contrast, it is not easy for DC pensions to make such a forecast. This is because DC pensions grow not only through regular and irregular saving of money but also by the growth of the value of the investments in the fund. This growth is impossible to predict, so savers into DC pensions may find themselves subject to the LTA charge through no decision of their own.

Money Purchase Annual Allowance

3.63 The Money Purchase Annual Allowance rules are intended to prevent 'recycling', where earnings saved into a DC pension (which have already attracted tax relief) are taken out and saved again into another DC pension, attracting more tax relief. (This is something that became easier to do to a greater extent when 'pension freedom' was introduced in 2015.)

3.64 The rules work by creating an annual limit (reduced to £4,000 from 6 April 2017) on the amount that can be saved into 'money purchase' (also called

[21] https://www.gov.uk/government/publications/senior-salaries-review-body-report-2018 para 3 "These changes [to pension taxation] are creating incentives for people to leave service earlier and are starting to influence individual behaviour and decisions."

[22] https://www.gov.uk/government/news/nhs-pensions-for-senior-clinicians-new-changes-announced-to-improve-care

Defined Contribution) pension schemes, if the saver takes savings out of any other DC scheme they have saved into in certain circumstances.[23]

3.65 People who have more than one personal pension and who access one of their pension pots under the pension freedom rules, may be unaware that their ability to continue to save into their main pension can be significantly restricted. They will also be subject to penalties from HMRC for not notifying their other pension providers that they are subject to the reduced Annual Allowance.

3.66 In response to a recent Freedom of Information request, HMRC said that they had the information to quantify how many people had been penalised for this, but it would be too costly to analyse that information.[24]

3.67 It is particularly notable that taking certain amounts out of a small DC pension pot can have an ongoing and disproportionate effect on one's capacity to secure tax relief on future pension saving. By contrast, it is possible to cash in up to three small DC pots of £10,000 or less in their entirety without triggering the MPAA rules.

Illustrative case study 3.B: Karen - MPAA

Karen is 57. Since leaving school at 18 she has had a variety of employers. Karen's parents struggled financially in their retirement and Karen does not want to be in their position, so has always tried to put money aside for her old age. She has several pension pots, from different employers, and has also been saving separately into a personal pension since she was 35.

A year ago, the business Karen was working for went into administration and she was made redundant. She found another job a few months later and hopes to continue working until state pension age, which for her is 67.

When she was made redundant, she took stock of all her pension pots. One was quite small (£11,000) and she took £3,000 of it out as a lump sum using a flexible access drawdown arrangement.

She did some research before doing this and saw that people are encouraged to take professional advice. But as these were such small pots and not material to her savings, she did not think there would be much point in spending money on professional advice.

She discovered later that as the £3,000 was more than 25% of the £11,000 (£2,750), she had to pay income tax on the excess of £250, but this modest tax bill seemed a small price to pay.

23 For comparison HMRC data suggests that the median level of overall contributions from an individual and their employer to a DC scheme is less than £2,000.

24 https://www.thisismoney.co.uk/money/pensions/article-7261449/Beware-dipping-old-pension-without-tellingcurrent-provider.html

Karen's new job pays her a good salary and she wants to increase the amount she saves every month: she has 10 years left to build up her pot and the money columns she reads in the papers encourage people to save as much as they can, even in their fifties and sixties, because of the tax relief, which adds 20% to any amount she saves. For her workplace pension the employer will also contribute, adding significantly to the value of her savings.

Karen now plans to save around £650 a month in total. She is shocked when she is told that she will not get tax relief on much of her contribution. She is told that something called the Money Purchase Annual Allowance (MPAA) means that anyone who takes a lump sum from a pension pot (and is liable to income tax on all or part of it) can only get tax relief on future contributions of up to £4,000 in any year.

Karen is very surprised. Taking just £3,000, rather than £2,750, means that over the next 10 years the MPAA rules will cost her around £7,600 in tax relief (if she continues to pay in £650 per month for the full 10 years). Karen is told this rule is intended to stop people from abusing the system. She doesn't understand why that should apply to her: she thought the new system was intended to be more flexible than before and to allow people to make better use of small pension pots.

3.68 One possible approach to remedying this would be to mirror an approach adopted in the analogous situation of people's savings into Individual Savings Accounts (ISAs).

3.69 In that context, when people save into and withdraw from an ISA, they can replace the money withdrawn (so long as the provider offers that facility). They may continue to save more money into their ISA, provided the total saved net of the replaced withdrawal does not exceed the annual ISA limit.

3.70 In the DC pension context, the MPAA calculation could remove tax relief from amounts recontributed after a withdrawal, but not otherwise limit pension saving.

3.71 Another possible approach would be to exempt contributions from auto-enrolment (AE) schemes and salary sacrifice schemes that qualify for AE from counting towards the MPAA limit.

3.72 Either of these would have at least some impact on the Exchequer, and would involve some system and process changes, the extent and costs of which would need to be considered.

Conclusions

3.73 The Lifetime Allowance Charge and the Annual Allowance Charge can present significant complexities for pension savers in different circumstances, and in either DB or DC schemes.

3.74 Given the policy aim of limiting the overall amount of pensions savings tax relief available to any one individual, applying both the AA and LTA charges to pensions may be unnecessary.

3.75 One possibility would be for the AA to apply in relation to DC schemes and the LTA in relation to DB schemes, reflecting the most natural operational and administrative fit between the two approaches and the type of scheme involved.

3.76 This approach to simplifying things for most people would of course involve an additional complexity for people who have saved into both a DB and a DC pension.

3.77 This will include individuals who have DC pension savings and have also (or previously) been members of a DB scheme but have either left that employment or the scheme in question has closed. In particular, many private sector DB schemes have closed completely or closed to new members. The overall numbers of active members of private sector DB schemes continue to fall, from 2.6 million in 2008 to 1.1 million in 2018.[25]

3.78 In relation to the Money Purchase Annual Allowance, the effects of the rules on taking certain amounts out of a pension pot can have an ongoing and disproportionate effect, beyond the policy objective of preventing inappropriate recycling.

Recommendation 7

HMRC should play a full part in helping to ensure that guidance on the tax consequences of particular pension arrangements and choices is available and clear to all concerned.

Recommendation 8

The government should continue to review the annual allowance and lifetime allowances and how, in combination, they deliver against their policy objectives, taking account of the distortions (such as those affecting the National Health Service) they sometimes produce.

Recommendation 9

The government should review the operation of the Money Purchase Annual Allowance, gathering better evidence, considering whether it meets its policy objectives, is set at the right level and is sufficiently understood, given the present potential for disproportionate outcomes.

[25] Office for National Statistics, Occupational Pension Schemes Survey, Chapter 6, Chart 3 (https://www.ons.gov.uk/peoplepopulationandcommunity/personalandhouseholdfinances/pensionssavingsandinvestments/bulletins/occupationalpensionschemessurvey/2018)

Chapter 4
Later life

Introduction

4.1 It is projected that there will be over 12.2 million people aged 65 and over in the UK in 2019, most of whom will be eligible for the state retirement pension.[1]

4.2 Between 1948 and 2010, the state pension age was essentially fixed at 60 for women and 65 for men. But the state pension age for women was gradually increased between 2010 and 2018 to be equal with men, and the standard pension age for both men and women is being increased to between 66 and 68 for those born after 5 December 1953. These increases have been prompted mainly by increases in life expectancy for both men and women since 1948.

4.3 There have also been significant changes to pensions; the pension freedom changes in 2015 remove what amounted to a requirement for pension savers to take an annuity and allow access to lump sums from pension savings in defined contribution schemes.[2]

4.4 The PAYE system was developed at a time when most workers remained in one job until they retired and started taking the state retirement pension. Income in retirement would typically consist of the state pension and perhaps an occupational pension.

4.5 Over time, working and retirement patterns became more flexible, with people moving jobs more often, having more than one occupational pension and perhaps a personal pension too.

4.6 There is also no longer the same connection between retiring and receiving the state pension, with some people retiring 'early' (either by choice or because of ill health) and others continuing to work after their state pension age, typically in part-time occupations.

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1 https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/datasets/tablek22youngagestructurevariantgbpopulationinagegroups - Table K2-2, released 28 November 2017

2 Defined Contribution schemes are those where the size of the eventual pension is based upon how much money has been paid into the pension pot supplemented by investment growth https://www.pensionwise.gov.uk/en/pension-types?gclid=EAIaIQobChMItZ2BwNvt4QIVxfZRCh3KJA-nEAAYASAAEgI2DfD_BwE

4.7 So, although stopping work marks a watershed in many people's lives, it is difficult to generalise, especially given the changes to pension age and flexible access.

4.8 But one thing that is true for most pensioners is that, for the first time in their lives, they will be without the support of their employer's pay department and their PAYE scheme (as the OTS 2013 Review of Pensioner Taxation noted).[3]

4.9 This chapter first considers some of the particular complexities people can experience when drawing pensions, and then turns to the tax issues that their partners or family member can face in the context of bereavement, when loved ones die.

Drawing a pension

Introduction

4.10 The great majority of pensioners receive a State Pension of some kind, which unlike occupational or private pensions, is never taxed at source under PAYE.

4.11 This approach is simple for all concerned in relation to the many people who receive small state pensions and do not pay tax because their total income is less than the personal allowance. However, it can result in administrative complexity in cases where the individual does have other income, as any tax on the state pension may need to be deducted from other sources.

4.12 A number of such tax complexities are recurring themes in this context, as evidenced in a variety of published reports from The Low Incomes Tax Reform Group[4] of the Chartered Institute of Taxation (CIOT), the National Audit Office[5] and previous OTS reports.[6]

4.13 Most recently, in July 2017, Prof Jane Frecknall-Hughes of the University of Nottingham carried out an academic study, commissioned by the CIOT, to examine tax problems experienced by older taxpayers. In 2016-17, while a professor at the University of Hull, she analysed 708 case files held by the charity Tax Help for Older People.[7]

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3 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/198500/ots_final_review_pensioner_taxation_230113.pdf

4 LITRG publications include 'Older people on low incomes: the case for a friendlier tax system' (December 1998); 'Older people on low incomes: the taxman's response' (July 1999); 'Tax Help for Older People' (January 2004); 'Older people on low incomes: the case for tax reform' (May 2007).

5 National Audit Office: 'HM Revenue and Customs: Dealing with the tax obligations of older people' (October 2009) (see https://www.nao.org.uk/report/hm-revenue-customs-dealing-with-the-tax-obligations-of-older-people/).

6 Office of Tax Simplification: 'Review of pensioners' taxation: Interim report' (March 2012); 'Review of pensioners' taxation: Final report' (January 2013).

7 Prof Jane Frecknall-Hughes: 'The tax problems experienced by older people'– see https://www.tax.org.uk/sites/default/files/July%202017%20%E2%80%93%20The%20tax%20problems%20experienced%20by%20older%20people.pdf.

