

EXPLANATORY MEMORANDUM TO
THE INCOME TAX (PAY AS YOU EARN) (AMENDMENT NO. 4) REGULATIONS
2015

2015 No. 1927

1. Introduction

- 1.1 This explanatory memorandum has been prepared by HM Revenue and Customs (HMRC) and is laid before the House of Commons by Command of Her Majesty.
- 1.2 This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

- 2.1 This instrument amends the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) (“the PAYE Regulations”) to:
- remove the requirement for certain expenses payments made to employees to be reported on form P11D;
 - allow employers to opt to collect income tax on certain benefits through the Pay As You Earn (“PAYE”) system and not report those benefits to HMRC on form P11D; and
 - deal with consequential effects of the repeal of Chapter 11 of Part 3 of the Income Tax (Earnings and Pensions) Act 2003 (“ITEPA”).

3. Matters of special interest to Parliament

Matters of special interest to the Select Committee on Statutory Instruments

- 3.1 Regulation 3 of this instrument repeals the definition of “Scottish Rate” which was inserted in error into regulation 2 of the PAYE Regulations by regulation 3(d) of the Income Tax (Pay As You Earn) (Amendment No. 3) Regulations 2015 (S.I. 2015/1667). That instrument was reported for defective drafting by the Select Committee on Statutory Instruments in its Fourth Report of Session 2015/16 (published on 30th October 2015)¹ and HMRC undertook to rectify the error at the earliest opportunity.

Other matters of interest to the House of Commons

- 3.2 As this instrument is subject to the negative procedure and has not been prayed against, consideration as to whether there are other matters of interest to the House of Commons does not arise at this stage.

4. Legislative Context

- 4.1 Amendments were made to ITEPA by sections 11, 13 and 17 of the Finance Act 2015 (“FA 2015”) to:
- exempt from income tax certain expense payments and benefits in kind provided to employees;

¹ <http://www.publications.parliament.uk/pa/cm201516/cmselect/cmstatin/461-iv/461iv.pdf>

- repeal the £8,500 threshold that determines whether employees (with the exception of ministers of religion) are taxed on benefits in kind and expenses depending on their earnings rate; and
 - provide powers to the Commissioners of HMRC to make regulations to authorise employers to ‘payroll’ specified benefits in kind provided to their employees.
- 4.2 The PAYE Regulations govern the operation of the PAYE system under which employers deduct income tax at source from employees’ pay. As benefits in kind provided by an employer to an employee are not ‘payments’ for the purposes of the PAYE Regulations then they are not directly subject to deductions under PAYE. However, the PAYE system allows for the value of the benefit to be taken into account when calculating an employee’s tax code, so tax can be collected through PAYE on both an employee’s pay and benefits in kind.
- 4.3 This instrument amends the PAYE Regulations to allow authorised employers to deduct (or repay) income tax through PAYE on the benefits that they provide to their employees (payrolling) rather than operating adjusted PAYE tax codes for employees. It also amends the PAYE Regulations so that employers that opt to payroll benefits in kind do not have to make annual returns for each employee to whom a benefit is provided.
- 4.4 This instrument amends the PAYE Regulations to omit the definition of “excluded business expenses” and to remove the requirement for expense payments (whether deductible or not) to be reported to HMRC on form P11D after 6 April 2016.
- 4.5 This instrument also amends the PAYE Regulations to remove references to excluded employment and the requirement to report benefits in kind provided to those in excluded employment to HMRC on form P9D.

5. Extent and Territorial Application

- 5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

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

7. Policy background

What is being done and why

- 7.1 In their second report on employee benefits and expenses, the Office of Tax Simplification (OTS)² made suggestions about how the tax rules could be simplified to reduce employer burdens. As part of this work, they recommended:
- the introduction of a legislative framework to allow employers to payroll some or all of their benefits and expenses on a voluntary basis;
 - replacing the expenses dispensation regime with an exemption for paid and reimbursed expenses; and

² <https://www.gov.uk/government/publications/review-of-employee-benefits-and-expenses-second-report>

- removing the £8,500 threshold for benefits in kind and taxable expenses - so that all employees would be liable to tax on their benefits and expenses in the same way.

