

PAYE code applied to employees in certain circumstances

Who is likely to be affected?

- Employers
- Employees
 - who fail to complete employee starter form P46
 - who are in receipt of both pension payments and normal income from the same employer
 - who receive a payment from a former employer
- Payroll software industry
- Agents

General description of the measure

Regulations will be laid to change the default PAYE tax code employers and pension providers are required to operate in certain circumstances. From 6 April 2011 employers will be required to operate tax code 0T (zero T) as follows:

1. On employment income of a new employee – when the employee fails to complete form P46 (a form which tells the employer what tax code to operate where the employee does not provide them with form P45).
2. On pension income of a person who is still in receipt of employment income.
3. On payments made to an individual who has left their employment and the P45 has already been completed. The 0T code will not apply to payments made in connection with employment related securities. The employer will be required to operate BR code on these payments, as currently.

Policy objective

PAYE tax is deducted throughout the year and is calculated each pay period based on previous pay and tax deducted in that tax year. This cumulative method of deducting tax is designed to help ensure employees pay amounts of tax during the year that will equal the total tax due figure when the year as a whole is reconciled.

Changes are being made to the tax code employers are required to operate in specific circumstances, to a) help ensure the tax paid by individuals in those circumstances is at that time a more accurate deduction and b) reduce the number, and the value of, underpayments of tax as a whole.

Background to the measure

- The proposed changes to the default tax code were communicated to the payroll software industry during November 2010. Employers, employer representative bodies and agents were informed of the proposed changes during December 2010.
- HMRC took informal advice from stakeholders regarding the proposed change to the default tax code, but did not consult formally.
- The amended PAYE Regulations were laid on 11 March 2011.
- Representations were made to HMRC that made clear the adverse effect this change will have on payments made in connection with employment related securities. As a result a further amendment was made to the PAYE regulations and from 6th April 2011 employers and share scheme administrators will continue to operate the basic rate tax code (BR) where there is a liability to PAYE.
- Revised PAYE Regulations were laid on 04 April 2011.

Detailed proposal

Operative date

Employers will be required to operate the new default tax code (code 0T) on and after 6 April 2011.

Current law

Regulation 37 of the Income Tax (PAYE) Regulations 2003 provides that PAYE income paid to an employee after employment has ceased and not included in a form P45 shall be taxed at the basic rate.

Regulation 46 of the Income Tax (PAYE) Regulations 2003 provides that, where an employee commences employment and fails to give an employer a form P45, and also fails to provide to the employer relevant information required for a form P46, tax has to be deducted at the basic rate

In both circumstances described above, an underpayment generally occurs where the income of an employee is subject to tax at the higher or additional rate.

Regulation 54 of the Income Tax (PAYE) Regulations 2003 provides that where an employee begins to receive relevant pension payments whilst continuing to receive relevant employment payments from their employer, the employer should operate the same code for both incomes. This results in the duplication of personal allowances in the calculation of tax.

Proposed revisions

The current law will be changed by Regulations, which will provide that the payments referred to in regulations 37 and 46 will be taxed on a non-cumulative basis using the 0T tax code. Amendment Regulations No. 2 provide that where the payments referred to in Regulation 37 are in connection with employment related securities,

from 6 April 2011 tax will continue to be deducted by employers and share scheme administrators using the basic rate. These proposed revisions will help reduce underpayments where the employee's income is subject to tax at the higher or additional rate.

Regulation 54 changes the tax code used in respect of an employee who retires but continues to work for the employer (for example on a part time basis) and receives pension income in addition to employment income. As a result of the changes made the employee's pension income will be taxed on the non-cumulative basis using the 0T code thereby preventing duplication of personal allowances.

Summary of impacts

Exchequer impact (£m)	<p>The Exchequer impacts of operational changes in the tax system are reflected in the underlying tax revenue forecasts, in contrast to Budget policy changes, which are set out in the Budget document.</p> <p>The precise revenue impact of this operational change cannot be readily quantified. However, introducing the new tax code is expected to have some effect, as the coding changes made will help ensure either:</p> <ol style="list-style-type: none"> 1. that more taxpayers pay the correct amount of tax at the right time, or 2. pay an amount of tax that would bring them closer to the true tax due figure when the year as a whole is reconciled. <p>These outcomes will result in a reduction in the scale of PAYE underpayments at the year end.</p>
Economic impact	The measure is not expected to have significant economic impacts.
Impact on individuals and households	These changes will make tax deductions fairer for both HMRC and individuals, so we expect the impact on individuals to be positive. If, however, individuals find themselves suffering an over deduction of tax, processes and guidance are in place to help enable them to make an in-year claim for any repayment due. At this stage it is difficult to provide estimates around numbers affected.
Equalities impacts	These changes are not expected to have a disproportionate impact on any equality group.
Impact on businesses and civil	Employers will be required to operate the new default tax code on and after 6th April 2011. The majority of employers are unlikely to encounter a situation where they would use the new tax code.

society organisations	<p>However, most businesses will incur a compliance cost from familiarising themselves with the new rules. A very small number will have to amend their calculation methods where a business does not rely on payroll software. For those that do use software costs will be reduced to negligible amounts as the tax code change will be accommodated within regular updates. Assuming that software updates will be provided at no additional costs, the cost of compliance is estimated at around £3.5m.</p> <p>There will also be ongoing administrative burdens for those (mostly small) employers who do their tax calculations manually, as the new code introduces some additional steps to the calculation. The ongoing costs will be small, around £100,000, as only a minority of these firms will need to operate the code in any given year.</p>
Operational impact (£m) (HMRC or other)	Negligible.
Other impacts	<p>Small firms will need to make changes to their PAYE payroll to reflect the new tax codes. The ongoing administrative burdens may affect small businesses as they are more likely than larger firms to calculate their tax liability manually. However, the situations in which the new tax code will be required are less likely to occur for small businesses. HMRC provides guidance to all employers to minimise any potential impacts. HMRC have also updated contact centre guidance who also provide support for employers and employees.</p>

Monitoring and evaluation

This policy may be kept under review through communication with taxpayer groups affected by the measure.

Further advice

If you have any questions about this change, please contact Lynn Carroll on 020 7147 2636 (email lynn.carroll@hmrc.gsi.gov.uk).

Declaration

David Gauke MP Exchequer Secretary to the Treasury has read this Tax Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.