4.14 Three particular issues emerge from these sources, and the work carried out for this report:

- the PAYE system takes time to accurately collect tax from an individual in the year they start to receive a new pension
- issues arising from the need for any tax on the state pension to be taken from other sources subject to PAYE, such as other pensions or earnings from a part-time job
- where there is more than one source of PAYE income, duplicate personal allowances can creep in through error, or delay in passing information

General issues arising when someone starts to receive a new pension

4.15 Office of National Statistics data[8] shows a projected UK population of over 3.3 million people aged between 65 and 69 in 2019. So around 660,000 people will reach state retirement age every year.

4.16 It necessarily takes a little time for the PAYE system to adjust and accurately collect tax from an individual in the year they start to receive a new pension.

4.17 This is because a new pension, or an adjustment to the state pension as a result of the death of a partner, will typically take effect part way through a tax year, and so the allocation of personal allowance between the various sources of income across the year may need to be adjusted.

4.18 If someone's state pension is relatively large, as a result of entitlement to the additional state pension,[9] then because the State Pension is not subject to PAYE, any tax on the state pension must be deducted from other income of the individual that is subject to PAYE, or collected through self-assessment. Where possible this is done through the PAYE system, by changing the tax code on another source of income.

Illustrative case study 4.A: Fred

Fred has a state pension of £10,000 per annum and an occupational pension of £5,500. His tax-free income is equal to his personal allowance of £12,500. This tax-free income is reduced by the amount of the state pension, leaving £2,500 of remaining tax-free income to set against his occupational pension.

The tax on the whole of his taxable income, including both pensions, minus his personal allowance, is collected from the occupational pension as follows:

Occupational pension	£5,500
Less remaining tax-free income	(£2,500)

[8] UK Population at mid-year in five-year age groups - Office for National Statistics, ukpppsumpop16 https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/datasets/tablea21principalprojectionukpopulationinagegroups

[9] https://www.gov.uk/additional-state-pension/eligibility

Taxable income	£3,000
Tax at 20% of £3,000	£600

His tax code, operated on the occupational pension, is '250L', which means that the first £2,500 is tax free, leaving £3000 of the pension to bear tax at 20% = £600.

(The most common tax code is '1250L', meaning that the first £12,500 (for tax year 2019-20) is tax free. The large difference is because the £10,000 of state pension has no tax deducted from it.)

4.19 DWP inform HMRC weekly about people who are about to draw their State Pension for the first time, in an automatic update made directly into HMRC's National Insurance and PAYE System (NPS). This triggers two things:

- the primary employer or occupational pension provider receives a notice changing the tax code they are to use
- the individual also gets a notice of the change to their tax code, including one of three variant explanatory notes (depending upon their circumstances), around the time they first receive their state pension

4.20 The tax code will be reduced so that more tax is collected from the main source of income paid under PAYE.

4.21 This can result in an underpayment of tax in the first year of receipt of the state pension if:

- the new code is not used for the first month for which it is issued because of the time taken to process payroll changes
- it is too late in the tax year for the coding adjustment to be made, in which case any underpayment will be collected by adjustment to the following year's code
- a spouse or civil partner dies, triggering an increase in the state pension of the survivor

4.22 When the underpayment has been collected (which can in some cases take between 12 and 23 months) the tax code will change again to reflect that.

4.23 Such underpayments have become less frequent with the advent of 'dynamic coding', under which coding adjustments are made in real time and an annualised value is included in the coding estimate. In most cases, the coding change will collect the right amount of tax over the year in which the state pension is first received.

4.24 The main practical cause of confusion, leading to pensioners calling HMRC, is the fact that their tax code has changed and there is insufficient explanation of the reason. One of the three (similarly worded) explanatory notes that the pensioner will get is as follows:

"This income is taxable but tax is not taken off the payments before they are paid to you. We use your tax-free allowance against your pension so you pay tax on this. We have reduced your tax-free amount by the estimated amount of pension we think you will receive this year. You don't pay National Insurance contributions when you reach State Pension age so your employer(s) or pension provider(s) should not take National Insurance contributions from you. For more information go to www.gov.uk/tax-national-insurance-after-state-pension-age/stopping-paying-national-insurance"

4.25 This wording is somewhat opaque and the OTS suggests that it is rewritten to provide a much clearer explanation.

4.26 While the PAYE system will usually catch up in time, it is not always easy for the taxpayer to know how things stand or whether things have settled down.

Illustrative case study 4.B: Alfred and Annie – pension tax codes

Alfred is 77 and his wife, Annie, is 75. They each receive a combination of state and private pensions.

Alfred gets a state pension and two private pensions, one of which increases annually in line with inflation, and one which pays out a fixed amount every year, with no increases for inflation.

Alfred's tax codes were incorrect, so that for two years either too much or too little tax was collected. Alfred got letters from HMRC at the end of each year telling him that he either needed to pay or would get a refund. Alfred became increasingly uncertain about the system, which he did not trust to get his tax right. He could not afford to pay an adviser.

A friend suggested he could contact a tax charity that he had found helpful in dealing with HMRC. The charity adviser got the code corrected so that tax on the small non-increasing pension was taken from the bigger pension. This worked for a year but at the end of the year the HMRC system reverted to the previous position. Alfred noticed that the codes had changed, and the charity helped him get them corrected, but there remains a worry that it will go wrong again.

Annie has three pensions in addition to her state pension. Two are quite small pensions: one is more substantial, reflecting 20 years' work for a local school. The HMRC system incorrectly applied a code to one of the smaller pensions that tried to collect all the tax due across all the pensions. The tax due was more than the amount of the smaller pension and so some tax was uncollected. Annie got a letter from HMRC at the end of the year telling her that she had underpaid tax and needed to pay more next year.

Annie did not understand how the underpayment had happened and was not sure that it was due. She tried to search online for the answer but finds it all quite confusing. She called the HMRC helpline but gave up after a long wait.

Annie decides to try the charity who have helped Alfred. They explain that the tax needed to be taken from the bigger pension so that it will all be paid each month. They contact HMRC and the problem is resolved: the additional tax for the underpayment is taken each month from the bigger pension. Annie is relieved that the debt can be paid painlessly in this way and hopes that it will not happen again.

4.27 Clearer information on tax coding notices and greater access to information through the personal tax account will help, together with continued improvements to the PAYE/Real Time Information systems, and dynamic coding. This could enable information about new income sources to be more quickly included into PAYE codes which take overall account of the individual's income.

4.28 The OTS has recently called for a renewed and continuing focus in this area,[10] recommending that 'a strategic focus on the PAYE system should be an HMRC priority to ensure effective implementation of improvements and system changes'.

Recommendation 10

HMRC should improve the explanatory notes provided with tax coding notices issued when people first receive the state pension, or another pension.

4.29 In addition, as noted at paragraph 2.50, recommendation 5 is highly relevant in the context of people who begin to receive pensions.

The state retirement pension and K-codes

4.30 Sometimes to collect the right tax in relation to the state pension, it is necessary to apply a special type of tax code, called a 'K-code', to another source of income that is within PAYE.

4.31 This happens if the state pension is larger than the personal allowance, so that the excess must be treated for PAYE coding purposes as additional income on which tax is payable in relation to another source of income. This can happen if there is a relatively large state pension resulting from contributions to the State Earnings Related Pension or the Second State Pension.[11]

4.32 If the state pension is (say) £15,000, then the personal allowance of £12,500 is completely used up, and the excess of £2,500 (£15,000 less £12,500) will

[10] See the OTS's May 2019 report on 'Simplifying everyday tax for smaller businesses', recommendation 2 https://www.gov.uk/government/publications/simplifying-everyday-tax-for-smaller-businesses

[11] https://www.gov.uk/additional-state-pension/eligibility

appear on the coding notice as additional taxable income, resulting in a code of K250.

4.33 What the K-code of K250 means is that the employer is told to add £2,500 to the occupational pension of £5,500 (a total of £8,000). This total is taxed at 20% giving tax of £1600 (the correct amount), but which has all to be taken from the occupational pension.

Illustrative case study 4.C: Ellen

Ellen has a state pension of £15,000 and an occupational pension of £5,500.

State pension	£15,000
Occupational pension	£5,500
Total	£20,500
Tax on £20,500:	
On first £12,500	NIL
On remaining £8,000 @ 20%	£1,600
Total	£1,600

4.34 The tax of £1,600 will then be collected via PAYE from the £5,000 occupational pension leaving Ellen in possession of the whole of her state pension and £3,400 of his occupational pension.

4.35 K codes can cause anxiety and confusion among older taxpayers as to why more tax is collected from their private pension than they expect should be directly due on it. Nor is it clear to them that the extra tax relates to their state pension, which many of them mistakenly believe to be non-taxable.[12] (Understanding is not helped by the fact that some benefits paid with the state pension, such as the winter fuel allowance, are non-taxable.)

4.36 To limit the amount of tax taken off each payment, a K-code is not used to collect more than 50% of a given source of income, so where the whole of the tax due on an untaxed source cannot be collected by this means, the individual may be asked to complete a self-assessment return in order to collect the balance, as illustrated in case study 4.D.

4.37 In 2010-11 there were some 29,000 pensioners in this category, a figure that was expected to fall as the number of pensioners with State Retirement

[12] Prof Jane Frecknall-Hughes: 'The tax problems experienced by older people'– see https://www.tax.org.uk/sites/default/files/July%202017%20%E2%80%93%20The%20tax%20problems%20experienced%20by%20older%20people.pdf page 12.

Pensions greater than the personal allowance diminished over time and the personal allowance increased.[13]

Illustrative case study 4.D: Zara

Zara has State Retirement Pension of £15,000 and an occupational pension of £1,000.

Her tax liability is as follows:

State pension	£15,000
Occupational pension	£1,000
Total	£16,000
LESS personal allowance	(£12,500)
Taxable income	£3,500
Tax due at 20%	£700

Zara's total tax bill of £700 is too large to be collectable from her occupational pension because the 50% rule only allows £500 to be taken from the occupational pension through PAYE.

The remaining £200 may have to be collected through self-assessment. Zara must complete a self-assessment return, and HMRC must process the return, to collect £200.

4.38 More recent HMRC data shows that the number of pensioners with state pension close to or exceeding the personal allowance is on the increase. In 2015-16, when the personal allowance was £10,600, there were 1,130,000 pensioners with a state pension greater than £10,000 per annum, and in 2016-17 when the personal allowance was £11,000 the equivalent figure was 1,276,000.[14]

4.39 It would be simpler if HMRC were able to extend the new 'simple assessment' approach to a wider group of taxpayers.

4.40 More widely, K codes can work perfectly well, but are poorly understood and ill-explained. This leads to confusion and errors being made by taxpayers, pension providers or employers, or in fact by HMRC.

4.41 For example, where there is more than one source of PAYE income, the K code is sometimes applied to the smaller rather than the larger source, which means that it is more likely that the 50% barrier will be exceeded and

[13] Office of Tax Simplification: 'Review of pensioners' taxation: Final report' (January 2013). Para 4.5

[14] HMRC data.

an underpayment arise,[15] or the taxpayer is more likely to be put into self-assessment to collect the remaining tax.

