

**Draft regulations – proposed amendments in respect of salary advances
Response from the Low Incomes Tax Reform Group (LITRG)**

1 Executive Summary

- 1.1 We are pleased to have the opportunity to respond to this short technical consultation. Our comments are made from the perspective of both the low-income worker and the small, unrepresented employer.
- 1.2 The proposed amendments ‘allow employers to delay reporting an advance payment of salary (salary advance) made to an employee until payment of the remainder of that salary instalment.’¹ Our understanding is that the proposed amendments mean that the advances will **not** get reported - rather the employer will just report the full amount of monthly pay as normal. HMRC will therefore have no visibility at all over the flow of money to the employee. This is a potentially significant change to Real Time Information (RTI) reporting requirements.
- 1.3 These amendments have come about in large part to accommodate salary advance schemes, whereby people can simulate being paid more frequently than monthly. Low income employees are the main target market for these schemes and are typically charged a fee to access their monthly salary earlier. Salary advance schemes are seen by some as positive, but for others, raise ethical and tax technical questions because they involve charging workers a fee to access their accrued earnings.² A summary of the points that LITRG have raised can be found in a November 2022 blog entitled ‘Salary advance serves up tricky conundrum for HMRC’³ in Appendix 1.
- 1.4 We are disappointed that HMRC are treating this as a small change and do not seem to be appreciating the wider significance of it. In our view amending the regulations in this way is

¹ <https://www.gov.uk/government/consultations/draft-regulations-proposed-amendments-in-respect-of-salary-advances#:~:text=Consultation%20description,where%20certain%20conditions%20are%20met.>

² See for example the debate here: <https://www.peoplemanagement.co.uk/article/1806353/salary-advance-schemes-big-debate>

³ <https://www.tax.org.uk/salary-advance-serves-up-tricky-conundrum-for-hmrc>

signalling that HMRC support the use of schemes that the Financial Conduct Authority (FCA) have raised some concerns about.

- 1.5 While the proposed changes will potentially give some employers the certainty that they need to offer advances themselves (without resorting to using third party schemes who will charge the employees a fee) and make it easier to do so; the schemes have now gathered such momentum that this change probably comes too late to row them back in any significant way. Indeed, this change looks set to encourage them further.
- 1.6 We are also not convinced that HMRC have thought through all of the potential practical issues/interactions, including the fact the proposed changes undermine the entire principle of 'on or before'¹, which employers, large and small have worked hard to adapt to. Indeed, the use of the word 'must' in the draft legislation looks set to penalise all those employers who have chosen to be compliant and who have accounted for advances in the correct manner to date and who may wish to continue to do so, rather than change to a new system.
- 1.7 We also wonder how many employers that currently pay weekly are going to swap to using this monthly system to reduce their admin burden and exposure to penalties? This (and the flip side of more monthly paying employers essentially now paying weekly by using advances), means HMRC lose control of the digital process and it breaks the link between payments actually made and them being reported. As explained in para 3.1.4, this is particularly important for Universal Credit recipients. HMRC need to fully consider the impact of these changes on existing weekly/monthly payrolls.
- 1.8 It also occurs to us, although we need to test it further, that given the fact that NIC operates on a pay period by pay period basis, rather than cumulatively, and that monthly NIC thresholds are larger than weekly NIC thresholds, this may introduce some scope for employers looking to reduce their employer NIC burden, to alter payments to take advantage of the system.
- 1.9 To the extent that the changes do encourage more direct advances, without good guidance on how advances should be handled, employers could easily get into a payroll mess. It is also important to note that Basic PAYE Tools (popular with small employers) does not allow you to record advances. This also means that the 'net amount' shown on the employee's payslip will not be the actual amount of take-home pay. Employees may struggle to reconcile their payments into the bank with their payslips, particularly where more than one advance has been taken in the pay period. The employer will have to manually calculate the amount to be paid on pay day, which introduces further scope for errors or otherwise change their payroll systems to a more sophisticated product, which will mean incurring financial and time costs.

¹ Under RTI, employers are required to report Pay As Your Earn (PAYE) information to HMRC 'on or before' their employees' pay day.

- 1.10 HMRC say that no TIIN has been prepared as this does not constitute a substantive change in tax policy. We do not agree. We think there are many aspects that need to be explored further as some serious issues are at stake. Rather than proceeding with these regulations, we urge HMRC to run a full Stage 1/Stage 2 consultation in line with their own framework¹, so as to ensure that all of these wider issues can be considered in full. As part of this, HMRC need to state what, if anything, they are going to do in terms of all the historic non-compliance generated by these schemes.

