

PO-CH/NL/0273

PART A

Part A

CONFIDENTIAL

(Circulate under cover and notify REGISTRY of movement)

Begins: 25/3/87.
Ends: 30 13/87.



PO -CH /NL/0273



PART A

Chancellor's (Lawson) Papers:

THE INLAND REVENUE NON
CUMULATIVE PAY AS YOU
EARN SCHEME

Disposal Directions: 25 Year

11/10/95.

PO -CH /NL/0273

PART A



*Thanks.
Having read this, I
am 100% here - there are
other tax reform candidates
to be used. There are
attach greater importance,
we cannot do anything
at once. I wd, however,
be happy to meet you
2.1 broadly agree with
A.J.G.'s point which
@ AW. But a
key question is
whom to advise & re
my own tax reform options.
I wd like to discuss that
with you
2(a) at the next
form to be
(b) @
payas.*

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

FROM: A J G ISAAC

25 MARCH 1987

CHANCELLOR OF THE EXCHEQUER

NON-CUMULATIVE PAYE

1. We have prepared the attached note here, in response to your request that non-cumulative PAYE should be looked at again, as a possibility for the next Parliament (your Private Secretary's note of 26 February).
2. As your note implies, it is already none too soon to be thinking about the major studies - and we suggest public consultation - which would be needed, if we were to prepare for legislation during the next Parliament.

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State
Mr Scholar
Mr Cropper
Miss Sinclair

Mr Battishill
Mr Isaac
Mr Painter
Mr Rogers
Mr Pollard
Mr Matheson
Mr Cherry
Mr Lewis
Mr Johns
Mr Martin
Mr Mace
Mr Bush
Mr J C Jones
Mr Yard
Mr Allen
Mr Deighton
Mr Fraser
Miss Dyall
Dr Keenay
Mr Kent
PS/IR
Mr Beighton

3. At this stage, I think it might be helpful to pick out a few main points: first, on the policy and operational implications of non-cumulation (paragraphs 4-9); and then on some wider or "strategic" choices (paragraphs 10-14).

Non-cumulation: policy aspects

4. There are substantial arguments in favour of non-cumulation, if, for example, the priority objective is a shift in compliance costs off the Revenue's shoulders, or "privatisation" (which we understand to have been Lord Cockfield's main motive) or integration of tax and benefits etc (the Liberal Party response to the Personal Tax Green Paper). As I suggested in the early discussions a couple of years ago, it would also sit much more easily with a system of transferable allowances.

5. As the Green Paper also noted, however, there are substantial arguments on the other side if these objectives do not have overriding priority. And of those few who responded to this part of the Green Paper, almost all (ranging from people in the small business lobby to the poverty lobby) voted against non-cumulation.

6. You will remember that, when the previous Conservative administration reviewed non-cumulation, it rejected it on political (not just technical) grounds. Many things have changed since then. But you may think it would be helpful to discuss this question of priority between policy objectives before we take highly skilled manpower from other work and perhaps take on additional consultants to prepare a more substantive feasibility study.

- operational aspects

7. Even making full allowance for the flexibility which we have sought to build into COP and are planning for BROCS, I need again to record the sheer scope of the implied change in our tax administration and the possible opportunity cost.

8. This leads on to the timetable. In particular, you will remember from the previous discussions that we could not operate non-cumulation without an efficient, modern collection system, with computer support - that is, without BROCS. In itself, BROCS is not a constraint, but an opportunity. But BROCS is as challenging a project as COP, and the calendar itself is two years later. Starting from now, we are looking to basic BROCS to come in by 1993. And "basic BROCS" would have to be further enhanced to support a non-cumulative PAYE.

ck
You may remember that last year we agreed to some delay on BROCS for PES/minimum costs reasons
dwx

9. The note gives, as our best guess - in advance of any detailed operational study - that we might be looking at an earliest implementation date in the mid-1990s, if not the second half of that decade.

Wider aspects

10. In brief, there are a number of themes here which will be familiar to you - from (for example) the discussions on transferable allowances.

- Logical dependencies on a critical path (so that, for example, we need to press ahead with modernisation of our basic system, and at points to upgrade it, to accommodate new policy options).
- Long lead times (so that actions taken or omitted in the mid-1980s open or close doors for policy options in the mid-1990s).
- Competition for scarce resources, not just of money but more important of skilled and experienced manpower - on the operational and computer side (during the planning phase of a new development) and in tax and collection offices (during implementation) - something which the Chairman had to underline firmly before the PAC two weeks ago.

X | 11. You will remember that we set up the Departmental Development Plan in 1985, precisely in order to handle these complex issues and help you (and us) to manage change - and also to ensure so far as possible that none of us overlooked possible "windows" of opportunity; and we gave an oral presentation of the Plan to the previous Financial Secretary. We are currently revising the Plan to reflect your decision not to proceed for the time being with transferable allowances. If you are interested, we have it in mind to show you the revised Plan and (if you wish) again offer an oral presentation.