4.42 The OTS has reported on the tax problems of pensioners before. Recommendations made by the OTS and others that DWP should operate PAYE on the State Retirement Pension or issue a DWP P60 at the end of each year to every pensioner, setting out which benefits they receive are taxable and which non-taxable, has not proved practicable.

4.43 While it is perhaps understandable why PAYE would be complicated and costly to operate for millions of pensioners, many of whom are not taxpayers, there could be merit in including some information about the tax treatment of the state pension when the annual letter is sent out on the state pension increase.

4.44 Another constraint is the fact that levels of digital capability tend to be lower among older people[16] so any online-only solution is likely to be unsuitable for a significant minority. If older people are to see the benefit of any improvements in the information given on coding notices, for example, such notices must continue to be issued in paper form as well as through the Personal Tax Account.

4.45 Dynamic coding (adjusting codes in real time to keep pace with changes in taxpayer's income), if applied sensitively, will also make a difference, as this improves.

Recommendation 11

HMRC should explore the potential for developing automated checks or other tools for 'designing out' errors such as the allocation of 'K-codes' to smaller PAYE sources.

Multiple pensions

4.46 When pensioners have multiple income sources, such as the state pension, one or more occupational or private pensions, and perhaps earnings from a job, it is possible for a personal allowance to be set against each source, in error.

4.47 When this happens, the duplication of allowances results in an underpayment of tax. It can easily take two or more years for the system to catch up with this, resulting in a substantial tax bill which causes the taxpayer distress and may not be easy for them to pay.

4.48 Separately, problems sometimes arise where a taxpayer has more than one pension with the same pension administrator, but the processing of these multiple payments is treated as involving duplicate payments. The OTS has

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15 Prof Jane Frecknall-Hughes: 'The tax problems experienced by older people'– see https://www.tax.org.uk/sites/default/files/July%202017%20%E2%80%93%20The%20tax%20problems%20experienced%20by%20older%20people.pdf page 12.

16 See ONS, Exploring the UK's digital divide, March 2019: "Since 2011, adults over the age of 65 years have consistently made up the largest proportion of the adult internet non-users, and over half of all adult internet non-users were over the age of 75 years in 2018".

heard that this issue, which HMRC acknowledged in December 2017,[17] continues to cause problems. This is both for individuals needing to claim a tax repayment (as HMRC systems may only show one payment) and for pension administrators (who HMRC erroneously thinks have overpaid).

4.49 A large number of pensioners have multiple income sources (9,250,000 in 2016-17).[18] So recommendation 5 (see paragraph 2.50) also applies in this context.

Death and bereavement

Introduction

4.50 The death of a partner is never easy for the survivor or other family members. But tax issues, whether relating to the deceased or the survivor, often create problems that, by their very nature, are new and often complicated.

4.51 Such changes can prove particularly difficult for the survivor of a couple where the deceased partner handled most financial matters, or indeed anyone who has been used to their own tax affairs being handled through the PAYE system.

4.52 The difficulty can be exacerbated by certain system errors that can arise following a bereavement. Such errors can create overpayments or underpayments of tax which the survivor is unlikely to notice unless they have a professional adviser to spot mistakes or omissions in their PAYE coding or simple assessment letters. Those who self-assess are more likely to get to the right answer, provided they complete their tax return correctly.

4.53 HMRC has over the past few years put in place procedures designed to make life easier for personal representatives. Chief among these are HMRC's participation in the Tell Us Once service and the specialist Bereavement Service located in Cardiff. But simpler procedures can come at the expense of complete accuracy, and the forms issued following a report of a death can contain a significant amount of duplication.

Registering a death – Tell Us Once

4.54 When a death is registered, in most areas[19] the registrar will offer a government service[20] known as Tell Us Once (TUO) which the person reporting the death can access by phone or online. This ensures that the person reporting the death only has to do so once, specifying who is responsible for handling the deceased's affairs and which government organisations they wish to be informed. Among these are HMRC and DWP,

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17 https://www.gov.uk/government/publications/pension-schemes-newsletter-94-december-2017/pension-schemes-newsletter-94-december-2017#reporting-multiple-small-pots-payments-through-real-time-information-rti

18 HMRC data.

19 https://www.gov.uk/after-a-death/organisations-you-need-to-contact-and-tell-us-once - provides a list of areas that do not provide it.

20 On behalf of the Department for Work and Pensions.

which should then make contact to finalise the tax and benefits position of the deceased.

4.55 The information gathered through the TUO process includes personal details of the deceased such as date of birth and NINO, and the identity of the next of kin, the surviving spouse or civil partner, and any person or company dealing with the estate (the executor or administrator).

Initial contact from HMRC following death

4.56 When a death is reported to HMRC, whether or not through the TUO process, this triggers an "automated process that calculates the tax liability of the person who has died based on information HMRC already holds".[21]

4.57 Under this process, where HMRC have been told who the personal representative is (as would normally happen under the TUO process), a form (P1001) is issued containing a short factsheet and asking for details of any agent who may be acting.

4.58 If HMRC are not told who the personal representative is, a form P1000 is sent automatically by the system 16 days after HMRC is notified of the death. This form asks for details of the "administrator, executor or personal representative". It also asks if a solicitor or accountant is to be appointed to act on behalf of the personal representative and provides a form for the personal representative to sign to authorise the agent to act.

4.59 Although the P1000 should not be issued if the death is notified through TUO, as HMRC will normally then have information about the personal representative, the OTS has heard of cases where the P1000 is issued in such cases. One possible reason for this is HMRC had not received details of the personal representative until after the P1000 had been issued, in which case HMRC manually issue a P1001.[22]

4.60 Where personal representatives use the TUO procedure, and do then receive forms P1000 and P1001, they are asked for the same information more than once. The OTS was told that where such duplication arises, callers see it as unnecessary bureaucracy, especially at such a sensitive time. The forms are also seen as poorly worded and lacking in empathy.

4.61 As both P1001 and P1000 ask if any third party such as a professional adviser is acting, HMRC will accept these in place of the usual form for appointing an agent (form 64-8). This can be an effective way of enabling the deceased's existing agent to continue to wind up their late client's affairs with minimum bureaucracy. Nevertheless, the OTS has been told of a case where that transfer of authority did not appear to work, and the agent had to wait for a form 64-8 to be processed before being authorised to act in resolving the deceased's tax affairs.

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[21] Trusts and Estates Newsletter, June 2015.

[22] Where the deceased was in self-assessment, two different forms are used – the P1004 and P1000 (SA).

4.62 These forms replaced two previous forms[23] that were misunderstood more than half the time.[24] The OTS understands that the process was changed to improve customer experience, because the onus was on the customer to complete the form and agent fees were often involved. However, the OTS has heard that professional agents and voluntary sector advisers found one of the forms, R27, to be a useful checklist and an effective way of establishing communication between the Personal Representative (PR) and HMRC. It is 'sorely missed' by some.

4.63 Reliance by HMRC on information they already hold can lead to mistakes in calculations where data is wrong or missing. An article in Taxation magazine[25] gives a number of examples: one case in which a pension paid to the deceased's widow was quite simply missing from HMRC's records; another where the widow and personal representative received a repayment for £1,500 and subsequently a demand for £420, when the correct position was a repayment of a further £1,609.

4.64 Instances such as those tie in with what the OTS has heard from HMRC's Bereavement Service about what happens when a taxpayer's death is reported. On receipt of the TUO form, the state retirement pension is stopped. This will often result in a tax repayment for the year of death because the PAYE system spreads out entitlement to the personal allowance through the entire year during which the death occurs. But in simple assessment cases, where the deceased had underpaid tax in the previous tax year, this can go uncollected.

4.65 If the TUO process goes smoothly, any underpayment in the year of death will be repaid to the estate and the deceased's tax account closed. This could happen before the previous tax year has been reconciled, stranding any underpayment which may then be written off. The estate will most likely not have been finalised and remains open. Conversely, an underpayment may arise in the year of death if HMRC's calculations do not take account of other taxable income which HMRC may not know about.

4.66 The current process has advantages. It

- is automated
- reduces form-filling required from personal representatives and survivors

4.67 However, it can be prone to duplication and is not error-free. This leads to complaints and sometimes the need to pay financial compensation to complainants.

4.68 It is clearly a challenge to balance HMRC's wish to minimise the burden on the relatives of deceased people against their need to have a more complete

[23] One (R27) asking for information about the income of the deceased and tax paid to the date of death. The other (P161(W)) which asked for the sources of income of the bereaved spouse, which were often inherited by the survivor. This helped HMRC see what would change for the surviving spouse or partner.

[24] Trusts and Estates Newsletter, June 2015: "The R27 was burdensome on several levels . . . the error rate was extremely high in completing the form. In excess of 50% of forms had to be returned."

[25] Death and Taxes: Taxation, 22 February 2018.

view of the deceased's tax affairs, and to be able to deal with the survivor (whether through a personal representative or not) at a particularly sensitive time. Repayments stemming from HMRC errors range from a few hundred pounds up to tens of thousands.

4.69 The extent and context of these problems is such that a dedicated team has been established within HMRC to handle this particular 'life event'. It is not clear however that this team's suggestions are consistently being acted on, presumably in the face of other pressing issues.

Common errors

4.70 As noted above, certain system-generated or human errors in handling a deceased person's affairs can cause overpayments or underpayments to arise for the survivor.

4.71 For example, a surviving spouse or civil partner may inherit their late spouse's private pension or additional state pension, or a reduced widow's pension may be augmented by inheriting the spouse's retirement pension

4.72 In such cases, it may take the tax system some time to assimilate the resulting increase in the survivor's taxable income. Commonly, both the deceased (before death) and the survivor will have had their tax-free income (chiefly their personal allowance) set against their PAYE coding. HMRC's 'needs extra support' teams have had to resolve cases where the survivor has received duplicate personal allowances through the coding on their existing pension and the inherited pension. Underpayments occur as a result.

4.73 Another example is where the deceased person was part of a married couple or civil partnership one of whom was born before 6 April 1935, one or the other might have received the Married Couple's Allowance (MCA) (see paragraph 1.45). Entitlement to the MCA continues for the year of death, but the allowance is sometimes withdrawn for that year in error.

4.74 The OTS has heard of cases where an underpayment arising from an incorrect coding of an inherited income source is countered by premature withdrawal of the MCA, creating a situation which is difficult to resolve. People in this situation may not immediately realise there has been an error and that they have overpaid tax.

4.75 For example, the OTS was informed of a case in tax year 2013-14 where, following the death of the taxpayer's wife, HMRC updated the taxpayer's tax code, removing the married couple's allowance. The following year the taxpayer learned from a charity that the married couple's allowance should not have been removed from his code for the year of his wife's death, as he was entitled to the allowance for the full year. HMRC acknowledged this, but because it was nearly the end of the tax year, it could not be added back, and had to be resolved separately.

4.76 It would be helpful if HMRC's systems left the deceased's tax affairs in the year of death and in the preceding year remain open to view in simple assessment cases until the estate has been finalised, and enabled any repayment due for the year of death has been netted off against any underpayment for the preceding year.

