

**EXPLANATORY MEMORANDUM TO THE
EDUCATION (STUDENT LOANS) (REPAYMENT) (AMENDMENT)
REGULATIONS 2005**

2005 No. 2690

AND THE

INCOME TAX (PAY AS YOU EARN) (AMENDMENT) REGULATIONS 2005

2005 No. 2691

1. This explanatory memorandum has been prepared by—
- (a) the Department for Education and Skills so far as it relates to S.I. 2005/2690 (“the Student Loan Regulations”); and
 - (b) Her Majesty’s Revenue and Customs (“HMRC”) so far as it relates to S.I. 2005/2691 (“the PAYE Regulations”)

By Command of Her Majesty this memorandum is laid—

- (a) before Parliament insofar as it relates to the Student Loan Regulations; and
- (b) before the House of Commons insofar as it relates to the PAYE Regulations.

This Memorandum contains information for the Joint Committee on Statutory Instruments in relation to the Student Loans Regulations: there are no matters of special interest to the Select Committee on Statutory Instruments in relation to the PAYE Regulations.

2. Description

2.1 The Student Loans Regulations amend the Education (Student Loans) (Repayment) Regulations 2000 (“the 2000 Regulations”), which deal with the repayment of student loans. The effect is to allow the HMRC Form P46, which is required to be completed in the case of an employee without a Form P45, to function as a notice to employers to start making deductions of student loan repayments from employees’ earnings.

2.2 The PAYE Regulations amend the Income Tax (Pay as You Earn) Regulations 2003 (“the 2003 Regulations”).

3. 3.1 Matters of special interest to the Joint Committee on Statutory Instruments

The definitions in regulation 3 of the Student Loan Regulations refer to the definitions of the relevant terms in the 2003 Regulations. Those definitions are long and it would be a very lengthy process to copy them into the 2000 Regulations. It is for this reason that the definitions operate by cross-reference to the 2003 Regulations.

3.2 Matters of special interest to the Select Committee on Statutory Instruments

None.

4. Legislative Background

4.1 The Student Loans Regulations amend the 2000 Regulations, and the PAYE Regulations amend the 2003 regulations.

4.2 The 2000 Regulations were made under sections 22 and 42(6) of the Teaching and Higher Education Act 1998 and sections 73(f) and 73B of the Education (Scotland) Act 1980. These sections give the Secretary of State the power to make provision for grants and loans to students taking higher education courses. The 2000 Regulations make provision for student loan repayments to be collected by Her Majesty's Revenue and Customs (HMRC) via the tax system.

4.3 The 2000 Regulations have previously been amended by—

- the Education (Student Loans) (Repayment) (Amendment) Regulations 2001 (S.I. 2001/971),
- the Education (Student Loans) (Repayment) (Amendment) Regulations 2002 (S.I.2002/2087),
- the Education (Student Loans) (Repayment) (Amendment) (No. 2) Regulations 2002 (S.I.2002/2859),
- the Education (Student Loans) (Repayment) (Amendment) Regulations 2004 (S.I. 2004/1175), and
- the Education (Student Loans) (Repayment) (Amendment)(No. 2) Regulations 2004 (S.I. 2004/2752).

4.4 The 2003 Regulations have been amended by the Income Tax (Pay as You Earn) (Amendment) Regulations 2004 (S.I 2004/851).

4.5 Together the amending instruments provide for changes to the Form P46 in anticipation of the tax year commencing 6th April 2006, when the new form will be introduced.

5. Extent

5.1 The Student Loan regulations extend to the United Kingdom in so far as they impose obligations on HMRC, employers or borrowers in relation to repayments of student loans granted in England, Wales and Scotland. The PAYE Regulations extend, as do the 2003 Regulations, throughout the United Kingdom.