2 About Us

- 2.1 The Low Incomes Tax Reform Group (LITRG) is an initiative of the Chartered Institute of Taxation (CIOT) to give a voice to the unrepresented. Since 1998, LITRG has been working to improve the policy and processes of the tax, tax credits and associated welfare systems for the benefit of those on low incomes. Everything we do is aimed at improving the tax and benefits experience of low-income workers, pensioners, migrants, students, disabled people and carers.
- 2.2 LITRG works extensively with HM Revenue & Customs (HMRC) and other government departments, commenting on proposals and putting forward our own ideas for improving the system. Too often the tax and related welfare laws and administrative systems are not designed with the low-income user in mind and this often makes life difficult for those we try to help.
- 2.3 The CIOT is a charity and the leading professional body in the United Kingdom concerned solely with taxation. The CIOT's primary purpose is to promote education and study of the administration and practice of taxation. One of the key aims is to achieve a better, more efficient, tax system for all affected by it – taxpayers, advisers and the authorities.

3 Introduction

- 3.1 We thought it would be useful to start with a short summary of the history of RTI and the emergence of salary advance schemes.
- 3.1.1 'Real Time Information' (RTI) is the system which requires employers to report Pay As Your Earn (PAYE) information to HMRC 'on or before' their employees' pay day.
- 3.1.2 RTI brought about a significant change in the way employers interact with HMRC in relation to PAYE. Under RTI, employers have to essentially report payroll information in 'real time', whereas previously it was sent in arrears (at the end of the tax year, employers would submit an annual return to HMRC detailing the employees they had paid that year and their annual gross pay and deductions in that year).

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/89261/tax-consultation-framework.pdf

- 3.1.3 RTI was such a significant change that initially there was an easement in place for micro-employers.¹ However eventually this easement was removed in April 2016 because 'ALL employers need to adapt to 'on or before' reporting by April 2016'.²
- 3.1.4 HMRC introduced RTI in order to improve the operation of the PAYE system, by making the system easier and more accurate and to be able to support the benefit Universal Credit. Any in-work support an employee is entitled to is calculated by the Department for Work and Pensions (DWP), taking into account earnings in an assessment period, the earnings details being taken from the RTI data which DWP receives from HMRC on a daily basis. Universal Credit is, broadly, supposed to reflect the money that someone has available to them in an assessment period and so relies on accurate information about earnings in each assessment period from HMRC.³
- 3.1.5 Per some CIPP research in 2016, 'In 2008 when this research began almost half of respondents (44.3%) operated a weekly payroll. Since then, there has been a steady decline and this downward trend continues in 2015-16 when now less than one quarter (24.6%) of respondents say that they run a weekly payroll.'⁴
- 3.1.6 Part of the move away from weekly pay is almost certainly due to employers wanting to avoid the extra payroll administration that RTI itself created. By paying monthly, employers only need to make 12 submissions to HMRC each tax year, rather than 52. Consequently, those who pay weekly are at risk of making an inadvertent mistake and incurring a penalty at least four times more often than an employer who pays monthly - therefore there is a significant increase in their exposure. However, being paid monthly often does not match an employee's cash flow needs, especially low paid employees, who can struggle to make their money last from one pay day to the next.
- 3.1.7 It is no coincidence that third party salary advance schemes started entering the market in response to this state of affairs. These arrangements now seem to have spread through all parts of the labour market.

¹ In order to give employers more time to adapt to on-or-before reporting HMRC announced in March 2013 a temporary relaxation or "easement" for small employers (those with 49 or fewer employees) who pay staff more often than monthly to report once a month. This was introduced from April 2013 for a six month period to 5 October 2013 but was subsequently extended for a further six months. This was replaced with a narrower easement in April 2014, which enabled existing micro employers only (those with 9 or fewer employees) to report on or before the last payment day of the tax month until April 2016.

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https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/460461/HMRC_research_report_369_PAYE_RTI_On_or_before_research.pdf

³ <https://www.legislation.gov.uk/uksi/2013/376/regulation/61>

⁴ <https://www.cipp.org.uk/static/uploaded/281a8fe0-bc09-49f4-a2d3c84e0a5024f3.pdf>