Recommendation 12

HMRC should review the current series of forms issued once a death has been notified through 'Tell Us Once' and consider how they could work more effectively with personal representatives to gain a complete view of the tax affairs of the deceased person, and the survivor, rapidly and sensitively.

Chapter 5
Helping others

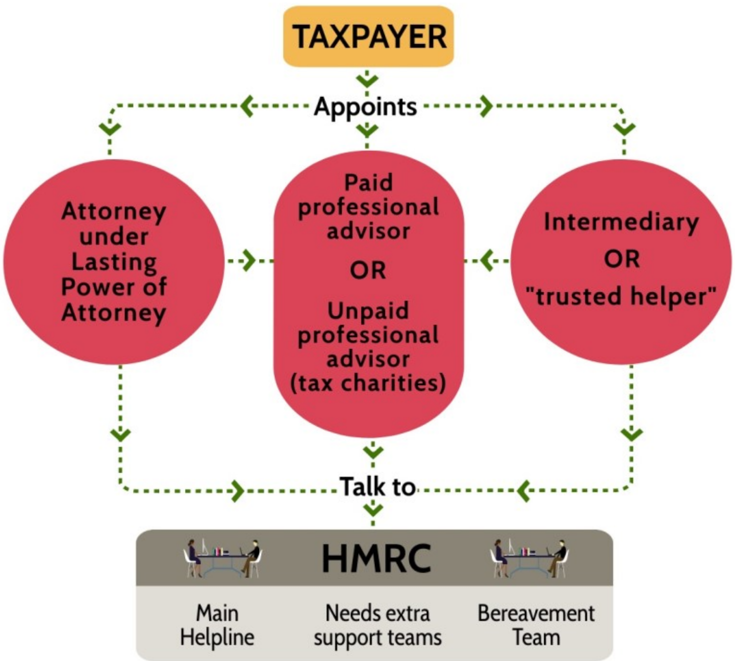
Introduction

5.1 People may benefit from help in handling their tax affairs for a variety of reasons: they may have a mental health issue or other disability, be less able to face dealing with their affairs because of a bereavement or other distressing life event, or may simply prefer this to be done by someone more capable or knowledgeable than they may be.

5.2 Options available include:

- appointing someone to have power of attorney
- asking a friend or family member to help, in which case the helper may apply to HMRC to be recognised as an 'intermediary' or a 'trusted helper'
- appointing an agent to act for them, who may be a paid professional, or, if the individual qualifies for free help, a volunteer with one of the tax charities[1]

Chart 5.A: Options for taxpayers wanting help with handling their tax affairs



Source: OTS

[1] Such as TaxAid or Tax Help for Older People.

Appointing an attorney

5.3 Appointing someone to have powers of attorney is something done under general law, rather than being specific to tax, and can in particular be done on a 'lasting' basis.[2] This works in essentially the same way across the UK, though some of the procedures are different in Scotland and Northern Ireland from those in England and Wales.

Intermediaries and trusted helpers

5.4 HMRC use the term 'intermediary' to describe 'a friend, relative or voluntary organisation' who a taxpayer can appoint to deal with HMRC for them if the taxpayer is 'ill, has a disability or does not speak English'.[3] An intermediary can talk to HMRC and answer any questions on the taxpayer's behalf, or fill in forms for them, but cannot get access to their tax online.

5.5 Alternatively, as a 'trusted helper' one can manage the person's tax affairs online.[4] Trusted helpers can include a son or daughter helping an elderly parent who finds dealing with tax returns too much of a struggle, someone helping a friend or relative who is abroad, or perhaps a parent helping a child who, owing to a disability or mental health condition, cannot deal with their own affairs.

5.6 Once appointed, a trusted helper can, for example:

- check the taxpayer is paying the right amount of income tax
- check or update their personal tax account
- claim a tax refund

5.7 However, a trusted helper cannot submit a self-assessment return in the way that an agent can.

5.8 There is a prominent note on the relevant GOV.UK page informing the taxpayer that they continue to bear responsibility for their own tax, even if they appoint a trusted helper.

Tax agents

5.9 A tax agent, whether or not a professional – being an accountant, lawyer or tax adviser who is a member of a professional body, may be appointed to act for the taxpayer.[5]

5.10 All paid tax agents registered with HMRC have to meet minimum standards set by HMRC,[6] including anti-money laundering compliance, whether professionally qualified and regulated or not.

[2] www.gov.uk/power-of-attorney/make-lasting-power

[3] https://www.gov.uk/appoint-tax-agent - 'Appoint someone to deal with HMRC on your behalf'

[4] https://www.gov.uk/help-friends-family-tax

[5] https://www.gov.uk/appoint-tax-agent

[6] https://www.gov.uk/government/publications/hmrc-the-standard-for-agents/hmrc-the-standard-for-agents

Tax charities

5.11 For individuals who are unable to afford professional fees, there are two tax charities to which they can turn for help.

- TaxAid was founded in 1992 and helps around 7,000 taxpayers a year, particularly working age people with mental ill health or long-running tax debt
- Tax Help for Older People was established in 2002 to help low-income individuals following or approaching retirement, and assists around 15,000 taxpayers a year

Illustrative case study 5.A: John – trusted helper

John's recently widowed mother Susan is 85. Although Susan is quite well able to manage her finances in general, the death of her husband Mark has brought a range of additional complexities into her financial affairs.

Mark had two pensions, a number of ISAs and other financial products and assets, in addition to their jointly-owned home. Following his death, Susan receives income from a state pension and three personal pensions (one from her years as a teacher, and two widow's pensions). There is a need to ensure that tax is properly collected on these, and that appropriate codes are issued to the pensions.

Susan and John understand that tax needs to be collected from the pensions and are aware from previous experience that this can go wrong. Susan is very keen to ensure that her tax affairs are in order so that she does not overpay or underpay.

The combination of complexity and the grief of her recent loss make it difficult for her to deal with her affairs on her own. She asks John to take over day-to-day management of the process of transferring the ISAs and pensions into her name and managing the tax consequences.

John searches online for guidance on how to support his mother in her dealings with HMRC. He sees that he can help her with her income tax return and related matters by simply calling HMRC in her presence. This is helpful initially as he tries to establish what is happening and what HMRC knows about the changes in Susan's tax position. HMRC tell John that they don't think Susan needs to complete an income tax return, as all her income can be collected by PAYE from her pensions.

However, it will be important to check the codes are right and seek to collect the tax from pensions that are large enough. They tell John that he will be able to check this if he registers to help his mother with her tax.

John follows the online process at https://www.gov.uk/help-friends-family-tax. He is able to register through the online portal and his mother confirms that she wants him to have access to her accounts. Once the process is completed, John can see Susan's personal tax account and her income tax codes and can agree any necessary changes with HMRC.

5.12 Both charities harness the skills of tax professionals to give free help and advice to clients.

- TaxAid operates mainly via a helpline but also offers face-to-face advice in London and in certain major cities. It also takes referrals from voluntary sector advisers
- Tax Help for Older People also has a national helpline and runs 'surgeries' around the country in the premises of partners such as Age UK and Royal British Legion

5.13 They each make referrals to, and take referrals from, HMRC's Needs Extra Support (NES) team, which can help vulnerable taxpayers with routine matters, but is not equipped to provide support in terms of calculations, independent advice or where there is a dispute.

5.14 The tax charities are funded mainly by the tax and accountancy professions but also other grant-making institutions and by HMRC.

Practical experience and HMRC guidance

5.15 An agent can be appointed using form 64-8 or via an online process.

5.16 To appoint an intermediary, the taxpayer must write to HMRC with their name and address, tax reference number, details of the intermediary they wish to appoint and their signature.

5.17 To appoint a trusted helper there is an online process[7] involving the helper proving their identity using GOV.UK Verify. This can be a bit cumbersome and has suffered from lower than expected take-up and a low success rate.[8] Recent figures show that just under half of users have succeeded in verifying their identity using the system, and only 1,212 people have been accepted as trusted helpers through the GOV.UK Verify system between 2017 and July 2019.[9]

5.18 Whether for this reason or because the limited facilities that being a trusted helper offers, the OTS has been told that people circumvent the process by logging on to the Personal Tax Account of the individual they are helping, using that individual's identification details.

5.19 It has also been suggested to the OTS that HMRC might usefully consider using an easier route for verification, such as Government Gateway, given

[7] https://www.gov.uk/help-friends-family-tax - 'Help family or friends with their tax.'

[8] National Audit Office report 'Investigation into Verify', March 2019, para 4 of page 4: by February 2019, 3.6 million people had signed up through Verify as against a target of 25 million by 2020. As of February 2019, 48% of users were successful in having their identity confirmed by the system as against a 2015 target of 90%.

[9] HMRC data.

the recorded problems with Verify and the fact that it will no longer be financed by government after March 2020.[10]

5.20 Holders of powers of attorney are not mentioned at all in the public-facing guidance on GOV.UK mentioned above, and the OTS has been told that it can be difficult for those who are attorneys to know how to register that fact with HMRC.

5.21 The internal HMRC manual[11] indicates how this can be done, but the OTS has heard from various sources that the absence of public-facing guidance causes uncertainty.

5.22 The OTS considers that it would be timely for HMRC to provide practical, public-facing guidance on how attorneys can be recognised by HMRC, given that the number of registrations of lasting powers of attorney has increased from around 300,000 (6,000 a week) during 2014 to around 780,000 (15,000) a week during 2018.[12]

5.23 The OTS has received suggestions that an online link between HMRC and the Office of the Public Guardian, with whom such powers are registered, could simplify matters and reduce administration for everyone, perhaps by HMRC using this to verify such registrations.

5.24 The HMRC online guidance on GOV.UK gives the misleading impression that unpaid agents, such as family, friends or voluntary organisations, must adhere to the same standards as paid agents. However, this is not necessarily the case (and will depend on whether the agent is a member of a professional body and its rules).

5.25 In particular, the anti-money laundering rules only apply to professional agents carrying on a business, not to professionally qualified individuals assisting their relatives for no fee or to voluntary organisations acting for no reward. The guidance is also unclear about whether unpaid agents have to register with HMRC using form 64-8. These are examples of matters that could be addressed in the public-facing guidance recommended above.

Deemed consent

5.26 More widely, HMRC has a process of 'deemed consent' where they will give answers to a specific query to the helper if the taxpayer is in the room with them and comes on the phone to confirm their identity and to give their consent for HMRC to talk to their helper about their affairs.[13]

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[10] https://www.nao.org.uk/report/investigation-into-verify/

"The Cabinet Office announced in October 2018 that government would stop funding Verify in March 2020. After March 2020 the government digital service's intention is for the private sector to take over responsibility for Verify."

https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-10-09/HCWS978/

[11] Information Disclosure Guide IDG30431 https://www.gov.uk/hmrc-internal-manuals/information-disclosure-guide/idg30431 and following pages.