12. For the recent past and immediate future the overriding priority is to computerise our most basic assessment and collection systems: COP, CODA, OCTA, BROCS. Without these, we cannot either run the present system efficiently or accommodate a number of new policy options. But that itself is a formidable task and in the short run will stretch our limited resources.

13. Looking further ahead, we see some important new strategic choices emerging - not necessarily "all or nothing" choices, but questions of priority, between:-

(a) pressing on with modernisation of (broadly) the present administrative system and making it more efficient (for example, perhaps, enhancing COP to give more automatic support to tax offices and make more effective use of information available elsewhere in the Department; enhancing BROCS to give the taxpayer a - relatively - simple "statement" of his overall tax position - with all that might flow from that);

(b) simplifying the underlying system itself (for example, if the future increasingly lies with self-employment, there may be an increasingly strong case for picking up once again the staff-intensive way in which the antiquated and arcane statutory framework requires us to administer Schedule D);

(c) radical alternative systems (for example, transferable allowances, and/or non-cumulation).

14. You may think that it would be helpful at this stage to have at least a preliminary discussion as to the next steps. However, we are of course entirely at your disposal, if you would like any further material, either on the policy implications of a change to non-cumulation or (in advance of a major study) on the operational aspects.

Ch
I think a (fairly small) meeting, after Washington and the Easter break, would be useful before the Revenue do more work.

We had in mind, anyway, a meeting on radical options for the next Parliament, following the discussion you had a few months ago on George Manger's tax reform paper.

If you agree, I will ask Michael Scholten for an annotated agenda pulling together both strands.

AWK

C + C.

A J G ISAAC

NON-CUMULATIVE PAYE

1. Mr Kuczys' note of 26 February asked us to look again at non-cumulative PAYE, as a possibility for the next Parliament.
2. We welcome the opportunity to begin to consider with you the major studies - and we suggest public consultations - which would be needed if you wish to prepare for legislation during the next Parliament. We are talking here of changes too fundamental simply to be built into the existing or proposed systems on a contingency basis. If you decide that non-cumulation is a priority policy objective, time and money need to be spent on the necessary preparations and are likely to be well spent, if spent early.
3. I thought therefore that it might help you to have first a brief note of where we stand at the moment - perhaps as the basis for a discussion, if you would find that helpful.

The cumulative system

4. The present PAYE system is cumulative: that is, tax deductions in the later weeks or months of the year take account not only of the income for the current period, but also of income received and tax paid previously. Coupled with the long basic rate band it means that the UK has what is in effect (if not in theory) a "non-assessment" system for the large majority of employees - rather than either a self-assessment or a Revenue assessment system. Cumulative PAYE is designed to secure that the right amount of tax is paid

- when employees change jobs
- when they are unemployed or sick for part of the year (including taxing any benefit they receive)

- where they have more than one job or a pension and a job
- where their personal circumstances change to entitle them to increased allowances
- where the Budget changes rates and allowances.

The long basic rate band means that tax can be deducted at source from the majority of income other than earnings at the correct rate. So in practice in four PAYE cases out of five there is no end year adjustment and in a similar proportion of cases no need for an annual return either.

5. This means, however, that cumulative PAYE is not suitable for tax options which require the calculation of an employee's total income, as there is no return or assessment which totals up most basic rate taxpayers' total income. This causes difficulties for policy options such as a more graduated rate structure which would affect a significant proportion of taxpayers, or integration of tax and benefits. Moreover, coding can become very unwieldy and costly if it has to cope with large numbers of special reliefs and allowances, and is particularly ineffective for items such as employees' training costs which can be given only when the exact amount incurred is known. The marginal administrative cost of additional reliefs can thus be a policy constraint in introducing them. At present coding is in fact relatively simple, more so than 10 years ago, with the abolition of child tax allowances and the introduction of MIRAS and LAPRAS.

Non-cumulation

6. By contrast, under non-cumulation each payment of wages or salary would be looked at on its own without taking account of any earlier payment of income or tax. It is usually seen as part of a package of changes to the system, on the lines of the one

set out in Chapter 8 of the Personal Tax Green Paper a year ago. the system this described essentially consisted of:

- non-cumulative PAYE;
- self-coding by the employee (and minimal involvement in coding by the Revenue); and
- end of year adjustments at the end of the tax year, ie extra payments or repayments of tax, for all or most employees.