- 3.1.8 While many see them as ‘socially good’, one of the key issues with salary advance schemes is that, if used regularly, the fees, while appearing to be modest, can soon add up to a significant amount. These schemes therefore essentially mean that employees are paying a disproportionate price to access their wages on a weekly basis (whereas if employers simply paid weekly, there would be no need for the employee to incur fees to access their wages). Dependency on regular advances between usual paydayes may also indicate poor financial management and potentially underlying debt issues, with the schemes then fuelling these issues further.
- 3.1.9 In 2020, the Financial Conduct Authority (FCA) highlighted concerns about salary advance schemes - for both employees and employers.¹
- 3.1.10 In 2021, the Woolard report said ‘The FCA working with the government should encourage ESAS² providers and major employers to draw up a code of best practice. Where firms are regulated for part of their activity by the FCA, the FCA should look to formally recognise the code. Further, major employers should be encouraged to only contract with ESAS providers adhering to this code.’ And further that: ...‘the market should continue to be monitored and if the position changes, the question of bringing ESAS within the FCA’s remit should be re-considered.’³
- 3.1.11 In addition, scheme providers have told employers that using their schemes does not impact on their payroll processes as advances do not need to be reported to HMRC at the time they are made. HMRC have now confirmed what LITRG have been concerned about all along – that this is wrong and that they are not compliant with current tax law. The entire business model has therefore been based on non-compliance.
- 3.1.12 Given the importance attached by HMRC to the concept of ‘on or before’ and the fact there have been compliance activities in respect of RTI – including HMRC issuing late filing penalties in cases of trivial errors where there had been no intention to deceive⁴ - it is surprising that there has not been earlier intervention from HMRC on this issue.
- 3.1.13 HMRC, having created the conditions for these schemes to emerge and thrive in the first place, and who appear to have let the ‘on or before’ issue drift for many years in relation to these schemes, now find themselves having to deal with a proliferation of schemes and widespread non-compliance. The solution arrived at seems to be to change the law to accommodate them, legitimising their business practices and possibly opening the door for them to promote their schemes more widely, without consultation as to other options and without any full assessment of the potential impact on the market and workers.

¹ <https://www.fca.org.uk/news/statements/fca-sets-out-views-employer-salary-advance-schemes>

² ESAS = Employer salary advance schemes

³ <https://www.fca.org.uk/publication/corporate/woolard-review-report.pdf>

⁴ <https://www.taxadvisermagazine.com/article/quayviews-company-penalised-submitting-its-rti-returns-early>

4 Our comments

4.1 As stated above, we do not think legislating at this point is appropriate. We strongly urge HMRC to launch a full consultation to explore all of the issues and potential solutions. However if the legislation is to proceed we have the following comments.

4.2 Question 1 - Do the amendments meet the stated policy aims?

4.2.1 They appear to (with the proviso below) although, as explained above, this is potentially a significant change to RTI reporting requirements and there are wider considerations here if HMRC make legislative amendments which will ultimately support more employers using third party schemes to charge employees to access their wages.

4.2.2 Even if the changes also encourage more employers to offer advances directly, we do not know why the legislative wording in Regulation 67BD(3) is 'must'. This looks set to penalise all those employers who have chosen to be compliant and account for advances in the correct manner to date, and who may wish to continue to do so.

4.2.3 It is also not clear why this issue is felt to require legislation while the reporting changes around non-banking days/Christmas payments have just been designated as a permanent easement.¹ Why the divergence?

4.3 Question 2 - Will these changes cause any reporting difficulties for employers and their agents?

4.3.1 Focusing on employers making advances outside of third party schemes, presumably the idea is that an advance will be paid gross, outside of normal payroll processes and will then be recouped from an employee's net pay. But this raises many questions:

- How much can be advanced safely?² What if someone who earns £1,000 a month asks for an advance of £200 in weeks 1 -3, but in week 4 falls sick and instead of earning their regular wage only earns £43.76 of statutory sick pay? At the end of the month, will there be enough net pay (once deductions like tax, NIC and pension contributions, attachment of earnings orders – more on these in para 4.6.2) for the employer to recoup the advance? If not, will the employer need to recoup the advance over a longer period?
- Will employers somehow try to put the advance through the payroll as a tax/NIC free payment so that a formal record of the transaction can be created? If it is put through the payroll, will the correct treatment be applied by the employer? What if it is taxed/NIC'd by mistake?

¹ See para 1.8: <https://www.gov.uk/government/publications/cwg2-further-guide-to-payee-and-national-insurance-contributions/2023-to-2024-employer-further-guide-to-payee-and-national-insurance-contributions#sec1>

² The third party schemes usually have limits in place, but employers who offer advances directly may not understand the significance/importance of such.

