



Readers can hardly have failed to notice the great excitement in the national press over the weekend (and still continuing) about the letters which HMRC is sending to taxpayers who have paid too much or too little tax under PAYE. Many well-known tax pundits have spoken about it on TV, radio or in the papers.

Undoubtedly the actions HMRC is taking now will affect many taxpayers, and it is important that taxpayers and advisers should understand what is happening and what action to take. Some of the tax apparently underpaid may be wrong and can be challenged.

But some of the press coverage has been a little misleading. The new National Insurance and PAYE computer (NPS) has had its problems, but here it is not really the villain of the piece – rather, it has highlighted how deficient the system of yearly reconciliation was before.

Here we explain:

- what HMRC is doing
- what taxpayers and their advisers should do if HMRC writes to them about under or overpayments
- and what the future has in store.

### **What HMRC is doing**

HMRC installed the new NPS computer system in summer 2009, with the aim of improving the operation of Pay As You Earn (PAYE). The PAYE system has never catered well for people with more than one employment or pension, and this was not helped by having different employments/pensions dealt with by different tax offices which did not always communicate. The NPS is designed to bring all a taxpayer's records together and so make sure that allowances and tax rates are operated correctly across all employment or pension income sources.

It is well known that the NPS had many teething problems, and generated many incorrect codings notices, which we have reported on in previous news items.

The NPS has the ability to perform automated end-of-year reconciliations – in broad terms, to compare the tax deducted under PAYE with other information which HMRC holds about that person's income. HMRC started to use this function at the weekend (4–5 September 2010).

Following this, HMRC is sending out a small number of calculations (forms P800) to individual taxpayers showing if they have paid too much or too little PAYE tax for the years 2008/09 and 2009/10. HMRC is looking at two years because the 2008/09 reconciliation was been put on hold until the NPS was up and running.

So the under- and overpayments for 2008/09 and 2009/10 are not necessarily errors (though some of them may be wrong) but are the result of HMRC reconciling open PAYE years in a way it has not done for some time.

HMRC says that the current exercise will help it 'gauge customer reaction' and HMRC hopes to start full live-running of end-of-year reconciliation in mid-September.

According to the BBC website, the reconciliation exercise is expected to throw up over 4m repayments and close to 2m underpayments.

### **What taxpayers can expect to get**

Those taxpayers who have underpaid or overpaid tax for 2008/09 and/or 2009/10 should expect to get a tax calculation form P800. This will be accompanied by a set of notes.

HMRC has also put up [further information on its website](#). This is aimed at taxpayers but will be useful to agents.

If there is an overpayment:

- HMRC says it will send the repayment automatically, usually within a week.

If there is an underpayment:

- HMRC will code out underpayments of less than £2,000, ie it will include them in the 2011/12 tax code and collect the tax via PAYE. This will be done automatically – so if you want to pay directly, instead, you must tell HMRC.
- HMRC will allow the coding-out to cover a longer period, if the extra deductions will cause hardship.
- Underpayments of £2,000 or more must be paid directly. HMRC will write, separately from the P800, and ask for payment. Taxpayers can request time to pay if they cannot pay in one sum.

### **What taxpayers and advisers should do**

HMRC will not be issuing copies of the P800 tax calculation forms to agents, so it is important for agents to alert their clients to look out for these forms and send them on. HMRC has also put a message to this effect with the P800.

The P800 is not a demand but a calculation – a statement of what HMRC thinks the person's tax position is. Payment request will be dealt with separately, as described above.

It is vital to check the P800 – even if it shows an overpayment and a refund due. Bear in mind that HMRC may not have full or up-to-date information about other income or about available allowances or reliefs. There may also be errors in the employment income data held on the NPS.

If there are errors, the taxpayer or agent should tell HMRC. This may have the happy result of reducing any tax liability or increasing a refund. But even if correcting the errors could increase the tax due, the taxpayer still has an obligation to tell HMRC about errors he or she has spotted.

Even if the P800 seems correct, there are three situations where HMRC will agree not to recover any tax underpaid:

1. Where the employer or pension provider has not operated PAYE correctly – eg not using the right PAYE code. In law, HMRC should first approach the employer to collect the shortfall (under Regulation 72 of the PAYE regulations).
2. Where Extra-statutory Concession A19 applies. This technical-sounding rule is actually very useful. It applies where HMRC has been slow in using information provided to it, and where the taxpayer reasonably believed that his or her tax affairs were up to date. HMRC will write off the tax underpayment in view of its delay.

It is going to be up to the taxpayer to check whether ESC A19 might apply and ask for it. HMRC has put up a website item about ESC A19 - [HMRC delays in using information](#). This is quite useful but not entirely accurate (eg it says that A19 applies just to income tax, when in fact it also applies to CGT). It is well worth looking at the full text of the concession itself, which can be found [in the HMRC PAYE manual](#).

3. Where paying the tax would cause hardship. As well as allowing extra time to pay, HMRC will in some situations agree to ‘remit’ the tax. This is tantamount to writing it off (though strictly the debt is not written off but deep-frozen and could be revived if the taxpayer’s fortunes change). Remission is only given where the person has a very low income and no assets and the situation is unlikely to change.

HMRC says that if you do not agree with something included in the calculation, you can contact it on 0845 3000 627 or write to the address shown on the calculation.

### **The future**

HMRC is continuing its reconciliations for 2008/09 and 2009/10 – the letters going out this week are just the first wave. The press furore suggests that HMRC did not get its media message right, and that many people are worried or confused, and have no idea how to set about checking their tax calculations. We shall see how things go.

Meanwhile, one thing the media have not really spotted is that this exercise is only looking at the last two years, those dealt with by NPS. Lurking behind this are the earlier open PAYE years which have never been reconciled, as this work needs manual intervention and a lot of HMRC staff time. These have been highlighted regularly in the National Audit Office’s report on HMRC’s annual accounts. In the most recent accounts we learned that there are 18.2m of such cases from 2007/08 and previous tax years, affecting around 15m people.