7.2 These recommendations were accepted by the government. FA 2015 put into effect some of the necessary changes by introducing legislation providing for: a new expenses exemption, the removal of the £8,500 threshold for those in lower paid employment and new powers to make regulations to authorise employers to collect tax through PAYE on the benefits that they provide to employees.

7.3 This instrument amends the PAYE Regulations to ensure full effect is given to the OTS recommendations by making consequential amendments further to the changes implemented by the FA 2015 and by setting out the detailed framework for voluntary payrolling.

New expenses exemption: consequential amendments in respect of form P11D

7.4 At the end of the tax year employers are currently required to make a return to HMRC on form P11D of any expenses paid or reimbursed to their employees. Where an expense qualifies for tax relief, the employee must notify HMRC of their entitlement to relief unless the employer has agreed a dispensation with HMRC.

7.5 Section 11 of FA 2015 introduced a new exemption from tax effective from 6 April 2016 for expenses paid or reimbursed by an employer, or benefits treated as earnings, where the employee would have been entitled to an income tax deduction for that expense. The new exemption also applies to approved scale rate payments in respect of allowable expenses incurred by an employee, and means that almost all allowable expenses payments will be exempt from tax and no longer need to be reported to HMRC.

7.6 There are two exceptions to the new exemption. Firstly, if an employer pays a scale rate that is not an approved scale rate, or they do not operate a suitable checking system, then the scale rate payment will fall outside the new exemption and will be taxable. The second exception is if an employer pays expenses through a salary sacrifice (or similar) arrangement.

7.7 Where an employer pays expenses that fall into the exceptions from the new exemption, or pays non-allowable expenses, they will be required to operate PAYE on the payments. This instrument accordingly makes a number of changes to the PAYE Regulations to remove the need for such payments to be reported to HMRC on form P11D.

7.8 There will be no change to the requirement for employers to make annual returns on form P11D where they pay an expense on behalf of their employee, or provide an employee with a non-cash benefit in kind.

Abolition of £8,500 threshold: consequential amendments in respect of form P9D

7.9 Removing the £8,500 threshold means that all employees are chargeable to tax in the same way on any taxable benefits in kind or expenses they receive, regardless of their earnings rate (except for ministers of religion), and employers no longer have to use different forms to return information about such payments to HMRC. Instead, all returns are made on form P11D only.

7.10 This instrument makes the necessary changes to the PAYE Regulations that govern the P9D and P11D forms so that employers no longer need to submit form P9D.

7.11 This instrument also makes the necessary changes to the PAYE Regulations to enable employers to payroll all benefits, except employer provided accommodation, beneficial loans and credit tokens and vouchers, from 2016/17. Where an employer opts to payroll, their obligation to make a return of these benefits and expenses on form P11D will be disapplied and employers will report their value under Real Time Information (RTI).

Voluntary payrolling: the detailed framework

7.12 An employer who wishes to payroll benefits must make an electronic application for authorisation, using HMRC's payroll registration service unless they are employers who have difficulty in using electronic communications and are already allowed to make RTI returns on paper. The application for authorisation must: (1) be made before the start of the tax year; (2) be made in respect of employees receiving benefits and (3) identify the benefit(s) which the employer wants to payroll. If an employer wants to stop payrolling, they can give notice to HMRC to withdraw an application to for authorisation. Withdrawal will take effect from the end of the tax year in which notification is given to HMRC. But withdrawal will have immediate effect where: (1) an employee who has insufficient income to cover their tax liability, (2) the employer has stopped providing a benefit and the tax in respect of that benefit has been collected or (3) the employer made an error in their original application.

7.13 Where an authorised employer intends to payroll certain benefits, this instrument sets out the 'general rule' for calculating the amount of income tax an employer must deduct from, or repay to, an employee in respect of the specified benefits. They must first calculate the cash equivalent of the benefit (for a tax year). There has been no change to existing methods of calculating the 'cash equivalent' of benefits that are to be payrolled, but these regulations set out how the cash equivalent will then apply for payrolling purposes. Once the cash equivalent has been determined it must then be divided by the number of payments to be made to an employee in the tax year (known as "main relevant payments"). The resulting amount is the taxable amount of the benefit on which PAYE must be operated. The employer must add that amount to each of the employee's main relevant payments, when made, and then deduct or repay income tax on the total pay by reference to the employee's PAYE tax code.