7. Such a system could either involve self-assessment by employees (as in the US) or assessment by the Revenue (as in France). In either case every employee would have to complete a tax return each year. With Revenue assessing each return would need to be examined to see whether there was a need to make a repayment or send out a demand for additional tax; with self-assessment the taxpayer would himself claim the repayment or send a cheque for the balance at the time he made his return. In practice, countries operating these systems ensure that the tax tables normally over-deduct tax so that the taxpayer has an incentive to put in his return: this is seen as necessary to save the Revenue the cost and hassle of chasing up tens of millions of unwilling returns, and of enforcing collection of tens of millions of unpaid tax bills (repayment, of course, being generally much easier and cheaper than collection). It does, however, involve a cash-flow cost to the taxpayer.

8. With Revenue assessment - and still more with self-assessment - much of the responsibility for calculating his liability would pass from the Inland Revenue to the taxpayer; and with that responsibility would not merely go the burden of work but there would also be a need for a considerably more rigorous investigation of taxpayers' affairs and tougher sanctions by way of interest and penalties. Employers would have simpler calculations to perform during the year but year end work might increase; they could face more queries from employees, and

receive self-coding notices in less handy form than Revenue notices. The Government have twice had to retreat when asking employers to take on additional responsibilities in this area - in 1971 in relation to the Tax Credit scheme and in 1982 in respect of benefits in kind.

9. Perhaps partly because of the cash flow cost, perhaps partly because of the difficulties of operating self-coding for people with multiple sources of income especially where some (like our State pensions) are not subject to any deduction at source, the US exempts large slices of retirement pensions which we tax in full. Relief from taxability of pensions and/or the application of deduction at source to the state pension might need to be considered, especially as the trend to complexity of income among pensioners is likely to increase as pensions choice widens.

10. In the longer term it is possible that technology would permit us to dispense with 100% issue of returns and end year adjustments if all payers of income (not just employers but also banks, building societies, insurance companies, stockbrokers, and companies in respect of interest and dividends) were required to send us details of their payments in machine readable form together with a standard reference number for each taxpayer. The US Internal Revenue Service have expressed hopes that they can move in this direction and we are keeping in touch with developments. But, even with the more advanced level of their technology, dispensing with end year adjustments is still some way off and the acceptability of such a system to taxpayers and the providers of information has yet to be tested.

Reasons for non-cumulation

11. Five reasons have been put forward for non-cumulation. Two of these, however, have been tackled by other means - the taxation of unemployment and statutory sick pay, and the denial of repayments of tax to people on strike. Three possible advantages remain.

12. First, the Green Paper suggested there might be savings in compliance costs for smaller employers without access to computerised payroll systems. However, in their response the National Federation for the Self Employed challenged this. They felt that any savings on simpler in-year calculations would be exceeded by the additional end year work, the inconvenience of receiving self-coding notices sporadically compared with notices direct from the Revenue, and what they foresee as a likely increase in tax queries from employees. Larger employers would be unlikely to benefit significantly from the simpler calculations because of their use of computers.

13. Second, a non-cumulative system would be able to cope more flexibly than the present system with those types of policy change which involve end year adjustments to taxpayers' affairs. These are of two main types:

- those changes which require knowledge of people's total income, such as a more graduated rate scale or transferable allowances. But changes of this sort could still cause extra costs for those taxpayers with investment income - whose number will be growing as share-ownership spreads - where the withholding tax would no longer be necessarily at the right rate;
- those changes involving one-off adjustments each year, such as special reliefs for favoured types of expenditure such as medical insurance or home insulation. In some of these cases you might need (as the US have) a flat rate deduction which could be claimed as an alternative to a multiplicity of special itemised deductions to keep tax simple for the majority (the so-called "ZEBRA" proposal).

14. Finally, it has been thought that non-cumulation would lead to a substantial reduction in Revenue staff. There would be less work for the Revenue during the year on coding but more at the end of the year for the greater number of adjustments. The size

of any overall reduction in our staff is not easy to estimate. Since 1979, the scope for saving has been reduced by the staff savings which have already been achieved by other administrative reforms: to date the changes implemented or in prospect will have produced staff savings of around 13,000 by 1988. But whatever the saving it would not stem from a reduction in the total work required. It would effectively be achieved by our pushing some of the work on to taxpayers and their advisers. Recent academic work suggests that the total cost (to the Revenue and the taxpayer) of operating the UK and the US systems are broadly similar; it is the split between the public and private costs which differs.

The Green Paper

15. As mentioned above, Chapter 8 of the Personal Tax Green Paper canvassed the possibility of non-cumulative PAYE. Public interest in the Green Paper focused, however, very much on transferable allowances. Part III as a whole (tax and benefits, NICIT, and non-cumulation) attracted relatively little comment; on Chapter 8 in particular, only 19 of the 52 national organisations responding to the Green Paper made any comment. Comment from local organisations and individuals was practically nil.

