

EXPLANATORY MEMORANDUM TO
THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT) REGULATIONS
2011

2011 No. 729

1. This explanatory memorandum has been prepared by Her Majesty's Revenue & Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.

2. **Purpose of the instrument**

These Regulations amend the Income Tax (Pay As You Earn) Regulations (S.I.2003/2682) ("the PAYE Regulations 2003") to, amongst other things;

- provide a definition for the additional rate of income tax
- define the "OT" tax code
- require employers in certain circumstances to tax income using the "OT" tax code (with zero allowances) instead of the basic rate flat rate or the additional rate instead of the higher rate
- correct a small drafting error in regulation 198A of the PAYE Regulations 2003
- allow HMRC to notify an individual of an amended code by telephone.

3. **Matters of special interest to the Select Committee on Statutory Instruments.**

None.

4. **Legislative Context**

4.1 The PAYE Regulations 2003 were made under section 684 of the Income Tax (Earnings and Pensions Act) 2003 which requires the Commissioners [of Her Majesty's Revenue and Customs] to make regulations with respect to the assessment, charge, collection and recovery of income tax in respect of all PAYE income.

4.2 Section 6(1) and (2) of the Income Tax Act 2007 provide for income tax to be charged at the basic, higher and additional rate of income tax and for such rates to be determined by Parliament each year. For the tax year 2010 -11, section 1(2)(c) of the Finance Act 2010 sets the additional rate of 50%.

4.3 The Income Tax (Pay As You Earn) (Amendment) Regulations 2011 ("Amendment Regulations 2011") deal with the following matters:

OT and emergency codes

4.4 Regulation 4(b) of the Amendment Regulations 2011 inserts into regulation 7(3) of the PAYE Regulations 2003 the meaning of the “OT Code”. This code deducts income tax without allowing for personal allowances at the basic, higher and additional rates depending on the level of income in question.

4.5 Regulation 4(c) of the Amendment Regulations 2011 amends the meaning of “emergency codes” in regulation 7(3) by allowing for emergency codes to deduct at the basic, higher and additional rates in addition to deduction at either or both of the basic and higher rates

Additional rate (50%) code and consequential amendments

4.6. Regulation 3 of the Amendment Regulations 2011 inserts into regulation 2 of the PAYE Regulations 2003 a definition of “additional rate” as meaning the rate of income tax as determined under section 6(2) of the Income Tax Act 2007. Regulation 4(a) of the Amendment Regulations 2011 amends regulation 7(3) of the PAYE Regulations 2003 to introduce a new additional rate code which will allow for tax to be deducted from relevant PAYE income at the additional rate of 50%.

4.7 The introduction of the additional rate has a consequential impact on the payment of tax due under a PAYE Settlement Agreement (PSA). A PSA is an agreement entered into by an employer and HMRC under which the employer makes a single annual payment to HMRC to cover the tax and National Insurance liabilities that arise on certain benefits in kind provided to their employees. Regulation 108 of the PAYE Regulations 2003 defines the calculation of tax payable under the PSA at the basic and higher rate for the year to which it relates. Regulation 14 of the Amendment Regulations 2011 amends regulation 108 of the PAYE Regulations 2003 to allow for PAYE income under a PSA to be taxed at the additional rate of tax as well as the higher and basic rates.

4.8 An amendment is also made to regulation 37A(2)(b) of the PAYE Regulations 2003 that applies where an employer has not been notified of a code for the relevant year and following termination of employment, income is paid to a former employee. Regulation 37A(2)(b) of the PAYE Regulations 2003 currently states where such income is not included on form P45 and is later determined to be liable to PAYE, that income is subject to tax at the higher but not additional rate of tax applicable for the year in which the payment is made. This can result in an underpayment of tax for employees with income subject to the additional rate of tax. Regulation 9 of the Amendment Regulations 2011 will amend regulation 37A(2)(b) of the PAYE Regulations 2003 to allow where appropriate, tax to be deducted at the additional rate of tax.