[12] https://www.gov.uk/performance/lasting-power-of-attorney

[13] https://www.gov.uk/help-friends-family-tax - Help family or friends with their tax.

5.27 HMRC guidance[14] explains that this "is about making it easier for those who need extra support to seek help through intermediaries, such as unpaid agents (e.g. friends, family, voluntary sector)". The facility is available on PAYE, self-assessment and National Insurance helplines only.

5.28 If the taxpayer is not in the room when their helper calls, HMRC may take on board information given by the helper but may not divulge any personal information about the taxpayer. Any follow-up correspondence must go directly to the taxpayer, not the helper.

5.29 DWP have a comparable process known as 'alternative enquiry' (though not currently in relation to Universal Credit).[15] DWP will take information from the helper and also answer their specific questions about the person they are helping, without written authority, or the claimant being present.

5.30 The helper has to demonstrate that they know certain things about the claimant (such as their NINO, date of birth, address, and aspects of their benefits affairs). The helper can only ask questions that the DWP would expect a genuine representative to ask (for example progress chasing or asking the reason for a decision) or quotes from DWP correspondence with the claimant.

5.31 While recognising the need for taxpayer confidentiality, it has been suggested to the OTS that HMRC consider whether HMRC could, consistently with that duty, follow DWP practice in some matters. This would mean that the taxpayer does not have to participate at all in the helper's contact with HMRC (for example, where the taxpayer has dementia, or is unable to use the phone).

HMRC's Needs Extra Support team

5.32 If an individual finds themselves in particularly vulnerable circumstances, such as a mental health issue, a bereavement or communication difficulty such as hearing or sight impairment, they may need more help from HMRC than is available through the usual helplines or online.

5.33 Accordingly, after HMRC's local enquiry centres were closed in June 2014, a nationwide mobile and telephony support service was launched for individual taxpayers who required extra support over and above that provided by the telephone contact centres.

5.34 This Needs Extra Support (NES) team[16] is available to those who, when calling one of the standard HMRC telephone lines, show at least one of a number of characteristics that marks them out as in some way vulnerable in

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[14] https://www.gov.uk/hmrc-internal-manuals/information-disclosure-guide/idg30447 - Information Disclosure Guide IDG30447.

[15] https://www.gov.uk/government/publications/working-with-representatives-guidance-for-dwp-staff - Working with representatives: guidance for DWP staff.

[16] Initially known as 'Needs Enhanced Support'.

relation to their tax affairs. Nearly 111,500 taxpayers were supported by NES in 2018-19.[17]

5.35 There is also an online form for those who are deaf or hard of hearing or have a speech impairment to request a face-to-face appointment with the NES team.

5.36 An evaluation of NES was published by HMRC in June 2015.[18] In April 2019 it was announced that NES would in time extend its remit to help individuals in need of extra support during a tax investigation or compliance check.[19]

5.37 The OTS is encouraged to learn that HMRC is continuing to further develop their strategy for supporting individuals in vulnerable circumstances to improve their experience of the tax system.

5.38 Once a case has been passed to the NES, the NES team works with the individual until their issue is resolved. To facilitate this, mobile staff are able to go see customers in DWP Jobcentres or even in their own home.

5.39 The kind of problems NES case workers deal with range from help with completion of tax returns, including VAT and corporation tax, helping the taxpayer to file online, explaining PAYE codes (often the very basics are a mystery to the taxpayer), the distinction between self-employed or employed status where the official guidance is unclear, handling tax debt, and dealing with the fall-out from scams.

5.40 Some queries involve the cross-over between tax, tax credits and benefits such as Universal Credit: for example, if a payment of wages is reported late or early, or appears on the DWP's systems a day or more after it has been reported to HMRC, and the taxpayer's universal credit award is affected as a result. The OTS considers that closer working between the respective departments' officials at this level would benefit both departments by enabling problems, involving both tax and benefits systems, to be resolved in one session (a 'once-and-done' approach).

5.41 The OTS have learned from speaking with the NES team that an estimated 94% of referrals arose from not being able to understand the rules, and being afraid of getting things wrong:

> "I'm afraid to fill it in wrong because you [HMRC] will come and knock on my door."

5.42 The fear factor gets worse if the customer has ignored successive HMRC communications (a series of brown envelopes), so that problems escalate and, for example, penalties multiply.

[17] HMRC Annual Report and Accounts 2018-19, page 43.

[18] www.gov.uk/government/publications/evaluation-of-the-needs-enhanced-support-service-national-roll-out

[19] https://www.gov.uk/government/publications/hmrc-issue-briefing-support-for-customers-who-need-extra-help/hmrc-issue-briefing-support-for-customers-who-need-extra-help

5.43 The NES teams try to apply an 'educative' approach: if the individual does not understand the wording of a form, the NES team explain it so that they are able to understand it in the future. If the query is about a process, the team will take the enquirer through step by step, so as to increase their confidence.

5.44 The OTS was told that many customers of the NES teams find HMRC standard letters threatening or impersonal. The OTS considers that these letters would benefit if NES case workers, with their unique skills and experience, were consulted on how they are drafted.

Increasing pace of digitalisation – help for those who are digitally less capable

5.45 One of the circumstances in which individuals may be, or become, vulnerable is if they lack digital skills or internet access.

5.46 Over the last two decades or so, HMRC has been gradually moving more of its services online and cutting back on more traditional paper channels.

5.47 There is no doubt that the use of technology has greatly streamlined tax administration and offers many opportunities for future simplification. The possibilities of the personal tax account in this sphere are a prime example. The adoption of online filing of income tax self assessment returns demonstrates that millions of taxpayers are happy to use online solutions.

5.48 But, as the OTS has noted in its Technology Review[20] there is also a risk of leaving behind those who are less digitally capable. With nearly all official HMRC guidance now available only online, and the increasing requirements for businesses to interact with HMRC online, most businesses will need to use technology to comply with their tax obligations. Individuals who cannot access the internet, or who are not comfortable with technology, may also find that complying with their tax obligations becomes more difficult as the emphasis shifts to online channels.

5.49 HMRC-commissioned research published in 2015,[21] showed that 15% of the general UK population (7.5 million adults) are digitally excluded, meaning that they are either unable (4 in 5) or unwilling (1 in 5) to access the internet. Comparable figures[22] for 2018 point to 10% digital exclusion (5 million adults).

5.50 Despite this improving trend, those who are incapable or not comfortable using computers and the internet are a large enough minority to justify HMRC in taking steps to ensure their experience of the tax system is considered alongside that of the majority for whom digitisation is a significant help.

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20 Technology Review: a vision for tax simplicity (OTS January 2019) para 1.117ff.

21 HMRC Digital exclusion and assisted digital research, August 2015 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/457800/Digital_Exclusion_and_Assisted_Digital_research_publication_report.pdf

22 ONS, Exploring the UK's digital divide, March 2019.

5.51 The OTS is aware that HMRC has started an internal project looking to extend the service the NES teams provide to taxpayers under enquiry, recognising that vulnerable people may make mistakes that result in a detailed examination of their tax affairs, but still need a greater than usual level of support.

Process and expectation challenges

5.52 As noted above, the GOV.UK page dealing with trusted helpers makes clear that the taxpayer still bears the legal responsibility for their tax affairs when a trusted helper is appointed. It is reasonable to ask though, in practical terms, how 'responsible' someone can be if they lack capacity, and how 'responsible' their helper then in reality becomes.

5.53 The OTS has heard that it is particularly difficult to persuade people to focus on tax and similar matters if day-to-day living has become a struggle, and even more so if their capacity to deal with their finances has diminished owing to disability, illness, or conditions such as dementia.

5.54 The challenge for HMRC is to enable the vast majority of people who want to do the right thing, or to help ensure that others' responsibilities are fulfilled, to be able to do this easily, while ensuring a proportionate response to compliance risks.

5.55 Such issues also arise as a result of the increasing use of mechanisms designed to help the taxpayer, such as pre-population of figures in tax returns, as discussed in the OTS's Technology review.[23]

5.56 If these figures are wrong, it may not be realistic to expect a taxpayer in vulnerable circumstances to spot the mistakes. Such taxpayers are more likely to trust that anything coming from an official source is correct, and will distrust their own workings if they are different.[24] The helper may be equally in the dark, and feel obliged to engage a professional agent, particularly if they themselves have no particular tax expertise.

5.57 Sometimes taxpayers can receive help in carrying out tasks for which they are responsible, such as the 'Tell Us Once' service whereby a report of a death to the registrar is passed on to several government departments, including HMRC and DWP. Such mechanisms do things that the taxpayer is required to do, but if they fail, the taxpayer is still technically responsible.

5.58 A comparable example is the PAYE system, which deducts tax from the earnings of employees without them having to do anything. However, once they leave employment to take up self-employment for example, they become solely responsible for their tax, probably from a base of little knowledge of the tax system. Or if something goes wrong with their PAYE and too little tax is deducted, the taxpayer (or in some cases their employer) remains responsible for making good the under-deducted tax.

[23] Technology Review: a vision for tax simplicity (OTS January 2019) para 1.22ff

[24] See Chapter 5 in 'Digital Revolutions in Public Finance', IMF 2017, ISBN 9781484315224, Gupta, Keen, Shah and Verdier. Chapter 5 by Chen, Grimshaw and Myles.

5.59 Nevertheless, such mechanisms can make a big contribution towards easing and simplifying the tax experience of most people. In a similar way there are mechanisms internal to HMRC that could help alert them to a taxpayer's disability or lack of capacity.

5.60 One possibility would be an option to flag a taxpayer's record to indicate such characteristics, to alert officers dealing with that individual to their likely needs. Such a mechanism might help to avoid situations, like a now vulnerable but previously compliant taxpayer accruing daily penalties for failure to file a tax return, or a previously prompt payer having a debt enforced because they can no longer handle correspondence. It could also help HMRC decide on an appropriate way to treat a taxpayer who they can see has a learning or communication difficulty.

Conclusions

5.61 HMRC has provided or supports a variety of ways in which people who may benefit from help in handling their tax affairs can be supported, either by helpers, agents or HMRC.

5.62 However, the OTS particularly noted the confusion experienced by people trying to help others fulfil their responsibilities about what ways could be used to do this.

5.63 The public-facing guidance on GOV.UK about appointing someone to deal with HMRC on behalf of a taxpayer is incomplete and misleading in parts. It leaves out appointment of attorneys; it is unclear about whether voluntary helpers, family or friends, must complete a form 64-8 and comply with money-laundering regulations. It does not make the distinctions between different types of 'helper' clear.

5.64 Given that these are issues that affect many people, as evidenced by the rise in the number of registered lasting powers of attorney (see paragraph 5.22), signposting the ways that people can get help, and explaining how this could be achieved, seem to be a particular gap.

Recommendation 13

HMRC should integrate and improve its various sources of guidance for those helping others, including agents and those with powers of attorney, to help make it easier for suitable people (whether paid or not) to take on such roles.