16. From the 19 national organisations who did comment, the balance was pretty strongly against a move to non-cumulation. From the summary attached in the Annex you will see that non-cumulation was supported by only the Institute of Cost and Management Accountants (and then on the unrealistic basis, at least in the medium term, of avoiding end year returns for a large proportion of simpler taxpayers) and the Liberal Party. It was opposed by ten bodies including the National Federation of the Self Employed, the NFU, the Scottish Lawyers and Child Poverty Action Group (all of which also opposed self-assessment) and by the Certified Accountants and Scottish Accountants (though these, oddly, supported self-assessment). The sort of points made by the opponents were that non-cumulation would mean more

need for people to take costly professional advice; would rebound on employers, who would probably end up having to help their employees with it; would be confusing and difficult for the elderly; and would mean delays for more people in getting repayments.

17. Given the comparatively sparse response to this aspect of the Green Paper it would be wrong to draw too firm a conclusion. However, the wide spread of the opponents across the spectrum suggests that it would equally be wrong to dismiss it too readily.

Operational aspects and timing

18. Certainly the first conclusion to be drawn from the response to the Green Paper is that the next steps on non-cumulation with self-coding and/or self-assessment would be some more thorough consultation (and some very careful education of opinion). More generally, experience with Keith suggests that detailed consultation on all relevant aspects of this with employers and professional interests would be both highly desirable but time consuming. And after the legislation has been enacted they themselves would insist on ample time before implementation to allow for the necessary adaptations to their computer systems.

19. For our part, before providing firm advice about the order and timing of events on the critical path, we should need to do a great deal of detailed planning work, both for a non-cumulative system itself and for its interaction with the other major programmes. However, we have tried to take a first quick, broad view of the probabilities.

20. Non-cumulative PAYE would in practice be unworkable without computer support both for assessment and for collection and enforcement.

- For assessment, we have COP/CODA, which is now being implemented across the country. This provides a

network of computers with links to local tax offices which creates the mechanical infrastructure for any computerised system of taxing employees. We should need to equip ourselves in addition with the necessary specialised hardware and other arrangements to handle over four times the number of individual tax returns a year that we deal with at present, ie an increase from 5.7 to 24 million (or to 29 million if all married women here sent returns separately from their husbands). As far as systems are concerned, they have been carefully designed in "modular" form, to be capable of development and enhancement. And a balance was struck between concentration and dispersal of processing power to give more flexibility for future change than if either extreme had been adopted. But non-cumulation would require a fundamental rewriting of the software (the total development of COP/CODA took 2,600 man-years) and a reappraisal of the organisation of work.

- For collection and enforcement: you have agreed that we may this year start work on BROCS, and this means that we can now hope to have the basis of a modern collection system in place by about 1993. But it is a highly complex project which will need to be given absolute priority after COP/CODA. Even so, it too would need enhancement to handle the much larger number of individual (small) cases and the new enforcement measures (paragraph 8 above).

21. As the Green Paper foreshadowed, self-assessment looks hardly practicable, unless it extends to Schedule D as well as Schedule E (and to the very large number of taxpayers who have income under both Schedules); and this in turn seems to make self-assessment dependent on a prior reform and simplification of the statutory regime for Schedule D and the 'previous year' basis. One of the questions for a more detailed study is whether the new compliance regime for a non-cumulative PAYE would be

practicable (even without self-assessment) if Schedule D was still left on one side.

22. Putting together these external and internal considerations so far as we can now foresee - and leaving the Schedule D complexities on one side at this stage - if you decide in favour of non-cumulation, the likely timetable might aim for legislation in the next Parliament and implementation perhaps in the mid-1990s if not the second half of the 1990s.

Other countries

23. Finally, two or three points from other countries.

24. In the United States the Government have asked the IRS to change the self-coding arrangements so that (within the constraints of their system) the citizen can get much closer to his true liability "in year" - without a substantial repayment or debt to be settled at the end of the year. The resulting new self-coding form (attached) ran into a storm of criticism last November for its complexity, and the IRS have just produced an alternative, simpler, form for categories of taxpayers with simpler circumstances. In the medium to longer term, the IRS still have their eyes on a "return-free" system for the majority of employees.

25. When the Canadian Minister of Revenue was over here last year, he also talked of moving away from their present self-assessment system (and when we explained the argument in Chapter 8 of the Green Paper, he suggested that we might next meet in mid-Atlantic).

26. By contrast, the outgoing Irish Government recently published a consultation document on self-assessment, based on IMF advice (and explaining the familiar prerequisites of adequate investment in computer and other support, effective enforcement powers, and full public consultation, education and backing).

27. A superficial reaction might be that the international trend is "the grass always looks greener the other side of the fence",

but it might be fairer to recognise that there are serious arguments on both sides of the debate, and of the Atlantic.

Conclusions

28. Although some of the advantages originally seen in non-cumulation have been achieved by other means, other arguments for it remain. It might achieve the "privatisation" of some of our costs rather than a reduction in the total cost to the country of running the system. However, this may be consistent with the broad thrust of Government policy. In any event, new policy options would be opened up and in particular transferable allowances would fit in more happily.