Changes to the tax codes that employers operate in certain circumstances

4.9 Regulation 46 of the PAYE Regulations 2003 outlines the process that is followed by both the employer and employee when an employee starts a new job without handing in a form P45 and where a tax code has not been issued to the employer in respect of the employee. Currently if the employee does not

complete the form P46 this results in deduction of tax at the basic rate and in the case of higher paid employees this may result in an underpayment of tax. Regulation 10 of the Amendment Regulations 2011 will now direct employers to deduct tax using tax code 0T to ensure that tax is deducted at the basic, higher and additional rates as necessary.

4.10 Currently, the regulations at Chapter 3 of Part 3 do not cover the situation where an employee begins to receive an occupational pension whilst continuing to work for an employer (on a part-time basis for example). If the pension payer follows the existing regulations in Chapter 3 the employee may receive duplicate personal allowances resulting in an underpayment of tax at the year end. Regulations 12 and 13 of the Amendment Regulations 2011 will require pension payers, in these circumstances to operate code 0T (zero personal allowances) on the non-cumulative basis against the pension payments to eliminate the duplication of personal allowances. In addition regulation 13 of the Amendment Regulations 2011, by inserting regulation 54A into the PAYE Regulations 2003 requires the pension payer to provide HMRC with the information specified in regulation 54A.

4.11 Where an employer makes a payment to an employee after their employment has ceased and the payment is not included on the form P45, Regulation 37 of the PAYE Regulations 2003 requires the employer to deduct tax at the basic rate for the tax year in which the payment is made. As a result, employees liable to tax at higher or additional rates will have insufficient tax deducted. Regulation 8 of the Amendment Regulations 2011 amends regulation 37 of the PAYE Regulations 2003 so that employers will be obliged to operate code 0T against any such payments to ensure that tax is deducted at the appropriate basic, higher and additional rates.

Notification of amended code

4.12 Regulation 3(b) of the Amendment Regulations amends the definition of “notice” contained in regulation 2 of the PAYE Regulations 2003 to allow HMRC to notify an amended code to an individual by telephone in addition to notification by writing.

Regulation 198A drafting correction

4.13 Regulation 15 of the Amendment Regulations 2011 amends paragraph (3) of regulation 198A of the PAYE Regulations 2003. This now correctly defines the specified date on which employers must determine whether they are large employers (250 employees or more) for the purpose of making PAYE payments electronically to HMRC. The specified date should be the 31st October in the preceding tax year.

5. Territorial Extent and Application

This instrument applies to all of the United Kingdom

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

Additional Rate (50%) code

7.1 From 6th April 2010 the additional rate of tax has been applied to taxable income above £150,000. The PAYE tax tables currently ensure that tax at the additional rate is deducted as necessary. However, the flat rate 50% tax code has not been provided for in legislation. The Amendment Regulations 2011 amend the PAYE Regulations 2003 to provide for the additional rate code, denoted as D1, which will operate from 6th April 2011. This code will be operated against an individual's taxable receipts which will or are likely to exceed £150,000 during the year 2011-12 in one employment. Employers have been expecting this new code.

Changes to the tax codes that employers operate in certain circumstances

7.2 These amendments are being made to improve the operation and administration of the PAYE system and ensure that the correct deductions of tax are made at the right time.

Regulation 198A drafting correction

7.3 Regulation 198A which applies to the tax year 2011-12 and subsequent years corrects a drafting error. The specified date should correctly read the 31st October of the preceding tax year and has been amended to reflect this.

8. Consultation outcome

8.1 No consultation was undertaken for the additional tax rate amendments because the changes made by the amendments are required to ensure the right amount of tax is collected at the right time.

8.2 Discussions have taken place informally with employers and other interested parties regarding the need for a code other than the basic rate code to be operated in certain circumstances. Employers were generally supportive of the need to operate code OT in these circumstances.

9. Guidance

We have notified employers and software developers of the new 50% code through our existing communication routes so that they can make appropriate changes by April 2011. A similar timetable has been taken to notify employers and software developers of the other coding changes.

10. Impact

An impact assessment has not been prepared for this instrument as it has a negligible impact on businesses, charities, public sector and voluntary bodies.

11. Regulating small business

The legislation does apply to small business.

12. Monitoring & review

We continue to monitor the operation and administration of PAYE and any adverse changes arising from these amendments will be assessed.

13. Contact

Donna Todd at HMRC Tel; 020 7147 3643 or email donna.todd@hmrc.gsi.gov.uk who will answer any queries regarding the instrument.