6. European Convention on Human Rights

6.1 The Minister of State for Lifelong Learning, Further and Higher Education, Bill Rammell, MP has made a statement that he is satisfied that the Student Loan Regulations do not amend primary legislation and are not subject to the affirmative procedure, and that accordingly no statement of compatibility with the European Convention on Human Rights is required. The Paymaster General, Dawn Primarolo MP, has made a statement in the same terms in respect of the PAYE Regulations.

7. Policy background: Student Loans Regulations

7.1 When a student loan borrower changes employment, they normally receive a Form P45 which they pass to their new employer. A tick box on the Form P45 notifies the new employer that the employee has a student loan and that the employer has to make student loan deductions from the employee's earnings, which are paid to HMRC.

7.2 In many cases, however, when an individual changes employment they do not receive a Form P45 or they fail to pass it to their new employer, in which case the employer and employee have to complete a P46 form. Previously this would result in deductions ceasing until such time as the employer was notified in some other way that the employee had a student loan.

7.3 Currently employers start student loan repayment deductions when they receive a start notice form HM Revenue & Customs or the employee provides a form P45 with the continuation box ticked. Borrowers using a Form P46 face a delay while HMRC process information and send out a start notice. Delays potentially extend the life of the loan and reduce the speed of recovery. The opportunity has therefore been taken to introduce a new box covering student loans. This will enable a borrower (ex-student) to indicate to a new employer that he should make student loan deductions where appropriate, thus improving the student loan recovery process.

7.4 These amendments require the employee to indicate on a Form P46 whether they have a student loan. If so, the employer can commence deductions in the normal way. This will reduce delays in collection and other problems caused when an employee does not use the Form P45.

Policy background: PAYE Amendments

7.5 The Form P46 is used where an employee is not able to provide a Form P45 to his new employer. The Form P46 is the means by which an employer allocates an initial code number on the basis of the new employees circumstances and reports details to HMRC.

7.6 Employees and employers find the current Form P46 confusing and so it is very often completed incorrectly, with the result that incorrect codes are allocated leading to under and over payment of tax.

7.7 In partnership with employers, an improved Form P46 has been designed which will lead to more accurate completion and attribution of code numbers.

8. Impact

8.1 A Regulatory Impact Assessment has been prepared for the changes effected by these instruments. A copy is attached.

9. Contacts

Nick Atkinson at the Department for Education and Skills, telephone 0207 925 7501 or e-mail Nick.Atkinson@dfes.gsi.gov.uk can answer any queries regarding the Student Loan Regulations.

Huw Johns at HMRC, telephone 020 7147 2481 or e-mail Huw.Johns@hmrc.gsi.gov.uk can answer any queries regarding the PAYE Regulations.

REGULATORY IMPACT ASSESSMENT

Improved PAYE coding and Student Loan recovery for new employees

14th September 2005

Purpose and intended effect

Objectives

1. To improve the form P46 PAYE coding process, the Student Loan recovery process and the quality of data received at HM Revenue & Customs (HMRC) by:
 - allocating the correct tax code to more employees starting new employment without a form P45
 - making the P46 form clearer and easier to complete for both employee and employer
 - enabling relevant employees starting work without form P45 to continue paying their Student Loans.

Background

2. When an employee ceases in employment, the old employer sends part 1 of a form P45 to HMRC and gives the employee parts 1A, 2&3. The P45 shows details of their pay and tax deducted to date and the code number operated.
3. The employee keeps part 1A, but hands over parts 2&3 to the new employer. The new employer uses the details contained on the form P45 to create a record to account for the deduction of tax (and continue to make Student Loan deductions where applicable) from future payments of earnings.
4. The new employer keeps part 2 but completes and forwards part 3 to HMRC.
5. For a number of different reasons, not all new employees have a form P45 to hand over to their new employer before their first pay day. These new employees are asked by their employers to complete a form P46. This enables HMRC to check the employee's records and allocate the correct tax code, and allows the employer to operate an emergency code whilst HMRC carries out the checks.
6. The form P45 also shows if Student Loan deductions have been made.
7. When a Student Loan borrower changes employment, the new employer is alerted of the need to make Student Loan deductions by a box on the P45 'Details of Employee Leaving Work'. In many cases (over 70%), however, when an individual changes employment they will use a P46 form which would result in

deductions ceasing.