29. The balance of such response as the Government received to the Green Paper's discussion of it was, however, unfavourable. It would involve cash-flow costs to many taxpayers since the scheme would need to be biased in favour of over-deduction. There would have to be an extension of Revenue compliance powers going beyond Keith. If Ministers were to go ahead there would be a lot of education and consultation to do which would inevitably take time.

30. An essential pre-condition for non-cumulation is the completion of COP/CODA and BROCS. Implementation would probably be for the mid-1990s or the second half of the 1990s. There might be an interaction with Schedule D.

31. If you wish to keep non-cumulation in play as an option, we imagine you would need to see a substantive detailed study of the implications. You could then decide whether to put out any proposals for public consultation before taking firm decisions. There would be a cost. We would need to divert resources from improving the efficiency of the existing system and put them to work on the possibility of non-cumulation. The details are something which we should have to work out and consider with you, but we have not held up this submission for this purpose, in advance of a preliminary discussion with you.

ORGANISATION	FOR			AGAINST			POINTS MADE							
	NC	SC	SA	NC	SC	SA	A	B	C	D	E	F	G	H
1. Institute of Cost and Management Accountants	✓													
2. Liberal Party	✓		✓											
3. Chartered Association of Certified Accountants			✓	✓										
4. Institute of Chartered Accountants (Scotland)		✓	✓	✓										
5. TUC				✓	✓			✓	✓	✓	✓		✓	
6. Inland Revenue Staff Federation				✓	✓	✓		✓	✓	✓	✓	✓	✓	✓
7. Law Society of Scotland				✓		✓				✓	✓	✓		
8. National Farmers' Union				✓	✓	✓						✓		
9. Nat Federation of Self Employed and small businesses Ltd				✓	✓	✓		✓	✓	✓	✓	✓	✓	
10. Child Poverty Action Group				✓		✓			✓	✓	✓			✓
11. Association of Women Solicitors				✓	✓	✓				✓	✓	✓		
12. EOC Northern Ireland				✓	✓					✓	✓			
13. National Council of Women of Great Britain					✓									
14. Public Service Pensioners Council						✓		✓						
15. National Board of Catholic Women					✓			✓	✓	✓				
16. War Widows Association of Great Britain						✓		✓	✓			✓		
17. National Federation of PO and BT Pensioners					✓					✓		✓		
18. Association of Independent Businesses														
19. Institute of Taxation														

Key to Points (main points only)

- A. SA/SC worrying for pensioners.
- B. SA/SC will cause confusion and error.
- c. SA/SC will allow avoidance and evasion.
- D. SA/SC an unjustifiable burden on taxpayer, who may need expensive professional help.
- E. NC will cause hardship/cash flow disadvantage to those temporarily unemployed.
- F. NC of little benefit to employers since (a) many have computerised payrolls (b) more end year accounting work under NC (c) employees will demand advice if SA/SC introduced.
- G. No reduction in total IR workload. Inconvenient peaks and troughs.
- H. Penalties needed for SA would be unpalatable.

Abbreviations:

- NC: non-cumulation
- SC: self coding
- SA: self assessment

1987



Department of the Treasury Internal Revenue Service

Instructions for Form W-4 Employee's Withholding Allowance Certificate

Why Must I Complete a New Form W-4?

The Tax Reform Act of 1986 made many changes to the tax law that could affect your taxes for 1987. Therefore, the amount of tax that is now withheld from your pay may no longer be correct. So that your employer will not withhold too much or too little tax from your pay, give your employer a new Form W-4.

When Must I File the Form?

Give your employer a new Form W-4 as soon as possible. While the law requires you to file a new form before October 1, 1987, you are urged to file early to avoid incorrect withholding.

What Happens If I Do Not Complete the Form?

The amount of tax withheld from your pay may not be close to the amount of tax you will owe when you file your tax return. If you do not give your employer a new Form W-4, your employer will have to ignore any previous form you have filed, and the amount withheld will probably not be correct for your tax situation.

How Do I Complete the Form?

The following instructions tell you how to complete the Form W-4 on this page. Use the worksheet on page 3 to figure the number of withholding allowances you can claim on Form W-4.

Please Note: Most employees will have to complete ONLY lines A through E of the worksheet. But if you have a spouse who is also employed, or you have more than one job at the same time, or you have nonwage income, complete the rest of the worksheet. You should also complete the worksheet if you have itemized deductions, tax credits, adjustments to income, or the age or blindness deduction.

Should I Claim the Special Withholding Allowance?

Claim this allowance if you have only one job at a time and you don't have a working spouse. Take this allowance so that you won't have too much tax withheld from your pay. See line B of the worksheet on page 3.

