How to reduce the burden of tax returns upon millions of self-employed taxpayers

Management of taxes

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The time has surely come to reduce the burden of tax returns on millions of taxpayers.

One of the best series of events – at least in my view(!) – is the History of Tax events run by the Worshipful Company of Tax Advisers and often hosted by the CIOT (see bit.ly/3lCfLxn). It was here I learnt about the precedent value of the Magna Carta (Professor Jane Frecknall-Hughes) and in October 2011 about the invention of the PAYE system, from John Pearce.

The PAYE system was introduced in 1944 as the Inland Revenue was very concerned that the growth in incomes during the Second World War could mean that many might not be able to pay their tax. Before WW2, about 10% of adults paid income tax; by the end of the war that had risen to about 30%. The idea of withholding tax from payments to employees should mean that far fewer people would have an unexpected tax bill, many months after they had received the income.

Time for the next step

The PAYE system defines the UK tax system for individuals. Employers and pension payers do the work for most of us by calculating the correct amount of tax due, deducting it and sending it off to HMRC. The point of the clever but impenetrable tax code is to personalise the deductions from or additions to taxable income, so that for millions of people the PAYE deductions represent their final tax liability. All this means that out of about 31 million income tax payers, only 12 million are required to complete a tax return.

Surely the time is approaching when we should consider using technology to reduce the burden of tax returns for millions of taxpayers?

HMRC data based on the Survey of Personal Incomes shows that in 2019/20 about 2 million individuals received rental income; 13.9 million received bank/building society interest; and 4.2 million received dividends (see bit.ly/3MK9yeP). In the same year, about 5.3 million received self-employment income (see bit.ly/3sTsYWG), with 1.5 million of those also having rental, interest or dividend income.

Two reports in 2019 and 2021 from the Office of Tax Simplification have discussed extending the reporting system to cover some or all of these income sources (see bit.ly/3PFIsXW and bit.ly/3sS24hT). The 2021 report found a broad welcome for more reporting, both from taxpayers and from potential data providers. Both groups had some reservations. For taxpayers, it was making sure that there is a suitable way to manage errors. For data providers, such as banks, the key issue is to specify the data needed and the manner of providing it well in advance, so that new systems could be designed – and additional data obtained from individuals.

The essential elements

One vital aspect of data reporting will be having a unique taxpayer reference in a digital format, so that data can be accurately provided to HMRC, whose systems can then automatically populate the correct taxpayer account. The national insurance number is what is used for PAYE and it must be the main contender for broader use. A decision from government would be needed in this area and additional systems introduced to ensure that every adult had a personal tax identifier (at present, not everyone has an NI number). Data providers would need time and systems to collect and verify these identifiers.

HMRC will need time to develop the forthcoming Single Customer Account, underpinned by the single customer record, which will gather the necessary data from different HMRC systems. This vital programme has been funded by the Treasury for the next three-year spending cycle.

Perhaps the big question for ministers and HMRC is how we should best use technology. Should it be a background reporting aid, reducing administrative tasks for individuals and increasing overall accuracy of reporting, or should it take over the management of the system? This apparently simple question has implications for general understanding of the tax system, error correction and ultimately trust in our tax system and tax authority. Work at the Exeter-based Tax Administration Research Centre highlights that we are all too accepting of figures presented to us (see bit.ly/3sRx9lI). However, its research shows that this can be mitigated by carefully designed 'nudges' tailored to the individual (see bit.ly/3Ny291Y). 'Nudges shown inappropriately to individuals lead to an increase in filing errors, while correctly shown nudges lead to substantial reductions in errors only if they are prescriptive in nature; generic nudges lead individuals to replace one filing error with another.'

Greater involvement of technology and third parties in tax reporting brings benefits and is inevitable. However, we need to work hard on transparency, presentation and error correction to promote broad understanding of and trust in the tax system.