

## EXPLANATORY MEMORANDUM TO

### THE INCOME TAX (PAY AS YOU EARN) AND THE INCOME TAX (CONSTRUCTION INDUSTRY SCHEME) (AMENDMENT) REGULATIONS 2022

2022 No. 227

#### 1. Introduction

- 1.1 This explanatory memorandum has been prepared by Her Majesty's 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 provides for the Commissioners for HMRC to make a direction which prescribes how information must be provided relating to an employee's entitlement to tax relief in respect of certain specified allowable expenses. This change will come into force on 6 May 2022.
- 2.2 This instrument also enables employers and contractors who elect to have different "schemes" (administrative references each of which have their own statutory obligations) in relation to different groups of employees and sub-contractors have their elections take effect mid-year. These changes come into force on 6 April 2022.

#### 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, which inserts a new regulation 65A into the Income Tax (Pay As You Earn) Regulations 2003 (S.I. 2003/2682) ("the PAYE Regulations"), sub-delegates power to the Commissioners for HMRC to specify certain matters in a direction. The authority for such sub-delegation is point 8A in subsection (2) of section 684 of the Income Tax (Earnings and Pensions) Act 2003 (ITEPA), which provides that the power to make PAYE Regulations under section 684 includes power to make provision requiring compliance with any directions the Commissioners may give about the form and manner in which any information is to be provided under the PAYE Regulations.

#### 4. Extent and Territorial Application

- 4.1 The territorial extent of this instrument is the United Kingdom.
- 4.2 The territorial application of this instrument is the United Kingdom.

#### 5. European Convention on Human Rights

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

## **6. Legislative Context**

- 6.1 The PAYE Regulations govern the operation of the PAYE system under which income tax is deducted at source from payments made to employees and pensioners.
- 6.2 The Income Tax (Construction Industry Scheme) Regulations 2005 (S.I. 2005/2045) (“the CIS Regulations”) set out the detailed rules for how contract payments to subcontractors for construction operations must be handled by contractors operating in the Construction Industry Scheme, and certain other businesses.

### ***Deductible expenses regulation changes***

- 6.3 Entitlement to a deduction from taxable earnings is absolute, granted by section 327 of ITEPA. Deductions for employees’ expenses are allowable under Chapter 2 of Part 5 of ITEPA. Employees are entitled to deduct certain amounts whilst calculating their net taxable income, and notify HMRC about those deductions, when they spend their own money on allowable employment expenses in relation to a tax year.
- 6.4 Where an employee’s expenses do not exceed £2,500 for a tax year in respect of all their employments, employees may now notify HMRC of tax relief due on those expenses under regulation 65A, using the form and manner set out in any Commissioners’ direction made under regulation 65A. Information notified during the tax year will enable HMRC to make an appropriate adjustment to the employee’s tax code part way through that tax year. In other cases, HMRC will be able to give effect to any relief due to the employee in the form of a repayment.
- 6.5 Employees can currently notify HMRC about their expenses using a form P87, but also any other format as an alternative to the form P87. This is because form P87 is not a statutory form and neither ITEPA nor the PAYE Regulations require employees to notify HMRC about allowable employment expenses by using a particular form.
- 6.6 This instrument applies only to employees who have not received a notice to file an Income Tax Self-Assessment (ITSA) tax return under section 8 of the Taxes Management Act 1970 (TMA) (unless that notice has subsequently been withdrawn under section 8B of TMA) or made a return under section 12D of TMA. These employees can notify HMRC under regulation 65A either in year or at the end of the year. Alternatively, employees can use the formal route under TMA where they are required to notify HMRC of employment expenses through an ITSA tax return.
- 6.7 Regulation 3 of these Regulations inserts a new regulation 65A into the PAYE Regulations to allow the Commissioners for HMRC to make a direction which specifies the form and manner that specified information about employees’ expenses should be provided to HMRC. The Commissioners’ Direction will be made and published on GOV.UK on 6 May 2022 and will provide details of the form and manner by which the information specified in regulation 65A(4) must be provided. It will also reflect the version HMRC plan to publish on GOV.UK before 6 April 2022.