Step-by-Step Instructions

Step 1—How To Complete Form W-4.—First, fill in the information asked for on lines 1 through 3 of the form. Then, if you think you might be exempt from withholding, read the instructions for Step 2 below. Otherwise, skip to Step 3 on page 2. If you want to have more money withheld from your pay, see Step 4 on page 2.

After your new Form W-4 takes effect, you should check to see if you are having the proper amount withheld. To do this, you may want to get Publication 919, Is My Withholding Correct? For more details on withholding, get Publication 505, Tax Withholding and Estimated Tax, and Publication 553, Highlights of 1986 Tax Law Changes. You can get these publications by calling 1-800-424-FORM (3676).

Note: If Your Allowances Change.—If the number of withholding allowances you are entitled to claim decreases to fewer than the number you claim on this Form W-4, you must file a new W-4 within 10 days.

Step 2—Are You Exempt From Withholding?—You are exempt from withholding ONLY if:

- 1. Last year you did not have any Federal income tax liability; AND
2. This year you expect to have no Federal income tax liability.

Important Change in the Law.—If you can be claimed as a dependent on another person's tax return (for example, on your parent's return), you may not be exempt. You cannot claim exempt status if you have any nonwage income, such as interest on savings, and expect your wages plus this nonwage income to add up to more than \$500.

If you are exempt, go to line 6 of Form W-4 and complete the appropriate boxes. Your exempt status will remain in effect until February 15 of the next year. If you still qualify for exempt status next year, complete and file a new form by that date.

(Continued on page 2)

Cut along this line and give this form to your employer. Keep the rest for your records.

Form W-4 Employee's Withholding Allowance Certificate. Includes fields for name, social security number, marital status, allowances, and employer information.

Step 3—Complete the Worksheet on Page 3.—By using this worksheet, the amount of tax withheld from your pay should closely match your tax liability for the year.

Please claim all the withholding allowances to which you are entitled. In certain cases, your employer must send copies of the Form W-4 to IRS. You may then be asked to verify your allowances. This applies if you claim more than 10 withholding allowances, or you claim exemption from withholding under Step 2 and your wages are expected to usually exceed \$200 a week.

Penalty.—You may be fined \$500 if, with no reasonable basis, you file a Form W-4 that results in less tax being withheld than is properly allowable. In addition, criminal penalties apply for willfully supplying false or fraudulent information or failing to supply information requiring an increase in withholding.

Line B—Special Withholding Allowance.—The Special Withholding Allowance is very important. Claim it if you qualify for it, because if you **do not**, too much tax may be withheld from your pay.

Claim this allowance if:

- You are single and have only one job at a time; OR
- You are married, have only one job at a time, and your spouse does not work; OR
- You have two jobs at a time and only one job paid more than \$2,500; OR
- You are married, both you and your spouse work, and only one job paid more than \$2,500.

Line E—Should I Stop Here?—You may stop here and enter the total from line E on Form W-4, line 4, **only** if you do not need to increase or decrease your allowances as explained between lines E and F of the worksheet.

Line F—Adjustments to Income.—Enter the total of the following:

- Qualified reimbursed employee business expenses (unreimbursed expenses are allowed only as an itemized deduction)
- Qualified alimony payments made
- Deductible business and investment losses
- Penalty on early withdrawal of savings
- Qualified contributions to an IRA account or Keogh plan. If either you or your spouse, if applicable, have an IRA and are covered by an employer's pension plan, your 1987 IRA deduction may be reduced or eliminated if your adjusted gross income is at least \$40,000 (\$25,000 if single, or \$0 if married filing separately). Get **Publication 590**, Individual Retirement Arrangements (IRAs), for details.

Line G—Itemized Deductions.—Enter the total of the following:

- Medical expenses in excess of 7.5% of your AGI*
- State and local taxes (exclude sales taxes)
- Home mortgage interest and 65% of personal interest
- Qualified investment interest
- Charitable contributions
- Certain casualty and theft losses in excess of 10% of AGI*
- Moving expenses (if reimbursed, include only if your employer withheld tax on them)
- Miscellaneous deductions (most of these are now deductible only in excess of 2% of AGI*; see Publication 553)

* In general, your AGI (adjusted gross income) is your income less any adjustments to income included on line F of the worksheet.

Line J—Additional Standard Deduction for Age or Blindness.—If you do not expect to itemize deductions on your 1987 tax return and either you or your spouse is age 65 or over or blind, use the following table.

	If 65 or over or blind, enter on line J:	If 65 or over and blind, enter on line J:
Single	\$1,210	\$1,960
Head of Household	\$2,610	\$3,360
Married-Joint	\$1,840 **	\$2,440 **
Married-Separate	\$1,220	\$1,820
Qualifying Widow(er)	\$1,840	\$2,440

** If your spouse is 65 or over or blind, add \$600 to this amount. Add \$1,200 if spouse is both 65 or over and blind.

Line K—Tax Credits.—Enter the amount of any tax credits you expect to claim, such as the credit for child and dependent care expenses, the earned income credit (EIC), and other credits shown on the 1986 Form 1040. The amount of the EIC has increased for 1987. Get Publication 553 for details. Do not include the EIC if you are receiving advance payment of it.