Chapter 6

Tax education and awareness

> "Tax which each individual is bound to pay ought to be certain, and not arbitrary. The time of payment, the manner of payment, the quantity to be paid, ought all to be clear and plain to the contributor, and to every other person."[1]

Features of an effective tax system and taxpayer engagement

6.1 A common theme across all the areas covered in this report is taxpayers' lack of awareness of various issues concerning their own tax affairs. This ranges from not knowing the basics to specific instances where lack of knowledge can have a significant impact.

6.2 In an ideal world, any tax system would be simple and transparent, allowing the people and businesses that are taxed to understand what the tax is being used for, what the tax is being charged on, how the amount of that tax is calculated and when that tax must be paid.

6.3 Most people would then be able to check that the tax authority is charging them the right amount of tax at the right time. The responsibilities of each taxpayer would be clear, and they would understand their part in funding public services.

6.4 Of course, that ideal world does not exist. Tax legislation needs specialist training and years of experience to interpret, so it needs 'translating' into ordinary English, in the form of guidance, so that non-experts can understand what they must do to comply with the law. In many cases this itself is a difficult task, so people employ expert tax advisers to help them.

6.5 HMRC faces the task of collecting tax as efficiently and cost-effectively as possible. Systems of collecting the tax at its source have evolved to do this for large numbers of people with relatively simple tax affairs.

6.6 The most well-known of these is 'Pay as you Earn' (PAYE), introduced in 1944. This system works well, collecting £162 billion of income tax and £62 billion of employee NICs in 2018-19.[2] In most cases the right amount of tax was collected at the right time.

[1] Adam Smith's second maxim on tax. From 'Wealth of Nations'.

[2] See Chart B on page 5

6.7 However, because of this, the workings of the tax system are often hidden from taxpayers who, as long as things go right or they don't notice things going wrong, are content not to interact with HMRC, who they view in either a neutral or negative way.[3].

6.8 Levels of taxpayer engagement generally will increase as people make more frequent use of personal tax accounts. However, although 19 million taxpayers have opened one up since their launch in 2015,[4] a recent YouGov survey[5] found that only 19% of people realised they had one, and if the tax rules are particularly complex or difficult to understand, then the quality of their engagement will be that much lower.

6.9 People on the lowest levels of income can have very complicated tax affairs, made more complex by the interaction with the benefits system. At the other end of the income range, complex rules have the same effect, for example, people having to self-assess Annual Allowance and Lifetime Allowance pension charges.

6.10 A short study published in June 2019,[6] from Warwick University's Centre for Competitive Advantage in the Global Economy and the Social Market Foundation, based on HMRC data on tax audits, noted that, for self-assessed tax over the last ten years, around £8 billion is not collected from a theoretical total of £48 billion every year.

6.11 This comes from one out of every three of the 10 million taxpayers who file self assessment tax returns. It covers tax lost due to mistakes, as well as through deliberate evasion; it does not cover tax avoidance. But the majority of these 3.3 million people owe relatively small amounts. 2% of these owe the majority of the uncollected £8 billion. The report suggests that some of the rest may be due to mistakes.

6.12 Failing to understand the rules is one of the causes of mistakes, as a result of which people can either overpay or underpay tax, contributing to the tax gap (the difference between the amount of tax that should be paid, and what is actually paid). 10% of the 2017-18 tax gap was due to error.[7] This is

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3 https://www.gov.uk/government/publications/public-perceptions-of-hmrc - June 2017, p5:

"Amongst those with low engagement and minimal contact, HMRC was perceived as a somewhat faceless organisation that was viewed quite neutrally and was generally assumed to be doing a decent job, certainly trying to do its best. It was also assumed to be fairly straight and honest in the way it conducted its role. As an organisation, it was largely believed to be big and bureaucratic and was assumed to be somewhat stretched, with the potential to be more efficient. Finally, it was seen as a powerful body with potentially negative consequences for individuals who experienced an issue with it."

4 HMRC Annual Report 2018/19, Overview (page 6). https://www.gov.uk/government/publications/hmrc-annual-report-and-accounts-2018-to-2019

5 https://www2.deloitte.com/uk/en/pages/tax/articles/tax-education-gap.html

6 http://www.smf.co.uk/one-in-three-self-assessment-taxpayers-under-pay-costing-treasury-8-billion-a-year/

7 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/810818/Measuring_tax_gaps_2019_edition.pdf - see page 10.

estimated to be £3.4 billion across all taxes. This in turn requires HMRC to police and enforce the rules through its various tax compliance activities.

6.13 This analysis of the tax gap and study referred to above both point in the same direction; errors are a common feature of non-compliance.

Approaches to tax compliance

6.14 In the last few decades, there has been increasing academic interest in the idea of 'tax morale', or the level of the intrinsic motivation individuals and societies may have to pay tax.

6.15 Broadly the factors that influence tax morale include people's trust in formal institutions (for example, the government, the tax authority and tax officials), trust in informal institutions (for example, a sense of community, the local and national culture) and personal factors (including gender, age and economic status).[8]

6.16 The OTS report, 'Guidance for taxpayers'[9] observed the vital role clear guidance has on encouraging cooperation between HMRC and taxpayers, one of a number of factors that influence the degree of trust that taxpayers have in HMRC.

6.17 There has also been academic interest in the tax compliance strategies used by tax authorities around the world, leading to an idea called 'the slippery slope framework'.[10] Professor Andy Lymer and Dr Diana Onu[11] have stated that:

> "The 'slippery slope' framework presents a model by which high rates of compliance can be achieved through either the deterrence approach (through the perceived power of authorities) or the cooperative approach (through building trust in authorities). While they are both effective at revenue collection, the former is more costly to enforce and maintain in the longer term. However, while the cooperative approach may seem desirable, trust in authorities is very difficult to build, especially in low-trust climates."

6.18 Both the cooperative and the deterrence approaches are reflected in HMRC's over-arching compliance strategy, which is couched in terms of 'promote, prevent, respond':

> "The best way to tackle non-compliance is to prevent it happening in the first place, while cracking down on the minority who do break the rules, so we are:

[8] Ioana Alexandra Horodnic, (2018) "Tax morale and institutional theory: a systematic review", International Journal of Sociology and Social Policy, https://doi.org/10.1108/IJSSP-03-2018-0039 Permanent link to this document: https://doi.org/10.1108/IJSSP-03-2018-0039

[9] https://www.gov.uk/government/publications/guidance-for-taxpayers

[10] Economic Psychology: An introduction by Erich Kirchler and Erik Hoelzl, CUP, 2017.

[11] Prof Andy Lymer and Dr Diana Onu, https://www.taxadvisermagazine.com/article/evidence

- promoting good compliance by designing it into our systems and processes, enabling customers to get their affairs right from the outset
- preventing non-compliance by using the data we have to spot mistakes, prevent fraudulent claims, personalising online services and automating calculations
- responding to non-compliance by identifying and targeting the areas of greatest risk, and using tough measures to tackle those who deliberately try to cheat the system"[12]

6.19 In this context, work to raise awareness and educate people about tax is part of what it can mean to 'promote' good compliance. If people have a basic understanding and awareness of how tax works, then when they encounter it in practice, it will make more sense and be easier to see what needs to be done and why.

Tax education and awareness; effects on tax compliance

6.20 The OECD encourages countries throughout the world to develop tax education programmes. In its 2015 publication, 'Building Tax Culture, Compliance and Citizenship',[13] it says:

"Taxpayer education is rapidly becoming a strategic business line of tax administration. As governments and their tax administrations the world over are exploring alternative approaches to complement traditional enforcement-based techniques, they turn to taxpayer education programmes to improve tax compliance and tax morale."

"Taken together, the country cases show that successful taxpayer education programmes rest on partnerships, backed by high-level political commitment. Sound partnerships, be they domestic, regional or international, can ensure sustainability and support long-term cultural change. For programmes targeting schoolchildren or university students, it is crucial to build solid alliances with the country's education sector, usually the Ministry of Education. Other key partners include business and civil society, as well as well-known public figures, such as singers, actors or sport stars, which can also play an active role for taxpayer education initiatives"

6.21 The UK National Curriculum at Key Stage 4 (age 14 to 16) for Citizenship provides that "pupils should be taught about "income and expenditure,

12 https://www.gov.uk/government/publications/hmrc-strategy/our-strategy

13 Building Tax Culture, Compliance and Citizenship: a global source book on taxpayer education (OECD 2015) ISBN 978-92-64-20515-4.

credit and debt, insurance, savings and pensions, financial products and services, and how public money is raised and spent".[14]

6.22 This is not compulsory, although the OTS has seen examples of good practice in secondary education and, outside the National Curriculum, in tertiary education.

Box 6.A: Secondary school

Finchley Catholic High School, a state comprehensive school in North London, runs level 2 (GCSE) and level 3 (A-level) courses in Financial education using accredited qualifications provided by the London Institute of Banking and Finance. These cover how finance affects individuals, businesses and society, covering the idea of taxation, its place in the country's economy and how it applies to individuals and businesses. In addition, Key Stage 3 Finance is delivered outside of the mainstream curriculum through LIBF's online material, with support provided to students by their form tutors in form time. Adoption of this was driven by a determined and enthusiastic subject teacher.

Box 6.B: Tertiary:

University of Birmingham. In 2019 Professor Andy Lymer and members of the University's Funding support team piloted a number of one-off, voluntary, seminars for all graduating students, after discovering that there was very little, if any, formal provision of tax and financial education in universities nationally targeted at students who were about to finish their studies. The seminars used a payslip to introduce the ideas of income tax and National Insurance Contributions (NICs), how income tax and NICs are calculated, PAYE tax codes and what they mean, and how to check that income tax and NICs have been calculated correctly. They also included more wide-ranging exploration of tax and finance topics students were likely to face as they started work addressing issues such as debt, insurance and pensions.

6.23 HMRC has an active tax education programme called 'Tax Facts' which the Times Educational Supplement endorses on its website.[15] Tax Facts is a series of accessible explanatory animations ranging from why people pay tax, to starting a first job. This work is led by HMRC's Sustainability Team which is working to increase this programmes exposure in schools.

6.24 There are other bodies who are also building programmes of financial education, from government bodies such as the new single financial authority, called 'Money and Pensions Service, to financial industry sponsored organisations like the London Institute of Banking and Finance

14 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/239060/SECONDARY_national_curriculum_-_Citizenship.pdf

15 https://www.tes.com/teaching-resource/hmrc-tax-facts-12109552

(LIBF), and organisations such as Young Enterprise.[16] LIBF works closely with secondary schools[17] to encourage and support them to take up their formally recognised financial GCSE and A-level qualifications.

6.25 Young Enterprise have released, in early 2019, two frameworks for Financial Education in primary and secondary schools,[18] which address tax issues such as why the government collects tax, how to interpret a payslip and the link between NICs and the State Pension.

6.26 The Money and Pensions Service have been consulting widely in 2019 on financial issues affecting children and young people.

6.27 In September 2019, some specific insights on what may be termed the Tax Education Gap were published in a YouGov survey of 2000 adults commissioned by Deloitte.[19] The group with the least knowledge were found to be those aged 18 to 24, just those who are likely to be starting work or self-employment.