Rationale for Government intervention

8. Originally the target population for the form P46 was new employees who had previously been unemployed or self-employed, and therefore would not have an existing employer to provide a P45. However the numbers of P45s HMRC receive has dropped over recent years and the number of P46s submitted in its place has steadily risen.
9. The situation now is that over 70% of all new employees are reported to HMRC via a P46 (In 2003-2004 HMRC received around 8 million P46s rather than a form P45). So accurate completion of the P46, by both employers and employees, has become increasingly important to the efficient running of the PAYE process.
10. The P46 has also not undergone a fundamental redesign for quite a few years. It does not match up to modern design principles, and in at least a couple of respects it fails to reflect current employment realities.
11. First, it carries the employee's signature, but not his or her printed name. This leads to inevitable confusion especially when the employee works in a different town or city from the employer's payroll office.
12. Second, employees with more than one job often struggle to understand how their circumstances fit to the three options (Boxes A, B and C on the current P46 at Annex A) on the form, and end up ticking an inappropriate box.
13. Increasing numbers of employers now use the online equivalent of the P46. This is less susceptible to erroneous completion, but it still largely replicates the paper version (Boxes A, B and C are covered by the same Regulations) and thus carries the same disadvantages in most respects.
14. Employer representatives have been pressing for changes to the form for some time now. And within HMRC (staff suggestions, reviews etc) we have also recognised this form as a sizeable contributor to incorrect PAYE codes and incomplete or inaccurate data within HMRC systems. This ultimately leads to unnecessary employer and HMRC re-work and incorrect taxation of employees for lengthy periods.
15. So we have been working up a fresh design (see Annex B) and a new process to better fit with the needs of today's employers, employees and HMRC, and in particular lead to:
 - more accurate identification of the individual employee to facilitate matching against an existing HMRC record
 - clearer and more complete forms received – employees will now be responsible for completing their own details, such as name and address, whereas previously employers were faced with this responsibility
 - a marked increase in the numbers of new employees who start their

new job with a cumulative tax code number that fits their circumstances

- earlier notification via the P46 form that an employee has a Student Loan, and thus reduced delays and problems caused when an employee does not use the P45.

Consultation

- Within Government

16. The P46 review was conducted in consultation with HM Treasury, all relevant HMRC business areas, as well as the Department for Education and Skills (DfES) through a series of meetings and workshops.

- Public consultation

17. A group was established early in the review, the representatives of which spanned employee, large and small employers and payroll software industry sectors. A number of face to face meetings and workshops were held with the group at appropriate times during the review. Throughout the review the group contributed towards the development of the new form and process. In particular the group's suggestions relating to the National Insurance number advisory sentence, and the concept of the new mutually exclusive employee statements were taken on board and accepted.

18. In addition an employer survey was conducted during August 2005. Employers of various sizes and business types were questioned on what impacts, positive or negative, they thought the new form and process would have on them.

19. The National Union of Students (NUS) have been given the opportunity to comment on the changes and have no major concerns, feeling that any streamlining of the current system is worthwhile. They also said that it was important that the Student Loan change was communicated effectively to borrowers to ensure that the Student Loan box was not ticked in error.

Options

20. Redesign the form P46 and associated processes.

The information required in the form P46, including the statements, is set out in the Pay As You Earn (PAYE) regulations and so change necessitates a change to the underpinning regulations.

21. Do nothing.

Sectors and groups affected

22. 1.8 million employers, approximately 8 million employees annually, employer representative bodies, agents, payroll bureaux, HMRC, DfES, software developers, and external support bodies such as banks and building societies.