Line O.—Round the result to the nearest whole number. Drop amounts under .50. Increase amounts from .50 to .99 to the next whole number. For example, 3.25 becomes 3, and 4.61 becomes 5.

Lines Q through T—Working Spouse? More Than One Job? Nonwage Income?—So that you will have enough tax withheld, you **MUST** complete any lines that apply to you.

Line U—Total Withholding Allowances.—If the number on line T is larger than the number on line P, you will probably owe more tax when you file your return and may have to pay a penalty unless you take further

steps to have more tax withheld from your pay. You may use the instructions for Step 4 to estimate how much additional tax you should request your employer to withhold each pay period. As an alternative, you may use the 1987 **Form 1040-ES**, Estimated Tax for Individuals, to make this computation.

Step 4—Additional Amount You Want Deducted From Each Pay.—In some instances, you will be underwithheld, even if you do not claim any withholding allowances on Form W-4. This could occur if you have a working spouse, more than one job at a time, or nonwage income, AND the number on line T of the worksheet is larger than the number on line P.

To correct this problem, you may have more tax withheld by filling in a dollar amount on line 5 of Form W-4. A method of figuring this amount follows:

1. Enter the number from line T of the worksheet _____
2. Enter the number from line P of the worksheet _____
3. Subtract line 2 from line 1 _____
4. Enter the amount from the table below that applies to you \$ _____
5. Multiply line 3 by line 4 \$ _____
6. Divide line 5 by the number of pay periods each year. Enter the result here and on Form W-4, line 5 \$ _____

Married Workers' Combined Annual Income	Line 4 Amount
Under \$4,860	\$209
\$4,860 - \$29,860	\$285
\$29,861 - \$46,860	\$532
\$46,861 - \$91,860	\$665
\$91,861 and over	\$732
Unmarried Worker's Annual Income	Line 4 Amount
Under \$2,440	\$209
\$2,440 - \$17,440	\$285
\$17,441 - \$27,640	\$532
\$27,641 - \$54,640	\$665
\$54,641 and over	\$732

Privacy Act and Paperwork Reduction Act Notice.—We ask for this information to carry out the Internal Revenue laws of the United States. We may give the information to the Department of Justice for civil or criminal litigation and to cities, states, and the District of Columbia for use in administering their tax laws. You are required to give this information to your employer.

Worksheet To Figure Your Withholding Allowances

Note: If you have a working spouse or more than one job at a time, use only one worksheet to figure your total allowances, combining all income, deductions, and credits on the one worksheet.

- A Enter "1" for yourself unless you can be claimed as a dependent on another person's tax return A _____
- you are single and you have only one job; or
- B **Special Allowance.**—Enter "1" if: ● you are married, you have only one job, and your spouse does not work; or } B _____
- wages earned by you on a second job or earned by your spouse (or both) }
are \$2,500 or less.
- C Enter "1" for your spouse unless your spouse can be claimed as a dependent on another person's tax return C _____
- D Enter number of dependents other than your spouse that you expect to claim on your tax return D _____
- E Add lines A through D and enter the total*—Read the following instructions to see if you should stop here ▶ E _____

You **MUST** complete lines Q through T if you have total income of \$950 or more from the following sources:

- A Working Spouse ● More Than One Job ● Nonwage Income

You **SHOULD** complete lines F through P if you expect to have:

- Itemized Deductions ● Tax Credits ● Adjustments to Income ● Age or Blindness Deduction

Otherwise, **STOP** here and enter the number from line E on Form W-4, line 4.

- F Enter your estimated adjustments to income F \$ _____
- G Enter your estimated itemized deductions G \$ _____
- H Enter: { \$3,760 if married filing jointly or qualifying widow(er) } H \$ _____
 { \$2,540 if single or head of household }
 { \$1,880 if married filing separately }
- I Subtract the amount on line H from line G. Enter the result, but not less than zero I \$ _____
- J **Age 65 or Over? Blind?** If you do not plan to itemize deductions, enter your additional standard deduction from instructions for line J on page 2 J \$ _____
- K Enter your estimated tax credits, such as child and dependent care credit or earned income credit K \$ _____
- L If line K is zero, skip to line N. Otherwise, enter the number from the table below L _____