7.14 The general rule may be modified in certain specified circumstances:

- **Continuing benefit where employment has ceased:** where an employee leaves an employment during the tax year but continues to receive the benefit, the employer should payroll all the remaining taxable amount in the remaining main relevant payments to be made to that employee for the tax year.
- **In-year adjustments:** where there is:
 - a change to the benefit being provided,
 - the employer becomes aware during the tax year that the cash equivalent of the benefit calculated at the start of the year is no longer accurate,
 - the employer stops providing a benefit during the tax year, or
 - where the employee is paid on an infrequent basis, there is a change to the number of main relevant payments taken into account at the start of the year

the amounts included in the remaining main relevant payments should be adjusted accordingly.

- **Making good:** where an employer expects an employee to ‘make good’ any amount of the benefit, the employer can take that into account when calculating the taxable benefit subject to PAYE deductions. If the employee makes good during the tax year, or is expected to have made good the full amount by the end of the tax year, the employer does not need to deduct tax in respect of that amount. However if the employee has failed to make good the benefit of a car, van or other employment-related benefit by the final main relevant payment of the year, the employer must deduct tax for the full amount.
- **Failure to make good car fuel benefit:** where an employee has failed to make good the expected amount of fuel benefit by 1 June after the end of that tax year (tax year 1), the taxable amount of the benefit not payrolled is to be brought into account in the first main relevant payment in tax year 2.

Consolidation

7.15 There are currently no plans to consolidate the PAYE Regulations.

8. Consultation outcome

8.1 In accordance with the Government’s Tax Consultation Framework, draft regulations were published on the HMRC website for comment from 8 July 2015 to 2 September 2015.

9. Guidance

9.1 Guidance will be made available when this instrument comes into effect.

10. Impact

10.1 The impact on businesses, charities or voluntary bodies is reduced administrative burden where these organisations:

- pay qualifying expenses or provide qualifying benefits in kind to their employees as they will no longer need to report these payments to HMRC on form P11D;
- adopt voluntary payrolling as they will no longer have to submit P11Ds in respect of payrolled benefits and their reporting burdens will significantly decrease. Employers who volunteer to payroll benefits will be required to provide an annual statement to their employees of the total taxable amount of the benefit on which PAYE has been operated. This replaces rather than adds to an existing administrative requirement for employers to provide a statement to every employee in respect of which they have submitted a P11D to HMRC. If an employer stops being authorised to payroll benefits during the year but the employer continues to provide those benefits, then the obligation to submit P11Ds is re-engaged. Employers who currently payroll on an informal basis will also benefit as they will no longer have to submit P11Ds for the benefits covered by this instrument; and
- have lower paid employees as they will no longer need to continually monitor the level of an employee’s earnings and benefits in kind to see if they fall below or above the £8,500 threshold. It is estimated that these savings will outweigh the additional cost of submitting forms P11D for the small number

of benefits in kind received by employees whose earnings are below the threshold.

- 10.2 The impact on the public sector is the same administrative saving set out above.
 - 10.3 Tax Information and Impact Notes covering this instrument were published on 10 December 2014 alongside the draft clauses and explanatory notes for Finance Bill 2015 and are available on the website at <https://www.gov.uk/government/collections/tax-information-and-impact-notes-tiins>. They remain an accurate summary of the impacts that apply to this instrument.
- 11. Regulating small business**
- 11.1 The legislation applies to activities that are undertaken by small businesses who will benefit from the same administrative savings as other businesses.
- 12. Monitoring & review**
- 12.1 The changes introduced by this instrument will be monitored and reviewed as appropriate within the context of the wider tax framework.
- 13. Contact**
- 13.1 Sarah Radford at HM Revenue and Customs, Tel: 03000 521589 or email: employmentincome.policy@hmrc.gsi.gov.uk can answer any queries regarding the instrument.