### ***Multiple elections regulation changes***

- 6.8 Where an employer or a contractor wants to be treated as a different employer or contractor in relation to different groups of their employees or sub-contractors, they may do so by making an election to HMRC. This instrument requires that, when an election is made, the employer or contractor must confirm the tax month from which it is to have effect on the election notice. Thereafter, an election will continue to have effect for subsequent tax months until it is revoked. An election notice must be given

before the beginning of the tax month immediately preceding the tax month from which the election is to have effect. Elections may not be made retrospectively or for a closed tax year. In practice, the first tax month in relation to which an election may be made mid-year, because of the changes made by this instrument, will be the tax month beginning with 6 June 2022. Regulation 211 of the PAYE Regulations provides that a notice of an election under regulation 98 must be given using a form P350. Quarterly payers – falling within either regulation 70 of the PAYE Regulations, or regulation 8 of the CIS Regulations – may also make an election that can take effect at any point during a tax year.

- 6.9 Where an election notice is given late, HMRC will treat the election as if it had been made in relation to the tax month immediately following the tax month from which the election was intended to have had effect based on what was in the election notice. Any notice of revocation of an election must be given before the beginning of the tax month from which the revocation is to have effect. However, a notice of revocation does not prevent a further election being made in relation to that tax month or another tax month.
- 6.10 These Regulations also provide that whilst an election is in force, an employer or contractor must allocate any new employees or new subcontractors to “at least” one of the groups of employees/contractors, recognising that some employees or subcontractors may be allocated to more than one group. In such circumstances, as well as in cases where an existing employee or sub-contractor is allocated to more than one group, an employee will be treated (for the purposes of the PAYE Regulations) as if they had more than one employer. A subcontractor will be treated (for the purposes of the CIS Regulations) as if they had more than one contractor from whom they receive payments relating to construction operations.
- 6.11 Regulations 4 and 6 of these Regulations amend regulation 98 of the PAYE Regulations and regulation 3 of the CIS Regulations respectively, to enable future employer and contractor elections (made on or after 6 April 2022) to have effect midway through a tax year.

## **7. Policy background**

*What is being done and why?*

*Deductible expenses regulation changes*

- 7.1 HMRC has seen a very significant increase in the volume of information (claims) related to employment income submitted by employees or their agents since the start of the pandemic, particularly those relating to working from home. A significant number of claims are not on the standard form HMRC provides for this purpose: form P87. The processing of non-standard forms cannot be automated, requiring HMRC to process them manually.
- 7.2 Specifying the format by which information about employees’ expenses should be provided will enable HMRC to automate the processing of these claims. This will reduce processing times, reduce backlogs, and increase the quality of customer service.
- 7.3 Any Commissioners’ direction made under these Regulations may authorise or specify a requirement for the delivery of employees’ expenses by an approved method of electronic communication or sending a paper-based form. The direction will

provide details of the form and manner by which information about employees' expenses should be provided to HMRC. However, the initial direction will not be mandating electronic delivery.

- 7.4 Employees are required to provide HMRC the nature and amount of each of the expenses they have incurred in respect of each of their employments. The regulations also require the information must be given no later than 4 years after the end of the tax year to which the information relates.
- 7.5 In those circumstances where the employee's expenses exceed £2,500 for a tax year, the rules in regulation 65A will not apply, and employees will instead be required to complete an ITSA tax return to notify HMRC about the expenses.

*Multiple elections regulation changes*

- 7.6 Generally, employers have a single registered PAYE scheme reference with HMRC which dictates their obligations in terms of submitting returns and making payments. The same is true in terms of contractors and CIS scheme references. Some employers want to be treated and registered as a separate employer in relation to different groups of their employees, for example, for separate branches of their organisation. Similarly, some contractors want to be treated as a separate contractor in relation to different groups of their sub-contractors. Employers and contractors may seek to give effect to separate schemes by making an election to HMRC before the beginning of the tax year for which the election is to have effect. An election continues in effect until a notice of revocation is given to HMRC, which must be given before the beginning of the tax year for which the election is to be revoked.
- 7.7 However, this causes difficulties because at present, employers or contractors wishing to do so, must make an election to HMRC before the beginning of the tax year for which it is to have effect. The current PAYE Regulations and CIS Regulation reflect a pre-digital era, when it would have been extremely difficult for HMRC to have administered the movement of large numbers of workers and allocate responsibilities and liabilities for part years. Now post-digitisation and with automated payrolls, it is both quicker and easier to facilitate election notices to take effect mid-year rather than having to wait until the beginning of a new tax year. This legislation provides for mid-year elections and addresses representations from employers requesting greater flexibility.