Costs and benefits

Redesign the form P46 and associated processes

- Benefits

23. To the employee:

It will:

- be easier to work through the form with its unambiguous statements
- reduce occasions when employee needs to refer to either the employer or HMRC with queries
- put more new employees on the right tax code (and so pay the right tax) from the start of the new employment – shifting at least 1 million from a non-cumulative week 1 month 1 tax code to a standard cumulative code (please see glossary at Annex C for definition of week 1 month 1 and cumulative code)
- temporarily advantage an estimated 100,000 higher rate tax payers with two or more jobs who change their main job, as they will move from non-cumulative week 1 month 1 to BR
- increase the number of Student Loan repayments that continue when a new employment starts, reducing the delays and confusion that exists with the current Student Loan recovery process

Usability testing was recently carried out with a selection of employees on the new P46 form. As well as 'normal' employees, the group also contained students and pensioners. No negative issues arose from the tests.

24. To the employer:

- employer resources will be saved due to employees now completing their own details on the form as opposed to the employer attempting to do it. This is particularly relevant in cases where the employee is on a different site to the person responsible for dealing with P46s
- time will be saved in ensuring clear identification of the new employee -

particularly where new employees are not necessarily known to employer. This invariably leads to HMRC having to get in touch with employers to clarify details about the employee which are unclear

- easier to follow form and unambiguous statements will result in less time being spent explaining to employees how the form should be completed
- anticipated time saved because many more employees will be given a normal cumulative code instead of a non-cumulative week 1 month 1 code, therefore avoiding re-work by employer when a new code arrives
- resource will be saved dealing with employee follow-up queries as a result of more employees being given correct code from the start, as opposed to, for example, employees asking employer why they are on a week 1 month 1 code
- resource will be saved as result of employer having cleaner data supplied by their employees.

New Student Loan statement

- the general feeling was that the present P45 system did not work very well for the Student Loan recovery process
- this change will save time in the long run as Student Loan deductions could be set up when the new employment starts rather than setting up the employment then having to go back to set up deductions once a start notice has been received
- reassurance that deductions are being made as they should be and reduce unnecessary fears that HMRC will pursue employers for not making deductions they think they should be making.

Anticipated saving on annual compliance cost overall for employers will amount to between £5m and £15m per year.

25. To Government:

- as a result of mutually exclusive and clear statements, (shifting around 1 million employees on to a standard cumulative code) time will be saved around correcting incorrect code numbers and issuing repayments
- an estimated 100,000 lower rate taxpayers with two or more jobs at the same time move from non-cumulative week 1 month 1 to BR when they change their main job
- generally fewer coding notifications and repayments being issued

Estimated total of identified annual savings relating to the above improvements of around £600, 000 per year.

There are also some very difficult to quantify savings attached to the improvement in the format and design of the form, which should lead to an improvement in the volume and quality of the data submitted to HMRC:

- there will be cleaner data as employees are completing their details.
- there will be a reduction in missing or erroneous data
- the clearer layout and format means it will be easier to read the forms

All of which will lead to less re-work for HMRC in contacting employers to obtain and clarify missing or incorrect information. Given that in 2003-2004 HMRC received around 8 million forms P46 this should be a real improvement in the process.

Even though we cannot quantify the savings arising from this aspect of the improved form P46 we can say that they will make a positive contribution to both objectives I and II of the HMRC Public Service Agreement. The new form P46 will help to improve the extent to which individuals pay the right amount of tax due, and receive credits and payments to which they are entitled, because more will be put on to a cumulative code from the start of their new employment. It will also improve the customer experience for both employees and employers, and reduce their burden as well as reducing the level of contact between them and HMRC.

The introduction of the new P46 statement for Student Loan borrowers will significantly reduce delays encountered in the current process where people move job or start work for the very first time (due to any delay in receiving the initial start notice).

The number of borrowers coming into repayment will also increase as there will be borrowers completing the form who have otherwise been unmatched for one reason or another.