6.28 There is a balance to be struck between the need to collect tax as efficiently and effectively as possible, and the need for people to know and understand the tax system, both widely as to why tax is taken from them and in detail as to what it means for them as individuals.

6.29 When people have to do something for their tax to be collected correctly, any errors make the system less effective and efficient. Removing errors, using targeted education and greater awareness of potential problems as one of a range of compliance tools, is a mechanism that is being adopted across the world.[20] But it is noted that:

> "Preventative measures are currently perceived as less effective at tackling undeclared work than deterrence measures. However, this is not an evidence-based belief. There is currently little ex-ante and ex-post evaluation of either deterrence or preventative policy measures in EU Member States, and a marked lack of pilot studies. This lack of evidence on what works and what does not, discourages change."

6.30 HMRC's compliance strategy appears firmly rooted in the modern way of looking at tax compliance. Its 'prevent and respond' activities are well known (even if little understood). Its 'promote' activity, as far as it relates to education in schools, is also well recognised but run by a small team.

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16 https://www.young-enterprise.org.uk/teachers-hub/financial-education/resources-hub/financial-education-planning-frameworks/

17 In 2019 it is working with over 830 schools and 40,000 students – LIBF, personal communication, 22nd February 2019.

18 https://www.young-enterprise.org.uk/teachers-hub/financial-education/resources-hub/financial-education-planning-frameworks/

19 https://www2.deloitte.com/uk/en/pages/tax/articles/tax-education-gap.html

20 Elements of a preventative approach towards undeclared work: an evaluation of service vouchers and awareness raising campaigns" Colin C Williams, University of Sheffield, May 2018. Paragraph 3

6.31 Embedding and growing that arm of HMRC's tax compliance work would be desirable, by placing the team on a firmer footing, growing its collaboration with others and taking into account the issues relating to key life events highlighted in this report in prioritising and focusing its work.

6.32 At the same time, engaging with interested parties in academia to provide solid evidence about the effectiveness of this strategy would help HMRC make its case and contribute to the wider understanding of the factors behind tax compliance and non-compliance.

Recommendation 14

HMRC should collaborate more with relevant external bodies, including schools and in further and higher education, seeking to improve the public's understanding of tax and finance, when seeking to extend the reach of its own tax education materials.

Recommendation 15

HMRC should extend its collaboration with academic researchers to quantify the effect of HMRC's tax education programme and explore the potential for a cost/benefit measure to allow HMRC to prioritise and target its tax education resources.

Annex A

People we consulted

Association of British Insurers	Institute of Chartered Accountants of Scotland
Association of Tax Technicians	London Institute of Banking and Finance
Barnett Waddingham	Low Incomes Tax Reform Group (LITRG)
British Medical Association	Professor Andy Lymer - University of Birmingham CHASM
Paul Bryant – Christ's Hospital	Money and Pensions Service
Chartered institute of Taxation	Net Pay Action Group
Emma Chamberlain OBE, barrister	St Mary's School, Roughton, Norfolk
Erpingham School, Erpingham. Norfolk	TaxAid
Finchley Catholic High School, London	Tax Help for Older People
Fran Bennett, Oxford University	Sir Steve Webb - Royal London
Professor Jane Frecknall-Hughes - University of Nottingham Business School	Prof Colin Williams, Sheffield University
Institute of Chartered Accountants in England and Wales	

Annex B

Net Pay and Relief at Source pension schemes

Table B.1: Comparing net pay and relief at source pension schemes

Table x	Earning Gross	Pension Contributions	Taxable Pay	Claim by Pension Scheme	Income Tax	Take-home Pay	Pension Fund	Take-home Pay + Pensions Fund	PA unused
1. Net Pay	£12,000	£293.20	£11,706.80	£0	£0	£11,706.80	£293.20	£12,000	£793.20
2. RAS	£12,000	£234.56	£12,000	£58.64	£0	£11,765.44	£293.20	£12,058.64	£500
1a. Net Pay	£12,500	£318.20	£12,181.80	£0	£0	£12,181.80	£318.20	£12,500	£318.20
2a. RAS	£12,500	£254.56	£12,500	£63.64	£0	£12,245.44	£318.20	£12,563.64	£0
3. Net Pay	£13,700	£378.20	£13,321.80	£0	£164.36	£13,157.44	£378.20	£13,535.64	£0
4. RAS	£13,700	£302.56	£13,700	£75.64	£240	£13,157.44	£378.20	£13,535.64	£0
5. Net Pay	£14,000	£393.20	£13,606.80	£0	£221.36	£13,385.44	£393.20	£13,778.64	£0
6. RAS	£14,000	£314.56	£14,000	£78.64	£300	£13,385.44	£393.20	£13,778.64	£0
7. Net Pay	£28,000	£1,093.20	£26,906.80	£0	£2,881.36	£24,025.44	£1,093.20	£25,118.60	£0
8. RAS	£28,000	£874.56	£28,000	£218.64	£3,100	£24,025.44	£1,093.20	£25,118.60	£0

B.2 This table illustrates the detailed workings of a Net Pay compared to a Relief at Source (RAS) pension scheme. Starting with gross pay and the employee's pension contribution the taxable pay is worked out. For Net Pay, taxable pay is gross pay less pension contributions. For RAS, gross pay is the same as taxable pay. Then, for Net Pay, the pension scheme makes no claim from the government. For RAS the pension scheme does make a claim. This is the difference in how these types of scheme work.

B.3 Next, Income tax is calculated: Taxable pay less personal allowance, what's left is taxed at 20% and any other appropriate rates for the tax bands covered. If there is no taxable pay left there is no tax. Take home pay is what is left after pension savings and tax (note, NICs have been ignored here).

B.4 The total savings into the pension fund are the total of the employee's savings and any government contribution claimed by the Pension Scheme.

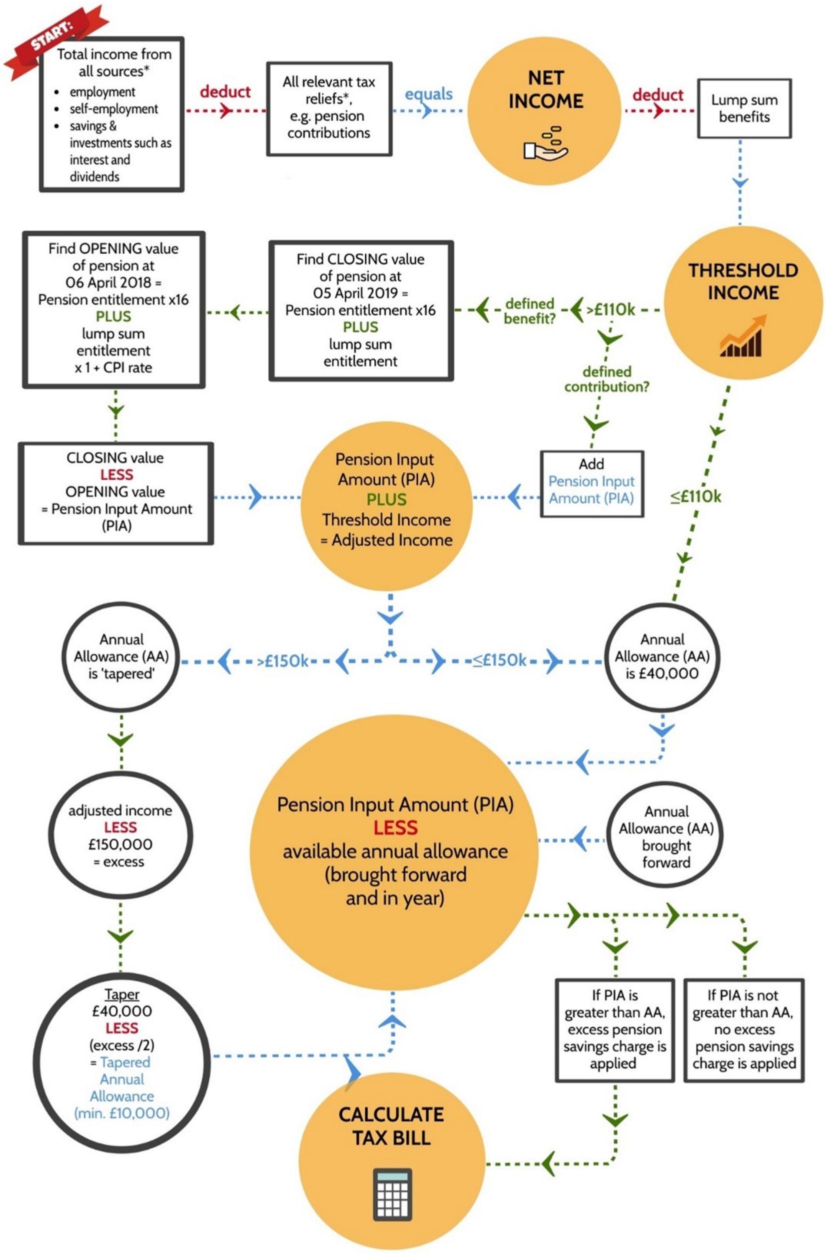
B.5 As a result, people in Net Pay, paid at or under the personal allowance level, use less of their personal allowance than someone in a RAS scheme.

Annex C

Pension Annual Allowance and Tapered Annual Allowance

This Annex outlines how an annual allowance charge is calculated. The flowchart below is supplemented by a narrative description and a detailed example.

Chart C.1 Annual Allowance flowchart



Source: OTS

Narrative description

For a taxpayer to identify whether they are affected by the Annual Allowance (AA) charge and, if so, by how much and when, involves a calculation affected by many complex factors, over many of which the taxpayer will have little influence.

Table C.1: Some factors affecting the Annual Allowance calculation

Other income the individual receives	How much pay the individual received in the tax year	Rate of inflation (CPI)	Past liability to AA, which affects the 'carry forward' of AA	The individual's marginal rate of tax	Specific pension scheme rules, such as double accrual for Police Officers	Ratio of DB final salary pension to pension from later 'Career Average' pension schemes

The calculation proceeds by reference to a number of key reference points:

Net income

The starting point for the calculation of an individual's AA is the individual's 'net income'. This is the sum of all income (earnings, investments, self-employed income) less all tax reliefs; it is the figure in an individual's tax return on the basis of which the tax payable is calculated.

An error which is sometimes made when calculating net income, is to include pension contributions paid under a 'net pay' scheme twice. This happens because an employee's end-of-year tax summary (form P60) shows their gross earnings less employee contributions. The P60 does not state what the employee contributions were, to make it clear that they have been deducted from gross pay to arrive at taxable pay. To see this clearly, the employee would have to compare the P60 information to the totals on all their payslips for the year.

An individual's net income is compared to three limits:

- £110,000, called in HMRC's guidance an 'income floor'[1]
- 'Threshold Income'. If this is £110,000 or more then the AA may be reduced ('tapered')
- 'Adjusted income'. If this is over £150,000 then the AA will be tapered.