**8. European Union Withdrawal and Future Relationship**

- 8.1 This instrument does not relate to withdrawal from the European Union.

**9. Consolidation**

- 9.1 There are currently no plans to consolidate the instruments that are being amended.

**10. Consultation outcome**

- 10.1 No consultation was carried out on this instrument because it introduces minor changes to streamline existing processes.

## **11. Guidance**

### *Deductible expenses regulation changes*

- 11.1 Guidance on claiming Income Tax relief for employment expenses is available on the GOV.UK website at [www.gov.uk/guidance/claim-income-tax-relief-for-your-employment-expenses-p87](http://www.gov.uk/guidance/claim-income-tax-relief-for-your-employment-expenses-p87). This will be updated to reflect the changes in March 2022.

### *Multiple elections regulation changes*

- 11.2 Guidance for employers wanting different schemes for different groups of their employees is available on the GOV.UK website at: <https://www.gov.uk/government/publications/cwg2-further-guide-to-payee-and-national-insurance-contributions/2022-to-2023-employer-further-guide-to-payee-and-national-insurance-contributions#para121> and guidance for contractors wanting to split into smaller sections and have more than one contractor scheme for different groups of their sub-contractors is available on the GOV.UK website at: <https://www.gov.uk/guidance/construction-industry-scheme-multiple-contractor-status>. Both sets of guidance will be updated in April 2022 to reflect that new elections can now take effect mid-year.

## **12. Impact**

- 12.1 There is no, or no significant, impact on business, charities, or voluntary bodies.
- 12.2 There is no, or no significant, impact on the public sector.
- 12.3 A Tax information and Impact Note has not been prepared for this instrument as it contains no substantive changes to tax policy.

## **13. Regulating small business**

- 13.1 The legislation applies to activities that are undertaken by small businesses.
- 13.2 No specific action is proposed to minimise regulatory burdens on small business.
- 13.3 The basis for the final decision on what action to take to assist small businesses, is to i) give advance notice to businesses of the deductible expenses change, delaying the date of making a direction and bringing the provisions into force on 6 May 2022 and ii) minimise burdens on employers and contractors by amending the rules under which election and revocation notices can take effect mid-year.

## **14. Monitoring & review**

- 14.1 The approach to monitoring of this legislation is to consider the continuing processing performance and effectiveness of:
- the new standard format for employee expenses information. This will be done through regular communication with repayment agents by HMRC's agent relationship managers. HMRC will monitor the improvement of speed in processing this information and managing the reduction in backlogs we currently have for these claims, and the performance on customer service.
  - the new streamlined process for employers and contractor elections. This will be done through regular communication with affected businesses and external stakeholder groups using established employer and agent representative bodies.

14.2 As this instrument is not made by a Minister of the Crown, no review clause is required.

**15. Contact**

15.1 Yousuf Akubat at HMRC Telephone: 03000 541130 or email: [yousuf.akubat@hmrc.gov.uk](mailto:yousuf.akubat@hmrc.gov.uk) can be contacted with any queries regarding the PAYE changes in regulation 3 of this instrument.

15.2 Craig Maffey at HMRC Telephone: 03000 517956 or e-mail: [craig.r.maffey@hmrc.gov.uk](mailto:craig.r.maffey@hmrc.gov.uk) can be contacted with any queries regarding the PAYE changes in regulation 4 and the CIS changes in regulation 6 of this instrument.

15.3 Helen Page, Deputy Director for Tax Administration Policy and Strategy, at HMRC can confirm that this Explanatory Memorandum meets the required standard.

15.4 The Rt Hon Lucy Fraser QC MP, Financial Secretary to the Treasury, can confirm that this Explanatory Memorandum meets the required standard.