- Will the payroll software do anything strange or unexpected? For example, when we tried to enter £100 advance in Basic PAYE Tools as a tax/NIC free advance for a weekly paid employee on a 1257L code, a tax refund of £48.40 was generated¹, making the net pay amount £148.40. While this will come out in the wash, it creates confusion and complexity.
- If payroll software does not have the functionality to capture advances (see below), it increases the possibility of employees being paid twice. Alternatively, employers may have to get more sophisticated software which deals with advances correctly, which will be an extra cost for them, both financially and in terms of time spent switching over payroll systems and learning a new system.
- We are also concerned about the possibility of employers recouping advances from gross pay rather than net pay (not helped by the description of the main payment in Regulation 67BD(2c) – ‘as reduced by the amount of the advanced payment’). Gross pay deductions reduce pay before tax is calculated, meaning the employee will then pay the wrong amount of tax and NIC in this scenario.

4.3.2 In a nutshell, without good guidance on how payroll advances should be handled, employers could easily get in a mess and potentially be exposed to penalties. Even with very basic payroll tasks, human error and oversights can easily happen, especially when talking about small, unrepresented employers who are trying to do everything themselves. In an effort to rectify mistakes in how advances have been handled through payroll, it is likely that issues will just get compounded.

4.3.3 As well as covering detailed payroll processes, the required guidance mentioned in para 4.3.2 needs to cover the benefits of having clear boundaries and procedures for handling advance requests, all the different ways employers can help employees if they are struggling financially including simply paying weekly or paying the fee for the employee where they choose to use a third party scheme (and the status of that fee as far as the employer’s tax position is concerned) and whether there is any difference in permitted treatment between an advance of pay that has already been earned and other money; and any difference between advances made within a particular pay period, and advances made over different pay periods.

4.3.4 Employees also need support to understand exactly what is happening when money is advanced, so that questions to employers, representative bodies, and HMRC are minimised. As we can see from this query to our website, the impact of advances (even though instigated by employees) are not always easy to understand:

4.3.5 *I am being paid an extra 800 pound in May from a Advance, it is being taken from my June pay as repayment, my Net pay for may is 1008, but the payment shows as 1808. In June my net pay shows*

¹ Obviously the payroll software doesn’t know that this is an advance and is treating it like the only payment in that pay period, meaning there is an unused personal allowance amount of £242 for the week, which creates the refund of £48.34 ($£242 \times 20\% = £48.34$).

as 1500 but my payment shows as 700, what will HMRC report as my wages the Net pay or the amount paid into my account. (Or as I fear the 1808 may and the 1500 as an advance is deducted as it's not tax, NI or a pension, causing me to have a reduction twice on the same 800). HMRC and my work have been unable to tell me what will be reported to UC and as my new statement is due on the 1st I want to get ahead of any issues

4.3.6 We also wonder how many employers that currently pay weekly, are going to swap to using this 'pay monthly with advances' system to reduce their admin burden and exposure to penalties? This goes against the entire objective of RTI, means HMRC lose control of the digital process and breaks the link between payments actually made and them being reported. HMRC need to do some research and analysis to ensure they understand the potential changes in behaviour and any potential associated risks.

4.3.7 It also occurs to us, although we need to test it further, that given the fact that NIC operates on a pay period by pay period basis, rather than cumulatively, and that monthly NIC thresholds are larger than weekly NIC thresholds, this may introduce some scope for employers looking to reduce their employer NIC burden, to alter payments to take advantage of the system.

4.4 **Question 3 - Employers who wish to make salary advances outside of a third party scheme will need to ensure that their software can report the salary advance at the next scheduled reporting date. Other than that, HMRC does not believe that these changes will require significant revision of current RTI reporting software. Do you agree? If not, what other changes do you anticipate will be necessary?**

4.4.1 This question appears to envisage a scenario where employers show the advances and the remaining monthly pay separately in their payroll software and this then flows through to submissions/payslips.

4.4.2 Our understanding of the proposed amendments is that it means the advances may not get captured at all (rather the employer will just report the full amount of monthly pay as normal). But in any case, it is important to note that Basic PAYE Tools does not have a dedicated field that allows you to record advances.¹ This also means that HMRC will have no idea that advances have been made and the 'net amount' shown on the payslip will not be the actual amount of take-home pay. The employer will also have to manually calculate the amount to be paid on pay day.

4.4.3 We think all payslips should show that the employee had an advance and that it is now being recouped. Transparency about advances on payslips seems important for many reasons:

- From the employer's perspective - having a prompt will make it more likely that they will not forget they have already made an advance and overpay the employee by accident
- From an employee's perspective - having the payslip show the true take home pay position will help an employee reconcile their position per their bank account

¹ We have only tested Basic PAYE Tools - it is possible that this issue extends more widely.

- From a third party perspective – payslips are relied on by third parties on for many reasons including when employees might be trying to get loans/mortgages.¹ We would have thought they would like/need visibility over whether employees are having to take salary advances on a regular basis to make ends meet.