Threshold Income

This is, broadly, net income (taxable income from all sources less tax reliefs)[2] less taxed lump sum death benefits. This includes tax relief because the individual has paid money into their pension or pensions. Usually, threshold income is the same as net income.

If threshold income is £110,000 or less the individual needs to go no further. Their AA is £40,000.

[1] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm057100#Income

[2] This includes many different and specialised tax reliefs such as trading losses, losses from sale of shares and some gifts to charities. The full list is in Section 24 of the Income Tax Act 2007.

Adjusted Income

This is 'Threshold Income' plus the individual's 'Pension Input Amount' (PIA). In particular, the calculation of pension input amount for DC schemes and DB schemes is quite different.

Pension Input Amount – DC schemes

For DC schemes the PIA is the total money contributed by the employee and employer (and anyone else on the employee's behalf) in the 'pension input period'. (This period changed in 2015-16 and is now the same as the tax year.) This information is provided to the individual by their pension scheme or schemes, but much of it can also be found from the individual's personal records if they are contributing towards a private pension (that is, one not provided through an employer).

Pension Input Amount – DB schemes

For DB schemes there is different calculation, which depends upon information provided to the individual by the pension scheme. That calculation establishes the growth of the DB pension fund over the tax year/pension input period. This is a simplified version:

- find the 'opening value': Calculate the pension and lump sum entitlement as at 6 April of the previous year
- multiply that entitlement by 16 and add any lump sum
- increase that number for inflation (using the Consumer Price Index, CPI). There is a helpful link in the mainstream guidance, but no clear instruction to use CPI rather than CPIH. CPIH is the first number a reader comes to on the CPI page; it refers to house price inflation. One has to read down a couple of sentences to get to the CPI figure
- the result of that step is the 'opening value'
- find the 'closing value': Calculate the pension entitlement as at 5 April and multiply that by 16. Add any lump sum
- the result of that is the 'closing value'
- find the growth: Subtract the opening value from the closing value.
- if the result is negative then pension input amount (PIA) is nil (this is important for people with two DB schemes, because any negative PIA cannot be set against any positive PIA)
- if the result is positive then that is the PIA

Determine whether AA is tapered:

If the Threshold income is £110,000 or less then the individual will have the full £40,000 annual allowance.

If the Threshold Income is over £110,000 and their Adjusted Income is over £150,000 then their annual allowance will be reduced by the 'taper'. For every £2 of Adjusted income over £150,000, the AA is reduced by £1.

The minimum that AA can be is £10,000. For Adjusted incomes between £150,000 and £210,000, AA will be somewhere between £40,000 and £10,000.

Anyone with an adjusted income of £210,000 or more will have an AA of £10,000.

Calculate the carry forward of any unused allowance

Any unused AA from the preceding three years can be brought forward and added to the AA for the current year. For any year, AA that exceeds the Pension Input Amount for that year is 'unused' and can be carried forward for three years. If it is not used by then it expires.

The AA for the current year and the unused AA from the previous three years is the total available AA for the year.

Calculate the Annual Allowance Charge

Once the individual has determined their total available AA for the year, they can calculate whether they have incurred an Annual Allowance charge.[3]

Compare the Pension Input Amount in that year to the available AA. The excess is subject to the AA tax charge, at a rate as if the excess was the top slice of their income.

HMRC's Pension Tax Manual, the guide for tax specialists, is clear on this point;

> "The annual allowance charge is not at a fixed rate but will depend on how much taxable income the individual has and the amount of their pension saving in excess of the annual allowance."[4]

Later in HMRC's Pensions Tax Manual,[5] it states;

> "From 6 April 2016, individuals with income for a tax year above £150,000 have their annual allowance for that tax year reduced on a tapered basis (a 'reduced annual allowance').
>
> The annual allowance is reduced by £1 for every £2 of income above £150,000, subject to a minimum reduced annual allowance of £10,000."

Under 'examples' it states;

> "Based on an annual allowance of £40,000 for the tax year; An individual with income of £160,000 has a reduced annual allowance of £35,000 for the tax year."

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[3] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm056110

[4] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm056110

[5] https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm057100

The italics are OTS's. Where it says '…income…' it should read " …adjusted income…'
Compare those sentences to the mainstream guidance,[6] intended for use by non-specialists, where it clearly states;

> "If your adjusted income is over £150,000 your annual allowance in the same tax year will be reduced."

It would appear that the mainstream guidance is correct when the specialist guidance is imprecise. This appears to have created the impression that AA is only tapered if total income is over £150,000, which is not the case.

The overall effect of this long series of interlocking computational steps is to produce a calculation that is extremely sensitive to differences in the numbers going into it, many of which are beyond the control of the individual.

[6] https://www.gov.uk/guidance/pension-schemes-work-out-your-tapered-annual-allowance

Examples 1-3: Threshold income just exceeded, partial taper

Examples 1-3 illustrate the effect of a small increase in income, leaving other circumstances the same, and how the charge recovers more than the higher rate tax relief it is intended to recover. This same effect is noted for senior civil servants[7] and others in public sector pension schemes.

Extra income outside of employment can be within the taxpayer's control - they could stop that activity or, perhaps, curtail it. A pay rise in employment may well be outside of the taxpayer's control. Or they may be offered a promotion and have to quickly calculate the impact of that. Uncertainty as to the outcome could cause them turn it down, fearing the financial consequence, given the variation in outcomes given even small changes in income. The consequences of these decisions, for the organisation concerned, could well be deleterious.

Table C.2: Illustration of effect of small increase in income

	Example 1		Example 2		Example 3
		Additional Income non pensionable		Additional Income pensionable	
Taxable income from all sources after tax relief including contributions	**£109.999**	£501	**£110,500**	£501	**£110,500**
Pension Input Amount DB pension	£80,000		£80,000		£86,107
Threshold Income	£109,999		£110,500		£110,500
If threshold income is £110,000 or less, tapering of the AA does not apply					
Standard AA not tapered	**£40,000**				
Adjusted Income			£190,500		£196,607
Adjusted Income over £150,000			£40,500		£46,607
Reduce AA by			£20,250		£23,304
Tapered AA (minimum is £10,000)			**£19,750**		**£16,696**

7 https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/740064/Fortieth_Annual_Report_on_Senior_Salaries_2018.pdf - Appendix G para 14.

Excess Pension Input Amount		**£40,000**		**£60,250**		**£69,411**
Total taxable income		**£149,999**		**£170,750**		**£179,911**
Marginal rate tax on excess pension						
Tax rate on income in 40% band	40%	£16,000	40%	£15,800	40%	£15,800
Tax rate on income over £150,000	45%	£0	45%	£9,337	45%	£13,460
Total tax on excess pension		**£16,000**		**£25,137**		**£29,260**
Summary, cliff edge effect of TAA						
Extra taxable income				£501		£501
Extra pensions tax				£9,137		£13,260
Tax rate on extra taxable income				1823.75%		2646.71%
Assume 12.5% pension contribution				£13,812.50		£13,812.50
Tax relief at 40%				£5,525		£5,525
Ratio pension tax: higher rate tax relief				1.7		2.4

Example 4: The effect of changing inflation, presuming that full AA is available and other factors are unchanged

A higher inflation rate can turn a year with an Annual Allowance Charge into one with a smaller or no charge. Inflation is outside the taxpayer's control and so adds uncertainty.

Table C.3: Illustration of the effect of inflation

	CPI = 0%		CPI = 3%	
	Start year	End year	Start year	End year
Pay	£79,879.00	£82,456.00	£79,879.00	£82,456.00
Pension entitlement				
80ths scheme (20/80)	£19,969.75	£20,614.00	£19,969.75	£20,614.00
60ths scheme (6/60)	£7,987.90	£8,245.60	£7,987.90	£8,245.60
Career Averaged Revalued Earnings scheme	£3,296.00	£5,028.34	£3,296.00	£5,028.34
Total annual pension	£31,253.65	£33,887.94	£31,253.65	£33,887.94
Lump sum from 80ths scheme	£59,909.25	£61,842.00	£59,909.25	£61,842.00
Pension value				
Pension x 16	£500,058.40	£542,207.04	£500,058.40	£542,207.04
Lump sum	£59,909.25	£61,842.00	£59,909.25	£61,842.00
Total	£559,967.65	£604,049.04	£559,967.65	£604,049.04
Total indexed	£559,967.65		£576,766.68	
Pension savings = PIA		£44,081.39		£27,282.36
AA		£40,000.00		£40,000.00
Excess pension savings		£4,081.39		-£12,717.64

Annex D
Annual Allowance charge example

This is an example created by the OTS, based upon the situation described in the HMRC Pensions Tax Manual at ptm056104 (https://www.gov.uk/hmrc-internal-manuals/pensions-tax-manual/ptm056410#IDAYCILD)

Tracey is a 55 year-old Civil Servant with 30 years' service in the old Classic 'final salary' pension scheme, paying her personal pension contribution at a rate of 7.35%. She has a salary of £135,267 with no other taxable income. She gets a promotion with a pay rise of 9.6% taking her salary to £140,313, an increase of £5,046. Her pension contribution becomes £10,313.

Tracey's pension prior to promotion was 30/80ths of her salary, £50,725, with a lump sum of three times that, at £152,175. After her promotion, with another year's service her pension increased by £3,646 to £54,371 (31/80ths of her salary), and her lump sum by £10,938 to £163,114.

Her pension growth (assuming inflation at 2%) is:

Opening value: (50,725 x 16 + 152,175) x 1.02 inflation = 983,053

Closing value: (54,371 x 16) + 163,114 = 1,033,054

Growth = 1,033,054 - 983,053 = 50,002

Table D.1: Annual Allowance charge calculation

Pensionable income	A	£140,313
Personal pension contribution (7.35%)	B	£10,313
Non pensionable income	C	£0
Pension growth ('pension input amount', PIA)	D	£50,002
Threshold income	E = A+C-B	£130,000
Adjusted income	F = E+D	£180,002
AA taper	G = (F – 150k)/2	£15,001
Available AA	H = £40k – G	£24,999
Excess PIA	I = D – H	£25,001
Excess PIA tax charge @ 40% and 45%		£10,475

Given only small pay rises in later years, pension growth may well not exceed the annual allowance so there may not be a recurring AA charge. Tracey may be able to pay this AA charge from taxed income, despite it being as large as her pay rise.

If she chooses 'scheme pays', the loan of £10,475 will accrue interest until she chooses to retire. Assuming she retires at 60 and that the scheme charges at around 4% (CPI around 2% plus SCAPE rate around 2.4%) then the total scheme loan will become around £12,800, The actuarial reduction of her pension to pay this charge would reduce her pension by about £800 each year, from £54,371 to around £53,600.

In Tracey's case, a pay rise (before tax) of £5,046 creates a tax charge of £10,475. Her tax relief (at her highest rate on income tax, 40%) is £4,125.

Tracey's pay increase has increased the value of all 31 years of her scheme membership as she is in a final salary pension scheme. Another member may have had a smaller charge if they had less years of membership or were in a career average scheme.