There will be significant benefits to the resource accounting cost to Government of Student Loans, but these are difficult to assess. General analysis around initiatives aimed at reducing delays within the system suggests expected benefits of this particular change to be as follows:

2006 – 2007 £5 - £6 million
2007 – 2008 £10 - £12 million
2008 – 2009 £11 - £13 million

Total estimate of identified savings to Government in first year - £6.6 million

- Costs

26. To the employee:

- an estimated 100,000 lower rate tax payers who have more than one job at the same time and change their main job, would have been able

to tick a statement which would have given them a week 1 month 1 code under the old form P46. However with the new unambiguous statements they will have to tick the statement which results in code BR being applied for their main job

- additional time will have to be spent completing personal details such as name, address and National Insurance number. However this will be balanced out by the clearer, easier to understand statements
- Student Loans - There will be no impact on the employee other than minimising delays in starting deductions. The form itself is self explanatory.

27. To the employer:

- employee down time – time lost whilst employee reads and completes employee section of the P46.
- education. Time spent on familiarisation of new form and process
- changes to employer software – time and cost spent in adapting own software or spreadsheets
- external payroll software – time spent on familiarisation of payroll software packages altered to reflect new P46 form and procedure
- internal HR procedures – time and cost involved in updating internal procedures, for example induction packs, welcome packs
- Student Loan box - employers will need to familiarise themselves with the new box and their responsibilities however there is no additional cost to the employer as they would be required to start deductions anyway when they received a P45 or start notice.

Estimated one-off compliance cost to employers between £0.6 and £1.8 million.

28. To Government:

- changes to HMRC online Internet and Electronic Data Interchange (EDI) version. A one-off cost of approximately £50,000
- change HMRC internal and external guidance. To fall within the annual maintenance budget
- guidance on HMRC employer communication vehicles e.g. Employer Bulletin, Notes for Software Developers. To fall within the annual maintenance budget
- advise external new business support groups e.g. Business Link, banks etc. To fall within the annual maintenance budget
- the cost of introducing the Student Loans change to the P46 is

minimal as the Student Loan change is being introduced with other general P46 changes.

The do nothing option

- Benefits

29. To the employee:

- None.

30. To the employer:

- Under the do nothing option employers will have no benefit because no changes will be made.

31. To Government:

- Under the do nothing option HMRC will not benefit because no changes will be made.

- Costs

32. To the employee:

- an increasing number may temporarily suffer incorrect deduction of tax whilst HMRC carry out the necessary checks to allocate the right tax code.

33. To the employer:

- ever increasing compliance costs for the employer in terms of employee queries and re-working because of having to change code numbers. Recent statistics revealed that around 8 million P46's were received at HMRC over the 2003-2004 year.

34. To HMRC:

- general employer dissatisfaction in meeting their PAYE obligations
- ever increasing HMRC costs in rectifying incorrect tax codes and in some cases making repayments that could be avoided
- ever increasing HMRC costs in having to refer back to employers because data is unclear or incomplete
- reflect badly on the Department for not responding to various sources of evidence suggesting the need for change, including both

internal and external feedback. The recent survey indicated of 91 forms P46 received only 10 required no further action

- a continuing and potentially increasing gap in the Student Loan recovery process.

Small Firms Impact Test

35. This was applied via an employer survey conducted with 15 employers in the Kent area and 1 university.

36. Employers varied in size, and the very nature of their size determines the amount of time spent on dealing with P46 employees, the smaller the employer, the lower the frequency of P46 usage. The impact therefore is proportional to employer size.

37. For employers with fewer than 50 employees estimated costs:

- the one-off compliance costs for employers will be between £0.5m and £1.5m. The majority of the one-off compliance costs will fall to small employers with less than 50 employees. This is because all employers who use P46s for new staff may need to prepare for and adjust to the changes and the large majority of these employers will have less than 50 employees. However the overall one-off compliance costs for employers with less than 50 employees are estimated to be relatively low considering the number of such employers that may be affected and are substantially outweighed by the recurring compliance cost savings these changes will bring for them.
- the recurring compliance cost savings for them will be between £1m and £5m per year.