4.4.4 This may mean that some software products need to be modified and this should be factored into the timeframe for the introduction of any changes to the regulations. As mentioned above, it may mean that small employers have to change their software for more sophisticated products and so suffer the associated financial and time costs this brings.

4.5 **Question 4 - Will these changes cause any administrative difficulties for employers and their agents?**

4.5.1 We think there could be additional pressure placed on employers to either adopt salary advance schemes or offer advances directly. The latter may cause unnecessary headaches for employers who are suffering their own financial instability and/or cash flow issues, or who are micro or 'accidental' employers (for example care and support employers), who are just simply trying to get by and who are not experts in payroll or HR matters.

4.5.2 Employers who do make advances will need to understand that they will need good record keeping procedures in place to maintain evidence of salary advances made to employees, including the amount, repayment terms (that is, when it is to be recouped) and any related communications in terms of potential impact on future pay packets/Universal Credit. This will help ensure transparency and accountability.

4.5.3 Following on from this, it occurs to us, that there could be impacts on the employee/employer relationship of salary advances – while salary advances can provide short-term financial relief, they may also create a sense of dependent or financial stress if not managed properly. There is even the possibility of employment employer/employee relationships being put under strain in the event of misunderstandings and disputes over advances.

4.6 **Question 5 - Will these changes produce any other consequences, for employers or their workers?**

4.6.1 We are concerned that HMRC have not thought through all of the potential practical issues/interactions, such as those related to minimum wage and Universal Credit(UC), as set out in the article in Appendix 1. The changes require consultation and collaboration with minimum wage policy owners about the status of the fees deducted by third parties, and Universal Credit counterparts about the fact that the RTI feed is not going to match the flow of the money to the employee and what issues this might cause. For example, if someone has an advance which falls into one UC assessment period they might expect their UC award to reduce when in fact it will not. We question whether it will be clear to DWP staff to know what to do where bank statements show payments in other assessment periods and which do not match the RTI feed. We suggest communications and guidance are needed to help Universal Credit claimants (such as the person in

¹ <https://www.litrg.org.uk/latest-news/news/230417-why-payslips-are-so-important>

para 4.3.5) navigate the interactions and understand the impact (or not) of taking salary advances on their money.

- 4.6.2 Presumably attachment of earnings deductions from net pay will take precedence over recoups of employee advances? Lower paid employees are the ones most likely to need advances but they are also the ones most likely to have attachment of earnings orders for debt or benefits¹. Employers will need to understand how things should work when an employee has both in play at any one time. Also, will employers think it possible to charge towards their administrative costs (as they can for processing net pay deductions for attachment of earnings orders)? Employers need to be aware that charges like this will reduce the worker's pay for minimum wage purposes.

5 Conclusion

- 5.1.1 We see no justification for not following the full consultation process for this change and have significant concerns that the impact of the change has not been understood or adequately assessed. We recognise that action is needed - we have long been concerned by the conditions which have allowed third party schemes to proliferate in the first place (due to the administrative burden of RTI for weekly paying employers) and feel that non-compliance has been allowed to drift. However, the proposals and how they have been communicated² lack transparency, which is leading to a lack of understanding of the impact.
- 5.1.2 The changes are too wide-reaching not to require full consultation, (especially with their interactions with minimum wage and Universal Credit), and fundamentally undermine the 'on or before' principle of RTI. Added to this they could lead to confusion and unforeseen costs for both employers and employees. The question of whether salary advance schemes should be regulated needs to be answered before HMRC do anything that may encourage them further. Indeed, if the reality is that the loss of weekly pay periods is what is causing the problem here, then it could potentially be better for HMRC to consider introducing a more wholesale change that facilitates a return to weekly pay periods – for example, the reintroduction of the easement that allowed small employers to pay weekly/report monthly.
- 5.1.3 We therefore call on HMRC to do a full Stage 1/Stage 2 consultation in line with their own framework, to ensure all the issues are properly explored, all the options are considered and so that they avoid introducing further complexities, anomalies, or unintended consequences as a result of trying to deal with this issue. As part of this, HMRC need to state what, if anything, they are going to do in terms of all the historic non-compliance generated by these schemes.

LITRG, 9 October 2023

¹ For example: Benefits debt: <https://www.gov.uk/make-benefit-debt-deductions>, Child maintenance: <https://www.gov.uk/child-maintenance-for-employers>, Court orders: <https://www.gov.uk/debt-deductions-from-employee-pay>

² We comment on the manner used to explain the proposals in our press release: <https://www.litrg.org.uk/latest-news/news/221118-press-release-hmrc-give-salary-advance-answer-%E2%80%93-questions-remain>