Married Filing Jointly or Qualifying Widow(er)			Single or Married Filing Separately			Head of Household		
If your combined estimated wages are—		Enter on line L	If your estimated wages are—		Enter on line L	If your estimated wages are—		Enter on line L
At least	But less than		At least	But less than		At least	But less than	
\$0	\$12,500	9	\$0	\$6,200	9	\$0	\$8,800	9
\$12,500	\$37,500	6.5	\$6,200	\$21,000	6.5	\$8,800	\$29,000	7
\$37,500	\$55,000	3.5	\$21,000	\$31,500	3.5	\$29,000	\$44,000	4
\$55,000	\$110,000	3	\$31,500	\$70,000	3	\$44,000	\$100,000	3
\$110,000 or over		2.5	\$70,000 or over		2.5	\$100,000 or over		2.5

- M Multiply the amount on line K by the number on line L and enter the total amount here M \$ _____
- N Add lines F, I, J, and M. Enter the total amount here N \$ _____
- O Divide the amount on line N by \$1,900. Round to the nearest whole number (see instructions on page 2) ▶ O _____
- P Add lines E and O and enter the total number here ▶ P _____
- Q **Nonwage Income?**—Enter the estimated amount, if any, of all your nonwage income Q \$ _____
- R **Working Spouse? More Than One Job?**—Too little tax may be withheld if either of these situations applies. See page 4 for line R instructions and tables to figure the amount to enter on this line R \$ _____
- S Add amounts on lines Q and R and enter the total amount here S \$ _____
- T Divide the amount on line S by \$1,900. Round to the nearest whole number (see instructions for line O) ▶ T _____
- U **Total Withholding Allowances.**—Subtract the number on line T from the number on line P. Enter the result here and on Form W-4, line 4.* If the result is zero or less, enter zero and see instructions for line U on page 2 ▶ U _____

* If you have more than one job or if your spouse works, you may claim all of your allowances on one job or you may claim some on each job, but you may **NOT** claim the same allowances more than once. Your withholding will usually be more accurate if you claim all allowances on the Form W-4 for the job with the largest wages and claim zero on all other Forms W-4.



Chancellor.

Following his morning's
brief conversati about
from Isaac's paper, I
am putting this in to
you alone.

M. → Notes.
Discuss with pge.
(Review to
no long-awaited
why!)
(also sample form)



CONFIDENTIAL

FROM: P J CROPPER
DATE: 30 March 1987

CHANCELLOR

NON-CUMULATIVE PAYE

May I set the ball rolling with some observations arising out of Mr Isaac's note on Non-Cumulative PAYE of 25 March.

2. It seems to me that:

- (1) We should be moving, as fast as possible, to a situation in which every adult fills in some form of tax return every year - either a full document as at present, or a declaration of sources of income. The black economy is an unhealthy feature of our society, but we can hardly complain about it if only one in five people is sent a tax return each year. The present obligation to declare taxable income is far too weak, if what we are aiming at is low rates of tax, collected on a broad base, with minimum evasion.
- (2) A long basic rate band is very desirable, in that it makes possible the payment of all sorts of payments under deduction of tax. But it cannot be right to have a cliff edge where the marginal rate of tax (+ NI) for an individual goes straight up from 0% to 33%. If we think we can get that combined rate of 33% down to 20% then the cliff edge can be lived with; otherwise I would have thought a reduced rate band was inevitable as part of a permanent and stable system. With or without a merger of income tax and employees NI contributions.

(3) It is almost certain that employment patterns will continue to diversify, and that multiple sources of income will become the rule among individuals. That being so, PAYE will become less and less adequate on its own, and the separation of Schedule D and Schedule E will become more and more anomalous. I would have thought we would have to move towards a system in which PAYE was used for the taxation of employment income; but where a taxpayer's PAYE account was only one element in his tax computation. In short, I would envisage the P61 as a certificate of tax paid on employment income, which would be forwarded by the employee to the Inland Revenue along with his tax return or declaration of income at the end of each year. Some employees would, of course, forward a P61 and a nil return of other income. But a diminishing proportion of employees will do so.

(4) PAYE is an elegant, efficient and painless system of deduction of employment income and I would be reluctant to see it go. I wonder whether to preserve it - alongside a universal system of individual tax returns or income declarations - would be prohibitively expensive? Is it a matter of choosing either PAYE or a non-cumulative assessment system?

(5) The choice between self assessment by employees and assessment by the Revenue is an intriguing one. Recent work on Pay and File has persuaded me that self assessment is the right answer. I am not saying that the man or woman in the street is ready yet to take on the job of assessing his or her tax liability; that would be a task for Messrs H & R Block or some such. But there is a great deal of attraction in "privatising" the crude work of assessment - putting it out to private

firms of assessors - and converting the Revenue itself into a high powered inspectorate instead of an enormous corps of assessors. Messrs H & R Block would not often put in false or erroneous assessments for their clients if they knew their reputation depended on getting them right.

3. It is depressing to hear from Mr Isaac that none of these bright ideas could be realised until the mid-nineties or later. One imagines, however, that nothing but good could come of planning now for a post-COP, CODA, OCTA and BROCS world.



P J CROPPER