38. Most of the overall recurring compliance cost savings are estimated to accrue for employers with at least 50 employees as although they are quite a small proportion of all employers they employ the majority of employees and hence should have to deal with the majority of P46s.

Competition assessment

39. These proposed changes to the P46 form are not expected to lead to significant competition effects. This is because the effects on compliance costs for employers in relation to their overall costs should be relatively small and most employers competing in various different industries will be affected. This assessment has been informed through the use of the Cabinet Office Competition Filter Test.

Enforcement, sanctions and monitoring

40. Because of the improvements made to the new form and process employer and employee compliance is expected to increase.

41. Within 2 years of implementation we will conduct a review of the new process:

- using the normal HMRC annual statistics we will measure what changes there have been in terms of how many more employees are able to benefit from being on the normal cumulative code from the start of their new employment
- using a sample local office we will measure the impact the new form has had on HMRC in terms of follow up work that has had to be carried out, and compare to the sampling exercise carried out earlier this year which measured the same things.

Implementation and delivery plan

42. New form and process to be implemented from 6th April 2006. Existing forms will be run down towards 5th April 2006. Old stocks held at the HMRC Employer Orderline will be destroyed from 6th April 2006.
43. The 2006 Employer Annual Pack issued in the first week in February will contain all the related guidance that employers will need to prepare themselves for the start of the new tax year. Part of this pack will include the guidance employers will need to familiarise themselves with the new P46 form and process.
44. The Employer Bulletin issued at the same time will also contain guidance.
45. The timing and content of these issues is part of the normal annual cycle that employers would expect.
46. The HMRC Notes for Software Developers will be issued in September 2005 confirming the details of the changes to the P46 as well as a copy of the new form.
47. The Employer CD-ROM issued in February 2006 will span the 2 financial years and will hold both versions of the P46. Appropriate health warnings will be posted to both advising as to when to use each form. This will be managed by HMRC Employer CD-ROM development team.
48. Internet. New P46 will replace the current one from 6th April 2006.
49. HMRC staff will be advised of the changes through the Intranet.

Post-implementation review

50. HMRC has a programme in place to ensure that the compliance cost assessments made for all RIAs are reviewed after the policies are implemented. The assessment of compliance costs in this RIA will be part of this process and will be carried out within 2 years of implementation.

Summary and recommendation

51. The form P46 is the means by which an employer can allocate a tax code to a new employee who does not have a P45 from their previous employer. In 2003-2004 HMRC received around 8 million of these forms and numbers have been generally rising over the years.
52. The form and the associated process need to change because far too many employees that should be on a normal cumulative code are allocated a non-cumulative temporary code. This invariably leads to:
- avoidable HMRC re-work
 - employees overpaying tax
 - an unnecessary drain on employers' resources.
53. The employer and employee detail received at HMRC is often incomplete or unclear. The new style form in no small part will go some way to improving the quality of this data.
54. The review gave us an opportunity to add a Student Loan indicator box to the form. This will help to ensure the Student Loan recovery process continues in the appropriate cases.
55. The following table summarises the estimated overall costs and benefits for employers and the Government of these changes:

	Costs	Benefits
Employer	£0.6 - £1.8 million initially	£5 - £15 million per year
Government	Approximately £50,000	£6.6 - £7.6 million

56. We recommend that the new form and process be adopted and implemented from 6th April 2006.

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REGULATORY IMPACT ASSESSMENT

Improved PAYE coding and Student Loan recovery for new employees

Statement of Ministerial Approval

I have read the regulatory impact assessment and I am satisfied the benefits justify the costs.

Signed by the responsible Minister:

Dawn Primarolo

14th September 2005